Govt bonds in for higher demand

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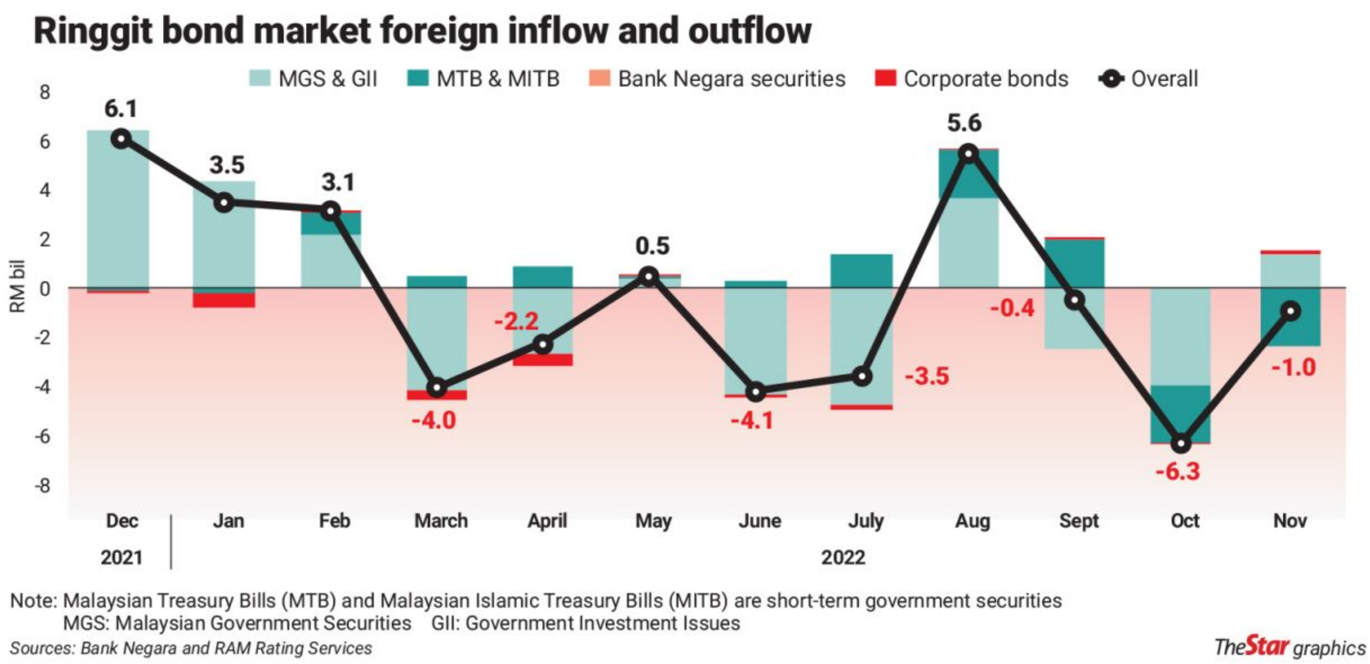

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PETALING JAYA: Economists and fixed-income analysts are cautiously optimistic that foreign demand for ringgit bonds will pick up next year.

The total net foreign outflows improved to RM1bil in November from a high of RM6.3bil in October.

However, they said the demand for local bonds would hinge closely on the pace of the US Federal Reserve's (Fed) policy rate hikes and the state of the global economy, adding that the Fed has started to take a more dovish view with the upcoming rate hikes not expected to rise as fast as the previous hikes.

RAM Rating Services senior economist Woon Khai Jhek

According to RAM Rating Services Bhd senior economist and head of economic research Woon Khai

The sell-off is primarily triggered by the aggressive rate hikes by the Fed, which sent bond prices into a freefall globally.

Woon told StarBiz that the sell-off pressure in emerging markets such as Malaysia was further compounded by elevated risk aversion amid fears of an impending global recession.

This has dragged bonds into a bearish market in 2022 as yields jumped to a multi-year high.

With the recent Fed's message of a slower pace of rate hikes moving ahead, he said the sell-off pressure should ease in 2023 as the risk-off sentiment dissipates among foreign investors.

"There are some signs of a return in buying interest as bond yields started to fall last month, with the 10-year US Treasury (UST) and Malaysian Government Securities (MGS) yield declining to 3.68% and 4.13%, respectively, as of end-November 2022.

"Should investor appetites continue to improve, demand for MGS in 2023 is likely to be stronger. Bond market trends next year will still be largely dependent upon the eventual monetary policy decision, particularly by the Fed.

"If the Fed decides to re-adopt a more hawkish stance to fight rising inflation and raise policy rates faster and higher than initially expected, this could negatively impact investor demand for MGS in 2023," said Woon.

Bond Pricing Agency Malaysia (BPAM) CEO Meor Amri Meor Ayob also shared similar views that the Fed is expected to slow down the interest rate hike regime as inflationary pressures started to show signs of weakness recently.

“This is a boon for the bond market in general,” he said.

Furthermore, judging from the recent strengthening of the ringgit against the US dollar, Meor Amri said: “It appears that foreign investors have returned to Malaysia in droves, especially in the MGS space.

“As a result, a stronger demand is expected for these instruments in 2023 compared with 2022,” he noted.

Meanwhile, Maybank Investment Banking Group head of fixed-income research Winson Phoon anticipates “a bumpy ride, but better return for ringgit government bonds in 2023.”

He foresees a continuation of high volatilities as the market is torn between the risks of inflation (bond negative) and recession (sovereign bond positive).

“Considering Bank Negara’s rate hike cycle is probably nearing the tail end, we expect another 25 bps hike to 3.00% in the first quarter of 2023, coupled with growing global macro headwinds.

“Hence, we expect sustained demand for ringgit government bonds and high-grade credits such as corporate bonds,” he said.

He also envisaged demand for ringgit government bonds to remain healthy, primarily driven by major domestic investors such as pension funds and banks.

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Maybank Investment Banking Group head of fixed Income research Winson Phoon

An improvement in bond returns and growing recession risk could also drive some inflows to bond funds, said Phoon, who is cautiously optimistic on foreign demand although the flows could be choppy and inconsistent.

Drawing a scenario of the drivers and challenges for the ringgit bond market, Meor Amri said: “With the Covid-19 pandemic and the general elections behind us, the drivers for the local bond market include sustainable economic growth, well anchored inflation expectations coupled with prudent

Phoon believed the biggest risk to ringgit bonds would come from the US inflationary pressures and interest rate outlook.

This is because the US labour market condition is still tight and inflation remains well above the 2% goal, hence forcing the Fed to keep raising interest rates in the near term, which raises the risk of a deeper recession later.

“We expect the UST curve inversion to stay deep or deeper for now, but may bull-steepen in the second half of next year or earlier when recession becomes a bigger fear than inflation,” Phoon added.

In terms of bond yields in 2023, RAM Rating’s Woon said as policy rate hikes are expected to continue on an upward trajectory next year, bond yields are likely to continue facing upward pressure in 2023.

Based on the last interest rate dot-plot, he said the Fed is projecting for the policy rate to be raised by another 50 bps in 2022, followed by a further 25 bps increase in 2023.

“Domestically, we are also expecting at least another 25 bps hike in the overnight policy rate in 2023 to bring the policy rate back to the pre-pandemic level of 3.00%.

“However, interest rate expectations are likely to have already been priced in by investors.

“Hence, future increases in bond yields in response to policy rate hikes are unlikely to be as steep as seen in 2022,” Woon said.

Phoon is forecasting the 10-year MGS yield at 3.50% and 10-year UST yield at 2.75% by the end of next year.

Separately, for 2023, RAM Rating expects the overall corporate bond issuance to reach RM120bil to RM130bil, propelled by private refinancing initiatives, continued infrastructure financing needs and financial institutions’ capital augmentation plans.

Year-to-date November 2022, corporate bond issuance totalled RM109.2bil, versus RAM Rating’s forecast of RM110bil to RM120bil this year.

As for MGS and Government Investment Issues (GII), the rating agency expects it to rise to between RM170bil and RM180bil in 2023, considering the government’s larger deficit financing requirement as well as the refinancing of debts maturing next year.

Total MGS and GII issuance for the first 11 months of this year stood at RM163bil and remains on

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