Bond market to remain resilient

Growth due to debt issuances for project, infrastructure financing needs

BY J ARUL

ROBUST growth in the local bond market will continue this year as companies look to raise funds to address project and infrastructure financing needs for key sectors of the Economic Transformation Programme (ETP), on the back of promising domestic economic growth.

RAM Rating Services Bhd CEO Foo Su Yin says the still-resilient growth in Malaysia's domestic demand and sustained fiscal support will underpin the continued strong growth of the domestic bond market in 2013.

Foo says domestic economic growth, which is forecast to expand to 5.3% this year before accelerating to 5.8% next year, will be supported by robust demand, fiscal support measures and the ongoing recovery of the external environment.

Meanwhile, global conditions are also projected to gradually recover this year as policymakers in systemically important economies adopt an accommodative stance in an attempt to combat their respective structural deficiencies, she adds.

Malaysian Rating Corp Bhd (MARC) CEO Mohd Razlan Mohamed agrees that the local bond market will continue to be positive as ample liquidity remains in the local financial system.

"Optimism over Malaysia's medium-term growth potential will sustain interests from both local and foreign investors to invest in the local bond market. However, there could be a slight moderation in terms of bond/sukuk issuance volume this year compared with last year based on MARC's projection," he adds.

Mohd Razlan says primary drivers dictating the pace of the local bond or sukuk market are investors' expectations of economic performance and inflation. Malaysia has become an attractive destination for foreign investors in recent times due to ongoing uncertainty over the global economy.

"Moving forward, we could see some of that interest moderating as we expect inflation to begin picking up in 2013 and investors becoming more discerning over credit risk premiums," he adds.

Bond Pricing Agency Malaysia (BPAM) Sdn Bhd CEO Meor Amri Meor Ayob adds that investors' risk appetite, external factors such as the sustainability of the economic recovery in the US and its Western counterparts, interest rate differential, and the local currency (MYR) exchange rate are some of the other considerations that will drive the bond market performance this year.

MARC's Mohd Razlan says the local bond/sukuk market will remain healthy this year in terms of issuance and investor demand. Debt issuance will be fuelled by capital expenditure and working capital financing needs of corporates, particularly in the construction, real estate and oil and gas-related sectors, as well as project and infrastructure financing and refinancing needs while investor demand will come from the highly liquid domestic market.

BPAM's Meor Amri agrees that project financing for infrastructure projects under the ETP such as the Mass Rapid Transit (MRT) system will be a key driver for bond issuance this year.

MARC estimates that corporate bond/sukuk issuance to be around RM70-RM90 bil, of which RM15-RM25 bil will be unrated debt securities that are largely government guaranteed with the balance of RM55-RM65 bil from the rated corporate issuers.

Mohd Razlan says private sector debt issuance should be lower this year as the bond market in 2012 was marked by a one-off major issue (eg PLUS Bhd's RM19.6 bil), which is unlikely to be repeated this year.

However, the growth momentum is expected to be sustained after adjusting for this one-off occurrence, he adds.

Meanwhile, RAM Rating's Foo is optimistic that this year will be another strong year for private debt securities (PDS) given the various large-ticket infrastructure projects related to the ETP, 10th Malaysia Plan and other private finance initiatives that are also likely to be implemented.

Foo says domestic growth will be supported by robust demand, fiscal support measures and external environment recovery

Meor Amri says infrastructure project financing will be a key driver for bond issuance this year

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> – MOHD RAZLAN

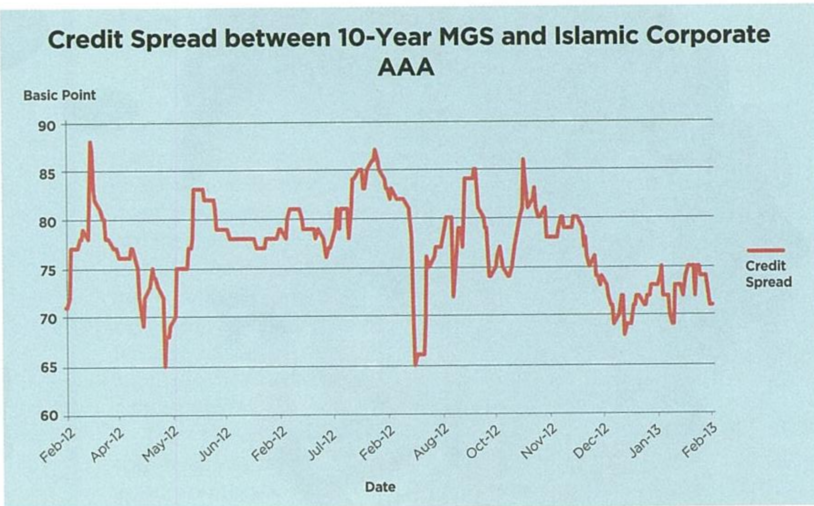
RAM Rating forecasts gross PDS issuance to reach between RM95-RM100 bil this year, based on the remaining unissued programmes and new expected issuances.

"Apart from the infrastructure sector, we expect to see more bond offerings by issuers from the construction, oil and gas, real estate and plantation sectors as the ETP momentum continues to gain traction. Sukuk is expected to remain the preferred mode of financing and possibly account for up to 70% of gross PDS issuance in 2013," she adds.

Based on data from BPAM, gross issuance of PDS (excluding quasi-government bonds) was up 60% year-on-year to RM120.03 bil last year.

"This was one of the highest gross issuance on record. Sukuk remained the firm favourite with investors, comprising 60% of total bonds issued while 88% of total bonds were rated. Corporate bond yields largely tracked their Malaysian Government Securities (MGS) counterpart in 2012," says Foo.

As for MGS issuances, market consensus is that issuances would range between RM90-RM95 bil for the year.



Source: BPAM

"Compared with 2012, there will be a lower supply of government issues given the smaller deficit target," says Mohd Razlan.

Total gross MGS (including Government Investment Issue and Treasury Bills) issued in 2012 stood at RM101.5 bil, a 6.6% increase from 2011. The MGS yield curve was flat, in the face of an unchanged Overnight Policy Rate (OPR) and relatively stable inflationary environment, says Foo.

"Domestic monetary and financial conditions are expected to remain relatively stable this year. While inflation is expected to be moderate in the short term, certain recently implemented policies (such as the minimum wage policy) may exert some longer-term upward price pressures," she adds.

RAM Ratings opines that Bank Negara Malaysia may likely adjust the OPR upwards by 25 basis points (bps), as the global economic recovery will augment the already robust domestic demand conditions.

"Therefore, we anticipate the yield curve to rise in the later part of 2013," Foo says.

Mohd Razlan agrees, saying that MARC does not expect any major movements in yields for the first half of the year but some inflationary pressure may creep in for the second half of the year.

"This might put slight upward pressure on yields, especially if Bank Negara feels obligated to respond with monetary tightening. Our base case assumption is that yields will probably start trending upwards at the end of 2013," he says.

Meor Amri says that with foreign holdings in MGS reaching 42% at the end of the third quarter last year, it is crucial to track the yield differential between Malaysia and US sovereign securities.

"The yield of the 10-year US Treasuries (UST) has embarked on a little uptrend since December 2012 with its yield rising from circa 1.6% to 2% as at end-January 2013," explains Meor.

By comparison, the 10-year MGS yield has barely moved during the same period and remained in the 3.5% region. The spread between the 10-year UST and MGS has now narrowed in the last two months from 190 bps to 150 bps. The average spread between UST and MGS was around 170 bps over the last 12 months.

Meor Amri adds that the credit spread between the 10-year MGS and Islamic Corporate AAA has also narrowed from circa 85 bps to 70 bps while the average credit spread over the past 12 months was roughly 77 bps.

BPAM estimates that gross domestic sovereign issuance (MGS, GII and Sukuk Perumahan Kerajaan) for this year will be RM90.6 bil compared with last year's RM94 bil (excluding SPK issuance and switch auction). It expects net issuance to be around RM40 bil since sovereign bonds maturity this year stands at RM50.6 bil. FocusM