

Foreign investors may pull US\$1b out of M'sia this week

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Foreign investors could pull up to another billion dollars out of embattled Malaysia's bond markets this week, pushing the country a step closer to a currency reserves crisis that would send shudders across the region.

A widening political scandal and tumbling currency have steadily taken their toll on investor sentiment towards the South-East Asian economy, unnerving its emerging Asian neighbours despite the central bank's efforts to contain the damage.

About RM11 billion (US\$2.5 billion) worth of government bonds are due to mature tomorrow and foreigners, who own on average 45 percent of outstanding bonds, are seen likely to pull their cash out rather than re-invest it in Malaysian debt.

"The risk-reward of investing in Malaysia assets is quite unattractive for now," said Prashant Singh, lead portfolio manager for local currency debt at Neuberger Berman in Singapore, citing the political and currency risks, as well as the high foreign ownership of the bond market.

"Huge outflows are unlikely, that doesn't mean that the risk is not there that some of this money can go out. We would not be surprised to see a significant portion of the maturing bond not being reinvested."

Malaysia's markets have been ground down since July, primarily by the escalating political fallout from allegations of graft and mismanagement swirling around indebted state fund 1MDB.

Weak link

The scandal has amplified concerns that the country is emerging as the weakest link in a region struggling with falling commodity prices, feeble global demand and impending interest rate rises in the United States.

The risk of contagion for countries with similar vulnerability to capital flows, such as Indonesia, South Korea and Thailand, is all too real, as Asia's experience of sharp bond outflows during the 2013 'taper tantrum' showed.

Malaysia's ringgit has fallen 26 percent this year against the dollar, plumbing levels not seen since the depths of the Asian financial crisis in the late 1990s, its bonds have fallen and the stock market has declined 8.5 percent.

Indonesia, South-East Asia's biggest economy, has seen its stock market fall 21 percent. Investors in Indonesia expect foreign demand to be weak at today's auction of 8 trillion

rupiah (US\$544 million) worth of bonds.

“You are seeing it across all emerging markets - Brazil, South Africa, Indonesia, Turkey - they are all victims to the same trend of underperformance of the local fixed income markets, continued foreign investor outflows and overall risk aversion,” said Mirza Baig, head of emerging Asia currency and rates research at BNP Paribas in Singapore.

Policy risk

Anxious about a regional spillover effect, Indonesian authorities are seeking to bolster their currency reserves, which at US\$105 billion limit their ability to defend the traditionally volatile rupiah.

“Indonesia’s economy ministers are keenly focused on the contagion risk from the market pressures being experienced by Malaysia,” a senior Indonesian government official told Reuters.

While foreign investors have been selling out of Malaysian debt sporadically this year, they became effective net sellers in July and August, after the 1MDB furore erupted.

If they were to pull all their proceeds out tomorrow, it would subtract another billion dollars from Malaysia’s already precarious currency reserves, which have dropped US\$10.2 billion since the end of June to US\$95.3 billion.

Central bank chief Zeti Akhtar Aziz said last week she expected the ringgit to recover once the 1MDB issues were resolved, and that the public deserved to get answers to what went on there.

The fund, whose advisory board is chaired by Prime Minister Najib Abdul Razak, has been dogged by controversy over its US\$11 billion debt and alleged financial mismanagement.

Although Najib has denied any wrongdoing, a series of international investigations are under way into 1MDB’s affairs.

In the meantime, weak prices for Malaysia’s liquefied natural gas exports are eating into its trade surplus, there are concerns about its ability to repay its massive short-term foreign debt and the banking system has seen an erosion in ringgit deposits.

Ratings agencies have said they would be concerned if there were signs of broader policymaking being affected by the crisis, with Fitch warning at the beginning of the month of the risk it could downgrade the outlook on its debt.

For some investors, the idea of the well-regarded Zeti being replaced as head of Bank Negara Malaysia (BNM) at the end of her term in early 2016 is another cause for worry.

“BNM is a very credible central bank, but at this point in time the concerns are not really

about monetary policy,” said Neuberger Berman’s Singh. “There are a lot of other external and domestic factors which haven’t gone to plan.”

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