

MARKET COMMENTARY

FIXED INCOME MARKET REVIEW AND OUTLOOK

August 2021





REVIEW

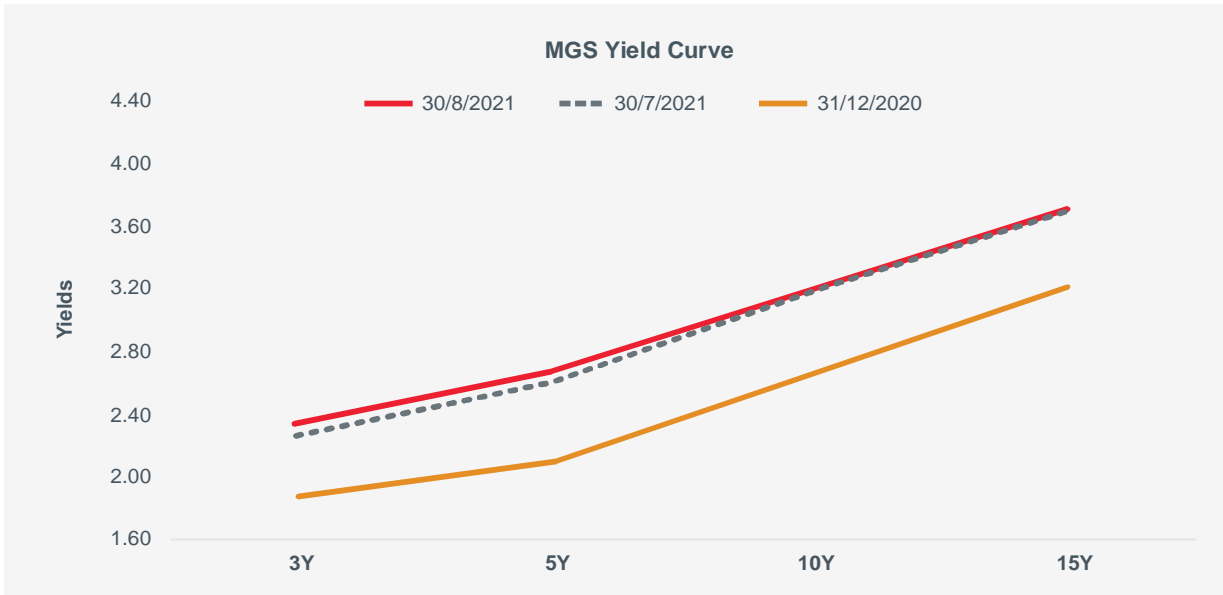
- ▶ The minutes of the most recent Federal Open Market Committee meeting showed consensus among officials to begin tapering the Fed's asset purchase although there was disagreement in terms of timing and quantum.
- ▶ At the Jackson Hole Economic Symposium held in end-Aug, Fed Chair Powell appeared to be a touch more dovish compared to other Fed officials, focusing on making the case that recent spikes in inflation are transitory. That said, Powell endorsed the now widely shared view that purchase reductions could be appropriate this year although he reiterated that this is contingent on continued progress on the employment front. While Powell's message suggests that the economy will be able to weather the threat from the surge in cases caused by the Delta variant, market now generally expects the first tapering announcement to only happen in Nov or Dec 2021.
- ▶ The Senate voted 69-30 to pass the bipartisan infrastructure bill that will see about USD550b in new federal spending on traditional infrastructure such as roads and bridges as well as projects expanding access to broadband and electric vehicle charging stations. Meanwhile, Democrats in the House have leveraged on the bipartisan bill and voted 220-212, strictly along party lines, requesting Senate Democrats to vote in unison on President Biden's ambitious USD3.5tr package through budget reconciliation. The reconciliation blueprint, to be spent over 10 years, is considered by some moderate Democrats as massive when the economy is on the verge of overheating. The lower chamber is expected to take-up the Senate-passed bipartisan USD1.2tr infrastructure bill by end Sept 2021.
- ▶ On the pandemic front, the U.S. Food and Drug Administration ("**FDA**") has authorized the Covid-19 booster shots for people with compromised immune systems following the surge of infections caused by the Delta variant. The FDA also granted full approval, from the previous approval for emergency use, to Pfizer-BioNTech's vaccine for people who are 16 and above. Separately, President Biden has announced its administration's plan to offer booster shots for all Americans eight months after their second vaccine dose, after months of debate. This is despite global health advocates arguing the move would deepen global inequalities.
- ▶ The U.S. 2Q2021 economic growth has been revised slightly higher to an annualized rate of 6.6% in the second estimate, from 6.5% previously, underpinned by higher intellectual property product investment and net exports. In 1Q2021, the economy grew an annualized 6.3% on the back of higher personal consumption, non-residential fixed investment, exports and government spending. Separately, ECB President Lagarde indicated that the Eurozone is emerging from the pandemic and supports will be targeted, focusing on sectors that have been badly hurt.
- ▶ Malaysia vaccination rate continued to accelerate although reported daily Covid-19 cases have remained elevated. As of 3 Sep 2021, some 35.8m shots of vaccines have been administered (62.0% of population) with 15.6m individuals having fully inoculated (47.8% of population). The encouraging vaccination rate has led to the government easing restrictions, including inter-district travel, for fully vaccinated individuals from 10 Aug. Also announced in the month of Aug was the reopening of 11 more economic activities in all states and federal territories under Phase 1 of NRP that have 50% of the adult population fully vaccinated. At the time of writing, more states have advanced to Phase 2 and Phase 3 and the government is looking into moving Klang Valley to Phase 2 as more than 80% of its adult population have been fully inoculated. The government remains confident to vaccinate all adults or 80% of the country's population by Oct 2021.



- Malaysia's 2Q2021 GDP grew a strong 16.1% YoY on the back of improved domestic demand and robust exports performance. The economy nevertheless contracted 2.0% QoQ amid the imposition of lockdown to contain the spread of the pandemic. Meanwhile, the official 2021 GDP forecast has been revised down to 3.0%-4.0% from 6.0%-7.5% as Bank Negara Malaysia ("**BNM**") expects growth to trough in 3Q2021 before recovering in 4Q2021 and into 2022, underpinned by the normalization of economic activities and positive spill-overs from external demand. BNM also lowered its 2021 full year headline inflation target to 2.0%-3.0% from 2.5%-4.0% previously.
- Malaysia's political scene took a new turn in the month of Aug 2021. Datuk Seri Ismail Sabri bin Yaakob, the former Deputy Prime Minister and Minister of Defence, has been appointed by the King and sworn in as the country's 9th Prime Minister ("**PM**") on 21 Aug after Tan Sri Dato' Haji Mahiaddin shocked Malaysia with his resignation as the country's 8th PM on 16 Aug. The King delivered the decision after receiving sufficient statutory declarations that showed PM Ismail commanded majority support in the Parliament. In his first televised speech after his inauguration, PM Ismail called on all members of Parliament to work together to revive Malaysia's economy and combat the Covid-19 pandemic. The PM's new Cabinet line-up, announced 6-day after his inauguration, came with only minor reshuffling. This is not entirely surprising as PM Ismail draws support from the same political parties under the previous government.
- Malaysia's sovereign yield curve bear flattened in Aug 2021. The yields of the 3-, 5-, 10- and 15-year MGS rose 6bps, 6bps, 2bps and 1bp respectively to close the month at 2.34%, 2.68%, 3.19% and 3.70% respectively. The market remained well supported despite political chaos making the headlines in the month. Similarly, the MGII curve bear flattened with the 3-, 5-, 10-year MGII closing 6bps, 3bps and 2bps higher at 2.36%, 2.64% and 3.31% respectively while the 15-year MGII ended the month unchanged at 3.89%.
- Three auctions were held in the month of Aug 2021, the re-opening of the 30-year MGS 06/50, the re-opening of the 7-year MGII 08/28 and the re-opening of the 3-year MGS 06/24. The auctions received an average bid-to-cover ratio of 2.07x.
 - RM2.0b re-opening of the 30-year MGS averaging 4.289% at a bid-to-cover ratio of 2.28x;
 - RM4.5b re-opening of 7-year MGII averaging 3.163% at a bid-to-cover ratio of 1.98x; and
 - RM5.0b re-opening of the 3-year MGS averaging 2.355% at a bid-to-cover ratio of 1.95x.

BENCHMARK	Dec 2020 Yield	Jul 2021 Yield	Aug 2021 Yield	MOM Change	YTD Change
3-year MGS	1.88%	2.28%	2.34%	+ 6 bps	+ 46 bps
5-year MGS	2.10%	2.62%	2.68%	+ 6 bps	+ 58 bps
10-year MGS	2.65%	3.17%	3.19%	+ 2 bps	+ 54 bps
15-year MGS	3.19%	3.69%	3.70%	+ 1 bp	+ 51 bps

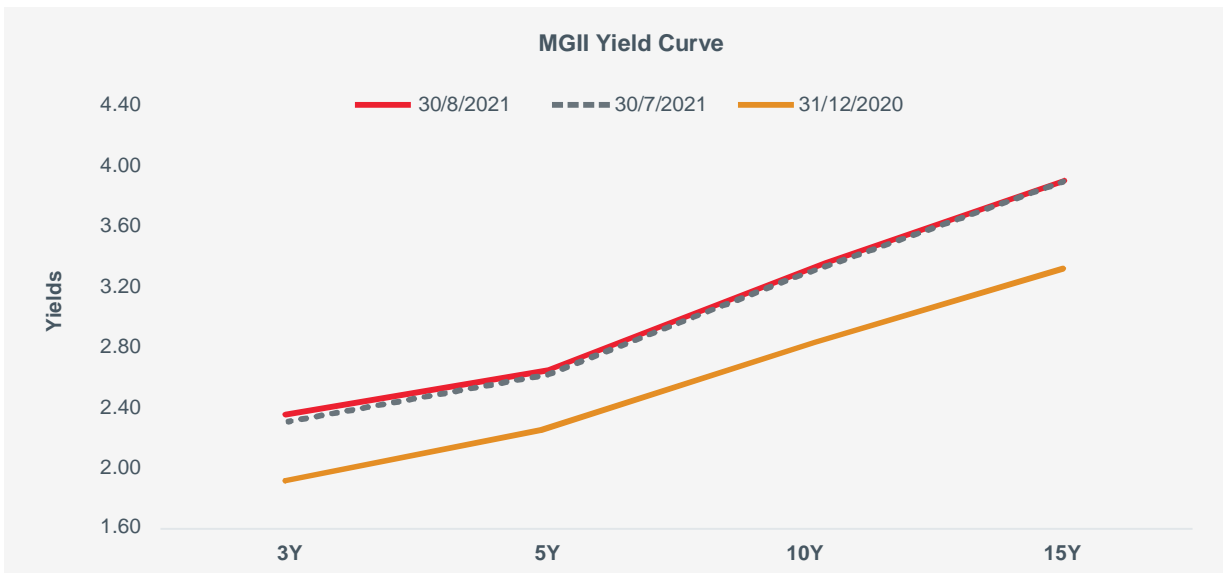
Source: Bloomberg



Source: Bloomberg

BENCHMARK	Dec 2020 Yield	Jul 2021 Yield	Aug 2021 Yield	MOM Change	YTD Change
3-year MGII	1.92%	2.30%	2.36%	+ 6 bps	+ 44 bps
5-year MGII	2.26%	2.61%	2.64%	+ 3 bps	+ 38 bps
10-year MGII	2.81%	3.29%	3.31%	+ 2 bps	+ 50 bps
15-year MGII	3.32%	3.89%	3.89%	+ 0 bps	+ 57 bps

Source: Bloomberg



Source: Bloomberg



OUTLOOK

- ▶ The confirmed Covid-19 cases continue to rise across the world, albeit at a slower pace, surpassing 218m with approximately 4.5m fatalities. We note that the effectiveness of Covid-19 vaccines against mutated variants has become the key risk to sustainable economic growth as reports showed lower efficacy rate of vaccines against new variants and waning effectiveness over time. Specifically, the more infectious Delta variant seems to have put a ray of doubt about reopening the economy safely. That said, it is encouraging that vaccination rate continued to advance in major economies and most Asian countries, raising hope that inoculation rate could accelerate the pace of economic recovery in the coming months. Presently, we understand that more than 5.43b doses of the Covid-19 vaccines have been administered across 183 countries or at a daily rate of 41m doses.
- ▶ Malaysia's headline inflation rate moderated further for the third straight month, coming in at 2.2% YoY in July 2021 from Jun 2021's 3.4% YoY attributable mainly to a sharp slowdown in costs of Housing, Water, Electricity, Gas and Other Fuels in July (+0.7% YoY compared to +3.2% YoY in Jun) and Transport (+11.6% YoY compared to +16.6% YoY in Jun), a result of electricity discount as well as fuel subsidy provided by the government. Year-to-date, inflation growth averaged 2.3% compared to -0.9% in 7M2020. Meanwhile, core CPI continued to hold steadily at 0.7% YoY for the second consecutive month, an indication that price pressures remained subdued amid the pandemic uncertainties. Full year inflation rate is expected to come in within BNM's forecast of 2.0% to 3.0%.
- ▶ There will be three auctions in Sep 2021, the re-opening of the 20Y MGII 09/41, the re-opening of the 10Y MGS 04/31 and the re-opening of the 5Y MGII 03/26. While there is still ample liquidity in the system, the outcome of these auctions is likely to be influenced by prevailing market sentiment. On the corporate front, we expect mixed demand for corporate bonds as investors continue to be selective in their investments.
- ▶ Malaysia's Pre-Budget Statement highlighted the challenges faced by the country and the stimulus aids required to cushion the impact of the pandemic triggered lockdowns. As a result, 2021 GDP growth forecast has been revised to 3.0% to 4.0% compared to 6.0% to 7.5% previously while fiscal deficit is estimated to increase to between 6.5% to 7.0% compared to 5.4% when the Budget 2021 was first announced. That said, the government reiterated its commitment to fiscal consolidation, guided by the Medium-Term Fiscal Framework and Medium-Term Revenue Strategy to broaden its tax base. As for 2022, the Budget will be formulated with the objective to support and spur economic recovery, rebuild resilience and catalyse socio-economic reforms.
- ▶ Malaysia's sovereign yield curve has bear steepened quite a fair bit since early of the year, underpinned by the narrative of a recovering economy and higher inflationary pressure in 2021. Having said that, concerns over a delay in the recovery trajectory triggered by the highly infectious Delta variant, both in Malaysia and globally, have provided support to bond prices. On balance, we still see a steepening bias in Malaysia's sovereign yield curve, where the shorter-end of the curve continues to be anchored by BNM's accommodative monetary stance while the longer-end of the curve will remain under pressure on the expected economic recovery, on the back of Malaysia's accelerating vaccination rate, fiscal slippages as well as unfavourable demand-supply dynamics. Going forward, we believe the performance of the bond market will continue to be dictated by economic data, effectiveness of vaccines against hospitalization and deaths, as well as global risk sentiment.



Table 1: Indicative Rates (%)

	31 Aug 21
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	1.76
3-mth BNM MN	1.77
3-mth KLIBOR	1.94
CP	
1-mth (P1)	2.24
3-mth (P1)	2.36

Source: Bloomberg/Bondstream

* Maybank2u.com.my

Table 2: Indicative Bond Yields (%)

	3 yr	5yr	7yr	10yr	15yr
MGS	2.40	2.65	3.09	3.22	3.77
GII	2.35	2.73	3.15	3.40	3.89
Swap rate*	2.37	2.63	2.84	3.09	3.34
AAA	2.76	3.09	3.41	3.71	4.28
AA1	2.89	3.24	3.53	3.85	4.44
AA2	3.02	3.38	3.66	3.98	4.57
AA3	3.15	3.50	3.78	4.11	4.69
A1	4.23	4.25	4.82	5.25	5.88
A2	5.01	5.45	5.88	6.41	7.20
A3	5.78	6.35	6.87	7.57	8.44

Source: Bloomberg*/Bondstream



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