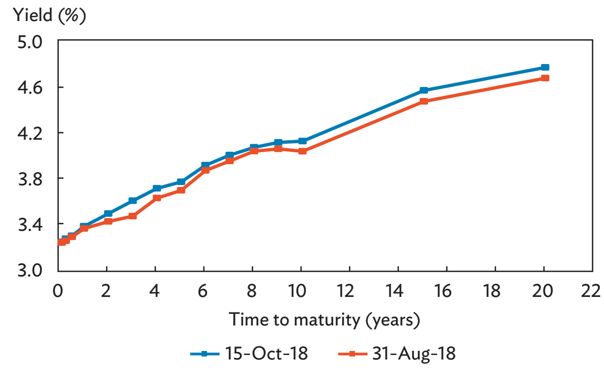
Malaysia

Yield Movements

Malaysia's local currency (LCY) government bond yield curve shifted upward across all tenors between 31 August and 15 October (**Figure 1**). Small yield increases were seen in maturities of 1 year and below, ranging from 0.6 basis point (bp) to 2 bps. Yields for the remaining tenors increased 7 bps on average with the exception of the 3-year bond, which increased 13 bps. The yield spread between the 2-year and 10-year government bonds slightly widened from 61 bps to 63 bps during the review period.

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



Source: Based on data from Bloomberg LP.

The upward movement in yields reflects the diminished buying interest for LCY bonds amid investors' risk aversion. The retreat in risk appetite resulted from external risk factors that include the escalation of trade tensions between the People's Republic of China and the United States (US) and the fear of widespread contagion from emerging markets outside of Asia, although the latter has since subsided. Monetary policy tightening from the US Federal Reserve and the European Central Bank, which can lead to reduced liquidity, also contributed to waning interest in Malaysian LCY government bonds, albeit to a minor extent as the tightening stance of central banks in advanced economies had already been priced in by the market. On the domestic front, the continued weakening of the Malaysian ringgit and concerns over the economy's fiscal position led to some wariness. However, support from local investors remained strong overall.

Bank Negara Malaysia (BNM) maintained its overnight policy rate at 3.25% during its monetary policy meeting on 5 September. The central bank kept its policy rate unchanged on the back of Malaysia's steady economic growth, supported by the private sector and external demand despite downside risks globally and some uncertainty over domestic policies. Inflation is expected to edge upward through 2019 with the impact of the change in consumption tax policy, although it is expected to remain relatively stable.

Malaysia's consumer price inflation picked up to 0.3% y-o-y in September, slightly increasing from August when it hit a 42-month low of 0.2% y-o-y. The muted inflation was the result of most commodity groups continuing to register price declines, while the reinstatement of the sales and services tax on 1 September did not have a significant effect on the Consumer Price Index. From January to September, the Consumer Price Index rose 1.2% y-o-y on average.

Malaysia's gross domestic product (GDP) expanded 4.5% y-o-y in the second quarter (Q2) of 2018, which was slower than the 5.4% y-o-y expansion logged in the previous quarter. It was the slowest pace of GDP growth since the fourth quarter of 2016. The private sector continues to be the key driver of growth, underpinned by favorable labor market conditions, capacity expansion, and the zeroing out of the goods and services tax, which may have boosted consumption. On the production side, subdued performance was seen across the sector with a contraction in agriculture and mining weighing down GDP growth. BNM revised downward its full-year 2018 GDP growth forecast to 5.0% from an earlier projection of 5.5%–6.0%.

The Malaysian ringgit extended its depreciation against the US dollar through the middle of October, losing 2.6% year-to-date and 1.1% between 31 August and 15 October. Despite rising crude oil prices, the ringgit struggled to gain traction as sentiment toward the domestic currency was weighed down by rising US Treasury yields and strong US economic data that translated into increased demand for the US dollar.

Size and Composition

The size of Malaysia's LCY bond market barely changed in the third quarter (Q3) of 2018, expanding a mere 0.7% quarter-on-quarter (q-o-q) to reach MYR1,379 billion at the end of September (**Table 1**). On an annual basis, growth was more substantial at 9.1%. The growth in bonds outstanding was slower compared with the previous quarter. Both the government and corporate segments experienced slower quarterly growth in Q3 2018, with corporate bonds rising faster than government bonds. Malaysia's bonds outstanding at the end of Q3 2018 comprised 53% government bonds and 47% corporate bonds. Total *sukuk* (Islamic bonds), which comprised a 60% share of the LCY bond market, increased 1.0% q-o-q to MYR826 billion.

Government bonds. Total government bonds outstanding in Malaysia at the end of Q3 2018 amounted to MYR725 billion, reflecting a slight increase of 0.4% q-o-q. The expansion mainly came from the central government segment, which grew 0.8% q-o-q. The marginal expansion during the quarter was due to a large amount of maturities of government paper and lower target issuance. Central bank bonds provided some restraint on growth as they contracted 15.3% q-o-q despite a higher issuance volume. *Sukuk* increased to MYR332 billion at the end of September, comprising 46% of the government bond market.

Issuance from the government increased 11.4% q-o-q, lifted by an increase in central bank bonds that was somewhat countered by decreased issuance from the central government. Central bank bills continued to expand, with increased issuance of BNM Interbank Bills, as part of the central bank's ongoing effort to enhance short-selling and liquidity in the bond market. Central bank bills amounted to MYR26.5 billion at the end of September on growth of 39.5% q-o-q. On the other hand, issuance of Malaysian Government Securities and Government Investment Issues declined 9.2% q-o-q and 11.7% q-o-q, respectively, as government issuance targets were smaller relative to Q2 2018.

In Q3 2018, foreign holdings of LCY government bonds continued to trend downward with fund outflows amounting to MYR0.3 billion. However, the attrition was much less than the MYR22.1 billion worth of outflows in Q2 2018 (**Figure 2**). Fund flows turned positive in July, amounting to MYR3.3 billion. However, this was immediately offset by outflows in August and September amounting to MYR3.6 billion in total. Risk aversion remained the key driver of the fund outflows. Reduced buying interest among foreign investors for LCY bonds was underpinned by the protracted trade tensions between the People's Republic of China and the US. Fears of emerging market contagion also contributed, although these concerns moderated as the quarter went on. Uncertainties regarding the Malaysian government's fiscal and economic strategies accentuated this flight to safety.

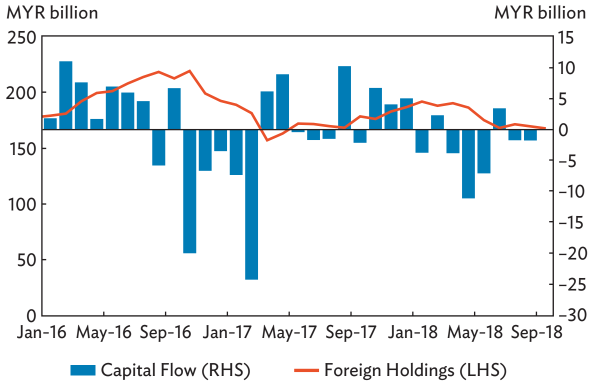
Table 1: Size and Composition of the Local Currency Bond Market in Malaysia

	Outstanding Amount (billion)						Growth Rate (%)			
	Q3 2017		Q2 2018		Q3 2018		Q3 2017		Q3 2018	
	MYR	USD	MYR	USD	MYR	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**1,263**	**299**	**1,369**	**339**	**1,379**	**333**	**1.4**	**8.1**	**0.7**	**9.1**
Government	671	159	722	179	725	175	0.1	6.2	0.4	8.1
Central Government Bonds	637	151	676	167	681	165	0.5	7.5	0.8	7.0
of which: *Sukuk*	266	63	295	73	301	73	1.1	12.7	2.0	13.2
Central Bank Bills	5	1	18	5	16	4	(27.2)	(50.2)	(15.3)	189.7
of which: *Sukuk*	0	0	6	1	3	0.7	–	–	(45.5)	–
Sukuk Perumahan Kerajaan	28	7	28	7	28	7	0.0	0.0	0.0	0.0
Corporate	593	140	646	160	653	158	2.9	10.4	1.1	10.2
of which: *Sukuk*	439	104	489	121	493	119	3.4	11.7	1.0	12.3

( ) = 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.

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. The LCY corporate bond market's growth was also modest in Q3 2018 at 1.1% q-o-q, although it was faster compared with growth of the government segment. On a y-o-y basis, corporate bonds outstanding increased 10.2%. The size of Malaysia's corporate bond market reached MYR653 billion at the end of September, which included MYR493 billion worth of *sukuk*. The relatively unchanged amount of corporate bonds outstanding during the quarter was due to weaker issuance activities.

The aggregate bonds outstanding of the top 30 corporate issuers amounted to MYR369.6 billion at the end of September, or the equivalent of 56.6% of the total corporate bond market (**Table 2**). Danainfra Nasional remained the top issuer with total bonds outstanding of MYR48.8 billion. Of the 30 issuers, 20 companies are state-owned and only 6 are listed companies. Firms from the finance industry dominate the list with 12 issuers and outstanding bonds totaling MYR186 billion, or 50% of the aggregate bonds outstanding of the top 30.

Bond issuance from the corporate segment continued to edge downward in Q3 2018. Debt sales amounted to MYR35.3 billion, reflecting a further decline of 11.4% q-o-q from a decline of 6.3% q-o-q in Q2 2018. The reduced issuance was expected as corporates frontloaded their debt sales before the May election.

After the election, corporates tapered their issuances as they adopted a wait-and-see stance following the change in government. Issuance has been further muted amid some uncertainties as the government continued its cost rationalization of various infrastructure projects.

Tenaga Nasional had the largest bond sales in Q3 2018 with total issuance of MYR3.0 billion in two tranches of Islamic medium-term notes. Issued in August, the 15-year and 20-year bonds carry coupon rates of 4.78% and 4.98%, respectively. Other notable issuances during the quarter include those from GENM Capital and Cagamas (**Table 3**).

Investor Profile

Government bonds. The profile of LCY government bond investors at the end of June 2018 was barely changed from a year earlier except that social security institutions (33.5%) had overtaken financial institutions (31.7%) as the single-largest investor group, compared with 30.8% and 32.0%, respectively, at the end of June 2017. (**Figure 3**). Foreign investors' share remained the third largest, while falling to 24.8% in June 2018 from 27.0% in June 2017. Foreign holdings of LCY government bonds have not recovered following the BNM's strict reinforcement of the prohibition on offshore trading of the Malaysian ringgit in November 2016. The wariness of foreign investors to enter the Malaysian bond market amid domestic and global uncertainties also contributed to the declining share of foreign holdings. The shares of the remaining investor groups were practically unchanged during the review period, with the BNM again having the smallest share of only 0.9%.

Corporate bonds. Domestic commercial and Islamic banks overtook life insurance firms in having the largest share of corporate bond holdings between June 2017 and June 2018 (**Figure 4**). The share of domestic commercial and Islamic banks increased to 41.5% from 38.9% during the review period, while that of life insurance firms decreased to 35.0% from 40.0%. The other investor group that saw an increase in its share of corporate bond holdings was the group comprising foreign commercial and Islamic banks. All other investor groups saw a slight decline in their shares. General insurance firms had the smallest holdings share of corporate paper in both June 2017 and June 2018.

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	48.8	11.8	Yes	No	Finance
2.	Cagamas	36.2	8.7	Yes	No	Finance
3.	Project Lebuhraya Usahasama	30.2	7.3	No	No	Transport, Storage, and Communications
4.	Prasarana	27.5	6.6	Yes	No	Transport, Storage, and Communications
5.	Perbadanan Tabung Pendidikan Tinggi Nasional	19.0	4.6	Yes	No	Finance
6.	Khazanah	16.0	3.9	Yes	No	Finance
7.	Lembaga Pembiayaan Perumahan Sektor Awam	14.8	3.6	Yes	No	Property and Real Estate
8.	Pengurusan Air	14.6	3.5	Yes	No	Energy, Gas, and Water
9.	CIMB Bank	13.6	3.3	Yes	No	Finance
10.	Maybank	11.9	2.9	No	Yes	Banking
11.	Danga Capital	10.0	2.4	Yes	No	Finance
12.	Sarawak Energy	9.8	2.4	Yes	No	Energy, Gas, and Water
13.	CIMB Group Holdings	9.1	2.2	Yes	No	Finance
14.	Jimah East Power	9.0	2.2	Yes	No	Energy, Gas, and Water
15.	GENM Capital	7.6	1.8	No	No	Finance
16.	Bank Pembangunan Malaysia	7.3	1.8	Yes	No	Banking
17.	GOVCO Holdings	7.3	1.8	Yes	No	Finance
18.	Maybank Islamic	7.0	1.7	No	Yes	Banking
19.	Rantau Abang Capital	7.0	1.7	Yes	No	Finance
20.	Tenaga Nasional	7.0	1.7	No	Yes	Energy, Gas, and Water
21.	Public Bank	6.9	1.7	No	No	Banking
22.	Sarawak Hidro	6.5	1.6	Yes	No	Energy, Gas, and Water
23.	YTL Power International	6.1	1.5	No	Yes	Energy, Gas, and Water
24.	ValueCap	6.0	1.4	Yes	No	Finance
25.	Turus Pesawat	5.3	1.3	Yes	No	Transport, Storage, and Communications
26.	Aman Sukuk	5.2	1.2	Yes	No	Construction
27.	EDRA Energy	5.1	1.2	No	Yes	Energy, Gas, and Water
28.	1Malaysia Development	5.0	1.2	Yes	No	Finance
29.	Celcom Networks	5.0	1.2	No	No	Transport, Storage, and Communications
30.	Telekom Malaysia	5.0	1.2	No	Yes	Telecommunications
Total Top 30 LCY Corporate Issuers		**369.6**	**89.3**			
Total LCY Corporate Bonds		**653.4**	**157.9**			
Top 30 as % of Total LCY Corporate Bonds		**56.6%**	**56.6%**			

LCY = local currency, MYR = Malaysian ringgit, USD = United States dollar.
Notes:
1. Data as of 30 September 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 Third Quarter of 2018

Corporate Issuers	Coupon Rate (%)	Issued Amount (MYR million)
Tenaga Nasional		
15-year Islamic MTN	4.78	1,000
20-year Islamic MTN	4.98	2,000
GENM Capital		
5-year MTN	4.98	1,400
10-year MTN	5.30	750
15-year MTN	5.58	450
Cagamas		
1-year Islamic MTN	3.95	25
2-year MTN	3.95	50
3-year MTN	4.05	550

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

Ratings Update

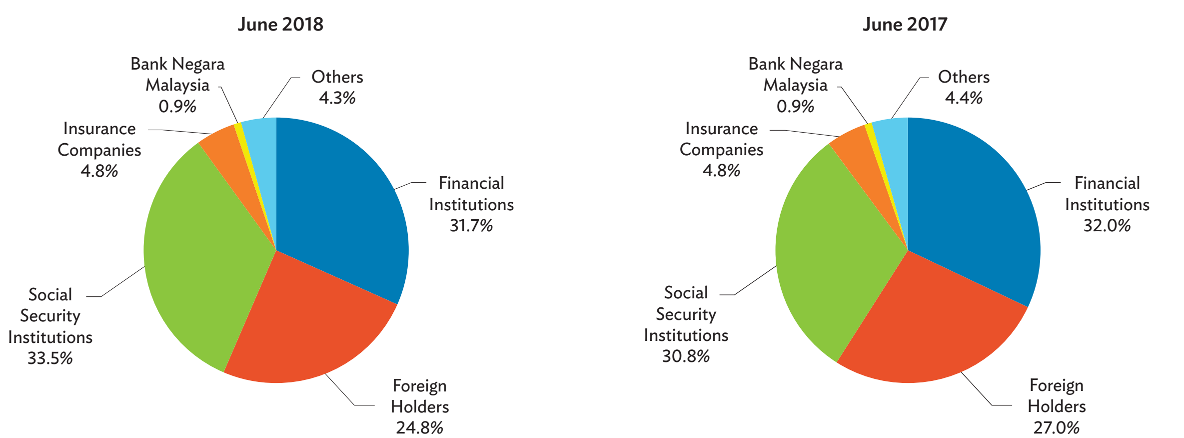
Fitch Ratings (Fitch) affirmed Malaysia's long-term foreign-currency issuer default rating at A– with a stable outlook on 14 August. The affirmation was based on the economy's solid growth, a sound external financial position, the government's commitment to reduce the fiscal deficit, and other efforts to improve governance. Fitch views some of the new administration's election promises, such as the removal of the goods and services tax and the plan to continue to subsidize fuel, as damaging to Malaysia's credit profile. However, the administration has implemented offsetting measures such as the reintroduction of a sales and services tax and the review of a number of infrastructure projects to keep the government on track to meet its 2018 deficit target of 2.8% of GDP. The rating agency expects economic growth to slow on the back of spending cuts and delays in implementing new revenue measures.

Policy, Institutional, and Regulatory Developments

Bank Negara Malaysia Enhances Foreign Exchange Administration Policies

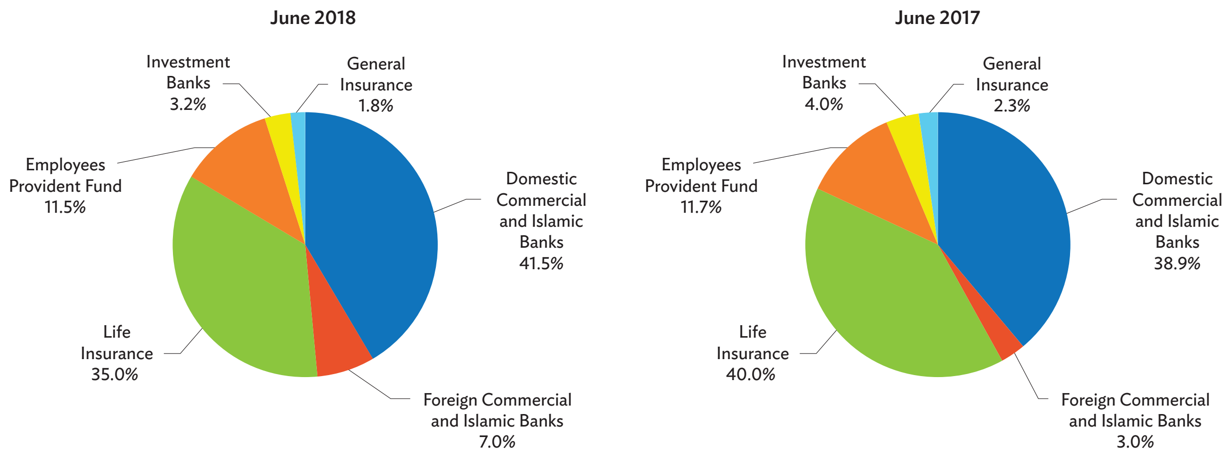
On 17 August, the BNM announced changes to its foreign exchange administration policies, effective immediately. The amendments include (i) greater flexibility in the management of export proceeds, which allows exporters to maintain their foreign currency trading accounts with onshore banks to meet up to 6 months worth of foreign currency obligations without the need to first convert proceeds into ringgit; (ii) flexible hedging of foreign currency obligations; and (iii) wider access for nonresidents to the onshore market financial market, allowing them to trade in MYR-denominated interest rate derivatives via the appointed overseas offices, subject to back-to-back arrangements with onshore banks.

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.

Securities Commission Malaysia Liberalizes the Corporate Bond and *Sukuk* Markets for Retail Investors

The Securities Commission Malaysia announced on 19 September the liberalization of its regulatory framework to provide greater access for retail investors to Malaysia's corporate bond and *sukuk* markets. The liberalized framework will allow a more efficient issuance process for corporate bonds and *sukuk* to be offered to retail investors, as well as expand the range of corporate bonds and *sukuk* that can be offered. The Securities Commission Malaysia also introduced a new seasoning framework to enable retail investors to access existing corporate bonds and *sukuk*, which are currently traded by sophisticated investors in the over-the-counter market. The regulation came into effect on 11 October.