Foreign buying of Malaysian bonds to continue - Business News

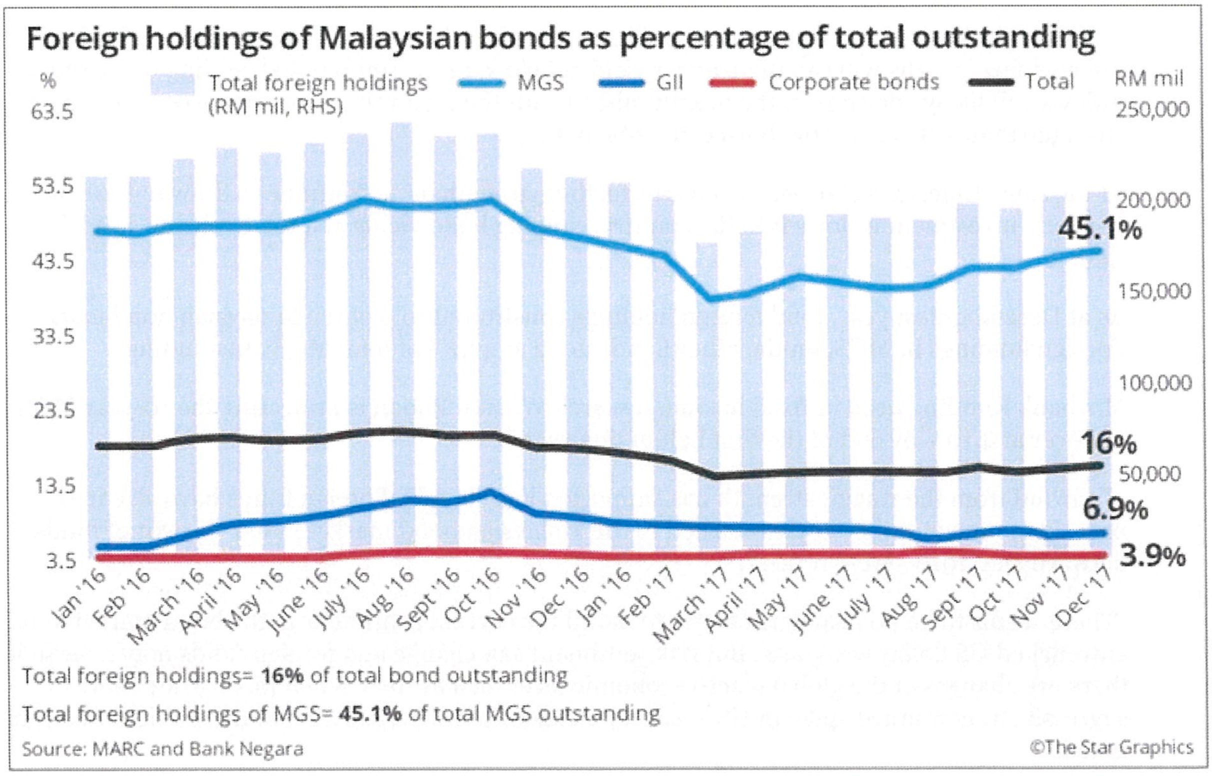
by daljit dhesi

PETALING JAYA: Yield differentials between Malaysian government securities (MGS) and US treasuries (UST) is set to narrow supported by healthy foreign buying of Malaysian bonds amid the country's positive economic fundamentals.

Historically, the yields on UST and MGS is seen to move in tandem, but many economists and bond analysts this time around agree that the UST yields would rise faster than that of the MGS.

This would mean that the price of UST would inch down faster than the price of MGS, the latter would be supported by increasing capital inflows. Bond yields and prices have an inverse relationship.

Some economists and analysts are of the view that In the event of a more pronounced correction in the equity market, there may be a possibility of outflow of portfolio capital from the region and an upward pressure on MGS yields. They don't expect the current correction in the US equity market to see a major outflow of funds from the region, including Malaysia.



The scenario of higher UST yields going forward is due to stronger inflationary pressure in the US, partly driven by the recent tighter labour market, which gives now more room for the US Federal Reserve (Fed) to hike up at least three Fed rates this year and a couple more in 2019.

The US 10-year bond yield surged to 2.86% on Feb 5 from a low of 2.41% at end-2017, on stronger job and wage data. On Friday, the 10-year UST yield was up by 0.4% to 2.86% while the 10-year MGS yield stood at 3.89%.

AmBank Group chief economist Anthony Dass told StarBiz that he expected the yields differential between UST and Malaysia's 10-year MGS to narrow, more so due to a much faster rising US yields compared to Malaysia's yields.

"We expect the US Fed to raise rates three times this year, each by 25 basis points and another one or two rate hike in 2019 underpinned by higher inflationary expectations driven by tighter labour market that will see wages grow.

"For 2018, we expect a big jump of 60 basis points up in the yields of the 10-year UST to 3.00% from 2.40% end 2017. We expect the 10-year MGS bond yield to rise moderately this year by 10 basis points to 4.01% in 2018 from 3.91% end 2017. This, among others, will be underpinned by the country's healthy macro fundamentals with Malaysia's GDP expected to grow by 5.5% this year and the undervalued ringgit at 3%-4% against the US dollar," he noted.

Malaysian Rating Corp Bhd chief economist Nor Zahidi Alias noted that the yield spread between the UST and MGS has narrowed from around 180 basis points (bps) in early August 2017 to around 105 bps in early February this year.

"Although historically, yields on USTs and MGS tend to move in tandem (an upward movement in UST yield will normally be accompanied by a rise in MGS yield), this time around I believe the yield gap will continue to be compressed going forward, at least under our base case scenario. This is because UST yields will rise faster than expected while MGS yields will be capped by increasing capital inflows into the country," he said.

As for the MGS, the base case scenario still suggests that the prospects of more capital inflows in the next few months will cap the 10-year yield at below 4.1%, Zahidi noted, adding that capital inflows will likely continue in the months ahead with the Malaysian economy expected to post a stronger-than-expected growth pace of 5.8% in 2017.

At the same time, expectations of ringgit's further strengthening continue to draw in foreign portfolio investment inflows into the country, capping bond yields at a relatively low level, he said.

As at December last year, total foreign holdings constituted 16% of the Malaysian bond market. Foreign holdings in MGS, on the other hand, stood at 45.1% of total MGS outstanding.

Maybank Kim Eng head of fixed income research Winson Phoon is projecting the 10-year MGS to hover at 4.10% by end of the first half of this year.

"Tailwind from the ringgit strength has supported local bonds. Foreign funds have also in the past six to nine months slowly returned to the Malaysian bond market - after the exit of funds between Dec 2016 and Mar 2017.

"There seems to be no near-term factor to derail the current sentiment in the bond market amid entrenched US dollar weakness. But risk sentiment can change and foreign funds may reverse if there are changes at the global macro economic level such as the US Fed raising rate more aggressively, continued spike in US Treasury yields or the strengthening of the US dollar etc," he noted.

CIMB Investment Bank Bhd group head of treasury and markets Chu Kok Wei said the 10-year MGS yield should still find support marginally below the 4.00% level while gradually inching up towards the 4.05% area towards the year-end.

"We expect spreads between the US and Malaysian government bonds to compress marginally, if at all. Though the pace of normalisation by the Fed is expected to be faster than that of Bank

Negara, local bond yields may increase in tandem because an uptick in US yields may be limited due to mixed inflation outlook and political risks, whilst a rise in MGS yields may be limited by the continued strong demand for emerging market bonds, the pace of Bank Negara tightening and in view of the expected strong ringgit this year, Chu noted.

Bond Pricing Agency Malaysia Sdn Bhd (BPAM) CEO Meor Amri Meor Ayob agreed that spread between the 10-year MGS and the 10-year UST has narrowed in the past few months, adding that this credit spread would continue to narrow if the U.S. Fed surprises the market with even more hawkish rhetorics.

From international investors' perspective, he said UST has become more attractive than MGS as the spreads between them narrow.

That said, as the Malaysian economy has performed tremendously well, coupled with the strengthening ringgit, he said BPAM have not witnessed any major outflows from the MGS thus far.

CIMB Investment Bank Bhd senior managing director and global head of capital markets Nor Masliza Sulaiman expect the Malaysian bond market to remain resilient this year.

"We foresee about RM90bil in corporate bond issuances this year on the back of infrastructure projects announced in Budget 2018, refinancing activities as well as the financing needs of the corporate sector. Primary deals with no fixed drawdowns may optimise offerings in the first half of the year.

"The issuance pipeline largely depends on the requirements of borrowers, be it the Government or companies. As announced in the latest budget, there are several infrastructure projects that are expected to kick off this year, with funding requirements till completion of up to RM1.0 trillion over the next few years, and we expect a large proportion of this to be funded via the bond markets," she noted.