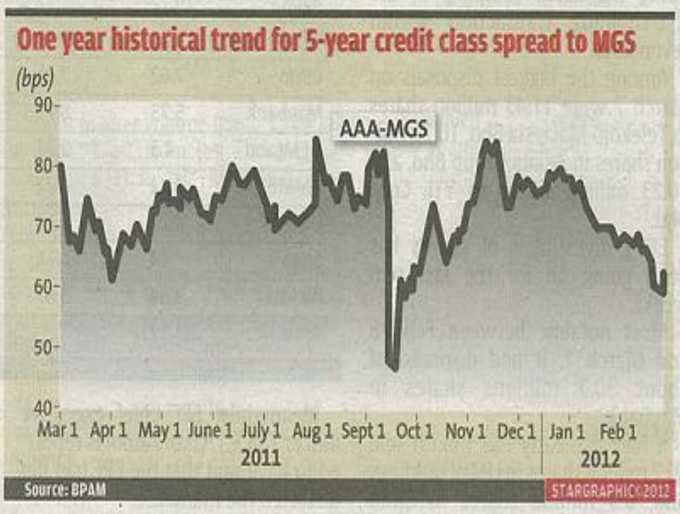
The Star, 13 March 2012

Wider credit yield spread?

If it happens, it could cause outflow of funds from domestic market

By DALJIT DHESI
daljit@thestar.com.my



Razlan: 'The domestic corporate and government bond spreads are expected to remain stable for now.'

PETALING JAYA: Credit yield spreads in the local bond market could widen in the latter part of the year if the eurozone sovereign debt crisis is unresolved and the US economy remains weak, resulting in the outflow of funds from the domestic market.

Malaysian Rating Corp Bhd chief executive officer Mohd Razlan Mohamed said there was more room for credit yield spreads to increase than decrease from current levels if economic growth were to sharply decelerate and signs of corporate weakness were to rise.

Credit yield spread is the difference between what a corporate entity pays to borrow and what the Government pays to borrow without the risk of default. Generally, yield levels would rise if the supply of debt papers outstrip demand, causing the price for these papers to fall.

"However, unlike the developed market which had already witnessed widening spreads, the domestic corporate and government bond spreads are expected to remain stable for now," he said.

Bond Pricing Agency Malaysia Sdn Bhd (BPAM) chief executive officer Meor Amri Meor Ayob said corporate yield spread for the Malaysian Government Securities (MGS) was expected to remain around the same level but could widen if there was exodus of funds that could rock the confidence in the global financial market.

Meor Amri said BPAM expected a maximum rate cut of up to 25 basis points (bps) in the overnight policy rate (OPR) for 2012 from the current level of 3% due to the impact of external weaknesses on the real economy and moderation in headline inflation.

"However, we will not be surprised if the OPR is maintained at the current level as a result of abating negative economic pressure," he said.

Following this view, he said, the current credit yield spreads in domestic corporate bonds were not expected to show any signs of widening as had been the case in recent periods.

"For example, the three-year AA-rated corporate spread against MGS of similar maturity is hovering around its long run mean of 120 bps. The current level is well below the peak of 260 bps recorded during the global financial crisis in late 2008 and early 2009."

Meor believed that interest rate differential and exchange rate risks played a major role in the direction of the MGS market as there were a lot more offshore players in this market compared with the corporate bond and sukuk markets.

He said if the ringgit exchange rate were to weaken, assuming Bank Negara were to cut the OPR in the first half of this year, this would temporarily exert some form of pressure to the performance of the MGS papers.

"As long as the Federal Reserve maintains its benchmark rate near zero until the end of 2014, the interest rate differential is still very much in favour of the MGS market, as this would attract foreign money to take advantage of this carry trade, provided the ringgit does not weaken," he added.

Islamic finance consultancy Amanie Advisors Sdn Bhd director Baiza Bain said that there were now ample liquidity in Malaysia to absorb local and foreign sukuk issuers seeking funding but this scenario could change by the middle or end of this year as more issuances hit the market.

This, he said, might lead investors to ask for tighter credit rating and a higher yield spread as they would be spoilt for choices amongst the many issuers that had entered the market by then.

Baiza said there were institutions from the eurozone and the Gulf Cooperation Council (GCC) currently exploring ringgit-based sukuk issuances.

Maybank IB chief executive officer Tengku Datuk Zafrul Aziz said total corporate bond issuances stood at around RM66bil for the year 2011 and this healthy trend was expected to continue this year, with total issuances possibly exceeding RM90bil.

Year-to-date, total issuances have been in excess of RM39bil. Sizeable bond issuances recently include by Manjung Island Energy Bhd, ANIH Bhd, Malayan Banking Bhd, Projek Lebuhraya Usahasama Bhd, Sarawak Energy Bhd and Maxis Bhd.

Tengku Zafrul noted that yield curves for corporate bonds had substantially bull-steepened over the last 12 months, wherein the yield on longer tenures had compressed more than that of shorter tenures.

Going forward, he said corporate bond yields were expected to move within a tight band on the account of flush liquidity, which should be able to adequately absorb increasing supply of papers.

OCBC Al-Amin head of treasury Johar Amat said the deep and liquid ringgit sukuk market, coupled with Kuala Lumpur's reputation as the global Islamic financial hub, would help attract international issuers.

"Will the supply from these new issuers put pressure on the overall market? This will depend on the quality of these issuers.

"Investors may want to diversify their portfolio but given what has happened in the eurozone and GCC, the key is to be very selective of the names from these regions," he said.