QUOTE OF THE WEEK

TWO THINGS ARE INFINITE: THE UNIVERSE AND HUMAN STUPIDITY; AND I'M NOT SURE ABOUT THE UNIVERSE | ALBERT EINSTEIN

THE WALL

NEWS

Local bonds to continue providing steady income

BY **KUEK SER KWANG ZHE** AND **PATHMA SUBRAMANIAM**

Despite the worst quarterly loss in six years for local currency bonds, and battling the perception of junk status, industry professionals remain positive on the outlook for the local bond market over the next 12 months.

Bond Pricing Agency Malaysia Sdn Bhd CEO Meor Amri Meor Ayob says the bond market will still be able to give investors a steady stream of income in the coming year, as compared with the stock market, despite the challenging landscape.

"The Malaysian bond market has had a compound annual return of about 4.2% in the past seven years. And based on the TR BPAM All Bond Index, the local bond market has not seen a negative return on a yearly basis since the inception of the index. This has reinforced the fact that the bond market is relatively safer than the stock market."

From the perspective of yield, investors should be able to see "value" in Malaysian Government Securities (MGS) at current levels, says Meor Amri. "As long as investors are comfortable with the yields offered, they should stay invested. Seasoned investors would know that it is almost impossible to pick a market bottom or top."

MGS yields rose 15 basis points (bps) to 40bps in the 3-year to 20-year tenors in the third quarter (3Q2015), he adds.

According to a Sept 30 Bloomberg news report, Malaysian local currency bonds fell 1% in 3Q2015, the biggest drop since June 2009, according to the JPMorgan Chase & Co index. In the same report, it said the CMA Credit Default "five-year credit-default swaps insuring debt rose more than one percentage point to 247, the highest level since 2009..."

RAM Rating Services Bhd deputy CEO Promod Das says that despite Moody's Investors Service's market-implied rating that credit default swap (CDS) investors perceive Malaysian bonds as junk bonds, the country's sovereign fundamentals are still better than those of its regional peers.

"If you look past the noise, it can be observed that Malaysia's sovereign fundamentals are still within the single A sovereign international scale rating parameters, which is still a better investment grade ranking than some of its regional peers," he adds.

"Even though the Malaysian economy is expected to slow in the second half, we still expect gross domestic product growth in 2015 to record a decent 4.9%, relative to Thailand's 2.7% and Indonesia's 4.7%."

Promod also says it is important to note that Malaysia's resilience during turbulent times stems from its position as a diversified economy backed by a robust banking system.

"Malaysia's foreign exchange reserve buffers that have been built over several years for the 'rainy day' moments we are experiencing now are strong enough to support seven months of retained imports, which is more than double the International Monetary Fund's three months prudential recommendation," he says.

Lee Heng Guie, an independent economist, concurs with the view that it is "totally misleading" to equate Malaysia's sovereign bond rating status with the likes of Brazil and South Africa, as it does not reflect the country's fundamentals.

"The Malaysian government has a good track record of meeting its debt obligations. It has never defaulted on its debt obligations," he says.

According to RAM's forecast, the local corporate bond market will glide down to the RM75 billion to RM85 billion range in the face of a slowing economy, which Promod says is "still healthy". This compares with the RM92 billion achieved last year.

He says the domestic bond market remains a resilient part of the Malaysian capital market. As at end-September, gross government securities and private debt securities (PDS) issuance were RM83.7 billion and RM60.7 billion respectively.

"We have also observed that the proportion of foreign ownership in outstanding MGS and PDS was relatively stable through the year to end-August, at 46% and 2.6% respectively," he adds.

But there may be some moderation in physical investment activities in the coming year, which may impact funding through the PDS, Promod says, adding that PDS issuances to the infrastructure and financial services sectors will continue to buttress the corporate bond market.

Lim Teck Ghee, CEO of the Centre for Policy Initiatives in Malaysia, says the bond market is one of few financial instruments that indicate the fiscal health of a nation. The recent losses and poor perception indicate a much larger problem that should be addressed before it is too late, he points out.

"The biggest concern for Malaysia is not the day-to-day gyrations and performance of the bond market. These do not affect the public or man in the street much. It is the possibility of a catastrophic meltdown — and the ripple effects across the entire economy and society — should there be racial violence or some act of terrorism, which signals to the country and the world that the government has lost control of the situation," he says.

"This is what our decision-makers and leaders should be most concerned about rather than what bond traders are doing. Unfortunately, recent events have shown that there is little or no political will to address this danger. In fact, some members of the ruling party appear to be involved in instigating or inflaming racial unrest and are getting away with it. They are providing disincentives to anyone holding or intending to invest in Malaysian bonds."

FED HIKE, BUDGET 2016 WILL IMPACT BONDS

There will be challenges ahead. Meor Amri says one of the challenges faced by the local bond market is obviously the ongoing uncertainty of the timing of the US Federal Reserve's interest rate hike.

The recent lower-than-expected job figures in the US, which added 142,000 jobs in September, were lower than the 205,000 forecast by economists. This may prolong the period of uncertainty as the market expects the Fed to delay the rate hike, he adds.

"Besides, the eventual rate hike by the Fed is expected to affect the Malaysian bond market, especially as the MGS foreign holdings, which were at a relatively high level of 46% at end-August. Nonetheless, the impact on the local bond market will probably not be as bad as initially thought. This is due to the fact that most of the rate hike expectations have already been priced in."

Bond investors are actually more concerned about domestic issues such as economic growth, inflation expectation, government fiscal policy and Malaysia's credit standing, says Meor Amri.

"However, any favourable budget announcement or positive surprise in the economic data releases, such as better-than-expected growth in the economy, will likely boost the bond market," he adds.

Second Finance Minister Datuk Seri Ahmad Husni Hanadzlah said Oct 1 that the government will announce a slightly higher budget for 2016 to implement the 11th Malaysia Plan and boost the economy.

While Budget 2016 is expected to have a positive effect on the bond market, Lee says budget quality remains a challenge. "Investors are keeping an eye on Budget 2016 for a near and medium-term direction to shelter Malaysia against domestic tailwinds and external headwinds. However, budget quality remains a challenge, given the need to balance between expectations and fiscal prudence," he adds.

"What investors are looking for are credible and responsible measures and spending programmes that can help sustain Malaysia's economic resilience and enhance its economic growth potential and investment opportunities.

"Besides maintaining a business-friendly environment, the government needs to reassure domestic and foreign investors' confidence in the factors that have long made Malaysia an attractive investment destination, namely political stability, strictest standards of good governance and integrity of public institutions." E

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