MARKET COMMENTARY

FIXED INCOME MARKET REVIEW AND OUTLOOK

October 2020

REVIEW

- Following the resurgence of Covid-19 cases in Malaysia, the Government has re-imposed Conditional Movement Control Order ("CMCO") and Enhanced Movement Control Order ("EMCO") in some localities to curb the infection rate. The CMCO, which bars inter-district travel, was announced on 12 October for an original period of two weeks for Selangor, Kuala Lumpur and Putrajaya. The continued emergence of new clusters in peninsular Malaysia ever since has led to the extension of the CMCO and a longer list of CMCO states. Collectively, Selangor, Kuala Lumpur and Putrajaya contribute about 40% to the national GDP. While the CMCO is not as strict and the economic impact not as severe as the MCO announced earlier in March, the restriction could still weigh on domestic recovery progress made so far.

- On the domestic political scene, Malaysians were surprised by the news that PM Muhyiddin had met the King on a proposal to declare a state of emergency that could result in the suspension of parliament and a need for elections. This is on the back of rumours that the government will not have enough support to pass the upcoming budget tabling in parliament, which could tantamount to a vote of no confidence. The recent event underscores the fragility of the domestic political situation as the government only holds a razor thin majority. While the King had rejected the state of emergency declaration and the political temperature had cooled down recently, the ongoing uncertainty on this front could dampen the overall investment climate, derail Malaysia's economic and public finances recovery, pressure Malaysia sovereign rating and inject volatility to the market.

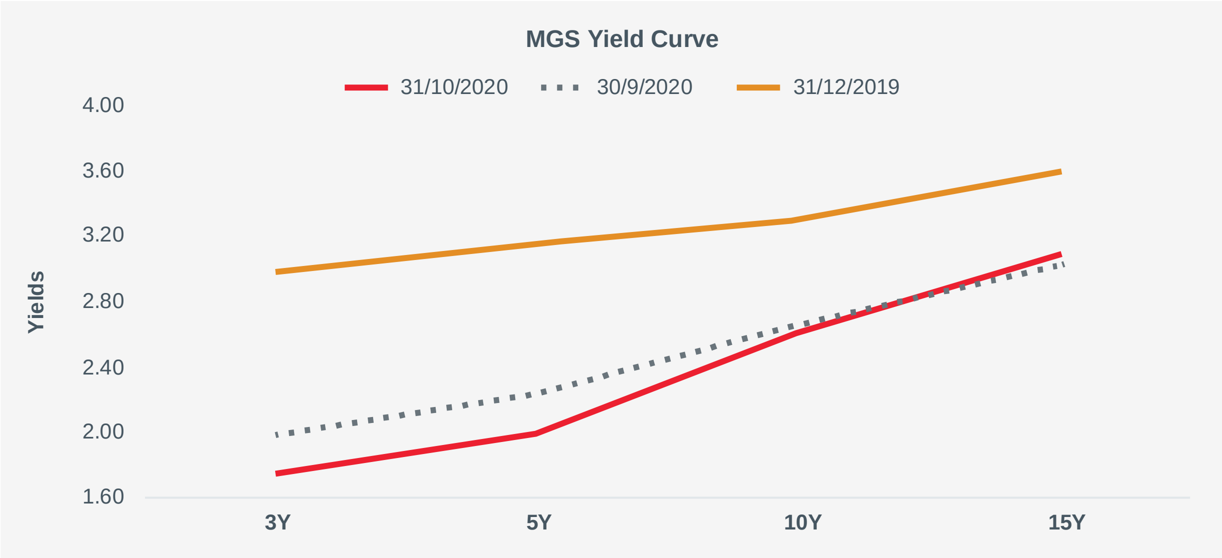
- September 2020's headline inflation declined 1.4% YoY (August: -1.4%), mainly due to price deflation in Transport, -9.9% YoY (August: -9.9%) and Housing, Water, Electricity, Gas & Other Fuels, -3.0% YoY (August: -3.0%). Meanwhile, September 2020's core inflation slipped to 1.0% YoY (August: 1.1% YoY).

- Malaysia's sovereign yield curve steepened in October 2020 as 3-, 5-, 10-years MGS yields moved lower by 24bps, 25bps, 5bps to close at 1.75%, 2.00%, 2.62%, respectively, while the 15-years MGS yield on the other hand moved 8bps higher to 3.10%. The drop in the shorter-end yields was due to the combination of reinvestment flows from huge maturities in the month and market's speculation on possible OPR cut in November Monetary Policy Committee ("MPC") meeting. Generally fragile market sentiment during the month led to yields creeping higher for longer-tenor MGS. Similarly, MGII yield curve also steepened during the month, with 3-, 5-, 10- and 15-year GII yields closed -25bps, -4bps, -4bps and +6bps at 1.79%, 2.17%, 2.59% and 3.21%, respectively.

- There were 3 government bond auctions in October:
  - RM4.5b re-opening of the 3-year MGII averaging 1.981% at a bid-to-cover ratio of 3.093x.
  - RM5.0b new issue of the 10-year MGS averaging 2.632% at bid-to-cover ratio of 1.994x.
  - RM5.0b re-opening of the 5-year MGII averaging 2.204% at a bid-to-cover ratio of 1.996x.

BENCHMARK	31/12/2019 Yield	30/9/2020 Yield	31/10/2020 Yield	MOM Change	YTD Change
3-year MGS	2.98%	1.99%	1.75%	- 24 bps	- 123 bps
5-year MGS	3.15%	2.25%	2.00%	- 25 bps	- 115 bps
10-year MGS	3.30%	2.67%	2.62%	- 5 bps	- 68 bps
15-year MGS	3.60%	3.02%	3.10%	+ 8 bps	- 50 bps

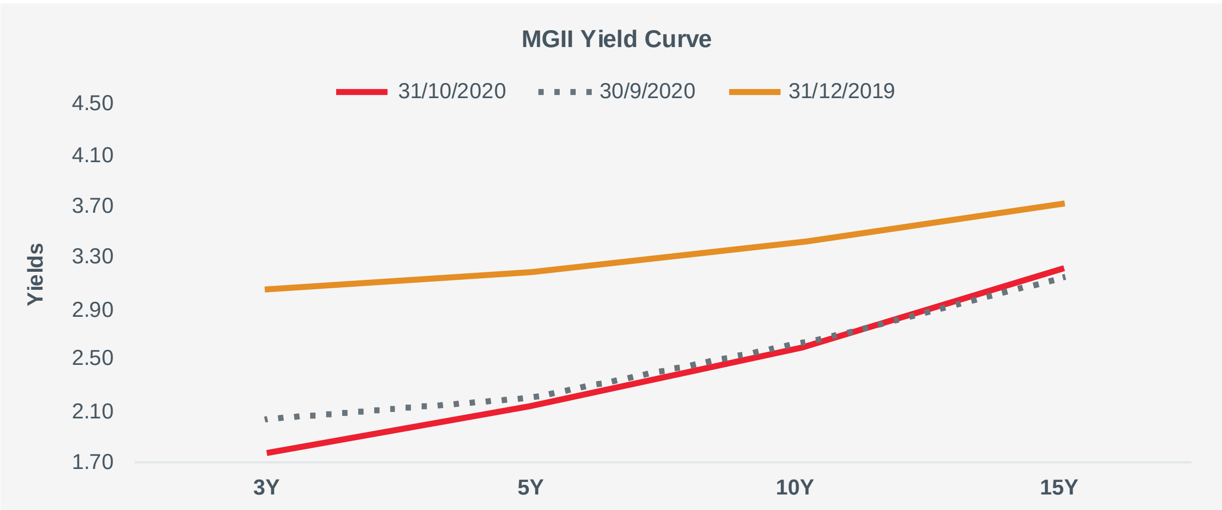
Source: Bloomberg



Source: Bloomberg

BENCHMARK	31/12/2019 Yield	30/9/2020 Yield	31/10/2020 Yield	MOM Change	YTD Change
3-year MGII	3.06%	2.04%	1.79%	- 25 bps	- 127 bps
5-year MGII	3.19%	2.21%	2.17%	- 4 bps	- 102 bps
10-year MGII	3.42%	2.63%	2.59%	- 4 bps	- 83 bps
15-year MGII	3.72%	3.15%	3.21%	+ 6 bps	- 51 bps

Source: Bloomberg



Source: Bloomberg

OUTLOOK

- US election concluded four days after the poll closed with President-elect Joe Biden securing enough votes to become the next US President. At the point of writing, the counting of ballots is still ongoing with Senate control is still up for grab while the Democratic Party is expected to maintain their control over the House, though with a narrower majority. The change in White House will bring about many shifts in US policies, but the notable one would likely be on US foreign policy especially with regards to the US-China relations. US may still pressure China on points such as forced intellectual property transfers, human rights abuse and so on, and existing tariffs between the two nations might not be rolled back immediately. However, the US-China trade negotiations can be restarted on a more stable and predictable platform.

- The US Federal Reserve ("Fed") held rates unchanged at 0-0.25% during its November Federal Open Market Committee ("FOMC") meeting. The FOMC statement continued to be dovish with an expectation to maintain an accommodative monetary policy until it achieves its average inflation target of 2% over time. The US Treasury yield curve steepened in October, reflecting markets earlier expectation of a Democrat sweep in the US election. In the immediate term, we expect US Treasury yields to be driven by the resumption of US House and Senate's additional fiscal stimulus negotiation to aid the American economy.

- Malaysia's Budget 2021 was tabled on 6 November 2020. Themed as "Resilient as One, Together we Triumph". The Budget is the biggest to date in absolute term at RM322.5b (+2.5% YoY). In 2021, the economy is projected to grow 6.5% to 7.5%, underpinned by a strong rebound in global trades, consumer sentiments, public and private investments. Government's revenue in 2021 is projected to grow 4.2% YoY, driven mainly by higher projected tax collections, supported by a strong rebound in economic activities, which will more than offset the lower dividend payments of RM18b and RM1.0b respectively from Petronas and Khazanah. Notably, development expenditure is set to increase 38.0% YoY to RM69.0b in 2021. The government is committed to continue several infrastructure projects that are expected to have high multiplier impact on the economy including the Pan Borneo Highway, Gemas-Johor Bahru Electrified Double-Tracking and Klang Valley Double Tracking Project Phase 1, Johor-Woodlands Rapid Transit System Link as well as the Klang Valley MRT Line 3.

- Fiscal deficit is expected to be lower at 5.4% (2020E: 6.0%) in 2021. While this is a deviation from the Medium-Term Fiscal Plan announced in 2019, we believe that government's fiscal consolidation plan has not been necessarily derailed, but merely delayed on the back of the unexpected health and economic crisis. Considering the budget deficit of RM84.8b and RM67.7b worth of MGS/MGII maturities in 2021, total gross MGS/MGII issuances is expected to be between RM145-155bn for next year. While the headline issuance figures are large, they are not surprising and are within market's expectation. We note that government funding can also be raised through increased issuance of government treasury bills, like what we have seen this year.

- MPC held OPR steady at 1.75% in its November meeting as per economist's consensus. BNM acknowledges that the recent resurgence of Covid-19 cases locally will affect the momentum of the economic recovery seen during the 3Q2020, however it expects the annual 2020 GDP growth to still be within its forecast range of -3.5% to -5.5%. The policy statement came out with a neutral tone, albeit market expecting for a more dovish tilt. Moving forward, BNM is expected to stick to its data-dependent approach and future OPR decisions will likely depend on the prevailing economic conditions. That said, the recently announced Budget has provided the needed fiscal impetus to the economy in 2021 and we see less burden on BNM to support growth through monetary policy.

- There are re-openings of 7-year MGII, 15- and 30-years MGS in November. While there is still ample liquidity in the system, the outcome of the auctions will depend on the prevailing market sentiment. On the corporate bond front, we expect demand for corporate bonds to remain mixed, with a preference for higher quality names due to the ongoing economic challenges. While corporate issuances have picked up recently on the back of the low interest rate environment, total issuances in 2020 will likely be lower year-on-year as corporates assess their funding needs on the back of slower economic activities.

Table 1: Indicative Rates	
	31-Oct-20
MBB O/N*	0.25%
MBB1-Week*	0.35%
MBB 1-Mth FD*	1.50%
MBB 6-Mth FD*	1.80%
MBB 1-Year FD*	1.85%
1-mth BNM MN	1.60%
3-mth BNM MN	1.58%
3-mth KLIBOR	1.95%
CP	
1-mth (P1)	2.24%
3-mth (P1)	2.45%

Source: Bloomberg/Bondstream
* Maybank2u.com.my

Table 2: Indicative Bond Yields (%)					
	3 yr	**5yr**	**7yr**	**10yr**	**15yr**
MGS	1.82	2.04	2.38	2.57	3.18
GII	1.86	2.13	2.36	2.61	3.27
Swap rate*	1.89	2.07	2.27	2.50	2.73
AAA	2.40	2.62	2.81	3.09	3.53
AA1	2.63	2.83	3.01	3.29	3.75
AA2	2.81	3.01	3.18	3.45	3.91
AA3	2.96	3.14	3.31	3.58	4.04
A1	4.10	4.39	4.67	5.04	5.62
A2	4.88	5.30	5.70	6.18	6.93
A3	5.65	6.20	6.67	7.31	8.16

Source: Bloomberg*/Bondstream