

Malaysia

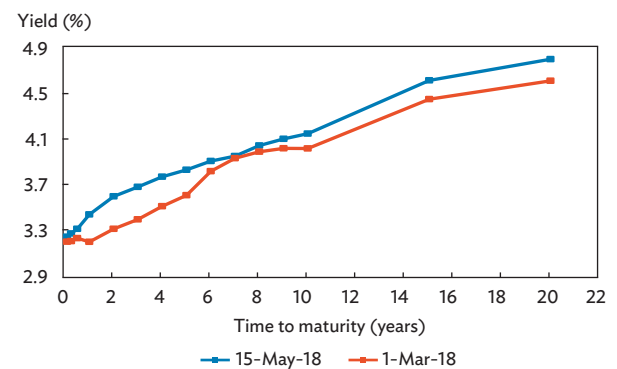
Yield Movements

Malaysia's local currency (LCY) government bond yield curve shifted upward for all tenors between 1 March and 15 May (**Figure 1**). Large yield increases were seen in tenors from 1 year to 5 years, with an average gain of 26 basis points (bps). Yield for maturities of 10 years and above increased 16 bps on average. Treasury bills and Treasury bonds with maturities of 6–9 years saw small average increases in their yields of 6 bps each. The yield spread between 2-year and 10-year government bonds narrowed 15 bps during the review period.

The upward trend in Malaysia's local government bond yields during the review period was driven by a number of factors. First, the yield increases were in line with rising global yields, especially for United States (US) Treasuries. Expectations of faster monetary policy normalization in the US and other major economies are putting upward pressure on sovereign bond yields. Another factor was Bank Negara Malaysia's (BNM) interest rate hike in January. BNM raised its overnight policy rate by 25 bps to 3.25% as a preemptive move to prevent the buildup of risks from a low-interest-rate environment. Third, the unexpected outcome of the Malaysian general election has made investors cautious in setting their position on local bonds as they wait for more clarity from the new government on its policies. Uncertainties in the near- to medium-term will weigh on the sovereign debt performance, likely translating into higher yields. At the same time, Malaysia's sound macro backdrop may help moderate yield pressures.

BNM maintained its overnight policy rate at 3.25% during its monetary policy meeting on 10 May. Previously, BNM raised the overnight policy rate for the first time since 2014 by 25 bps on 25 January. Inflation is expected to remain manageable, owing to smaller effects from global cost factors. A stronger ringgit relative to 2017 will lessen import costs, despite some observed volatility related to the general election. Core inflation is also expected to remain moderate on the back of stable domestic demand. The Malaysian economy is expected to continue to expand, buoyed by vibrant private sector activity, while growth momentum in the global economy will fuel exports.

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



Source: Based on data from Bloomberg LP.

Malaysia logged an inflation rate of 1.4% year-on-year (y-o-y) in April, which was little changed from 1.3% y-o-y in March when consumer price inflation reached its lowest level since August 2016. Food and nonalcoholic beverages, which account for the largest share of the Consumer Price Index, have seen continued price moderation since the start of the year. Transportation costs moderated the most among all components of the Consumer Price Index, increasing only 0.4% y-o-y in April after registering double-digit growth in the latter months of 2017. Price declines in transportation were observed in February and March. Core inflation, which excludes commodities that are subject to fluctuations, slowed to 1.5% y-o-y in April from 1.7% y-o-y in March.

The Malaysian ringgit appreciated 1.5% year-to-date through 15 May against the US dollar on account of strong macroeconomic fundamentals and firmer crude oil prices. However, weakness set in during the run-up to the general election. From 1 April to 15 May, the ringgit depreciated 3.0% against the US dollar. Moreover, rising yields in the US may have led to weaker demand for the ringgit. While volatility may persist, downside risks will be fairly contained given the healthy current account, ample foreign reserves, and robust growth outlook.

Malaysia's economy expanded 5.4% y-o-y in the first quarter (Q1) of 2018, underpinned by strong private sector expenditure and a buoyant external sector.

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q1 2017		Q4 2017		Q1 2018		Q1 2017		Q1 2018	
	MYR	USD	MYR	USD	MYR	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	1,206	272	1,286	318	1,339	347	3.3	5.7	4.1	11.1
Government	651	147	673	166	705	182	2.7	3.5	4.7	8.3
Central Government Bonds	613	138	637	157	656	170	2.7	5.9	3.0	7.1
of which: <i>Sukuk</i>	252	57	270	67	287	74	6.6	12.9	6.3	13.9
Central Bank Bills	10	2	7	2	20	5	9.7	(55.3)	173.5	109.4
of which: <i>Sukuk</i>	0	0	0	0	1	0.3	-	-	-	-
Sukuk Perumahan Kerajaan	28	6	28	7	28	7	0.0	0.0	0.0	0.0
Corporate	555	125	613	152	635	164	4.0	8.3	3.5	14.3
of which: <i>Sukuk</i>	409	92	460	114	480	124	3.6	11.7	4.4	17.4

(-) = negative, -- = not applicable, MYR = Malaysian ringgit, q-o-q = quarter-on-quarter, Q1 = first quarter, Q4 = fourth 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.

Private consumption and investment grew 6.9% y-o-y and 0.5% y-o-y, respectively, and exports grew 3.7% y-o-y during the quarter. On the production side, all economic sectors expanded, with the services and manufacturing sectors providing the growth impetus at 6.5% y-o-y and 5.3% y-o-y, respectively. Economic growth in Q1 2018 represented the second consecutive quarter of deceleration. BNM expects the Malaysian economy to remain on a favorable growth path in 2018, anchored on domestic demand and spillovers from the external sector.

Size and Composition

Malaysia's LCY bond market continued to expand in Q1 2018, increasing 4.1% quarter-on-quarter (q-o-q) and 11.1% y-o-y (Table 1). The growth rates logged in Q1 2018 were faster compared with the preceding quarter and Q1 2017. Total LCY outstanding bonds amounted to MYR1,339 billion (USD347 billion) at the end of March, comprising a mix of 53% government bonds and 47% corporate bonds. Both segments propelled the growth of the LCY bond market. *Sukuk* (Islamic bonds) dominate Malaysia's LCY bond market with a share of 59.4%. This share is up from 58.9% at the end of December.

Total issuance in Malaysia's bond market reached MYR100.1 billion in Q1 2018. On a q-o-q basis, government bond sales increased while corporate bond sales dropped, leading to moderating issuance growth of

7.8% q-o-q versus 21.1% q-o-q in the fourth quarter (Q4) of 2017. On an annual basis, issuances from both the government and corporate segments saw increases, leading to growth of 30.2% y-o-y in Q1 2018, although this was much slower than growth of 86.6% y-o-y in Q4 2017.

Government bonds. Malaysia's LCY government bond market posted growth of 4.7% q-o-q, climbing to a size of MYR705 billion at the end of March. Central government bonds mainly propelled the increase, having the largest share in the government bond stock, with 3.0% q-o-q growth on the back of increased gross issuance and lower redemptions during the period. Central bank bills outstanding more than doubled in Q1 2018 to reach MYR20 billion at the end of March, although they only comprised 3.0% of total government bonds. On a y-o-y basis, the LCY government bond market grew 8.3%.

Total issuance of LCY government bonds in Q1 2018 surged 60.4% q-o-q to MYR57.6 billion. Sales of Malaysian Government Securities (MGS) totaled MYR18.7 billion and sales of Government Investment Issues (GII) totaled MYR14.0 billion, both of which were higher compared with Q4 2017. The markets for MGS and GII received fairly strong support from local as well as foreign investors on the back of a firm Malaysian ringgit. Issuance of Treasury bills and BNM bills surged in Q1 2018 on a q-o-q basis, bringing their combined share to about half of total government issuance from just 21.0% in Q4 2017. BNM issued a total of MYR16.9 billion

in Q1 2018, up from MYR6.0 billion in Q4 2017. The bulk of the issuance comprised BNM Interbank Bills (MYR15.9 billion), which were introduced in November 2017 as part of the central bank's initiative to strengthen the financial markets by enhancing short-selling and liquidity operations in the bond market.

Foreign investor holdings of LCY government bonds decreased to MYR185.8 billion at the end of April from MYR186.3 billion at the end of December (**Figure 2**). Foreign holdings at the end of April were equivalent to 27.9% of total LCY government bonds outstanding. The bulk of foreign holdings were in MGS, amounting to MYR162.8 billion. Net foreign inflows of MYR4.9 billion were recorded in January, while net outflows of MYR3.8 billion were recorded in February. Foreign investors became net buyers of local government bonds again in March, registering net inflows of MYR2.2 billion, but this was reversed in April with net outflows of MYR3.9 billion, the largest since March 2017. Rising yields in US Treasuries prompted a sell-off in the Malaysian bond market along with many other emerging East Asian economies. In the first 4 months of 2018, MGS saw cumulative net outflows of MYR1.6 billion, while GII and Treasury bills saw cumulative net inflows.

Corporate bonds. The stock of corporate bonds grew 3.5% q-o-q to reach MYR635 billion in Q1 2018. The growth was at par with the growth logged in Q4 2017.

Sukuk remained the dominant corporate bond segment with a share of 75.6% of the total in Q1 2018, slightly higher than in the preceding quarter (74.9%).

Aggregate bonds outstanding among the top 30 corporate issues amounted to MYR359.9 billion at the end of March (**Table 2**). As a share of total LCY corporate bonds, the top 30's bonds outstanding were little changed from the end of December at 56.7%. The top 30 list predominantly comprises firms from the finance industry, who have aggregate outstanding bonds of MYR177.2 billion. On the other hand, firms from the construction industry only account for MYR5.3 billion of outstanding bonds. Danainfra Nasional, the government's funding vehicle for infrastructure projects, remained the largest issuer at the end of March with MYR46.6 billion of LCY bonds outstanding.

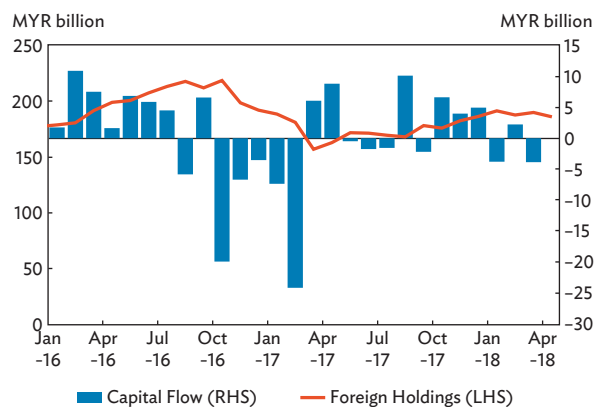
The corporate bond market saw subdued issuance activity in Q1 2018, with issuances declining 25.4% q-o-q to MYR42.5 billion. Monthly declines were observed in January and February; in March, issuance rebounded with a notable increase in medium-term notes. Issuance in March, however, were not enough for the Q1 2018 tally to match the amount issued in Q4 2017. Lower corporate issuance during Q1 2018 can be attributed to upward pressures from higher interest rates as a result of BNM's monetary policy rate hike, expectations of accelerated monetary tightening from the US Federal Reserve as inflationary pressures heighten, and portfolio reallocations to safe havens.

Edra Energy had the highest total issuance during Q1 2018, amounting to MYR5.1 billion, which included a 6-year Islamic medium-term note amounting to MYR235 million (**Table 3**). Other notable corporate issuances in the quarter were from Danga Capital, Danainfra Nasional, Prasarana, and Cagamas.

Investor Profile

Social security institutions had the largest holdings of government bonds among all investor groups at the end of December with a share of 32.0%, up from 28.3% in December 2016 (**Figure 3**). Foreign investor holdings of LCY government bonds were down at the end of December 2017 to 29.2% from 32.2% a year earlier. Subsequent to the outflow of foreign funds in late 2017, foreign holdings have remained relatively low. Financial

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:

- Figures exclude foreign holdings of Bank Negara Malaysia bills.
- 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.

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	46.6	12.1	Yes	No	Finance
2.	Cagamas	33.3	8.6	Yes	No	Finance
3.	Project Lebuhraya Usahasama	30.2	7.8	No	No	Transport, Storage, and Communications
4.	Prasarana	27.7	7.2	Yes	No	Transport, Storage, and Communications
5.	Perbadanan Tabung Pendidikan Tinggi Nasional	19.0	4.9	Yes	No	Finance
6.	Khazanah	17.0	4.4	Yes	No	Finance
7.	Pengurusan Air	14.4	3.7	Yes	No	Energy, Gas, and Water
8.	Maybank	14.3	3.7	No	Yes	Banking
9.	CIMB Bank	13.2	3.4	Yes	No	Finance
10.	Lembaga Pembiayaan Perumahan Sektor Awam	10.8	2.8	Yes	No	Property and Real Estate
11.	Sarawak Energy	10.5	2.7	Yes	No	Energy, Gas, and Water
12.	Danga Capital	10.0	2.6	Yes	No	Finance
13.	Jimah East Power	9.0	2.3	Yes	No	Energy, Gas, and Water
14.	Maybank Islamic	8.5	2.2	No	Yes	Banking
15.	CIMB Group Holdings	7.9	2.1	Yes	No	Finance
16.	Bank Pembangunan Malaysia	7.3	1.9	Yes	No	Banking
17.	GOVCO Holdings	7.3	1.9	Yes	No	Finance
18.	YTL Power International	7.3	1.9	No	Yes	Energy, Gas, and Water
19.	Rantau Abang Capital	7.0	1.8	Yes	No	Finance
20.	Sarawak Hidro	6.5	1.7	Yes	No	Energy, Gas, and Water
21.	Public Bank	6.4	1.6	No	No	Banking
22.	ValueCap	6.0	1.6	Yes	No	Finance
23.	Turus Pesawat	5.3	1.4	Yes	No	Transport, Storage, and Communications
24.	Aman Sukuk	5.3	1.4	Yes	No	Construction
25.	Edra Energy	5.1	1.3	No	Yes	Energy, Gas, and Water
26.	1Malaysia Development	5.0	1.3	Yes	No	Finance
27.	Celcom Networks	5.0	1.3	No	No	Transport, Storage, and Communications
28.	GENM Capital	5.0	1.3	No	No	Finance
29.	Putrajaya Holdings	4.6	1.2	Yes	No	Property and Real Estate
30.	Jambatan Kedua	4.6	1.2	Yes	No	Transport, Storage, and Communications
Total Top 30 LCY Corporate Issuers		359.9	93.2			
Total LCY Corporate Bonds		634.5	164.2			
Top 30 as % of Total LCY Corporate Bonds		56.7%	56.7%			

LCY = local currency, MYR = Malaysian ringgit, USD = United States dollar.

Notes:

1. Data as of 31 March 2018.

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 First Quarter of 2018

Corporate Issuers	Coupon Rate (%)	Issued Amount (MYR million)
Danga Capital		
5-year Islamic MTN	5.02	2,000
5-year Islamic MTN	4.94	1,000
Danainfra Nasional		
15-year Islamic MTN	5.24	1,000
10-year Islamic MTN	5.11	1,500
Prasarana		
15-year Islamic MTN	5.25	1,200
Cagamas		
3-year Islamic MTN	4.17	1,000
Edra Energy		
6-year Islamic MTN	6.43	235

MTN = medium-term note, MYR = Malaysian ringgit.
Source: Bank Negara Malaysia Bond Info Hub.

institutions were the third-largest holders of government bonds at 27.7%. BNM continued to have the smallest share of LCY government bond holdings.

The investor profile of the LCY corporate bond market was marginally changed in March 2018 from a year earlier (Figure 4). Domestic commercial and Islamic banks remained the largest corporate bond holders, with their share inching up to 40.3% at the end of March from 38.9% a year earlier. Life insurance companies were the second-largest holders at the end of March, but their share was slightly down to 37.9% from 39.2%. General

insurance companies continued to have the smallest share at 1.9% at the end of March, which was lower compared with a year earlier.

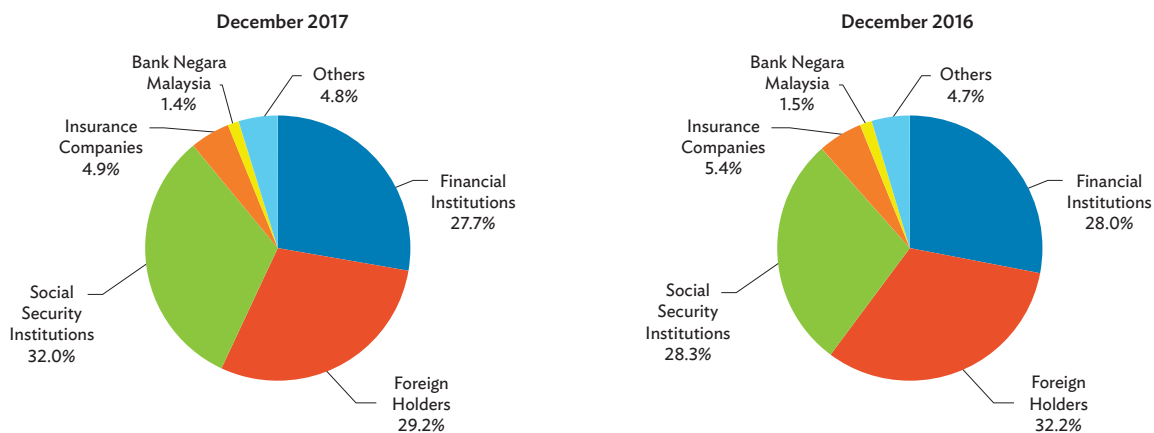
Ratings Update

RAM Ratings Affirms Malaysia's Sovereign Ratings

RAM Ratings reaffirmed Malaysia's respective sovereign ratings of A_2 (global), AAA (ASEAN), and AAA (domestic-scale), with a stable outlook, on 19 January. According to RAM Ratings, the affirmation reflected Malaysia's resilient economic growth and the government's fiscal consolidation efforts. Malaysia's economy is estimated to have grown 5.8% in 2017, which exceeded the rating agency's expectation of 4.5%. The government's lower fiscal deficit target of 2.8% of gross domestic product in 2018, compared with 3.0% in 2017, is seen as being supported by solid domestic economic conditions and the gradual recovery in oil prices.

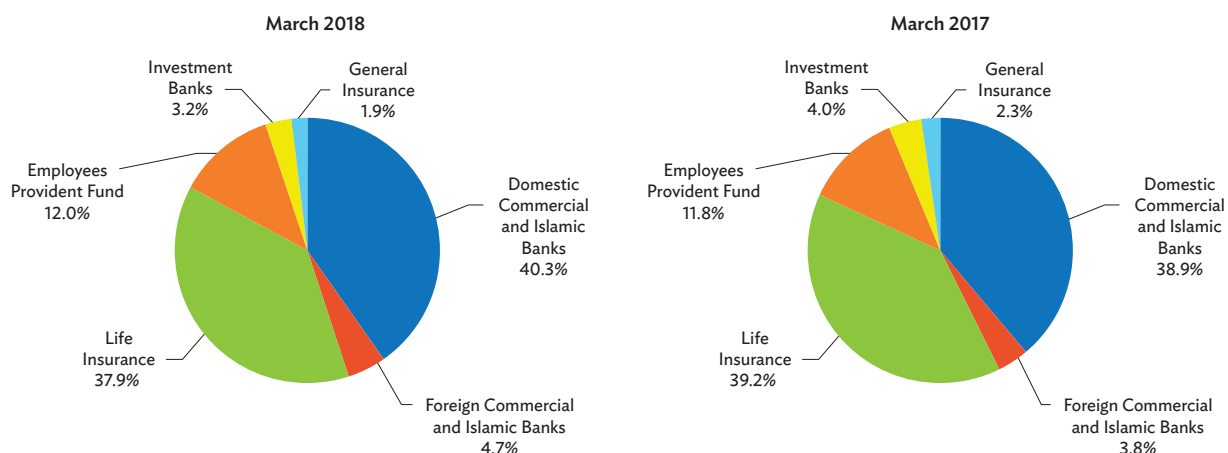
Fitch Ratings Affirms Malaysia's Sovereign Ratings

Fitch Ratings affirmed Malaysia's long-term, foreign-currency issuer default rating at $A-$ with a stable outlook on 28 March. The affirmation reflected Malaysia's resilient economic growth, which is backed by strong private consumption and investment spending, and exports amid a strong external environment. The rating affirmation

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 31 December 2017, as data are based on the EPF's annual report.
Sources: Bank Negara Malaysia and the Employees Provident Fund.

also reflected Malaysia's net external creditor position as a result of sustained current account surpluses, the large external assets of the private sector, and falling government debt and deficit levels. According to Fitch Ratings, Malaysia's rating is constrained by weaker governance standards and lower levels of income per capita and human development compared to the median for sovereigns rated in the A category. It also cited downside risks, such as threats of trade protectionism and tighter global monetary conditions, which could leave Malaysia's open economy vulnerable to shocks.

Policy, Institutional, and Regulatory Developments

Prime Minister Razak Announces Plan to Establish Malaysia-Singapore Stock Trading Link

Prime Minister Najib Razak announced on 6 February an initiative for Malaysia to collaborate with Singapore in establishing a stock market trading link. According to Prime Minister Razak, the Malaysia-Singapore link will

spur further mutual benefits and harness the economic potential of both countries as it will provide investors with seamless access to each other's markets, which together have a combined market capitalization of more than USD1.2 trillion and 1,600 public listed companies.

Bursa Malaysia Implements Intraday Short-Selling

Bursa Malaysia implemented the intraday short-selling (IDSS) framework on 16 April to boost liquidity in the local stock exchange. The measure is part of Bursa Malaysia's efforts to build a dynamic and vibrant capital market that will further improve flexibility for investors to refine their trading and risk management strategies. The list of approved stocks for IDSS comprises 280 securities and the list will be reviewed every 6 months. Compliance requirements and safeguards will also be put into place that include market controls for IDSS suspensions if a stock price falls more than 15% from the previous day's closing price or if the gross short-selling volume exceeds the daily maximum limit of 3% of outstanding shares per security.