

Sime Darby

Developing Sustainable Futures



By DALJIT DHESE

daljit@thestar.com.my

A robust bond market

But there are potential risks

THE bond market is expected to be abuzz with more activities this year underpinned by a more positive economic outlook, rising mergers and acquisitions (M&As) and improved appetite for debt papers.

RAM Rating Services Bhd chief executive officer Liza Mohd Noor says the rating agency is anticipating a more robust market activity this year right into 2012.

"One of the prime movers is the outlook for recovery as we foresee commercial activities and correspondingly private investments to be further stimulated. Growth, and by extension funding requirements, is likely to be supported by domestic and foreign private sector-led projects under the Economic Transformation Programme (ETP), the resilient domestic demand and growing intra-Asian exports," she adds.

At the same time, the market will see a number of new issues stemming from the rising M&A transactions as corporates and institutions expand.

The other factor that may encourage the supply of ringgit-denominated papers is the more robust demand from investors, in particular foreign investors.

Based on latest available Bank Negara statistics, the average proportion of foreign holdings of total outstanding securities in the first nine months of 2010 grew from 7.9% to 13.5% from the previous corresponding period.

Malaysian Rating Corp Bhd (MARC) chief executive officer Mohd Razlan Mohamed expects corporate bond issuance to hit RM50bil in 2011 against its 2010 full-year estimate of RM38bil as the economy continues its sustained recovery path.

He says the volume of bond issues will be largely led by growth-related investments by local corporates, increased foreign direct investments and the implementation of Private-Public-Partnership (PPP) projects and high-impact strategic projects.

Signs of improvement in corporate credit quality will further drive this growth.

Razlan points out that the economic rebound since the fourth quarter of 2009 has been accompanied by a reduced rating downgrade momentum.

For MARC's rating universe, the issuer downgrade-to-upgrade ratio has fallen from 2.7:1.0 to 1.8:1.0.

Given the expected higher proportion of public offering, Liza expects greater market participation for new bonds and *sukuk* issuances (as opposed to private placements), and a higher flow of rated (as opposed to unrated) transactions.

Noteworthy is that the ringgit bond market may see a new asset class for investors with the debut of foreign sovereign bonds, says Razlan, adding that more new foreign issuers are anticipated to tap the ringgit bond market for funding.

On the Malaysian Government Securities (MGS), she says there would be an increase in public debt due to the Government plans to facilitate the nation's long-term growth programme, the ETP.

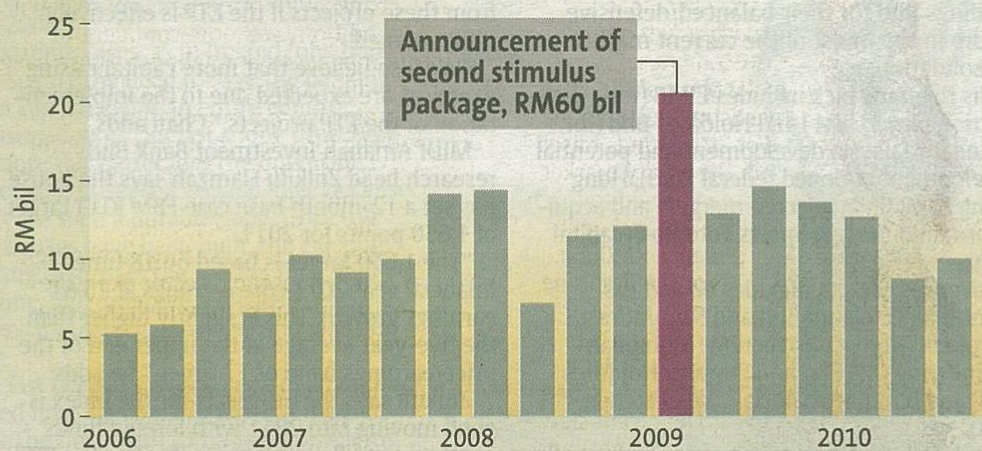
Notably, Liza says the Budget 2011 has penciled in a net issuance of public debt of up to RM51bil in 2011.

This, she said, translates to an expected aggregate gross issuance size of around



From left: Liza Mohd Noor, Mohd Razlan Mohamed and Meor Amri Meor Ayob are predicting an active bond market based on robust demand.

Issuance of MGS



Source: Bank Negara Malaysia and RAM Economics

Star GRAPHICS © 2010

RM96bil in 2011 compared with RM61bil in 2009 and RM55bil year-to-date in 2010.

In addition, Razlan says there would be RM45bil of MGS/GII maturing in 2011, higher than that in 2010, which would translate into more issuance in 2011.

Foreign holdings of MGS as a percentage of the outstanding amount had climbed to an all-time high of 26.8% in September 2010, surpassing the previous high of 24.6% recorded in the middle of 2008, on speculation the local currency would continue to strengthen against the greenback.

Bond Pricing Agency Malaysia (BPAM) chief executive officer Meor Amri Meor Ayob says based on consensus, the total gross issuance of MGS is expected to be in the region of RM90bil (factoring in the fiscal budget deficit expectations - RM45.48bil, and existing government debt maturing next year that needs to be refinanced - RM44.98bil).

As such, the expected issuance is much higher than the total gross issuance last year of RM58.1bil, which will definitely lend a boost to the liquidity of government securi-

ties this year.

Ten-year MGS yield, he says, has declined to 3.82% from 4.33% in early-2010 and the same phenomenon can be observed in the three and five-year regions where yields have fallen by 18 and 44 basis points respectively.

He attributes the growth in trade volume and declining yields to the buying interest of foreign investors in the MGS market due to the strengthening of the ringgit as well as yield differential play by investors who allocated their funds into higher yielding emerging markets like Malaysia.

As for the local corporate/*sukuk* market, Meor Amri says yields had generally declined in 2010 due to an interest rate environment that was conducive and improving business condition.

In 2011, the challenge for the bond market could stem from regulatory risks and the heightened risk of default which the Selangor water-related bond issuers are facing as a result of the unresolved scheduled water tariff hike.

Another challenge, says Razlan is the continued risk-aversion among investors towards lower-rated investment grade papers in the single-A rating category.

Externally, the worry is over another round of debt crisis like the Dubai or European sovereign debt problems, which could trigger massive sell-off of currencies in emerging markets.

Under this scenario, asset classes in emerging markets, including local currency sovereign bonds, would be adversely impacted.