

09 October 2019

## 4Q2019 : Fixed Income Market Outlook

### FTSE Russell Maintains Malaysia on WGBI Index, synchronized monetary easing paving way for tightening EM Asia bond yields

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Overall bond yields have been heading south in line with our previous investment theme in which we anticipate global bond yields to remain lower for longer taking cue from concerted monetary easing measures from global central banks. Central banks of developed markets and growing pool of regional central banks in Asia are expected to embrace a more dovish monetary policy regime as the focus on growth remains a key agenda for now. Globally, we opine inflation outlook is still manageable, in fact still rather benign.

The case of synchronized monetary easing measures with now the ECB prepared to resume its bond buying activities will be positive for EM Asia bonds as the search for higher yielding assets are expected to be more amplified reaffirming our views that a new wave of liquidity will help keep bond yields lower for longer. On the local front, the recent reaffirmation by FTSE Russell in maintaining Malaysia's continued inclusion in the WGBI Index at Market Accessibility Level 2 is deemed as a positive progress. On this note, Malaysia is still on a 6 months Review Period under FTSE Russell's semi-annual review. (Next review due on March 2020)

Negative spreads of 10-year versus 2-year US Treasuries mirroring an inverted yield curve back in late August recently fuelled US recession fears. We now expect more central banks globally to join the dovish camp. Recall, BNM reduced the OPR by 25 bps in its May monetary policy meeting, as a pre-emptive measure to support growth whilst inflation outlook stays manageable, with latest CPI at 1.5% YoY. On a related note, search to generate alpha is becoming more challenging especially for European banks and European based NBFIs (asset managers and lifers) after the ECB slashed its deposit rate by another 10 bps to -0.50% from -0.40%.

In the near term, we expect focus to shift towards Malaysia's Budget 2020 which will be tabled this Friday. From a fiscal perspective, we opine Malaysia remains on track in terms of fiscal consolidation with the fiscal deficit potentially narrowing from its previous level of -3.7% in 2018 to a targeted level of -3.4% this year. For the coming 2020, we opine there could be a prospective fiscal stimulus package in which our Economics team have penciled in at pace of MYR3bn to help anchor domestic growth to range within the 4.3%-4.8% target as per BNM's growth projection. On a related note, the upcoming October US FOMC meeting this month will also be keenly watched by market players on hopes on further policy easing. The latest dot plot projections at time of writing shows chance of more than 70% and market players are still pricing in a 25bps cut by the Fed at this upcoming monetary policy meeting.

The softer BTC of the recent 10-year MGS 8/29 was due to investors preferring to stay on the sideline ahead of upcoming US and China leaders meeting in Washington this week as well as Malaysia's upcoming Budget 2020. The lower BTC print for this week's tender is somewhat transient as we expect demand to eventually pick up following the recent upward movement in bond yields which opens the door for potential buying opportunities. The overall low yielding environment in developed markets will shore non-resident investors' interest to flow back to the local currency EM Asia space. Overall we remain constructive of MYR bonds, for both the corporate bonds/sukuk and government bond segments as we now expect carry trade themes to again anchor demand.

#### Analysts

Chang Wai Ming  
Head, Fixed Income Strategy  
Group Treasury & Global Markets  
+603 92806869  
[chang.wai.ming@rhbgroup.com](mailto:chang.wai.ming@rhbgroup.com)

**Back to back Fed cuts at both July and September FOMC meeting, led UST yields to trade tighter. Lower yielding UST increasing appeal of EM Asia bonds**

We opine interest for EM Asia bonds are making a comeback as the hunt for higher yielding assets are expected to persist. Tightening UST yields have increased the appeal of local currency EM Asia bonds as valuations although have turned relatively more expensive still continue to appeal to offshore investors of developed markets. The theme which had earlier resonated “**Prospects for bond yields to remain lower for longer**” is being echoed louder, with more global central banks joining the Fed, with monetary policy tone tilting towards a dovish slant.

For instance, UST rallied significantly during the period in review with bond yields tightening c.20bps-50bps across the curve, as trade tensions continue to intensify further with renewed focus on global growth concerns with ECB resuming its bond buying programme at a pace of EUR20bn per month starting November 2019. Trade developments between the US-China continue to stay elusive and appears to be spreading to other parts of the world with US policymakers prepared to impose tariffs of up to USD7.5bn on European goods as a retaliation for illegal subsidies to European plane-maker Airbus.

Investors have been rotating into safe haven UST as a form of refuge, following listless developments from trade negotiations, amplified further by flip-flopping back to back series trade tariffs implemented. Concerns over dampened global demand amid lingering trade tensions have somewhat delayed the prospects of any trade truce. Up next is the key meeting between both leaders of the US and China this week on 0<sup>th</sup>- 11<sup>th</sup> October in Washington.

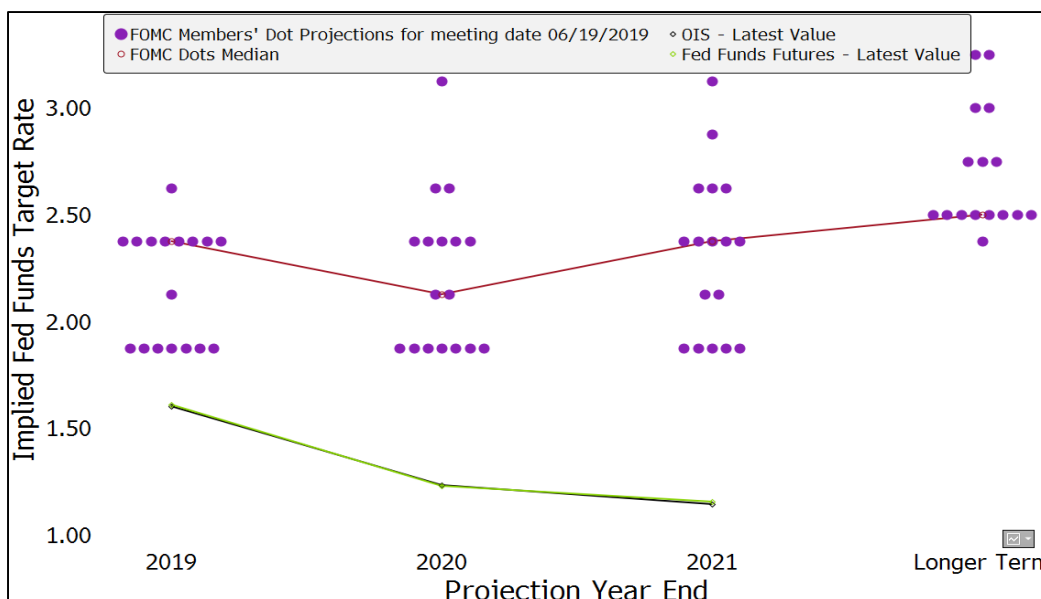
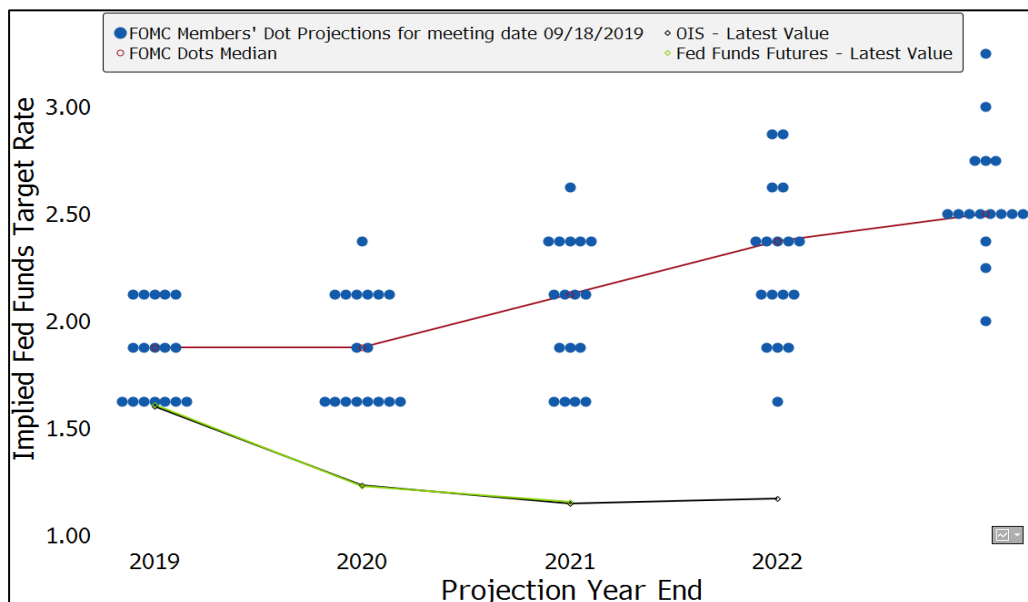
Negative spreads of 10-year versus 2-year US Treasuries mirroring an inverted yield curve is also spooking concerns over US recession fears (Refer to Chart 1). We opine focus on supporting growth remains a key agenda for now, with more central banks potentially entering into a rate cutting cycle if not a dovish slant. Recall, BNM reduced the OPR by 25 bps in its May monetary policy meeting, as a pre-emptive measure to support growth whilst inflation outlook stays manageable, with latest CPI at 1.5% YoY. On a related, hunt to generate alpha is becoming more challenging especially for European banks and NBFIs (asset managers and lifers) after the ECB slashed its deposit rate by another 10 bps to -0.50%.

**Chart 1 : Inversion of US Treasury 10-year versus 2-year**



Source: Bloomberg, RHBFI

Chart 2 : Fed dot plot projections, Sep vs June FOMC release



Source: Bloomberg, RHBFIC

**Fed lowered interest rates for another consecutive FOMC meeting, assessing US economy as growing on a solid path despite weakness in global growth. Trade issues continues to amplify downside risks to growth**

At the recently concluded US FOMC back in September, US policymakers slashed the key policy rate by another 25 bps bringing the target level to 1.75%-2.00%, as widely expected by market players. **On US growth outlook, the latest September projections released by the Fed revised growth a tad higher for 2019 at 2.2% with levels potentially moderating to 2.0% for 2020. (June projections: 2.1% for 2019, 2.0% for 2020).** Going forward, a closer look on revised dot plot projections suggest investors are still divided in terms on future monetary policy easing outlook. Please refer to Chart 2 above. **7 Fed officials still expect 1 more rate cut bringing the target level to 1.50%-1.75% by end 2019 which is also in line with the Fed Fund futures, refer to Chart 3.** Odds are still showing chance of more than 70% for a 25 bps cut at the next FOMC meeting scheduled this month.

**Chart 3: Fed Fund Futures: Current Implied Probabilities shows odds for another 25 bps priced in, > 70% chance**

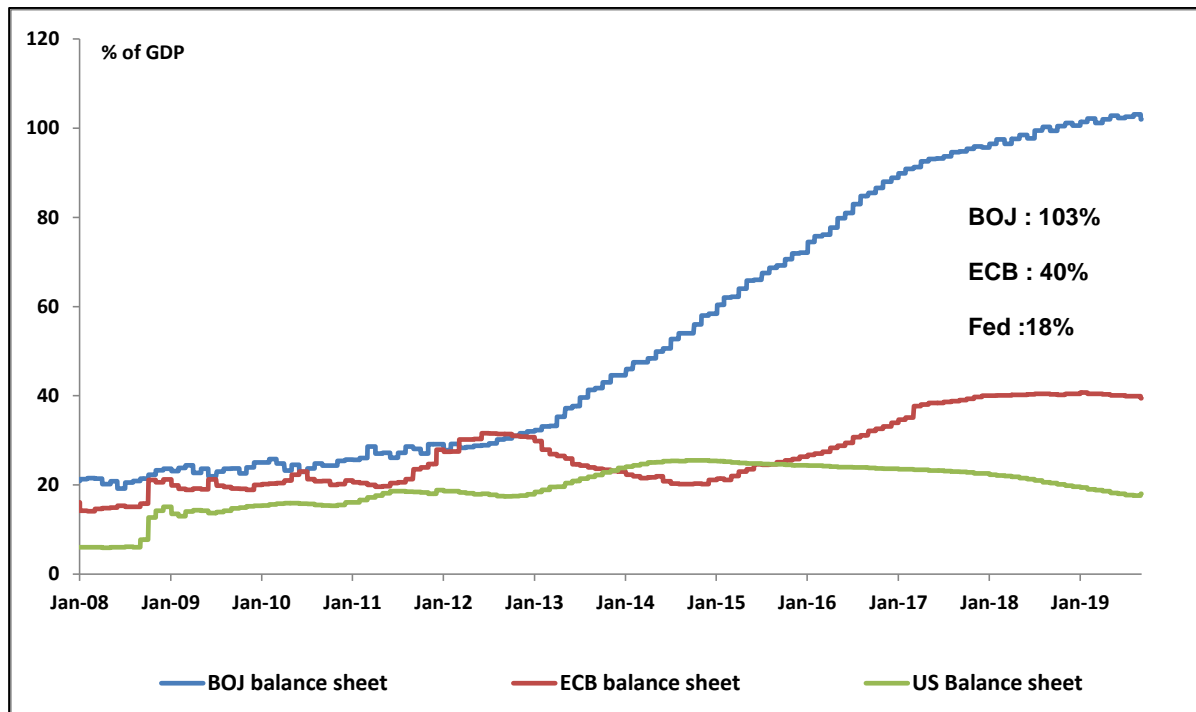
Current Implied Probabilities			Add/Remove Rates						
Dates	Meeting	Calculation	Calculated 10/07/2019 Based on rate 1.75-2.00						
Meeting	Hike Prob	Cut Prob	0.75-1	1-1.25	1.25-1.5	1.5-1.75	1.75-2	Fwd Rate	
10/30/2019	0.0%	76.0%	0.0%	0.0%	0.0%	76.0%	24.1%	1.65	
12/11/2019	0.0%	91.4%	0.0%	0.0%	48.7%	42.6%	8.6%	1.49	
01/29/2020	0.0%	96.7%	0.0%	30.1%	45.0%	21.6%	3.3%	1.34	
03/18/2020	0.0%	97.8%	9.9%	35.0%	37.3%	15.6%	2.2%	1.26	
04/29/2020	0.0%	98.4%	16.7%	35.6%	31.4%	12.0%	1.6%	1.19	
06/10/2020	0.0%	98.7%	20.2%	34.8%	27.8%	10.0%	1.3%	1.14	
07/29/2020	0.0%	99.0%	23.4%	33.3%	24.0%	8.2%	1.0%	1.09	
09/16/2020	0.0%	99.1%	24.7%	32.1%	21.9%	7.2%	0.9%	1.05	
11/05/2020	0.0%	99.3%	25.9%	30.4%	19.4%	6.1%	0.7%	1.01	

Source: Bloomberg

**Concerted monetary easing to spur demand for relatively higher yielding EM Asia bonds. ECB opens the door to resume bond buying activities.**

In Asia, other central banks as also adopting a more prudent approach in echoing a dovish tilt. *In China, the PBOC in September cut the required deposit ratio by another 50 bps, bringing the level to 13.00% from previous 13.50%. Overall, we expect the infusion of liquidity to remain robust, with the ECB opening the door to resume bond buying activities starting with a pace of EUR20bn per month effective November 2019.* Chart 4 provides an overview of the size of balance sheets of the BOJ, ECB and Fed. We expect increase in balance sheet size as % of GDP for the ECB as it is prepared to embark on further bond buying programme.

**Chart 4: Balance sheet size of central banks of developed markets (% of GDP)**



Source : Bloomberg, RHBFC

## Risk of liquidity stress emerging in the US

We opine liquidity in the domestic MYR space remains ample and well supported mirrored by strong demand seen from both primary corporate bonds and government bonds issuances. The lower print for the recent 10-year MGS reopening is somewhat transient as investors were seen preferring to stay on the sideline ahead of Budget 2020 which will be tabled this Friday on 11<sup>th</sup> October.

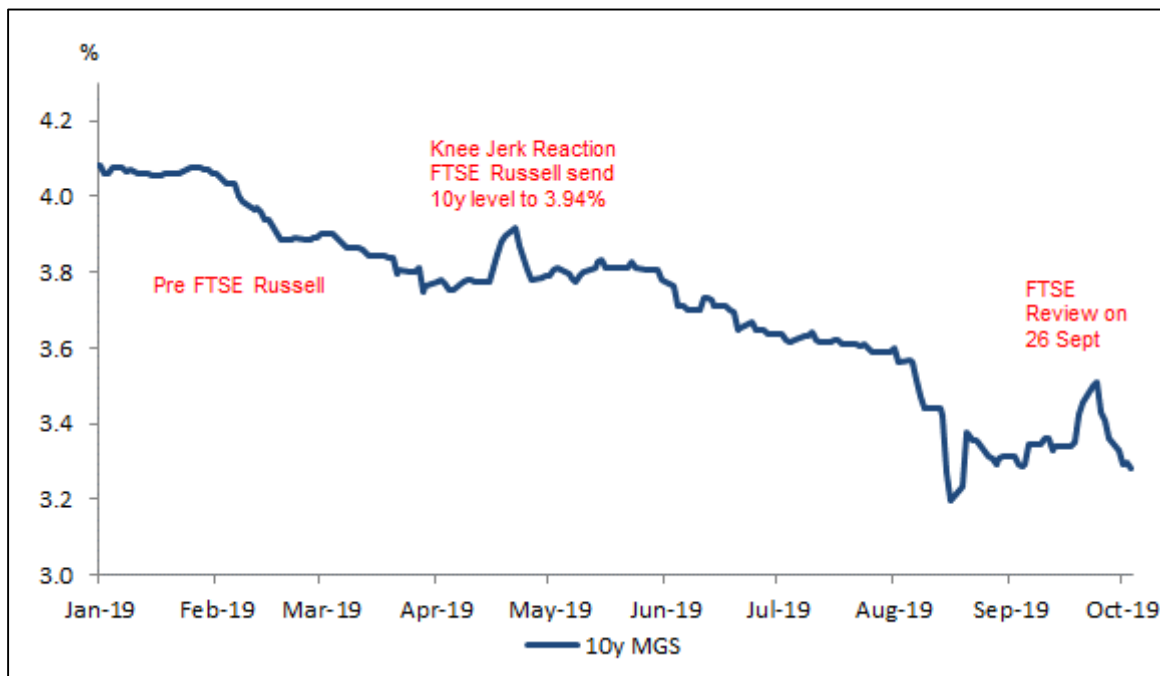
***In comparison, liquidity stresses have started to emerge in the US space resulting with the Fed intervening with a slew of cash injections during the month of September. Short-term repo rates surged to a high of 10% resulted with the Fed intervening with cash injections to calm markets. Levels have since normalized following a series of cash injections.***

## MGS/MGII Outlook

**MYR govovies bonds yield continue to tighten taking the cue from tighter UST yields anchored by scarcity supply of primary corporate bonds issuances.**

We expect MYR bond yields to tighten further with renewed interest from foreign investors following Malaysia's recent reaffirmation on continued inclusion on WGBI index by FTSE Russell. Malaysia is still on a 6-month Watch List (next review due on March 2020) but on balance we believe this as a positive progress following recent engagements by FTSE Russell with regulators in addressing the market accessibility criteria. 10-year MGS benchmark is now hovering at 3.38%-3.40% level and have since tightened c.70bps from the previous level of 4.08% back in early January this year. The index provider will continue to assess the improvement in market accessibility following recent slew of positive measures by BNM in addressing improvements to market liquidity and accessibility criterias. We now expect foreign inflows to turn positive in the coming months as we expect traction to improve, with 10-year yields potentially tightening further from current levels and likewise for other benchmarks of the MYR sovereign curve.

Chart 5 : Yield of 10y MGS

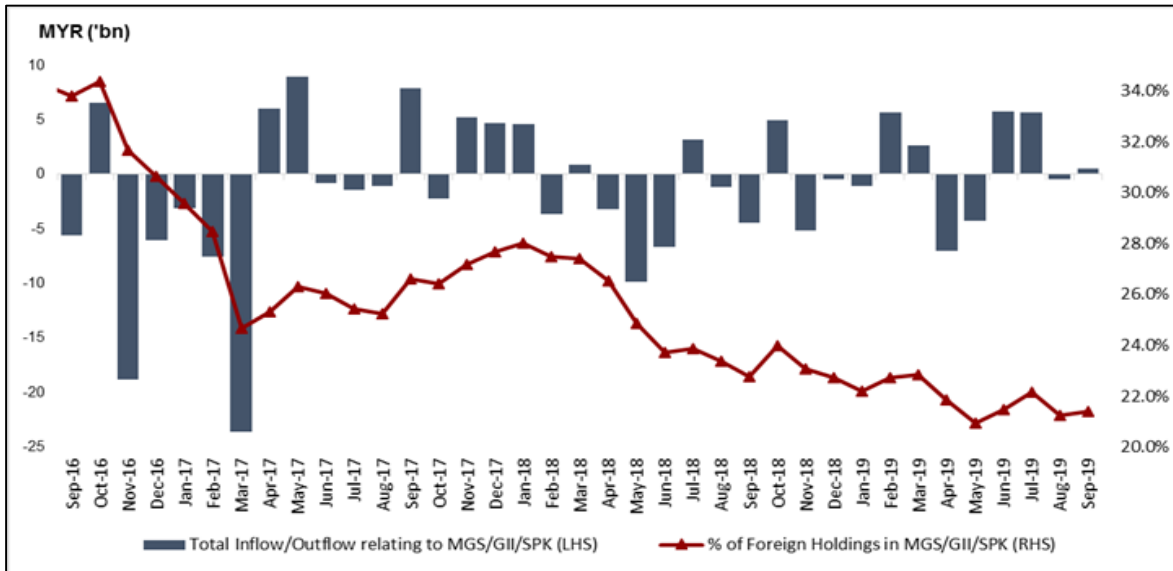


Source : Bloomberg, RHBFIC

## We expect foreign inflows to turn positive in the upcoming months

Following positive inflows seen for both months of June and July, we expect traction to improve in the upcoming months. In fact, directionally, bonds inflows have started to resume for the month of September, with c.MYR900m of net inflow on a MoM basis i.e. September versus August levels (in combined amounts for both government and corporate bonds). In terms of government bonds segment, the current total foreign ownership stands at 22.1% as at end September 2019.

Chart 6: Foreign holdings returned to positive territory in June and July

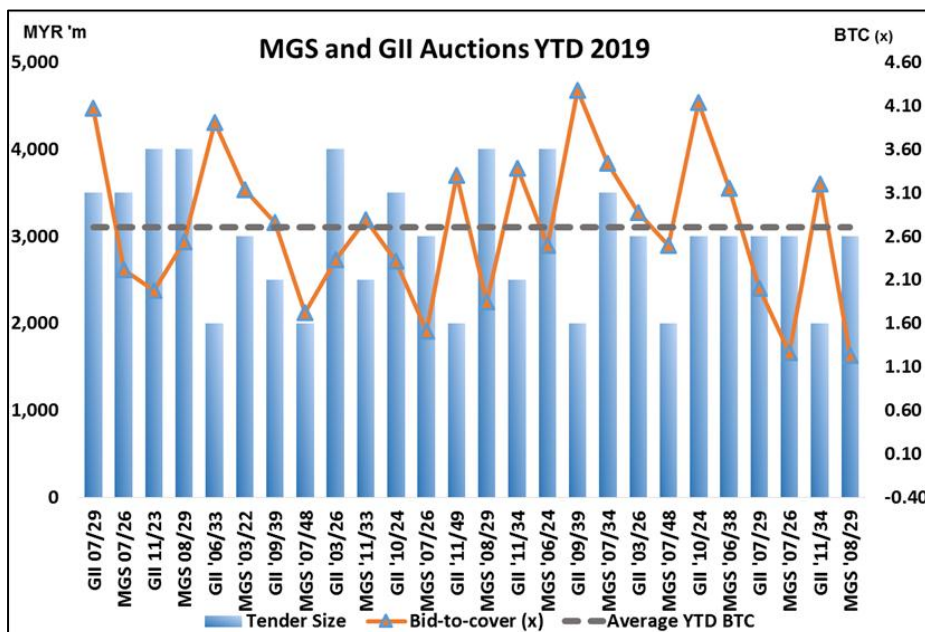


Source : BNM, RHBFC

## Latest BTC moderated to 1.23x for 10-year MGS 8/29 reopening but overall YTD average still healthy, at 2.70x .

We opine the softer BTC of the recent 10-year MGS 8/29 was due to investors preferring to stay on the sideline ahead of upcoming US and China leaders meeting in Washington this week as well as Malaysia's upcoming Budget 2020. The lower BTC print is somewhat transient as we expect demand to eventually pick up as attractive valuations to spur buying opportunities. The overall low yielding environment in developed markets will continue to shore up demand for local currency EM Asia bonds.

Chart 7: BTC trends of concluded MGS/MGII tenders for 2019

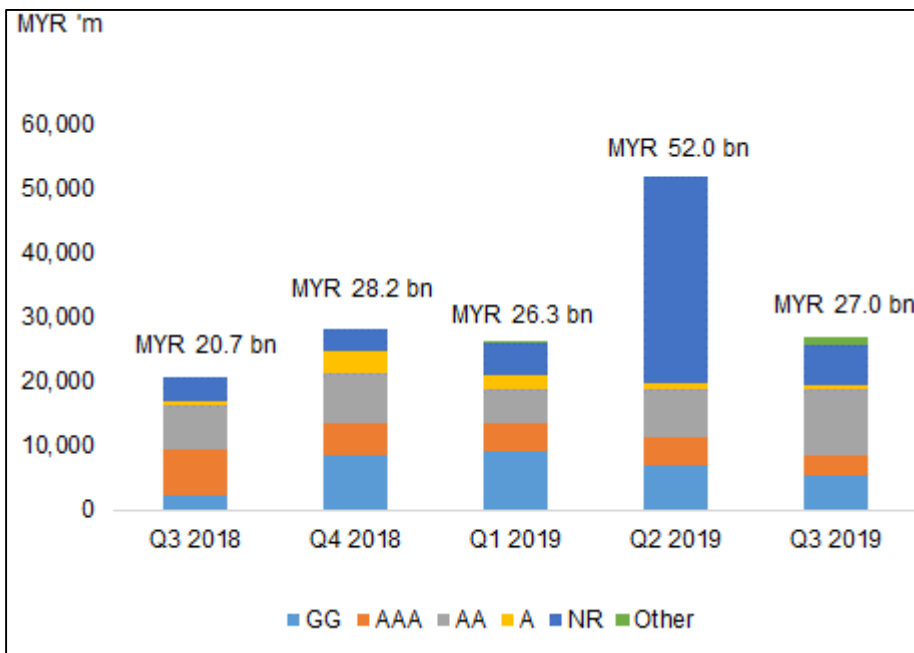


Source : BNM, RHBFC

## MYR Fixed Income Outlook – Corporate Bonds/Sukuk

**Corporate bonds issuances saw a pickup post 1H2019 following the BNM May OPR cut, MYR27bn in combined amounts printed in 3Q2019.** We are maintaining our projections for gross supply of corporate bonds at MYR90bn-MYR95bn for 2019. (Note: our projections excludes the previous non-rated MYR27bn by Urusharta Jamaah issued in May 2019 as this is a one-off issuance). The accommodative OPR level at 3.00% and global easing backdrop has been providing good funding windows for issuers since May. We are expecting another bumper 4Q2019 in anticipation of pick up in issued amount as issuers may speed up respective issuance plan given that the current bond/sukuk funding cost is still attractive. The upcoming Budget 2020 may see further incentives for green sukuk or bonds issuances from the angle of tax advantages for issuers. Let's watch out for these space as we are expecting potential measures on increasing the depth of the green sukuk space as well as the value proposition for these segments to both issuers and investors.

**Chart 8 : Corporate bonds/sukuk issuances by quarter**

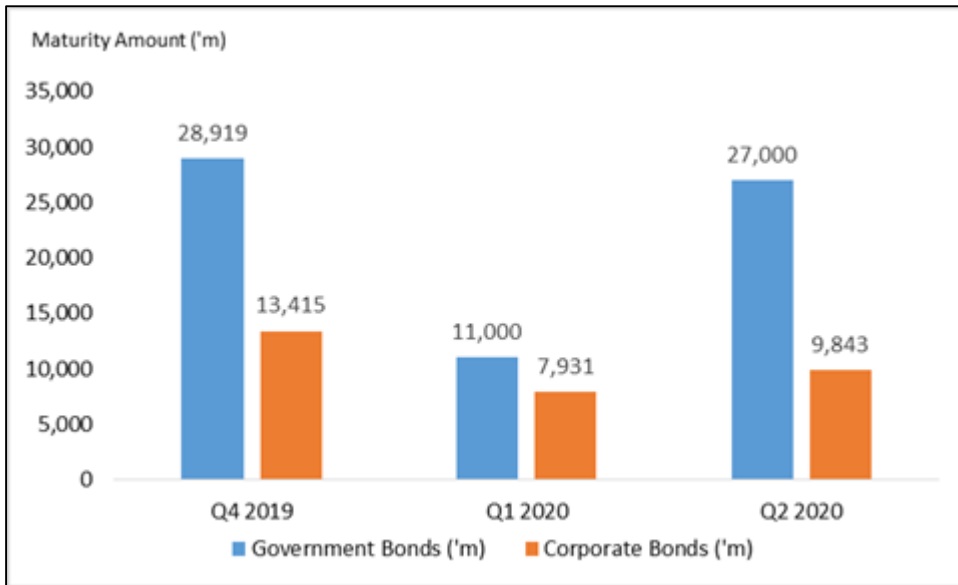


Source : BPAM, RHBFC

### High level of maturities for both government and corporate bonds worth c. MY42.3bn in 4Q2019 to bode well for pricing of primary corporate bonds/sukuk in anticipation of reinvestment flows from scheduled maturities

We opine the upcoming bond maturities in combined amount for both corporate bonds/sukuk inclusive of local govies to bode well for pricing of primary bond issuance in anticipation of scheduled reinvestment flows. Reinvestment flows are expected to translate to tighter pricing for upcoming bond issuances which has already started during the recent completed issuances for the month of September. In combined MYR corporate bonds/sukuk and MYR govies, maturities stands at MYR42.3bn in 4Q2019.

**Chart 9 : Maturities from Q42019 to Q22020**



Source : BPAM, RHBFC

**Chart 10 : Notable Corporate Bonds/Sukuk Maturities for 4Q2019**

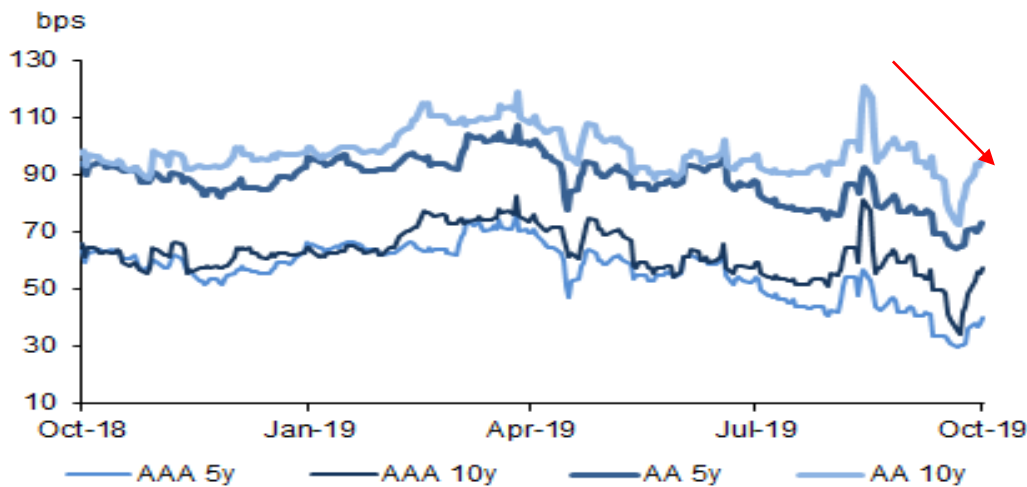
Issuer Name	Amount (MYR' m)	Rating
GB Services Berhad	1,450	AAA
Sabah State Government	1,000	AAA
Cagamas Berhad	800	AAA
Malakoff Power Berhad	670	AA-
Pengurusan Air SPV Berhad	650	AAA
BGSM Management Sdn Berhad	645	AA3
Cagamas Berhad	580	AAA
Manjung Island Energy Berhad	520	AAA
HSBC Amanah Malaysia Berhad	500	AAA

Source : BPAM, RHBFC

We have listed and summarized some of the notable corporate bonds/sukuk maturities in 4Q2019 ranked by maturing amount (Please refer to Chart 10). Most of the maturing bonds will be from the AAA and AA3/AA- space. Investors currently invested in these mentioned bonds will be on the look out for investment replacements, within the similar rating band although we opine some investors are prepared to extend out duration in search of better relative yields. Upcoming top 3 corporate bonds/sukuk issuers with maturities are GB Services '11/19 rated with amount of MYR1.45bn, followed by Sabah State Government '12/19 and Cagamas '12/19 with maturity amounts of MYR1bn and MYR800m respectively. (All the three mentioned are rated AAA)



Chart 11: Corporate bonds space saw some recent tightening



Source: Bloomberg, RHB FIC

A closer analysis on the credit spreads suggest levels have actually tighten significantly towards the end of 3Q2019 i.e. mid-August, with spreads on 5-year and 10-year AAA hovering at around 35bps and 40-42bps. Given the scarcity of new fresh primary corporate bonds within the AAA segment, we opine there is room for further tightening. In fact any widening of spreads in the AAA/AA curves is purely more of laggard in terms of relative speed of tightening as normally there is a timing difference between the tightening in MGS/MGII before the similar follow thru can pick up in the corporate credit segments. The rationale for this is because investors tend to await for replacements or possible switches and hence the delay in yield tightening mode.

### Focus in the near term...Budget 2020 and FOMC this month

We expect investors to focus on upcoming Budget 2020. The upcoming Budget will be keenly watched on further fiscal consolidation progress. We opine the fiscal deficit is expected to narrow from -3.7% in 2018 to a targeted level of -3.4% in 2019. For the coming 2020, there is a possible fiscal stimulus package which may be announced by the Government to help anchor domestic growth. Upcoming pipeline of possible incentives and catalyst to boost capital market activities in the form of extension of tax exemptions and possible tax incentives for green sukuk for both issuers and investors may be some of the measures to be tabled at the upcoming Budget 2020. On a related note, the upcoming US FOMC scheduled at the end of the month will be a key focus as investors will try to gauge the rhetoric of the US Fed on future monetary policy directions although current market probabilities are still pricing in more than 70% of another 25bps cut in the Fed funds rate at this upcoming meeting.

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