Rough ride ahead for Malaysian bond market

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Revenue source: Petrol price will influence the performance of the government bonds. - The Star filepic

Uncertainty on US rate hike, Greek debt crisis to dampen sentiment

PETALING JAYA: THE bond market is in for a rough patch, with analysts taking a cautious stance on the outlook of the debt market while a rating agency is revising its bond issuance this year amid the external and domestic developments affecting sentiment in the capital market.

Yields are expected to further creep up with the uncertainty in the US interest rate hike, which has prompted recent foreign capital outflows. A sell-off in the European government bonds coupled with the debt crisis in Greece could further dampen the debt market worldwide this year.

On the domestic front, industry observers and analysts concur that the growing concern of the 1Malaysia Development Bhd (1MDB) RM42bil debt issue, the Government's initiative in managing the country's fiscal deficit, the weak ringgit and a slower economic growth as well as the credit rating agencies' assessment of Malaysia's sovereign rating will put pressure on yields. Data compiled by Bloomberg showed Malaysia's Government bonds fell this week, with the 10-year yield rising six basis points (bps) to 4.13%.

RAM Ratings head of research Kristina Fong told StarBiz that given the spate of market uncertainty, which she felt would be more pronounced this year than the last, it was likely that private debt securities (PDS) activity would be slightly more muted this year.

"We recently revised our gross PDS (private debt securities) issuance expectations marginally downwards to RM75bil-RM85bil this year from RM85bil-RM95bil initially, based on our expectations of pipeline-rated deals which originate mainly from the financial services and infrastructure sectors. In comparison with the January-May period of last year, gross PDS issuance is 14.2% lower year-to-date in 2015," she said.

"However, this would not be solely attributed to the currency exchange rate factor, but a combination of uncertainties both emanating from domestic and external sources which have and are still having significant effects on overall market sentiment," Fong added.

Moving ahead, she said yields had the possibility of trending higher on the back of lower foreign investor participation in the bond markets, given the current period of uncertainty concerning global liquidity conditions.

US Treasury (UST) yields were also rising, but expectations of gradual tightening by the Federal Reserve would give rise to the fact that the positive yield spread against Malaysian Government Securities (MGS) would remain, she noted.

Maybank Investment Bank fixed-income analyst Winson Phoon, who is maintaing the bond issuance forecast of RM75bil for PDS this year, said he expected MGS yields to trend mildly higher on a lower-beta basis in line with expectations of a gradually higher global rate environment led by the United States.

"We have a target yield of 4.25% for the 10-year MGS by end-2015. As the MGS is steep after the recent correction, in the near term the MGS curve may flatten, ie, short-dated MGS yields underperforming the longer-dated tenors.

"The bank is neutral on the bond market after the recent correction in yields, as healthy demand from domestic funds should be supportive to the market. The key risk, however, is that policy-driven uncertainties from the US Federal Open Market Committee will continue to be the source of volatility affecting the regional bond markets, including Malaysia's MGS," he noted.

More challenging year

This year would be a more challenging year for the bond market, said CIMB Group head of treasury and markets Chu Kok Wei, adding that this was primarily due to rising yields attributable to global and domestic factors.

From the current level, Chu said he foresaw some risk of a further sell-off, especially in the medium to long end of the yield curve.

As there was no expectation of Bank Negara raising the overnight policy rate in the near term, short-end papers would be well-supported, he said, adding that the phase of the liquidity coverage ratio (LCR) could also help to support bond prices, especially in the shorter end of the yield curve.

For corporate bonds, Chu said he expected the yield differential to MGS to tighten, primarily driven by higher MGS yields.

The latest ruling by the central bank now requires Malaysian banks to have a minimum LCR of 60% by June this year. The rationale for the new ruling is to protect banks from any liquidity stress, as was experienced by some US and European banks during the 2009 financial crisis.

The new guidelines state that banks need to maintain a minimum LCR of 60% starting

June 1, to be stepped up gradually to 100% by Jan 1, 2019. The LCR is defined as stock of high-quality assets divided by total net cash outflows over the next 30 calendar days.

On the yield spread, Malaysian Rating Corp Bhd (MARC) said the MGS curve has steepened bearishly of late, with 10-year and five-year yield spreads widening to about 50 bps, the highest since May 2014.

If selling in European bond markets persists and the Fed delays its rate-hike plan, the rating agency added that it will not be surprised to see the tenure spreads widen further in the second half of the year.

In the primary market, MARC continues to envisage gross Government bond issuances to come in within the range of RM85bil to RM95bil this year on the back of a budget deficit target of 3.2% of GDP or RM37bil in 2015.

Bond Pricing Agency Malaysia chief executive Meor Amri Meor Ayob opines for shorter tenure papers, the yield movement generally reflects investors' expectations of monetary stance by the central bank.

Since the start of the year, over 20 central banks worldwide had adopted expansionary monetary policies and some market players expected Malaysia to jump on the bandwagon, he said.

"The one-year consolidated MGS yield published on the Fully Automated System for Issuing/Tendering website showed a downward shift in the one-year MGS rate since the start of 2015.

"Nonetheless, there is no clear indication of market expectations of a rate cut in the country, as the downward shift in yields could be due to a shift in market preference for shorter-tenure papers. MGS yields tend to move relatively in tandem with the UST yields. A sooner rate hike in the US is likely to cause the ringgit bond market yields to trend higher," Meor Amri said.

Bond outlook

Elaborating on the bond outlook and yield spread, OCBC Bank (M) Bhd head of global treasury Ng Seow Pang feels the outlook for MGS for the rest of the year is uncertain.

"When US interest rates increase, the differential to Malaysian rates will narrow. Investors will then need to assess if the narrower spread would suffice to remain invested in an emerging market like Malaysia.

"The price of oil is another factor that will influence the performance of MGS. It is common knowledge that oil-related revenues are a component of Government funding. Should the price underperform against the Government's budgeted level, pressure will mount for borrowing to increase. This will, in turn, increase the supply of MGS," Ng added.

Commenting on the ringgit, Maybank Investment Bank chief economist Suhaimi Illias said he expected the ringgit to remain volatile with weakness bias in the short term, particularly when the US Fed's interest rate lifted off probably by September this year amid ongoing concerns over issues like the impact of soft commodity prices on the country's current account and fiscal balances, the 1MDB issue and sovereign credit rating.

Suhaimi added that over the next three months, ie, between end-June and

end-September, he expected the ringgit to trade within a 3.65-3.75 range to the US dollar. "We expect the ringgit to be at 3.60 by end-2015, mainly as US interest rate hikes will not be seen as aggressive going forward, hence the prolonged sizeable interest rate differential with Malaysia, coupled with a firmer outlook on commodity prices to ease the downside risk on the trade and budget balances," he said.