

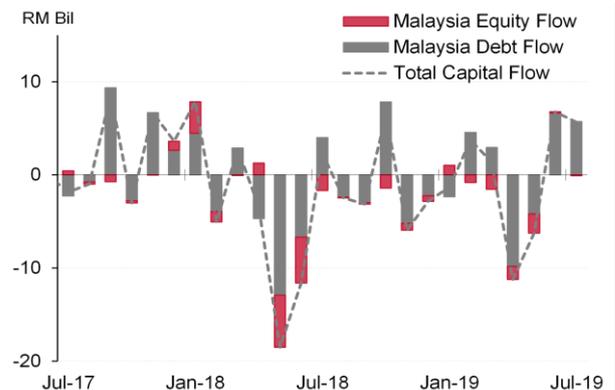
# Malaysia Bond Flows Update

Net foreign debt flows extended in July on US Fed policy shift

## OVERVIEW

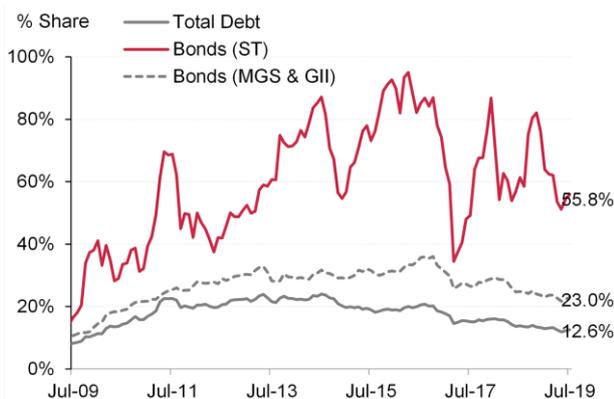
- Foreign investors remained net buyers of Malaysia's debt securities in July**, as total foreign holdings increased by RM5.7b (Jun: +RM6.6b) or 3.1% MoM (Jun: +3.8%) to RM188.3b (Jun: RM182.6b), extending a positive inflow for the second straight month. Consequently, the share of total foreign holdings of Malaysia's debt edged up to 12.6% (Jun: 12.3%). Meanwhile, foreign investors turned net sellers in the equity market in July, registering a net outflow of RM0.1b (Jun: +RM0.1b). Collectively, the capital market extends its net inflow of foreign funds for the second consecutive months at RM5.6b (Jun: RM6.8b).
- July's improvement was largely attributable to a net increase in holdings of Malaysian Government Securities (MGS) (+RM5.6b; Jun: +RM5.8b) and short-dated bonds (+RM0.2b; Jun: +RM0.9b)** albeit at a slower pace. Consequently, the foreign holdings share of total MGS and short-dated bonds increased to 38.3% and 55.8% respectively (Jun: 36.9% and 54.5% respectively). These have more than offset the marginal decline of foreign holdings in Private Debt Securities (PDS) of RM0.1b (Jun: -RM0.1b), resulting of its share to 1.66% (Jun: 1.68%).
- So far, **total capital outflow recorded this year stood at only RM1.3b versus RM25.6b in the same period of last year** thanks largely to positive net flow in the debt capital market. This indicates that the Malaysian debt capital market remains attractive to foreign investor as economic fundamentals remain resilient amid growth slowdown, while the revival of mega projects helps to boost investor's confidence. Though there is a possibility for the trend to reverse into a net-outflow in the 2H19 due to downside risk of the global trade war and heightened risk in geopolitical tension, we foresee that the pull-out of funds by foreign investors would be less compared to the previous year. This is premised on the increasingly dovish monetary policy stance by the US Fed and the European Central Bank, leading to highly probable benchmark rate cuts and liquidity injections as growth outlook darkens, enforcing a shifting trend in capital flow into the emerging market. Against this backdrop, the 10-year Treasury note average yield increased marginally in July by 1 basis point (bps) to 2.07%, while the benchmark Malaysian 10-year MGS average yield continues to decreased by 6 bps to 3.61%. Consequently, the average yield spread reduced to 154 bps (Jun: +161 bps).
- Overall, we view that **Bank Negara Malaysia (BNM) may opt for another rate cut by this year** following a rate cut of 25 bps in May on the back of increasingly dovish major and regional central banks, escalation in the trade war as well as prospect of growth slowdown in the major economy. This will put pressure on the Ringgit, and is expected to fall to 4.20 against the greenback by year-end from our initial forecast of 4.10 (2018: RM4.13).

Graph 1: Net Foreign Capital Flows



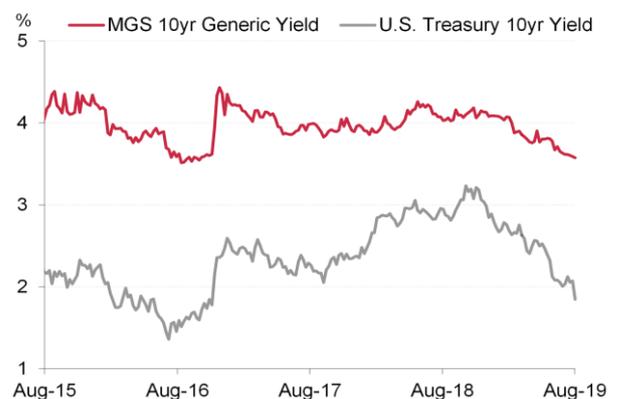
Source: BNM, Kenanga Research

Graph 2: Foreign Holdings of Malaysian Debt



Source: Dept. of Statistics, Kenanga Research

Graph 3: 10-Year US Treasury Yield Vs 10-Year MGS Yield



Source: Bloomberg, Kenanga Research

09 August 2019

Table 1: Foreign Holdings of Malaysian Bonds

		Feb-19	Mar-19	Apr-19	May-19	Jun-19	Jul-19
<b>MGS</b>	Value (MYR billion)	149.3	150.7	147.1	143.4	149.1	154.7
	% of Total MGS	38.3%	38.7%	37.1%	35.8%	36.9%	38.3%
<b>GII</b>	Value (MYR billion)	17.4	18.7	15.2	14.7	14.7	0.0
	% of Total GII	5.5%	5.8%	4.8%	4.5%	4.4%	4.4%
<b>BNM bills</b>	Value (MYR billion)	5.0	5.0	5.0	5.0	5.0	5.0
	% of Total BNM bills	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
<b>PDS</b>	Value (MYR billion)	13.5	13.5	11.9	12.0	12.0	11.9
	% of Total PDS	2.0%	2.0%	1.7%	1.7%	1.7%	1.7%
<b>Total Foreign Debt Holdings</b>	Value (MYR billion)	187.0	190.0	180.1	175.9	182.6	188.3
	% of Total Securities	13.1%	13.3%	12.5%	11.9%	12.3%	12.6%

Source: BNM, Kenanga Research

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