Investors more attracted to government bonds

by daljit dhesi

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MORE longer dated tenures for bonds are in the pipeline, with investors continuing to show stronger interest in government bonds over corporate bonds.

Amid the current low interest rate environment, coupled with the roll-out of infrastructure and utility projects, among others, analysts say that the bond market would stay vibrant with issuers aiming for longer tenure bonds with lower yields.

Maybank Investment Bank fixed-income analyst Winson Phoon tells *StarBizWeek* he expects more investors to tap longer tenure bonds (i.e. 10 years or more) despite the challenging market and economic conditions.

He feel this is the case, especially for government bonds issuance, which will see notably higher supply of duration, with the supply of longer-dated bonds (10 years or more) almost doubling year-on-year (2016 versus 2015).

This is because the Government, he adds, needs to issue more long-tenure bonds to avoid the concentration of maturity that will raise refinancing risk.

Government bonds include Malaysian government securities (MGS) and Government investment issue (GII).

Phoon says the bank is maintaining its projection of bond issues for this year at between RM70bil and RM80bil for private debt securities (PDS) and RM87bil for government bonds.

CIMB Group head of treasury and markets Chu Kok Wei says he expects Government bond funding requirements to be more than PDS financing as the Government will likely refinance the entire MGS/GII which are maturing this year to ensure there is sufficient supply to meet the liquidity needs of the market.

The banking group is maintaining its forecast on gross government bond offerings of between RM87bil and RM87.5bil versus the PDS issuance of between RM70bil and RM75bil this year.

In the MGS and GII space, Chu says based on Bank Negara's 2016 MGS auction calendar, the upcoming issuances are also skewed towards longer tenures ie 10, 15 and 20-year papers, adding that the most recent 30-year MGS tender received fairly good demand from investors with a bid to cover ratio of 2.6 times.

Meanwhile, CIMB Investment Bank senior managing director and global head of capital markets Nor Masliza Sulaiman says based on the recent PDS trades done in the market, there are more bond issues with longer tenures (10 years and above) as issuers take advantage of the current low interest rate environment to borrow for longer term to lengthen their debt maturity profile. Additionally, she notes that the requirements are likely to be heavier towards longer term funding, especially for issuances relating to project financing transactions.

Last month, Bank Negara said there were now more foreign governments and central banks holding MGS. A total of 29% was held by these two groups and 13% by pension funds.

Nomura research in a note on April 7 said Malaysia's debt markets saw inflows of RM11.5bil, versus RM1.4bil of outflows in February. The March foreign inflow was the largest monthly inflow since May 2014.

Meanwhile, overseas fund managers increased their holdings of government bonds by RM10bil last month – the largest monthly rise since April 2015, the Japanese research house said.

International Trade and Industry Minister II Datuk Seri Ong Ka Chuan, in a recent interview with *StarBiz*, said that the government of China had started buying more MGS and this inflow of new foreign money could rise to 50 billion yuan (RM30bil) in total.

On the yield spread between MGS and PDS, Bond Pricing Agency Malaysia chief executive Meor Amri Meor Ayob says the credit spread between MGS and PDS is unlikely to widen further from the current level.

More often than not, he adds the PDS yield would lag the movement of the MGS yield. Since MGS yield has started to trend lower recently, PDS yield is likely to follow suit to a certain extent, thus narrowing the spread between MGS and PDS instead, Meor notes.

"Since beginning of the year, the yields in the longer end have declined more than the shorter end of the curve for both MGS and PDS (bull flattening). Between January 4 and March 21, the 3-year MGS yield was relatively unchanged but the 10-year MGS yield has shed 30 basis points. The same phenomenon was observed in the PDS segment as well with the 10-year yield in the Islamic corporate *AAA* curve shedding more than the 3-year yield during the same period.

"Barring any unforeseen circumstances, it is possible for yields to go lower as international investors started to readjust their portfolio allocation following the recent dovish monetary policy statement released by the US Federal Reserve," he notes.

Phoon adds yield levels should remain stable in the next one to two months, noting that he expect the return of volatility in the second half of this year or around mid-year amid challenging global economic outlook. Volatility risk asides, he expects yields to stay within reasonably affordable levels (for debt funding activities) with, for example, the 10-year MGS yield probably averaging 4% this year.

Malaysian Rating Corp Bhd chief economist Nor Zahidi Alias adds that going forward he feels the primary corporate debt market activities could be weighed down by weaker momentum of the domestic economy.

"As such, we are anticipating weaker PDS supply in 2016 as compared to 2015. A challenging economic environment and subdued private investment trend will induce corporates to be more cautious in their expansion and capital expenditure spending. As such, we are maintaining our forecast for gross corporate bond issuance to be in the region of RM65bil to RM75bil this year.

"As in the past, the financial services, infrastructure and utilities sectors will likely continue to dominate primary market activities. Notable issuances year to date include RM3bil by Prasarana Malaysia Bhd, RM1.75bil by Pengurusan Air SPV Bhd, RM1bil by EKVE Sdn Bhd and RM1.9bil by Cagamas Bhd, which, other than Prasarana, are from these two sectors. Thus, for 2016, we expect this trend to prevail i.e. significant financing via PDS from infrastructure and utilities, and financial services sectors," he says.

RAM Ratings economist Kristina Fong says the MGS 10-year benchmark yield that had been trending above 4% at the height of the market volatility in the third quarter of last year, remained below this level in the first two months of this year.

As the market further stabilizes, yield curves may flatten somewhat with greater diversification of investor portfolios across the maturity spectrum, she points out.

Fong, meanwhile, expects gross PDS and government securities issuances to reach between RM75bil and RM85bil and between RM90bil and RM100bil respectively this year.

Last year, gross government securities totalled RM106.5bil and total PDS stood at RM85.9bil.

She says although the recalibration of Budget 2016 has rationalised some development expenditure, the rating agency expects high impact projects and those already under way will continue to tap the bond market.