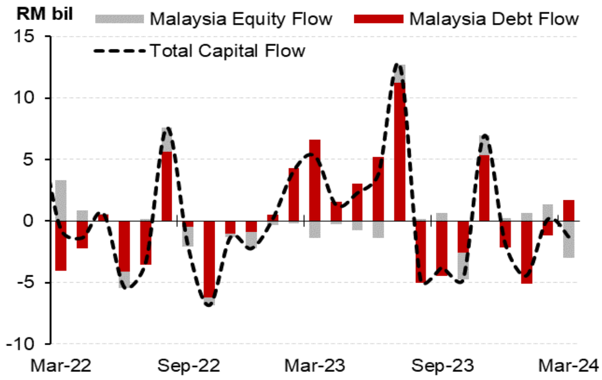
08 April 2024

Malaysia Bond Flows

March marks 2024's first inflow: Investors favour local bonds as ringgit strengthens

- **Foreign investors reverse trend, net-buying Malaysia's debt in March after three straight months of outflows (RM1.7b; Feb: -RM1.2b)**
  - As a result, total foreign debt holdings increased to RM265.8b in March (Feb: RM264.1b). However, its share of the total outstanding debt dropped to a 44-month low of 13.10% (Feb: 13.11%) due to new issuance and reopening of GII amounting to RM10.0b and reopening of MGS amounting to RM5.0b.
  - Initially, during the period of March 13-15, foreign investors divested RM1.0b worth of Malaysian government bonds, a move attributed to the unexpectedly robust core inflation reading in the US. However, subsequent actions taken by the government and BNM to facilitate the repatriation and conversion of foreign investment income of Government Link Investment Companies contributed to a strengthening of the ringgit, thereby enticing investors to redirect their funds into the Malaysian debt market. As expected, the allure of a potentially strengthening ringgit, along with expectations of a possible Fed rate cut in June, may have revived some interest in Malaysian debt securities.

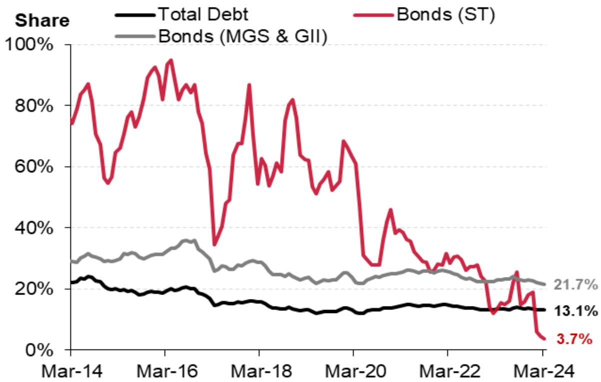
Graph 1: Monthly Net Foreign Capital Flows



Source: BNM, Kenanga Research

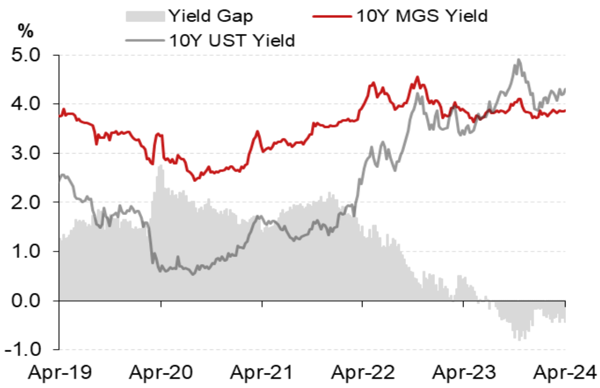
- **Foreign investors loaded up on long-term bonds, that is, Government Investment Issue (GII) and Malaysian Government Securities (MGS), but reduced their exposure to Malaysia Treasury Bills (MTB)**
  - GII (RM1.4b; Feb: -RM2.2b): largest inflow in four months, increasing the foreign holdings share to 8.9% (Feb: 8.8%), which is the second lowest point in a year, partly due to an increase in the total outstanding.
  - MGS (RM0.8b; Feb: RM0.6b): second consecutive months of net foreign buying. However, the foreign holdings share continued to decline to 33.2% (Feb: 33.3%).
  - MTB (-RM0.4b; Feb: RM0.0b): reverted to an outflow after last month's marginal net buying (RM1.6m), resulting in the foreign holdings share reaching 3.8% (Feb: 10.1%) its lowest level since January 2015 (1.5%).
- **Foreign investors reversed almost all their net equity purchases from the preceding four months, leading to significant outflows in the local bourse in March (-RM3.0b; Feb: RM1.3b)**
  - The equity market experienced its first net foreign outflow in five months, marking the largest net selling since the first wave of the pandemic in June 2020. This decline was primarily driven by the offloading of financial services stocks. The diminished foreign demand for domestic stocks can be attributed in part to subdued sentiment in regional markets, profit-taking activities, and investors' inclination towards small-cap stocks.
- **Following a brief inflow last month (RM0.1b), the capital market witnessed a reversal in fund flows (-RM1.3b)**
- **Malaysian debt market remains attractive due to the potential for price and currency appreciation**
  - Despite reduced hard landing risks for the US economy, the Fed is still expected to cut rates this year, likely starting in June. This expectation stems from the ongoing disinflationary trend, which is expected to persist as the lag impact of the 525 basis points (bps) cumulative rate hikes take effect. However, the resilient US economy suggests the Fed may now only reduce rates by 75-100 bps, down from as high as 100-125 bps previously.
  - As such, investors may seek current attractive yields and shift towards high-quality emerging markets with currency appreciation potential once signs of a cooling US economy emerge. Malaysia stands to gain from this shift, as potential subsidy rationalisation in 2H24 is expected to boost fiscal resilience and credit outlook. Additionally, BNM's policy stability and measures for repatriating foreign earnings could support a stable ringgit with an upward bias.

Graph 2: Foreign Holdings of Malaysian Debt



Source: Dept. of Statistics, Kenanga Research

Graph 3: US Treasury (UST) Yield vs. MGS Yield



Source: Bloomberg, Kenanga Research

Table 1: Foreign Holdings of Malaysian Bonds

		Oct-23	Nov-23	Dec-23	Jan-24	Feb-24	Mar-24
MGS	Value (MYR billion)	199.7	203.0	202.9	201.1	201.6	202.4
	% of Total MGS	34.4%	35.0%	34.4%	33.8%	33.3%	33.2%
GII	Value (MYR billion)	50.6	52.9	50.7	50.1	47.9	49.3
	% of Total GII	9.7%	10.0%	9.6%	9.3%	8.8%	8.9%
MTB	Value (MYR billion)	1.3	1.9	2.0	0.5	0.5	0.2
	% of Total MTB	27.8%	34.4%	35.8%	12.6%	10.1%	3.8%
MITB	Value (MYR billion)	2.8	1.7	1.8	0.8	0.4	0.5
	% of Total MITB	13.2%	11.8%	12.6%	4.6%	2.6%	3.7%
Corporate Bond and/or Sukuk (CBS)	Value (MYR billion)	12.8	13.1	13.0	12.9	13.7	13.5
	% of Total CBS	1.5%	1.5%	1.5%	1.5%	1.6%	1.6%
Total Foreign Debt Holdings	Value (MYR billion)	267.2	272.6	270.4	265.3	264.1	265.8
	% of Total Securities	13.5%	13.8%	13.6%	13.2%	13.1%	13.1%

Source: BNM, Kenanga Research

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