A member of Prudential plc (UK)

MARKET COMMENTARY

FIXED INCOME MARKET REVIEW AND OUTLOOK

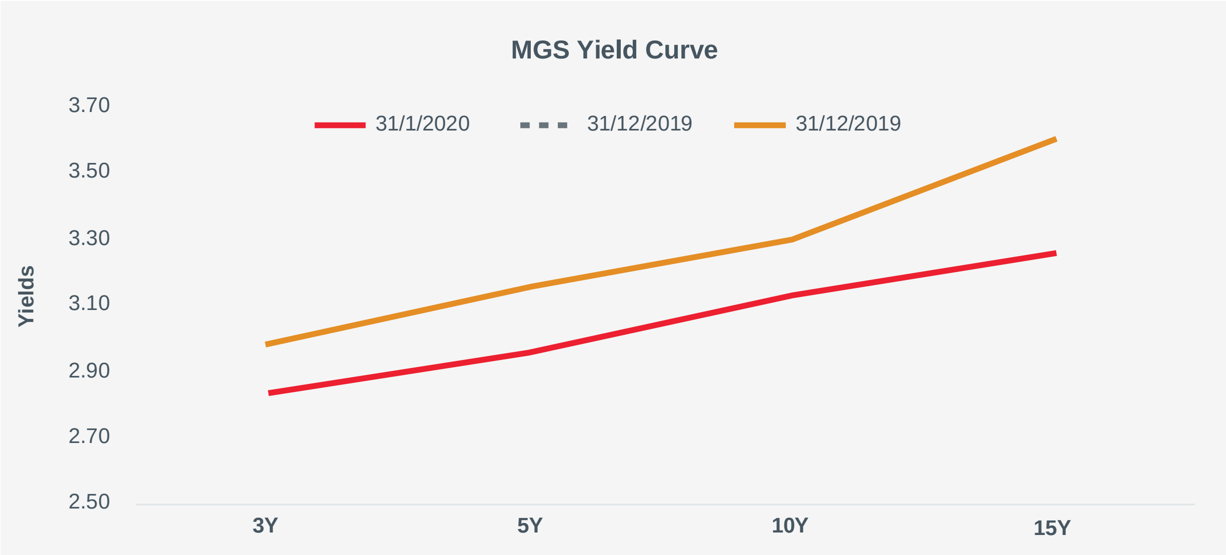
January 2020

REVIEW

- Domestically, Bank Negara Malaysia ("BNM") surprised the market in its first Monetary Policy Committee ("MPC") meeting for 2020 in January by lowering the Overnight Policy Rate ("OPR") from 3.00% to 2.75%. This "pre-emptive" cut and the pro-growth fiscal measures announced by the government in Budget 2020 are expected to lessen the pressure on monetary policy to push growth. BNM's monetary policy direction for 2020 broadly is expected to be data-dependent and event-driven given the uncertainties surrounding geopolitical developments and the potential spillover effects onto the domestic economy.
- December'19 headline inflation increased 1.0% YoY, slightly higher than November +0.9% YoY mainly contributed by the increase in Food & Non-Alcoholic Beverages +1.7% (Nov: +1.5% YoY) and lower contraction in transportation costs -1.9% YoY (Nov: -2.4% YoY). On the other hand, core inflation remained stable at +1.4% YoY in December. For 2020, BNM expects the headline inflation to average higher than 0.7%, nonetheless it is dependent on global oil and commodity price development and the timing of the lifting of the domestic retail fuel price ceilings.
- Malaysia sovereign bond yields bull-flattened in January where 3-, 5-, 10- and 15-years MGS decreased by 12bps, 20bps, 17bps and 35bps to close at 2.86%, 2.95%, 3.13% and 3.25% respectively. The yield curve movement was mainly reflective of the 25bps OPR cut which took the market by surprise and to a lesser degree, the global risk-off sentiment due the spread of coronavirus. Broadly, we expect the direction of domestic bond market in the next few months to largely hinge on BNM monetary policy and to a certain extent the global risk sentiment. Similarly, MGII yield curve shifted downwards during the month, as 3-, 5-, 10- and 15-year closed 15bps, 18bps, 22bps and 37bps lower at 2.91%, 3.01%, 3.20% and 3.35%, respectively.
- There were 3 government bond auctions in January:
    - RM3.5b re-opening of the 7-year MGS averaging 3.281% at a bid-to-cover ratio of 2.498x.
    - RM2.5b re-opening of the 15-year GII averaging 3.507% at a bid-to-cover ratio of 3.396x
    - RM3.0b re-opening of the 3-year MGS averaging 2.858% at a bid-to-cover ratio of 2.183x.
- Meanwhile, trading in corporate bonds for the month of January mostly concentrated in selected quasi-government and AAA rated bonds.

BENCHMARK	31/12/2019 Yield	31/12/2019 Yield	31/1/2020 Yield	MOM Change	YTD Change
3-year MGS	2.98%	2.98%	2.86%	- 12 bps	- 12 bps
5-year MGS	3.15%	3.15%	2.95%	- 20 bps	- 20 bps
10-year MGS	3.30%	3.30%	3.13%	- 17 bps	- 17 bps
15-year MGS	3.60%	3.60%	3.25%	- 35 bps	- 35 bps

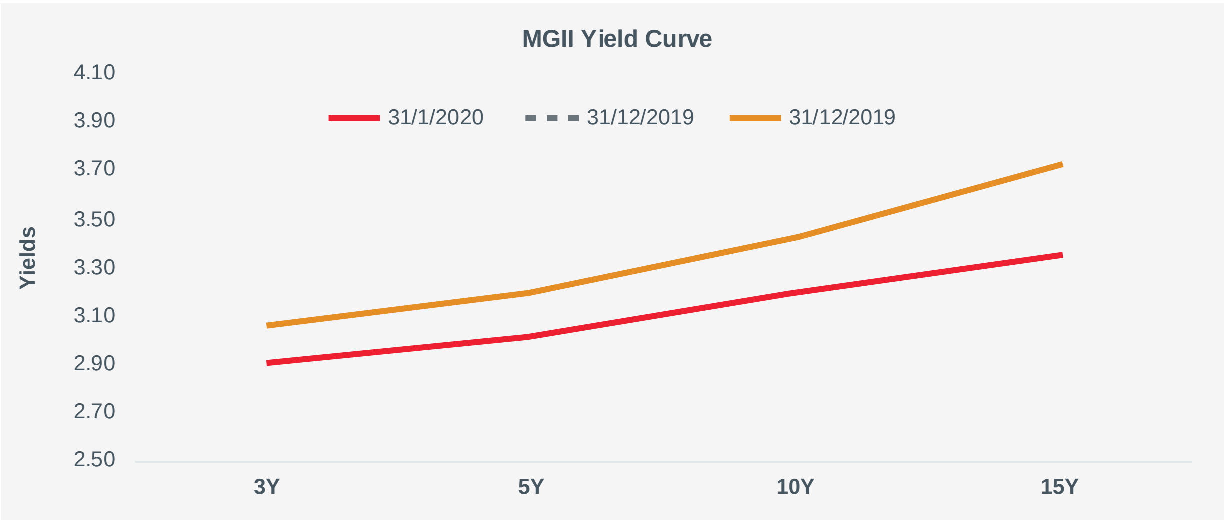
Source: Bloomberg



Source: Bloomberg

BENCHMARK	31/12/2019 Yield	31/12/2019 Yield	31/1/2020 Yield	MOM Change	YTD Change
3-year MGII	3.06%	3.06%	2.91%	- 15 bps	- 15 bps
5-year MGII	3.19%	3.19%	3.01%	- 18 bps	- 18 bps
10-year MGII	3.42%	3.42%	3.20%	- 22 bps	- 22 bps
15-year MGII	3.72%	3.72%	3.35%	- 37 bps	- 37 bps

Source: Bloomberg



Source: Bloomberg

OUTLOOK

- Globally, the market started off 2020 with a risk-on mode on the back of positive progress from the US-China Phase 1 deal which was signed off by the two major economies in mid-January 2020. During the month, the killing of Iran's leading general by the US injected volatilities in the global market for a potentially full-blown geopolitical conflict however the tension was eventually de-escalated by both sides.
- The market further turned into risk-off mode when the outbreak of coronavirus loomed in and the Chinese Government locked down more than 10 cities and extended the Chinese New Year holiday by 3 days and banned package travel. Uncertainties on the effective containment of the spread of coronavirus, the finding of a cure or vaccine, prolonged travel restrictions and business closures in China and affected areas will affect business activities around the world and weigh on the global economy.
- The risk-off sentiment has sent the 10-year US Treasury yields from 1.92% at end-Dec 2019 to 1.51% at end-January 2020. Should the spread of the virus be contained in the near term or an effective treatment be found and fear abates, we expect to see some correction to the yield levels.
- US Federal Reserve ("Fed") maintained its policy rate at 1.50 – 1.75% in its January meeting as widely expected by the market. The policy language for the January meeting was largely unchanged from the previous meeting in December, in that the US economy remains firm and the committee would monitor "global developments and muted inflationary pressures" while marginally downgrading its assessment of consumer spending from "strong" to "moderate". In the press conference, the Chairman noted the seriousness of coronavirus outbreak which may weigh on global growth. Its monetary policy will largely hinge on the underlying economic performance and condition, and the development of the spread of coronavirus but there is still policy space in the US in the event that signs of downside risks materialise.
- In February, there will be re-openings of 10-year MGS, 5-year MGII and 30-year MGII with no government bond maturity. We believe the demand for government bond auctions will remain healthy as seen in the last three government auctions in January on the back of ample domestic liquidity.
- The recent coronavirus outbreak is likely to weigh down on the domestic GDP growth for 2020, which may fuel speculation of another BNM rate cut and put pressure on local yield curve. Nonetheless, the Government has recently announced that it is ready to deploy additional economic stimulus package to tackle the impact from the virus.
- On the corporate bond front, the pickup in new issuances is expected to be sustained amidst the relatively low-interest rate environment which is still favorable for issuers. We expect demand for corporate bonds to remain strong due to scarcity of quality corporate bond supply and ample domestic liquidity.

Table 1: Indicative Rates	
	31-Jan-20
MBB O/N*	1.30%
MBB1-Week*	1.40%
MBB 1-Mth FD*	2.65%
MBB 6-Mth FD*	2.80%
MBB 1-Year FD*	2.85%
1-mth BNM MN	2.78%
3-mth BNM MN	2.79%
3-mth KLIBOR	3.10%
CP	
1-mth (P1)	3.29%
3-mth (P1)	3.51%

Source: Bloomberg/Bondstream
* Maybank2u.com.my

Table 2: Indicative Bond Yields (%)

	3yr	5yr	7yr	10yr	15yr
MGS	2.88	2.99	3.09	3.15	3.28
GII	2.90	3.05	3.13	3.22	3.36
Swap rate*	3.04	3.09	3.15	3.27	3.45
AAA	3.39	3.45	3.52	3.60	3.80
AA1	3.52	3.59	3.66	3.76	4.00
AA2	3.63	3.71	3.78	3.90	4.17
AA3	3.73	3.82	3.89	4.03	4.32
A1	4.25	4.49	4.73	5.08	5.70
A2	4.93	5.33	5.69	6.20	7.03
A3	5.64	6.19	6.67	7.31	8.17

Source: Bloomberg*/Bondstream