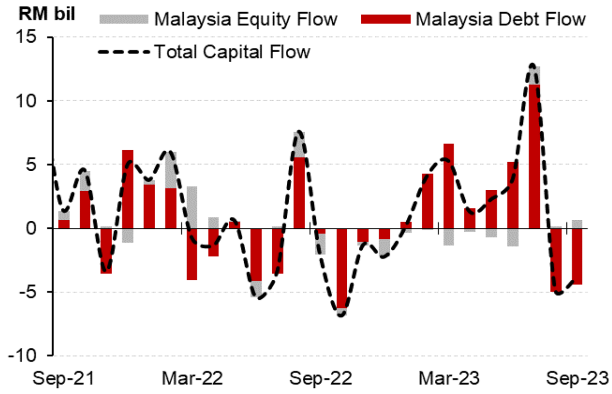
10 October 2023

Malaysia Bond Flows

September records a second outflow in 2023, driven by declining investors' risk appetite

- **Foreign investors were net sellers of Malaysia's debt securities for the second consecutive month in September (-RM4.4b; Aug: -RM5.0b), mainly due to a sharp sell-off in short-dated securities**
  - Consequently, the share of total foreign holdings of Malaysia's debt was reduced to 13.7% after it rallied to a 15-month high last month (14.0%).
  - Foreign demand remains hampered by a declining risk appetite driven by rising global economic uncertainty. Additionally, domestic bonds have become less appealing due to the negative widening of MY-US 10-year government bond yield spread (average yield spread Sep: -45.0 basis points (bps); Aug: -31.0 bps).
- **This month's outflow stemmed from a net divestment of Malaysian Islamic Treasury Bills (MITB) and Malaysian Government Securities (MGS), outweighing an increase in Government Investment Issues (GII)**
  - MITB (-RM4.3b; Aug: -RM0.2b): largest outflow on record; foreign holdings share fell to a four-month low of 12.4% (Aug: 24.3%).
  - MGS (-RM0.5b; Aug: -RM5.2b): continued to record an outflow, albeit at a softer pace; foreign holdings share edged down to a seven-month low (35.4%; Aug: 35.8%).
  - GII (RM0.5b; Aug: -RM0.7b): foreign investors turned net buyers but holdings share decreased marginally (9.7%; Aug: 9.8%).

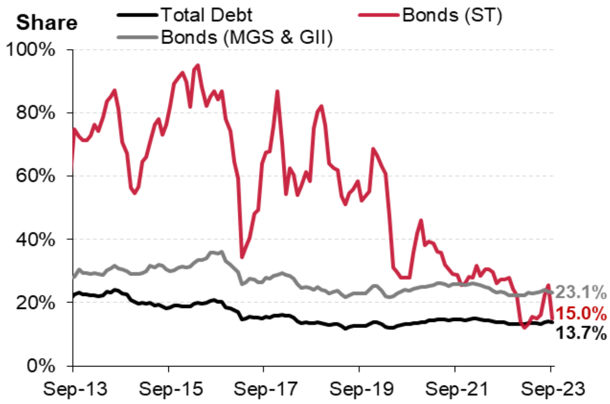
Graph 1: Monthly Net Foreign Capital Flows



Source: BNM, Kenanga Research

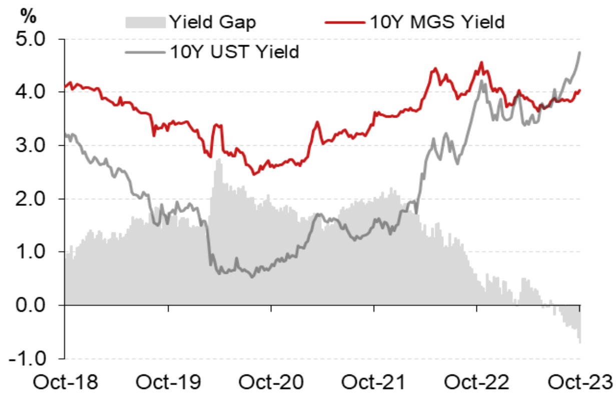
- **Foreign investors remained net buyers (RM0.7b; Aug: RM0.1b) of Malaysian equities for the third straight month**
  - Although investors offloaded RM27.7m and RM44.7m worth of local shares in the first and last weeks of September, respectively, they notably increased their purchases by RM0.8b during the middle of the month, primarily within the utilities sector. This was mainly due to investors' conviction that the Fed has done enough. As a result, they are diversifying away from the US markets and into undervalued blue chips of emerging markets, such as Malaysia.
- **Overall, the capital market recorded its second net outflow (-RM3.8b; Aug: -RM4.9b) in nine months**
- **Investors and China's shift away from US bonds may benefit the local debt market in the near to middle term**
  - Given Malaysia's robust economic fundamentals (i.e. solid current account surplus and a favourable balance of trade), it is emerging as an attractive destination for bond investors seeking to diversify away from the US bond markets, as 30-day futures price in that the Fed's next major move would be a 25 bps rate cut in June 2024. The local bond market is also expected to benefit from China's portfolio reallocation away from US Treasuries (UST). Notably, China reduced its UST holdings by 12.5% YoY or USD117.4b to USD821.8b in July. However, the recent surge in risk aversion due to the Middle East conflict may prompt investors to seek the safety of UST and hold onto their positions for a bit longer.
  - Stabilising inflation rates and slowing growth outlook may prompt the BNM to maintain the overnight policy rate at 3.00% until end-2024. However, government's potential subsidy rationalisation, coupled with the possibility of a third wave of inflation due to the recent geopolitical conflict, could complicate the price outlook.

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

		Apr-23	May-23	Jun-23	Jul-23	Aug-23	Sep-23
MGS	Value (MYR billion)	194.0	197.9	199.4	207.0	201.9	201.3
	% of Total MGS	35.9%	36.0%	35.9%	36.6%	35.8%	35.4%
GII	Value (MYR billion)	46.4	45.6	49.3	51.0	50.4	50.8
	% of Total GII	9.2%	9.2%	9.7%	10.2%	9.8%	9.7%
MTB	Value (MYR billion)	2.9	2.5	1.0	0.5	1.3	1.2
	% of Total MTB	32.3%	28.3%	25.3%	22.5%	37.8%	34%
MITB	Value (MYR billion)	4.3	5.0	6.3	7.8	7.5	3.2
	% of Total MITB	11.5%	12.1%	15.3%	22.2%	24.3%	12.4%
PDS	Value (MYR billion)	12.0	11.7	11.9	12.9	13.1	13.2
	% of Total PDS	1.5%	1.4%	1.3%	1.4%	1.6%	1.6%
Total Foreign Debt Holdings	Value (MYR billion)	259.7	262.7	267.9	279.2	274.2	269.7
	% of Total Securities	13.5%	13.4%	13.2%	13.8%	14.0%	13.7%

Source: BNM, Kenanga Research

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