A member of Prudential plc (UK)

MARKET COMMENTARY

FIXED INCOME MARKET REVIEW AND OUTLOOK

September 2021

REVIEW

- As widely expected, the Federal Reserve **(**the **"Fed")** kept its federal funds rate **("FFR")** unchanged at 0%-0.25% in Sep. While the Fed will continue its asset purchases programme of at least USD120b US Treasury and mortgage-backed securities per month for now, the Committee indicated that the pace of its asset purchases will be moderated if the labour market continues to improve with formal tapering expected to be announced at the next meeting and be concluded near the middle of next year. Meanwhile, the Fed's revised dot projections show nine out of 18 officials expect at least one rate hike in 2022 and all but five expect at least two rate hikes by end-2023. This is despite the Committee revising down its 2021 economic growth forecast to 5.9% and increasing its unemployment forecast to 4.8% from Jun 2021's median estimate of 7.0% and 4.5% respectively. That said, 2021 inflation and core inflation forecasts were both revised upward to 4.2% and 3.7% from 3.4% and 3.0% previously.

- Despite numerous discussions, the Democrats' impasse over the larger reconciliation package has yet to be resolved as moderate Democrats considered the USD3.5tr reconciliation package as massive and refused to lend support. As a result, the vote on the USD1.2tr bipartisan infrastructure bill has also been delayed.

- Meanwhile, the House and Senate passed a temporary spending bill to fund the federal government through 3 Dec 2021. However, the bill does not address the U.S. debt ceiling crisis which was suspended by the Congress in Aug 2019 and expired in end July 2021. Since then, the government has been kept solvent under "extraordinary measures" that will likely run out in Oct 2021 according to the US Treasury Secretary Yellen.

- Over in China, market generally expects the world's second largest economy to deliver a slower growth in 2H2021 due the latest wave of Covid-19 as well as regulatory tightening measures on selected sectors such as property and high-polluting industries. Not helping is the expected decline in industrial production in the near term, stemming mainly from the shutting down of energy intensive production firms to meet annual energy usage and intensity targets as well as power shortages. While concerns over contagion risk arising from Evergrande's fallout have eased, it is clear that the Chinese authorities are willing to risk some slowdown in growth to narrow wealth inequality under China's new "common prosperity initiatives", which will continue to shape its future policy. Separately, China's Aug headline CPI fell to 0.8% YoY (July: 1.0% YoY) on lower fuel and pork prices, providing flexibility for policy makers to manage the country's growth downtrend.

- While the US-China presidential call in early Sep 2021 made no reference to tariffs and both sides had agreed on continued engagements, the U.S. Trade Representative Katherine Tai has recently outlined Biden's new approach to the U.S.-China trade relationship that includes the underperformance of China under the Phase 1 agreement, targeted tariff exclusion process as well as concerns over China's industrial policy although details are scarce at this juncture.

- In Malaysia, as of 4 Oct 2021, some 44.6m shots of vaccines have been administered (73.4% of population) with 20.7m individuals having fully inoculated (63.4% of population). With the encouraging vaccination rate, Klang Valley has advanced to Phase 3 starting 1 Oct 2021 and interstate travel restrictions will be lifted and tourism hubs will re-open when 90% of Malaysian adults are fully vaccinated (now at 88.0%). In addition, local businesses are also allowed to operate with 100% capacity if the employers and all workers are fully vaccinated.

- Prime Minister Ismail unveiled the 12th Malaysia Plan **("12MP")** for 2021-2025. Focusing on Shared Prosperity Vision 2030, the key highlights are an allocation of RM400b to development expenditure (+61% from 11MP's RM248.5b actual spending), average annual GDP growth of 4.5%-5.5%, fiscal deficit of 3.0%-3.5% by 2025 and greenhouse gas emission reduction of 45% of GDP by 2030.

- As widely expected, Bank Negara Malaysia **("BNM")** kept its Overnight Policy Rate unchanged at a record low of 1.75% at its Sep 2021 Monetary Policy Committee meeting with a largely neutral tone. Externally, BNM noted that the global economy continued to recover although the strength varied across countries. Domestically, the re-imposition of nation-wide lockdown had dampened growth momentum but the impact is mitigated by the gradual relaxations for more sectors to operate, continued policy support and stronger external demand. BNM maintained its headline inflation forecast range of 2.0% to 3.0%.

- Malaysia's political uncertainty seems to have abated following the signing of a historic Memorandum of Understanding **("MoU")** between the government and the opposition. Among the terms agreed are a Covid-19 plan (additional RM45b Covid-19 fund), administrative transformation (anti-party hopping law, UNDI18 and limiting PM's term to 10 years), parliamentary reforms (equal funding for all MPs), independence of judicial institutions, Malaysia Agreement MA63 and the setting up of Steering Committee. All reforms are expected to be completed by the first sitting of 2022 and the MoU will remain effective until the Parliament is dissolved. With the latest development, the proposals to raise the Covid-19 fund to RM110b (RM91.8b spent) from RM65b and debt ceiling to 65% from 60% are expected to be tabled and approved by the Parliament in Oct 2021.

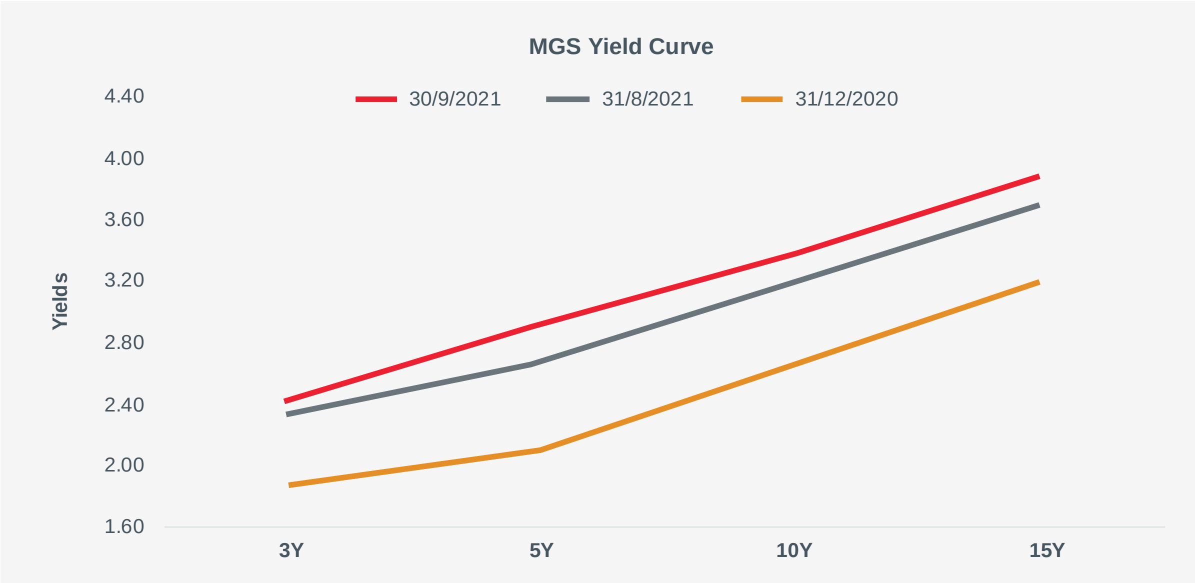
- Malaysia's sovereign yield curve bear steepened in Sep 2021. The yields of the 3-, 5-, 10- and 15-year MGS (this is a repeated typo in the past few Reviews) rose 10bps, 24bps, 18bps and 20bp respectively to close the month at 2.44%, 2.92%, 3.37% and 3.90% respectively. Similarly, the MGII curve also moved higher with the 3-, 5-, 10 and 15-year MGII increasing 20bps, 35bps, 15bps and 9bps to close at 2.56%, 2.99%, 3.46% and 3.98% respectively.

- Three auctions were held in the month of Sep 2021, the re-opening of the 20-year MGII 09/41, the re-opening of the 10-year MGS 04/31 and the re-opening of the 5-year MGII 03/26. The auctions received an average bid-to-cover ratio of 2.142x.

  - RM2.5b re-opening of the 20-year MGII averaging 4.178% at a bid-to-cover ratio of 2.687x;
  - RM4.0b re-opening of 10-year MGS averaging 3.292% at a bid-to-cover ratio of 1.606x; and
  - RM4.0b re-opening of the 5-year MGII averaging 3.025% at a bid-to-cover ratio of 2.133x.

BENCHMARK	Dec 2020 Yield	Aug 2021 Yield	Sept 2021 Yield	MOM Change	YTD Change
3-year MGS	1.88%	2.34%	2.44%	+ 10 bps	+ 56 bps
5-year MGS	2.10%	2.68%	2.92%	+ 24 bps	+ 82 bps
10-year MGS	2.65%	3.19%	3.37%	+ 18 bps	+ 72 bps
15-year MGS	3.19%	3.70%	3.90%	+ 20 bp	+ 71 bps

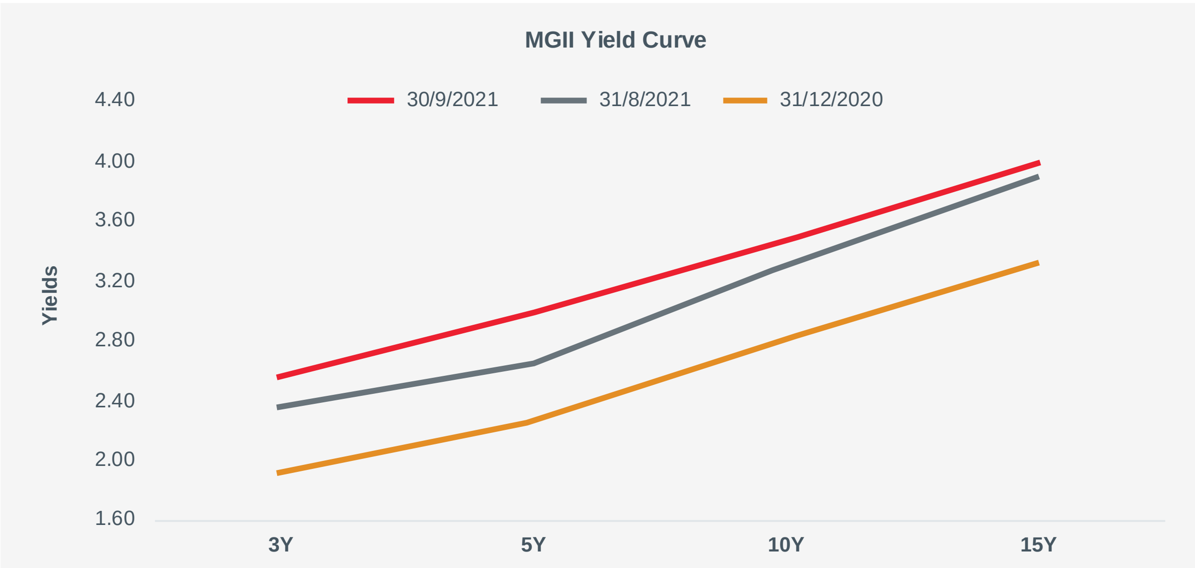
Source: Bloomberg



Source: Bloomberg

BENCHMARK	Dec 2020 Yield	Aug 2021 Yield	Sept 2021 Yield	MOM Change	YTD Change
3-year MGII	1.92%	2.36%	2.56%	+ 20 bps	+ 64 bps
5-year MGII	2.26%	2.64%	2.99%	+ 35 bps	+ 73 bps
10-year MGII	2.81%	3.31%	3.46%	+ 15 bps	+ 65 bps
15-year MGII	3.32%	3.89%	3.98%	+ 9 bps	+ 66 bps

Source: Bloomberg



Source: Bloomberg

OUTLOOK

- The confirmed Covid-19 cases continue to rise across the world, albeit at a slower pace, surpassing 235m with approximately 4.8m fatalities. We note that the effectiveness of Covid-19 vaccines against mutated variants as well as the reported waning effectiveness over time continue to be the key risks to sustainable economic recovery. Despite that, the accelerating vaccination rate as well as planned booster shots in major economies and some Asian countries, are expected to bring the number of hospitalization cases under control, which bodes well for the re-opening of economic activities.

- Malaysia's headline inflation rate moderated further for the fourth consecutive month, coming in at 2.0% YoY in Aug 2021 from July 2021's 2.2% YoY attributable mainly to a slowdown in costs of Food & Non-Alcoholic Beverages (+1.2% YoY compared to +1.3% YoY in July), Housing, Water, Electricity, Gas and Other Fuels in Aug (+0.6% YoY compared to +0.7% YoY in July) and Transport (+11.0% YoY compared to +11.6% YoY in July), a result of electricity discount as well as fuel subsidy provided by the government. Year-to-date, inflation growth averaged 2.3%. Meanwhile, core CPI moderated to 0.6% YoY (July: 0.7% YoY), 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 four auctions in the month of Oct 2021, the re-opening of the 7Y MGS 06/28, the re-opening of the 30Y MGII 11/49, 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 highly infectious Delta variant, both in Malaysia and globally, have provided some support to bond prices as central banks are expected to maintain their accommodative monetary policy to sustain growth momentum. On balance, we still see a steepening bias in Malaysia's sovereign yield curve with the longer-end of the curve to 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. In the immediate term, all eyes will be on Malaysia's 2022 Budget announcement in end-Oct 2021. 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 (%)

	30-Sep-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	1.93
CP	
1-mth (P1)	2.26
3-mth (P1)	2.47

Source: Bloomberg/Bondstream
* Maybank2u.com.my

Table 2: Indicative Bond Yields (%)

	3yr	5yr	7yr	10yr	15yr
MGS	2.52	2.89	3.34	3.40	3.93
GII	2.56	3.07	3.30	3.54	3.97
Swap rate*	2.45	2.79	2.98	3.22	3.43
AAA	2.92	3.34	3.71	3.85	4.34
AA1	3.05	3.46	3.80	3.97	4.49
AA2	3.16	3.57	3.89	4.08	4.61
AA3	3.28	3.68	3.99	4.19	4.72
A1	4.32	4.66	4.97	5.31	5.92
A2	5.07	5.54	5.97	6.45	7.22
A3	5.82	6.41	6.93	7.60	8.46

Source: Bloomberg*/Bondstream

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