MALAYSIAN RATING CORPORATION BERHAD

SEPTEMBER 2015

Monthly Bond Market & Rating Snapshot

FINANCIAL VARIABLE	AUG-15	SEP-15	MoM CHNG
OVERNIGHT POLICY RATE (%)	3.25	3.25	0 bps
3-YEAR BENCHMARK MGS (%)	3.31	3.69	37 bps
10-YEAR BENCHMARK MGS (%)	4.39	4.14	-25 bps
3-YEAR IRS (%)	4.10	4.13	3 bps
10-YEAR IRS (%)	4.58	4.63	5 bps
RINGGIT 3-YEAR AAA (%)	4.07	4.12	4 bps
RINGGIT 3-YEAR AA (%)	4.41	4.44	2 bps
RINGGIT 3-YEAR A (%)	6.44	6.10	-34 bps
10-YEAR US TREASURY (%)	2.22	2.04	-18 bps
2-YEAR US TREASURY (%)	0.74	0.63	-11 bps
MYR/USD	4.1925	4.3950	4.8%
KLCI INDEX	1,612.7	1,621.0	0.5%
S&P 500 INDEX	1,972.2	1,920.0	-2.6%

Source: Bloomberg, MARC Fixed Income Research

Global Markets 2

In line with our expectation, the Federal Reserve (Fed) decided to keep its short term interest rates unchanged in September policy meeting, citing concerns about the global economy. While the Fed acknowledged the improvement in the housing sector, moderate increase in the household spending and business fixed investment and continued improvement in the labour markets, the central bank decided it was prudent to wait for evidence that external weakness was not knocking the economy off course.

Ringgit Bonds 2

The MGS yield curve flattened with the MGS 10/3 spread tightened to 45 bps. Longer-dated government bonds booked a hefty gains with benchmark 10-year yield reversed 25 bps lower following a broad selling last month. Despite some capital pullback from offshore investors which has exacerbated the local currency's decline, we saw some bidding interest from local investors. Shorter-dated local government bonds however, extended losses despite Fed's decision to leave its interest rate pinned near zero level.

Currency 2

In line with Emerging Markets (EM) currencies, the ringgit continued its downslide. Lingering weak sentiments both domestically and abroad i.e. slowing China's growth, soft oil prices and concerns on domestic political situation continued to weigh on local currency, along with continued foreign selling in domestic stocks and bond market.

Analysts

Raja Zarina
Analyst
zarina@marc.com.my

Lee Si Xin
Associate
sixin@marc.com.my

Market Review

Global Markets

In line with our expectations, the Fed decided to keep its short-term interest rates unchanged in its September policy meeting, citing concerns about the global economy. While the Fed acknowledged improvements in the housing sector and labour markets, and moderate increases in household spending and business fixed investment, the central bank decided it was prudent to wait for evidence that external weaknesses were not knocking the economy off course. According to Yellen, *"In light of the developments that we have seen and the impacts on financial markets, we want to take a little bit more time to evaluate the likely impacts on the United States"*. Nine voting members preferred the Fed to keep the rates low while Jeffrey Lacker was the only Fed governor to dissent, arguing for a quarter-point increase. The US treasuries rallied in response to the Fed's action with the benchmark 10-year yield marching lower to 2.16% post-announcement. The riskier environment has also impacted investors' sentiment, prompting further flight-to-safety bids. The Fed will have two more scheduled policy meetings this year, on October 27 and December 15. The delay in the Fed's tightening has added to investor uncertainty. Therefore, we expect more volatility ahead.

Meanwhile, across the Atlantic, the German bund headed for a monthly gain as the Fed decided to stand pat and the euro zone's inflation dipped below zero for the first time since March, reinforcing speculation that the ECB will step up its stimulus. The gauge for inflation expectation - the five-year inflation swap rate - has also dropped 26 bps since the end of June. The German 10-year bund yield ended the month at 0.59%, a drop of 20 bps m-o-m.

Ringgit Bonds

The MGS yield curve flattened, with the MGS 10/3 spread tightening to 45 bps. Longer-dated government bonds booked hefty gains with the benchmark 10-year yield reversing 25 bps lower following broad selling last month. Despite some capital pullback from offshore investors which has exacerbated the local currency's decline, we saw some bidding interest from local investors. Concerns over a massive capital flight ahead of the maturity of some RM11 billion in government bonds has caused the MGS 10-year yield to soar as high as 4.4% on September 28, before stabilising and closing the month lower at 4.14%. Shorter-dated local government bonds however extended losses despite the Fed's decision to leave its interest rate pinned near zero.

Trading volume for government bonds improved in September, picking up slightly to RM59 billion at September-end. In August, the trading volume dropped to RM56 billion from RM79 billion in the previous month as investors were gripped by fears stemming from negative sentiments amid the devaluation of the yuan and the decline in global markets.

In the primary market, three government offerings have raised total funds of RM9.0 billion, namely the RM4.0 billion 3.5-year new issue of the MGS, RM3.0 billion seven-year re-opening of the GII and RM2.0 billion 15-year re-opening of the MGS. The bid-to-cover ratio was at 1.5x in the earlier auction of the 3.5-year MGS, but improved to 1.9x and 2.2x in the auction of the seven-year GII and 15-year MGS, respectively.

In September, foreign investors reduced their holdings of the MGS to RM153.8 billion (August: RM157.4 billion) or 45.6% (August: 46.0%) of total MGS outstanding in the market. Similarly, foreign holdings of the GII in September also declined to RM8.3 billion (August: RM8.7 billion) or 4.1% (August: 4.3%) of the total GII outstanding. We expect support from domestic institutional investors to remain strong amid a decline in offshore holdings to keep yields of local government bonds in check.

Currency

In line with EM currencies, the ringgit continued its downslide, albeit declining at a slower pace of 4.8% m-o-m. Lingering weak sentiments both domestically and abroad i.e. China's growth slowdown, soft oil prices and concerns on the domestic political situation continued to weigh on the local currency, along with continued foreign selling in domestic stocks and the bond market. BNM leaving the policy rate unchanged at 3.25% in their September meeting was widely anticipated, and therefore caused little reaction in the market. While BNM reiterated that the stance of its monetary policy remains accommodative and supportive of economic activity, we noted a less upbeat tone in BNM's assessment of the global economy particularly in Asia, and increased downside risks in EM economies, weaker commodity prices as well as uncertainty in the financial markets.

The Current State of Our Fiscal Deficit

Back in January, the official deficit projection for 2015 was revised upwards by the government to 3.2% of Gross Domestic Product (GDP) from the initial forecast of 3.0% of GDP on the back of falling energy prices. The revision involved a number of expenditure cuts and a shuffle in government spending, with the assumption that oil prices have been revised downwards to USD55 per barrel. While we applauded when the government announced the revision in the Budget 2015, we argued that meeting the new budget deficit target would be challenging – although not impossible, unless the entire reduction in output from Organization of the Petroleum Exporting Countries (OPEC) materialises and nominal GDP remains robust in 2015 (See *Monthly Bond Market and Rating Snapshot - January 2015*). We did a sensitivity analysis back then and presented a few possible scenarios of deficit levels. And with RM37 billion deficit, the revised fiscal target requires a nominal GDP growth of at least 7% from 2014.

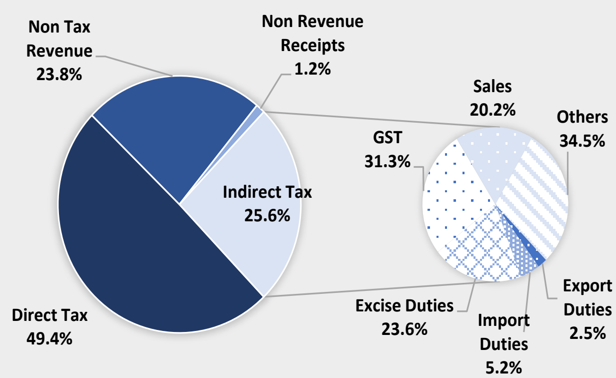
A lot of things have happened since the revision. Oil prices unfortunately continued to march lower from the assumed level (USD49.6 per barrel at the time of writing), but not all is gloomy. Latest fiscal data reveal that the government ran a fiscal deficit of just RM15.6 billion in 1H2015, which is about 2.8% of GDP. The fiscal accounts continued to withstand the fall in oil prices although the 2H2015 performance will be the key to the overall achievement.

Exhibit 1.0: Malaysia's Budget Details

	Budget 2014	Budget 2015 (Revised)	Change (%)
Revenues	220.6	222.9	1.0
Operating Expenditure	219.6	212.4	-3.3
Current Budget Balance	1.0	10.5	
Gross Development Expenditure	39.5	48.5	22.8
Loan Recoveries	-1.1	-1.0	
Net Developent Expenditure	38.4	47.5	23.7
Overall Budget Balance	-37.4	-37.0	
Overall Budget Balance (% of GDP)	-3.5	-3.2	

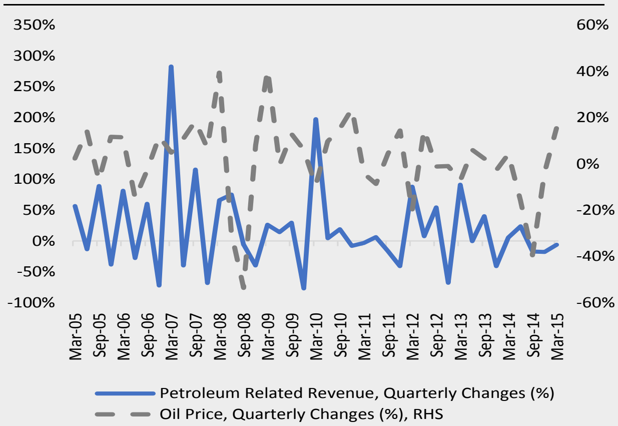
Source: CEIC, MARC Economic Research

Exhibit 2.0: Government Revenue



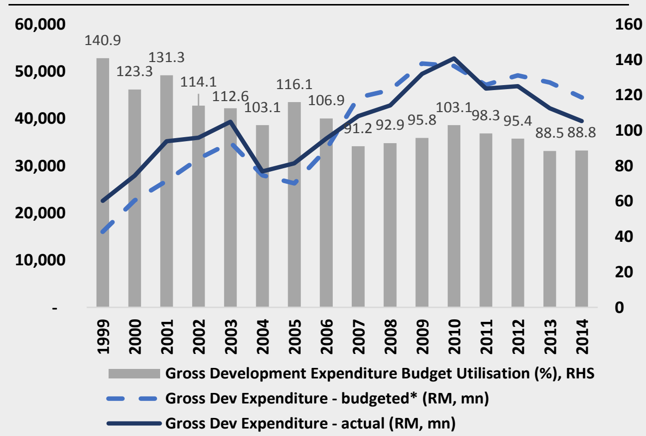
Source: CEIC, MARC Economic Research

Exhibit 3.0: Oil Price and Petroleum related revenue



Source: Bloomberg, CEIC, MARC Economic Research

Exhibit 4.0: Development Expenditure



Source: MoF, MARC Economic Research
*Note: * = excluding RM 2 billion for contingencies*

Total government revenue held up well in 1Q2015 (+4.8% y-o-y) and 2Q2015 (+4.9% y-o-y), putting 1H2015 revenue 4.9% higher from the corresponding period in 2014. Interestingly, a notable increase was seen in the indirect tax revenue collection in 1H2015, with revenue from GST offsetting declines in all other components. The implementation of the GST in April resulted in a tax collection of RM7.6 billion (51.4% of indirect tax revenue, 13.7% of total government revenue) in 2Q2015 alone. The strong growth in revenue in 1H2015 was also attributed to a higher collection of sales and services tax, supported by front-loading consumption ahead of the implementation of the GST. Nevertheless, along with the continued fall in oil prices, there were declines in petroleum-related revenue (-15.9% in1H2015), which comprises petroleum income tax, export duties, petroleum royalties, and interest and investment returns (which include Petronas dividends).

On the expenditure side, total operating expenditure registered a miniscule increase of 0.3% in 1H2015 from the corresponding period in 2014 (+0.4% y-o-y in 1Q2015 and +0.2% y-o-y in 2Q2015) as a significant reduction in the subsidies expenditure helped keep the rise in spending in other components at bay. However, gross development expenditure rose more sharply at 7.1% for 1H2015, along with increases in all its components. To us, this is not a concern as Malaysia's actual development expenditure has been lower than its allocations in the past several years (Exhibit 4.0). If the trend continues, total reduction in expenditures may be more than what has been projected in the latest Budget review.

Table 1.0: Fiscal Deficit to NGDP ratio

		Growth in Gov Revenue (%)						
		-3.0	-2.0	-1.0	0.0	1.0	2.0	3.0
Growth in Gov Expenditure (OPEX + NDE, %)	-1.5	-3.4	-3.2	-3.0	-2.8	-2.7	-2.5	-2.3
	-1.0	-3.5	-3.3	-3.1	-3.0	-2.8	-2.6	-2.4
	-0.5	-3.6	-3.4	-3.3	-3.1	-2.9	-2.7	-2.5
	0.0	-3.7	-3.5	-3.4	-3.2	-3.0	-2.8	-2.6
	0.5	-3.8	-3.7	-3.5	-3.3	-3.1	-2.9	-2.7
	1.0	-4.0	-3.8	-3.6	-3.4	**-3.2**	-3.0	-2.8
	1.5	-4.1	-3.9	-3.7	-3.5	-3.3	-3.1	-2.9

Source: CEIC, MARC Economic Research

We have updated our sensitivity analysis, and concur with the view that despite the continued fall in oil prices which is widely believed to drag down government revenue, the fiscal target remains feasible. Table 1.0 shows the fiscal balance as a percentage of GDP at various scenarios of growth in government expenditure and revenue. We set two assumptions in estimating nominal GDP: (1) a conservative forecast of 4.5% real GDP growth (in-house call: 4.7%) and 2.5% inflation (in-house call: 2.5% to 3.0%). If growth in government expenditure and revenue are not materially different from the budgeted level, fiscal target for 2015 requires a nominal GDP growth of 6.4% from 2014. On balance, we are positive that with the fiscal reform efforts on track, the combination of subsidy expenditure being kept in check, along with the better-than-expected revenue collection from the GST should allow the government to meet its fiscal target.

Summary of Corporate Bond Issuance and Outstanding

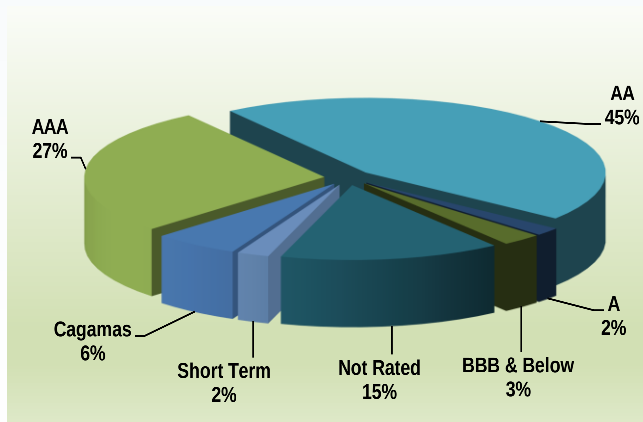
Historical Trend of Bond Issuance by Category (RM billion)

Year	MGS/GII	Rated Corporate Bonds	Unrated Corporate Bonds	Unrated Government Guaranteed	Cagamas	Total Corporate Bonds
2009	88.5	31.4	7.5	13.9	8.3	61.0
2010	58.1	36	6	4.7	6.3	53.1
2011	93.3	47.6	5.2	15.0	2.8	70.6
2012	96.2	76.6	13.4	30.4	3.4	123.8
2013	92.5	52.4	12.3	13.6	7.9	86.2
2014	84.5	52.7	8.0	21.9	3.3	85.9
2015 YTD	70.5	25.4	7.2	10.4	0.7	43.7

Source: BPAM, MARC Fixed Income Research

In September, primary market activities came in lower at RM3.2 billion compared with RM6.4 billion in August as gains in the unrated segment were offset by lower issuances in the rated segment. Fund-raising activities in the rated corporate bonds declined to RM0.7 billion (August: RM6.4 billion) with zero issuances from Cagamas. However, unrated private placements raised RM0.9 billion in September (August: no issuances) while the unrated government-guaranteed segment raised RM1.5 billion (August: no issuances). YTD, total gross issuances of long-term corporate debt stood at RM43.7 billion, a drop of 32% from RM64.0 billion issued in the corresponding period last year. Total rated issuances (including rated Cagamas) were also lower at RM26.1 billion versus RM40.4 billion recorded for the same period last year.

PDS Outstanding: Distribution by Rating Type



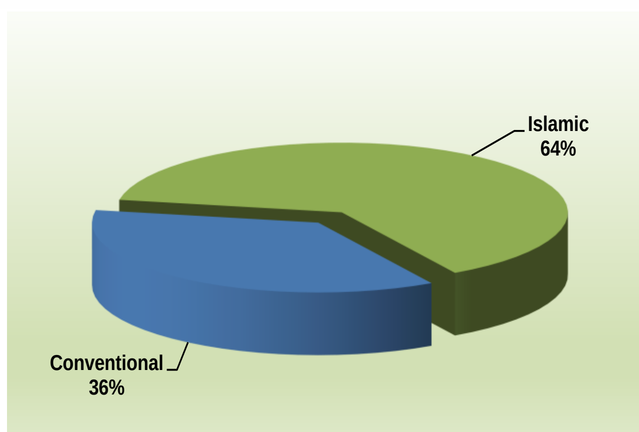
Source: BPAM, MARC Fixed Income Research

Outstanding Size of Sovereign, Cagamas and Corporate Bonds as of September 2015 (RM billion)

Asset Class	Conventional	Islamic	Total
Sovereign	348.34	234.90	583.24
Cagamas	10.52	10.63	21.15
PDS	124.25	218.87	343.12
Corporate	41.68	164.34	206.03
Corporate Guaranteed	15.06	33.06	48.12
Financial	59.07	17.58	76.64
ABS	8.44	3.90	12.34

Source: BPAM, MARC Fixed Income Research

PDS Outstanding: Conventional & Islamic



Source: BPAM, MARC Fixed Income Research

Summary of Corporate Bond Issuance and Outstanding

Secondary Market Volume (RM billion)

Asset Class	Aug-15	Sep-15	MoM Chng
MGS/GII	56.8	59.0	20.6
Cagamas	0.2	0.3	0.2
FI Corporate	1.2	1.2	0.0
Non-FI Corporate	4.6	3.3	-1.4

Source: BPAM, MARC Fixed Income Research

Non-FI Corporate Traded by Rating Type (RM billion)

Rating Type	Aug-15	Sep-15	MoM Chng
AAA	1.9	1.4	-0.5
AA	2.3	1.4	-0.9
A	0.0	0.1	0.1
BBB and below	0.1	0.0	-0.1
Short term	0.4	0.3	-0.1

Source: BPAM, MARC Fixed Income Research

MARC Rating Activities in 2015

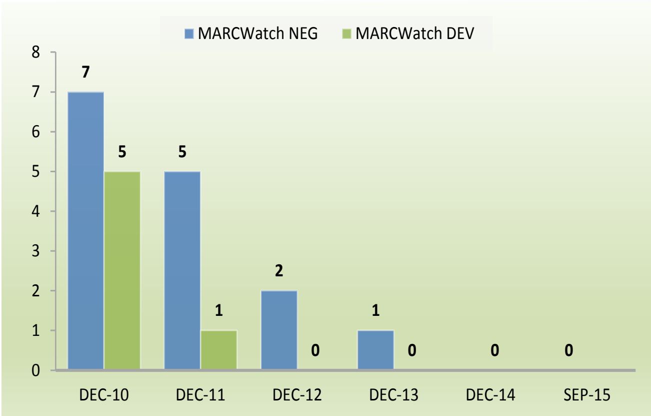
List of Rating Actions in September 2015

Principle	Category	Main Sector	Issuer	Date Announced	Rating Action	Rating Outlook	Long-Term Rating		Short-Term Rating		Issue Size (MYR mil)	Credit Enhancement
							Before	After	Before	After		
Islamic	Project Finance	Infrastructure & Utilities	ANIH Bhd	30-Sep-15	AFFIRMED	STA	AA	AA			2500	
Islamic	Corporate Debt	Industrial Products	Antara Steel Mills Sdn Bhd	29-Sep-15	AFFIRMED	STA	AAA	AAA			300	fg
Islamic	Corporate Debt	Trading/Services	MMC Corporation Bhd	22-Sep-15	INITIAL	STA	AA-	AA-			1500	
Islamic	Corporate Debt	Plantation	TSH Murabahah Sdn Bhd	21-Sep-15	INITIAL	STA			MARC-1	MARC-1	50	
Islamic	Corporate Debt	Plantation	TSH Murabahah Sdn Bhd	21-Sep-15	INITIAL	STA	AA-	AA-			150	
Islamic	Corporate Debt	Infrastructure & Utilities	Celcom Networks Sdn Bhd (fka Celcom Transmission (M) Sdn Bhd	15-Sep-15	DOWNGRADED	STA	AAA	AA+			5000	
Conventional	Corporate Debt	Property	Sunway Bhd	14-Sep-15	INITIAL	STA	AA-	AA-	MARC-1	MARC-1	2000	
Islamic	Corporate Debt	Property	Sunway Treasury Sukuk Sdn Bhd	14-Sep-15	INITIAL	STA	AA-	AA-	MARC-1	MARC-1	2000	cg
Islamic	Structured Finance	Infrastructure & Utilities	DHTI Capital Sdn Bhd	10-Sep-15	WITHDRAWN		A+	A+			10	
Islamic	Corporate Debt	Finance	Bank Pembangunan Malaysia Bhd	4-Sep-15	AFFIRMED	STA			MARC-1	MARC-1	2000	
Islamic	Corporate Debt	Construction	Talam Transform Bhd	4-Sep-15	AFFIRMED	STA	B-	B-			134.21	
Conventional	Corporate Debt	Finance	Malayan Banking Berhad	3-Sep-15	INITIAL	STA	AAA	AAA			10000	
Islamic	Project Finance	Infrastructure & Utilities	Jimah East Power Sdn Bhd	2-Sep-15	PRELIMINARY	STA	AA-	AA-			10000	

Source: BPAM, MARC Fixed Income Research

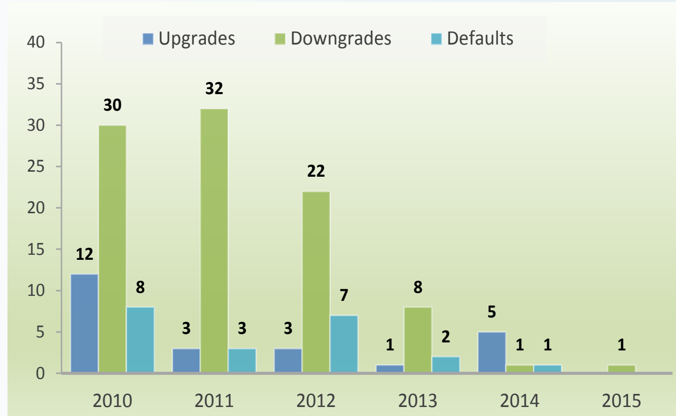
**fg – financial guarantee*
**cg – corporate guarantee*

YTD MARCWatch Placements, by Issue Count



Source: BPAM, MARC Fixed Income Research

YTD Upgrades, Downgrades and Defaults, by Issue Count



Source: BPAM, MARC Fixed Income Research

List of Rating Migrations YTD

Principle	Category	Main Sector	Issuer	Date Announced	Rating Action	Rating Outlook	Long-Term Rating		Short-Term Rating		Issue Size (MYR mil)	Credit Enhancement
							Before	After	Before	After		
Islamic	Corporate Debt	Infrastructure & Utilities	Celcom Netw orks Sdn Bhd (fka Celcom Transmission (M) Sdn Bhd	15-Sep-15	DOWNGRADED	STA	AAA	AA+			5000	

Source: BPAM, MARC Fixed Income Research

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MALAYSIAN RATING CORPORATION BERHAD (Company No.: 364803-V)
5th Floor, Bangunan Malaysian Re, No. 17, Lorong Dungun, Damansara Heights, 50490 KUALA LUMPUR
Tel.: +603 2082 2200 Fax: +603 2094 9397 E-mail: marc@marc.com.my
Homepage: www.marc.com.my