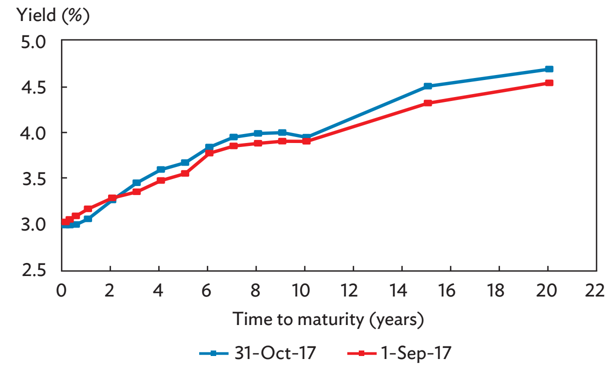
Malaysia

Yield Movements

Between 1 September and 31 October, yields for local currency (LCY) government bonds in Malaysia rose for most tenors (**Figure 1**). Yields for bonds with maturities of 2 years or less fell between 2 basis points (bps) and 11 bps. Yields for all maturities between 3 years and 20 years rose 11 bps on average. Among this group, 15-year maturities had the largest increase at 18 bps and 10-year maturities had the smallest increase at 4 bps. The yield spread between the 2-year and 10-year tenors widened during the review period from 61 bps to 68 bps.

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



Source: Based on data from Bloomberg LP.

The concentration of yield declines at the short-end of the curve reflects investors' preference for short-term tenors as the United States (US) Federal Reserve rate hike in December is highly likely even amid subdued inflation. The Federal Reserve recently assessed the US economy to be expanding at a solid pace and the labor market continues to strengthen. Investor cautiousness and the Federal Reserve's hawkish tone has possibly diminished buying interest for Malaysia's longer-tenor LCY government bonds, causing yields at the long-end of the curve to edge higher. However, yield increases were not substantial, suggesting onshore investor support for the local bond market. On the domestic front, the upward trend in domestic inflation may have contributed to rising yields even.

BNM decided to maintain its overnight policy rate at 3.00% during its monetary policy meeting on 9 November given the vibrant domestic economy supported by spillovers from the external sector, stable financial markets, and broadly upbeat prospects for global economic growth despite some risks coming from geopolitical concerns and monetary policy developments in advanced economies. However, amid strong local and global economic conditions and with inflation for full-year 2017 expected to be at the upper end of the forecast range, BNM stated that its Monetary Policy Committee may consider reviewing its accommodative monetary policy stance.

Consumer price inflation in Malaysia continued to trend upward, climbing to 4.3% y-o-y in September from 3.7% y-o-y in August and 1.5% y-o-y in September 2016.

Price increases were observed in most major components of the Consumer Price Index. The transport group registered the most rapid y-o-y price advance, gaining 15.8% y-o-y in September. Inflation for the January–September period was 4.0% y-o-y, while core inflation remained unchanged at 2.4% y-o-y in September.

The Malaysian ringgit strengthened by 6.0% against the US dollar year-to-date through 31 October, spiking in September at MYR4.19 to USD1. The strength of the Malaysian ringgit is supported by a vibrant economy, the influx of foreign funds into the local bond market, the continued expansion of exports, and firmer oil prices.

Malaysia's gross domestic product expanded 5.8% in the second quarter of 2017, its fastest pace of growth since the first quarter of 2015. The economy's strength was underpinned by domestic demand and a pickup in global trade spilled over into the domestic economy. With faster growth rates in the first 2 quarter of 2017, BNM expects the economy to grow more rapidly than its initial forecast of 4.8% for full-year 2017.

Size and Composition

Malaysia's LCY bonds outstanding increased 1.4% q-o-q and 8.1% y-o-y to reach MYR1,263 billion (USD299 billion) at the end of September (**Table 1**). The buoyant Malaysian bond market was driven by both

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q3 2016		Q2 2017		Q3 2017		Q3 2016		Q3 2017	
	MYR	USD	MYR	USD	MYR	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**1,168**	**282**	**1,246**	**290**	**1,263**	**299**	**0.4**	**8.6**	**1.4**	**8.1**
Government	632	153	670	156	671	159	(1.9)	4.9	0.1	6.2
Central Government Bonds	592	143	634	148	637	151	(1.3)	8.0	0.5	7.5
of which: *Sukuk*	236	57	263	61	266	63	1.9	14.6	1.1	12.7
Central Bank Bills	11	3	7	2	5	1	(29.5)	(56.7)	(27.2)	(50.2)
of which: *Sukuk*	0	0	0	0	0	0	–	(100.0)	–	–
Sukuk Perumahan Kerajaan	28	7	28	7	28	7	0.0	0.0	0.0	0.0
Corporate	537	130	576	134	593	140	3.3	13.3	2.9	10.4
of which: *Sukuk*	393	95	425	99	439	104	4.9	15.5	3.4	11.7

( ) = negative, – = not applicable, MYR = Malaysian ringgit, q-o-q = quarter-on-quarter, Q2 = second quarter, Q3 = third 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.

the government and corporate segments, with much of the growth coming from corporates. Government bonds outstanding summed to MYR671 billion and comprised 53.1% of the total, while corporate bonds outstanding summed to MYR593 billion and comprised 46.9%.

Total *sukuk* outstanding amounted to MYR733.7 billion at the end of September, an increase of 2.4% q-o-q and 11.5% y-o-y. *Sukuk* as a share of total LCY outstanding bonds increased to 58.1% at the end of September from 57.5% at the end of June. The larger proportion of *sukuk* than conventional bonds in Malaysia' LCY bond market is due to a broad investor base; most Malaysian fund managers are encouraged to invest in *sukuk*. The strong demand for *sukuk* results in high levels of liquidity, which translates to lower borrowing costs and encourages issuers to borrow via *sukuk* issuance. There is also a government-led push to develop Malaysia as a global center of Islamic finance, especially with the growing interest in using *sukuk* for financing and rising investor demand.

Government bonds. Total LCY government outstanding bonds in Malaysia amounted to MYR671 at the end of September on increases of 0.1% q-o-q and 6.2% y-o-y. Among the government bond segment's components, only central government bonds increased during the third quarter (Q3) of 2017. Central bank bills continued to fall amid maturing debt and sparse issuance, while the amounts of Sukuk Perumahan Kerajaan outstanding was unchanged at MYR28 billion.

The issuance of government securities increased 9.8% q-o-q to MYR33.5 billion in Q3 2017, reversing the 21.5% q-o-q drop in Q2 2017. The expansion during the quarter was supported mainly by increases in the issuances of Malaysian Government Securities and Treasury bills while the issuances of Government Investment Issues and central bank bills fell.

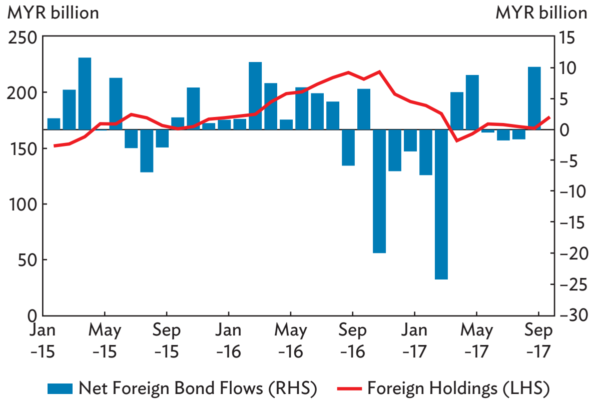
Foreign holdings of LCY government bonds totaled MYR177.9 billion at the end of September, climbing to its highest level since February (**Figure 2**).[20] The amount was 4.0% higher than at the end of June but 16.0% lower than at the end of September 2016.

In June–August, net outflows resulted from the maturing of foreign investments and profit taking, and the lingering effects of BNM's barring of Malaysian ringgit offshore trading which negatively affected foreign investor sentiment and consequently the inflow of funds.

In September, net inflows of MYR10.1 billion were recorded, the highest level since March 2016, after

[20] Excluding Bank Negara Malaysia bills.

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.

3 consecutive months of net outflows. The reversal appeared to reflect renewed confidence among foreign investors seeking long-term returns in the Malaysian bond market on the back of strong economic fundamentals and an improving growth outlook. Positive flows were seen in all components of government securities, with Malaysian Government Securities having the biggest increase.

Year-to-date through September, foreign holdings of LCY government bonds registered net outflows of MYR13.9 billion, while foreign holdings as a percentage of total outstanding LCY government bonds fell to 27.9% at the end of September from 35.8% a year earlier. Market participants from our annual bond market liquidity survey indicated that these developments should not concern local regulators and that the Malaysian bond market investor base remains diverse. Most foreign investors who remained in the local market are "sticky" investors—such as central banks, governments, and pension funds—who are less swayed by shifting sentiments, thus reducing the risk of volatile outflows. In addition, measures from BNM to deepen the financial market have helped slow the pace and moderate the magnitude of foreign fund outflows. Survey participants also noted that the foreign holdings share is normalizing at around 25%–27% and it is unlikely to return to its pre-November 2016 levels. Survey participants further noted that with the lower level of foreign holdings, Malaysia will be less susceptible to volatility arising from speculative capital flight.

Corporate bonds. Outstanding LCY bonds in the corporate sector at the end of September showed faster growth rates than government bonds on both a q-o-q and y-o-y basis. Corporate bonds rose 2.9% q-o-q and 10.4% y-o-y, bringing the total outstanding amount to MYR593 billion. The share of *sukuk* in the Malaysia corporate bond market was 74.1 % at the end of Q3 2017, up from 73.7% in the preceding quarter. By instrument type, most corporate outstanding bonds are medium-term notes.

The bonds outstanding of the top 30 corporate issuers totaled MYR336.5 billion at the end of September, comprising 56.8% of the LCY corporate bond market (**Table 2**). By industry, financial firms were the biggest debt issuers with MYR158.4 billion, while telecommunications firms were the smallest with MYR4.5 billion. Danainfra Nasional remained the largest issuer with MYR36.9 billion of outstanding bonds at the end of September.

Corporate bond issuance continued to rise in Q3 2017, with issuances totaling MYR43.2 billion. The bulk of corporate bond issuance during the quarter came in September when the monthly total of MYR22.5 billion almost doubled the amount in August and more than tripled issuances in July. The growing amount of corporate bonds outstanding can be traced to the increase in government-guaranteed corporate bonds issued to finance infrastructure projects of the government as well as issuers seeking to lock in favorable rates ahead of further monetary tightening in advanced economies. *Sukuk* continue to comprise a higher proportion of corporate issuances than conventional bonds, accounting for 63.6% of the total in Q3 2017. *Sukuk* are more liquid than conventional bonds in Malaysia's corporate market, which induces issuers to borrow via *sukuk*. BNM is also encouraging corporates to promote deeper liquidity and offerings in the *sukuk* market to attract a more diverse group of foreign investors to Malaysia.

Table 3 shows the notable bond issuers in Q3 2017. In September, Prasarana Malaysia issued six tranches of government-guaranteed *murabahah sukuk* (Islamic bonds backed by a commodity mark-up sale transaction) totaling MYR4 billion, with maturities between 5 years and 30 years. Lembaga Pembiayaan Perumahan Sektor Awam again tapped the debt market during the quarter, raising MYR3.5 billion via multitranche sales; in Q2 2017, the property firm raised MYR3.25 billion.

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	8.7	Yes	No	Finance
2.	Project Lebuhraya Usahasama	30.4	7.2	No	No	Transport, Storage, and Communications
3.	Cagamas	28.6	6.8	Yes	No	Finance
4.	Prasarana	22.7	5.4	Yes	No	Transport, Storage, and Communications
5.	Perbadanan Tabung Pendidikan Tinggi Nasional	18.5	4.4	Yes	No	Finance
6.	Khazanah	18.0	4.3	Yes	No	Finance
7.	Maybank	16.4	3.9	No	Yes	Banking
8.	Pengurusan Air	14.4	3.4	Yes	No	Energy, Gas, and Water
9.	Lembaga Pembiayaan Perumahan Sektor Awam	12.8	3.0	Yes	No	Property and Real Estate
10.	CIMB Bank	12.5	2.9	Yes	No	Finance
11.	Sarawak Energy	9.5	2.3	Yes	No	Energy, Gas, and Water
12.	Jimah East Power	9.0	2.1	Yes	No	Energy, Gas, and Water
13.	GOVCO Holdings	8.8	2.1	Yes	No	Finance
14.	Bank Pembangunan Malaysia	7.4	1.7	Yes	No	Banking
15.	YTL Power International	7.3	1.7	No	Yes	Energy, Gas, and Water
16.	Rantau Abang Capital	7.0	1.7	Yes	No	Finance
17.	Sarawak Hidro	6.5	1.5	Yes	No	Energy, Gas, and Water
18.	Danga Capital	6.5	1.5	Yes	No	Finance
19.	Public Bank	6.4	1.5	No	No	Banking
20.	ValueCap	6.0	1.4	Yes	No	Finance
21.	CIMB Group Holdings	5.7	1.4	Yes	No	Finance
22.	Aman Sukuk	5.5	1.3	Yes	No	Construction
23.	Putrajaya Holdings	5.4	1.3	Yes	No	Property and Real Estate
24.	Turus Pesawat	5.3	1.3	Yes	No	Transport, Storage, and Communications
25.	RHB Bank	5.2	1.2	No	No	Banking
26.	1Malaysia Development	5.0	1.2	Yes	No	Finance
27.	Celcom Networks	5.0	1.2	No	No	Transport, Storage, and Communications
28.	GENM Capital	5.0	1.2	No	No	Finance
29.	Jambatan Kedua	4.6	1.1	Yes	No	Transport, Storage, and Communications
30.	Telekom Malaysia	4.5	1.1	No	Yes	Telecommunications
Total Top 30 LCY Corporate Issuers		**336.5**	**79.7**			
Total LCY Corporate Bonds		**592.7**	**140.4**			
Top 30 as % of Total LCY Corporate Bonds		**56.8%**	**56.8%**			

LCY = local currency, MYR = Malaysian ringgit, USD = United States dollar.
Notes:
1. Data as of end-September 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 Third Quarter of 2017

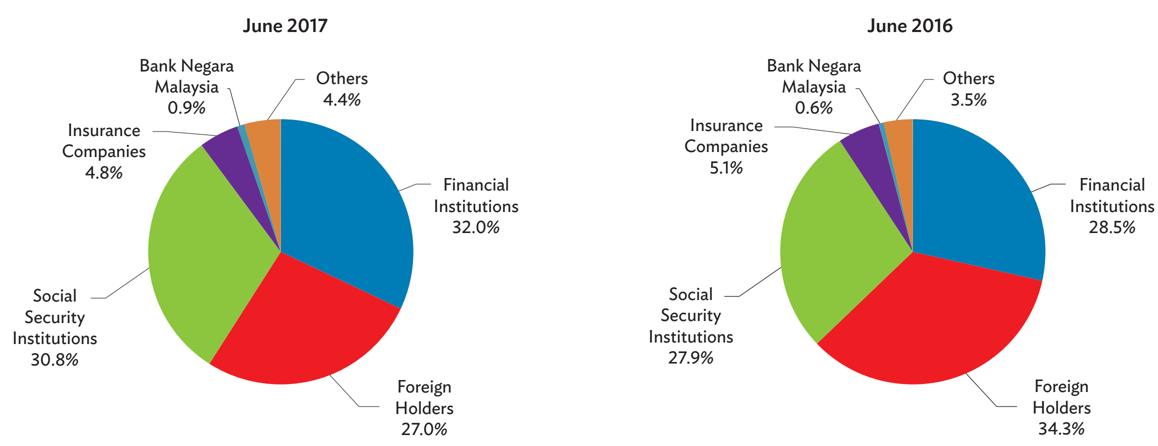
Corporate Issuers	Coupon Rate (%)	Issued Amount (MYR million)
Prasarana Malaysia		
5-year Islamic MTN	4.08	500
7-year Islamic MTN	4.28	800
8-year Islamic MTN	4.34	850
20-year Islamic MTN	5.01	650
25-year Islamic MTN	5.11	600
30-year Islamic MTN	5.23	600
Lembaga Pembiayaan Perumahan Sektor Awam		
3-year Islamic MTN	3.95	300
5-year Islamic MTN	4.08	500
7-year Islamic MTN	4.28	700
20-year Islamic MTN	5.05	1,000
30-year Islamic MTN	5.26	1,000
Cagamas		
1-year Islamic MTN	3.78	230
1-year Islamic MTN	3.78	180
5-year Islamic MTN	4.09	1,000

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

Investor Profile

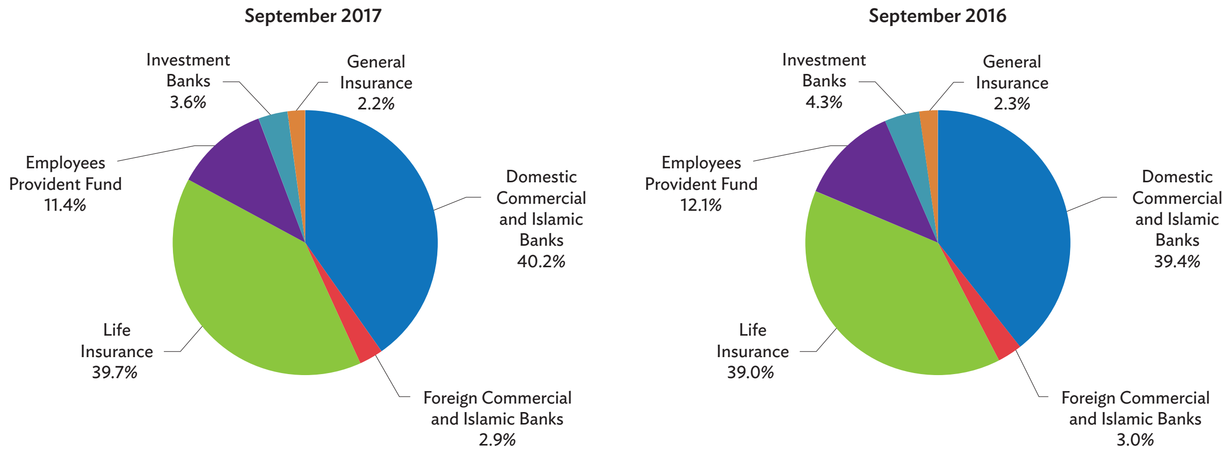
Foreign investors' share of LCY government bonds declined considerably to 27.0% at the end of June from 34.3% a year earlier (**Figure 3**). The drop was due to a sell-off by foreign investors after BNM strictly reinforced the prohibition on offshore trading of the Malaysian ringgit, which left the foreign investors with limited avenues to hedge risks, thus discouraging them to hold local bonds. This led to financial institutions having the highest share of government bond holdings among all investor groups in the Malaysian LCY bond market, accounting for a 32.0% share at the end of June, up from 28.5% a year earlier. Social security institutions were the second largest holders of government bonds at 30.8%. (Financial institutions such as banks and social security institutions such as pension funds are also known to be sticky investors.) Investor groups with smaller holdings as a share of the total LCY government bond market include insurance companies (4.8%), other investors (4.4%), and BNM (0.9%).

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.

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.

The investor profile of the LCY corporate bond market was little changed in September from a year earlier (**Figure 4**). Domestic commercial and Islamic banks and life insurance companies remained the dominant corporate bond holders. Domestic commercial and Islamic banks had the largest share at the end of September at 40.2% while life insurance companies were second with a 39.7% share. The two investor groups saw slight increases in their shares from 39.4% and 39.0% at the end of September 2016, respectively. On the other hand, the rest of the investor groups saw slightly decreases in their shares of corporate bond holdings.

Policy, Institutional, and Regulatory Developments

Bank Negara Malaysia Sets Out Additional Hedging Flexibility for Foreign Exchange

On 11 September, BNM set out additional hedging flexibility to further facilitate foreign exchange risk management as part of its measures to promote development of the Malaysian financial market. In its Supplementary Notice No. 3 on Foreign Exchange Administration Rules, BNM allows registered nonbank, nonresident market participants to forward hedge crude palm oil futures and options on crude palm oil futures for the purpose of managing ringgit exposure arising from such contracts.

Malaysian Government Sets Budget for 2018

Prime Minister Najib Razak announced Malaysia's 2018 budget on 27 October, which amounted to MYR280.3 billion, or 7.5% higher than in 2017. A total of MYR234.3 billion will be allotted for operating expenditure and MYR46 billion for development. While the spending plan has increased, revenue collection is also projected to expand 6.4% to MYR239.9 billion in 2018, allowing the government to maintain its fiscal consolidation target. Also announced was a cut of 2 percentage points to the personal income tax for those earning between MYR20,000 and MYR70,000 annually.