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Reversal likely for bonds: Report

MALAYSIA'S sovereign bonds, which have seen some gains amidst a tightening of spreads recently, may come in for a reversal in the run-up to the general elections, says global investment banker Salomon Smith Barney. If elections are held in November, as have been rumoured, the tightening momentum in Malaysian spreads could be slowed, said Salomon managing director Steve Taran, in the October issue of Asian Debt Perspective. Although the investment banker believes that the vote is likely to produce a solid majority for the governing Barisan Nasional coalition, elections in emerging markets tend to dull investors' enthusiasm for emerging market paper, he said.

Malaysian bonds, Taran said, "... have had a very good run but in the face of political uncertainty, investors may be wise to take some of their money off the table".

He added that there is only limited upside at risk of about 15 to 20 basis points by the end of November, while the potential downside could be 30 basis points.

Any selloff would be capped by renewed buying if spreads backed up beyond 290 basis points because the country's economic trends are very favourable to bondholders and its political stability is not at risk, he pointed out.

Taran said the country's external liquidity, continued progress in bank reform and favourable electoral prospects for Prime Minister Datuk Seri Dr Mahathir Mohamad's ruling coalition should have translated into new lows for Malaysia's spreads (up to 10 to 15 basis points) in coming months. Meanwhile, Barclays Capital in its report on Malaysia for October said the health and integrity of the financial system is a key determinant of the country's sovereign picture in the longer term.

Barclays, in stressing that the recovery of banks should take precedence over both the household and corporate sectors, said the recent evidence on recapitalisation and non performing loans (NPLs) suggests that financial institutions are overly conservative.

Although such an approach has helped recapitalisation significantly, "... perpetuating such conservatism will put a lid on growth until banks are ready to assume more corporate and household risk".

As at August 31 1999, national asset management company Pengurusan Danaharta Nasional Bhd has addressed over RM39.3 billion worth of bank loans, of which RM31.3 billion came from the core banking system. It has also acquired RM8 billion worth of NPLs from non-banking and offshore institutions. Danaharta further expects to carve out an additional RM8 billion in NPLs from the banking system.

Barclays also said that the on-going improvement in external accounts will not be derailed by a revival in domestic demand as the current account surplus should continue to grow and with external debt peaking at US\$443 billion (US\$1 = RM3.80) in the fourth quarter of 1999, total external debt to gross domestic product is expected to be at a comfortable 56 per cent.

The reduction in offshore borrowing by banks has led to a substantial decline in short term external debt to a mere US\$7.6 billion, which represents only 18 per cent and 25 per cent of total debt and foreign reserves respectively, it said.

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