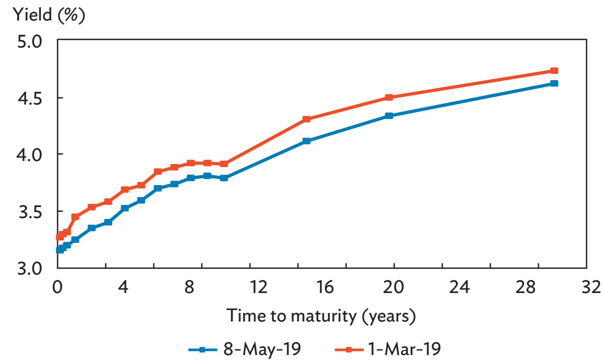
Malaysia

Yield Movements

Malaysia's local currency (LCY) government bond yield curve shifted downward across all tenors between 1 March and 8 May (**Figure 1**). Tenors declined an average of 15 basis points (bps), with the 1-year maturity declining the most at 20 bps, followed by the 15-year bond, which declined 19 bps. The 2-year and 3-year tenors followed with an 18-bps decline each. The yield spread between 2-year and 10-year government bonds widened from 38 bps on 1 March to 44 bps on 8 May.

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



Source: Based on data from Bloomberg LP.

The cut in interest rate by the Bank Negara Malaysia drove the yields downward. The dovish sentiment of Bank Negara Malaysia had already been priced in as investors reacted to the central bank's statement in March.

During its monetary policy committee meeting on 7 May, Bank Negara Malaysia cut its key policy rates 25 bps to maintain accommodative monetary conditions that support economic growth and price stability. The overnight policy rate stood at 3.00%. Likewise, the ceiling rate of its interest rate corridor was reduced to 3.25% and the floor rate to 2.75%. The central bank took into consideration the resilient domestic financial market amid tightening financial conditions. Despite the slowing Malaysian economy in the first quarter (Q1) of 2019, the monetary policy committee expects stable labor market conditions and capacity expansion to drive spending. Inflation is expected to remain low due to policy measures such as the price ceiling for fuels and the change in consumption tax.

Prices for basic goods and services in Malaysia increased 0.2% year-on-year (y-o-y) in April, unchanged from March. The price increase was largely driven by upward price adjustments in the food and nonalcoholic beverages group, while transport costs declined. In January, Malaysia recorded consumer price deflation—for the first time since November 2009—of 0.7% y-o-y on the back of declining transport prices. Consumer price growth was again negative in February, dipping 0.4% y-o-y.

Malaysia's economy grew 4.5% y-o-y in Q1 2019, which was slower than the growth of 4.7% y-o-y recorded in Q4 2018. Weaker growth was registered in Q1 2019 in all sectors except agriculture and mining and quarrying. The slower domestic product growth can be attributed to the slowdown in the services, manufacturing, and construction sectors.

The Malaysian ringgit depreciated against the United States (US) dollar between 1 March and 8 May, losing 1.8%. Due to concerns about liquidity, FTSE Russell announced in April that it was mulling excluding Malaysian government debt from its World Government Bond Index. This placed pressure on the ringgit. The interest rate cut by Bank Negara Malaysia also put pressure on the currency as the gap between Malaysian and US interest rates narrowed. This led to foreign capital outflows in April.

Size and Composition

Malaysia's LCY bond market expanded 2.9% quarter-on-quarter (q-o-q) and 7.6% y-o-y, reaching a size of MYR1,441 billion (USD353 billion) at the end of Q1 2019 (**Table 1**). Compared with Q4 2018, the q-o-q growth rate was faster while the y-o-y growth rate was slower. The government and corporate segments both supported the expansion of the bond market, with shares of 53.1% and 46.9%, respectively. The share of *sukuk* (Islamic bonds) in Malaysia's bond market was 61.0% at the end of Q1 2019, amounting to MYR879 billion, up slightly from 60.2% at the end of the previous quarter.

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q1 2018		Q4 2018		Q1 2019		Q1 2018		Q1 2019	
	MYR	USD	MYR	USD	MYR	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**1,339**	**347**	**1,401**	**339**	**1,441**	**353**	**4.1**	**11.1**	**2.9**	**7.6**
Government	705	182	739	179	766	188	4.7	8.3	3.6	8.7
Central Government Bonds	656	170	691	167	720	176	3.0	7.1	4.2	9.8
of which: *Sukuk*	287	74	306	74	327	80	6.3	13.9	6.7	14.1
Central Bank Bills	20	5	19	5	17	4	173.5	109.4	(9.9)	(13.9)
of which: *Sukuk*	1	0.3	4	0.9	5	1	–	–	40.5	420.0
Sukuk Perumahan Kerajaan	28	7	28	7	28	7	0.0	0.0	(1.8)	(1.8)
Corporate	635	164	662	160	675	165	3.5	14.3	2.0	6.4
of which: *Sukuk*	480	124	504	122	520	127	4.4	17.4	3.0	8.3

( ) = 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.

Malaysia's LCY bond issuance in Q1 2019 totaled MYR103 billion, reflecting a marginal increase of 0.7% q-o-q due to a minimal pick-up in government issuance, which was partly offset by the drop in corporate issuance. On an annual basis, issuance grew 2.9% y-o-y with government and corporate bonds showing an increase, but with only marginal growth in the latter. The logged q-o-q and y-o-y growth rates in Q1 2019 were considerably slower than in the previous quarter.

Government bonds. The amount of LCY government bonds outstanding climbed to MYR766 billon at the end of Q1 2019 on growth of 3.6% q-o-q, mainly driven by the expansion of central government bonds. On the other hand, outstanding central bank bonds declined to MYR17 billion at the end of Q1 2019 from MYR19 billion in Q4 2018 due to a high volume of maturities and lower bond sales. However, the stock of central bank *sukuk* continued to increase, climbing to MYR5 billion in Q1 2019 from MYR4 billion in the preceding quarter.

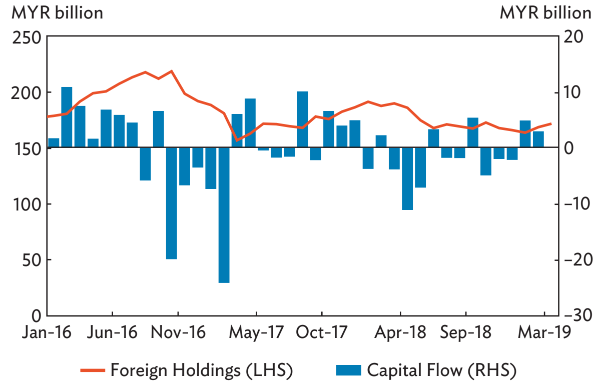
Total bond issuance from the government was vibrant in Q1 2019 at MYR60 billion, up from MYR59.0 billion in Q4 2018. Government Investment Issues dominated with sales of MYR21 billion during the quarter, while issuance of Malaysian Government Securities amounted to MYR16 billion. Buying interest in government bonds was high as evidenced by a strong bid-to-cover ratio, which can be traced to benign inflation.

Corporate bonds. LCY bonds outstanding in the corporate sector grew faster in Q1 2019 at 2.0% q-o-q versus 1.3% q-o-q in Q4 2018. The corporate bond stock amounted to MYR675 billion, with *sukuk* comprising a dominant share of MYR520 billion at the end of Q1 2019. On an annual basis, the growth of the corporate bond market decelerated to 6.4% y-o-y from 8.0% y-o-y in the previous quarter.

The aggregate LCY bonds outstanding of the top 30 corporate issuers amounted to MYR388 billion at the end of March, equivalent to 57.5% of total LCY corporate bonds (**Table 2**). The top 30 list was dominated by finance companies, with 12 such issuers who together had bonds outstanding of MYR191 billion. Danainfra Nasional remained the largest issuer with MYR56 billion in bonds outstanding at the end of March, climbing from MYR53 billion at the end of December. Cagamas and Project Lebuhraya Usahasama were second and third on the list, respectively, with MYR34 billion and MYR30 billion, although both of these amounts were down from the previous quarter due to maturities.

Issuance from the corporate sector was meek in Q1 2019, falling by 1.3% q-o-q to MYR43 billion, reversing the growth of 11.1% q-o-q in Q4 2018. The issuances were primarily medium-term notes and commercial paper. The lower debt sales during the quarter can be attributed to local factors such as the government's project rationalization policy, which has reduced

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



LHS = left-hand side, MYR = Malaysian ringgit, RHS = right-hand side.
Note: 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.

issuance activities from corporates, especially those in the infrastructure and construction sectors, as well as to external factors such as the protracted trade spat between the People's Republic of China and the US, and the global economic growth slowdown.

Notable debt sales from Malaysia's top issuers are listed in **Table 3**. Sunway issued two tranches of perpetual *sukuk* amounting to MYR300 million each, while the rest of its issuances in Q1 2019 comprised short-term commercial paper. Maybank issued a total of MYR3,759 million during the quarter. This included two short-term commercial paper issuances and two *sukuk* with 10-year and 12-year maturities amounting to MYR2,000 million and MYR1,700 million, respectively.

Investor Profile

At the end of December 2018, social security institutions remained the largest group among LCY government bond investors with a 33.1% share, up from 32.0% at the end of December 2017 (**Figure 3**). Financial institutions at 32.3% overtook foreign investors at 24.0% as the second-largest investor group; these figures compare with shares of 27.7% and 29.2%, respectively, at the end of December 2017. Insurance companies increased their share to 5.1% in December 2018 from 4.9% a year earlier. Bank Negara Malaysia remained the smallest investor share-wise, while slightly increasing its share to 1.5% from 1.4% during the review period.

Foreign investor holdings of LCY central government bonds climbed to MYR171 billion at the end of March, driven by net inflows of MYR6 billion in Q1 2019 (**Figure 2**). Despite the increase, the foreign holdings-to-LCY central government bonds outstanding ratio at the end of March slightly decreased to 23.8% from 24.0% at the end of December due to faster growth in the government bond stock. Malaysian Government Securities comprised the largest of share of foreign holdings amounting to MYR151 billion, while Government Investment Issues totaled MYR19 billion. In January, net outflows were recorded for the third consecutive month, amounting to MYR2 billion. However, the 3-month losing streak was reversed in February and March with total net inflows of MYR8 billion. The renewed interest of foreign investors in the local bond market can be traced to the dovish stance of the US Federal Reserve, Malaysia's benign inflation rate, and the depreciating ringgit.

Ratings Update

On 15 May, RAM Ratings affirmed Malaysia's sovereign long-term ratings of $_{g}A_{2}$ (global), $_{sea}$AAA (ASEAN), and AAA (domestic scale), and its short-term ratings of $_{g}$P1 (global), $_{sea}$P1 (ASEAN), and P1 (domestic scale), with a stable outlook for all ratings. The affirmation reflects the domestic economy's resiliency, which is underpinned by strong fundamentals and the government's commitment to long-term fiscal consolidation. The rating agency also noted that Malaysia's high level of government debt and heavy reliance on oil- and gas-related earnings remain concerns.

Fitch Ratings (Fitch) affirmed Malaysia's long-term foreign-currency issuer default rating at A– with a stable outlook on 21 February. The affirmation reflects Malaysia's higher growth rates compared with peer economies and a strong external creditor position underpinned by a current account surplus and large external assets, according to the ratings agency. However, a high level of government debt, low per capita income, and weak standards of governance were noted by Fitch as constraining factors. Fitch cited the reduction in government debt ratios, among other factors, as a trigger for the ratings upgrade, while it also noted the deterioration in the government debt-to-gross domestic product trajectory as one of the factors contributing to a possible negative rating action.

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	55.7	13.7	Yes	No	Finance
2.	Cagamas	33.7	8.2	Yes	No	Finance
3.	Project Lebuhraya Usahasama	29.9	7.3	No	No	Transport, Storage, and Communications
4.	Prasarana	29.5	7.2	Yes	No	Transport, Storage, and Communications
5.	Perbadanan Tabung Pendidikan Tinggi Nasional	21.6	5.3	Yes	No	Finance
6.	Lembaga Pembiayaan Perumahan Sektor Awam	17.8	4.3	Yes	No	Property and Real Estate
7.	Pengurusan Air	17.1	4.2	Yes	No	Energy, Gas, and Water
8.	Khazanah	14.0	3.4	Yes	No	Finance
9.	Maybank	13.8	3.4	No	Yes	Banking
10.	CIMB Bank	13.3	3.3	Yes	No	Finance
11.	Sarawak Energy	11.3	2.8	Yes	No	Energy, Gas, and Water
12.	CIMB Group Holdings	10.1	2.5	Yes	No	Finance
13.	Danga Capital	10.0	2.4	Yes	No	Finance
14.	Jimah East Power	9.0	2.2	Yes	No	Energy, Gas, and Water
15.	Maybank Islamic	8.5	2.1	No	Yes	Banking
16.	GENM Capital	7.6	1.9	No	No	Finance
17.	GOVCO Holdings	7.3	1.8	Yes	No	Finance
18.	Bank Pembangunan Malaysia	7.3	1.8	Yes	No	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.	Bakun Hydro Power Generation	6.5	1.6	No	No	Energy, Gas, and Water
23.	YTL Power International	6.1	1.5	No	Yes	Energy, Gas, and Water
24.	ValueCap	6.0	1.5	Yes	No	Finance
25.	Telekom Malaysia	5.8	1.4	No	Yes	Telecommunications
26.	Turus Pesawat	5.3	1.3	Yes	No	Transport, Storage, and Communications
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.	Aman Sukuk	5.0	1.2	Yes	No	Construction
Total Top 30 LCY Corporate Issuers		**388.0**	**95.1**			
Total LCY Corporate Bonds		**675.2**	**165.4**			
Top 30 as % of Total LCY Corporate Bonds		**57.5%**	**57.5%**			

LCY = local currency, MYR = Malaysian ringgit, USD = United States dollar.
Notes:
1. Data as of 31 March 2019.
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 2019

Corporate Issuers	Coupon Rate (%)	Issued Amount (MYR million)
GENM Capital		
5-year MTN	4.63	2,000
15-year MTN	4.71	1,700
Cagamas		
1-year Islamic MTN	4.19	200
2-year MTN	4.12	500
2-year MTN	4.22	100
2-year MTN	4.30	300
2-year MTN	4.28	750
2-year MTN	4.15	400
2-year MTN	4.38	250
2-year MTN	4.34	600
3-year MTN	4.54	400
Tenaga Nasional		
15-year Islamic MTN	5.80	300
20-year Islamic MTN	5.80	300

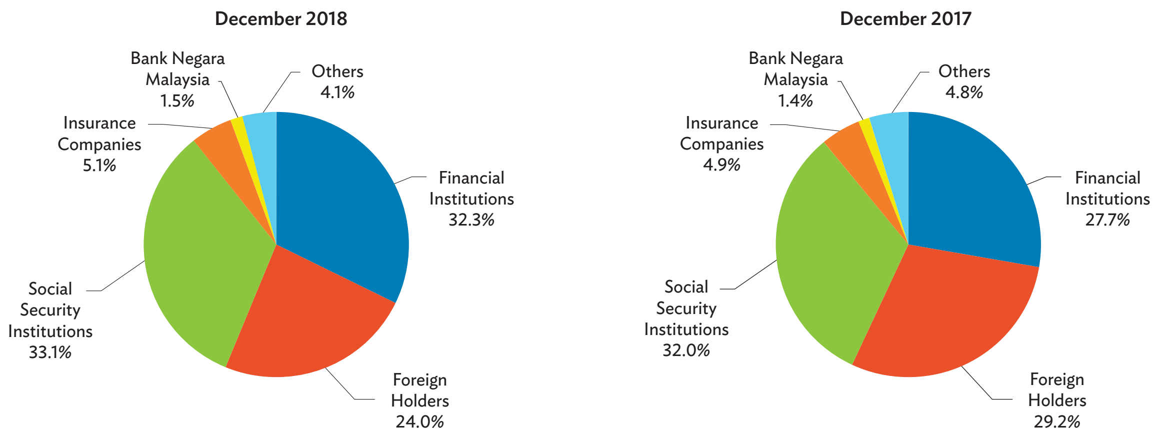
MTN = medium-term note, MYR = Malaysian ringgit.
Source: Bank Negara Malaysia Bond Info Hub.

Policy, Institutional, and Regulatory Developments

Bank Negara Malaysia Liberalizes Foreign Exchange Policies

On 27 March, Bank Negara Malaysia liberalized its foreign exchange administration framework to allow investors to hedge their foreign exchange risks more effectively. Residents are now allowed to hedge their foreign exchange obligations for up to 12 months. Approval must be obtained from the central bank for obligations with a tenor of more than 1 year. To help small and medium-sized enterprises hedge their foreign currency risk, net importers are allowed to receive foreign currency payments for their domestic goods and services from resident exporters.

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.