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Bond revival seen

Stronger economy, rising external demand point to a ripe corporate bond market

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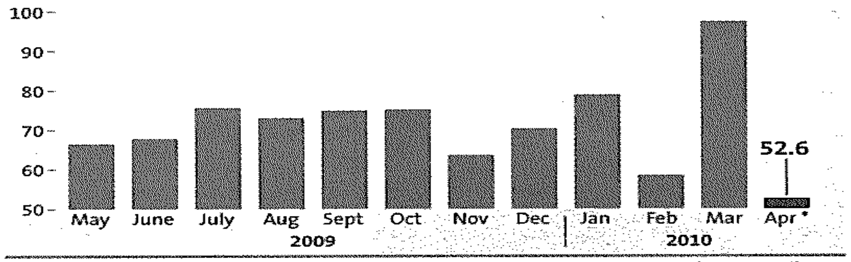
KUALA LUMPUR: Government bonds have seen active trade over the past couple of months after interest rates were raised and the ringgit strengthened against the major currencies but experts believe activity in the corporate bonds may be ripe for a revival.

A stronger economy, rising external demand and also a normalisation in the spreads between government and corporate debt may see the country's corporations tap the debt market in greater numbers in the coming quarters.

"With interest rates going up and with the market realising the business outlook is positive, maybe it's time for companies to commit," said Bond Pricing Agency Malaysia chief executive officer Meor Amri Meor Ayob.

"A lot of rating exercises were conducted but those companies have not yet issued debt."

Bond trading activity
(RM bil)



Source: Bond Pricing Agency Malaysia Sdn Bhd
* *up to April 14*

The Malaysian bond market saw a tremendous rise in trading activity, in particular Malaysian Government Securities (MGS), after the overnight policy rate was raised by 25 basis points in early March to 2.25%.

"Foreigners are basically riding on the gains in the local currency and their MGS purchases are quite understandable considering the extremely minimal credit risk in this asset class. MGS are also less volatile compared with equities," said Malaysian Rating Corp Bhd (MARC) head of fixed income research Wan Murezani Wan Mohamad.

In a report, MARC noted that foreign holdings as a percentage of MGS notes rebounded to 18.3% in January from a low of 12.5% in June 2009. Foreigners increased their holdings of MGS by RM16.7bil during that period.

The level so far remains below the shareholding peak of 24.6% recorded in April 2008 but as the ringgit appreciates against the dollar and as economic growth rebounds, MARC believes there is still room for more purchases in MGS notes.

While interest in the bond market so far has been concentrated on the government issues, conditions for more corporate issuances have emerged.

Helping in that consideration is the narrowing of the spreads between government and corporate debt to the pre-Lehman Brothers level of 40 basis points compared with 140 basis points during the

> TURN TO B5

Competition from bank loans may put lid on PDS issuances

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height of the crisis.

"While the spreads have come down, it depends on whether it meets their pricing," said RAM Ratings head of structured finance ratings Siew Suet Ming.

She said that while there would be conditions that may see companies raise debt, competition from the bank loan segment, apart from pricing, may put a lid on private debt securities (PDS) issuances.

RAM Ratings expects total bond issuance in the country to reach between RM50bil and RM60bil this year and Siew thinks corporates might be in the position to raise more debt, especially in the finance, construction and infrastructure segments.

Total bond issuance for 2009 was RM58.5bil but the bulk of that was MGS.

Another indication of increased corporate issuance was Danajamin Nasional Bhd saying it is targeting to issue total guarantees worth RM3bil this year after wrapping its *AAA* rating on RM1.4bil in guarantees last year.

Whether larger corporate issuances translate to higher trading demand is yet to be seen.

In terms of trading interest, CIMB fixed income research senior analyst Nik Ahmad Mukharriz said foreign shareholding of corporate bonds had increased from RM13bil in 2009 to RM15bil today, but the meagre increase commensurated with the trickle of PDS issuances.

Despite signs of sustainable economic recovery, primary activity in the PDS market remained lethargic with issuance of RM3.8bil in the first quarter of this year compared with RM6.4bil in the first quarter of 2009, said Wan Murezani.

With foreign interest in PDS still fixated on the highest rated debt from the country's largest companies such as Petroliam Nasional Bhd, Telekom Malaysia Bhd or Sime Darby Bhd, a lack of supply would hinder any big purchases in this segment.

MARC estimates that new issuance from this rating category stood at RM870mil in the first quarter of 2010 vis-à-vis RM2.8bil in the first quarter of 2009.

Should PDS issuances surge in the next few quarters, there is still doubt whether a greater supply would attract the interest of foreign investors.

"At this stage, it is unlikely that the focus of foreign interest will shift to PDS. As mentioned earlier, credit risk is extremely low in government bonds compared to corporate bonds, and institutional investors have a certain minimum rating threshold in their portfolio," Wan Murezani said.