

11 July 2023

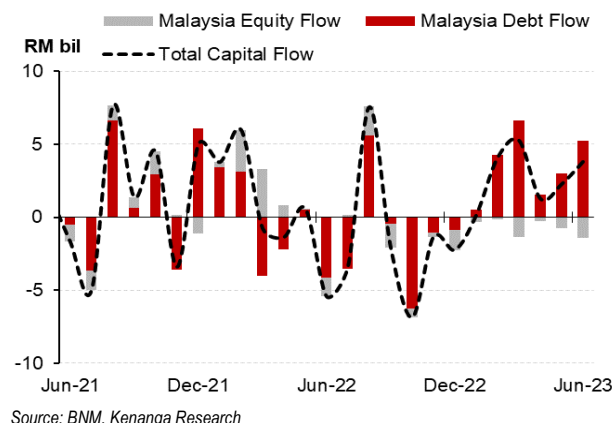
Malaysia Bond Flows

Foreign inflows into the bond market strengthened in June amid China outflows

- Foreign investors remained net buyers of Malaysia's debt securities for the sixth consecutive month in June (RM5.2b; May: RM3.0b), rising to a three-month high

- Total foreign debt holdings increased (RM267.9b; May: RM262.7b), with its share to total outstanding debt rising to a nine-month high (13.8%; May: 13.4%).
- The domestic bond market may have benefitted from the US Fed's decision to keep rates unchanged in June and amid foreign outflows from Chinese bonds over the past four months, due to China's sluggish economic recovery, the PBoC's rate cuts, and investor concerns over China-US tensions. This trend persisted despite narrowing yield differentials between Malaysian and developed market bonds, as well as tepid global risk sentiment due to hawkish posturing by the Fed.

Graph 1: Monthly Net Foreign Capital Flows



- The greater inflow was primarily driven by an increase in holdings of Government Investment Issues (GII) and Malaysian Islamic Treasury Bills (MITB), despite a smaller increase in Malaysian Government Securities (MGS)

- GII (RM3.6b; May: -RM0.8b): foreign holdings share of total outstanding bonds increased (9.7%; May: 9.2%).
- MITB (RM1.3b; May: RM0.7b): foreign holdings share rose to a six-month high (15.3%; May: 12.1%).
- MGS (RM1.6b; May: RM3.8b): foreign holdings share edged lower (35.9%; May: 36.0%).

- For the equity market, foreign investors remained net sellers for the tenth consecutive month in June

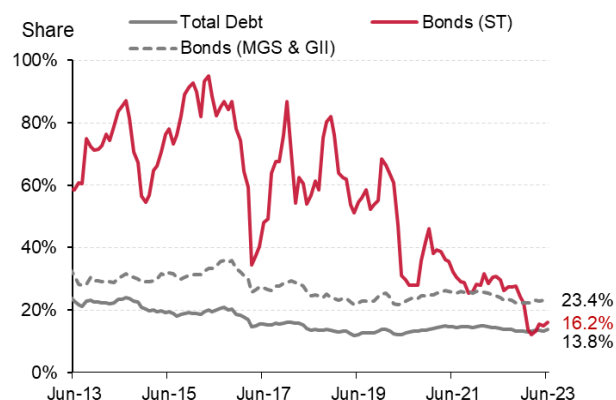
- Foreign outflows rose (-RM1.4b; May: -RM0.7b) amid subdued risk sentiment ahead of the US FOMC meeting.

- Overall, the capital market registered a greater net inflow of RM3.8b (May: RM2.3b), a three-month high

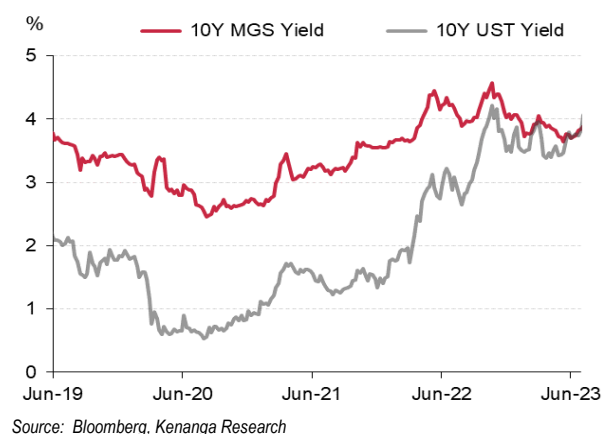
- Foreign inflows into the bond market to strengthen further should the Fed continue to keep rates unchanged

- The 10-year US Treasury average yield increased by 16 bps to 3.75% in June, whilst the 10-year MGS average yield rose by 4 bps to 3.76%, narrowing the average yield spread further (1.2 bps; May: 12.7 bps).
- Foreign inflows into the domestic bond market may taper slightly in July, given the narrow yield differentials against developed market bonds, with the 10Y MGS-UST spread currently negative. However, we expect foreign demand for bonds to strengthen from August onwards, now that BNM has likely finished raising rates, and based on our expectation that the Fed will maintain an unchanged funds rate until a potential pivot in 1Q24. Domestic bonds may also continue to benefit from portfolio outflows from China towards Emerging Asia, as the region's largest economy is weighed by tepid growth recovery and mounting political risk. Meanwhile, we reckon the upcoming local state elections will only have a negligible impact on foreign interest in domestic bonds.
- We believe that BNM has concluded its policy normalisation cycle and will keep the overnight policy rate at 3.00% for the rest of the year, on the expectation that both core and headline inflation will continue to moderate.

Graph 2: Foreign Holdings of Malaysian Debt



Graph 3: US Treasury Yield vs. MGS Yield



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Table 1: Foreign Holdings of Malaysian Bonds

		Jan-23	Feb-23	Mar-23	Apr-23	May-23	Jun-23
MGS	Value (MYR billion)	187.3	191.3	195.7	194.0	197.9	199.4
	% of Total MGS	34.5%	34.5%	36.0%	35.9%	36.0%	35.9%
GII	Value (MYR billion)	41.6	42.5	44.8	46.4	45.6	49.3
	% of Total GII	8.7%	8.7%	9.0%	9.2%	9.2%	9.7%
MTB	Value (MYR billion)	2.6	2.6	2.7	2.9	2.5	1.0
	% of Total MTB	28%	29%	30%	32%	28%	25%
MITB	Value (MYR billion)	2.3	1.9	3.1	4.3	5.0	6.3
	% of Total MITB	8.8%	6.6%	9.1%	11.5%	12.1%	15.3%
PDS	Value (MYR billion)	13.6	13.2	11.9	12.0	11.7	11.9
	% of Total PDS	1.7%	1.6%	1.5%	1.5%	1.4%	1.4%
Total Foreign Debt Holdings	Value (MYR billion)	247.3	251.5	258.2	259.7	262.7	267.9
	% of Total Securities	13.1%	13.2%	13.5%	13.5%	13.4%	13.8%

Source: BNM, Kenanga Research

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