Fixed Income Research

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Vol.: FI/001/2021

Bond Market Outlook 2021

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Malaysian Bond Market

Highlights in 2020

RM55.0 billion direct fiscal injection to stimulate economy ravaged by COVID-19

BNM reduced the OPR to 1.75% in 2020 from 3.00% in 2019

No defaults recorded in rated credits

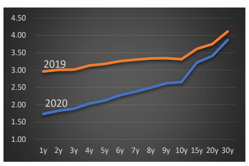
FTSE Russell maintained Malaysia in its watchlist for potential exclusion from the WGBI

+27.4% y-o-y

Issuance of govvies grew to its highest annual level in 2020 at RM147.4 billion

-20.8% y-o-y

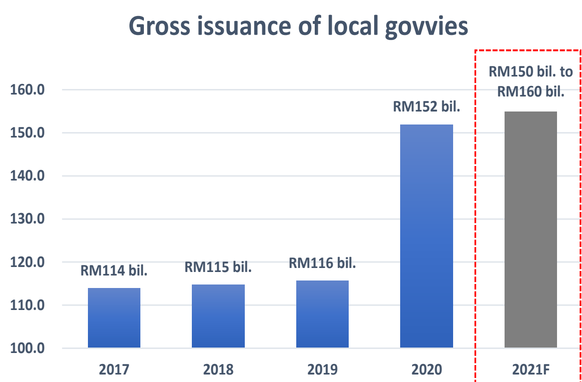
Issuance of corporate bonds fell to RM104.6 billion in 2020

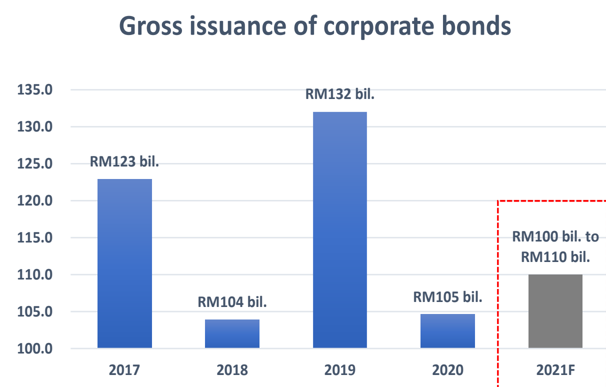


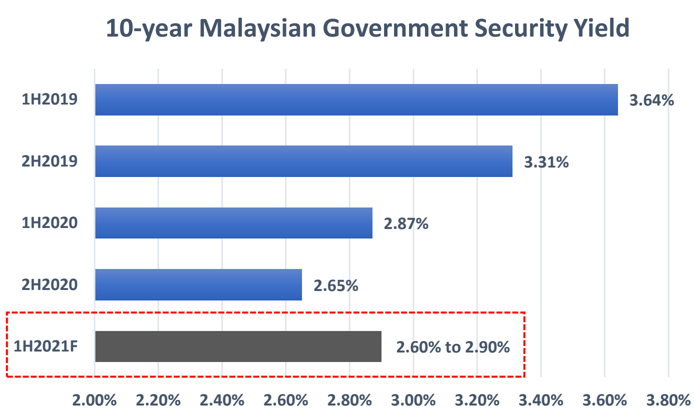
MGS curve bull flattened in 2020 with yields shedding between 25bps to 122bps y-o-y

Foreign investors remained as net buyers of local bonds, net foreign inflows amounted to RM14.8 billion

Projections for 2021







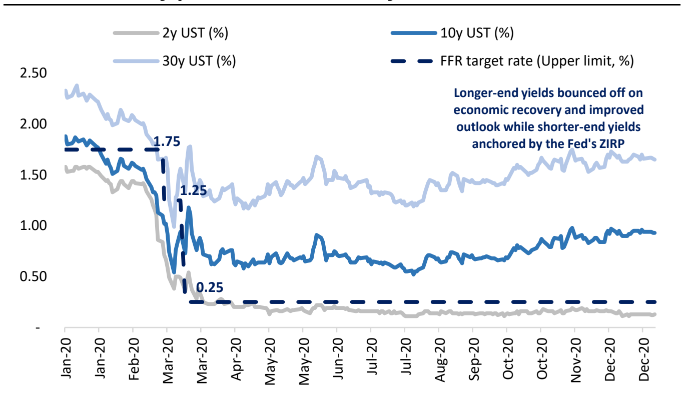
US Government Bond Market

- ***Sentiment in the UST market was bullish for the majority of 2020 amid a rush for safe-haven assets.*** Yield on the 10y US treasury (UST) fell below 1% for the first time in history as global economies grappled with supply-demand shock amid the COVID-19 pandemic. The synchronic decline in global policy rates added further downward pressure on yields and spilled over to emerging markets as investors looked for higher yield returns. UST yields began to increase in 4Q2020 as the global economy showed signs of recovery and positive news following the rapid development and deployment of COVID-19 vaccines. Nevertheless, UST yields remained low as the rise was gradual. The 10y UST ended 2020 at 0.93% (end-2019: 1.86%).

- ***Accommodative Fed policies to remain in place in 2021 with the FFR target range in between 0% to 0.25%.*** Fed officials remain dovish on rates according to the latest Fed dot plot and signalled that rates would be near zero at least through 2023. Although the US economy has continued to recover, the Fed also stated in its latest FOMC meeting that it will continue to buy USTs and agency mortgage-backed securities to increase employment and induce inflation. The Fed's accommodative stance was within expectations as economic recovery remains uncertain due to a spike in COVID-19 cases in the US and economic growth remains weak compared to 2019. The Fed did most of the heavy lifting in 2020 amid the US presidential elections and several deadlocks in expanding fiscal stimuli. The Fed had reduced the Federal Funds Rate (FFR) target range by 1.5% since March, implemented QE and initiate lending programmes to securities firms, banks, large corporates, SMEs, municipal governments, and even to non-profit institutions.

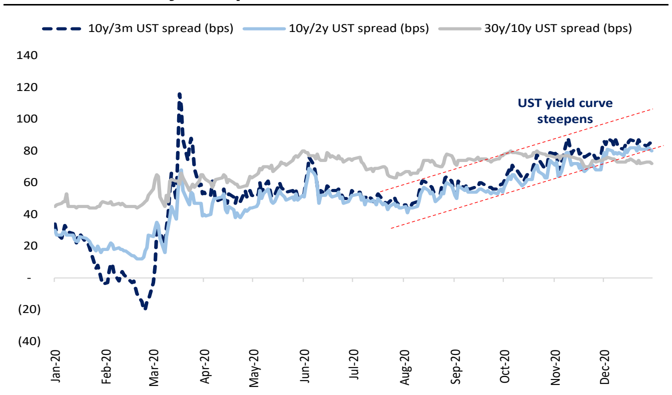
- ***UST yields to tread higher in 1H2021.*** Improved risk sentiment as a result of the rapid economic recovery in 2021 and heightened supply of long-term USTs would push yields higher. A rise in UST yields would be capped by ongoing uncertainties in US-China relations despite Biden's victory in the US presidential election. Trump's trade protectionism policies have "ceded" global economic leadership to China evident from conclusion of the Regional Comprehensive Economic Partnership negotiations, the world's largest trade agreement without the US. China's faster-than-expected economic recovery and growing influence on the global economy have given it leverage to dictate terms in global economic affairs. Even with Biden as president, US pressure on China will not likely ease. As such, we anticipate that US-China relations will continue to be strained, keeping UST yields from spiking as uncertainties remain.

Exhibit 1: Daily performance of UST yields vs FFR



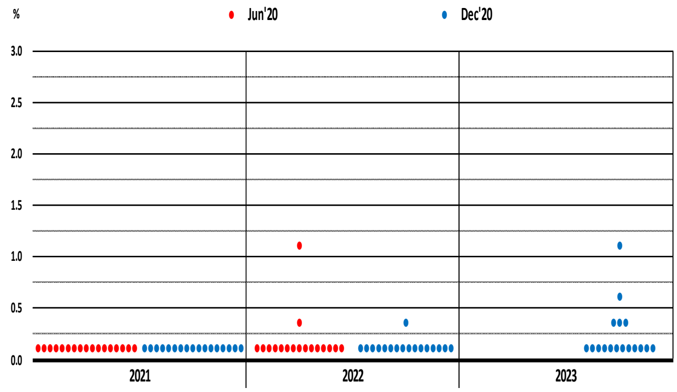
Sources: US Treasury, MARC Research

Exhibit 2: UST yield spreads



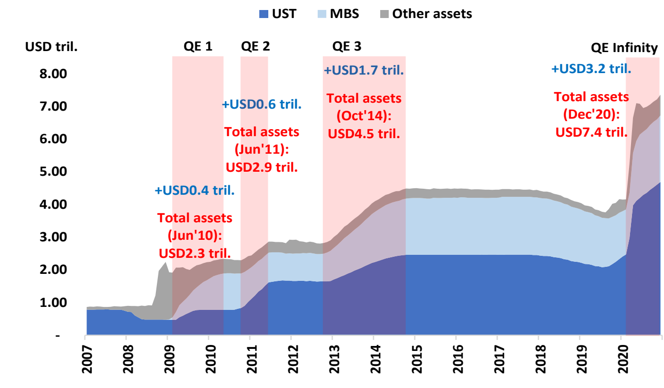
Sources: US Treasury, MARC Research

Exhibit 3: US Fed dot plot – Jun'20 vs Dec'20



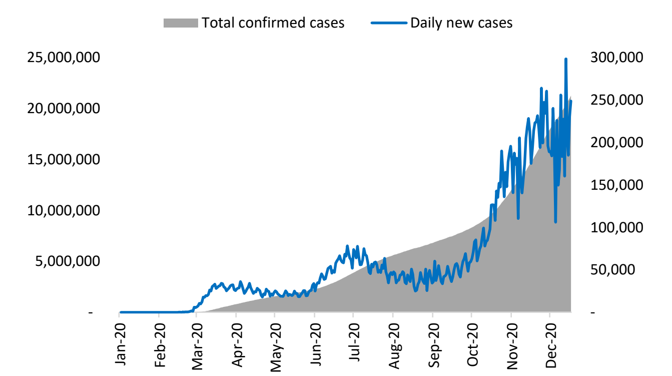
Sources: US Fed, MARC Research

Exhibit 4: US Fed's balance sheet (Assets)



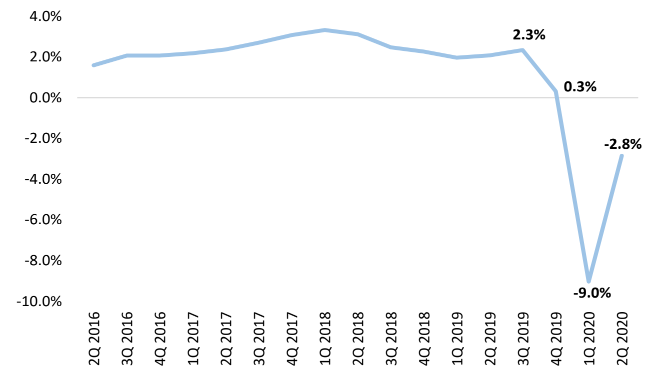
Sources: US Fed (St.Louis), MARC Research

Exhibit 5: US COVID-19 cases



Sources: CDC, MARC Research

Exhibit 6: US GDP growth y-o-y



Sources: US Fed (St.Louis), MARC Research

Exhibit 7: Economic projections by the US Fed

Fed projections (Median)	2020		2021		2022	
	Jun'20	Dec'20	Jun'20	Dec'20	Jun'20	Dec'20
Real GDP growth (%)	-6.5	-2.4	5.0	4.2	3.5	3.2
Unemployment rate (%)	9.3	6.7	6.5	5.0	5.5	4.2
PCE inflation (%)	0.8	1.2	1.6	1.8	1.7	1.9
Core PCE inflation (%)	1.0	1.4	1.5	1.8	1.7	1.9
FFR (%)	0.1	0.1	0.1	0.1	0.1	0.1

Sources: US Fed, MARC Research

Malaysian Government Bond Market

Primary market

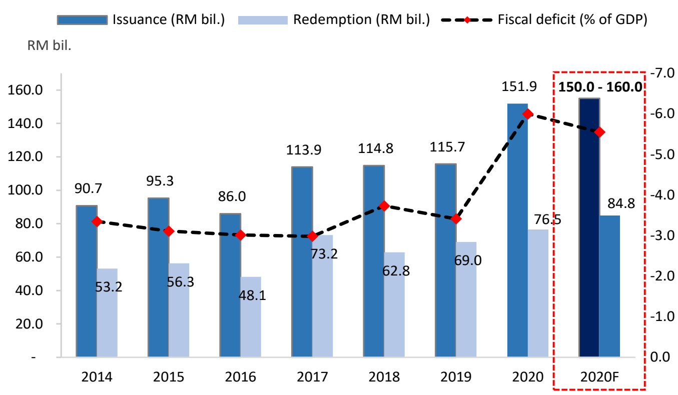
- ***Gross issuance of MGS/GII rose to RM151.9 billion in 2020.*** This was the highest amount recorded in a single year and was slightly below MARC's lower band projection of RM155.0 billion for 2020. Throughout 2020, the government borrowed its way out of the COVID-19 pandemic amid record low yields and fiscal limitations as revenue fell. The government has introduced huge fiscal stimuli in 2020 and expects its fiscal deficit to swell to 6.0% of GDP in 2020, its highest since the Asian Financial Crisis.

- ***Demand for MGS/GII at public auctions conducted in 2020 remains robust with an average bid-to-cover ratio of 2.2x.*** Support mainly came from local banks, the largest holder of Malaysian government securities (MGS)/government investment issues (GII) amid liquidity enhancement measures employed by BNM which include the flexibility of using MGS/GII as part of the statutory reserve requirement (SRR) compliance. Based on the latest data available, local banks have increased their holdings of MGS/GII in 3Q2020 by RM46.4 billion to RM257.0 billion (4Q2019: RM210.6 billion), equivalent to 32.3% of total outstanding (4Q2019: 28.7%). Demand was also partly contributed by the increased participation of BNM. BNM's holdings of MGS/GII in 3Q2020 rose RM9.1 billion to RM13.3 billion (4Q2019: RM4.3 billion), equivalent to 1.7% of total outstanding (4Q2019: 0.6%), or a threefold increase y-o-y.

- ***Gross issuance of MGS/GII to remain robust in 2021, similar to 2020 at between RM150.0 billion to RM160.0 billion.*** Our forecast is based on 1) the government's projected budget deficit of RM84.8 billion; and 2) RM67.7 billion worth of MGS/GII papers that would mature in 2021. Given the unprecedented scale and scope of the COVID-19 pandemic's impact, it is not surprising that 2021 would be a record year for new supply of MGS/GII as the government faces severe fiscal limitations. Furthermore, the statutory debt limit has been temporarily raised for two years to 60.0% of GDP from 55.0% previously. The government may revisit the debt ceiling should another round of fiscal stimulus be warranted amid a prolonged Conditional Movement Control Order (CMCO).

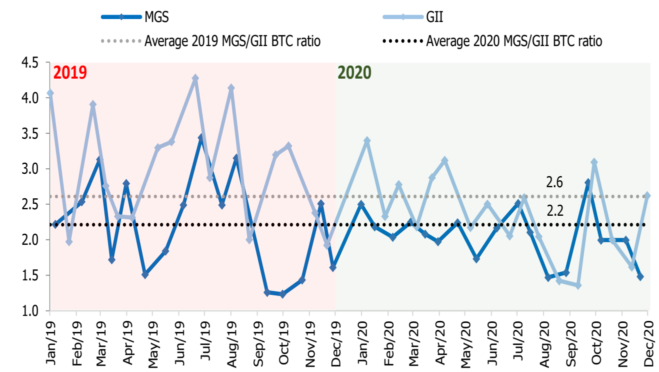
- ***Well balanced auction calendar for 2021, average issuance size expected to be between RM4.0 billion to RM4.5 billion.*** The total number of MGS/GII auctions to be conducted next year is scheduled to be a record high at 37 (2020: 34) with 19 from MGS and 18 from GII. 61% of the auctions scheduled next year have tenures between 3-year and 10-year, aiding the government to smoothen out its debt maturity profile and reduce some steepening pressure. There were only two new issuances, namely the 15.5-year GII 07/36 and the 20.5-year GII 09/41. The remaining 35 issues are re-openings, complementing regulators' efforts in boosting liquidity and keeping Malaysia in the FTSE Russell World Government Bond Index (WGBI) by increasing the outstanding sizes of existing MGS/GII. A total of 18 private placements are scheduled for 2021, mostly for MGS/GII with tenures between 15-year and 30-year as demand is generally lacking at the long-end of the curve.

Exhibit 8: Gross MGS/GII issuance



Sources: BNM Bond Info Hub, MARC Research

Exhibit 9: Bid-to-cover ratios of government bond auctions



Sources: BNM FAST, MARC Research

Exhibit 10: Auction results for government bonds 2020

Issues	Target Month	Issue Date	Total raised (RM Mil)	Amount (RM Mil)	Private Placement (RM Mil)	Bid-To-Cover ratio (x)	Average Yield (%)
7-yr Reopening of MGS 05/27 3.502%	January	8-Jan-20	3,500	3,500		2.50	3.28
15-yr Reopening of MGII 11/34 4.119%	January	15-Jan-20	3,500	2,500	1,000	3.40	3.51
3-yr Reopening of MGS 03/23 3.480%	January	24-Jan-20	3,000	3,000		2.18	2.86
30-yr Reopening of MGII 11/49 4.638%	February	5-Feb-20	4,000	2,500	1,500	2.33	3.78
10-yr Reopening of MGS 08/29 3.885%	February	14-Feb-20	4,000	4,000		2.04	2.89
5-yr Reopening of MGII 10/24 3.655%	February	21-Feb-20	4,000	4,000		2.78	2.85
15-yr Reopening of MGS 07/34 3.828%	March	6-Mar-20	4,000	3,500	500	2.25	3.03
20-yr Reopening of MGII 09/39 4.467%	March	13-Mar-20	4,300	2,800	1,500	2.18	3.34
5-yr Reopening of MGS 09/25 3.955%	March	23-Mar-20	4,000	4,000		2.08	3.45
7.5-yr New Issue of MGII (Mat on 09/27)	March	31-Mar-20	4,500	3,500	1,000	2.87	3.42
20-yr Reopening of MGS 05/40 3.757%	April	7-Apr-20	5,000	3,500	1,500	1.97	3.86
10.5-yr New Issue of MGII (Mat on 10/30)	April	15-Apr-20	5,000	4,000	1,000	3.12	3.47
7-yr Reopening of MGS 05/27 3.502%	April	30-Apr-20	4,000	4,000		2.24	2.68
15-yr Reopening of MGII 11/34 4.119%	May	15-May-20	5,000	3,500	1,500	2.17	3.24
10-yr Reopening of MGS 08/29 3.885%	May	22-May-20	4,500	4,500		1.73	2.80
3-yr Reopening of MGII 05/23 3.151%	June	4-Jun-20	4,500	4,500		2.50	2.31
30-yr New Issue of MGS (Mat on 06/50)	June	15-Jun-20	5,500	3,000	2,500	2.17	4.07
20-yr Reopening of MGII 09/39 4.467%	June	30-Jun-20	5,500	3,500	2,000	2.05	3.76
3-yr Reopening of MGS 03/23 3.480%	July	10-Jul-20	5,000	5,000		2.51	2.00
10-yr Reopening of MGII (Mat on 10/30)	July	17-Jul-20	5,000	5,000		2.59	2.67
15-yr Reopening of MGS 07/34 3.828%	July	24/Jul/20	5,000	5,000		2.10	2.97
7-yr Reopening of MGII (Mat on 09/27)	August	03/Aug/20	4,000	4,000		2.05	2.28
20-yr Reopening of MGS 05/40 3.757%	August	14/Aug/20	5,500	4,000	1,500	1.47	3.24
15-yr Reopening of MGII 11/34 4.119%	August	27/Aug/20	5,000	4,000	1,000	1.42	3.03
7-yr Reopening of MGS 05/27 3.502%	September	04/Sep/20	3,500	3,500		1.54	2.29
30-yr Reopening of MGII 11/49 4.638%	September	18/Sep/20	3,000	3,000		1.36	4.18
5-yr Reopening of MGS 09/25 3.955%	September	30/Sep/20	5,500	5,000	500	2.80	2.39
3-yr Reopening of MGII 05/23 3.151%	October	7-Oct-20	4,500	4,500		3.09	1.98
10.5-yr New Issue of MGS (Mat on 04/31)	October	15/Oct/20	5,000	5,000		1.99	2.63
5-yr Reopening of MGII 03/26 3.726%	October	28/Oct/20	5,000	5,000		2.00	2.20
30-yr Reopening of MGS (Mat on 06/50)	November	13/Nov/20	3,500	3,000	500	1.99	4.05
7-yr Reopening of MGII (Mat on 09/27)	November	20-Nov-20	4,000	4,000		1.62	2.52
15-yr Reopening of MGS 07/34 3.828%	November	30/Nov/20	3,000	3,000		1.48	3.43
10-yr Reopening of MGII (Mat on 10/30)	December	8-Dec-20	4,500	4,000	500	2.62	2.99

Sources: BNM FAST, MARC Research

Exhibit 11: MGS switch auctions 2020

Issues	Tenure (Years)	Issue Date	Amount (RM mil)	Yield (%)
MGS 5/2018 4.291% 06.07.2048	28	24-Sep-20	1,440	4.03
MGS 7/2013 4.935% 30.09.2043	23	24-Sep-20	1,228	3.98
MGS 4/2015 4.254% 31.05.2035	15	24-Sep-20	447	3.37

Sources: BNM Fast, MARC Research

Exhibit 12: Auction calendar for government bonds 2021

Issues	Target Month	Private Placement (RM Mil)
7-yr Reopening of MGS 06/28 3.733%	January	No
15.5-yr New Issue of MGII (Mat on 07/36)	January	Yes
10-yr Reopening of MGS 04/31 2.632%	January	No
5-yr Reopening of MGII 03/26 3.726%	February	No
20-yr Reopening of MGS 05/40 3.757%	February	Yes
7-yr Reopening of MGII 09/27 3.422%	February	No
30-yr Reopening of MGS 06/50 4.065%	March	Yes
10-yr Reopening of MGII 10/30 3.465%	March	No
5-yr Reopening of MGS 09/25 3.955%	March	No
20.5-yr New Issue of MGII (Mat on 09/41)	March	Yes
7-yr Reopening of MGS 06/28 3.733%	April	No
15-yr Reopening of MGII (Mat on 07/36)	April	Yes
3-yr Reopening of MGS 06/24 3.478%	April	No
30-yr Reopening of MGII 11/49 4.638%	May	Yes
15-yr Reopening of MGS 05/35 4.254%	May	Yes
5-yr Reopening of MGII 03/26 3.726%	May	No
10-yr Reopening of MGS 04/31 2.632%	June	Yes
3-yr Reopening of MGII 10/24 3.655%	June	No
20-yr Reopening of MGS 05/40 3.757%	June	Yes
15-yr Reopening of MGII (Mat on 07/36)	July	Yes
5-yr Reopening of MGS 11/26 3.900%	July	No
10-yr Reopening of MGII 10/30 3.465%	July	Yes
30-yr Reopening of MGS 06/50 4.065%	August	Yes
7-yr Reopening of MGII 08/28 3.871%	August	No
3-yr Reopening of MGS 06/24 3.478%	August	No
20-yr Reopening of MGII (Mat on 09/41)	September	Yes
10-yr Reopening of MGS 04/31 2.632%	September	Yes
5-yr Reopening of MGII 03/26 3.726%	September	No
7-yr Reopening of MGS 06/28 3.733%	October	No
30-yr Reopening of MGII 11/49 4.638%	October	Yes
5-yr Reopening of MGS 11/26 3.900%	October	No
10-yr Reopening of MGII 10/30 3.465%	October	Yes
15-yr Reopening of MGS 05/35 4.254%	November	Yes
3-yr Reopening of MGII 10/24 3.655%	November	No
20-yr Reopening of MGS 05/40 3.757%	November	Yes
7-yr Reopening of MGII 08/28 3.871%	December	No
3-yr Reopening of MGS 06/24 3.478%	December	No

Sources: BNM FAST, MARC Research

Secondary market

- ***2020 was a boon for MGS as yields fell to multi-year lows.*** The downward trajectory in yields was mainly supported by BNM's liquidity measures as well as the cumulative 125bps cut in the OPR. Demand for MGS was also supported by yield-hunting activities amid the low global interest rate environment and subdued inflation in 2020. The 10-year MGS ended 2020 at 2.65% (2019: 3.31%).

- ***MGS yields are projected to hover higher between 2.60% to 2.90% in 1H2021.*** Amid prospects of an improving economic outlook in the coming quarters next year, we expect MGS yields to gradually trend higher. Malaysia's 3Q2020 GDP print indicated that the economy had rebounded. MARC anticipates that Malaysia's economy would rebound by 6.2% to 6.7% in 2021. An improved inflation outlook would also slow down the buying momentum of MGS as witnessed in 2020 as real yields fall.

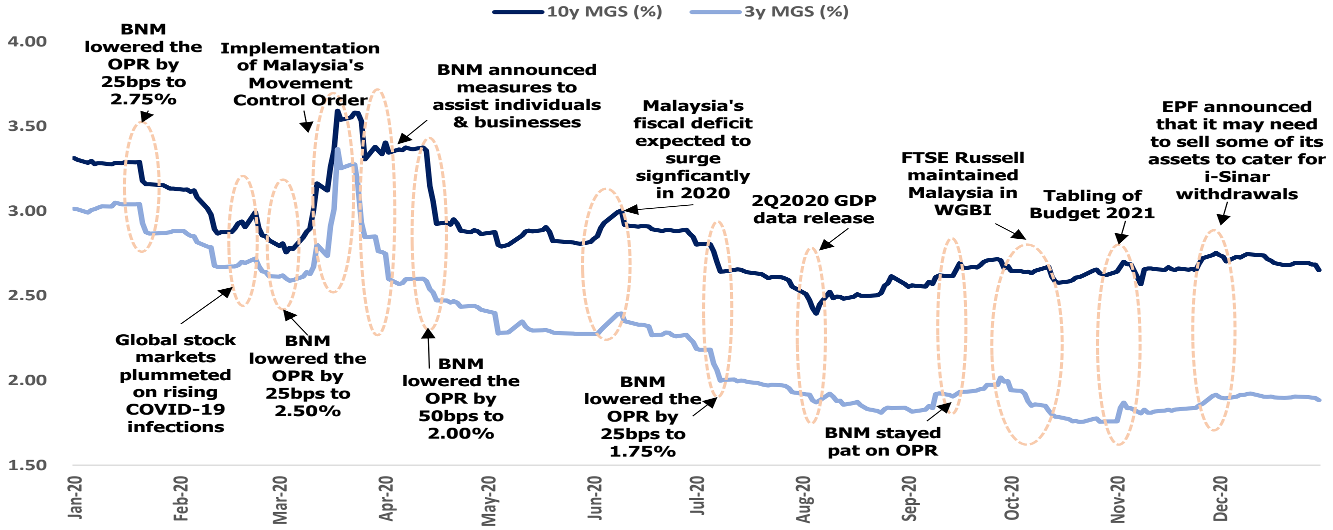
- ***MGS yield curve to steepen further in 1H2021 as heavy supply is expected to support fiscal initiatives.*** The tabling of the expansionary Budget 2021 reaffirmed expectations that additional fiscal support is much needed. As such, the government is expected to issue more debt to fund its initiatives to steer Malaysia towards recovery. MGS yields along the belly until the long-end of the curve would experience most of the upward pressure.

- ***A rise in short-end MGS yields would be capped by accommodative monetary policies.*** We do not expect any sharp rise in MGS yields at the short end as global central banks including BNM are expected to remain dovish to complement fiscal stimuli. While there is still ample space for BNM to cut the OPR, we opine that the OPR would remain at 1.75% through 2021. The prospects of a cut have faded as Malaysia has shifted its focus towards fiscal policies to enable economic recovery, coupled with the positive development of COVID-19 vaccines and their possible rollout in 1Q2021.

- ***Yields are not expected to spike on EPF's possible move to trim down its MGS holdings.*** The spike in MGS yields in November was a knee-jerk reaction towards EPF's statement that it may need to offload its assets to fund i-Sinar withdrawals. In 2020, EPF had been gradually trimming down its MGS holdings from 29.8% of total outstanding in 1Q2020 to 25.4% in 3Q2020. Despite this, MGS yields continued to trend downwards during this period as local banks and foreign investors increased their stakes. We believe that Malaysia has ample liquidity to buffer any sell-off activity by EPF.

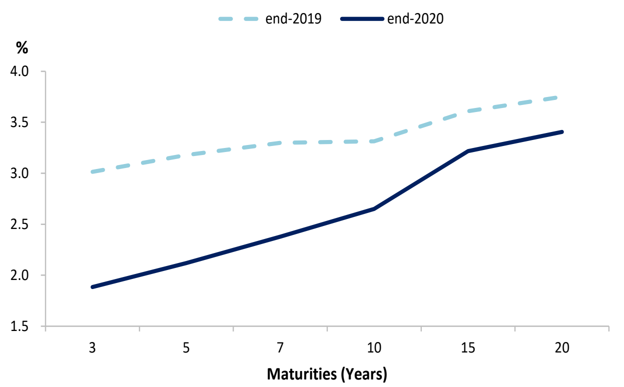
- ***There are significant downside risks to our forecast.*** While news of COVID-19 vaccines has fuelled the rally in risk assets, there are still lingering concerns about their effectiveness and take-up rate. We must acknowledge the possibility that the current public health and economic crisis could be prolonged as new cases continue to soar and most countries remain in lockdown. This may further compress MGS yields if international borders remain closed in 1H2021, hindering economic recovery prospects. Domestic demand would be supported by risk-off sentiment while foreign demand would rise on higher real yields as deflation continues to be rampant.

Exhibit 13: Daily performance of three- and 10-year MGS yields



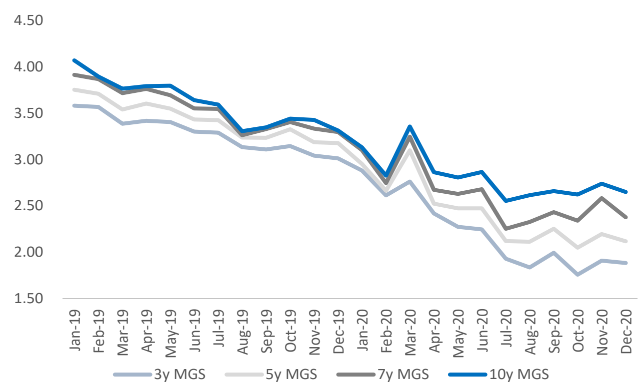
Sources: BNM, MARC Research

Exhibit 14: MGS yield curve comparison



Sources: BNM, MARC Research

Exhibit 15: Yield trend – MGS (%)



Sources: BNM, MARC Research

Exhibit 16: 10y/3y MGS spread (bps)

Sources: BNM, MARC Research

Exhibit 17: MGS benchmark yields

MGS yields	2019	2020	Change
1y	2.96	1.73	-122 bps
2y	3.01	1.83	-118 bps
3y	3.01	1.88	-113 bps
4y	3.13	2.03	-110 bps
5y	3.18	2.12	-106 bps
7y	3.30	2.38	-92 bps
10y	3.31	2.65	-66 bps
15y	3.61	3.22	-39 bps
20y	3.75	3.41	-35 bps

Sources: BNM, MARC Research

Malaysian Corporate Bond Market

Primary market

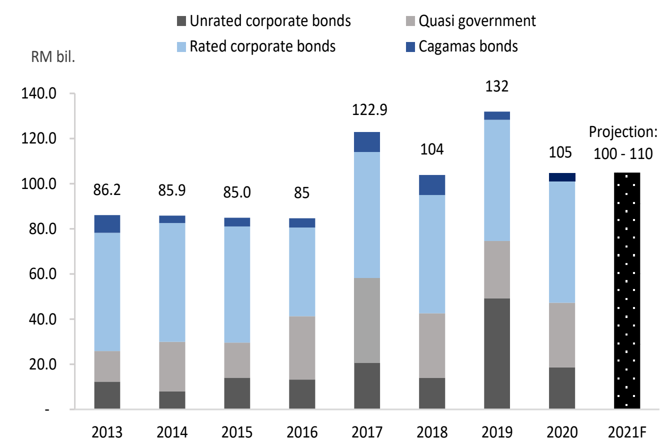
- ***In 2020, the gross issuance of long-term corporate bonds exceeded expectations, amounting to RM104.6 billion, above our forecast of between RM80.0 billion to RM90.0 billion.*** Gross issuance in 2H2020 surged to RM65.7 billion after recording a dismal RM38.9 billion in 1H2020 as the economy contracted significantly during the period when the first MCO was introduced. Issuers rushed to issue bonds in 2H2020 as the government began to ease restrictions, raising the prospects of a gradual economic recovery in 2021. Issuers from the financial services sector dominated primary market activities with a total gross issuance of RM41.2 billion.

- ***We foresee the gross issuance of corporate bonds to rebound to between RM100.0 billion to RM110.0 billion in 2021 similar to 2018.*** This assumes that the current economic recovery momentum would continue, leading to an improvement in private investments as business confidence increases. The current conducive financing landscape would also persuade issuers to raise their issuances to secure financing costs. We also expect a steady growth of quasi-government corporate bonds in 2021 amid the resumption of large infrastructure projects.

- ***Healthy asset growth to underpin demand for corporate bonds in 2021.*** Given that corporate bond maturity in 2021 is estimated to be around RM51.4 billion, the net issuance of corporate bonds is slated to be in the range of RM48.6 billion to RM58.6 billion. We opine that this excess supply of corporate bonds could be easily absorbed by the market in 2021 as the economy recovers. Based on the latest data available, total assets held by major fixed-income investors in Malaysia grew in 2020 despite the COVID-19 pandemic. AUM of local fixed-income funds expanded by RM28.4 billion in Jan-Nov'20 (end-2019: RM19.0 billion), total investments held by the EPF expanded by RM38.3 billion in Jan-Jul'20 (end-2019: RM70.9 billion) and total assets held by Malaysian-incorporated insurers expanded by RM0.6 billion in 1H2020 (end-2019: RM14.5 billion).

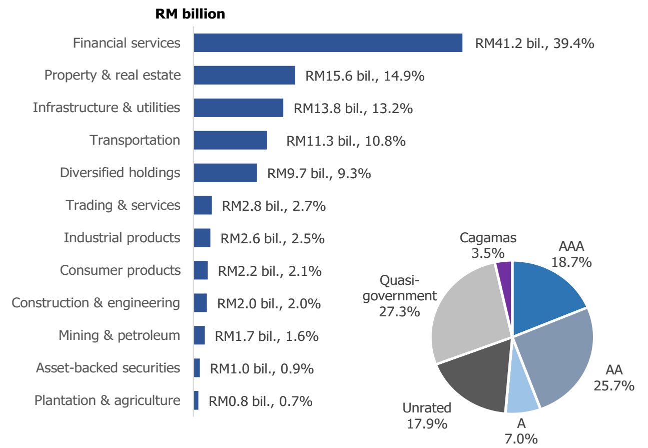
- ***Gross issuance of SRI sukuk to grow in 2021 due to government incentives.*** The government had introduced measures in Budget 2021 to boost issuances within the Sustainable and Responsible Investment (SRI) sukuk space. Measures include the extension of the green SRI sukuk grant scheme until 2025 and the RM2.0 billion Green Technology Financing Scheme 3.0 with a Danajamin guarantee until 2022. YTD, total outstanding SRI sukuk stood at RM6.1 billion with RM0.9 billion issued in 2020.

Exhibit 18: Corporate bond issuances by segment



Sources: BPAM, MARC Research

Exhibit 19: Corporate bond issuance composition in 2020



Sources: BPAM, MARC Research

Exhibit 20: Historical trend of corporate bond issuances by category (RM billion)

Year	*Unrated Corporate Bonds*	*Quasi-Government*	*Total Unrated*	*Rated Corporate Bonds*	*Cagamas*	*Total Rated*	*Total Corporate Bonds*
2011	5.2	15.0	**20.2**	47.6	2.8	**50.4**	**70.7**
2012	13.4	30.4	**43.8**	76.6	3.4	**80.0**	**123.8**
2013	12.3	13.6	**25.9**	52.4	7.9	**60.3**	**86.2**
2014	8.0	21.9	**29.9**	52.7	3.3	**55.9**	**85.9**
2015	14.0	15.6	**29.6**	51.5	3.8	**55.3**	**85.0**
2016	13.2	28.1	**41.3**	39.3	4.1	**43.4**	**84.8**
2017	20.7	37.6	**58.3**	55.8	8.7	**64.6**	**122.9**
2018	13.9	28.7	**42.6**	52.4	9.0	**61.3**	**103.9**
2019	49.3	25.3	**74.6**	53.7	3.7	**57.4**	**132.0**
2020	**18.7**	**28.6**	**47.2**	**53.7**	**3.6**	**57.3**	**104.6**
Jan-20	3.6	-	**3.6**	0.5	-	**0.5**	**4.1**
Feb-20	0.7	5.8	**6.4**	4.3	-	**4.3**	**10.7**
Mar-20	2.9	1.4	**4.2**	2.6	0.4	**3.0**	**7.2**
Apr-20	0.9	0.5	**1.4**	1.2	0.5	**1.7**	**3.1**
May-20	1.1	2.8	**3.9**	3.1	0.1	**3.2**	**7.1**
Jun-20	0.5	-	**0.5**	6.1	0.1	**6.2**	**6.7**
Jul-20	0.8	4.5	**5.3**	1.7	-	**1.7**	**7.1**
Aug-20	1.1	-	**1.1**	7.2	0.1	**7.3**	**8.4**
Sep-20	1.4	4.8	**6.2**	2.8	-	**2.8**	**9.0**
Oct-20	3.3	2.3	**5.6**	10.0	0.6	**10.6**	**16.2**
Nov-20	1.3	6.4	**7.6**	9.0	-	**9.0**	**16.7**
Dec-20	1.2	0.2	**1.5**	5.2	1.9	**7.0**	**8.5**

Sources: BPAM, MARC Research

Secondary market

- ***In 2020, a double-digit bps dip in yields was seen among investment-grade corporate bonds.*** The decline in yields has effectively extended the gains of the previous year. Yields on AAA, AA and A-rated corporate bonds shed 37bps to 95bps along the 3y15y curve, compared with 2019's fall of between 71bps to 222bps. Most of the gains were concentrated along the front-end to the belly of the curve. Corporate bonds garnered support mainly from the reduction in OPR and a benign inflation environment.

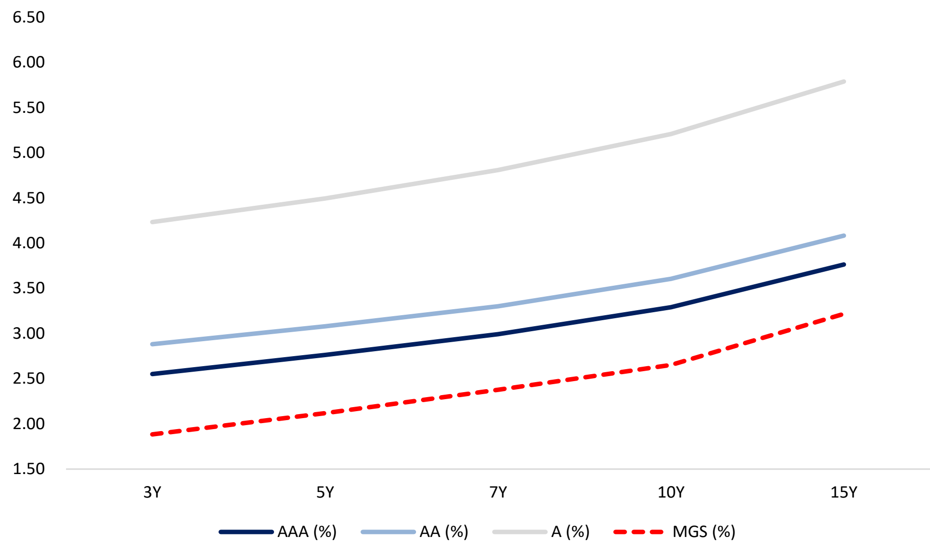
- ***However, credit spreads along the 3y7y curve widened as the yield declines in similar tenured govvies were more pronounced.*** Credit spreads along the 3y7y curve for AAA, AA, A-rated corporate bonds widened by 13bps to 41bps. Meanwhile, the credit spreads along the 10y15y curve rose by just 2bps to 7bps except for A-rated corporate bonds which declined by 15bps to 41bps. This was mostly due to a correction in MGS yields at the long-end that took place in the final quarter of the year amid expectations of a heavier supply in 2021.

- ***Trading momentum of corporate bonds softened in 2020 with the volume moderating to RM154.2 billion (2019: RM162.9 billion).*** Most of the trading interest was on quasi-government bonds with 38.0% of total trades, followed by AA-rated corporate bonds with 27.2% of total trades. Meanwhile, AAA-rated corporate bonds constituted about 23.1% of total trades. By tenure, trades were mostly skewed towards corporate bonds at the belly of the curve at 48.2%.

- ***Upward bias for corporate bond yields in 1H2021 on the back of a steepening MGS yield curve.*** Nonetheless, we expect the magnitude of yield increases in corporate bonds to be at a smaller scale compared to MGS, further narrowing the credit spread. Corporate bonds tend to be less sensitive to external shocks amid low foreign holdings. Thus, they are more susceptible to domestic factors such as the direction of fiscal and monetary policies.

- ***Credit spreads to remain broadly stable at least in early 2021.*** Malaysia's macroeconomic indicators suggests that the economy is on the recovery path from the rock-bottom in 2Q2020. An improved risk appetite could reignite demand for corporate bonds, narrowing the credit spreads. However, challenges remain as COVID-19 infections are still rampant and there is still the risk of extending the CMCO to January 2021. If the CMCO is extended, the negative impact should be less severe compared to 2Q2020 as most economic sectors are allowed to operate.

Exhibit 21: Yield curve comparison (conventional) as at end-2020



Sources: BNM, MARC Research

Exhibit 22: AAA corporate bond yields

AAA (%)	2019	2020	Y-o-y change
3-year	3.50	2.55	-95 bps
5-year	3.63	2.76	-86 bps
7-year	3.76	2.99	-77 bps
10-year	3.88	3.29	-59 bps
15-year	4.13	3.76	-37 bps

Sources: BNM, MARC Research

Exhibit 23: AA corporate bonds yield spread (bps)

AAA (%)	2019	2020	Y-o-y change
3-year	3.78	2.88	-90 bps
5-year	3.95	3.08	-87 bps
7-year	4.07	3.30	-77 bps
10-year	4.21	3.61	-61 bps
15-year	4.45	4.08	-37 bps

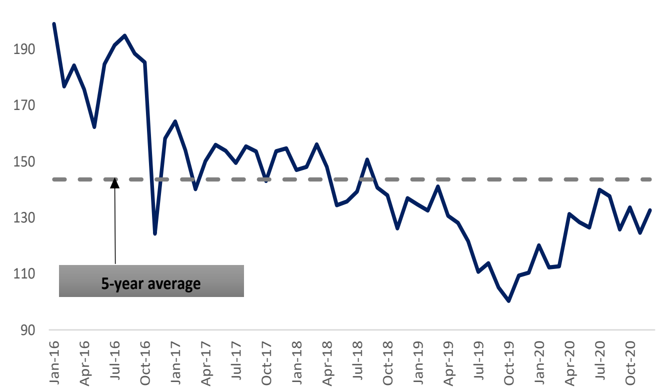
Sources: BNM, MARC Research

Exhibit 24: A corporate bond yields

AAA (%)	2019	2020	Y-o-y change
3-year	4.95	4.23	-72 bps
5-year	5.27	4.49	-78 bps
7-year	5.60	4.81	-79 bps
10-year	6.02	5.21	-81 bps
15-year	6.59	5.79	-80 bps

Sources: BNM, MARC Research

Exhibit 25: 5y corporate bond yield spread (bps)



Sources: BNM, MARC Research

Rating activities by MARC

- ***MARC's rating activities remained stable throughout 2020 despite the COVID-19 pandemic.*** Affirmations continued to dominate rating actions in MARC's universe. Ratings remained stable as most issues were within the investment grade rating band. In 2020, 91.2% of total outstanding corporate bonds rated by MARC were rated between AAA and A ratings bands with a heavy concentration in the financial services, infrastructures and utilities sectors. The total outstanding of 110 MARC-rated corporate bonds (2019: 100) stood at RM278.0 billion (2019: RM256.6 billion).

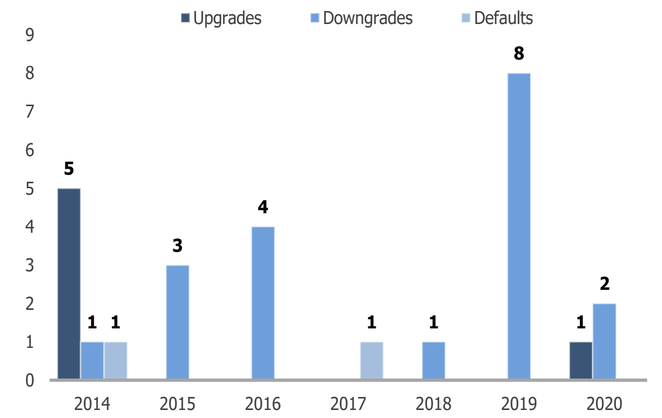
- ***Fewer negative rating actions in 2020 compared to 2019.*** There were only two downgrades (2019: eight) and one upgrade (2019: zero) while the number of defaults remained zero. MARC downgraded MEX II Sdn Bhd's RM1.3 billion Sukuk Murabahah Programme to BBB$_{IS}$ from A$_{IS}$/Negative and its RM150.0 million Junior Bonds to BB from BBB/Negative. The downgrades reflect MARC's increased concerns on MEX II Sdn Bhd's timely ability to obtain additional financing to meet its debt service next year and complete a debt restructuring process. Meanwhile, MARC upgraded TSH Sukuk Murabahah Sdn Bhd's RM50 million Sukuk Murabahah Islamic Commercial Paper programme rating to MARC-1$_{IS}$ from MARC-2$_{IS}$ amid the issuer's efforts to improve its liquidity position.

- ***MEX II issue ratings remained on MARCWatch Negative at end-2020.*** The ratings have been on MARCWatch Negative since May 2020 following insufficient progress with respect to MEX II's 16.8-km Lebuhraya Putrajaya-KLIA highway project. The MARCWatch Negative placement reflects the uncertainty over the company's ability to boost liquidity to repay near-term obligations and execute the refinancing plan in a timely manner. MARC may take further negative rating action if there is a lack of progress in MEX II's refinancing plans by Jan/Feb'21. The inability of MEX II to put in place a bridge facility by then or adequately address the RM106.9 billion sukuk obligations due next year, could drive a multi-notch downgrade.

- ***Rating outlook for issues in MARC's rating universe remained broadly stable in 2020.*** Only four issues had their rating outlooks revised from stable to negative. Alpha Circle Sdn Bhd's issue ratings were revised to negative from stable amid concerns that the increased risk of a decline in foreign worker permits issued or renewed due to the COVID-19 pandemic would weaken the issuer's cash flow generation. The rating outlook revision on Kapar Energy Ventures Sdn Bhd's issue rating reflect the issuer's continued weakening plant operating performance in 2019. Meanwhile, the rating outlook revision on Segi Astana Sdn Bhd's issue rating reflects MARC's concern that the sharp decline in passenger traffic volume at klia2 would impact the business performance of the issuer's gateway@klia2 mall.

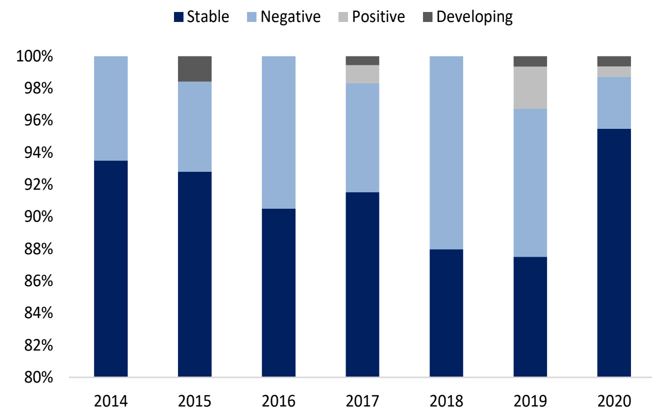
- ***For 2021, MARC foresees less negative and more positive ratings actions as the economy recovers.*** MARC's opinion reflects the expansionary nature of the Budget 2021 and the rollout of vaccines. Business operations could be resumed without further disruptions from movement restriction orders. The government's commitment to boosting the economy with the resumption of mega infrastructure projects is also in favour of strengthening the credit profile of issuers. MARC's opinion also reflects the stronger credit profiles of issuers compared to the 2008 global financial crisis amid more robust rating methodologies and a high concentration in investment grade. These factors reduce any imminent defaults. Cuts in the SRR and OPR in 2020 also provided relief to the issuers.

Exhibit 26: MARC rating migrations, by issue count



Sources: MARC Research

Exhibit 27: MARC's rating outlook distribution



Sources: MARC Research

Foreign ownership trend of local bonds

- ***2020 YTD foreign holdings of local bonds climbed to RM219.4 billion, the highest since November 2016, equivalent to 13.6% of total outstanding.*** Local bonds accumulated RM14.8 billion of net foreign inflows in the Jan-Nov'20 period (Jan-Nov'19: RM11.8 billion). Foreign investors have been consistently adding local bonds to their portfolios since May amid their attractive real yield valuations as Malaysia remains in deflation and global interest rates remain ultra-low. Malaysia's firmer 2021 GDP growth outlook and stronger international reserves position were also the main drivers. MGS accounted for most of the inflows in Jan-Nov'20 at RM11.1 billion (Jan-Nov'19: RM12.3 billion). As at end-November, foreign holdings of MGS amounted to RM175.0 billion, equivalent to 40.1% of total outstanding.

- ***Foreign investors are expected to continue adding local bonds to their portfolios in 1H2021 albeit at a slower pace compared to 2H2020.*** As global interest rates are expected to remain low next year, local bonds stand to continue benefiting from yield-hunting activities. Expectations of a faster economic recovery due to better measures to mitigate the pandemic, access to vaccinations and firmer crude oil prices would continue to drive foreign funds into local bonds. However, foreign buying momentum is expected to take a hit in 1H2021 as we expect foreign investors to remain cautious ahead of FTSE Russell's semi-annual review in March 2021. We expect Malaysia to be retained in the WGBI given the positive engagement between policymakers and FTSE Russell.

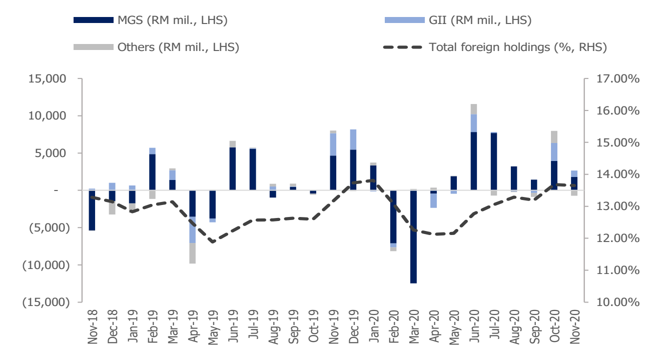
- ***Malaysia's sovereign downgrade has little impact on foreign demand of local bonds.*** Foreign investors were unfazed about the recent sovereign rating downgrade of Malaysia by Fitch. The ringgit continued to appreciate against the USD in the days following the announcement. YTD, the ringgit has strengthened by 10.8% against the greenback to 4.0130 from its peak in March when the MCO was first implemented. Malaysia's macroeconomic fundamentals remain sound and the current political turbulence is not expected hinder recovery measures. With the passing of the Budget 2021, the current administration's hold on policy-making remains firm. Government policy support and structural reforms would continue to maintain foreign interest on local bonds.

- ***Downside risk 1: Lockdowns continue to be the norm in 2021.*** Controlling the pandemic poses institutional challenges as the risk of resurgence remains at large. As lockdowns are expected to persist in Q12021, Malaysia may face an uphill task in its quest for economic recovery and the fiscal deficit may widen more than expected, diminishing the appeal of holding local bonds.

- ***Downside risk 2: Reduced weightage / complete exit from WGBI.*** There is still a possibility that Malaysia's influence on the WGBI might diminish or be completely eliminated as Malaysia remains on the watchlist for possible reclassification.

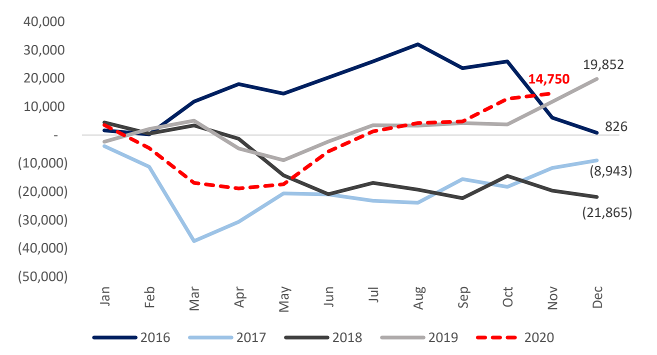
- ***Growing foreign interest for China bonds may also eat into the demand for Malaysian bonds but not much as Malaysia's weightage in the WGBI is already low at 0.4%.*** Foreign demand for China bonds has been steadily rising due to rapid market reforms as well as the low correlation of monetary policies between the PBOC and global central banks. Furthermore, China's early and harsh containment of COVID-19 has prepped its economy for a quicker rebound than most economies.

Exhibit 28: Monthly foreign flows and total foreign holdings of local bonds



Sources: BNM, MARC Research

Exhibit 29: Yearly cumulative foreign flows in local bonds performance comparison



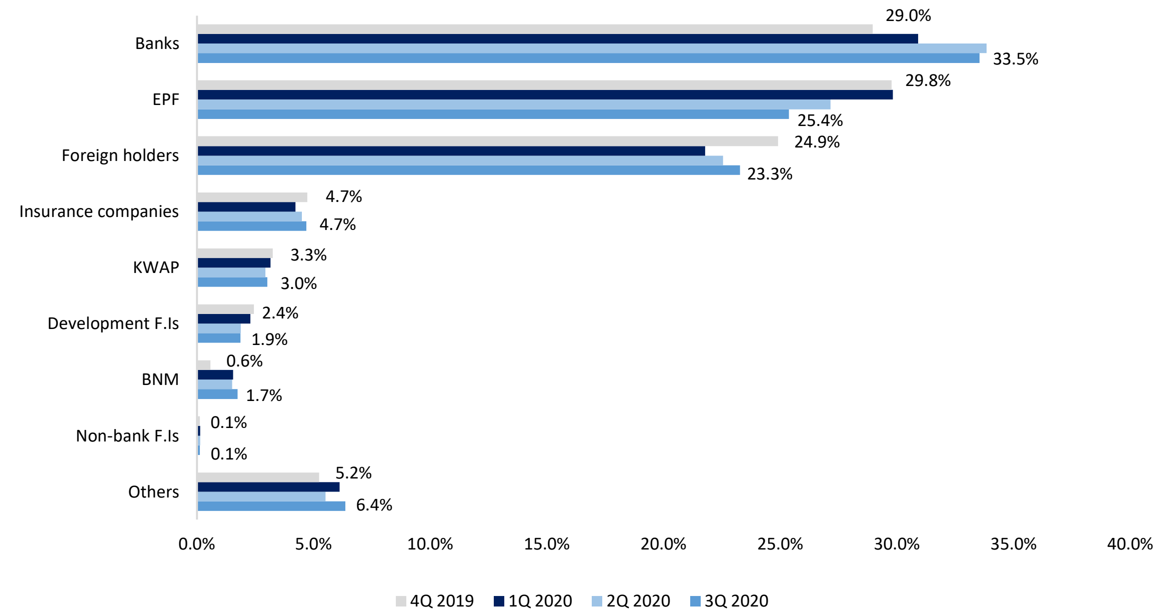
Sources: BNM, MARC Research

Exhibit 30: Cumulative net foreign flows in local bonds (RM million)

Year	Government						BNM			Corporate			Total net foreign flows
	MGS	MTB	GII	MITB	SPK	Total Government	BNMN	BNMNI	Total BNM	Conventional	Islamic	Total Corporate	
2014	8,207	-878	1,857	-88	610	**9,708**	-7,601	-9,127	**-16,728**	-1,001	471	**-530**	**-7,550**
2015	16,834	2,495	6,480	534	-605	**25,737**	-26,006	-10,872	**-36,878**	-222	295	**73**	**-11,067**
2016	6,334	-1,107	9,899	-452	-5	**14,670**	-15,557	-79	**-15,636**	1,001	791	**1,792**	**826**
2017	-4,041	753	-3,032	802	-	**-5,518**	-3,724	-	**-3,724**	-45	345	**300**	**-8,943**
2018	-18,287	325	-2,603	76	-	**-20,489**	650	-	**650**	-2,517	491	**-2,026**	**-21,865**
2019	17,735	-1,930	5,202	-291	-	**20,716**	-	-	**-**	327	-1,191	**-864**	**19,852**
Jan-Nov 2019	12,269	-1,523	2,496	-34	-	**13,209**	-	-	**-**	-228	-1,206	**-1,434**	**11,774**
Jan-Nov 2020	11,082	3,737	2,332	937	-	**18,086**	-3,000	-	**-3,000**	-785	448	**-336**	**14,750**

Sources: BNM, MARC Research

Exhibit 31: Cumulative net foreign flows in local bonds (RM million)



Sources: BNM, MARC Research

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