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Budget to set tone for bond market

nvestors expected to ride :hrough increased volatility

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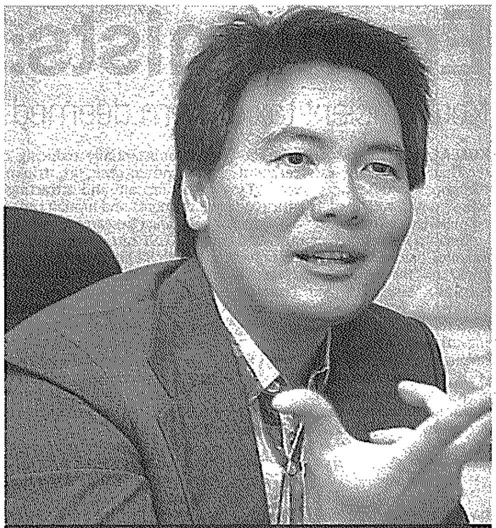
PETALING JAYA: Malaysia's economic conditions and the soon-to-be-announced Budget 2014 will set the tone for the domestic local bond market for the rest of the year and 2014, rather than the United States' looming debt ceiling and partial government shutdown, said industry observers.

RAM Holdings Bhd chief economist Dr Yeah Kim Leng said that unless there was a US sovereign debt default, investors would likely shrug off the US budget and raising of the debt ceiling deadline by Oct 17.

He said Malaysian bond investors, in all likelihood, would ride through the increased volatility with their eyes fixed on Malaysia's Budget 2014, due to be announced on Oct 25.



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Yeah said investors would be looking for clues in the ringgit bond market outlook as shaped by how the Government tackles the various short and medium-term fiscal challenges.

The respite from the postponed tapering of the US quantitative easing (QE) and mild knock-on effects of the partial US government shutdown and looming debt ceiling had, in some ways, "prepared" market participants for an increase in market volatility, interest rates and credit risk premium in the coming year, he said.

"While foreign inflows may taper off next year, we see ample domestic liquidity and a strong pipeline of issuers to sustain local bond market activities in 2014, albeit at a slower pace given the already high level of government and private sector indebtedness, as well as expectations of a rise in interest rates and inflation.

"The Malaysian bond yield curve is expected to normalise further next year, with a slight uptick across the tenures. However, borrowers would still find it relatively cheap to lock in long-term funding," he told *StarBiz*.

OCBC Bank (M) Bhd head of global treasury Ng Seow Pang said Malaysian yields would likely be pushed lower in the short term if talks on the debt ceiling in the United States prolonged, leading investors to review the US credit worthiness and a possible capital outflow from there.

But over the longer term, he said the bond market would take the cue from Budget 2014.

"The US QE would continue to support financial assets globally, but Malaysia's fundamentals would need to be sound and attractive. At this stage, we continue to look to the Government to provide the correct fundamentals for the country to operate at a competitive level.

"The outlook for local bonds for the rest of the year, and indeed the next, depends primarily on what the budget has to offer," he noted.

The most important element that would impact the bond market would be domestic economic conditions, according to Bond Pricing Agency Malaysia chief executive officer Meor Amri Meor Ayob.

This, he added, would include data like Malaysia's gross domestic product (GDP) growth, trade and current account surplus, fiscal deficit, debt-to-GDP ratio and the inflation outlook.

Since the US government shutdown on Oct 1, the local bond market had responded favourably rather than adversely, he said. The three-year Malaysian Government Securities (MGS) yield has fallen 13 basis points (bps) from 3.43% to 3.30% and the five-year MGS yield has shed 14 bps from 3.61% to 3.47% from Sept 30 to Oct 4.

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- OCBC's Ng Seow Pang

The US Treasuries were also rather muted after the news, as it had already been priced in, he said, adding that the 10-year US Treasuries yield had hovered around 2.62% to 2.66% for the entire week.

Malaysian Rating Corp Bhd chief economist Nor Zahidi Alias, meanwhile, feels that if the deadlock (on debt ceiling) persists and the sentiment in the financial market turns sour, then yields may spike temporarily.

But such increases, he said, would not likely last for too long and any jitters over the United Sttaes would likely push investors back into emerging markets and temporarily lead to the strengthening of their currencies.