Ringgit bonds to maintain steady momentum

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MARKETS

Monday, 12 Feb 2024

RAM Rating Services Bhd senior economist and head of economic research Woon Khai Jhek

PETALING JAYA: The ringgit bond market, which saw overall net foreign inflow amounting to RM23.6bil last year, is set to continue its momentum in 2024, underpinned by anticipation of falling global interest rates.

As global interest rates are expected to decline this year and moving forward, bond strategists and economists said foreign investors would be keen on buying longer-dated government bonds compared to shorter duration papers due to their attractiveness.

Furthermore, they said longer-dated government bonds are relatively more liquid than corporate bonds.

Government bonds include Malaysian Government Securities (MGS) and Government Investment Issues (GII). Foreign investor participation has historically been in the MGS space.

Of the total foreign investor holdings of ringgit bonds in Malaysia, approximately 75% are in MGS. This composition is not expected to change significantly in the near term.

RAM Rating Services Bhd senior economist and head of economic research Woon Khai Jhek told StarBiz he expects the ringgit bond market to maintain its momentum and continue to chart an overall net foreign fund inflow this year on the back of falling interest rates globally.

He said foreign participation in the bond market increased markedly last year as overall net inflow totalled RM23.6bil, reversing from a net outflow of RM9.8bil in 2022.

He attributed this improved investor sentiment to the possibility of the US fed fund rates having peaked and rate cuts heading into 2024.

The US Federal Reserve (Fed) at its last January Federal Open Market Committee meeting left the fed fund rate unchanged at between 5.25% and 5.5%.

With the Fed widely expected to cut interest rates in 2024, Woon said this would help improve market sentiment and increase investor appetite for riskier emerging market (EM) bonds, including Malaysian bonds.

"Furthermore, with the overnight policy rate (OPR) widely expected to stay unchanged through this year, the interest rate differential between MGS and US Treasury yields (UST) should turn even more favourable for local bonds as the US rates start to decline.

"The average MGS-UST yield differential narrowed to minus 23.1 basis points (bps) in January as markets start to price in for incoming rate cuts this year.

"This is a notably more attractive rate differential compared to the average of around minus 70.9 bps in October 2023," he noted.

Based on the last "dot-plot" published in December 2023, the Fed is projecting three 25-bps rate cuts this year, an upgrade from just two cuts forecast in September 2023. Four more 25 bps cuts are also expected for 2025.

“As we draw closer to these rate cuts, the yield differential should gradually turn more favourable for domestic bonds,” he said.

Nonetheless, Woon opined there would be some volatility in the near term as investors assess the aggressiveness of the Fed in loosening monetary policy this year.

Bond Pricing Agency CEO Meor Amri Meor Ayob

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Bond Pricing Agency Malaysia (BPAM) chief executive officer Meor Amri Meor Ayob is bullish on the local bond market.

He said the ringgit bond market is expected to hold up well against the lukewarm performance of the domestic stock market in flight-to-quality flow.

He said factors that will drive its growth include expectations of a lower fiscal deficit due to the subsidy rationalisation programme and a variety of new taxes introduced, coupled with anticipations that the Fed may start to cut the Fed fund rate this year, probably as early as May.

"Interest rate cuts by the Fed is a boon for EM assets like the ringgit bond and sukuk.

"Foreign investors will flock to the domestic bond market once the Fed begins cutting the benchmark Fed fund rate, given the relatively cheap ringgit at the moment.

"On top of that, structural reforms in the public service sector will surely boost the confidence of international investors," Meor Amri said.

HSBC head of Asia-Pacific rates strategy Tan Pin Ru

This is unlike in 2023, when market participants were regularly discussing the potential amount of additional policy tightening, which adversely affected bond market sentiment, she noted.

She expects more foreign inflows into the domestic bond market this year, adding that it will likely accelerate only after monetary easing begins in the United States, such that EM bonds start to look more attractive.

Tan said foreign investors are mostly invested into the MGS rather than corporate bonds.

"We favour long-dated MGS due to the presence of strong local demand for duration," she added.

BPAM's Meor Amri agreed, noting that foreign investors would invest in long-dated bonds this year and would most likely be in the MGS or GII space, as it is relatively more liquid compared to corporate bonds.

MARC Ratings Bhd chief economist Ray Choy

At the onset, MARC Ratings Bhd chief economist Ray Choy said foreign investors would likely start with short to medium-tenured bonds as the key theme relates to the anchoring of EMs' interest rates

He said longer-tenured bonds in Malaysia and EMs would eventually see interest as valuations lag, although sustaining foreign flows would require improvements in longer-term factors such as the sovereign credit rating, institutional and political quality of an economy.

Foreign investors coming to Malaysia have traditionally focused on MGS investments due to better liquidity and better awareness as compared to corporate bonds, he said.

He said foreign investors may have a general interest in the domestic government bond market due to stable interest rates expected in EM economies such as Malaysia, compared to the likely interest rate cuts in the United States, which would lift EM currencies.

“Nonetheless, the general market positive will be evaluated against the domestic situation of each country.

“In 2024, where majority of the world will experience elections, country-specific risk may rise, hence global investors will seek countries with solid institutions and political predictability.

“Malaysia is no different and has to progress towards exhibiting characteristics of institutional and socio-political quality,” Choy said.

In terms of bond projections for this year, he said MARC Ratings is expecting MGS and GII issuances to decrease to RM173bil from RM185bil in 2023, due to a lower budget deficit, while corporate bonds are projected to mildly increase to RM129bil from RM125bil last year.

RAM’s Woon said the rating agency expects corporate bond and sukuk financing to remain healthy with a pipeline of RM110bil to RM120bil in 2024 (2023: RM118.3bil).

This will be driven by private refinancing initiatives, continued infrastructure financing needs and financial institutions’ capital augmentation plans, he said.

“We project MGS and GII issuance to moderate slightly to around RM170bil to RM180bil (2023: RM190.9bil), underscored by the government’s smaller deficit financing requirement,” he said.