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Malaysian bonds remain attractive to yield seekers

MALAYSIAN bonds remain relatively attractive to yield seekers in the light of the US economic recovery, according to industry experts.

They said having lagged the Asian bond rally in the last quarter of 2001, Malaysian bonds are offering value at current spread levels.

Fiscal soundness, improving economic conditions, continuous corporate reforms, flush liquidity, comfortable short-term debt and ratings upgrade hopes have re-ignited investors' interest in Malaysia, they added.

"Malaysian bonds have benefited from investor risk appetites improving along with the search for higher yield in the face of the global low rate environment.

"Another aspect for better returns from Malaysian bonds is the possibility of a ratings upgrade," said Maya Sen, the financial markets analyst at MMS International in Singapore.

Industry sources said for the first half of the year, spread will remain firm with periods of volatility due to supply and upgrade rumours.

Spreads on Malaysian sovereign and corporate dollar bonds widened immediately after Prime Minister Datuk Seri Dr Mahathir Mohamad made a comment on the ringgit peg in January. Sovereign bond recorded an immediate widening of 15 basis points.

At present, Malaysian bonds are rated Baa2 by Moody's and BBB by Standard & Poor's, with a stable outlook by both rating agencies.

Inflationary pressures remain a distant concern until concrete evidence of economic recovery is in place, according to experts.

Going forward, they expect the inflation rate to rise albeit slowly. Higher inflation rate this year is expected due to increases in major cost items, but the subdued inflation will allow monetary conduct to remain easy for most of 2002.

According to Suresh Kumar, the emerging markets analyst at MMS International in Singapore, an uptick in inflation will be negative for local bond (MGS) sentiment, which has been rather bad this year .

"Also, with possible pressure on the ringgit peg, there is little or no scope for lowering rates anytime soon," he added.

With the overnight and three-month Kuala Lumpur Interbank Offered Rates at 2.76 and 3.27 per cent respectively, Bank Negara gets to stimulate demand with the low rates while maintaining a positive interest rate differential with the US dollar to ensure repatriation of export proceeds.

"I expect local rates to rise as much as 50 basis points by year-end, in line with the expected spike in Federal Reserve funds and local growth... this is not totally priced in by the market at the moment," said Kumar.

From a macro viewpoint, signs of an economic recovery in the US have caused US Treasuries, which often provide the market direction for other sovereign benchmarks, to slip further.

"As the US economy improves, safe, fixed returns of Treasury bonds become less appealing. Investors switch to equities or to corporate bonds which will benefit from the improving economy via improved corporate earnings and spread tightening versus Treasuries as US Treasury yields rise.

"A rise in US Treasury yields will occur as the probability of interest rate increases and inflation pressures begin to build," said Sen.

Domestically, technical analysts are pessimistic on Malaysian government bonds this week since the benchmark five-year Malaysian Government

Securities prices are falling below short-term moving averages.

However, they are more optimistic on equities as daily indicators are returning to positive territory.

"I believe that the bond market will take its cue more from the equity market, which remains strong, and prospects for the Federal Reserve rate tightening.

"As we see the global economy improving gradually, investors will likely continue to prefer equities over bonds," said Pieter VanDerSchaft, the associate director of economic research at Barclays Capital in Hong Kong.

(END)