

MGS hit badly by fund outflows

Analysts and traders remain cautiously positive on the local bond market outlook



by Dinesh Immanuel

MALAYSIAN Government Securities (MGS) is one of the worst-hit debt instruments thus far on the capital markets, as foreign funds flow out of the country.

Government-issued bonds are experiencing capital flight as foreigners trimmed their holdings with some RM11 bil of government bonds matured on Sept 30. The maturing of the bonds put a spotlight on how the bondholders, especially foreigners, are going to utilise their gains. Foreigners hold about 46% of the MGS issued.

"MGS became the casualty of outflows. In August, foreign investors reduced their holdings of MGS to RM157.4 bil or 46.4%, compared to 47.8% in July and 48.5% in June, of the total MGS outstanding in the market. However, foreign holdings of [Malaysian] Government Investment Issues (GII) increased slightly to RM8.7 bil or 4.3% of the total GII outstanding. As at end-August, outflows from total debt securities now totalled RM28.1 bil [for the year]," notes BMB Securities Research.

Market observers are speculating that some fund managers may resort to pulling out as much as US\$1 bil (RM4.4 bil) from Malaysia's bond market. Nevertheless, some economists have dismissed it as mere speculation. Bank Negara Malaysia governor Tan Sri Dr Zeti Akhtar Aziz says that the local bond market will not collapse. According to Zeti, local funds such as the Employees Provident Fund (EPF), Permodalan Nasional Bhd (PNB) and Lembaga Tabung Haji will move in to buy up the bonds.

The capital markets, including the

Malaysian bond market, are not spared from negative sentiments this year. The local bond market saw muted activity so far this year as investors deal with a host of less than desirable market conditions.

"Heightened expectations of a rate hike by the US Federal Reserve and persistent weak global crude oil prices have been weighing upon the local bond market," Bond Pricing Agency Malaysia CEO Meor Amri Meor Ayob tells *FocusM*.

On the corporate side, the weak ringgit and poor sentiment have lessened general interest in local bonds and has made it more expensive for companies to issue bonds. Higher premiums are now needed to attract investors.

Positive outlook for local debt market

However, despite the market being hit by foreign capital outflows and the underlying effects of the weak ringgit,



According to Zeti, local funds such as the Employees Provident Fund, Permodalan Nasional Bhd and Lembaga Tabung Haji will move in to buy up the bonds if needed

analysts and traders remain hopeful of the positive outlook for the local debt securities market.

Analysts say the bond market is still "okay." "The local bond market is seeing lower activity but in actuality it is still not much lower compared to last year. Like the equity markets, basically sentiment is poor. There has been some foreign money outflow," an economist tells *FocusM*.

The economist who tracks bond notes, "There was a Bank Negara issue

on Sept 30 and traders say the take-up is 'okay'. It is not as poor as some had expected. Some of the negative sentiment is also due to speculative news, especially recently."

Corporate *sukuk* (Islamic bonds) has seen some activity lately. In the corporate *sukuk* arena, Tenaga Nasional Bhd recently announced plans for a RM10 bil *sukuk* in what would be Malaysia's third-largest. SapuraKencana Petroleum Bhd too issued RM845.8 mil *sukuk* earlier last month.

According to Bloomberg data, corporate *sukuk* issues have fallen by 37% this year from last year - the lowest since 2010.

Foreign outflows

It appears that it is not only the local equity market which has come under the onslaught of a foreign investor sell-down this year. According to Bank Negara data, foreign investors have trimmed their holdings of Malaysian debt securities.

Data compiled by BMB Securities show that the local bond market saw net foreign outflows to the tune of RM8.9 bil in August. The recent outflow brings down foreign holdings of Malaysia's total debt securities to just under RM198 bil from RM207 bil in July. According to BMB, the latest foreign holdings figures are the lowest since June 2012, when foreigners held some RM188 bil of Malaysian debt securities.

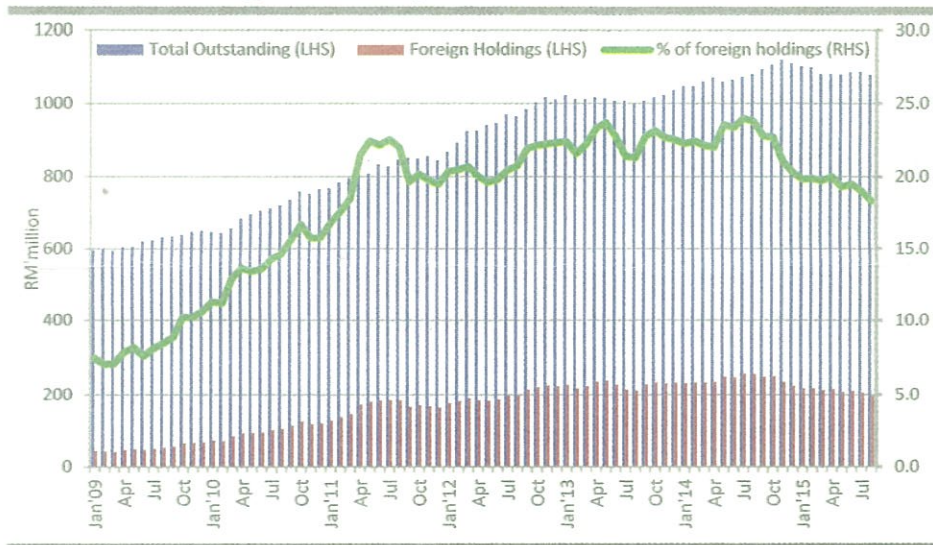
In comparison, the foreign selling of Malaysia bonds is worse than the capital flight from the equity market. According to MIDF Research, foreign investors have sold off RM17.7 bil from Bursa year-to-date.

The situation in the bond market appears to carry similar overtones regionally, especially Indonesia. Bloomberg data show that foreign funds have pulled money from Indonesian bonds in the last quarter for the first time since 2012, citing the weak rupiah.

Similarly, the prolonged weak ringgit could further motivate foreign investors to trim their holdings of local bonds and lessen their attraction to new local issues.

Nevertheless, observers are cautiously positive on the overall outlook. "Outlook is just okay. Nothing overly positive to focus on yet still outlook isn't negative also," the economist says. *FocusM*

Foreign holdings of Malaysia debt securities



Source: Bank Negara Malaysia, BMB Securities

With weak ringgit, MGS appears inexpensive

FOCUS Malaysia spoke to the CEO of Bond Pricing Agency Malaysia, Meor Amri Meor Ayob on his views about the current bond market outlook. The following are excerpts of the email interview:

FocusM: In general, how is the bond market performing?

Meor: To sum it up, Malaysian Government Securities (MGS) has taken the most hits from the foreign capital flight. The Private Debt Securities (PDS) market, although relatively less affected at this moment, was not entirely spared from the rising benchmark rates.

Therefore, corporate issuers were mostly on the sidelines and had begun slowing down their pace of bond issuance since MGS yields started to rise in the second quarter of this year.

In the primary market, the sovereign

bond issuance for the first three quarters of this year amounting to RM78.5 bil had actually surpassed the total issuance for the same period last year by RM4.9 bil. As for the PDS, the issuance size has decreased by approximately 22.3% to RM43.8 bil from RM56.4 bil during the same period.

Year-to-date, the 10-year MGS yield has gone up by 27.5 basis points (bps) to 4.377% while the 10-year Islamic Corporate AAA bond yield has increased by 13bps to 4.840% (as of Sept 28).

What has been the impact of the prolonged weak ringgit?

Generally, the weak ringgit did not bode well for the local bond market as foreign holdings of MGS were still at a relatively high level.

The weak ringgit could have prompted foreign investors to trim their MGS holdings recently to contain the forex losses. This also

Meor says the weak ringgit could present foreign investors a perfect timing to accumulate quality local assets like the MGS



limited their exposure to ringgit-denominated assets. Additionally, heightened expectations of a rate hike by the US Federal Reserve and persistent weak global crude oil prices have been weighing upon the local bond market.

Moving forward, should the ringgit remain weak, this could present foreign investors a perfect timing to accumulate quality local assets like the MGS, which has never defaulted before, at relatively inexpensive prices.

Moreover, the fundamentals of the economy and banking system remain sound and solid.

How are corporate bond issuances faring against government issues?

It depends on whether it is the primary or secondary market.

In the primary market, the issuance size in the MGS segment has actually gone up but for the PDS, the issuance size has shrunk.

Generally speaking, MGS is more volatile in the face of the challenging external environment but if MGS yields settle at these higher levels, PDS yields will eventually catch up as credit spreads normalise.

Why have MGS issues been seeing fewer bids?

This is due to market sentiments towards the MGS and issues surrounding the country.

For instance, low crude oil prices and US Fed rate hike expectations, have resulted in rising MGS yields and a weaker ringgit, thus pushing market players to the sidelines and hence, fewer bids seen in the market.

If this trend persists, the impact will be higher issuance cost for the government and corporate sectors.