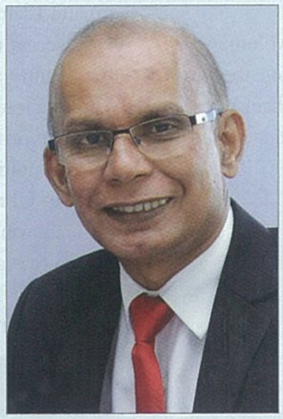
Raising the game

Stimulating greater bond market participation

What is the outlook for the Malaysian capital markets in 2016? What should drive the activities this year?

MARC has forecast the real GDP to grow at a slower pace of 4.4% in 2016 on the back of weak global economic growth prospects. This would affect the overall business investment growth. Against this backdrop, we expect lower private debt securities (PDS) issuance in 2016, with total gross corporate bond issuance of 65 billion ringgit to 75 billion ringgit. MARC foresees the demand for infrastructure funding via PDS issuance to continue; PDS issuance volume would also be supported by refinancing purposes as well as issuance of subordinated debt papers by financial institutions to meet Basel III requirements.



Rajan Paramesran
MARC chief rating officer

What is MARC's views on the Malaysian corporate credit landscape this year?

We see less benign credit conditions for corporates over the near term given the prevailing economic conditions. Corporate debt, which has steadily increased in the aftermath of the global financial crisis, remains relatively elevated and at the same time earnings capacity has weakened. This has put pressure on credit metrics; however not all sectors are affected with credits in the oil and gas-related and automotive sectors likely to face the brunt of credit quality weakness. Nonetheless, the overall leverage position of Malaysian corporates remains moderate.

What will be key factors for corporates to weather the challenging market environment this year?

We believe maintaining balance sheet discipline and managing working capital prudently as key factors. Corporates that undertake further measures to improve their liquidity positions, for example through asset monetization, would place them in a good stead to maintain their credit profile. However, major acquisitions or expansions that are largely funded by debt may exert pressure on their credit quality.

What are the major challenges faced by both potential issuers and investors and how are rating agencies helping them to address these challenges?

The disproportionate issuance of AA-rated papers remains a major challenge in the domestic bond market. The sharp decline of lower-rated investment grade papers, since the 2008 global financial crisis, has led to the domestic bond market being starved of yield choice. The underlining reason is the continued risk aversion displayed by investors. This has meant that companies with weaker credit profiles may find it challenging to access the bond market unless the credit quality of their bonds is sufficiently enhanced through guarantees, bond insurance or other mechanisms to meet investors' requirement.

To stimulate greater bond market participation, MARC recently published its approach to rating issuances backed by partial credit guarantees (PCG). The PCG mechanism would lower financing costs by improving credit rating of issuances. MARC continues to provide new methodologies and refine existing ones, highlighting excessive risk-taking and changes in corporate credit profiles, all of which are necessary to sustain the vibrancy of the bond market.

Malaysia is scrapping the mandatory bond rating for issuers beginning 2017. What will be its impact to the domestic bond market?

We do not believe that the move to scrap mandatory rating beginning 2017 would impact the domestic bond market. In fact, MARC expects the Securities Commission's liberalization agenda will further strengthen the debt capital market in terms of transparency and efficiency. We believe credit rating is an essential component of the bond market and that investors would take comfort from an independent entity such MARC to monitor and provide the required insights to make investment decisions and price-in the credit risk premium.

What are the prospects of MARC in light of the liberalization that will come into effect from 1 January 2017?

The liberalization of mandatory credit ratings on tradeable PDS commenced in 2015 whereby existing rated papers can opt to have their credit ratings removed upon meeting certain conditions. MARC has not experienced any voluntary withdrawal of credit ratings from our existing rated universe, underscoring our belief on the continuing importance of credit ratings. The demand for independent credit risk assessments on bonds will still be highly sought after by institutional investors to efficiently price credit-risk premiums. For example, for longer tenured project finance PDS with tenures exceeding 10 years, a continuous monitoring of the project performance by an independent arbiter of risk such as MARC is still required by Malaysia's growing investor community.