A member of Prudential plc (UK)

MARKET COMMENTARY

FIXED INCOME MARKET REVIEW AND OUTLOOK

May 2021

REVIEW

- The minutes of the most recent Federal Open Market Committee **("FOMC")** meeting showed the economic activity had picked-up sharply although the economy is still far from reaching the Committee's unemployment and inflation targets. While members in general agreed that inflation is likely to be transitory, the supply chain bottleneck and tighter labour market are expected to exert upward pressure on wages and prices going forward. More importantly, some officials indicated that it might be appropriate to start discussing about adjusting its ongoing asset purchase program at the upcoming meetings, a shift from FOMC's previous meeting in Mar 2021. That said, the FOMC is expected to be clear in its messaging before any tapering takes place.

- Despite a series of offers and counteroffers made by President Biden and the Senate Republicans on the President's infrastructure bill, no agreement has been reached thus far and further debates and negotiations are expected to continue in the coming weeks. Recall that Republican senators had first proposed a significantly reduced bill of USD568b to counter the President's USD2.3tr plan and the President responded with a USD1.7tr counterproposal which was again rejected by the Republicans with a refreshed offer of USD928b. Meanwhile, the U.S. Treasury Department indicated that 15% is the floor for the global minimum tax to start with and discussions should continue to push for a higher rate. The global minimum tax is one of the funding sources of President Biden's ambitious infrastructure plan and it was reported that France and Germany are supportive of the proposed 15% tax rate. On top of the considerable infrastructure spending, Biden has also proposed the largest post-World War II budget of USD6.0tr in spending for fiscal year 2022, highlighting the administration's desire to push forward with progressive expansionary policies. The budget is expected to be funded by a retrospective increase in the capital gains tax rate, which would raise the top rate to 43.4% from 23.8% for households with income over USD1m.

- The U.S. vaccination campaign reached a key milestone in May 2021 with over half of its population aged 18 and above fully vaccinated, while close to 50% of Americans of all ages have received at least one dose of a Covid-19 vaccine. The country is now expanding its vaccination programme to teenagers, authorizing the emergency use of Pfizer-BioNTech vaccine to include adolescents from 12 to 15 years old that account for approximately 5.1% of U.S. total resident population. Meanwhile, Sinovac became the second Chinese Covid-19 vaccine producer to receive the World Health Organization's authorization for emergency use of its vaccine, after state-owned Sinopharm Group was authorized in early May 2021.

- In response to the rising daily Covid-19 infections, the Malaysian government re-imposed a full movement control order **("FMCO")** for two weeks from 1 June until 14 June, the first of three phases of lockdown. Restrictions under the FMCO are similar to those during the first MCO in 2020 (**"MCO 1.0"** from 18 Mar to 3 May) with only essential economic and service sectors allowed to operate at 60% capacity. Meanwhile, Phase 2, which is estimated to span four weeks, and Phase 3 will see the reopening of economic sectors and implementation of relatively more relaxed rules. The FMCO is expected to have a more pronounced impact on the economy compared to the less restrictive movement controls, CMCO and MCO 2.0, which were estimated to cost the economy RM300m-600m per day. That said, a new stimulus package, named PEMERKASA+, worth RM40b (with RM5b direct fiscal injection) was subsequently announced by the government to mitigate the downside risk to growth caused by the FMCO. Among the key targeted measures are direct cash handouts, wage subsidies, loan moratorium as well as additional credit facilities to small businesses. While the government indicated that it is still too early to quantify the impact of the lockdown and the PEMERKASA+ fiscal aid, it acknowledged that a revision to its forecasted fiscal deficit and statutory debt to GDP of 6% and 58.5% for 2021 is warranted.

- As of 1 Jun 2021, some 3.1m shots have been administered with 1.1m individuals having fully inoculated while 2.0m individuals receiving the first dose of the Covid-19 vaccine. Meanwhile, more than 12m individuals have registered for the immunization programme.

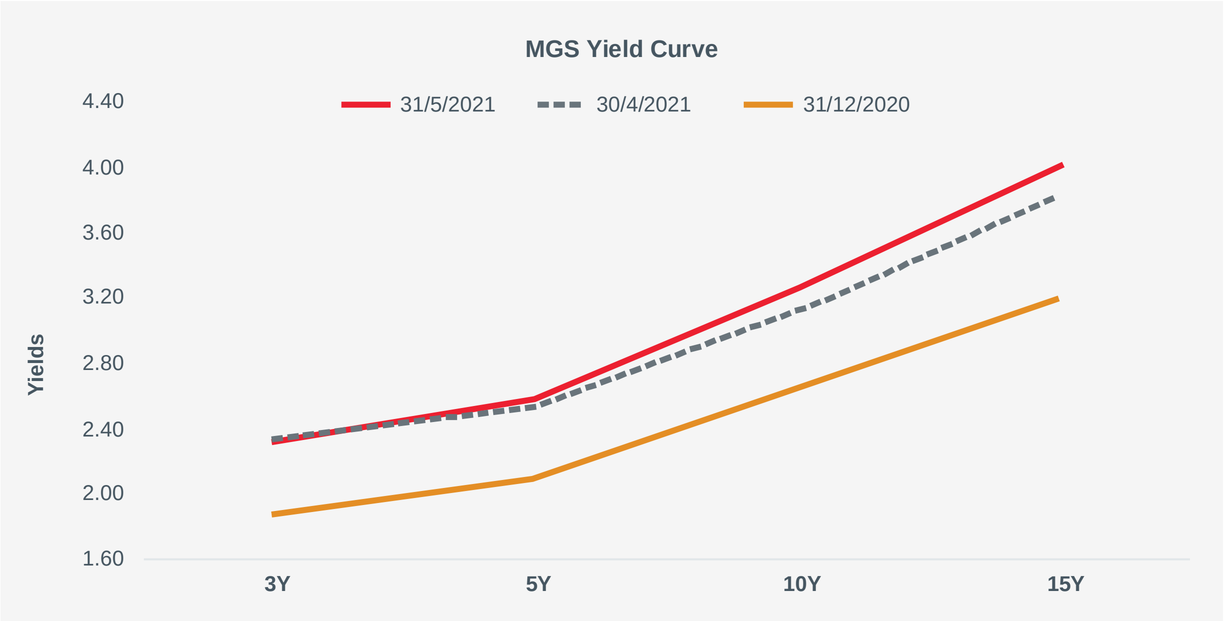
- Malaysia posted a 0.5% YoY decline in its 1Q2021 GDP (4Q2020: -3.4% YoY), negatively affected by the pandemic driven movement restrictions. Despite that, Bank Negara Malaysia **("BNM")** deemed the 1Q2021 performance as "better-than-expected" as the Covid-19 impact was cushioned by the improved domestic demand and strong export performance, particularly exports for electrical and electronic products. Furthermore, there are early signs of recovery in the labour market as evidenced by the improvement in employment. While BNM maintained its 2021 growth forecast of 6.0%-7.5%, it warned that downside risk to 2021 growth remains on the back of slower-than-expected vaccine rollout and major infrastructure projects. Elsewhere, Moody's expects Malaysia's GDP to grow 5.0% to 5.5% in 2021, supported by the base effects and the government's stimulus packages although it also noted the restrictions on movement and activity, stemming from the still high daily Covid-19 cases, will weigh on the recovery.

- Malaysia's sovereign yield curve steepened in May 2021. The yield of the 3-year MSG dropped 3bps to close the month at 2.31% while yields of the 5-, 10- and 15-year MGS rose 6bps, 12bps and 19bps to end the month at 2.59%, 3.23% and 4.00% respectively. The shorter end of the curve was pretty much anchored by BNM's accommodative monetary stance as well as the risk-off sentiment triggered by the heightened downside risk to growth while the re-imposition of FMCO and expected higher govvies supply from the additional stimulus aid exerted pressure on the mid- to longer-end of the curve. Likewise, the yield of the 3-year MGII declined 12bps at 2.04% while the 5-, 10- and 15-year MGII ended 7bps, 4bps and 23bps higher at 2.72%, 3.30% and 4.08% respectively.

- Three auctions were held in the month of May 2021, the re-opening of the 30-year MGII 11/49, the re-opening of the 15-year MGS 05/35 and the re-opening of the 5-year MGII 03/26. The auctions received an average bid-to-cover ratio of 2.294x.
  - RM2.0b re-opening of the 30-year MGII averaging 4.568% at a bid-to-cover ratio of 2.433x;
  - RM2.5b re-opening of 15-year MGS averaging 3.956% at a bid-to-cover ratio of 2.445x; and
  - RM4.5b re-opening of the 5-year MGII averaging 2.728% at a bid-to-cover ratio of 2.003x.

BENCHMARK	Dec 2020 Yield	Apr 2021 Yield	May 2021 Yield	MOM Change	YTD Change
3-year MGS	1.88%	2.34%	2.31%	-3 bps	+ 43 bps
5-year MGS	2.10%	2.53%	2.59%	+ 6 bps	+ 49 bps
10-year MGS	2.65%	3.11%	3.23%	+ 12 bps	+ 58 bps
15-year MGS	3.19%	3.81%	4.00%	+ 19 bps	+ 81 bps

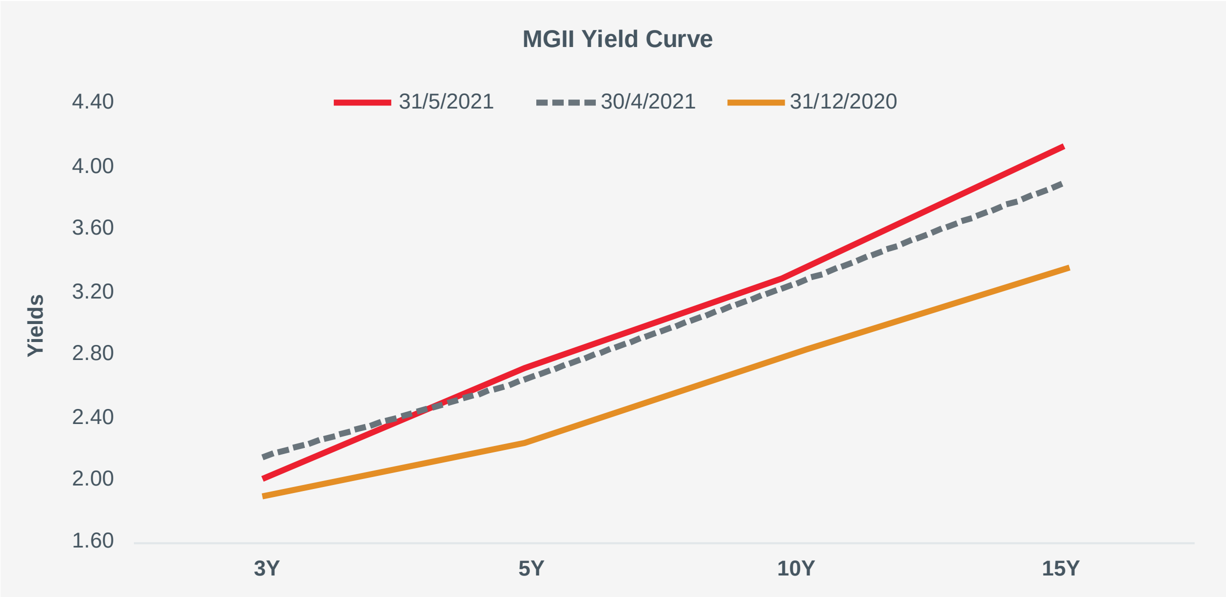
Source: Bloomberg



Source: Bloomberg

BENCHMARK	Dec 2020 Yield	Apr 2021 Yield	May 2021 Yield	MOM Change	YTD Change
3-year MGII	1.92%	2.16%	2.04%	- 12 bps	+ 12 bps
5-year MGII	2.26%	2.65%	2.72%	+ 7 bps	+ 46 bps
10-year MGII	2.81%	3.26%	3.30%	+ 4 bps	+ 49 bps
15-year MGII	3.32%	3.85%	4.08%	+ 23 bps	+ 76 bps

Source: Bloomberg



Source: Bloomberg

OUTLOOK

- The confirmed Covid-19 cases continue to rise across the world, albeit at a slower pace, surpassing 170m with approximately 3.5m fatalities. We note that efficacy, fears of potentially deadly side effects, detection of more infectious variants and the availability of vaccines are among the challenges faced in achieving herd immunity although developed countries comparatively have delivered better vaccination progress. Presently, we understand that more than 1.91b doses of the Covid-19 vaccines have been administered across 176 countries or at a daily rate of 33.5m doses. In Asia, the recent resurgence of Covid-19 infections in countries such as China's Liaoning and Guangdong provinces, Taiwan, Singapore and Malaysia have led to the governments tightening their containment measures to curb the spread of new variants. That said, commitment by Moderna to provide 500m doses of its vaccine to Covax starting 4Q2021 to boost global vaccination effort as well as news that Sinovac's vaccine was found to have a more than 90% protection rate among health workers in Jakarta are encouraging developments for developing countries.

- Malaysia's headline inflation rate accelerated to a four-year high of 4.7% YoY in Apr 2021 after registering a 1.7% YoY growth in the previous month. The jump in inflation was attributable mainly to the expiry of electricity rebates, part of the country's fiscal aids, as well as higher commodity prices and supply chain disruptions, which are deemed transitory. Average inflation now stood at 1.6% year-to-date while overall core inflationary pressures remain muted, coming in unchanged at 0.7% YoY in Apr 2021 for the sixth consecutive month.

- There will be three auctions in Jun 2021, the re-opening of the 10Y MGS 04/31, the re-opening of the 3Y MGII 10/24 and the re-opening of the 20Y MGS 05/40. 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. Following the re-imposition of a full lockdown nationwide, we expect investors to stay cautious and be watchful of the pandemic situation especially on the possibility of a FMCO extension, the vaccination progress as well as the potential impact on the country's economy and fiscal position. We believe concerns over a delay in the recovery trajectory, sticky jobless rate and the expected transient inflation spikes will contribute to some consolidation in the market in the near term. However, we believe concerns over the Covid-19 resurgence will normalize over time and hence upside risk for the sovereign yields remain. 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 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 (%)	
	31-May-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	1.78
3-mth BNM MN	1.79
3-mth KLIBOR	1.94
CP	
1-mth (P1)	2.40
3-mth (P1)	2.52

Source: Bloomberg/Bondstream
* Maybank2u.com.my

Table 2: Indicative Bond Yields (%)

	3 yr	5yr	7yr	10yr	15yr
MGS	2.30	2.71	3.03	3.25	4.02
GII	2.29	2.78	3.12	3.38	4.04
Swap rate*	2.32	2.66	2.90	3.15	3.38
AAA	2.84	3.17	3.48	3.89	4.48
AA1	2.94	3.29	3.63	4.04	4.59
AA2	3.07	3.42	3.76	4.16	4.68
AA3	3.23	3.56	3.87	4.26	4.76
A1	4.21	4.53	4.85	5.27	5.90
A2	5.00	5.46	5.90	6.43	7.22
A3	5.77	6.36	6.89	7.59	8.46

Source: Bloomberg*/Bondstream