

MARKET COMMENTARY

Fixed income market review and outlook

May 2022



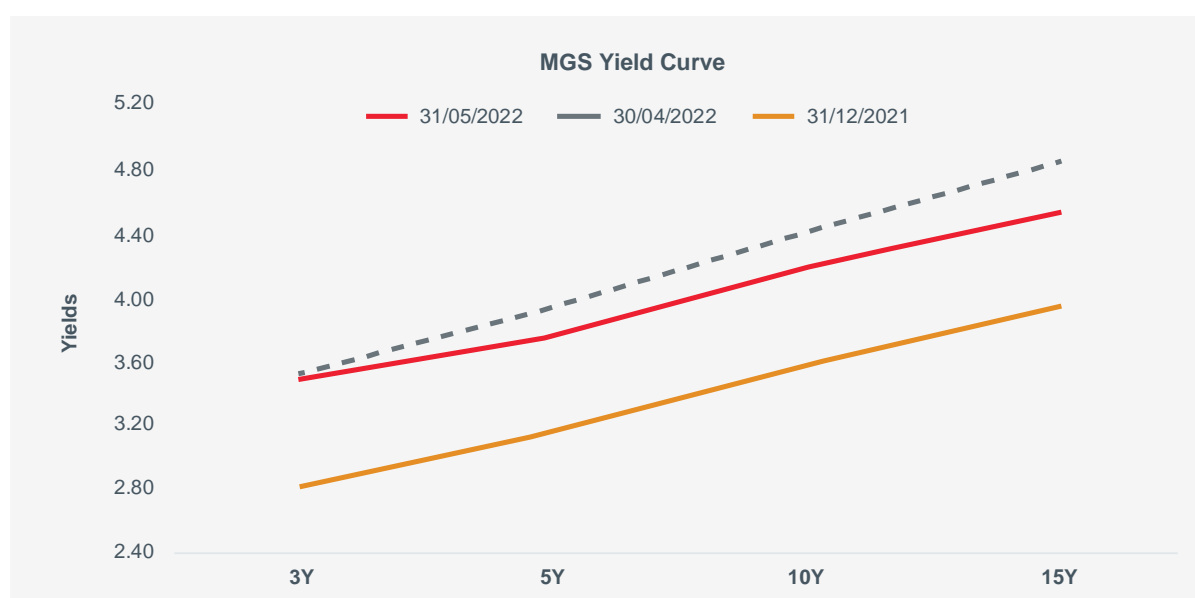
Review

- ▶ Fed Chair Powell made it clear that bringing inflation down is Fed's immediate focus and the central bank will not hesitate to raise rates above the neutral rate until there is clear and convincing evidence that inflation is trending lower. Powell went on to say that neutral rate of unemployment is likely to be closer to 5% versus the current 3.6% and repeatedly mentioned that supply chain issues have remained unresolved and continued to weigh on inflation. Powell's hawkish comments were reiterated by other Fed policymakers on different occasions. Meanwhile, the latest FOMC minutes signalled more 50bps hikes at upcoming meetings towards a neutral policy expeditiously as policymakers saw intensifying inflation threat.
- ▶ Globally, inflation continued to be the focus of central banks as the protracted conflict, supply chain disruptions and adverse weather have contributed to elevated food prices that prompted some countries to restrict exports of food products including palm oil, wheat and sugar. In May 2022, BNM joined some of the central banks in the developed markets to raise its policy rate, the first hike since Jul 2020 after BNM slashed its policy rate by a cumulative 125bps to 1.75%. Meanwhile, ECB could start its rate hike cycle in Jul 2022 and end the sub-zero territory by Sep 2022 with inflation running at almost 4x of the central bank's 2% target although President Lagarde said the central bank will not rush into withdrawing monetary stimulus.
- ▶ China's Apr 2022 industrial production, services activity and retail sales declined 2.9% YoY, 6.1% YoY and 1.1% YoY from Mar 2022's +5.0%, -0.9% and -3.5% respectively. Furthermore, fixed asset investment grew at a slower rate of 2.3% YoY (Mar 2022: 7.1% YoY). While the gradual re-opening of Shanghai is welcomed, the 2-month lockdowns are expected to negatively affect China's 2022 growth. Having said that, monetary easing efforts including the 15bps cut of the 5Y Loan Prime Rate, the major pricing reference, and a 20bps cut of minimum mortgage rate for first-time homebuyers have been announced. On the fiscal front, the State Council announced a slew of stimulus measures including the issuance of RMB500b railway and aviation bonds, RMB150b civil aviation emerging loan, phased reduction of RMB60b in passenger car purchase taxes and an expansion of VAT credit refunds quota of RMB140b to offset the impact of the country's Zero-Covid strategy. More support is expected to be forthcoming.
- ▶ The Russia-Ukraine war is now in the fourth month and there is no sign yet of when it will end. Notably, the US Senate approved Biden's proposed USD40b Ukraine aid package while Yellen said the G7 finance leaders have agreed to provide Ukraine the USD15b needed by Kiev during the G7 finance ministers meeting held in Germany. Meanwhile, the European Commission revealed a EUR300b REPowerEU plan to end EU's dependence on Russian energy imports before 2030, while Finland and Sweden abandoned their decades of neutrality by joining NATO, which is widely viewed as an evolution in European security and geopolitics. In addition, Germany Chancellor Scholz has called for increased international efforts to isolate Russia, accusing Putin of advocating war as a common political tool. Separately, Putin has indicated to Italian Prime Minister Draghi his willingness to ease grain and fertilizer exports ban if sanctions are lifted.
- ▶ Closer to home, the US-China relations remain tense. President Biden unveiled his Indo-Pacific Economic Framework for Prosperity ("IPEF"), aiming at re-asserting US' economic influence in the region on his first trip in office to Asia. IPEF focuses on key issues such as trade, supply chains, clean energy, decarbonisation and infrastructure, as well as tax and anticorruption. In response, China criticized the IPEF as a strategy of creating division, inciting confrontation and undermining peace. During his visit, Biden also vowed to defend Taiwan militarily when asked about the stability of the Taiwan Strait. Having said that, Biden also indicated his willingness to consider reducing tariffs imposed on imported Chinese goods.
- ▶ Malaysia posted a stronger-than-expected 1Q2022 GDP growth of 5.0% YoY (4Q2021: +3.6% YoY) as commendable performance of Services (+6.5% YoY) and Manufacturing (+6.6% YoY), following the re-opening of economy, helped offset the weak performance delivered by Mining (-1.1% YoY) and Construction (-6.2% YoY). By expenditure, domestic demand strengthened sharply at 4.4% YoY (4Q2021: +1.9% YoY), underpinned by strong public and private consumption. Despite the strong 1Q2022 performance, BNM maintains its GDP and inflation forecasts of 5.3% to 6.3% and 2.2% to 3.2% respectively for 2022.

- BNM surprised the market with a 25bps OPR hike at its May 2022 MPC meeting, bringing the policy rate to 2.00%. The central bank also signalled more hikes, to be done in a measured and gradual manner, given the firmer footing of domestic growth, which in turn is supported by strengthening demand, sustained exports and a stronger labour market. On the global front, BNM noted the sustained re-opening of global economy and improving labour market conditions have helped cushion the Ukraine crisis and lockdowns in China. It also expects inflation pressures to cause central banks to adjust their monetary policy at a faster pace. That said, BNM indicated that risks to growth remain, which include weaker global growth and further escalation of geopolitical conflicts, worsening supply chain disruptions and adverse developments surrounding Covid-19.
- Three auctions were held in the month of May 2022, the new 30Y MGII 05/52, the re-opening of the 10Y MGS 07/32 and the re-opening of the 3Y MGII 10/25. The auctions received an average bid-to-cover ratio of 2.933x.
 - RM2.5b new 30-year MGII averaging 5.357% at a bid-to-cover ratio of 2.570x;
 - RM4.5b re-opening of 10-year MGS averaging 4.294% at a bid-to-cover ratio of 2.598x; and
 - RM5.0b re-opening of 3-year MGII averaging 3.539% at a bid-to-cover ratio of 3.632x
- Malaysia's MGS curve bull flattened in the month of May 2022. The yields of the 3-, 5-, 10- and 15-year MGS dropped 3bps, 18bps, 21bps and 32bps respectively to close the month at 3.46%, 3.74%, 4.17% and 4.51% respectively. Meanwhile, yields of MGII closed mixed with yield of the 3-year MGII increasing 3bps to close the month at 3.51% while yields of the 5-, 10- and 15-year MGII declining 26bps, 22bps and 27bps respectively to end the month at 3.79%, 4.19% and 4.54% respectively.

BENCHMARK	Dec 2021 Yield	Apr 2022 Yield	May 2022 Yield	MOM Change	YTD Change
3-year MGS	2.81%	3.49%	3.46%	- 3 bps	+ 66 bps
5-year MGS	3.16%	3.92%	3.74%	- 18 bps	+ 58 bps
10-year MGS	3.56%	4.38%	4.17%	- 21 bps	+ 60 bps
15-year MGS	3.94%	4.83%	4.51%	- 32 bps	+ 57 bps

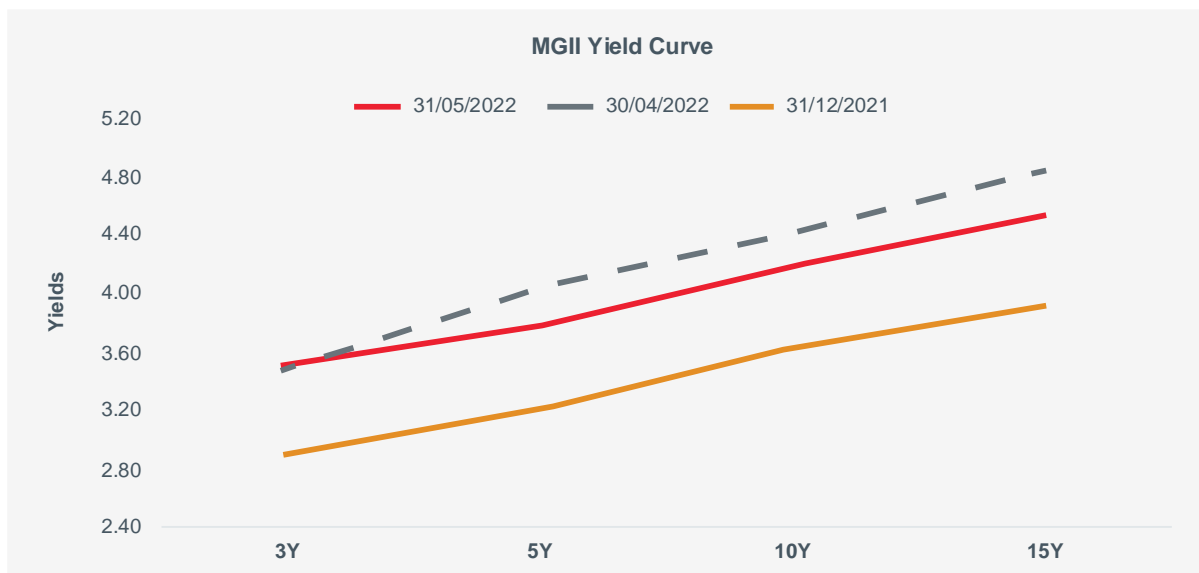
Source: Bloomberg



Source: Bloomberg

BENCHMARK	Dec 2021 Yield	Apr 2022 Yield	May 2022 Yield	MOM Change	YTD Change
3-year MGII	2.90%	3.48%	3.51%	+ 3 bps	+ 61 bps
5-year MGII	3.21%	4.05%	3.79%	- 26 bps	+ 58 bps
10-year MGII	3.62%	4.41%	4.19%	- 22 bps	+ 56 bps
15-year MGII	3.93%	4.82%	4.54%	- 27bps	+ 62 bps

Source: Bloomberg



Source: Bloomberg

Outlook

- ▶ Malaysia's Apr 2022 headline inflation rate grew marginally to 2.3% YoY (Mar 2022: 2.2% YoY), lifted mainly by higher Food & Non-Alcoholic Beverages (+4.1% YoY) and Transportation (+3.0% YoY) inflations. The increases were partially moderated by a softer growth in Housing, Water, Electricity, Gas and Other Fuels (+0.8% YoY) prices. Likewise, core inflation accelerated further to 2.1% YoY (Mar 2022: +2.0% YoY), a reflection of the broadening increase in prices of goods and services as the economy transitioned into the endemic phase. Overall inflationary risk remains tilted to the upside although the government's commitment to ensure price stability of basic necessities could help mitigate some pressure. For 2022, full year inflation is expected to remain modest, coming in within BNM's forecast of 2.2% to 3.2%.
- ▶ Markets across the globe remained highly volatile in May 2022 on heightened concern over the ability of central banks to engineer a soft-landing when tightening monetary policy to rein in inflation. While fear of recession seems to be overblown for now given the steady recovery trajectory and improving labour market conditions, the odds of an economic downturn have gone up in recent weeks as food inflation started to be felt globally as a result of the growing wave of food protectionism. In Malaysia, inflationary pressure has been staying relatively muted thus far but markets will watch closely on signs of a possible change to the current fuel subsidy scheme. In the near term, volatilities in the global market are expected to persist as sentiments continue to be weighed by concerns on global growth outlook and inflation outlook on the back of the on-going Russia-Ukraine war and China's strict Covid-19 containment measures. For 2022, we believe the main themes surrounding the Malaysian bond market are Malaysia's economic growth, inflationary pressures and monetary policy normalization, potential general elections as well as the supply-demand dynamics.
- ▶ There will be three auctions in the month of Jun 2022, the re-opening of the 15Y MGS 04/37, the re-opening of the 5Y MGII 09/27 and the re-opening of the 30Y MGS 06/50. 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.

Table 1: Indicative Rates (%)

	31-May-22
MBB O/N*	0.50
MBB1-Week*	0.60
MBB 1-Mth FD*	1.75
MBB 6-Mth FD*	2.05
MBB 1-Year FD*	2.10
1-mth BNM MN	2.04
3-mth BNM MN	2.13
3-mth KLIBOR	2.27
CP	
1-mth (P1)	2.60
3-mth (P1)	2.85

Source: Bloomberg/Bondstream

* Maybank2u.com.my

Table 2: Indicative Bond Yields (%)

	3yr	5yr	7yr	10yr	15yr
MGS	3.54	3.83	4.06	4.19	4.56
GII	3.41	3.68	4.09	4.18	4.51
Swap rate*	3.57	3.73	3.87	4.05	4.30
AAA	4.00	4.32	4.61	4.77	5.03
AA1	4.10	4.44	4.73	4.89	5.15
AA2	4.20	4.55	4.85	5.01	5.27
AA3	4.30	4.65	4.97	5.13	5.39
A1	4.96	5.39	5.80	6.04	6.43
A2	5.56	6.12	6.58	6.98	7.52
A3	6.16	6.83	7.38	7.93	8.61

Source: Bloomberg*/Bondstream

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