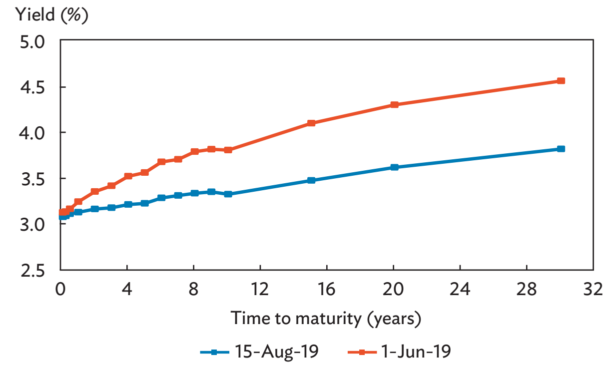
Malaysia

Yield Movements

Between 1 June and 15 August, Malaysia's local currency (LCY) government bond yields declined for all tenors (**Figure 1**). The shorter-end of the yield curve (1–6 months) declined an average of 5 basis points (bps), while the belly of the curve (4–10 years) decreased an average of 41 bps. On the other hand, longer-term tenors (15–30 years) decreased an average of 69 bps. The yield spread between 2-year and 10-year government bonds contracted from 46 bps on 1 June to 16 bps on 15 August.

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



Source: Based on data from Bloomberg LP.

The decline in LCY government bond yields during the review period can be attributed to Bank Negara Malaysia's (BNM) reduction of its overnight policy rate by 25 bps to 3.00% on 7 May. Overall confidence in Malaysia's economic growth also contributed to the demand for Malaysia's government securities. The decrease in the yield curve was reflective of the trend in the region after the United States (US) cut the federal funds rate during its Federal Open Market Committee meeting on 31 July.

Malaysia's economic growth accelerated to 4.9% year-on-year (y-o-y) in the second quarter (Q2) of 2019 from 4.5% y-o-y in the first quarter (Q1). The current account surplus has been increasing since the third quarter of 2018, reaching a peak of MYR16.4 billion in Q1 2019 on high levels of foreign direct investment. The trade surplus increased in June despite exports falling as electrical and electronic exports declined. According to the Department of Statistics, Malaysia's Leading Economic Index indicates continued growth for the Malaysian economy.

Consumer price inflation eased to 1.4% y-o-y in July from 1.5% y-o-y in June. Core inflation increased to 2.0% y-o-y in July from 1.9% y-o-y in June. Although inflation remained low, Bank Negara Malaysia projects it to rise in the coming months as the effects of changes in consumption tax policy wane.

BNM kept its policy rate unchanged during its monetary policy committee meeting on 9 July as the economy grew in line with expectations on continued domestic and external demand. The committee decision was also supported by the inflation outlook.

Despite strong economic prospects, the Malaysian ringgit depreciated during the latter part of the review period, reaching a high of MYR4.196 per US dollar on 13 August from a low of MYR4.1085 per US dollar on 15 July. The depreciation was attributed mainly to FTSE Russell raising concerns last April regarding Malaysian bonds and considering excluding them from its World Global Bonds Index, and Norway's sovereign wealth fund dropping Malaysia from its fixed income portfolio. The depreciation was also spurred by contagion concerns after the Argentine peso depreciated sharply on 13 August. According to BNM, the weakness of the ringgit is not a cause for concern as the domestic currency has played a key role in absorbing external shocks and ensuring no disruptions to the economy. Such external shocks include the ongoing trade war between the People's Republic of China and the US, and the looming threat of a global recession.

Size and Composition

Malaysia's LCY bond market expanded 3.3% quarter-on-quarter (q-o-q) in Q2 2019 to MYR1,488.1 billion (USD360.1 billion) from MYR1,440.8 billion in Q1 2019 (**Table 1**). The growth corresponds to an 8.7% y-o-y jump from MYR1,368.9 billion in Q2 2018. Growth in the LCY bond market in Q2 2019 was supported by both LCY government and corporate bonds, which accounted for 52.4% and 47.6%, respectively, of total LCY bonds outstanding at the end of June. Total outstanding *sukuk* (Islamic bonds) at the end of the review period

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q2 2018		Q1 2019		Q2 2019		Q2 2018		Q2 2019	
	MYR	USD	MYR	USD	MYR	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**1,369**	**339**	**1,441**	**353**	**1,488**	**360**	**2.2**	**9.9**	**3.3**	**8.7**
Government	722	179	766	188	779	189	2.5	7.9	1.8	7.8
Central Government Bonds	676	167	720	176	742	180	3.0	6.6	3.0	9.8
of which: *Sukuk*	295	73	327	80	333	81	3.0	12.2	2.0	13.0
Central Bank Bills	18	5	17	4	9	2	(9.0)	149.0	(46.8)	(49.7)
of which: *Sukuk*	6	1	5	1	2	0.4	450.0	–	(71.2)	(72.7)
Sukuk Perumahan Kerajaan	28	7	28	7	28	7	0.0	0.0	0.0	(1.8)
Corporate	646	160	675	165	709	172	1.9	12.2	5.0	9.7
of which: *Sukuk*	489	121	520	127	555	134	1.8	15.0	6.8	13.5

( ) = 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 local currency–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 and Bloomberg LP.

stood at MYR917.5 billion, growing 4.3% q-o-q from MYR879.4 billion at the end of the previous quarter, spurred by increased stocks of government and corporate *sukuk*.

Issuance of LCY bonds in Q2 2019 increased 9.8% q-o-q to MYR113.1 billion from MYR103.0 billion in Q1 2019, driven by the expansion of LCY corporate bond issuance, which was slightly offset by the contraction in issuance of LCY government bonds.

Government bonds. The LCY government bond market grew 1.8% q-o-q to MYR779.1 billion in Q2 2019, up from MYR765.7 billion in the previous quarter. The growth was mainly due to the 3.0% q-o-q increase in outstanding central government bonds, which comprised about 95% of total outstanding LCY government bonds. This was offset by the decline of almost one-half in the stock of central bank bills, although they represent only about 1% of total LCY government bonds outstanding. There was no change in the outstanding stock of Sukuk Perumahan Kerajaan, which had about a 4% share of total outstanding LCY government bonds.

LCY government bonds issued in Q2 2019 declined 31.7% q-o-q as issuances of government bonds, Treasury bills, and central bank bills all decreased. Issuance of Malaysian Government Securities and Government Investment Issues dropped as well compared to the previous quarter.

Corporate bonds. LCY corporate bonds outstanding jumped 5.0% q-o-q to MYR709.0 billion in Q2 2019 from MYR675.2 billion in Q1 2019. Outstanding corporate *sukuk* increased 6.8% q-o-q to MYR554.8 billion at the end of June from MYR519.5 billion in the prior quarter.

The top 30 LCY corporate bond issuers in Malaysia accounted for MYR416.2 billion, or 58.7% of total LCY corporate bonds outstanding as of the end of Q2 2019 (**Table 2**). Government institutions Danainfra Nasional and Cagamas dominated all issuers with outstanding LCY corporate bonds amounting to MYR57.8 billion (8.2% of total LCY corporate bonds outstanding) and MYR33.5 billion (4.7% of total LCY corporate bonds outstanding), respectively. By industry, finance companies comprised the largest share (53.2%) of the top 30 issuers of LCY corporate bonds during the review period with MYR221.6 billion in outstanding LCY corporate bonds. This was followed by the transport, storage, and communications industry with MYR70 billion, or a share of 16.8% of total LCY corporate bonds outstanding at the end of Q2 2019.

Issuance of LCY corporate bonds soared 68.3% q-o-q in Q2 2019 due to a large dual-tranche issuance in May by Urusharta Jamaah.

Urusharta Jamaah had the largest issuance in Q2 2019 (**Table 3**). The state-owned finance company issued dual-tranche zero coupon bonds comprising

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	57.8	14.0	Yes	No	Finance
2.	Cagamas	33.5	8.1	Yes	No	Finance
3.	Project Lebuhraya Usahasama	29.9	7.2	No	No	Transport, Storage, and Communications
4.	Prasarana	29.5	7.1	Yes	No	Transport, Storage, and Communications
5.	Urusharta Jamaah	27.6	6.7	Yes	No	Finance
6.	Perbadanan Tabung Pendidikan Tinggi Nasional	21.6	5.2	Yes	No	Finance
7.	Lembaga Pembiayaan Perumahan Sektor Awam	20.8	5.0	Yes	No	Property and Real Estate
8.	Pengurusan Air	17.3	4.2	Yes	No	Energy, Gas, and Water
9.	Khazanah	14.0	3.4	Yes	No	Finance
10.	CIMB Bank	13.3	3.2	Yes	No	Finance
11.	Maybank	11.9	2.9	No	Yes	Banking
12.	Sarawak Energy	11.3	2.7	Yes	No	Energy, Gas, and Water
13.	Maybank Islamic	11.0	2.7	No	Yes	Banking
14.	CIMB Group Holdings	11.0	2.7	Yes	No	Finance
15.	Danga Capital	10.0	2.4	Yes	No	Finance
16.	Jimah East Power	9.0	2.2	Yes	No	Energy, Gas, and Water
17.	GENM Capital	7.6	1.8	No	No	Finance
18.	GOVCO Holdings	7.3	1.8	Yes	No	Finance
19.	Bank Pembangunan Malaysia	7.3	1.8	Yes	No	Banking
20.	Rantau Abang Capital	7.0	1.7	Yes	No	Finance
21.	Tenaga Nasional	7.0	1.7	No	Yes	Energy, Gas, and Water
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.	Public Bank	5.9	1.4	No	No	Banking
26.	Telekom Malaysia	5.8	1.4	No	Yes	Telecommunications
27.	Turus Pesawat	5.3	1.3	Yes	No	Transport, Storage, and Communications
28.	EDRA Energy	5.1	1.2	No	Yes	Energy, Gas, and Water
29.	Celcom Networks	5.0	1.2	No	No	Transport, Storage, and Communications
30.	1Malaysia Development	5.0	1.2	Yes	No	Finance
Total Top 30 LCY Corporate Issuers		**416.2**	**100.7**			
Total LCY Corporate Bonds		**709.0**	**171.6**			
Top 30 as % of Total LCY Corporate Bonds		**58.7%**	**58.7%**			

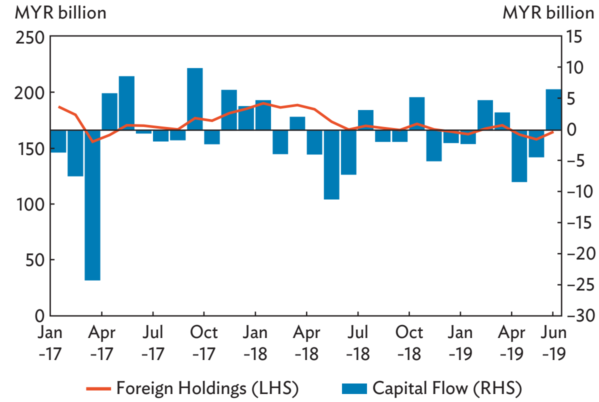
LCY = local currency, MYR = Malaysian ringgit, USD = United States dollar.
Notes:
1. Data as of 30 June 2019.
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on Bank Negara Malaysia Fully Automated System for Issuing/Tendering data.

Table 3: Notable Local Currency Corporate Bond Issuance in the Second Quarter of 2019

Corporate Issuers	Coupon Rate (%)	Issued Amount (MYR billion)
Urusharta Jamaah		
7-year Islamic MTN	0.00	13.2
10-year Islamic MTN	0.00	14.3
Danainfra Nasional		
7-year Islamic MTN	4.03	0.7
10-year Islamic MTN	4.08	0.4
15-year Islamic MTN	4.30	0.8
18-year Islamic MTN	4.53	0.6
24-year Islamic MTN	4.72	0.5
29-year Islamic MTN	4.82	0.8
Maybank		
10-year *Sukuk*	4.50	1.0

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

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.
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.

MYR13.2 billion worth of 7-year and MYR14.3 billion worth of 10-year Islamic medium-term notes. Proceeds from the *sukuk murabahah* (Islamic bonds where bondholders are entitled to shares in the revenues generated by the *sukuk* assets) will be used to finance the transfer of assets from the Malaysian hajj pilgrim fund board, Lembaga Tabung Haji, to Urusharta Jamaah after the former transferred underperforming assets to the latter. The asset transfer helped Lembaga Tabung Haji restore its balance sheet. Danainfra Nasional, the government-owned institution in charge of funding public infrastructure projects, issued six tranches of *sukuk* in April. Its tenors ranged from 7 years to 29 years with coupon rates between 4.03% and 4.82%. Maybank issued a MYR1.0 billion 10-year *sukuk* with a 4.50% coupon rate, the proceeds of which are intended to be part of Maybank's consolidated capital level.

Investor Profile

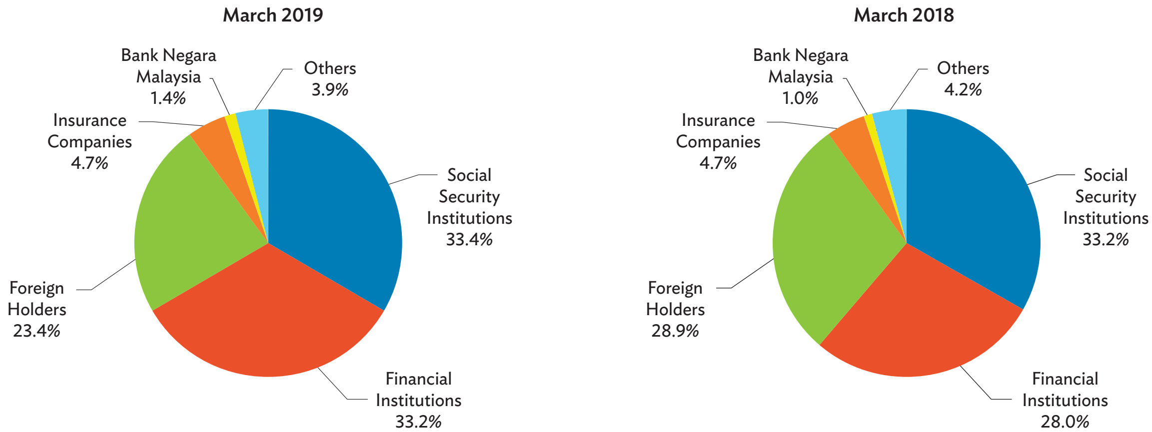
Foreign holdings of LCY government bonds in Q2 2019 dropped to MYR487.7 billion from MYR503.7 billion in Q1 2019 due to capital outflows in April and May spurred by FTSE Russell's announcement that it was reevaluating Malaysian bonds and may potentially exclude them from the World Global Bonds Index (**Figure 2**). Malaysia experienced heavy outflows amid easing economic growth in Q1 2019, weaker global oil prices, and heighted uncertainties in the trade war between the People's Republic of China and the US. Capital inflows recorded in June were not enough to offset the outflows. A total of MYR5.9 billion in capital outflows was recorded during the review period, a reversal from the capital inflows of MYR5.7 billion posted in the previous quarter. As a share of LCY government bonds, foreign holdings of LCY government bonds declined to 22.3% at the end of Q2 2019 from 23.8% at the end of Q1 2019.

Social security institutions dominated all investors in LCY government bonds with a 33.4% share of the total at the end of Q1 2019, up from 33.2% at the end of Q1 2018 (**Figure 3**). Financial institutions followed with a share of 33.2% at the end of Q1 2019, up from 28.0% at the end of Q1 2018, overtaking foreign holders, whose share fell to 23.4% from 28.9% during the review period. Insurance companies retained their share at 4.7%, while BNM's holdings of LCY government bonds increased to 1.4% of the total at the end of Q1 2019 from 1.0% a year earlier.

Ratings Update

On 18 July, Fitch Ratings affirmed Malaysia's long-term foreign currency issuer default rating at A– with a stable outlook. The affirmation was attributed to the economy's promising medium-term growth despite high public debt and weak governance indicators. The latter is expected to improve as the government continues to promote transparency and address corruption. Despite the anticipated moderation of economic growth due to external factors such as global trade tensions, Malaysia's diversified export base is expected to support the

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.

economy amid sluggish demand in some sectors. Public consumption and investment are both expected to pick up in the next few years as infrastructure projects are negotiated. On the other hand, expectations for private investment growth are less sanguine as investors face uncertainties in external trade and the domestic political scene. Fitch Ratings viewed BNM's monetary policy as being supportive of economic growth. A future ratings upgrade may be possible if there is sustained government debt reduction and the government commits to greater transparency . Malaysia's long-term local currency issuer default rating was likewise affirmed at A– with a stable outlook.

Policy, Institutional, and Regulatory Developments

Four Regional Central Banks Sign Letters of Intent on Local Currency Settlement

On 5 April, three bilateral letters of intent were signed by BNM, the Bangko Sentral ng Pilipinas, Bank Indonesia, and the Bank of Thailand. The Philippine central bank was party to all three letters with the three other central banks. The letters expressed intentions to establish LCY settlement frameworks between the four economies involved. Having such frameworks is beneficial as LCY settlement of trade and other financial obligations reduces transaction costs and foreign exchange risks. Furthermore, LCY settlement within the Association of Southeast Asian Nations region will promote economic and financial integration, and help develop member economies' foreign exchange and financial markets. Bank Indonesia and the Bank of Thailand already have an existing LCY settlement framework and agreed to expand its coverage.

Bank Negara Malaysia and Securities Commission Malaysia Discuss Financial Market Developments

On 23 April, BNM and Securities Commission Malaysia held a meeting to discuss sustainability, digital assets, and resilience in the financial market. BNM's value-based intermediation strategy and Securities Commission Malaysia's sustainable and responsible investment framework are already aligned, and the two institutions pledged to perform joint research to develop guidelines on fundraising and lending practices of sustainable economic activities. Another research opportunity relates to the mechanisms of feedback interaction of transferring environment-related risks to the financial system. BNM and Securities Commission Malaysia discussed how to develop innovations in digital assets, hold early-stage fundraising for companies, and trade such assets. The following considerations were incorporated into the discussion: oversight, monitoring of risks, and financial integrity. Finally, the two regulators looked into maintaining a resilient Malaysian financial market. Currently, Malaysia's economy is supported by domestic liquidity, sound market infrastructure, and strong macroeconomic fundamentals. The bond market is also thriving, supported by a strong secondary market with high average daily trading volume. BNM and Securities Commission Malaysia are committed to continued transparency with key market players in order to develop and maintain the stability of the financial market.

Bank Negara Malaysia Announces Development Initiatives for the Financial Market

On 16 May, BNM announced initiatives to improve efficiency, accessibility, and liquidity in the domestic financial market. Available off-the-run bonds that may be borrowed through reverse repurchase for market making will be increased. The proposed extension of reverse repurchase tenors beyond 1 year is still up for review. The delivery mechanism for settlement of Malaysia Government Securities futures will be enhanced. Trust banks and global custodians are now allowed to apply under the dynamic hedging program in order to perform dynamic hedging on behalf of their clients. Institutional investors may now buy or sell forward contracts to purchase Malaysian ringgit above the current threshold of 25% of the underlying security, upon approval of BNM. A standard documentation guide for foreign exchange transactions has been developed. Finally, the central bank will continue facilitating the market-making capabilities of appointed overseas offices to ensure global market participants have ample access to ringgit prices.