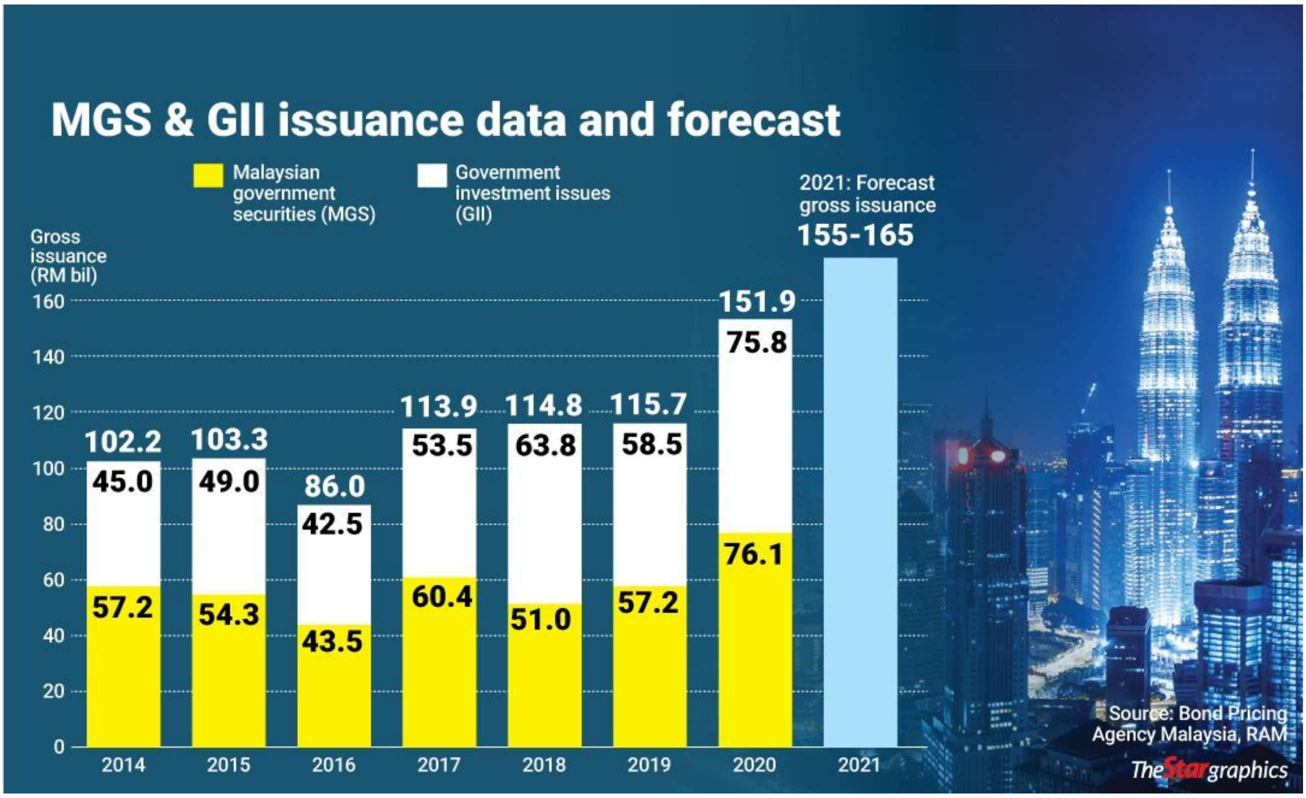
High demand seen for bonds

DALJIT DHESI DECEMBER 06, 2021



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PETALING JAYA: The demand for Malaysian bonds is expected to remain buoyant in the medium to long term, although there could be pressure posed by the more transmissible Omicron variant of the Covid-19 on the foreign holdings of ringgit bonds.

Economists and bond analysts said it was still early to tell how this variant may impact the foreign flows into the domestic bond market, as more information is needed to see how virulent the new strain is and the efficacy of the current vaccines.

Other hurdles also await the ringgit bond market. The market may feel the heat in the form of quantitative easing (QE) or tapering of asset purchases by the United States Federal Reserve (Fed) and the timing of the US interest rate hike in 2022, which could trigger foreign outflows from the local bond market.

By the Fed cutting back or tapering on its bond buying, it can result in higher treasury yields in the US, hence luring foreign investors in emerging markets, including Malaysia, to seek higher yields or returns in the US. Bond prices and yields are inversely related.

RAM Rating Services Bhd senior economist Woon Khai Jhek told StarBiz it was still too early

RAM Rating Services senior economist Woon Khai Jhek

"Risk aversion is likely to prevail over the near term, as the variant could threaten the reopening of borders and economic activity, which will further impact the economic growth for countries in 2022.

"The market will also be swayed by other factors such as the tapering of the asset purchase programme by the US Fed and the timing of the US interest rate hike in 2022," he said.

Woon, however, said over the medium to long term, foreign investors' interest would still be supported by the attractive Malaysian yield spread against developed market bonds, albeit capital inflow next year likely to be weaker than in 2021.

The yield differential between 10-year Malaysian government securities (MGS) and US treasuries (UST) has largely hovered above the 200 basis points (bps)-mark since September, he said, which makes buying MGS more attractive due to higher returns.

Foreign net purchase of Malaysian bonds rebounded in October this year despite the broad market selloff over the same period. The overall foreign net inflow accelerated to RM2.9bil in October from RM0.6bil the preceding month.

This was mainly led by the resurgence in demand for MGS and government investment issues (GII), which recorded a net inflow of RM5.4bil, reversing the net outflow of RM215.7mil in September.

OCBC Bank (M) Bhd head of global treasury Stantley Tan expects the demand for bonds to remain strong even though the country struggled to contain the pandemic for the better part of 2021 until September, when the high nationwide vaccination rate enabled the economy to reopen.

OCBC Bank (M) Bhd head of global treasury Stantley Tan

"For now, our base case is that demand will not be seriously affected by the latest Omicron variant, unless hospitalisation rates get to worrying levels," he said.

"As for the Fed tapering and rising inflation, the relatively high ringgit exchange rates will serve as a buffer before any significant outflows from the ringgit bond market, given that Bank Negara did not cut interest rates as much as most major central banks," he noted.

Going by statistics, he said foreigners have been net buyers of ringgit bonds to the tune of RM31bil for 2021, with net inflows for eight out of the last 10 months. The percentage of these bonds held by foreigners has also climbed steadily from a low of 23.11% in April 2020 to 27.1% in October 2021, he said.

OCBC's Tan foresees the main challenge for bonds for the remainder of 2021 being the evolving Omicron variant. While Malaysia now boasts one of the highest vaccination rates in the region, he said it remains to be seen if this would be effective against the new variant.

Maybank Kim Eng Group head of fixed income research, Winson Phoon, expects choppy foreign flows next year, given the uncertainties posed by the US Fed tightening.

Maybank Kim Eng Group head of fixed income research Winson Phoon

He said the impact of the Omicron variant was highly uncertain in terms of its severity and longevity of its impact on the economy.

"While it may create demand shock to the global economy, it could also extend the global supply-chain disruptions that add upward pressure on inflation, putting the Fed in a more precarious conundrum on rate decision," he said.

In terms of bond yields, Phoon said it has been a challenging year for the ringgit government bonds in 2021, with a year-to-date loss in total returns, but expecting a better 2022.

He said the domestic demand for ringgit bonds, coming from both the pension funds and banks, is expected to remain healthy.

Phoon is neutral on the MGS. "We forecast the 10-year MGS yield to hover at 3.50% by year-end and 3.55% by the middle of next year.

"We are still mildly bullish on the duration, preferring long bonds because this part of the curve is less sensitive to rate hikes, and as a hedge against the risk of a shorter economic cycle," he said.

On the bond issuance, he is projecting a government bond issuance of about RM160bil this year and for next year. For private debt securities (PDS) or corporate bonds, Maybank Kim Eng is forecasting a higher RM120bil gross issuance in 2022 compared with RM110bil this year.

RAM's Woon said the rating agency is maintaining its current gross corporate bond issuance projection for 2021 at between RM100bil and RM110bil (2020: RM104.6bil).

Year-to-date as of October 2021, RM92.8bil of corporate bonds had been issued, he said, signalling healthy financing and corporate investment activity.

As for MGS/GII, he said RAM is maintaining its projection at between RM155bil and RM165bil for 2021 (2020: RM151.9bil). Cumulative gross issuance for the first 10 months of this year is currently at RM140bil.

Bond Pricing Agency Malaysia CEO Meor Amri Meor Ayob felt foreign demand for Malaysian bonds may be impacted to a certain extent, as investors may view the current yields offered in the ringgit bond market to be less attractive.

Bond Pricing Agency CEO Meor Amri Meor Ayob

This is in view of the quickened interest rate hike expectations abroad coupled with the laggard economic conditions in the country, he noted.

"All in all, the current situation with regard to the monetary policy and inflation expectation as well as the implications brought on by the Omicron variant remain very fluid. In fact, the bond market performance has demonstrated this trait with the observed heightened volatility.

"Investors should go back to the fundamentals and at least take a medium term view instead of a short term stance.

"Barring any negative developments of the variant that could possibly spur safe haven flows, Malaysian bond yields, especially the MGS and GII yields would probably follow US Treasury yields to trend higher if Fed decides to walk the talk by communicating the will to increase the pace of tapering in the Federal Open Market Committee meeting on Dec 14 and 15," Meor Amri said.