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Malaysia remains leading sukuk issuer

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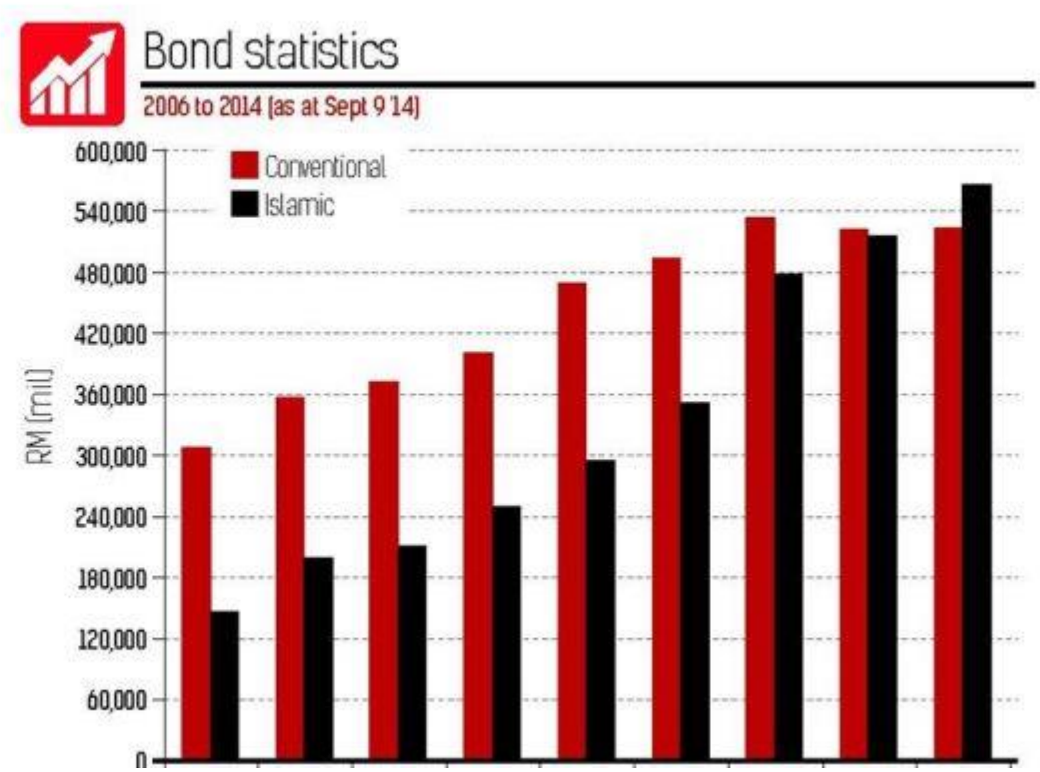

AMIDST some stiff challenges including the greater risk of a possible downgrade of debt issues in certain sectors, the bond market, which saw slower growth in the first half of this year, is expected to rebound in the second half of the year.

Analysts and industry observers concur that although the debt market grew at a slower pace in the first half, it could pick up in the second half despite the presence of some headwinds which could put a dampener on its growth.

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RAM Ratings, in its review of the rating movements in the first half of this year, says that from their portfolio of issuers, those with the greater risk of a ratings deterioration over the next six to 18 months are those currently on negative outlook which include issuers from the plantation and agriculture, property and real estate, as well as trading and services sectors. However, it added that all of these issues are either guaranteed by banks and/or other financial institutions.

The downgrade-to-upgrade ratio in the first half increased from 0.33 to 0.67, as the number of downgrades increase, the rating agency says, noting that it is maintaining its annual default rate for bond issues this year to be similar to last year at 0.6%-1.3%.

The corporate bond market decelerated in the first half, grossing RM42.2bil new issues, which was about 5% lower year-on-year.

RAM Rating Services Bhd head of structured finance Siew Suet Ming tells*StarBizWeek* she expects gross private debt securities (PDS) issuance at between RM90bil and RM95bil this year.

She says this will be driven by a number of infrastructure (toll roads) and utility projects in the pipeline, as well as funding needs of ongoing Economic Transformation Programme (ETP) initiatives, including construction projects.

On the other hand, Siew adds that the pace of the Malaysian Government Securities (MGS) issuance is forecast to moderate slightly in the second half and attributes this to the ongoing fiscal consolidation initiatives bringing expected gross issuance of MGS to between RM85bil and RM90bil for the year. As at end-August 2014, MGS issuances stood at RM73.2bil with only 45% consisting of Islamic securities or sukuk.

Fiscal consolidation refers to the government’s initiatives to reduce budget deficit.

Siew expects local currency issuance will be dominated primarily by sukuk issuance as Malaysia remains the leading issuer of sukuk, making up close to two-thirds of the global Islamic debt market. She says this is partly due to rising demand for syariah-compliant investments along with a growing domestic Islamic asset base, and pricing of Islamic instruments.

Sukuk instruments

With 52% of total PDS issued in 2014 being sukuk instruments, RAM Ratings expects this positive trend to continue for the rest of the year on the back of stronger corporate bond market activity in the second half.

As it stands, Siew says Malaysia has been the most active market in issuing sukuk through Basel III-compliant instruments, commanding 66.7% of such global sukuk issuances to date.

On bond yields for this year, she says yield curves were significantly quite steep since the end of last year, as investors increasingly priced in the anticipated interest rate hike.

Since the 25 basis point hike in July, there has been a gradual flattening of the yield curves of most risk classes, she notes, adding that the yields should maintain around the current level in the near-term as inflation moderates.

Areca Capital Sdn Bhd chief investment officer of fixed income Edward Iskandar Toh agrees the sukuk market will continue its dominance in the second half as Malaysia has the resources and requirement to continue in the path of building the country into an Islamic financial hub of the region if not a leader in the world.

Islamic finance is gaining prominence globally, he says, adding that tying in with our moderate Islamic political image, Malaysia stands out as a preferred destination for both issuers and investors.

“I think Malaysia’s path of building up its Islamic finance presence augurs well for the future considering the development of cross border cooperation within Asean to establish our relevance and significance in the global scene.

“Our experience can help anchor the region as an Islamic finance centre backed by a young and growing middle income based population. It can exert its competitive advantage where East meets West in financing terms,’’ Toh notes.

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Despite the bullish outlook of the bond market, Bond Pricing Agency Malaysia CEO Meor Amri Meor Ayob says there are certain factors which could put the brakes on the growth of the bond market.

Factors such as inflation outlook, speculation of a potential second overnight policy rate hike this year, investor risk appetite, political stability and, sustainability of the global economic recovery will play a significant role in the performance of the ringgit bond market this year, he says.

The hike in interest rates in July this year coupled with a mixed bag of economic data (lower-than-expected July CPI data and better-than-expected second quarter GDP growth) has resulted in heightened uncertainties surrounding the speculations of a second rate hike by Bank Negara in the remaining two Monetary Policy Committee meetings.

Last year, Meor Amri says the ringgit bond market registered a positive growth rate of 2.47% from a size of RM1.011 trillion to RM1.036 trillion despite a series of domestic and international events that placed clouds of uncertainty over the domestic financial market such as the 13th General Election and scaling back of the quantitative easing in the US.

This year, the market has expanded to a size of RM1.089 trillion as of Sept 9, marking a 5.12% growth from the previous year amid the nation’s robust economic growth in the first and second quarter of 2014 as well as global economic recovery that has started to gain momentum.

Commenting on the bond yields, he says: “During the first half of the year, macroeconomic factors such as strong GDP growth and the strengthening ringgit have helped to attract market interests to stay invested in domestic sovereign debts and this can be observed in the 19 basis point decline in the 10-Year MGS yield since the start of the year.

“Moving forward, factors such as inflation, potential interest rate hike, political stability and sustainability of the global economic recovery are expected to drive the movement in bond yields for the second half of the year.”