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Fund managers remain bullish on Malaysian bonds despite QE tapering

by daljit dhesi

Toh says the long term demand for bonds will continue to grow.

PETALING JAYA: Fund managers remain bullish on the local bond market despite the possibility of further hikes in Malaysian bond yields resulting in higher borrowing costs from the US Federal Reserve's (Fed) move to cut monthly bond purchases coupled with inflationary pressure in the domestic market.

Areca Capital Sdn Bhd chief investment officer of fixed income Edward Iskandar Toh told *StarBiz* that although the move to cut quantitative easing (QE) and inflation could exert upward pressure on yield curves, bond portfolio managers remain optimistic, as long-term demand for bonds, which provide a source of stable income, would continue to grow.

QE refers to bond purchases by the Fed to stimulate economic growth. The Federal Open Market Committee announced on Dec 18 that it would cut its monthly bond purchases to US$75bil from US$85bil beginning January this year.

Although the local yield curve faces steepening pressure, he said bonds provided continuous regular income while limiting the effects of rising rates.

He envisages policy interest rates as not likely to move up in any substantial manner this year, a prospect which is likely to see bonds featuring significantly in fund managers' overall portfolio.

In terms of projecting the level or range of bond yields this year, Toh said it could either overshoot by 25 to 50 basis points (bps) or correct downwards by a similar range.

The bond market, he noted, has "absorbed" the tapering of the US bond-buying issue well, as adjustments to this phenomenon began more than six months ago, adding that any rise would likely be limited in the current environment.

Bloomberg has reported that borrowing costs in Malaysia are rising, adding that the yield on the 3.48% sovereign notes due March 2023 had climbed to 4.19% on Jan 6, the highest since the debt was sold in March last year. CIMB Research in a recent note predicted the yield of the benchmark 10-year Malaysian Government Securities (MGS) at between 4.2% and 4.25% this year.

Malaysian Rating Corporation Bhd chief economist Nor Zahidi Alias said the rating agency was of the view that there was an upside bias for MGS yields, and expects the yield curve to steepen further.

He attributed this, among others, to the improving US economy and labour market, which would warrant the Fed to continue its tapering action at a measured pace in 2014.

"Another reason for the yield curve to rise could be from the stronger consumer price index growth in the country, especially in the second half of this year on the back of the resumption of the subsidy rationalisation and the rollout of the goods and services tax planned for April 2015. This would further exert upward pressures on bond yields.

"We believe Bank Negara will raise the benchmark overnight policy rate by 25 bps in order to be ahead of the curve in dealing with higher consumer prices and possible capital outflows in 2014," Zahidi noted.

Notwithstanding the rising yields, he said the MGS would be sufficiently supported by demand from institutional investors, adding that foreign investors with long-term investment horizons would not totally abandon the local Government papers, as they are less influenced by changes in the Fed's monetary policy stance and tend to focus more on Malaysia's long-term economic fundamentals.

Bond Pricing Agency Malaysia chief executive officer Meor Amri Meor Ayob concurred, adding that the domestic bond market had already priced in most of the news before the Fed's decision to taper its QE programme.

“At thispoint, the much-talked-about capital flight from the country has not materialised due to the measures and steps taken by the Government to rein in the country’s fiscal deficit since September. In fact, Moody’s Investors Service has since upgraded the Malaysian credit outlook to positive from stable.

“That said, domestic inflation is going to play a major part in 2014, as well-anchored inflation data would decrease the volatility in the Malaysian bond market as global economies are expected to grow modestly in 2014,” he noted.