MARKET COMMENTARY

Fixed income market review and outlook

December 2022

Review

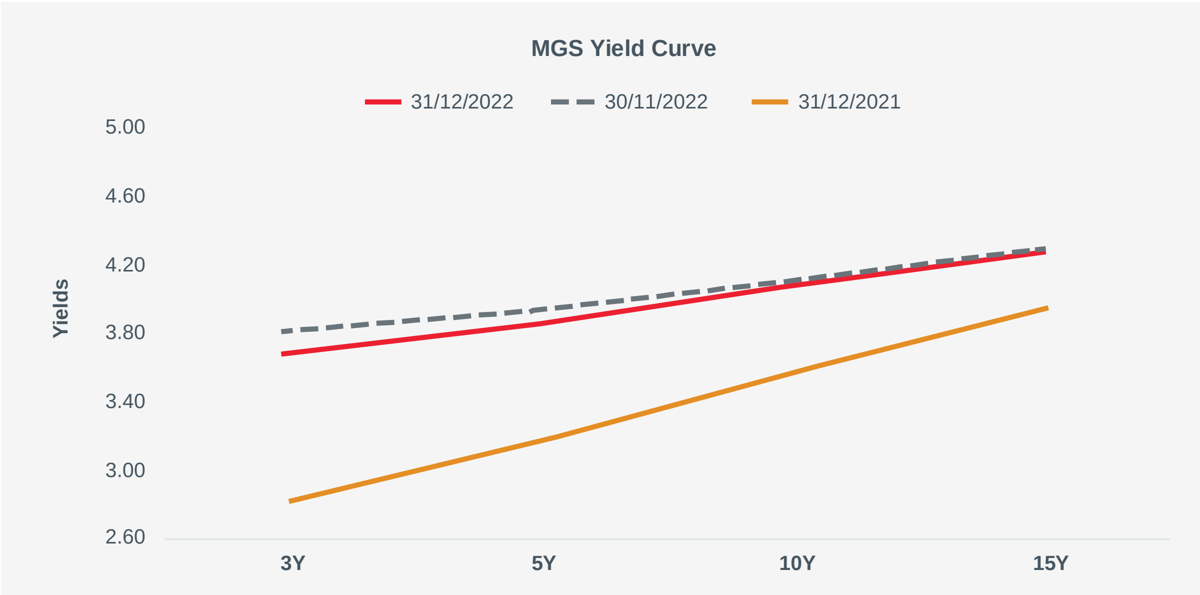
- The Federal Reserve **("Fed")** raised the federal funds rate by 50bps to 4.25-4.50% in December 2022. Its median projection federal funds rate for 2023 has also been revised upwards to 5.10% from its September projection. The Fed continues to seek to achieve maximum employment and inflation at the rate of 2 percent over the longer run. The Fed board members expected the Personal Consumption Expenditures **("PCE")** inflation to end 2023 at 3.1% and core PCE to finish next year at 3.5%, above the central bank's target rate of 2%. Minutes from the December meeting showed that the central bank was still committed to tame inflation.
- Recent indicators continue to point to higher risks of economic contraction in the U.S. Its Manufacturing Purchasing Managers' Index **("PMI")** fell to 46.2 in December 2022 from 47.7 in November 2022, hitting another 30-month low due to weak demand. The U.S. Services PMI recorded 44.7 in December 2022 from the revised 46.2 in November 2022, an indication that the services sector is continuing to decline. Inflation has been "sticky", with the PCE price index rising by 5.50% YoY in November, although below the revised 6.1% YoY in October. Meanwhile Core PCE rose 4.7% YoY, lower than 5.0% the previous month. University of Michigan consumer sentiment index however, increased to 59.7 from 56.8, but way below the final reading in December 2021 of 70.6. The ADP National Employment reported that U.S. private payrolls also increased more than expected in December by 235,000 (Nov 2022: 127,000), pointing to still-strong demand for labour despite higher interest rates.
- The Eurozone's downturn may have passed the trough, with its composite PMI increasing to 49.3 in December compared to the revised 47.8 in November mainly due to higher Manufacturing and Services PMI. German, Spanish and French consumer prices, harmonised to compare with other European Union countries, rose at a slower rate of 9.6%, 5.6% and 6.7% respectively in December, compared to an increase of 11.3% (Germany), 6.7% (Spain) and 7.1% (France) in November. Meanwhile, U.K. composite PMI also showed a mild increment of 49.0 in December compared to the final reading of 48.2 the month before. Although the PMI readings show improvements from the previous month, they still indicate a contraction.
- The Bank of Japan **("BOJ")** raised its cap on benchmark 10-year yields to around 0.5% from 0.25% while keeping both short- and long-term interest rates unchanged, in a move that surprised every economist surveyed by Bloomberg. This is a significant move because Japan is the world's largest creditor and a tightening move on its domestic financial conditions may result in a wave of capital returning to Japan. This may further increase global borrowing costs at a time the economic outlook is deteriorating. The BOJ also decided to increase its scheduled monthly purchases of Japanese Government Bond **("JGBs")** to around 9 trillion yen from 7.3 trillion yen in January-March 2023.
- Globally, the tightening cycle continued in December 2022 to tame high inflation. The Reserve Bank of Australia **("RBA")** raised its official cash rate by another 25bps to 3.10%. YTD, RBA has delivered a total of 300bps hikes. Similarly, Bank of England **("BoE")** voted by a majority of 6-3 to increase its bank rate by 50bps to 3.5%. The central bank mentioned in its statement that the U.K. economy is expected to be in recession for a prolonged period and CPI inflation is expected to remain very high in the near term. European Central Bank **("ECB")** also raised its refinancing operations, marginal lending facility and deposit facility by 50bps to 2.50%, 2.75% and 2.00% respectively. Meanwhile, central banks in ASEAN continued to hike rates with Indonesia (+25bps) and the Philippines (+50bps) raising their policy rates in December, while Malaysia and Thailand did not have meetings in December.
- China continued with its re-opening measures, whereby it will stop requiring inbound travellers to go into quarantine, in a major step towards easing curbs on its borders, which have been largely shut since 2020. This quarantine restriction as well as restriction on the number of passengers on international flights will be removed from January 8th. Travellers entering China will still have to undergo PCR testing 48 hours before departure. However, lingering concerns remain on Covid-19 infections in the country.
- China's November 2022 exports contracted by 8.7% YoY (Oct 2022: -0.3% YoY). Imports also declined by 10.6% YoY from a slip of 0.7% YoY in the previous month, due to cooling global demand. China's November 2022 economic data came in weaker as retail sales shrank by 5.9%, while industrial production grew at a slower pace of 2.2% YoY (Oct 2022: -0.5%; +5.0%). Meanwhile, fixed asset investment also grew at a weaker pace of 5.3% YoY for the 11M2022 (10M2022: +5.8% YoY).

- Malaysia’s inflation in November 2022 increased by 4.0% YoY (Oct 2022: 4.0%) with the main contributor to the rise in inflation being the ‘food group’ which recorded an increase of 7.3%. Meanwhile, core inflation registered higher increase of 4.2% YoY in November 2022 (Oct 2022: 4.1%), reflecting inflation risks. On the political front, Malaysian Prime Minister Anwar Ibrahim's motion of confidence was passed in parliament, bringing stability to the new unity government.
- Two auctions were held in December 2022, the re-opening of the 10Y MGS 07/23 and the re-opening of the 3Y MGII 10/25. The auctions received an average bid-to-cover ratio of 2.96x, mainly due to overwhelming demand for the 3Y MGII.
  - RM4.5b re-opening 10-year MGS averaging 4.063% at a bid-to-cover ratio of 1.707x; and
  - RM4.0b re-opening 3-year MGII averaging 3.808% at a bid-to-cover ratio of 4.205x.

  For the full year 2022, total gross MGS and MGII issuances amounted to MYR171.5b, 7.1% higher than RM160b in 2021.
- Malaysia’s MGS curve bull-steepened in the month of December 2022. The yields of the 3-, 5-, 10- and 15-year MGS declined by 14bps, 8bps, 4bps and 3bps to close the month at 3.67%, 3.84%, 4.07% and 4.26% respectively. The yields of MGII also follow a similar trend with the 3-, 5-, 10- and 15-year MGII declined by 12bps, 7bps, 6bps and 10bps to end the month at 3.76%, 3.85%, 4.13% and 4.31% respectively.

BENCHMARK	Dec 2021 Yield	Nov 2022 Yield	Dec 2022 Yield	MOM Change	YTD Change
3-year MGS	2.81%	3.81%	3.67%	- 14 bps	+ 86 bps
5-year MGS	3.16%	3.92%	3.84%	- 8 bps	+ 68 bps
10-year MGS	3.56%	4.10%	4.07%	- 4 bps	+ 50 bps
15-year MGS	3.94%	4.30%	4.26%	- 3 bps	+ 33 bps

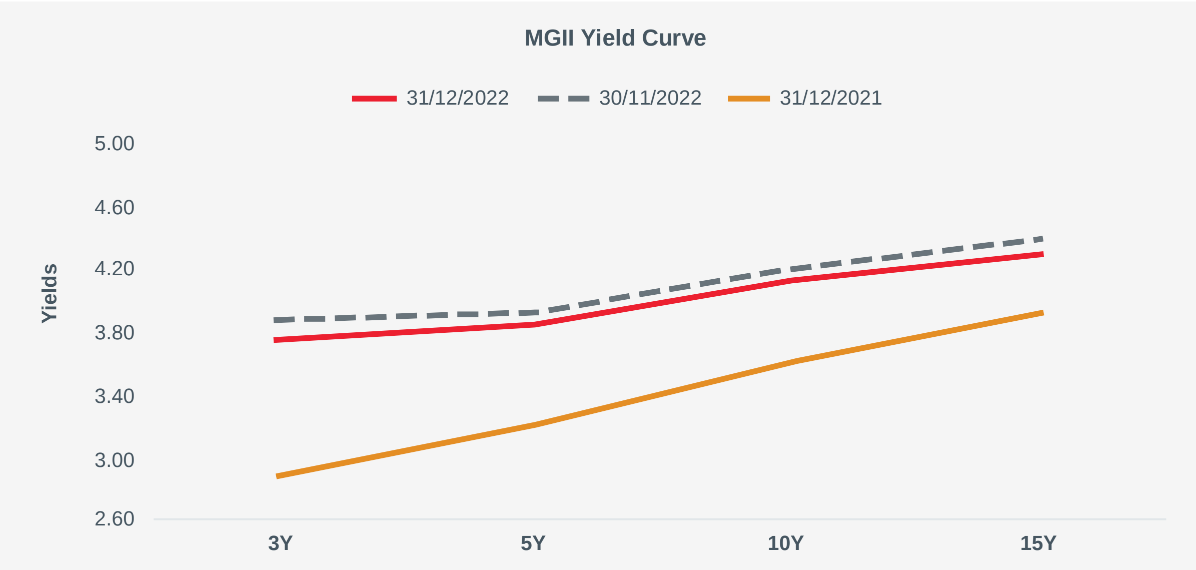
Source: Bloomberg



Source: Bloomberg

BENCHMARK	Dec 2021 Yield	Nov 2022 Yield	Dec 2022 Yield	MOM Change	YTD Change
3-year MGII	2.90%	3.88%	3.76%	- 12 bps	+ 86 bps
5-year MGII	3.21%	3.93%	3.85%	- 7 bps	+ 64 bps
10-year MGII	3.62%	4.19%	4.13%	- 6 bps	+ 51 bps
15-year MGII	3.93%	4.41%	4.31%	- 10 bps	+ 39 bps

Source: Bloomberg



Source: Bloomberg

Outlook

- China's re-opening will ease supply chain concerns and also have a widespread impact on sectors such as luxury goods, aviation and hospitality as Chinese consumers increases spending and traveling. Global inflation is likely to remain somewhat elevated through 2023, with risks coming from the ongoing Russian-Ukraine war and the rise in demand as China ramps up its economy. Meanwhile, recession risks have also increased especially in the U.S. and the Eurozone as central banks continue to maintain a restrictive stance of policy.

- For Malaysia, Bank Negara expects the Malaysian economy to expand 4-5% in 2023. Headline and core inflation in 2023 will remain elevated amid both demand and cost pressures, as well as any changes to domestic policy measures especially subsidies. With a vote of confidence being passed in the parliament, we expect stability in the unity government and thus improved market sentiment. A new Budget for 2023 is expected to be tabled in Parliament, likely on 24th February 2023.

- That said, Asian central banks are expected to maintain their respective pace of rate hikes given the still resilient domestic growth in the region. In Malaysia, policy normalization has been gradual and measured. While the MPC statement appears to be relatively upbeat on domestic growth, we opine that future monetary policy decisions will depend largely on the central bank's expectation of the sustainability of the current growth momentum given the increased risks of a recession especially in developed economies.

- There will be three auctions in the month of January 2023, the re-opening of the 10Y MGII 10/32, the 15Y re-opening of MGS 06/38 and a new issue of the 5.5Y MGII 07/28. 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.

- In 2023, based on the auction calendar released by Bank Negara, there will be a total of 37 auctions (comprising 19 issuances of MGII and 18 issuances of MGS) compared to the 36 auctions in 2022 (comprising of 18 equal issuances of MGS and MGII bond issuances). Gross MGS/GII supply is expected to be circa RM172.0 b for the coming year.

Table 1: Indicative Rates (%)	
	31-Dec-22
MBB O/N*	1.10%
MBB1-Week*	1.20%
MBB 1-Mth FD*	2.45%
MBB 6-Mth FD*	2.80%
MBB 1-Year FD*	2.85%
1-mth BNM MN	2.84%
3-mth BNM MN	2.95%
3-mth KLIBOR	3.68%
CP	
1-mth (P1)	3.64%
3-mth (P1)	3.81%

Source: Bloomberg/Bondstream
* Maybank2u.com.my

Table 2: Indicative Bond Yields (%)					
	3yr	**5yr**	**7yr**	**10yr**	**15yr**
MGS	3.73	3.87	4.01	4.07	4.29
GII	3.78	3.89	4.07	4.14	4.26
Swap rate*	3.71	3.78	3.93	4.05	4.26
AAA	4.20	4.36	4.50	4.64	4.86
AA1	4.31	4.49	4.66	4.82	5.06
AA2	4.42	4.63	4.83	4.99	5.23
AA3	4.53	4.76	4.98	5.15	5.39
A1	5.17	5.46	5.77	6.01	6.33
A2	5.75	6.12	6.51	6.91	7.36
A3	6.33	6.80	7.26	7.81	8.41

Source: Bloomberg*/Bondstream

Disclaimer