eastspring investments

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MARKET COMMENTARY

FIXED INCOME MARKET REVIEW AND OUTLOOK

June 2021

REVIEW

- The US Federal Reserve **(**the **"Fed")** kept its federal funds rate **("FFR")** unchanged at 0%-0.25% and pledged to continue its asset purchases programme of at least USD120b US Treasury and mortgage-backed securities at its Jun 2021 Federal Open Market Committee **("FOMC")** meeting. However, the Fed's revised dot projections show majority officials expect two rate hikes by end-2023, a year earlier than previously indicated, in view of the strengthening pace of economic recovery. Notably, 2021 economic growth and inflation have been revised upward to 7.0% and 3.4% from 6.5% and 2.4% respectively, although no revision was made to the projected 4.5% unemployment rate in 2021. It is also understood that the FOMC has started the tapering discussion. That said, Fed Chair reiterated that the spike in inflation is transitory and the Fed would not raise interest rates pre-emptively based only on the fear of coming inflation.

- After several rounds of negotiations, President Biden announced that a bipartisan agreement on a compromised USD1.2tr infrastructure spending over the next 8 years has been reached. The deal includes a USD579b new spending in "hard" infrastructure over the first five years, conditioned upon passing a party-line reconciliation bill covering the President's other initiatives, the caregiving economy and climate change mitigation investments, as well as tax increases. It is worth noting than more than half of the US population has received at least one dose of vaccine as of end-Jun 2021.

- The G7 summit, which was held in Cornwall, saw the member countries discuss international alliances, pandemic responses and concerns over China's economic and security dominance. The G7 agreed to finance infrastructure in developing countries, named Build Back Better World initiative **("B3W")**, to counter China's Belt and Road Initiative. The countries also reached a landmark agreement to impose a global minimum tax of at least 15% on multinational corporations at the summit, a move that Treasury Secretary Janet Yellen said will end the race-to-the-bottom corporate taxation.

- The Malaysian government **("GoM")** outlined a four-phase pandemic exit strategy, named the National Recovery Plan **("NRP")** to provide guidance on easing of restrictions based on daily Covid-19 cases, utilization rate of intensive care units **("ICU")** and the country's vaccination rate. Under the NRP, all economic activities will resume and restrictions on interstate travel and domestic tourism will be lifted in Phase 4, as early as end-Oct 2021, when daily infections fall below 500, ICU utilization rate at reasonable level and 60% of population vaccinated. The government indicated that the full lockdown will incur an estimated daily economic loss of RM1.0b. Following the extension of the full lockdown, the GoM unveiled the RM150b PEMULIH stimulus aid with RM10b direct fiscal injection to support the economy and businesses affected by the lockdown. Key measures under PEMULIH include cash handouts to households, wage subsidies, an opt-in loan moratorium as well as a new EPF withdrawal scheme.

- As of 2 Jul 2021, 18.7% of the population have had their 1st dose while 7.5% of the population have been fully inoculate. More positively, the GoM expects 10% of its population will be fully vaccinated by mid-July and 89% of the population in Kuala Lumpur and Putrajaya to be vaccinated by Aug 2021.

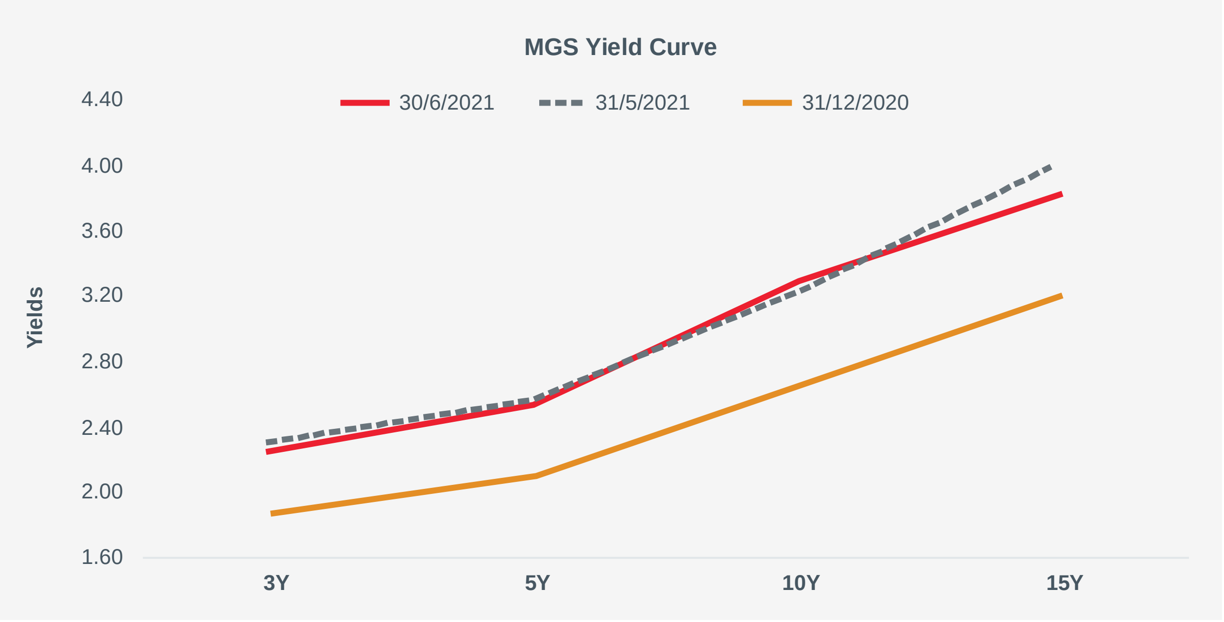
- Moody's reaffirmed Malaysia's A3 sovereign rating with a stable outlook after the announcement of the PEMERKASA+ stimulus package that would exert further downward pressure on the country's fiscal position. The rating agency is of the opinion that the pandemic will not have a sustained negative impact on Malaysia's economic model. Similarly, S&P maintained Malaysia's A- sovereign rating and negative outlook citing the country's strong external position, monetary policy flexibility and sustainable economic growth. However, elevated government debt and heightened political uncertainty remain key weaknesses of the sovereign credit profile.

- Malaysia's sovereign yield curve flattened in June 2021. The yields of the 3-, 5- and 15-year MSG dropped 4bps, 5bps and 19bps lower to close the month at 2.27%, 2.54% and 3.81% respectively while the yield of the 10-year MGS rose 5bps and ended the month at 3.28%. The market was supported by the risk-off sentiment on concerns over the country's growth prospects following the extension of the full lockdown, triggered by the still elevated Covid-19 infections. This is despite the potential higher govvies supply from the additional stimulus announced by the government. Meanwhile, the yields of MGII closed mixed with the 3- and 10-year MGII closing 26bps and 5bps higher at 2.30% and 3.35% respectively while the 5- and 15-year MGII ended 3bps and 8bps lower at 2.69% and 4.00% respectively. That said, the steep increase in the 3-year MGII yield was attributable mainly to the change of benchmark security in Jun 2021.

- Three auctions were held in the month of Jun 2021, the re-opening of the 10-year MGS 04/31, the re-opening of the 3-year MGII 10/24 and the re-opening of the 20-year MGS 05/40. The auctions received an average bid-to-cover ratio of 2.206x.
  - RM4.5b re-opening of the 10-year MGS averaging 3.313% at a bid-to-cover ratio of 1.966x;
  - RM4.5b re-opening of 3-year MGII averaging 2.341% at a bid-to-cover ratio of 2.001x; and
  - RM2.0b re-opening of the 20-year MGS averaging 4.254% at a bid-to-cover ratio of 2.651x.

BENCHMARK	Dec 2020 Yield	May 2021 Yield	Jun 2021 Yield	MOM Change	YTD Change
3-year MGS	1.88%	2.31%	2.27%	-4 bps	+ 39 bps
5-year MGS	2.10%	2.59%	2.54%	- 5 bps	+ 44 bps
10-year MGS	2.65%	3.23%	3.28%	+ 5 bps	+ 63 bps
15-year MGS	3.19%	4.00%	3.81%	- 19 bps	+ 62 bps

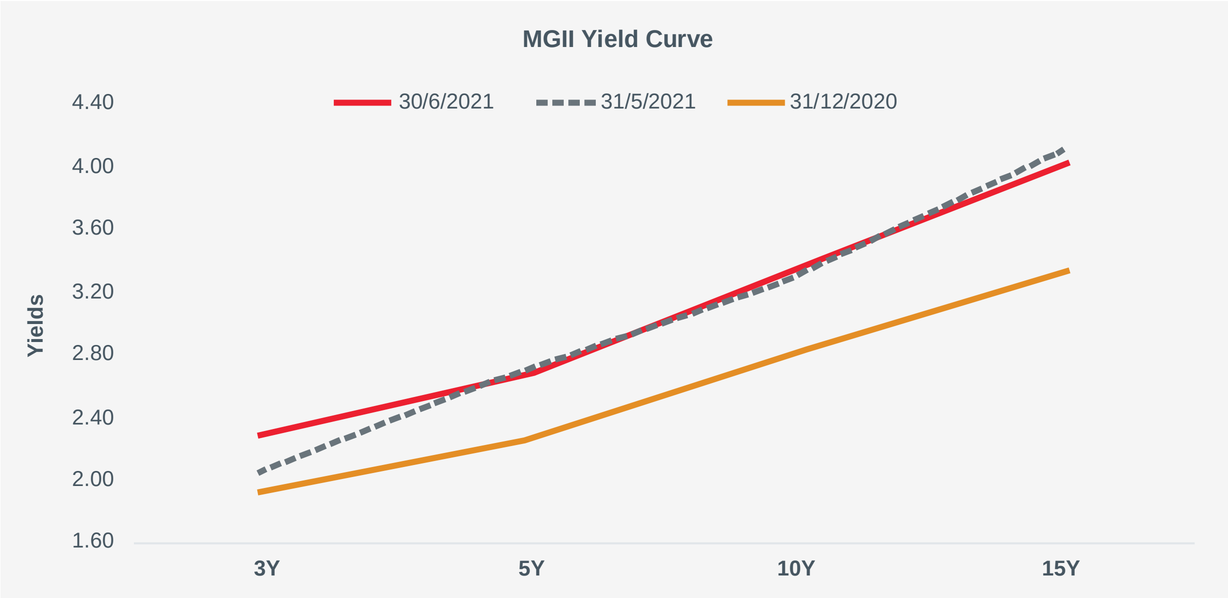
Source: Bloomberg



Source: Bloomberg

BENCHMARK	Dec 2020 Yield	May 2021 Yield	Jun 2021 Yield	MOM Change	YTD Change
3-year MGII	1.92%	2.04%	2.30%	+ 26 bps	+ 38 bps
5-year MGII	2.26%	2.72%	2.69%	- 3 bps	+ 43 bps
10-year MGII	2.81%	3.30%	3.35%	+ 5 bps	+ 54 bps
15-year MGII	3.32%	4.08%	4.00%	- 8 bps	+ 68 bps

Source: Bloomberg



Source: Bloomberg

OUTLOOK

- The confirmed Covid-19 cases continue to rise across the world, albeit at a slower pace, surpassing 182m with approximately 4.0m fatalities. We note that the detection of more infectious variants and availability of vaccines have continued to pose challenges in achieving herd immunity. That said, G7 leaders have committed to collectively donate at least one billion doses of vaccines over the next year to developing countries. Of note, U.S. will donate a total of 500m doses of Prizer-BioNTech vaccines overseas via the Covax initiative, on top of the initial committed 80m doses. Presently, we understand that more than 3.14b doses of the Covid-19 vaccines have been administered across 180 countries or at a daily rate of 40.8m doses. That said, the spread of the highly transmissible delta variant is weighing on market sentiment although recent studies found that vaccines produced by Pfizer-BioNTech and AstraZeneca-Oxford offered considerable protection against hospitalization from the new variant.

- Malaysia's headline inflation rate moderated slightly to 4.4% YoY in May 2021 from Apr 2021's high of 4.7% YoY attributable mainly to a slower growth in food and transport prices. Year-to-date, inflation growth averaged 2.1% compared to -0.6% in the first five months of 2020. Meanwhile, core CPI inched up for the first time in seven months to 0.8% YoY, after holding steady at 0.7% YoY in the past six months.

- There will be three auctions in July 2021, the re-opening of the 15Y MGII 07/36, the re-opening of the 5Y MGS 11/26 and the re-opening of the 10Y MGII 10/30. 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 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 extended lockdown and the expected transient inflation spikes provided support to the bond market in recent weeks. 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, 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 pandemic containment measures, the vaccine rollout progress, as well as global risk sentiment.

Table 1: Indicative Rates (%)

	30 June 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)	2.38
3-mth (P1)	2.49

Source: Bloomberg/Bondstream
* Maybank2u.com.my

Table 2: Indicative Bond Yields (%)					
	3 yr	**5yr**	**7yr**	**10yr**	**15yr**
MGS	2.27	2.68	3.01	3.29	3.89
GII	2.24	2.76	3.12	3.45	3.98
Swap rate*	2.37	2.63	2.82	3.12	3.34
AAA	2.77	3.14	3.47	3.86	4.39
AA1	2.91	3.29	3.62	4.01	4.54
AA2	3.08	3.44	3.77	4.15	4.66
AA3	3.23	3.56	3.89	4.27	4.77
A1	4.25	4.56	4.87	5.27	5.90
A2	5.02	5.48	5.91	6.43	7.22
A3	5.79	6.38	6.90	7.59	8.46

Source: Bloomberg*/Bondstream