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Bond harvest

Issuance of govt bonds expected to jump by 80%

IT looks like a bumper crop is coming into the bond market.

The issuance of government bonds is expected to leapfrog by 80% this year to a gross amount of RM90bil.

Even with a total of RM36.1bil maturing this year, the net issuance is still high at about RM54bil, according to statistics from Bond Pricing Agency Malaysia Sdn Bhd (BPAM).

Government-guaranteed bonds issuance by government-linked companies is expected to hit RM45bil compared with RM29.4bil last year.

Up to April, the outstanding amount of government conventional and Islamic bonds came up to RM261bil.

Including the outstanding amount of government-guaranteed bonds of RM32bil, the total outstanding from the government sector is RM293bil.

"Since government bonds are already more than half of the total bonds outstanding in the market, the increase in the supply of Malaysian Government Securities (MGS) and government-guaranteed bonds will further skew the overall credit concentration towards sovereign risk (in comparison, rated private debt securities outstanding is about RM210bil)," said BPAM CEO Meor Amri Meor Ayob.

Last year, issuance of government bonds was RM52.5bil. Up to April, the Government had issued RM25.5bil.

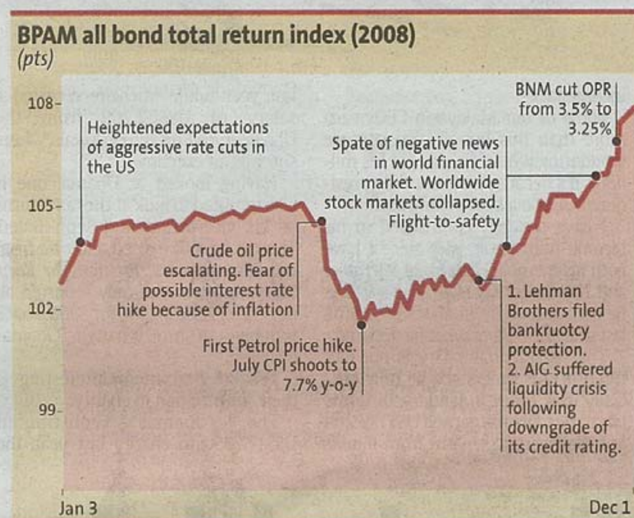
"The market is expecting an increase of more than 80% in new government issues to pump-prime the economy and support the mini budget.

"There will be demand, but the million-dollar question is at what price? That is something the market will have to decide at that point in time," said Simon Ng, head of pricing at BPAM.

The liquidity and size of market is available in Malaysia. For every auction of government bonds, the principal dealers representing clients that may be insurance companies or other banks, are obliged to put in a bid.

"No matter what happens, all government bonds will be taken up," Ng, a former bond dealer himself, said.

However, when it comes to pricing, a host of factors can come into play. The bond market is a professional market where every institution employs armies of analysts to comb through variables that can affect the price. Weather can be one of these factors.



Source: Bond Pricing Agency Malaysia

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Meor Amri Meor Ayob ... there will be demand, but the million-dollar question is at what price?

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The overnight policy rate (OPR) is the major determinant in the pricing of MGS.

"In the coming few months, this will be the main determinant to price MGS. This expected higher supply of government bonds could have an adverse impact on the yields of the bonds," said Ng.

So is there a likelihood that the government would further lower OPR to lessen the costs of such large issuances?

At this point in time, that would be hard to crystal ball. One leading indicator, said Ng, could be how interest rate swaps (IRS) – the borrowing and lending swap rates for banks – were trending MGS rates.

At one point, IRS rates were lower than those for MGS, indicating the market's expectation of a cut in OPR.

"If one refers to the bond index performance for the last one year, returns generated by government bonds were higher than those from PDS," said Meor Amri.

In the case of conventional corporate bonds, the returns are consistently high but the rate of return (as reflected by the slope) is higher for conventional government bonds.

"So investors need to know when to sell and take advantage of good prices.

"They must also know the risk reward relationship, how much their fund is invested in government, corporate and Islamic bonds," Meor Amri said, adding that investors should also find out about the constituent issuers and risks, going forward.

It is, therefore, very important to read the prospectus and make decisions on known facts.

Statistics show that conventional bonds have performed better than Islamic ones. The bulk of the issuance

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Sector should not be taken lightly

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by independent power producers, which were hit by a sudden windfall tax last year, was Islamic bonds.

IPP bonds became a negative sector, however, Islamic bonds have their own appeal as Islamic banks and funds like Lembaga Tabung Haji have to invest in syariah-compliant issues.

In the aftermath of the global banking crisis, it is crucial for the ordinary man, even if he is not an investor in a bond fund, to realise the significance of the debt markets. As investors in general become more risk averse, they tend to park more of their money in higher grade bonds and government securities.

"The debt markets in Malaysia are trading at two to three times higher than equities in terms of market value, with the bond market carrying about RM600bil in value. In fact, it is approximately close to the size of the equity market.

"Based on the performance of the BPAM All Bond Index vis-à-vis the KL Composite Index, when the equity markets collapsed last year, the bond market went up. In Malaysia, this was despite the announcement of the fuel price hike, the collapse of (the 120-year-old) Lehman Brothers and IPP issues," said Meor Amri.

Hence, this is a sector not to be taken lightly. More efforts are required by all parties concerned to demystify a lot of the technicalities so as to increase its relevance to all caring citizens.