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Bond market seen holding up despite negative news

ECONOMY

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Fong: Foreign investors may further rationalise their bond holdings in the domestic market due to the prevailing risk-off sentiment.

PETALING JAYA: The Malaysian bond market will likely hold up for now with the benchmark 10-year Malaysian Government Securities (MGS) projected to hover between 3.75 and 4.00 by year-end as investors adopt a wait-and-see stance in the wake of the recent negative newsflows.

Economists and bond analysts concurred that the local debt market is still resilient underpinned by the country's healthy macro fundamentals.

Having said that, many agree they do not foresee the 10-year MGS yield at this juncture or in the near term surpassing its highest level attained at 4.46% after the US election in November 2016.

Ambank Group's base projection for the 10-year MGS yield is for 2019 is between 3.75% and 3.80%. Maybank Kim Eng's is maintaining its 10-year MGS yield forecast at 3.90% by end-June and 4.00% year-end. Bond yields and prices have an inverse relationship. Net foreign bond outflows until April stands at RM2.6bil.

As at press time, the 10-year MGS was hovering at 3.89%.

The latest negative news hitting Malaysia was the US' move to include Malaysia in its currency manipulator watch list.

In April, FTSE Russell said it would review the nation's government bonds' participation in the World Government Bond Index (WGBI). It placed Malaysia on its fixed-income watch list for six months until September.

Phoon: The risk of exclusion from WGBI is unlikely to threaten macro-stability given the depths of domestic funds.

Maybank Kim Eng head of fixed income research Winson Phoon is maintaining a "neutral" stance on the MGS.

He is "positive" on the new initiatives by Bank Negara, but from a bond strategy point of view, the presence of external risk factors and that the curve has already rallied by 20-30bps year-to-date may see MGS strength capped by profit-taking.

The risk of exclusion from WGBI was unlikely to threaten macro-stability given the depths of domestic funds, he said.

On the central bank's initiatives, Phoon views the widening of accessibility to onshore dynamic hedging by including trust banks and global custodians as being the most important. It eases accessibility for foreign funds that have a preference to execute forex transactions via custodian.

"As things progress, we may see announcement from the regulator regarding the number and/or list of trust banks and global custodians registered for the dynamic hedging programme," he said.

AmBank Group chief economist Anthony Dass said despite a challenging 2019 bond market outlook, the country's overall healthy macro fundamentals supported by current account surplus, low inflation, steady growth and healthy reserves would continue to support the bond market.

Nor Zahidi: Malaysia's bond market is unlikely to be materially affected, barring a pronounced global downturn.

"Liquidity remains ample and we have adequate ammunition to address an issues relating to liquidity in the event it creeps up in the future.

"Our policies are pragmatic as it includes flexibility accorded by a floating exchange rate and strong external balance," he noted.

Dass said the Malaysian bond market is expected to benefit from the inflow of funds into the emerging market where growth remains attractive with increasing room for monetary easing and fiscal support in some of the economies, especially with growing odds of the US Fed to cut rates in the second half of the year.

The country's debt market was more sensitive to the announcement made by FTSE Russell on April 16 compared to the recent move by the US to include Malaysia on its list of currency manipulators, he said.

"With an estimated exposure of around US$8bil of Malaysian bonds in FTSE Russell's, their announcement saw MGS yields rose 15-20bps.

"Although our base projection for the 10-year MGS yield is 3.75% -3.80% in 2019, there is room for the 10-year MGS yields to reach 3.7% -3.75% supported by positive newsflows.

"Still, upside risk to our forecast remains on our cards, projected to reach 3.90%–4.05% levels driven by external noises and/or domestic issues that results in strong capital outflow by investors who in turn would seek for safe haven assets," Dass said.

Bond Pricing Agency Malaysia Sdn Bhd (BPAM) CEO Meor Amri Meor Ayob said foreign funds may decide to adopt a wait-and-see stance.

With the Malaysian ringgit at around 4.1900-4.2000 against the US dollar and foreign holdings of MGS at multi-year lows of 37% as of April, it is fair to expect that the cheaper ringgit and relatively higher Malaysian bond yields will entice foreign money to return en masse as the Malaysian economic growth remains healthy and steady on the back of benign inflationary pressures.

"The dovish monetary policy adopted by global central banks including Malaysia in face of heightened US-Sino trade tensions will be a boon to the bond market due to flight-to-safety flows.

"The resilience of the Malaysian bond market is proven by the benchmark Thomson Reuters BPAM All Bond Index which has always demonstrated a positive drift over the years that transcend good times and bad times," Meor Amri said.

Malaysian Rating Corp Bhd chief economist Nor Zahidi Alias felt that the inclusion of Malaysia in the US watchlist for currency manipulation would not materially affect its attractiveness as an investment destination for bond asset managers.

Yields, he said, remain generally attractive; economic growth continues to outpace those of its A-rated peers. FTSE-Russell's decision and the WGBI issue would, to a large extent, determine the trend of capital flows. And this would likely have an impact on the ringgit-US dollar exchange rate, he said.

"In the last two episodes of capital outflows, foreign holdings of Malaysian bonds fell by roughly RM28bil (during the Taper Tantrum) and RM63bil (during the Trump rhetoric). Accordingly, the ringgit depreciated by roughly 6%-7% during these two episodes," Zahidi said.

High-growth Asian economies will remain attractive. So Malaysia's bond market is unlikely to be materially affected, barring a pronounced global downturn, he said.

RAM Ratings head of research Kristina Fong felt the lack of clarity of what the US Treasury report on foreign exchange operations of US trading partners actually may precede to, and may cause some risk aversion.

"Foreign investors may further rationalise their bond holdings in the domestic market due to the prevailing risk-off sentiment.

"Some investors may also perceive the recent US Treasury announcement as a precursor to a wider net of tariffs on US trade partners with whom are at surplus with the US, which may exacerbate the flight to safety flows," she noted.

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