MALAYSIAN RATING CORPORATION BERHAD (364803 V)

Slower economic growth and lower bond issuance but recession not on the cards

MARC anticipates the ongoing weakness of the US economy to trigger a global recession in 2009 that will have an adverse impact on Malaysia's economic performance next year. The impact will likely to filter through as sharp moderation in the external sector as lower demand hits Malaysia's export sector.

According to Malaysian Rating Corporation Berhad's (MARC) Chief Executive Officer Mohd Razlan Mohamed, the slower economic activities have translated into lower financing which would have a bearing on corporate bond issuance in 2009.

Speaking at a forum on the topic of "Facing the Global Economic Challenges" hosted by MARC with corporate captains and capital market players, Razlan said: "There is no immediate cause for alarm among bond market participants as the deterioration in credit quality in the current economic slowdown remains confined to lower rated issues."

With the downward pressure continuing to weigh on Malaysia's macro performance, MARC anticipates the country's GDP growth to moderate to 3.5% in 2009 from an estimated 5.4% in 2008.

According to MARC's Chief Economist, Nor Zahidi Alias, Malaysia's direct dependency on the US as a major export destination has steadily declined in recent years but total exposures that include indirect exports have continued to climb, registering 32% in 2006, up from 25% in 2000.

Malaysia's economic growth in 2009 will also be constrained by the weakness in private investment as risk aversion heightens among investors, Nor Zahidi said, adding that both real exports and private investment are expected to bear the brunt of the global slowdown with growth rates moderating to 0.4% and 3.5% respectively in 2009.

Nonetheless, unless the ongoing turmoil begins to seriously affect Asian economies, MARC foresees the possibility of a recession occurring in Malaysia next year as remote, Nor Zahidi opined.

Given the anticipation of a slowdown in economic activity as well as a pronounced flight to quality, Razlan said, MARC expects lower corporate bond issuances in 2009 as companies defer plans and scale back on financing.

"The number of foreign entities who sought to issue in the ringgit bond market to capitalize on the lower financing cost, particularly between 2H2007 and 1H2008, has diminished in the wake of significant spikes in corporate yields. For instance, the 3-year AAA yield that averaged 4.08% in mid-2007 has moved up to 4.70% by 3Q2008."

The rising premium gap between what issuers are willing to pay and what investors are seeking may have created an incompatible situation for bond issuance for now, Razlan pointed out, adding that against this backdrop, the preliminary estimate of corporate bond issuance in 2009 will be in the range of RM25 billion to RM30 billion.

As at third quarter of 2008, the credit quality among Malaysian corporates in MARC's rating universe remained intact with an estimated downgrade to upgrade ratio of 1.0 time vis-à-vis its 10-year average of 1.8 times and significantly below the 1997-98 crisis level of 7.5 times.

Nonetheless, if the economic fundamentals deteriorate significantly, credit quality is likely to be affected. Signs of an increase in fragility have already emerged with few issuers breaching financial covenants and appealing for waivers in meeting sinking fund build-up payments, Razlan said.

"As of now, the situation is contained with these issuers placed under negative watch and are being closely monitored. The risk of this situation becoming more widespread would depend on the economic fundamentals going forward," Razlan added.

The breakfast forum was held at Ritz-Carlton Hotel, Kuala Lumpur from 9.30am to 12.30pm, Wednesday, 5th November 2008.

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