

MRT sukuk costs add to Najib's budget strain

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The financier of the MRT in Malaysia's capital is facing higher borrowing costs after a doubling of state-backed sales this year swamped the market.

State-owned DanaInfra Nasional Bhd sold RM1.5 billion (US\$465 million) of Islamic bonds with maturities of seven to 20 years at yields ranging from 4.4% to 5.25%, and RM500 million of 25-year debt via private placement, two people with knowledge of the matter said yesterday. It issued similar-tenor notes at coupon rates of 3.85% to 4.8% in Oct 2013.

The DanaInfra sukuk will take government-backed sales this year to US\$8.5 billion, compared with US\$4.6 billion at this point in 2013, after offers by an education fund, a public transport operator and a water management company. The higher borrowing costs will hamper efforts by prime minister Najib Razak to trim this year's budget deficit to the lowest level since 2007 after Fitch Ratings warned it may cut the nation's credit rating.

"Though we would prefer state-guaranteed debt to be lower, we aren't overly concerned at the moment as we believe the government is aware of this part of the equation," Elsie Tham, a senior fund manager at Kuala Lumpur-based Manulife Asset Management Sdn Bhd, who oversees more than US\$1 billion, said in an interview yesterday. "I would buy the DanaInfra sukuk given the strategic importance of the subway (MRT) to the overall development of the nation."

Fitch warning

Fitch lowered its outlook on Malaysia's A-ranking, the fourth-lowest investment grade, to negative from stable in July, citing public finances as the "key rating weakness." Najib has since cut fuel and power subsidies as part of efforts to reduce the budget deficit to 3.5% of gross domestic product this year and 3% in 2015 after shortfalls of 4% or more in the six years through 2013.

It still looks challenging for Malaysia to achieve its 2015 goal without “additional consolidation measures,” Andrew Colquhoun, Fitch’s head of Asia-Pacific sovereigns in Hong Kong, said in a Feb 13, 2014 e-mail.

The Kuala Lumpur subway project is part of Najib’s US\$444 billion 10-year plan to construct railways, roads and power plants to accelerate expansion in Southeast Asia’s third-biggest economy in order to attain developed-nation status by 2020. GDP increased 4.7% last year, following advances of 5.6% in 2012 and 5.1% in 2011.

DanaInfra’s offering attracted orders totalling RM4.5 billion, said the people who asked not to be named because the information isn’t public yet. The sukuk were priced slightly lower than the guidance range of 4.45% to 5.29%.

Interest rates

“Demand for the DanaInfra sukuk is strong because of the government guarantee and the attractive pricing,” Zulkiflee Nidzam, head of foreign exchange and bond trading at Kuala Lumpur-based Asian Finance Bank Bhd, said in an interview yesterday. “Given the current rising interest-rate environment, the issuance of state-backed debt now will be positive for the government in the long run as they will be able lock in prices at lower yields.”

Bank Negara Malaysia has held its policy rate at 3% since May 2011. Four of 12 analysts surveyed by Bloomberg forecast a 25 basis point increase this quarter, while 12 of 19 see a rate of 3.25% or higher by the end of the year.

The yield on Malaysia’s 10-year sovereign sukuk fell 14 basis points to 4.26% this year after gaining 80 basis points in 2013, central bank data show. The rate on similar-maturity non-Shariah-compliant debt slipped four basis points, or 0.04 percentage point, to 4.09% this year after increasing 63 basis points in 2013.

State-backed sales

Sales of Malaysian bonds that comply with Islam’s ban on interest have climbed 83% to RM19 billion in 2014 from the year-earlier period, data compiled by Bloomberg show. In the international market, issuance has fallen 1% to US\$13.8 billion.

Among the major state-backed sukuk offers in 2014, Perbadanan Tabung Pendidikan Tinggi Nasional Bhd, the education fund, sold RM2.5 billion of debt due from 2019 to 2024 to yield between 4.1% and 4.67%. Rail operator Syarikat Prasarana Negara Bhd issued RM2 billion of five- and 10-year notes at 4.08% and 4.67%, and water utility Pengurusan Aset Air Bhd offered RM1.2 billion of paper maturing in 2019 and 2021 at 4.16% and 4.42%.

The Bloomberg-AIBIM Bursa Malaysia Corporate Sukuk Index, a benchmark that tracks the most-traded local-currency notes, decreased 0.4% to 104.7 in 2014 after gaining 2.8% last year.

Sufficient liquidity

Work on the first MRT line began in July 2012 and it is due to be finished in 2016. DanaInfra, which has so far sold RM5.9 billion of sukuk via three offers, estimates the first line will cost RM30 billion. It announced an RM8 billion Islamic bond program to part-finance construction in July 2012 and increased the facility to RM21 billion this month.

“There is sufficient domestic liquidity to absorb government-guaranteed issuances,” said Khoo Poh Sim, a Kuala Lumpur-based senior portfolio manager at BNP Paribas Investment Partners Najmah Malaysia Sdn Bhd, who helps oversee 554 million euros (RM2.4 billion) said in an e-mail interview yesterday. “The government has taken concrete steps to curb fiscal spending. Hence, our concerns about sovereign indebtedness has been allayed somewhat.

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