eastspring investments

A member of Prudential plc (UK)

MARKET COMMENTARY

FIXED INCOME MARKET REVIEW AND OUTLOOK

January 2021

REVIEW

- The minutes of the Dec 2020 Federal Open Market Committee **("FOMC")** meeting showed the Federal Reserve **(the "Fed")** officials unanimously agreeing to continue the asset purchases until substantial further progress is made towards achieving the Committee's employment and inflation targets. It is also indicated in the minutes that the "substantial further progress" would be broad, qualitative and not based on specific numerical criteria or thresholds, providing the Fed significant flexibility to adjust its asset purchase program amid the highly uncertain macroeconomic environment. At a separate interview, the Fed Chair Jerome Powell said the Fed would require "clear evidence" that it is making progress toward the targets and pledged to "let the world know well in advance" when tapering of its asset purchases is being considered. The Fed also left its federal funds rate **("FFR")** unchanged at 0%-0.25% at its Jan 2021 FOMC and kept its asset purchases intact while noting that economic recovery appears to be moderating in recent months. Fed Chair Jerome Powell reiterated that the Fed will be patient on inflation and warned the pandemic still presents considerable downside risks after the latest FOMC meeting.

- With victories in Georgia's two hotly contested runoff elections in the first week of Jan 2021, the Democrats have now effectively taken control of the White House, the House of Representatives and the Senate, as an evenly split Senate allows Vice President Kamala Harris to break ties in the chamber. The Democrats' victory pushed the 10Y US Treasury yield to top the 1% psychological threshold for the first time since the pandemic began with investors pricing in expectations for more fiscal stimulus. The yield curve has also at the same time steepened, likely a reflection of Fed's guidance for the FFR to stay unchanged through the end of 2023, as well as a sign that the reflation trade is gaining momentum.

- Following his inauguration as the 46th U.S. President on 20 Jan 2021, Joe Biden wasted no time and signed off 15 executive orders and memorandums on his first day in office, to reverse some of the controversial measures by the previous administration, including ending the Muslim travel ban, re-joining the Paris Climate Accords, halting construction of the border wall, mandating mask use on federal property, as well as revoking the Keystone XL oil pipeline project. The new President also unveiled a 100-plus page national strategy to defeat Covid-19, focusing on vaccinations acceleration and virus containment. Besides, the Senate confirmed former Fed Chairwoman, Janet Yellen, as the U.S. Treasury Secretary with 85:15 votes. Meanwhile, 45 Republican senators voted in favour of the motion to declare former President Donald Trump's second impeachment trial as unconstitutional, making it clear that there will be no Senate conviction of Trump.

- The U.S. economy declined 3.5% in 2020, slightly better than the consensus' estimated 3.6% contraction, after registering a 4.0% QoQ growth in 4Q2020. Meanwhile, Democrats are set to release the party's draft budget resolution that will outline the maximum spending or revenue losses for another round of Covid-19 relief soon. It is reported that Democrats are ready to pass the additional stimulus via the budget reconciliation process that requires only a simple majority in the Senate compared to the regular 60-vote threshold for most major legislation. Further to that, it is understood that 10 Republican senators have asked President Biden to work with them on a USD618b bipartisan coronavirus relief package, about one-third of the USD1.9tr package proposed by the President.

- On the local front, the continued increase in Covid-19 cases forced the government to announce the re-imposition of full Movement Control Order **("MCO")** in Penang, Selangor, Malacca, Johor, Sabah, Kuala Lumpur, Putrajaya and Labuan as well as conditional and recovery MCO in other states from 13 Jan to 26 Jan 2021. The MCO was later extended to include all other states except for Sarawak until 18 Feb 2021. However, five sectors that are deemed essential, i.e. manufacturing, construction, services, trade and distribution as well as plantation and commodities, are allowed to operate during the MCO. To cushion the impact of the various degrees of MCO, which has an estimated RM600m-700m/day impact on the economy, the government announced a RM15b PERMAI stimulus package. Of the total, the estimated additional fiscal injection of RM6.6b is not expected to change the country's projected fiscal deficit of 5.4% in 2021. Meanwhile, private hospitals have been roped in to help ease the strain on the public healthcare system.

- Another key event to note in the month of Jan 2021 was the Agong's unexpected declaration of a state of emergency across Malaysia that will last until 1 Aug 2021, or earlier depending on the pandemic situation, in efforts to curb the spread of the Covid-19 virus following the recent spike in confirmed cases and infections emerging from new clusters. At the end of Jan 2021, Malaysia's cumulative Covid-19 cases were more than 200,000, the worst hit in the region.

- Having said that, Malaysia's vaccination plan continued to gain traction. The government signed another agreement with Pfizer-BioNTech for a further 12.2m doses of Covid-19 vaccine and this together with other agreements signed with AstraZenecca and COVAX are sufficient to vaccinate approximately 60% of the country's population. Meanwhile, Pharmaniaga Bhd announced the signing of a distribution agreement for 14m doses of vaccine with Sinovac that will be distributed in Mar 2021, suggesting frontloading of vaccination programme although actual rollout requires close monitoring. In addition, Duopharma Biotech Bhd also confirmed it will supply 6.4m doses of Russia's Sputnik V vaccine locally. All the vaccine arrangements in place to date are sufficient to vaccinate approximately 90% of the Malaysia's population with the first batch of vaccines reaching our shores in end February. Meanwhile, Health Director-General Tan Sri Dr Noor Hisham revealed that the nation's vaccination programme would be carried out in three phases involving frontline workers, vulnerable groups and all 17m Malaysians especially those who are working.

- Bank Negara Malaysia **("BNM")** kept its Overnight Policy Rate **("OPR")** unchanged at its first Monetary Policy Committee **("MPC")** of the year. While the policy rate was held steady, BNM again reiterated its commitment to utilize its policy levers as appropriate to support a sustainable economic recovery and indicated that its monetary stance going forward will be determined by new data and information and their implications on outlook and growth. The central bank highlighted that the pandemic and containment measures have affected Malaysia's recovery in 4Q2020 and as a result, growth for 2020 is expected to come in at the lower end of its earlier forecasted range of -3.5% to -5.5%. While growth in 2021 would be affected by the re-introduction of stricter containment measures, BNM opines that the impact will be less severe with growth trajectory improving from 2Q2021 onwards. The central bank has also extended the deadline for the use of government bonds by banks to meet their statutory reserve requirement **("SRR")** from 31 May 2021 to 31 Dec 2022, while maintaining the SRR at 2.00%.

- Separately on 28 Jan 2021, Moody's reaffirmed Malaysia's sovereign rating and outlook at A3/Stable citing Malaysia's strong medium-term growth prospects as well as its credible and effective macroeconomic policymaking institutions. These strengths, however, are moderated by the government's relatively high and increased debt burden that will weaken its fiscal strength for some time. While the rating agency expects a gradual fiscal consolidation over the next 2-3 years, it highlighted that it does not expect the rise in debt burden to reverse rapidly.

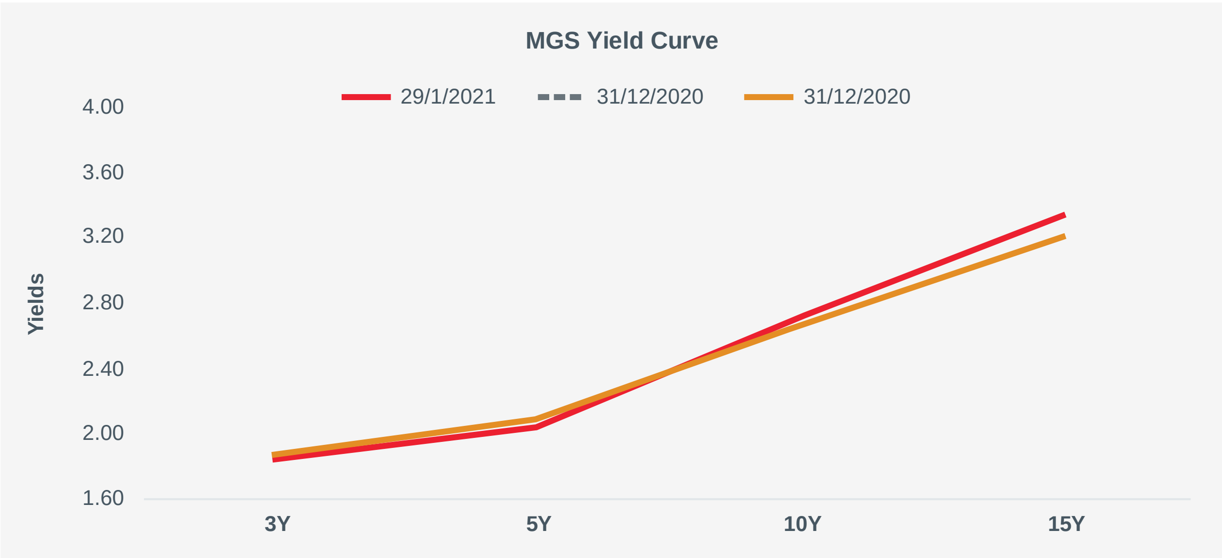
- The economic fallout caused by the pandemic has resulted in Malaysia registering the first annual deflation since 1969. In Dec 2020, Malaysia's inflation rate declined 1.4% YoY (Nov 2020: -1.7% YoY), attributable mainly to 8.4% YoY and 3.3% YoY declines in Transport (Nov 2020: -11.1% YoY) and Housing, Water, Electricity, Gas & Others Fuels (Nov 2020: -3.3% YoY). For the full year, the country's headline inflation rate contracted by an average of 1.2% YoY compared to +0.9% in the previous corresponding period. Inflation rate is expected to return to positive territory in 2021 on economic recovery, higher global oil prices on top of the low base effect in 2020.

- Malaysia's sovereign yield curve steepened in Jan 2021. The yields of the 3- and 5-year MGS declined 4bps and 5bps to close the month at 1.84% and 2.05% while the 10- and 15-year MGS rose 5bps and 13bps the end the month at 2.70% and 3.32% respectively. The shorter end of the curve was pretty much anchored by BNM's accommodative monetary stance and expectation of a possible OPR cut following the re-imposition of MCO while supply concerns continued to exert pressure on the longer-end of the curve. Likewise, MGII yields closed mixed during the month, with the 3-, 5-, and 10-year MGII closing 4bps, 6bps and 5bps lower at 1.88%, 2.20%, and 2.76%, respectively, while the 15-year MGII jumped 12bps to close the month at 3.44%.

- Three auctions were held in the month of Jan 2021, the re-opening of the 7-year MGS 06/28, the new 15.5-year MGII 07/36 and the re-opening of the 10-year MGS 04/31. The auctions received decent demand with an average bid-to-cover ratio of 2.31x given the lower-than-expected auction size.
    - RM3.5b re-opening of the 7-year MGS averaging 2.449% at a bid-to-cover ratio of 2.026x;
    - RM3.0b new 15.5-year MGII averaging 3.447% at a bid-to-cover ratio of 2.917x; and
    - RM4.0b re-opening of the 10-year MGS averaging 2.714% at a bid-to-cover ratio of 1.992x.

BENCHMARK	31/12/2020 Yield	31/12/2020 Yield	29/01/2021 Yield	MOM Change	YTD Change
3-year MGS	1.88%	1.88%	1.84%	- 4 bps	- 4 bps
5-year MGS	2.10%	2.10%	2.05%	- 5 bps	- 5 bps
10-year MGS	2.65%	2.65%	2.70%	+ 5 bps	+ 5 bps
15-year MGS	3.19%	3.19%	3.32%	+ 13 bps	+ 13 bps

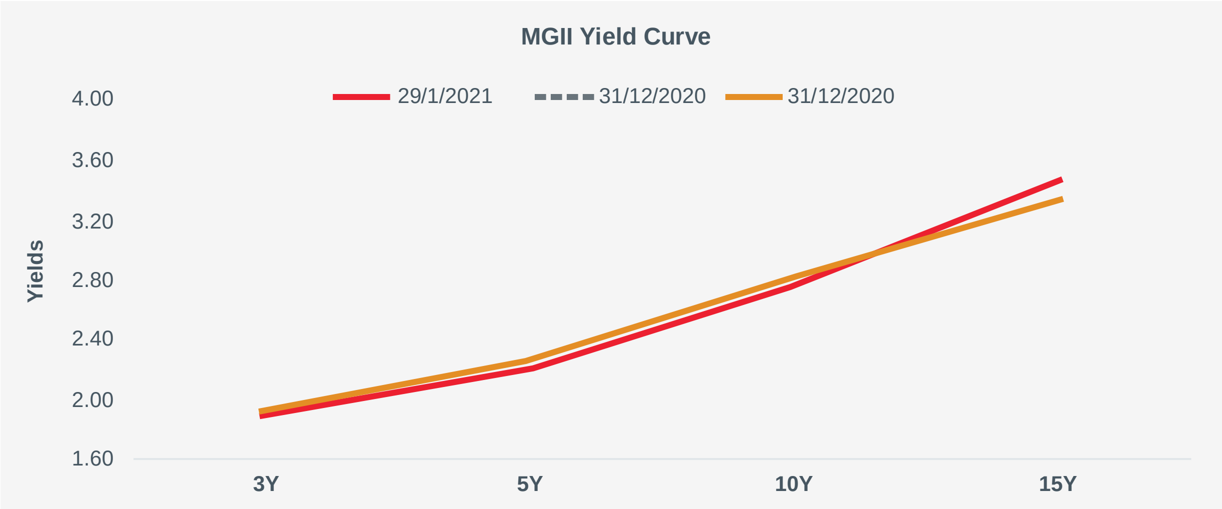
Source: Bloomberg



Source: Bloomberg

BENCHMARK	31/12/2020 Yield	31/12/2020 Yield	29/01/2021 Yield	MOM Change	YTD Change
3-year MGII	1.92%	1.92%	1.88%	- 4 bps	- 4 bps
5-year MGII	2.26%	2.26%	2.20%	- 6 bps	- 6 bps
10-year MGII	2.81%	2.81%	2.76%	- 5 bps	- 5 bps
15-year MGII	3.32%	3.32%	3.44%	+ 12 bps	+ 12 bps

Source: Bloomberg



Source: Bloomberg

OUTLOOK

- The confirmed Covid-19 cases continue to rise across the world, surpassing 100m with over 2.2m fatalities. On a more positive development, Pfizer-BioNTech's Covid-19 vaccine appears able to protect against a key mutation in the highly transmissible new variants of the coronavirus discovered in Britain and South Africa. Presently, we understand that at least 42 countries (36 high-income countries and 6 middle-income countries) are rolling out their respective vaccination programmes. In addition, Johnson & Johnson's single-shot coronavirus vaccine was reported to have an efficacy rate of 66% in a Phase 3 clinical trial, a level of protection above the Food and Drug Administration's minimum. While Johnson & Johnson's vaccine appears to be less effective than other vaccines, it could still be a game changer given its ease of transportation and affordability that are expected to benefit developing countries.
- In Malaysia, the National Pharmaceutical Regulatory Agency has granted conditional approval for Pfizer-BioNTech's covid-19 vaccine and Malaysia is set to receive its first batch of vaccine by end-Feb 2021. The recent news on additional vaccines secured by private sector as well as the possible involvement of private healthcare in the vaccination plan are supportive of the government's plan to immunise 80% of its population by 1Q2022. While the MCO is expected to adversely affect the country's economic recovery, the government has maintained its 2021 economic growth forecast at 6.5%-7.5%, underpinned by the expansionary 2021 Budget as well as the various stimulus packages announced. More importantly, the country's projected fiscal deficit of 5.4% in 2021 has also been kept unchanged.
- During her nomination hearing, Yellen outlined several of her priorities including the support for Biden's USD1.9tr stimulus plan, higher taxes on corporations and the wealthy after reining in the pandemic as well as an immediate review of U.S. financial sanctions policy administered by the U.S Treasury. Yellen also indicated that the country's long-term fiscal trajectory is a cause for concern although the impact is mitigated by the very low interest rate environment. On China, Yellen regards China as U.S.' most important strategic competitor and urged that the U.S. must make investments to enable it to compete with China. In the immediate term, we expect the Biden administration to focus on containing the spread of the pandemic through vaccine rollout as well as securing additional fiscal stimulus for the economy to sustain its recovery pace. While we expect the Congress to pass additional stimulus aids in the coming weeks, the negotiation process itself could bring some volatility to the markets, in our view.

- In its latest World Economic Outlook report, the International Monetary Fund ("IMF") raised its forecast for global economic growth in 2021 to 5.5% (+0.3% from its Oct 2020 forecast) and said the coronavirus-triggered global economic contraction in 2020 would come in at 3.5% compared to the 4.4% decline predicted earlier on given the stronger-than-expected rebound in 2H2020. Meanwhile, the U.S. economy is expected to grow 5.1% in 2021, a significant 2% upward revision, benefitting partly from the USD900b additional fiscal aid approved in Dec 2020. Growth could improve further if further stimulus is approved by the U.S. Congress. China's growth projection for 2021, on the other hand, was revised down slightly to 8.1% compared to its Oct 2020 forecast of 8.2%. Similarly, the 2021 growth estimate for ASEAN-5 was brought lower to 5.2% from 6.2% previously. Meanwhile, IMF warned that the global economy continues to face exceptional uncertainty and global economic activity would remain well below pre-Covid projections.

- The declaration of a state of emergency in Malaysia has effectively removed, for now, the heightened political risk triggered by the recent news that the key component of the current Perikatan Nasional ("PN") coalition government, i.e. UMNO, might withdraw its support, leading to a collapse of Prime Minister Muhyiddin Yassin's government. This coupled with the announcement of various MCO since 11 Jan 2021 would allow the PN government to focus on containing the spread of Covid-19.

- There will be three auctions in Feb 2021, the 5Y reopening of MGII 03/26, the 20Y reopening of MGS 05/40 and the 7Y reopening of MGII 09/27. 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 remain cautious on the still evolving pandemic situation.

- We opine that fiscal policy, especially direct stimulus, is a more effective way in sustaining growth and shoring up economic activities when compared to further monetary easing given the already low interest rate environment. The weakness in consumption caused by the MCO is expected to be largely offset by the new stimulus measures announced. We believe BNM's latest OPR decision is a reflection of its confidence over the country's recovery trajectory. Against this backdrop, BNM's next move will be largely data dependent and the country's labour situation is the key statistic to watch, in our opinion. Meanwhile, the extension of the flexibility for banks to use MGS/MGII to meet the SRR compliance is supportive of the bond market. It is understood that the 100bps SRR cut and the flexibility granted in 2020 released approximately RM46b worth of liquidity into the banking system.

- On balance, we continue to see a bear steepening bias in Malaysia's sovereign yield curve where short-term rates continued to be anchored by BNM's accommodative monetary policy stance, while the longer-end of the curve will come under pressure on the expected economic recovery, as well as the unfavourable demand-supply dynamics. Having said that, we highlight that the increase in yields will likely be gradual and capped following the re-imposition of MCO that is expected to delay a strong economic recovery and restoration of normalcy although the negative impact brought about by the MCO will be cushioned by the new stimulus aid. Going forward, we believe the performance of the bond market will continue to be dictated by the upcoming economic data, effectiveness of pandemic containment measures, the vaccine rollout progress, as well as global risk sentiment.

Table 1: Indicative Rates	
	31-Jan-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	1.75%
3-mth BNM MN	1.75%
3-mth KLIBOR	1.94%
CP	
1-mth (P1)	2.33%
3-mth (P1)	2.43%

Source: Bloomberg/Bondstream
* Maybank2u.com.my

Table 2: Indicative Bond Yields (%)					
	3 yr	**5yr**	**7yr**	**10yr**	**15yr**
MGS	1.93	2.13	2.42	2.68	3.38
GII	1.95	2.19	2.54	2.79	3.39
Swap rate*	1.98	2.18	2.34	2.60	2.78
AAA	2.43	2.68	2.92	3.29	3.83
AA1	2.60	2.83	3.08	3.43	3.94
AA2	2.76	3.00	3.24	3.56	4.04
AA3	2.92	3.16	3.39	3.70	4.14
A1	4.11	4.42	4.71	5.07	5.67
A2	4.89	5.32	5.72	6.20	6.98
A3	5.66	6.22	6.69	7.33	8.21

Source: Bloomberg*/Bondstream