Malaysia

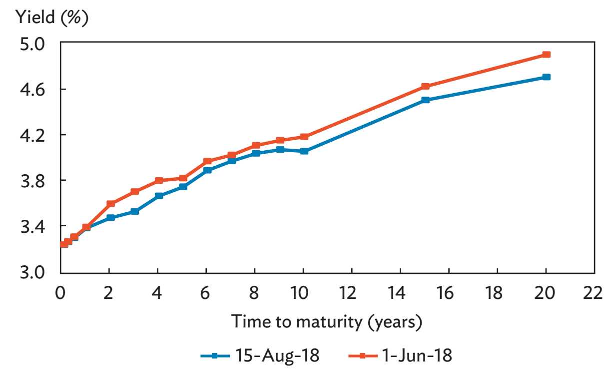
Yield Movements

Yields of local currency (LCY) government bonds declined across all maturities between 1 June and 15 August (**Figure 1**). Short-term Treasury bills (maturities of 1 year or less) and bonds with tenors of between 5 years to 9 years saw modest declines in their yields during the review period, which ranged from 0.3 basis point (bp) to 8 bps. The smallest declines were observed in 3-month to 6-month Treasury bills, which averaged 0.5 bp. On the other hand, bonds with maturities of between 2 years and 4 years and 10 years and above saw double-digit decreases in their yields, averaging 14 bps. The largest drop in yields was seen for the 20-year government bond at 19 bps. The yield spread between 2-year and 10-year maturities marginally narrowed from 58 bps to 57 bps during the review period.

The general decline in yields during the review period can be attributed to Bank Negara Malaysia (BNM) maintaining its policy rate after raising it by 25 bps in January as a preemptive move. The central bank's tone regarding its monetary policy remains neutral amid sustained economic growth momentum and a subdued inflation forecast. The positive outlook on the Malaysian economy is also a driving force for local bond demand, which could help moderate potential increases in yields, even with the backdrop of a faster pace of US interest rate hikes than previously expected and signals from major central banks that they will tighten their monetary policies. The return of foreign funds to the local bond market in July also helped hold down yield increases.

The Monetary Policy Committee of BNM maintained the overnight policy rate at 3.25% during its meeting on 11 July in line with market expectations. Malaysia's economy is forecast to remain on a steady growth path, supported by private consumption, while the financial sector is benefiting from the improving external position that underpins the economy's fundamentals. Inflation is projected to be lower than earlier forecast in full-year 2018 after taking into account the recent policy measures on domestic cost factors (see Policy and Regulatory Developments).

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



Source: Based on data from Bloomberg LP.

Consumer price inflation in Malaysia rose to 0.9% y-o-y in July after posting a 3-year low of 0.8% y-o-y in June. Malaysia's low inflation can be traced to the tax holidays following the government's removal of the goods and services tax on 1 June. The July inflation was largely driven by higher transport prices, which increased 6.7% y-o-y in July from 5.5% y-o-y in June on the back of costlier fuel. All other components of the Consumer Price Index either registered subdued price growths or price declines.

The Malaysian ringgit continued to slide against the United States (US) dollar between 1 June and 15 August, losing about 3.0% in value. The weakening of the ringgit was due to external developments such as rising yields for US Treasuries, speculation of accelerated interest rate hikes by the US Federal Reserve and monetary policy normalization among other major central banks, and global trade tensions. On the local front, the ringgit was weighed down by risk factors such as the unexpected win of the Pakatan Harapan coalition in the May elections, which generated some market nervousness due to uncertainty over future policies, and the fiscal implications of the 1Malaysia Development Berhad scandal.

Malaysia's GDP expanded 4.5% y-o-y in the second quarter (Q2) of 2018, which was slower than the expansion logged in the first quarter (Q1) of 5.4% y-o-y.

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q2 2017		Q1 2018		Q2 2018		Q2 2017		Q2 2018	
	MYR	USD	MYR	USD	MYR	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**1,246**	**290**	**1,339**	**347**	**1,369**	**339**	**3.3**	**7.1**	**2.2**	**9.9**
Government	670	156	705	182	722	179	2.9	4.0	2.5	7.9
Central Government Bonds	634	148	656	170	676	167	3.5	5.6	3.0	6.6
of which: *Sukuk*	263	61	287	74	295	73	4.6	13.6	3.0	12.2
Central Bank Bills	7	2	20	5	18	5	(23.4)	(51.8)	(9.0)	149.0
of which: *Sukuk*	0	0	1	0.3	6	1	–	–	450.0	–
Sukuk Perumahan Kerajaan	28	7	28	7	28	7	0.0	0.0	0.0	0.0
Corporate	576	134	635	164	646	160	3.8	10.9	1.9	12.2
of which: *Sukuk*	425	99	480	124	489	121	4.0	13.3	1.8	15.0

( ) = negative, – = not applicable, 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.

It was the lowest GDP growth since the fourth quarter of 2016. On the demand side, private consumption and gross fixed capital formation supported the expansion in Q2. On the supply side, the services, manufacturing, and construction sectors remained supportive of the economic expansion, although a growth slowdown was observed in the latter two sectors. Bank Negara Malaysia revised downwards Malaysia's full-year GDP growth to 5.0% for 2018 from an earlier projection of 5.5%–6.0% due to extended disruptions in oil and gas production, and the subdued performance of the agriculture sector.

Size and Composition

Malaysia's total LCY bonds outstanding expanded 2.2% quarter-on-quarter (q-o-q) and 9.9% y-o-y to reach MYR1,369 billion (USD339 billion) at the end of the second quarter (Q2) of 2018 (**Table 1**). The growth logged in Q2 2018 was slower than in the previous quarter on both a q-o-q and y-o-y basis. The government and corporate segments each showed expansion in Q2 2018, with government bonds outpacing the growth in corporate bonds. Government bonds outstanding amounted to MYR722 billion and corporates amounted to MY646 billion at the end of Q2 2018, accounting for 52.8% and 47.2% of the total, respectively. Total *sukuk* (Islamic bonds) amounted to MYR817 billion, accounting for a larger share of Malaysia's bond market at 59.7% in Q2 2018 versus 59.4% in Q1 2018.

Issuance of LCY bonds dropped in Q2 2018 by 9.3% q-o-q on account of lower bond sales from the government and corporates. Malaysia posted total issuance of MYR90.9 billion during the quarter. Upward pressure on domestic bond yields was observed in Q2 2018 on the back of cautious investor sentiment, both before and after the general elections, and due to persistent foreign fund outflows resulting from downside risks in global developments. Increased borrowing cost during the period may have held back debt issuances. On a y-o-y basis, however, LCY bond sales posted growth of 27.7%, with government issuance offsetting the drop in corporate issuance.

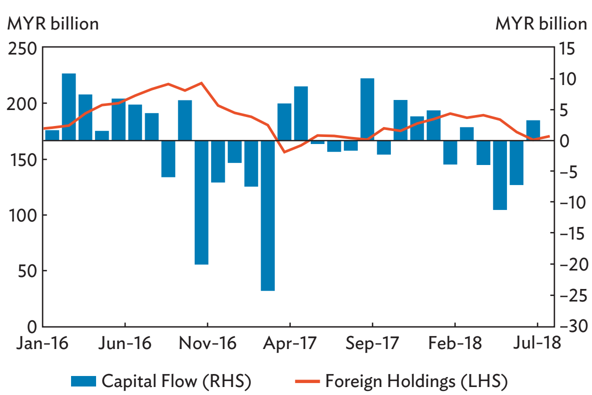
Government bonds. Total LCY government outstanding bonds in Malaysia increased 2.5% q-o-q and 7.9% y-o-y, reaching MYR722 billion at the end of June. Central government bonds remained the driver of growth in the government bond market on an expansion of 3.0% q-o-q. Central bank bills outstanding continued to fall, albeit at a slower pace, on the back high levels of maturing debt even as issuance increased during the quarter. Sukuk Perumahan Kerajaan outstanding were unchanged at MYR28 billion.

Total issuance of LCY government securities decreased to MYR51.0 billion in Q2 2018 from MYR57.6 billion in Q1 2018, reversing the 60.4% q-o-q gain in the previous quarter. Lower issuance volume for Malaysian

Government Securities in Q2 2018 offset the higher issuance volume for Government Investment Issues, resulting in an 8.3% q-o-q decline in long-term government bonds. Issuance of Treasury bills was also down in Q2 2018 to MYR2 billion from MYR8 billion in the preceding quarter. On the other hand, issuance of central bank bills showed an increase of 12.4% q-o-q, underpinned by the continued increase of BNM Interbank Bill issuance, which aims to enhance liquidity in the bond market. Despite some uncertainties over Malaysia's economic and fiscal policies following the change in government in May, the performance of the LCY government bond market remained satisfactory in Q2 2018, owing to the support of local investors.

Foreign holdings of LCY government bonds posted monthly outflows in Q2 2018 after briefly recovering in March (**Figure 2**). Foreign investors shed a total of MYR22.1 billion of their holdings in the LCY bond market during the quarter, largely canceling out the positive inflows in Q1 2018. The sell-off is attributed to several factors, including higher yields for US Treasuries that triggered fund outflows from Malaysia and in other emerging markets; the weakening of the Malaysian ringgit against the US dollar; the unexpected outcome of the May general elections, which clouded expectations of economic and fiscal policies and affected investor sentiment; the hawkish monetary policy stance of several central banks, which prompted investors to hunt for yield; and concerns over global trade tensions. LCY government bonds held by foreign investors amounted to MYR167.6 billion at the end of June, or 24.8% of total government bonds outstanding. The largest monthly attrition in Q2 2018 was recorded in May, when outflows reached MYR11.1 billion, the highest level since March 2017. In July, foreign fund flows into the local bond market recovered with MYR3.3 billion in net inflows following 3 consecutive months of net outflows. Bargain hunting among foreign investors following the earlier outflows, alongside the economy's solid fundamentals, prompted the return of foreign funds to Malaysia's LCY bond market.

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. Corporate bonds posted growth of 1.9% q-o-q and 12.2% y-o-y in Q2 2018, bringing the total outstanding amount to MYR646 billion at the end of June. The slower growth was driven by reduced issuance of corporate paper during the quarter. The share of ***sukuk*** in total corporate bonds outstanding was 75.6% at the end of June, practically unchanged from the end of March.

Corporate issuance continued to falter in Q2 2018, amounting to MYR39.9 billion, which was down 6.3% q-o-q. Issuance volume in the corporate sector in Q2 2018 was the lowest since Q1 2017, which can be attributed to the new government's review of various infrastructure projects, in line with its fiscal management policies that seek to restrain public debt, affecting the debt sales of major corporate issuers.

The aggregate bonds outstanding of the top 30 LCY corporate issuers amounted to MYR365.2 billion, or 56.5% of the total corporate bond market, at the end of June (**Table 2**). The top 30 corporate issuers are largely from the finance industry with cumulative outstanding bonds equal to MYR181.1 billion. Two-thirds of the list comprises state-owned enterprises, which includes Danainfra Nasional and Cagamas, two of the largest debt issuers.

Table 3 shows notable issuances during Q2 2018. Cagamas and Lembaga Pembiayaan Perumahan Sektor Awam had the single-largest issuances during the quarter at MYR1.5 billion each, with maturities of 5 years and 15 years, respectively.

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	48.4	12.0	Yes	No	Finance
2.	Cagamas	35.4	8.8	Yes	No	Finance
3.	Project Lebuhraya Usahasama	30.2	7.5	No	No	Transport, Storage, and Communications
4.	Prasarana	26.5	6.6	Yes	No	Transport, Storage, and Communications
5.	Perbadanan Tabung Pendidikan Tinggi Nasional	19.0	4.7	Yes	No	Finance
6.	Khazanah	17.0	4.2	Yes	No	Finance
7.	Pengurusan Air	14.6	3.6	Yes	No	Energy, Gas, and Water
8.	Lembaga Pembiayaan Perumahan Sektor Awam	13.8	3.4	Yes	No	Property and Real Estate
9.	Maybank	13.6	3.4	No	Yes	Banking
10.	CIMB Bank	13.2	3.3	Yes	No	Finance
11.	Danga Capital	10.0	2.5	Yes	No	Finance
12.	Sarawak Energy	9.8	2.4	Yes	No	Energy, Gas, and Water
13.	Jimah East Power	9.0	2.2	Yes	No	Energy, Gas, and Water
14.	CIMB Group Holdings	7.9	2.0	Yes	No	Finance
15.	Public Bank	7.9	1.9	No	No	Banking
16.	Maybank Islamic	7.8	1.9	No	Yes	Banking
17.	Bank Pembangunan Malaysia	7.3	1.8	Yes	No	Banking
18.	GOVCO Holdings	7.3	1.8	Yes	No	Finance
19.	YTL Power International	7.3	1.8	No	Yes	Energy, Gas, and Water
20.	Rantau Abang Capital	7.0	1.7	Yes	No	Finance
21.	Sarawak Hidro	6.5	1.6	Yes	No	Energy, Gas, and Water
22.	ValueCap	6.0	1.5	Yes	No	Finance
23.	Turus Pesawat	5.3	1.3	Yes	No	Transport, Storage, and Communications
24.	Aman Sukuk	5.2	1.3	Yes	No	Construction
25.	EDRA Energy	5.1	1.3	No	Yes	Energy, Gas, and Water
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.	Telekom Malaysia	4.8	1.2	No	Yes	Telecommunications
30.	Jambatan Kedua	4.6	1.1	Yes	No	Transport, Storage, and Communications
Total Top 30 LCY Corporate Issuers		**365.2**	**90.4**			
Total LCY Corporate Bonds		**646.5**	**160.1**			
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 30 June 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 Second Quarter of 2018

Corporate Issuers	Coupon Rate (%)	Issued Amount (MYR million)
Cagamas		
3-year MTN	4.22	400
5-year Islamic MTN	4.50	1,500
Danainfra Nasional		
7-year Islamic MTN	4.32	800
10-year Islamic MTN	4.55	700
15-year Islamic MTN	4.90	700
20-year Islamic MTN	5.08	300
Lembaga Pembiayaan Perumahan Sektor Awam		
5-year Islamic MTN	4.10	300
7-year Islamic MTN	4.32	1,000
10-year Islamic MTN	4.54	200
15-year Islamic MTN	4.90	1,500

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

Investor Profile

Social security institutions were the largest holders of LCY government bonds at the end of March, compared with March 2017 when financial institutions had the largest holdings (**Figure 3**). The holdings share of social security institutions rose to 33.2% in March from 29.8% a year earlier. Foreign investors had the second-largest holdings share of government bonds, with their share increasing to 28.9% in March (ahead of the foreign funds' sell-off in Q2 2018) from 25.6% a year earlier. BNM's holdings, which were already the smallest among the investor group in March 2017, fell to 1.0% from 1.6% during the review period.

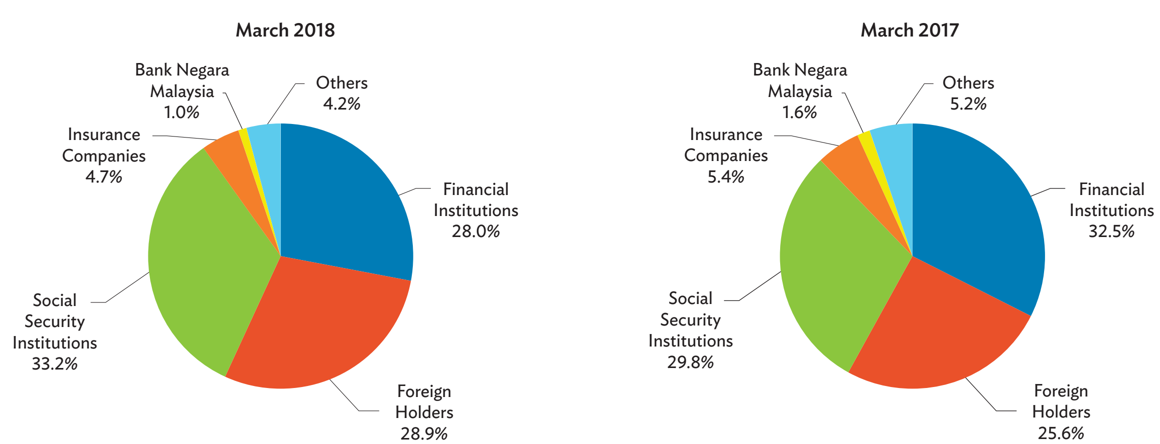
Domestic commercial and Islamic banks remained the largest holders of LCY corporate bonds with their share climbing to 41.5% in June 2018 from 38.9% in June 2017 (**Figure 4**). While life insurance companies had the second-largest holdings at the end of June, their share dipped to 35.0% from 40.0% a year earlier. Foreign commercial and Islamic banks saw their share increase, while the Employees' Provident Fund, investment banks, and general insurance companies all saw their shares decline in June 2018 compared with a year earlier.

Ratings Update

Fitch Ratings Affirms Malaysia's Sovereign Credit Rating at A–

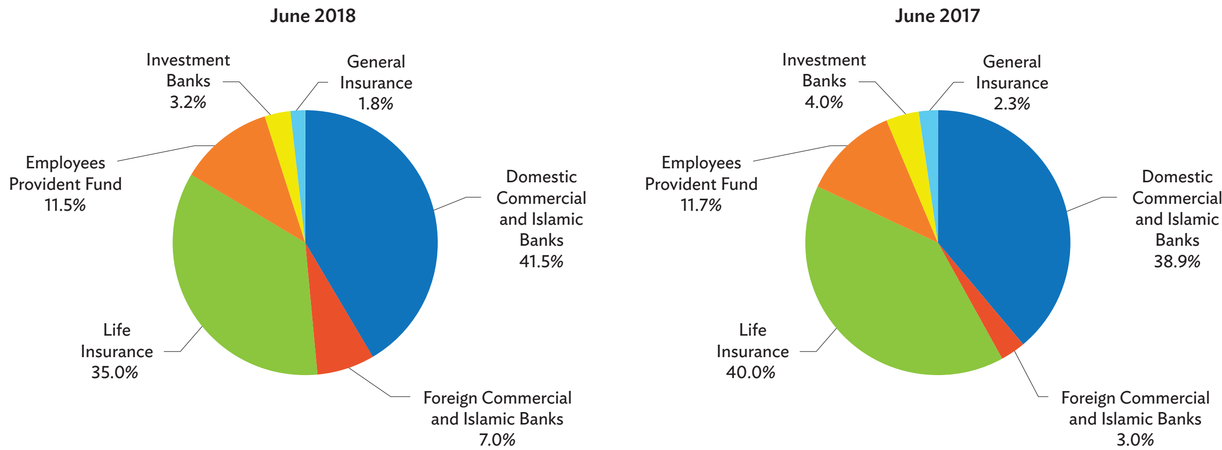
Fitch Ratings affirmed Malaysia's A– rating with a stable outlook on 11 May. According to Fitch, the election result was unlikely to lead to a significant economic policy shift. Nonetheless, it noted that it will monitor the new government's policy agenda as it evolves and highlighted any policy slippage leading to a deterioration in Malaysia's fiscal consolidation as grounds for a negative outlook. The economy's strong growth momentum and the improving external position were the underlying factors for the rating affirmation.

Figure 3: Local Currency Government Bonds Investor Profile



Note: "Others" includes 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.

S&P Global Ratings Affirms Malaysia's Sovereign Credit Rating at A–

S&P Global Ratings affirmed Malaysia's sovereign credit rating at A– with a stable outlook on 29 June. The rating agency cited Malaysia's resilient growth performance, robust external position, highly credible monetary policy settings, and well-established institutions that can moderate risks coming from the government's sizable debt burden and the new administration's transition to power. S&P Global Ratings, however, cautioned about downward pressure on the sovereign rating should it assess a weaker commitment to growth and fiscal consolidation.

Policy, Institutional, and Regulatory Developments

Malaysia's New Administration Scraps Goods and Services Tax

Malaysia scrapped the 6% goods and services tax (GST), effective 1 June, as a fulfillment of Prime Minister Mahathir Mohamad's campaign promise after his unexpected victory in the general election on 9 May. The abolition of the GST aimed to spur spending in Malaysia and address the rising costs of living. The new administration plans to replace the abolished GST with a sales and services tax (SST). Under the SST, the provision of services will be taxed at 6%, while the sale of goods will incur a 10% tax. The Ministry of Finance stated that the SST system would benefit Malaysia's low-income earners in the long run. The new tax system is expected to be implemented beginning 1 September after the necessary laws have been passed in Parliament.