eastspring investments

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MARKET COMMENTARY

FIXED INCOME MARKET REVIEW AND OUTLOOK

October 2019

REVIEW

- In Budget 2020 announced on 11 October 2019, the government is projecting Gross Domestic Product ("GDP") growth for 2020 to be 4.8% (vs 2019F at 4.7%) with fiscal deficit projected to be lower at 3.2% vs 3.4% in 2019F. The Budget is considered mildly expansionary as the new fiscal deficit target for 2020 of 3.2% is relaxed from the previous 3.0%. Inflation is expected to remain anchored at 2% in 2020. The government revenue for 2020 is projected to be lower by 7.1% to RM244.5bn, mainly due to the absence of one-off RM30bn special dividend from Petronas. Development Expenditure allocation for 2020 increased by 4.6% to RM56bn with higher allocations towards healthcare, agriculture and rural development, energy and public utilities and transport. With the expectation of heightening external headwinds, domestic demand is expected to spearhead growth — increasing by 4.8% in 2020 after registering a 4% rise this year, spurred by the stronger private sector expenditure. Private sector expenditure has again been projected as the key growth driver in 2020, with private consumption and investment rising 6.9% and 2.1%, respectively.

- We expect a slightly higher net supply of government debt with the Government's funding need for 2020 estimated at RM122.4bn. Considering the MGS & MGII maturities of RM70.7bn in 2020 and the potential issuance of another round of samurai bonds (RM5.0 – RM5.5 billion), the net supply of government bonds in 2020 is circa RM46.5 billion, higher than the RM44.7 billion estimated net supply in 2019. Net supply is within market expectation and bond-neutral as the domestic market is still flushed with liquidity.

- Headline inflation in September was recorded at +1.10% YoY (August: +1.5% YoY) driven by the index of Miscellaneous Goods & Services (2.7%), Alcoholic Beverages & Tobacco (2.4%), Food & Non-Alcoholic Beverages (2.2%) and Furnishings, Household Equipment & Routine Household Maintenance (2.1%). Core inflation for the month also registered lower at +1.50% YoY (August: +2.0% YoY). Now that the targeted fuel subsidy implementation has been moved to January 2020, inflation rate for the rest of 2019 is expected to be anchored around the current level. For the full year, BNM maintains its inflation forecast at 0.70% - 1.70% while the government expects 2019 inflation to be at 1.00%.

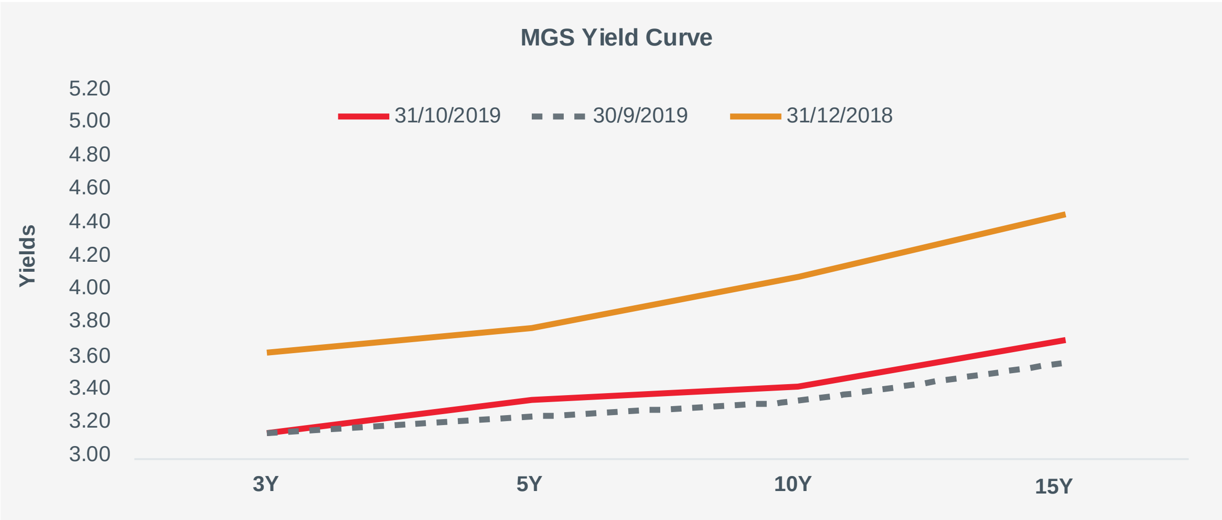
- Malaysia sovereign bond curve continued its bear-steepening move in October with yields for 3- and 5-years MGS inched higher by 3-9 bps to close at 3.15% and 3.33%, respectively. The rise in yields on the 10- and 15-years on the other hand was more prominent at 9-14bps to settle at 3.41% and 3.69%, respectively, resulting in a steeper curve. The broad movement in the domestic bond market in the month generally reflected the broader weakness in the global bond market on the back of improving sentiment following renewed signs of a deal breakthrough between US and China. While direction of local market over the medium-term will largely be contingent upon domestic factors e.g. BNM monetary policy and potential index exclusion in March 2020, in the near term, movements in the bond market would likely track the broader global sentiment on the back of many lingering uncertainties. MGII yield curve also steepened in the month, as 5-year moved 13bps higher to 3.34%, 10-years moved 7bps higher to 3.47% and 15-years moved higher by 16bps to close at 3.80%.

- There were three government bond auctions in October:
  - RM3.0b re-opening of the 10-year MGS averaging 3.407% at a bid-to-cover ratio of 1.233x.
  - RM2.0b re-opening of the 20-year MGII averaging 3.838% at a bid-to-cover ratio of 3.32x.
  - RM3.5b re-opening of the 5-year MGS averaging 3.364% at a bid-to-cover ratio of 1.433x.

- Meanwhile, trading in corporate bonds for the month of October mostly concentrated in selected quasi-government and AAA rated bonds.

BENCHMARK	31/12/2018 Yield	30/9/2019 Yield	31/10/2019 Yield	MOM Change	YTD Change
3-year MGS	3.62%	3.12%	3.15%	+ 3 bps	- 47 bps
5-year MGS	3.76%	3.24%	3.33%	+ 9 bps	- 43 bps
10-year MGS	4.07%	3.32%	3.41%	+ 9 bps	- 66 bps
15-year MGS	4.44%	3.55%	3.69%	+ 14 bps	- 75 bps

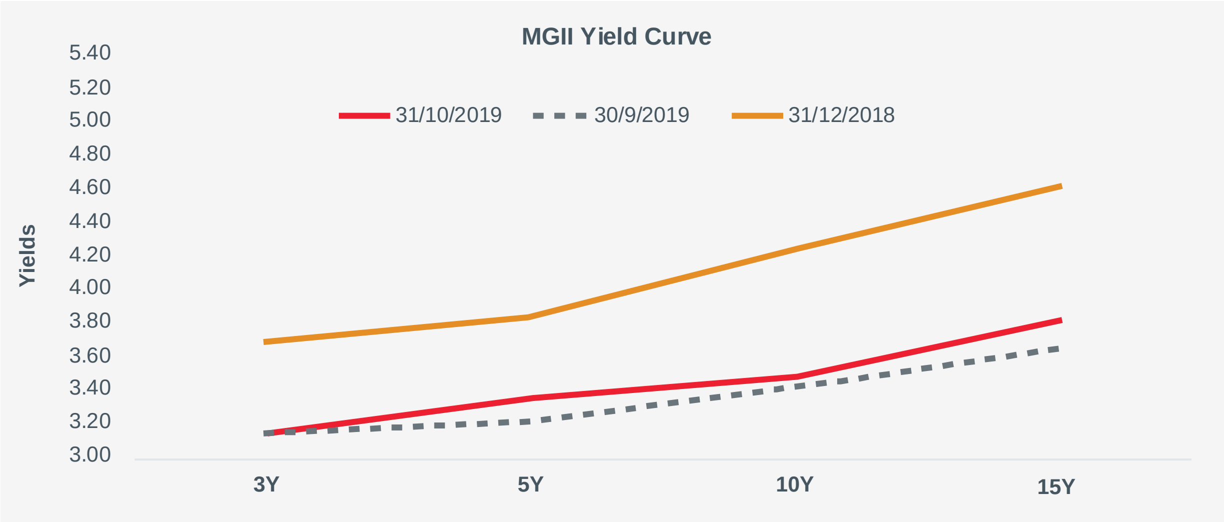
Source: Bloomberg



Source: Bloomberg

BENCHMARK	31/12/2018 Yield	30/9/2019 Yield	31/10/2019 Yield	MOM Change	YTD Change
3-year MGII	3.68%	3.12%	3.12%	-	- 56 bps
5-year MGII	3.83%	3.21%	3.34%	+ 13 bps	- 49 bps
10-year MGII	4.24%	3.40%	3.47%	+ 7 bps	- 77 bps
15-year MGII	4.61%	3.51%	3.80%	+ 16 bps	- 81 bps

Source: Bloomberg



Source: Bloomberg

OUTLOOK

- Globally, the September risk on mode continued into October as the trade talk between US and China progressed well. The two economies managed to strike a partial deal during the month where US agreed to suspend a tariff hike on USD250 billion in Chinese imports that was set to be in place mid-October while China agreed to buy between USD40-50 billion of US agricultural products. The partial deal revived global market sentiment and was welcomed as a step forward in the 15-months trade war. While the news has renewed hope of a resolution between the two, investors remained skeptical and cautious on a complete trade resolution due to the US and China deep differences in their demands. Market will continue to follow the progress of the talk closely and given that the end of the trade war is still far in sight, the lingering uncertainties will continue to weigh on global sentiments and add volatilities to the market.

- US Federal Reserve ("Fed") cuts its policy rate by 25bps to 1.50 – 1.75% in its October meeting as widely expected by the market. The latest policy move by the Fed would be the third cut in its policy 'adjustment' since the first cut in July this year. In the policy statement as well as the accompanying press conference, the Fed is seen to be done with its mid-cycle adjustment where the policy statement dropped the "to act as appropriate to sustain current expansion" language and Powell mentioned that monetary policy is in a good place during the press conference. The Fed's voting members were divided in the last policy decision, with 2 members voting for no change in rate while 8 members voted in favor. As suggested by the policy language, future direction of US monetary policy will largely hinge on the underlying economic performance and condition.

- Domestically, Bank Negara Malaysia ("BNM") convened its sixth and final Monetary Policy Committee ("MPC") meeting for 2019 in November. Market's expectation for BNM to keep its powder dry by maintaining OPR at 3.0% on the back improving visibility from the recently announced Budget 2020 was met. BNM's view on underlying economic factors are consistent with our narrative that growth will be anchored by healthy household spending on the back of stable employment and wage growth. For 2020, the pro-growth fiscal measures announced by the government in the budget are likely to reduce the pressure on monetary policy to push growth. BNM's monetary policy direction for 2020 broadly is expected to be highly data-dependent and event-driven given the uncertainties surrounding geopolitical developments and the drag that they have on global growth.

- In November, there will be three MYR government bond auctions, new issue of 3-year MGII and 20y MGS and re-opening of 10-year MGII against a RM17.1 billion MGS maturity. Despite the weaker bid-to-cover ratios seen in the recent government bond auctions as compared to those seen in 9M19, we believe that demand in the auctions is still healthy and expected to remain on the back of ample domestic liquidity.
- On the corporate bond front, the pickup in new issuances is expected to be sustained in November from refinancing activities on the back of upcoming corporate bond maturities, and the relatively low-interest rate environment which is favorable for issuers. We expect demand for corporate bonds to remain strong due to 1) scarcity of quality corporate bond supply and 2) ample domestic liquidity.

Table 1: Indicative Rates

	31-Oct-19
MBB O/N*	1.60%
MBB1-Week*	1.70%
MBB 1-Mth FD*	2.90%
MBB 6-Mth FD*	3.05%
MBB 1-Year FD*	3.10%
1-mth BNM MN	3.05%
3-mth BNM MN	3.07%
3-mth KLIBOR	3.38%
CP	
1-mth (P1)	3.41%
3-mth (P1)	3.68%

Source: Bloomberg/Bondstream
* Maybank2u.com.my

Table 2: Indicative Bond Yields (%)					
	3yr	5yr	7yr	10yr	15yr
MGS	3.21	3.34	3.39	3.44	3.72
GII	3.23	3.32	3.38	3.49	3.81
Swap rate*	3.29	3.34	3.39	3.45	3.60
AAA	3.55	3.69	3.78	3.89	4.09
AA1	3.68	3.82	3.92	4.05	4.29
AA2	3.82	3.96	4.06	4.19	4.43
AA3	3.94	4.09	4.19	4.32	4.56
A1	4.44	4.78	5.06	5.48	6.13
A2	5.10	5.64	6.02	6.61	7.48
A3	5.80	6.49	6.98	7.68	8.58

Source: Bloomberg*/Bondstream