A member of Prudential plc (UK)

MARKET COMMENTARY

FIXED INCOME MARKET REVIEW AND OUTLOOK

October 2021

REVIEW

- The Federal Reserve **("Fed")** kept its federal funds rate unchanged at 0%-0.25% at its Nov 2021 Federal Open Market Committee **("FOMC")** meeting but decided to reduce its monthly asset purchases programme of US Treasury and mortgage-backed securities by USD15b from USD120b previously starting mid-Nov 2021, implying a mid-2022 finish to tapering, as indicated in the Sep FOMC minutes, opening the door for a rate hike cycle in 2H2022. Having said that, the FOMC held on to its transitory inflation narrative, acknowledging that inflationary pressure is likely to last until 1Q2022 and maximum employment could be reached by mid-2022.

- The U.S. averted a possible debt default in Oct 2021 after the Senate agreed to raise the debt ceiling by USD480b through 3 Dec 2021. Meanwhile, the Democrats' impasse over the larger reconciliation package has yet to be resolved despite months of tense talks and the announcement of a much smaller USD1.75tr social spending package from the previous USD3.5tr to bridge the divisions between progressive and moderate Democrats. That said, the House has passed the bipartisan infrastructure bill at the time of writing. Separately, the U.S. 3Q2021 advance GDP growth came in at 2.0% annualized versus consensus 2.6% on weaker goods spending, triggered by supply chain bottlenecks, impact of the Delta variant, inflation as well as waning pent-up demand.

- China's 3Q2021 GDP slowed to 4.9% YoY (2Q2021: 7.9% YoY) on the back of power shortage that affected industrial production growth and a contraction in fixed asset investment, mainly weighed down by property investment. Overall, the economy grew 9.8% YoY in 9M2021. While 4Q2021 growth is expected to remain challenging, recent directives by China Banking and Insurance Regulatory Commission to encourage new loan extension to selected sectors including coal, electricity and heating sectors, as well as the People's Bank of China's pledge to ensure orderly lending and maintain market liquidity are expected to cushion the slowdown. Meanwhile, China's Sept 2021 PPI accelerated to 10.7% YoY (Aug +9.5% YoY) on soaring energy prices although headline CPI softened to 0.7% YoY (Aug: 0.8% YoY) attributable mainly to lower pork price.

- U.S. Treasury Secretary Yellen indicated that the U.S. expects China to meet its commitments under the Phase 1 trade deal entered into under the Trump administration and could look at eventually lowering some tariffs in a reciprocal way, which will have a disinflationary effect. It is worth noting that the US-China relations remain tense following the formation of the new AUKUS security pact in Asia Pacific between Australia, the U.K. and the U.S., a response to China's growing power and assertiveness in Asia.

- Malaysia lifted interstate travel restriction for fully vaccinated individuals from 11 Oct 2021 after 90% of the country's adult population were fully inoculated. With the improved situation, the country is ready to enter the endemic phase by following the footsteps of neighbouring countries to re-open its borders to qualified international travellers. Notably, fully vaccinated foreign tourists are allowed to visit Langkawi without having to undergo a quarantine from 15 Nov onwards although they are required to have sufficient insurance coverage. Meanwhile, Indonesia and Malaysia will hold talks for a mutual recognition of vaccination certificates through the respective country's monitoring apps, MySejahtera and PeduliLindungi.

- Malaysia unveiled another expansionary budget for 2022 **("Budget")** focusing on strengthening recovery, building resilience and driving reforms in end-Oct 2021. Specifically, the economy is projected to grow 3% to 4% in 2021 and 5.5% to 6.5% in 2022, underpinned by higher public and private investments, consumer spending and healthy net exports. Malaysia is expected to record a fiscal deficit of 6% of GDP (2021E: 6.5%) and a higher debt-to-GDP of 63.4% in 2022 (2021E: 61.1%), albeit still below the 65% debt ceiling. The Budget also laid out measures to attract quality investment as well as accelerate digital adoption towards achieving sustainable development goals. Having said that, the announcement of the one-off "Cukai Makmur" **("CM"),** which is expected to allow Malaysia to collect at least RM3b more revenue**,** was a major negative surprise. It is also worth noting that the government has announced the issuance of a Ringgit-denominated Sustainability Sukuk of up to RM10b in the Budget.

- Bank Negara Malaysia **("BNM")** kept its Overnight Policy Rate unchanged at a record low of 1.75% at its Nov 2021 Monetary Policy Committee meeting. Overall, the tone of the policy statement appeared less dovish. Externally, BNM noted that global economy remained on the recovery path and growth prospects will be supported by progress in vaccination coverage and relaxation of restrictions. Domestically, BNM noted that economic activity had weakened in 3Q2021 amid the re-imposition of nation-wide lockdown but has since recovered from the trough in Jul 2021. Also, BNM expects stronger external demand as well as higher private sector expenditure to spur Malaysia's growth going into 2022. Moreover, BNM expects inflation to average within its projected range of 2.0% to 3.0% for 2021 but warned that the outlook is subject to global commodity prices and prolonged supply-related disruptions.

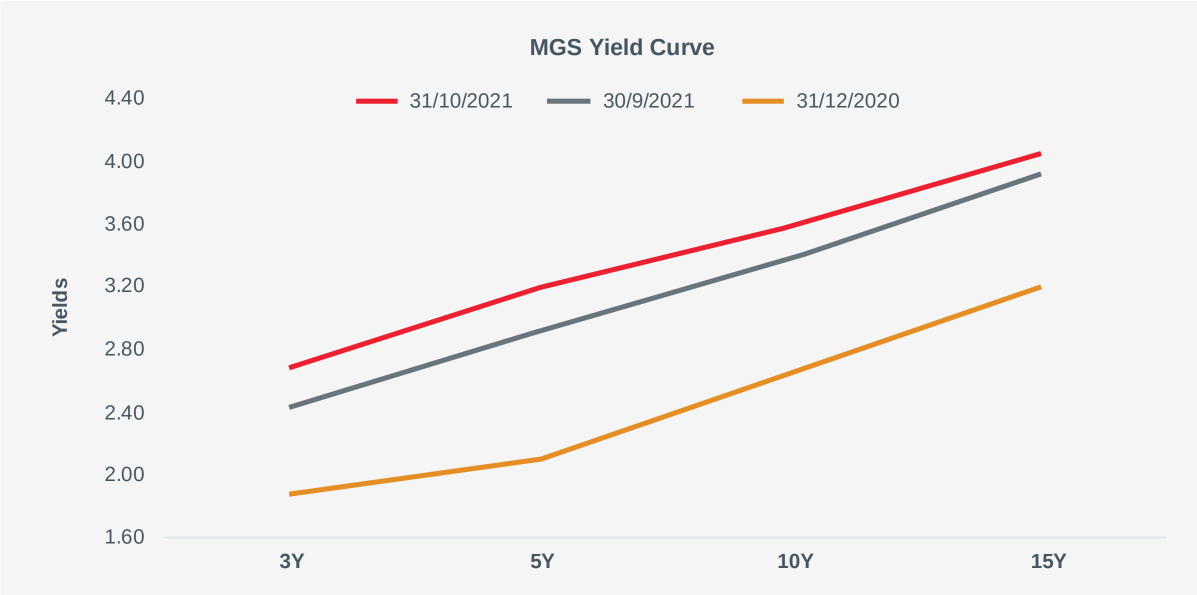
- Malaysia's sovereign yield curve moved higher in Oct 2021. The yields of the 3-, 5-, 10- and 15-year MGS rose 25bps, 27bps, 21bps and 14bp respectively to close the month at 2.68%, 3.19%, 3.58% and 4.03% respectively. Similarly, the MGII curve also moved higher with the 3-, 5-, 10 and 15-year MGII increasing 19bps, 20bps, 27bps and 21bps to close at 2.75%, 3.19%, 3.72% and 4.19% respectively.

- Four auctions were held in the month of Oct 2021, the re-opening of the 7-year MGS 06/28, the re-opening of the 30-year MGII 11/49, the re-opening of the 5-year MGS 11/26 and the re-opening of the 10-year MGII 10/30. The auctions received an average bid-to-cover ratio of 2.018x.

  - RM4.5b re-opening of the 7-year MGS averaging 3.409% at a bid-to-cover ratio of 1.598x;
  - RM2.0b re-opening of 30-year MGII averaging 4.557% at a bid-to-cover ratio of 2.521x;
  - RM4.5b re-opening of the 5-year MGS averaging 3.209% at a bid-to-cover ratio of 2.042x; and
  - RM3.5b re-opening of 10-year MGII averaging 3.682% at a bid-to-cover ratio of 2.018x.

BENCHMARK	Dec 2020 Yield	Sept 2021 Yield	Oct 2021 Yield	MOM Change	YTD Change
3-year MGS	1.88%	2.44%	2.68%	+ 25 bps	+ 80 bps
5-year MGS	2.10%	2.92%	3.19%	+ 27 bps	+ 109 bps
10-year MGS	2.65%	3.37%	3.58%	+ 21 bps	+ 93 bps
15-year MGS	3.19%	3.90%	4.03%	+ 14 bp	+ 84 bps

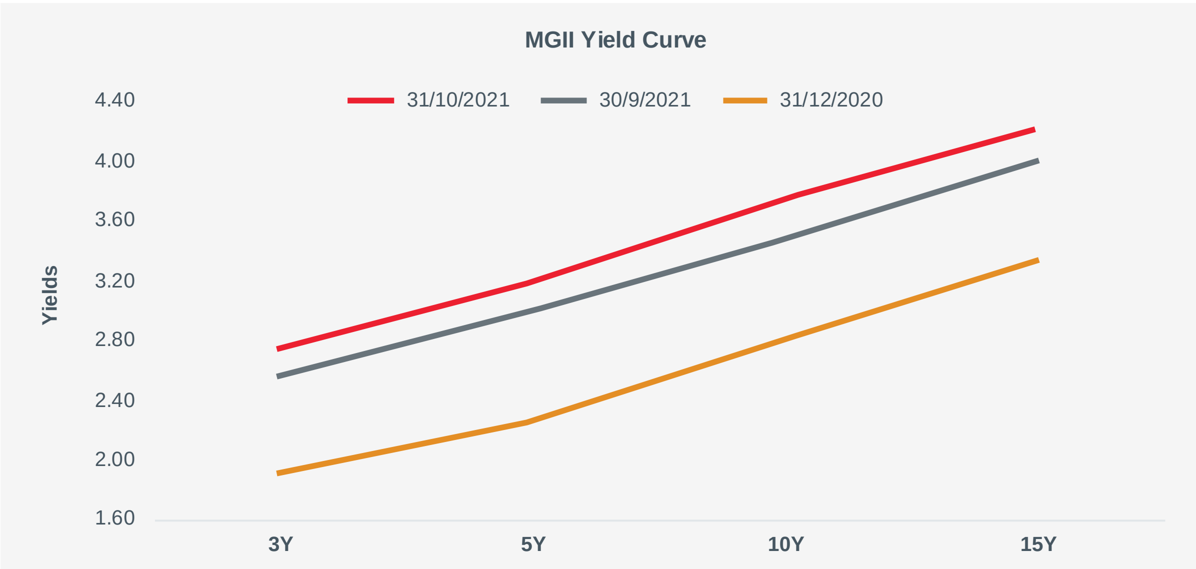
Source: Bloomberg



Source: Bloomberg

BENCHMARK	Dec 2020 Yield	Sept 2021 Yield	Oct 2021 Yield	MOM Change	YTD Change
3-year MGII	1.92%	2.56%	2.75%	+ 19 bps	+ 83 bps
5-year MGII	2.26%	2.99%	3.19%	+ 20 bps	+ 93 bps
10-year MGII	2.81%	3.46%	3.72%	+ 27 bps	+ 91 bps
15-year MGII	3.32%	3.98%	4.19%	+ 21 bps	+ 87 bps

Source: Bloomberg



Source: Bloomberg

OUTLOOK

- The confirmed Covid-19 cases continue to rise across the world, albeit at a slower pace, surpassing 247m with approximately 5.0m fatalities. “Living with Covid-19” has been adopted by many countries including Malaysia, after more than 18 months into the pandemic, and the focus of many countries, including the US, UK, Thailand, Indonesia and Singapore, has been shifted to establishing new framework for re-opening of international borders.

- Malaysia’s headline inflation rate inched up slightly in the month of Sep, coming in at 2.2% YoY (Aug: 2.0% YoY) attributable mainly to increases in cost of Transport (+11.0% YoY), Food & Non-Alcoholic Beverages (+1.9% YoY) as well as Housing, Water, Electricity, Gas and Other Fuels (+0.7% YoY). Year-to-date, inflation growth averaged 2.2% (9M2020: -1.0%). Meanwhile, core CPI stayed unchanged at 0.6% YoY, an indication that price pressures remained subdued amid the pandemic uncertainties. Full year inflation is expected to come in within BNM’s forecast of 2.0% to 3.0%.

- There will be three auctions in the month of Nov 2021, the re-opening of the 15Y MGS 05/35, 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 moved much higher since early of the year, underpinned by the narrative of a recovering economy and higher inflationary pressure in 2021. Following the Budget announcement, we expect another record year of MGS/MGII supply of RM165b-RM170b (2021E: RM160b), which will bring the total government domestic debt to above RM1.0tr by end-2022. Meanwhile, we see the remarks by BNM on supply chain disruptions, higher commodity prices and labour shortages indicating a shift of tones on inflation and a sign of potential policy normalization into 2022, although the central bank reiterated that its monetary policy will be data dependent. This is in line with comments by some central banks that price pressures may last longer than expected. On balance, we still see bonds facing headwinds in the medium term on the back of expected sustainable economic recovery, unfavourable demand-supply dynamics and inflationary pressures. Going forward, we believe the performance of the bond market will continue to be dictated by economic data, effectiveness of vaccines, as well as global risk sentiment.

Table 1: Indicative Rates (%)	
	31-Oct-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	1.77
3-mth BNM MN	1.78
3-mth KLIBOR	1.94
CP	
1-mth (P1)	2.26
3-mth (P1)	2.49

Source: Bloomberg/Bondstream
* Maybank2u.com.my

Table 2: Indicative Bond Yields (%)					
	3yr	**5yr**	**7yr**	**10yr**	**15yr**
MGS	2.85	3.23	3.46	3.62	4.07
GII	2.73	3.23	3.55	3.81	4.19
Swap rate*	2.83	3.06	3.27	3.50	3.66
AAA	3.11	3.60	3.99	4.17	4.58
AA1	3.25	3.75	4.11	4.30	4.73
AA2	3.38	3.86	4.23	4.42	4.85
AA3	3.49	3.97	4.35	4.53	4.96
A1	4.43	4.85	5.19	5.53	6.06
A2	5.15	5.69	6.12	6.61	7.27
A3	5.88	6.53	7.05	7.73	8.49

Source: Bloomberg*/Bondstream