An Update on the Malaysian Bond Market

Summary:

- The Malaysian bond market is underpinned by accommodative global and domestic monetary policies alongside the favourable demand dynamics from domestic institutional funds.

The Malaysian bond market continued to perform well over the first half of this year despite a brief consolidation in the month of March. Both government and corporate bonds recorded gains as bond yields declined further in the first half of 2020 (Table 1). When bond yields fall, bond prices rise; and vice-versa.

Table 1: 10-yr Malaysian Government Securities (MGS) & AA1-rated Corporate Bond Yields

	End-2019	End-June 2020	Change (in basis points, bps)
10-yr MGS Yield (%)	3.43	2.94	-49
10-yr AA1-rated Corporate Bond Yield (%)	4.05	3.60	-45

Source: Bond Pricing Agency Malaysia (BPAM)

Given the firmer bond prices and coupon income derived from their bond holdings, our bond and sukuk funds achieved total returns ranging from 2.32% to 3.80% in the first half of the year, outperforming the 12-month Fixed Deposit (FD) return. The funds also delivered returns that are significantly higher than the FD return over the 1-year, 3-year and 5-year periods as shown in Table 2.

Table 2: Public Mutual's Bond & Sukuk Fund Performance Ended 30 June 2020

	Total Return (%)				Fund Volatility Class	Fund Volatility Factor*
	YTD	1 Yr	3 Yrs	5 Yrs		
Sukuk Funds						
Public Islamic Infrastructure Bond Fund	3.71	6.61	19.98	30.82	Low	3.9
PB Islamic Bond Fund	3.39	6.31	20.25	31.62	Very Low	3.2
PB Aiman Sukuk Fund	3.36	7.22	22.47	34.49	Low	3.5
Public Islamic Bond Fund	3.11	6.13	19.38	30.52	Very Low	3.0
PB Sukuk Fund	3.08	6.40	18.47	28.77	Very Low	2.3
Public Sukuk Fund	2.98	6.26	18.92	29.24	Very Low	2.4
Public Islamic Select Bond Fund	2.46	5.01	15.20	24.89	Very Low	1.4
Public Islamic Strategic Bond Fund	2.32	5.10	16.28	25.20	Very Low	2.0
Public Islamic Income Fund	2.32	4.88	15.80	24.07	Very Low	2.3
Bond Funds						
PB Infrastructure Bond Fund	3.80	6.96	19.91	29.99	Low	3.5
Public Enterprises Bond Fund	3.54	6.93	21.90	32.17	Very Low	2.5
PB Fixed Income Fund	3.36	6.82	19.19	29.39	Very Low	2.0
Public Bond Fund	3.28	6.50	18.20	28.39	Very Low	2.1
PB Bond Fund	3.02	6.63	18.64	28.57	Very Low	2.0
Public Strategic Bond Fund	2.81	5.78	17.25	26.73	Very Low	1.6
Public Select Bond Fund	2.68	5.39	15.78	24.35	Very Low	1.5
Fixed Deposit Rate						
Public Bank 12-Month FD Rate	1.28	2.87	9.63	16.84		

**Based on the fund's portfolio returns as at end-May 2020 (Source: Lipper & Public Bank, June 2020)*

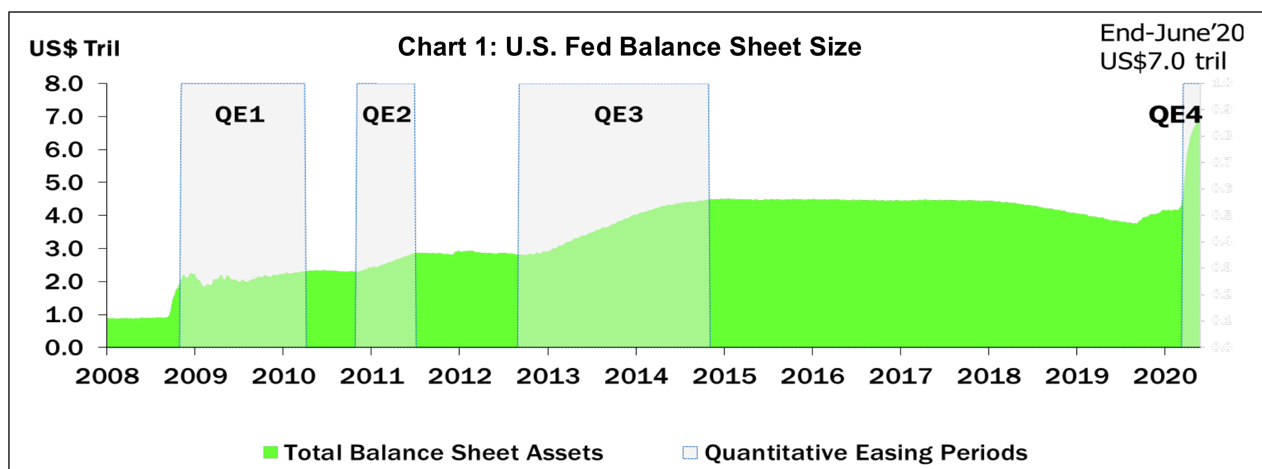
Looking ahead, three factors should help to underpin the domestic bond market:

1. Accommodative Global Monetary Policy

The U.S. Federal Reserve (Fed) continued to cut its Federal Funds Rate (FFR) by a total of 150 basis points (bps) in the first half of this year, alongside rate cuts by other major central banks due to the subdued global economic outlook resulting from the Covid-19 outbreak. This has contributed positively to the strong bond market performance globally for 2020 to-date.

During the scheduled Federal Open Market Committee (FOMC) meeting on 9-10 June 2020, the Fed maintained its FFR at the range of 0% to 0.25% and guided that U.S. interest rates will remain low through 2022.

The Fed also embarked on the fourth phase of its Quantitative Easing programme (QE4), whereby the Fed undertake bond purchases to inject liquidity into the economy to sustain economic activities. This measure, coupled with the lowering of the FFR, has helped to provide support to the U.S. financial market and economy.



Source: Federal Reserve

Going forward, while global economic activities are anticipated to improve following the easing of lockdown measures in selected countries, the recovery in the global economy is envisaged to be gradual amid the evolving Covid-19 pandemic. This should lead to central banks maintaining their accommodative monetary policies, which in turn helps to support global bond markets.

2. Accommodative Domestic Monetary Policy

On 7 July 2020, Bank Negara Malaysia (BNM) lowered the Overnight Policy Rate (OPR) by another 25 bps to a record low of 1.75%, which is below the 2% seen during the Global Financial Crisis (GFC) in 2009. This marks the fourth successive rate cut since the start of the year, which brings the cumulative reduction in the OPR to 125 bps.

As Malaysia's OPR of 1.75% remains relatively higher than the policy interest rates of developed countries and selected regional countries as shown in Table 3, this suggests that there is room for further cuts to the OPR if the need arises. Going forward, domestic monetary policies are envisaged to remain accommodative as the Covid-19 pandemic continues to pose a downside risk to the real economy.

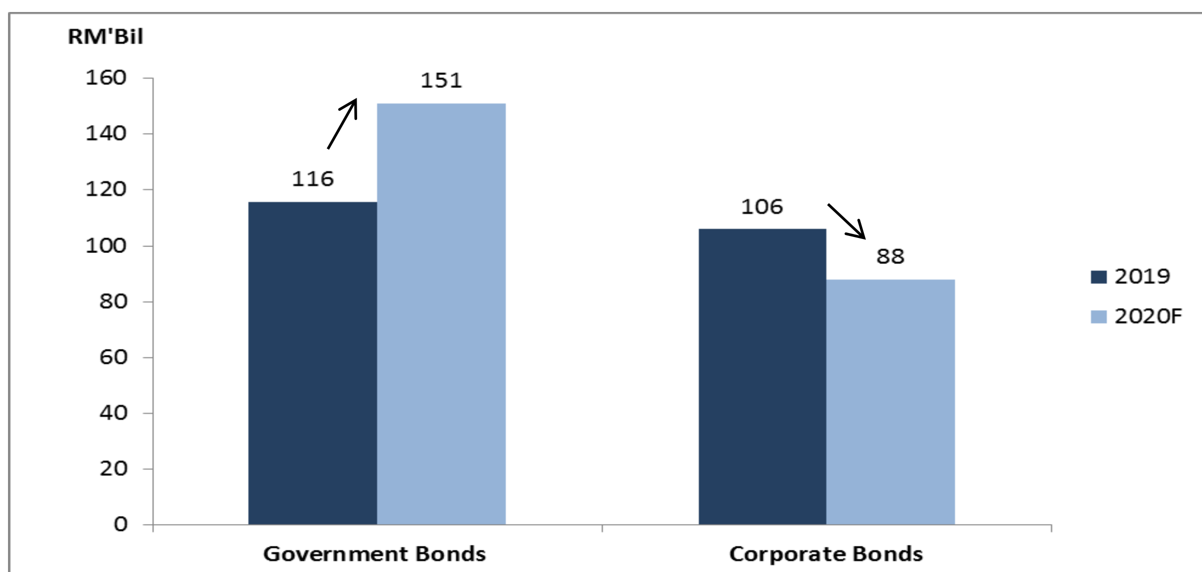
Table 3: Comparison of Policy Interest Rates during GFC and Current Levels

Policy Interest Rates	2009 GFC (lowest)	as at 8 July 2020
Indonesia	6.50%	4.25%
Malaysia	2.00%	1.75%
Thailand	1.25%	0.50%
Australia	3.00%	0.25%
US	0.25%	0.25%
UK	0.50%	0.10%
ECB	0.25%	-0.50%

Source: Bloomberg

3. Favourable Demand Dynamics

Table 4: Government and Corporate Bond Issuance in 2019 and 2020 (forecast)



Source: BPAM, RAM Ratings and in-house forecast

To mitigate the negative economic impact arising from the pandemic, the government has unveiled four economic stimulus packages in the first half of 2020. Therefore, the issuance of government bonds could increase this year as the government taps into the local bond market to fund RM35 billion out of the RM45 billion in direct fiscal injection required under the RM295 billion in stimulus measures announced.

However, these issuances are anticipated to be well-absorbed by domestic institutional funds amid an accommodative monetary policy and the reduced corporate bond issuances for this year due to the slowdown in economic activities.

Demand for government bonds remained healthy in the first half of 2020, with an average Bid-to-Cover (BTC) ratio of 2.4x for new government bond issuances; implying that demand has been more than double the issuance amount.

Conclusion

While the outlook for Malaysia’s bond market is envisaged to be underpinned by the accommodative global and domestic monetary policies alongside the favourable demand dynamics, investors are advised to adopt a medium to long-term investment horizon to ride through any short-term fluctuations in bond prices. This will place them in good stead to reap the benefits of investing in bond funds during their investment journey.

Lipper Fund Volatility

The Volatility Factor (VF) means there is a possibility for the fund in generating an upside return or downside return around this VF. The Volatility Class (VC) is assigned by Lipper based on quintile ranks of VF for qualified funds. VF is subject to monthly revision and VC is revised every six months or other interval as advised by FIMM. The volatility banding for the “Very Low”, “Low”, “Moderate”, “High” and “Very High” VCs as at 31 May 2020 are 0.000 ≤ VF ≤ 3.295, 3.295 < VF ≤ 9.495, 9.495 < VF ≤ 12.765, 12.765 < VF ≤ 15.215 and VF more than 15.215 respectively. For this period to 30 June 2020 the VCs for the funds are based on the VFs of the respective funds as at 31 May 2020. The fund’s portfolio may have changed since this date and there is no guarantee that the fund will continue to have the same VF or VC in the future. Presently, only funds launched in the market for at least 36 months will display the VF and its VC.