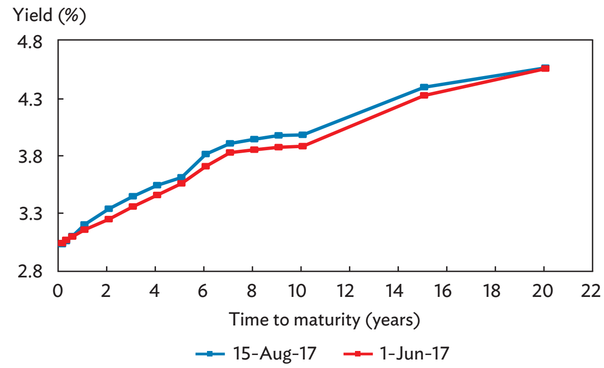
Malaysia

Yield Movements

Between 1 June and 15 August, bond yields for local currency (LCY) government bonds in Malaysia increased for all tenors except the 1-month and 3-month tenors, whose yields fell by 1 basis point (bp) each, and the 6-month tenor, whose yield was practically unchanged (**Figure 1**). Among the tenors that saw yield advances, the biggest was for 6-year government bonds, which posted an 11-bps increase, while 20-year tenors had the smallest increase of 1 bp. In the belly of the curve (2-year to 9-year maturities), bond yields increased by an average of 9 bps, and at the long-end of the curve (10-year to 15-year maturities), yields also increased 9 bps on average. The yield spread between the 2-year and 10-year tenors widened by 1 bp during the review period from 63 bps to 64 bps.

Figure 1: Malaysia's Benchmark Yield Curve—Local Currency Government Bonds



Source: Based on data from Bloomberg LP.

Yield movements in Malaysia's LCY government bond market between 1 June and 15 August were range-bound, with increases mainly reflective of the cautious stance of investors ahead of the United States (US) Federal Reserve's balance sheet reduction program and further interest rate hikes as recent US data suggest economic growth is gaining momentum. In addition, the European Central Bank is considering a policy shift away from its asset purchase program as the eurozone's recovery gains traction. The bond yield increases may also have taken their cue from the upward movement of US Treasury yields. Selling pressures due to profit-taking could have also lifted yields, but the market's anchor on onshore support tempered additional surges. On the domestic front, controversies surrounding the unresolved issues of state-owned 1Malaysia Development Berhad and the political and economic challenges of the upcoming general election also contributed to the increase in yields.

Bank Negara Malaysia (BNM) kept its overnight policy rate unchanged at 3.00% during its monetary policy meeting on 13 July. Inflation is expected to further moderate in the second half of 2017 as an effect of waning global cost factors. Current macroeconomic developments also supported the policy decision. The Malaysian economy expanded faster than expected in the second quarter (Q2) of 2017, underpinned by strong domestic demand and exports, and is projected to post higher growth in 2017. Favorable global prospects will bolster external demand, translating into stronger exports. The Malaysian ringgit continued to gain strength against the US dollar, while the BNM deemed that liquidity remains sufficient in the banking system, backed by strong buffers.

Consumer price inflation in Malaysia continued its downtrend in July, falling to 3.2% year-on-year (y-o-y) from 3.6% y-o-y in June, 3.9% y-o-y in May, and 4.4% y-o-y in April. The moderation was connected to tepid global oil prices, which translated into lower transportation costs. While transport costs registered the fastest growth among all components of the Consumer Price Index in July, they also exhibited the fastest pace of moderation. Inflation in transport costs peaked at 23.0% y-o-y in March, declining to 7.7% y-o-y in July. Inflation for January–July averaged 4.0% and is expected to remain modest for the rest of the year. Core inflation, which excludes most volatile fresh food items and administered prices of goods and services, rose slightly to 2.6% y-o-y in July from 2.5% y-o-y in June. BNM noted that price pressures are expected to be contained despite robust domestic demand.

The Malaysian ringgit continued to advance against the US dollar, appreciating 4.4% year-to-date through 15 August. The ringgit's appreciation was supported by several factors, including the revival of foreign investors' buying interest in local bond and equity markets; a solid external position backed by high international reserves and exports; efforts by the BNM to improve liquidity, trading activities, and infrastructure in the financial market; and strong economic growth prospects. In addition, low inflation in the US dampened expectations of a faster pace of Federal Reserve rate hike, leading to the broad weakness of the US dollar against most Asian currencies year-to-date through 15 August.

Malaysia's gross domestic product (GDP) growth sustained its upward momentum in Q2 2017, expanding 5.8% y-o-y, up from 5.6% y-o-y in the first quarter (Q1) 2017. It was the fastest growth rate recorded since Q1 2015. Domestic demand underpinned the strong growth, particularly private consumption expenditure, which grew 7.1% y-o-y in Q2 2017. Government expenditure, export, and import growth rates eased in Q2 2017 from Q1 2017. Growth in gross capital formation also moderated due to a contraction of public sector investment. On the production side, the services sector and the manufacturing sector expanded while the agriculture sector's growth slowed. On a quarter-on-quarter (q-o-q) and seasonally adjusted basis, GDP expanded 1.3% in Q2 2017. Malaysia's economy registered average annual growth of 5.7% in the first half of 2017.

Size and Composition

Total LCY bonds outstanding in Malaysia reached MYR1,246 billion (USD290 billion) at the end of June, an expansion of 3.3% q-o-q and 7.1% y-o-y (**Table 1**). Compared with the preceding quarter, growth was unchanged on a q-o-q basis but was faster on a y-o-y basis. *Sukuk* (Islamic bonds) continued to have a larger share in comparison with conventional bonds, amounting to MYR716.3 billion, or 57.5% of the total. The *sukuk* market expanded 4.0% q-o-q and 12.8% y-o-y in Q2 2017.

Government bonds. The size of the LCY government bond market continued to expand in Q2 2017, growing 2.9% q-o-q and 4.0% y-o-y. The growth rates were faster compared with those in the previous quarter. Central government bonds, which largely comprise Malaysian Government Securities (MGS) and Government Investment Issues (GII), continue to dominate the market with a total of MYR634 billion at the end of June on an increase of 3.5% q-o-q. Central bank bills outstanding continued to decline in Q2 2017, dropping 23.4% q-o-q, as securities matured and new issuance was low. Meanwhile, Sukuk Perumahan Kerajaan were unchanged at MYR28 billion at the end of June. Total government

Table 1: Size and Composition of the Local Currency Bond Market in Malaysia

	Outstanding Amount (billion)						Growth Rate (%)			
	Q2 2016		Q1 2017		Q2 2017		Q2 2016		Q2 2017	
	MYR	USD	MYR	USD	MYR	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**1,163**	**289**	**1,206**	**272**	**1,246**	**290**	**2.0**	**8.2**	**3.3**	**7.1**
Government	644	160	651	147	670	156	2.5	5.9	2.9	4.0
Central Government Bonds	600	149	613	138	634	148	3.8	7.9	3.5	5.6
of which: *Sukuk*	232	57	252	57	263	61	3.9	10.8	4.6	13.6
Central Bank Bills	15	4	10	2	7	2	(29.1)	(34.5)	(23.4)	(51.8)
of which: *Sukuk*	0	0	0	0	0	0	–	(100.0)	–	–
Sukuk Perumahan Kerajaan	28	7	28	6	28	7	0.0	1.8	0.0	0.0
Corporate	519	129	555	125	576	134	1.4	11.0	3.8	10.9
of which: *Sukuk*	375	93	409	92	425	99	2.5	11.2	4.0	13.3

( ) = negative, – = not available, MYR = Malaysian ringgit, q-o-q = quarter-on-quarter, Q1 = first quarter, Q2 = second quarter, USD = United States dollar, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Bloomberg LP end-of-period LCY–USD rates are used.
3. Growth rates are calculated from local currency base and do not include currency effects.
4. Sukuk Perumahan Kerajaan are Islamic bonds issued by the Government of Malaysia to refinance funding for housing loans to government employees and to extend new housing loans.

Sources: Bank Negara Malaysia Fully Automated System for Issuing/Tendering (FAST) and Bloomberg LP.

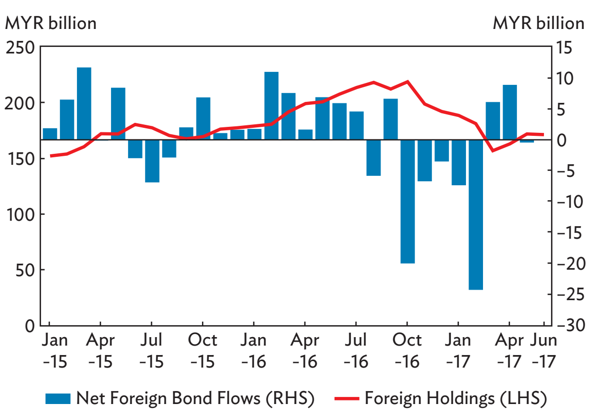
sukuk reached MYR291 billion at the end of June and comprised 43.5% of the total government bond stock.

Issuance of LCY government bonds during Q2 2017 declined 21.5% q-o-q to MYR30.5 billion from MYR38.9 billion in Q1 2017. Lower issuance volumes were recorded across all components of government bonds in Q2 2017: MGS issuance fell 16.7% q-o-q, GII dropped 6.5% q-o-q, and Treasury bills declined 73.3% q-o-q. MGS and GII together accounted for 88.5% of total government bond issuance during the quarter. On an annual basis, securities issued by the government were up 8.0% in Q2 2017.

Auctions for government bonds were met with strong demand, although longer-dated government bonds, particularly 20-year maturities, garnered softer interest from investors, reflecting concern over monetary policies in the US and eurozone. Government bonds were supported by onshore money and a stable Malaysian ringgit.

Foreign holdings of LCY government bonds increased 9.2% q-o-q at the end of June, supported by growth in holdings across all components of the government bond market (**Figure 2**). Foreign holdings at the end of June were up 15.5% q-o-q for Treasury bills, 10.1% q-o-q for MGS, and 2.4% q-o-q for GII. During Q2 2017, net foreign bond inflows into Malaysia's LCY government bond market reached MYR14.4 billion, a turnaround from the MYR35.0 billion of net outflows in Q1 2017. On a monthly basis, net inflows of MYR6.0 billion were recorded in April following 5 consecutive months of net outflows that were triggered by the uncertain policy direction in the US and the BNM's barring of offshore trading of the Malaysian ringgit. May saw increased net inflows of MYR8.8 billion, the bulk of which were in the form of foreign investor purchases of MGS. In June, however, net foreign outflows of MYR0.5 billion were observed in the LCY government bond market, mainly due to a decrease in foreign holdings of MGS. The reduction was attributed to the market's reaction to the US interest rate hike in June as well as due to profit-taking and the holiday-shortened trading month. The plan of the Federal Reserve to pare its balance sheet and possible monetary tightening among other major central banks could tighten global liquidity, resulting in a shift of investments to safe havens.

Figure 2: Foreign Holdings and Capital Flows of Local Currency Government Bonds in Malaysia



LHS = left-hand side, MYR = Malaysian ringgit, RHS = right-hand side.
Notes:
1. Figures exclude foreign holdings of Bank Negara Malaysia bills.
2. Month-on-month changes in foreign holdings of local currency government bonds were used as a proxy for bond flows.
Source: Bank Negara Malaysia Monthly Statistical Bulletin.

Corporate bonds. LCY corporate bond outstanding increased 3.8% q-o-q and 10.9% y-o-y in Q2 2017, registering a total of MYR576 billion at the end of June. The Q2 2017 expansion in the corporate segment was faster than that in the government bond market on both a q-o-q and y-o-y basis, as well as compared with the q-o-q and y-o-y expansions in Q1 2017. *Sukuk* totaled MYR425 billion at the end of June, comprising 73.7% of LCY corporate bonds outstanding.

Outstanding bonds from the top 30 corporate issuers amounted to MYR325.6 billion, or 56.5% of the total corporate debt stock, at the end of June (**Table 2**). The finance sector led the group with a combined amount of MYR153.2 billion from 12 firms, followed by the transport, storage, and communications sector with total outstanding bonds of MYR64 billion. Danainfra Nasional stayed on top of the list with MYR36.9 billion of bonds outstanding in Q2 2017, up MYR4.5 billion from Q1 2017.

Corporate bond issuance in Q2 2017 increased 6.8% q-o-q and 19.2% y-o-y to MYR40.6 billion. The q-o-q growth in Q2 2017 was slower compared with growth in Q1 2017, which was driven by a sharp rebound in issuance. Corporate issuance in Q2 2017 largely comprised commercial paper and medium-term notes amounting to MYR13.6 billion and MYR26.1 billion, respectively. The positive momentum in corporate bond issuance reflected an environment that is conducive to raising capital as interest rates remained favorable despite the Federal Reserve hinting at further tightening within the year. With ample liquidity in the market, firms

Table 2: Top 30 Issuers of Local Currency Corporate Bonds in Malaysia

	Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
		LCY Bonds (MYR billion)	LCY Bonds (USD billion)			
1.	Danainfra Nasional	36.9	8.6	Yes	No	Finance
2.	Project Lebuhraya Usahasama	30.4	7.1	No	No	Transport, Storage, and Communications
3.	Cagamas	27.8	6.5	Yes	No	Finance
4.	Prasarana	18.7	4.4	Yes	No	Transport, Storage, and Communications
5.	Khazanah	18.0	4.2	Yes	No	Finance
6.	Perbadanan Tabung Pendidikan Tinggi Nasional	16.7	3.9	Yes	No	Finance
7.	Maybank	15.6	3.6	No	Yes	Banking
8.	Pengurusan Air	14.4	3.4	Yes	No	Energy, Gas, and Water
9.	CIMB Bank	12.5	2.9	Yes	No	Finance
10.	Sarawak Energy	9.5	2.2	Yes	No	Energy, Gas, and Water
11.	Public Bank	9.4	2.2	No	No	Banking
12.	Lembaga Pembiayaan Perumahan Sektor Awam	9.3	2.2	Yes	No	Property and Real Estate
13.	Jimah East Power	9.0	2.1	Yes	No	Energy, Gas, and Water
14.	GOVCO Holdings	7.6	1.8	Yes	No	Finance
15.	Bank Pembangunan Malaysia	7.4	1.7	Yes	No	Banking
16.	YTL Power International	7.3	1.7	No	Yes	Energy, Gas, and Water
17.	Rantau Abang Capital	7.0	1.6	Yes	No	Finance
18.	Sarawak Hidro	6.5	1.5	Yes	No	Energy, Gas, and Water
19.	ValueCap	6.0	1.4	Yes	No	Finance
20.	CIMB Group Holdings	5.7	1.3	Yes	No	Finance
21.	Aman Sukuk	5.6	1.3	Yes	No	Construction
22.	Putrajaya Holdings	5.5	1.3	Yes	No	Property and Real Estate
23.	Turus Pesawat	5.3	1.2	Yes	No	Transport, Storage, and Communications
24.	1Malaysia Development Berhad	5.0	1.2	Yes	No	Finance
25.	Celcom Networks	5.0	1.2	No	No	Transport, Storage, and Communications
26.	Danga Capital	5.0	1.2	Yes	No	Finance
27.	GENM Capital	5.0	1.2	No	No	Finance
28.	Jambatan Kedua	4.6	1.1	Yes	No	Transport, Storage, and Communications
29.	AmBank	4.5	1.0	No	No	Banking
30.	Manjung Island Energy	4.5	1.0	No	No	Energy, Gas, and Water
Total Top 30 LCY Corporate Issuers		**325.6**	**75.8**			
Total LCY Corporate Bonds		**576.2**	**134.2**			
Top 30 as % of Total LCY Corporate Bonds		**56.5%**	**56.5%**			

LCY = local currency, MYR = Malaysian ringgit, USD = United States dollar.
Notes:
1. Data as of end-June 2017.
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on Bank Negara Malaysia Fully Automated System for Issuing/Tendering (FAST) data.

Table 3: Notable Local Currency Corporate Bond Issuance in the Second Quarter of 2017

Corporate Issuers	Coupon Rate (%)	Issued Amount (MYR million)
Danainfra Nasional		
5-year bond	4.06	750
7-year bond	4.27	700
10-year bond	4.37	500
15-year bond	4.89	700
20-year bond	5.10	350
25-year bond	5.20	780
30-year bond	5.25	720
Lembaga Pembiayaan Perumahan Sektor Awam		
5-year bond	4.17	800
7-year bond	4.39	500
10-year bond	4.58	450
15-year bond	4.94	700
20-year bond	5.07	300
30-year bond	5.22	500
YTL Power International		
10-year bond	5.05	2,500
Pengurusan Air		
3-year bond	3.96	700
5-year bond	4.06	900
7-year bond	4.27	500
Public Bank		
10-year bond	4.85	2,000

MYR = Malaysian ringgit.
Source: Bank Negara Malaysia Bond Info Hub.

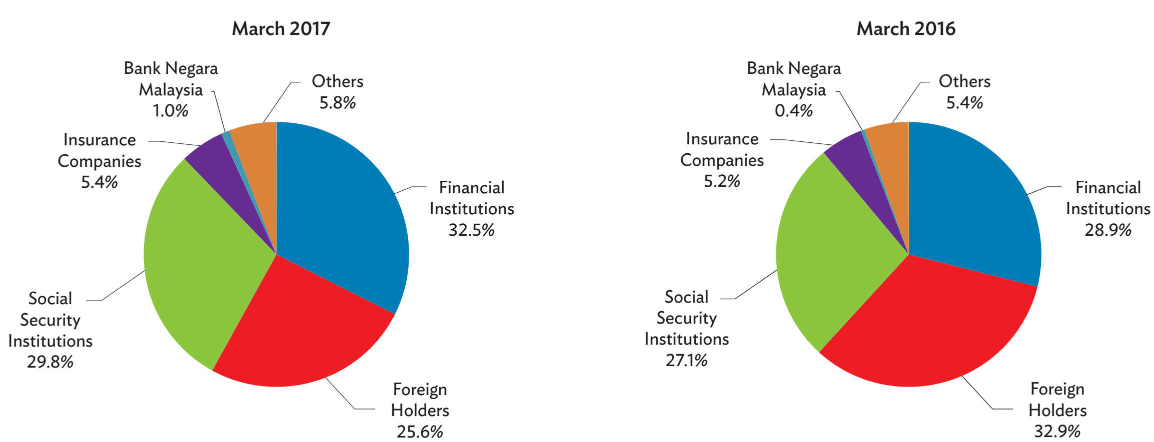
may continue raising funds, especially for infrastructure projects such as high-speed rail.

Danainfra Nasional dominated bond issuance in the corporate sector in Q2 2017, raising a total of MYR4,500 billion from a multitranche sale of 5-year through 30-year maturities (**Table 3**). Property firm Lembaga Pembiayaan Perumahan Sektor Awam raised MYR3,250 billion from a multitranche bond issuance and YTL Power International issued a 10-year bond worth MYR2,500 that fetched a coupon rate of 5.05%.

Investor Profile

The investor profile for LCY government bonds had several changes at the end of March compared with a year earlier (**Figure 3**). The share of foreign holders fell from 32.9% in March 2016 to 25.6% in March 2017, and no longer comprised the largest share in the market. The decline was due to the sell-off of government bond holdings by foreign investors, which began in the last quarter of 2016 and continued into Q1 2017, that was triggered by negative market sentiments due to uncertain policy directions in the US and was exacerbated by the BNM clamping down on offshore trading of the Malaysian ringgit in order to temper its volatility. The market share of foreign holders was surpassed by financial institutions

Figure 3: Local Currency Government Bonds Investor Profile



Note: "Others" include statutory bodies, nominees and trustee companies, and cooperatives and unclassified items.
Source: Bank Negara Malaysia.

and social security institutions during the review period, whose holdings accounted for 32.5% and 29.8% of the total LCY government bond market, respectively, at the end of March. The shares of insurance companies and other holders' share increased to 5.4% and 5.8% from 5.2% and 5.4%, respectively, while the BNM's holdings of government bonds climbed to 1.0% at the end of March from 0.4% a year earlier, which remained the smallest share among all LCY government bondholders.

In the LCY corporate bond market, life insurance companies had the largest share of holdings at the end of June (**Figure 4**). Life insurance companies increased their share of LCY corporate bonds outstanding to 40.0% from 38.5% a year earlier, while domestic commercial and Islamic banks experienced a marginal decrease to 38.9% from 39.0% during the review period. The Employees Provident Fund, foreign commercial and Islamic banks, and investment banks all saw decreases in their respective shares of LCY corporate bonds outstanding, while general insurance companies' share was steady at 2.3%.

Ratings Update

On 22 June, S&P Global affirmed Malaysia's foreign currency sovereign rating at A– for long-term and A-2 for short-term debt, and its local currency sovereign rating at A for long-term and A-1 for short-term debt. S&P Global cited Malaysia's sound growth prospects, solid external position, and flexible monetary policy in its affirmation. S&P Global maintained a stable outlook for Malaysia's sovereign ratings but warned of the challenges involving alleged corruption in 1Malaysia Development Berhard, as well as the political risk linked to the upcoming election.

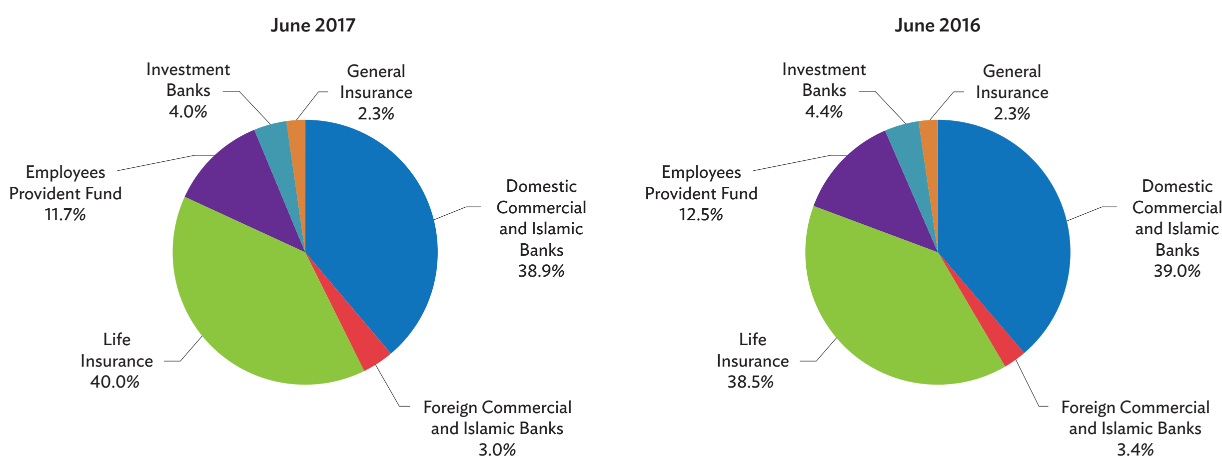
On 17 August, Fitch Ratings (Fitch) affirmed Malaysia's long-term foreign currency and LCY issuer default ratings at A–, with a stable outlook for both, on account of a resilient economic expansion despite lower oil prices and volatile capital flows, continued account surpluses, and a solid external position. However, the ratings agency cited lingering risks, which include sizeable contingent liabilities resulting from the 1Malaysia Development Berhad embezzlement charges that could worsen public finances, and rising political risk in the run-up to Malaysia's upcoming general election in mid-2018.

Policy, Institutional, and Regulatory Developments

Bank Negara Malaysia Removes Reserve Fund Requirement for Islamic Banks

BNM will no longer require Islamic banks to maintain reserve funds effective 3 May. In the past, Islamic banking institutions were required to set aside a percentage of

Figure 4: Local Currency Corporate Bonds Investor Profile



Note: The Employees Provident Fund's bond holdings data are as of end-December 2016.
Sources: Bank Negara Malaysia and the Employees Provident Fund.

profits into a reserve fund prior to dividend distribution to serve as a buffer to be drawn upon during periods of stress. This prudential tool ensured banks could continue serving as financial intermediaries without disruption. According to the central bank, with the new policy in place, Islamic banks are only required to maintain minimum capital to operate and provide financial services effectively, and also remain to comply with the stringent capital requirements of the Basel III accord.

Bursa Malaysia Launches Leading Entrepreneur Accelerator Platform

Bursa Malaysia launched in July a platform for small and medium-sized enterprises (SMEs), the Leading Entrepreneur Accelerator Platform (LEAP), to serve as avenue to tap the capital market. SMEs can be listed on LEAP to provide them fund-raising through the capital market and at the same time comply with the regulations required of a firm preparing for a formal listing. LEAP is part of a system in which SMEs and start-ups can be listed on the equity crowdfunding platform, then on LEAP, and subsequently on the Ace Market and Main Market. Qualifying for listing on the platform does not require a track record of profits and operating history.