



# MY Fixed Income Outlook 2016

## No place for complacency

- **Yield curve outlook:** We expect the MGS curve to bear-steepen in 2016 with the following targets for the 10y MGS yield: 1Q2016: 4.30%, 2Q2016: 4.35%, 3Q2016: 4.35%, 4Q2016: 4.40%.
- While the curve should trade sideways with reasonable support in the near term (1-2 months), the medium to longer term (6-12 months) themes of improving DM prospects and more challenging EM economic outlook remain intact, in our view, and this is not supportive of an outright bullish view on local bonds given the high foreign participation, though we reckon there will be pockets of opportunity to be so. Further, our expectation of higher duration supply in 2016, if turns out to be the case, may add to the steepening risk.
- After an observation period post the potential first hike in Dec-15, the US Fed may grow confident to take the normalisation path further with an additional 75bps FFR increase in 2016. We expect the UST curve to bear-flatten along the 2y10y next year.

**Foreign flows:** We expect near term stabilization with continued foreign demand from long-term real money type of foreign official funds on MGS. That said, volatility of flows will stay in 2016. In fact, the yearly pattern of flows seems to be pointing to a cyclical trend of subsiding foreign demand and such weakness, though debatable, may well be carried into next year.

**Demand profile:** Amid slowing foreign demand, we expect domestic pension funds to remain moderate buyers of MGS and insurance companies the marginal net buyers on structural demand. We think banks are the most likely candidates to step up on the purchase of government bonds in 2016 with a gradual shift in banks' appetite to increasing the holdings of government bonds, in our view.

**Supply:** We expect a moderate MYR87b gross MGS and GII issuance in 2016, plus USD1.25-1.50b from USD sovereign bond for refinancing purpose. On domestic supply profile, duration supply may inch higher, with potentially more issuances with 15-year tenor and beyond, adding to steepening risk along the 10y to 30y part of the curve.

**PDS market:** We expect MYR70-75b of PDS supply in 2016. Broad credit condition should remain stable, although with risks of seeing a moderate increase in negative outlooks/downgrades. On a slowing economic backdrop, investors may turn increasingly discerning on fundamentals.

### Analysts

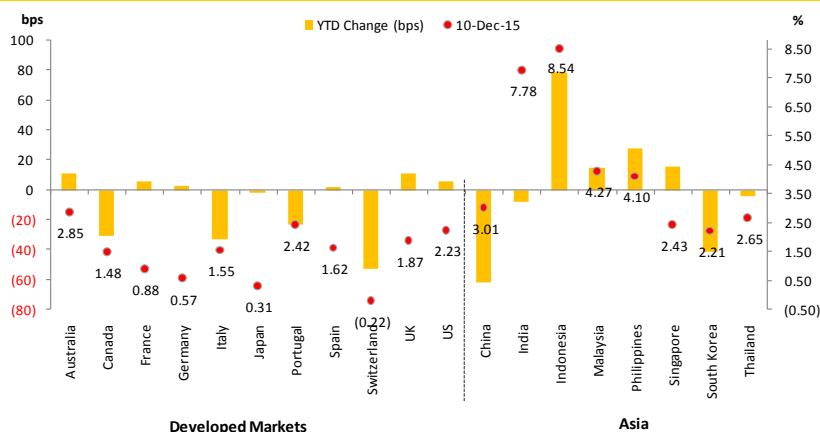
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## Market Review

Divergence in growth and monetary policy continued to drive bond market performance. In the developed markets (DM), the 10y government bond yields of both the European core and peripheral countries generally rallied on YTD basis. In contrast, the 10y yields of both the US treasury and UK gilt rose moderately as the US Fed is widely expected to press ahead with the first rate hike and the UK a potential candidate to follow suit. Whereas in EM Asia, the 10y bond yields generally edged higher except for China and Korea, which delivered rate cuts of 1.25% and 0.50% respectively in 2015.

Figure 1: 10y government bond yield - YTD change and current yield



Sources: Bloomberg, Maybank-IB

In local currency term, the Malaysia government bond market reported total return of 3.9% as at end-Nov, or an annualised return of 4.3% which is better than the 4.0% in 2014 and is modest in comparison with regional markets (Figure 2). The return was primarily driven by interest income given a par-weighted coupon of about 4% for the Malaysia government bond market.

In the emerging markets (EM) local currency bond markets, both the returns in USD unhedged and USD hedged basis showed rather dismal performances (Figure 3) due to the broad EM currency losses for the former while the latter was dragged by the Latin America region led by Brazil. A combination of USD strength, less favourable EM fundamentals and idiosyncratic country weaknesses had somewhat affected the appeal of EM local currency bonds.

Figure 2: Local currency total return for selected regional government bond markets, 2015YTD vs 2014

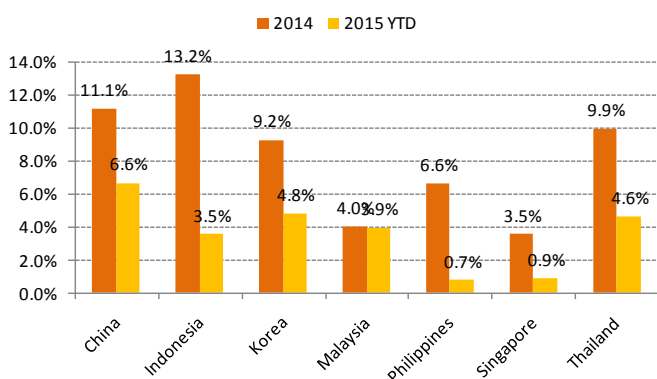
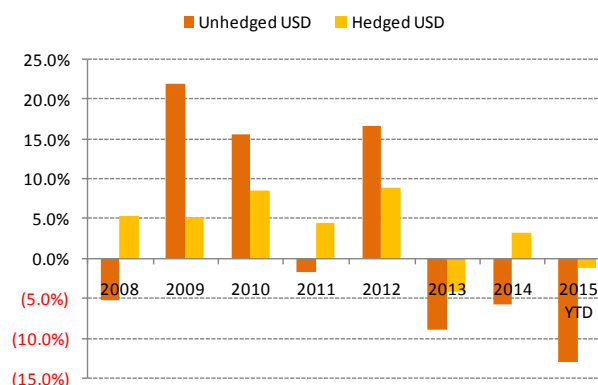


Figure 3: USD unhedged and hedged return for EM bond markets, 2008 to 2015YTD

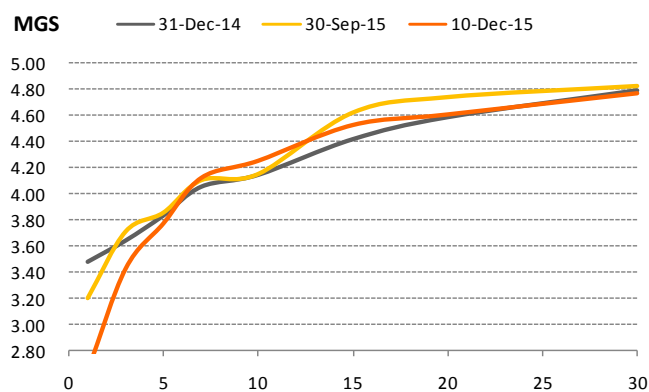


Sources: Bloomberg, Maybank-IB  
 \*YTD as at 30 Nov 2015

In Malaysia, on YTD basis the MGS curve steepened along the 3y10y, while longer end of the curve was fairly unchanged. The front-end MGS up to the 3y point rallied primarily driven by flows buying. After the selloff in Aug/Sep period, the MGS curve has so far recovered majority of the losses. Sentiment toward the Ringgit and local currency bonds have improved with generally a gradual repositioning by foreigner investors from underweight to neutral. On curve steepness, the MGS curve along 3y10y has steepened with the 3y10y spread widening to 80bps as we write from a low of 38bps in September.

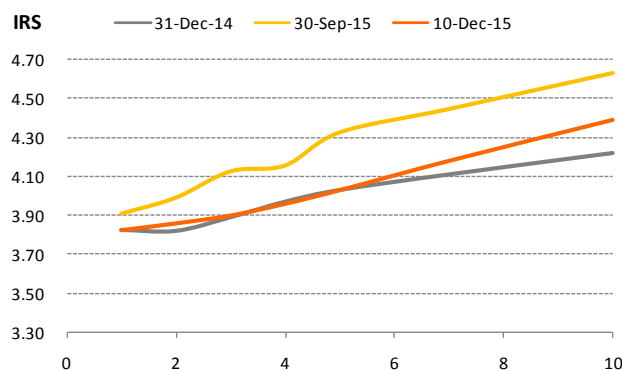
Sources: Bloomberg, Maybank-IB  
 \*YTD as at 30 Nov 2015, based on GBI-EM GD Index

Figure 4: MGS Yield Curve Movement



Sources: Bloomberg, Maybank-IB

Figure 5: IRS Yield Curve Movement



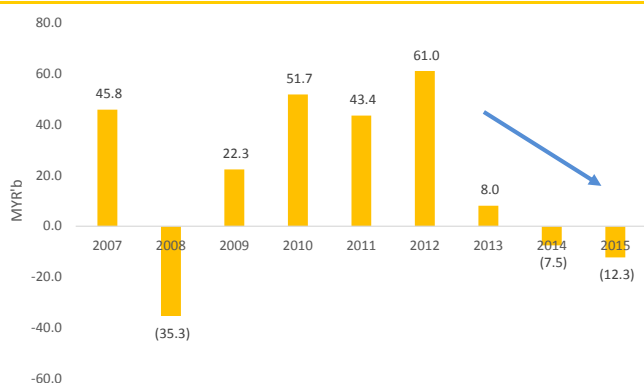
Sources: Bloomberg, Maybank-IB

## Foreign Holdings Outlook

Foreign outflows widened in 2015. After the bumper years of massive foreign inflows between 2010 and 2012, the pace of inflows had slowed in 2013, it turned into MYR7.5b outflows in 2014 and outflows widened to MYR12.3b in 2015 YTD as at end-Nov. The comfort is that the fear of foreign outflows, which peaked in August, appeared to have stabilised with net positive flows in the past three months and the foreign holdings of MGS held up nicely at 47.3% in November.

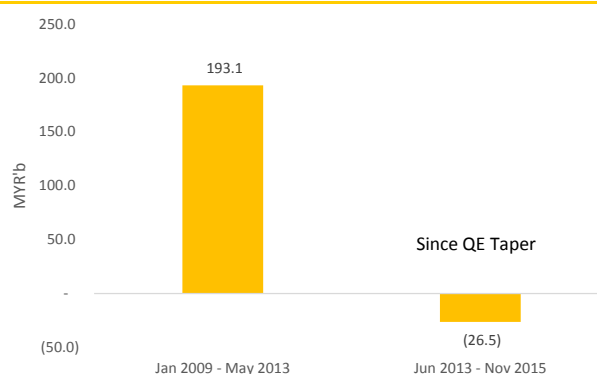
That said, we think it is worth paying some attention to the yearly trend, which seems pointing to a cyclical trend of subsiding foreign demand on local currency debt, and such weakness, though debatable, may well be carried into 2016. The theme of better growth prospects in DM led by the US and a broadly weaker EM fundamentals led by, among others, the slowdown in China may continue to weigh on the prospect of EM bond flows.

Figure 6: Foreign inflows/outflows of total debt securities



Sources: BNM, CEIC, Maybank-IB

Figure 7: Net outflows since the QE taper fear in May 2013



Sources: BNM, CEIC, Maybank-IB

Meanwhile, the monthly pattern of foreign flows has turned more volatile. Inflows used to be more persistent with extended period of net inflows, but since the QE Taper in 2013 there has been more swings in monthly flows.

Figure 8: Monthly inflows/outflows of total debt securities

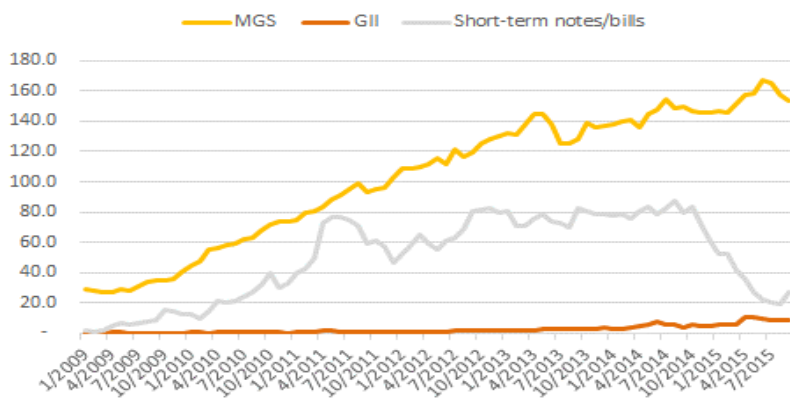


Sources: BNM, CEIC, Maybank-IB

MGS showed relative resilience. Worth noting is that, outflows have so far been mostly driven by sell-off/redemption in short-term notes and bills.

Collectively we group the BNM notes and treasury bills of both conventional and Islamic principles together as “discount instruments”. YTD, the foreign outflows of debt securities was primarily caused by outflows from discount instruments which saw foreign holdings declining from MYR60.9b (Dec-14) to MYR29.6b (Nov-15), although it was partly due to BNM stopped issuing new BNM notes at some point hence deterring rollover demand. In contrast, the foreign holdings of MGS showed relative resilience with net foreign buying which led to the increase of foreign ownership from MYR145.3b (Dec-14) to MYR159b (Nov-15).

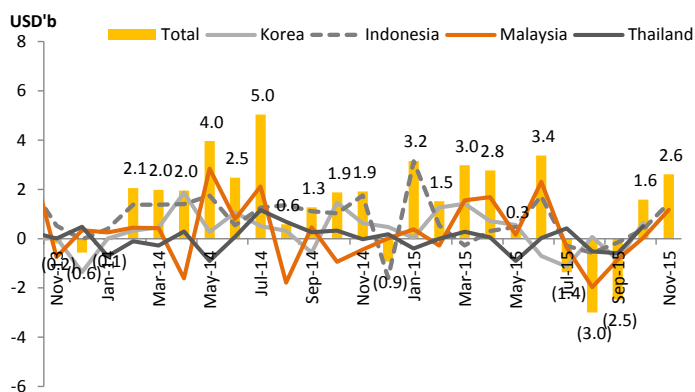
Figure 9: MGS showed relative resilience against short-term discount instruments



Sources: BNM, CEIC, Maybank-IB

No signs of broad regional weakness in foreign flows. The level of foreign holdings in the regional bond markets remain steady. Of the countries that we monitor for foreign holdings data, net receipt in flows totalled USD11.5b YTD at end-Nov, although admittedly the pace inflows had reduced to the slowest since 2008. On individual countries’ performance, KTB net received +USD2.0b YTD (end-Oct), IndoGB net gained +USD6.7b YTD (end-Nov), MGS net received +USD3.9b YTD (end-Nov) but ThaiGB saw net loss of -USD1.1b YTD (end-Oct).

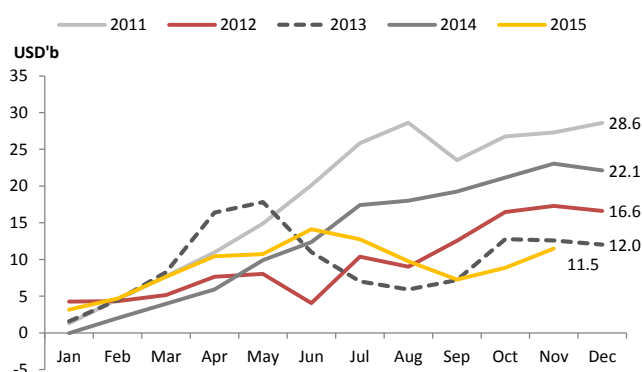
Figure 10: Regional foreign inflows/outflows on monthly basis



Sources: BNM, CEIC, Maybank-IB

\*Local currency government bonds; Malaysia include MGS only

Figure 11: Regional comparison of yearly foreign flows on cumulative basis



Sources: BNM, CEIC, Maybank-IB

\*Local currency government bonds; Malaysia include MGS only

2016: what lies ahead? We still expect net foreign demand on MGS barring any EM risk-off event that could cause a broad reversal of foreign bond flows from emerging markets. On a positive note, there has been a growing presence of long-term and real money type of investors in MGS with

sustained foreign official demand from central banks as well as pension funds and insurance companies especially those from the US and Europe. According to news, Premier Li Keqiang said that China will invest more in Malaysia's government bonds and the purchase will come direct from PBoC in addition to buying via its regional office in Singapore.

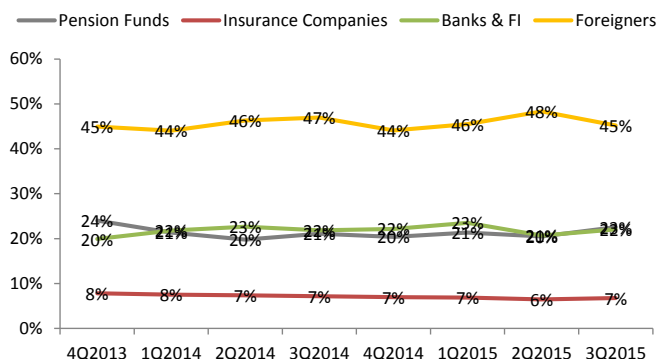
**...but cautious against outflows from short-term notes/bills and the very front-end MGS.** While our base case expectation for 2016 is still net foreign demand on MGS, we may however see net outflows from total debt securities perspective which include the foreign holdings of discount instruments. The Fed's "data dependant" clause means that the pace of rate normalisation can change. If the pace turns out to be faster than what the market has currently priced in for (about 50-55bps as we write), it could weigh on the regional foreign flows sentiment. Further, EM economies have generally been in transition to lower gear growth in addition to the continued uncertainty about China slowdown. A confluence of these events would weigh on EM growth outlook which in turn stir up volatility on foreign outflows, with the foreign holdings on short-term instruments and the very front to belly part of the MGS curve particularly at risk, in our view.

## Demand Profile & Outlook

Investor Group (% of total MGS)	2015 Trend	2016 Outlook
<b>Foreigners (47%)</b>	<p><b>Major net buyers.</b> Still a major source of demand for MGS with net purchase of MYR13.6b in 11M2015. Looking at the longer-term trend, demand has actually slowed to an annual average of ~MYR10b in 2013-2015, from an annual average of ~MYR30b in the good years of 2010-2012. MGS continue to receive demand from long-term and real money type of inflows that help enhance the overall stickiness of foreign holdings.</p>	<p><b>Flattish to slower demand.</b> We still expect net foreign demand on MGS, but the amount will likely be flattish or slower compared to 2015, in our view. Foreign official investors, such as the regional central banks and SWFs, should continue to see net inflows. With MGS's membership in several established EM bond and global investment grade bond indices, it should still benefit from index-driven fund flows but we are cautious against EM risk-off sentiment events that could lead to a broad-based reversal of flows, and if the US rate hike turns out to be in line with the existing Fed guidance, the higher-yielding USD may reduce the comparative attractiveness of EM local currency bonds.</p>
<b>Banks &amp; FI (22%)</b>	<p><b>Moderate buyers.</b> Banks were moderate net buyers of MGS, and major buyers of GII. In 9M2015, banks &amp; FI net purchased MYR6.3b of GII and net bought MYR2.4b MGS. Banks &amp; FI owned 22% of outstanding MGS and 47% of outstanding GII. To recap, banks &amp; FI's holdings of government bonds were nearly static between 2010 and 1H2013, but ramped up the purchase of government bonds between 2H13 and end-2014 which could be partly attributable to "transition demand" on HQLA.</p>	<p><b>Major buyers.</b> We think banks as an investor group is the most likely candidate to step up the purchase of government bonds due to structural and potentially an increase in cyclical demand in 2016, in our view. Additional demand on high quality liquid assets (HQLA) may be very limited as the banking industry's liquidity coverage ratio (LCR) had already reached 119% in Sep-15 and this is well beyond the compliance ratio of 70% from 1 Jan 2016. Therefore, we believe that additional HQLA demand on the ground of LCR compliance is very limited. That said, domestic banks' risk appetite appears to be turning defensive with costs rationing exercise and lower loans approval rate amid challenges from tightening NIM, rising loan/deposit ratio (LDR) to ~91% and low single-digit deposits YoY growth in recent months though it was partly due to conversion of Islamic deposit to investment accounts. Going forward, <b>we think it is possible to see a gradual shift in banks' appetite to increasing the holdings of government bonds</b> which offer comparative safety, liquidity and perhaps better risk-adjusted return under the context of slower economic growth, very limited chance for any thought of rate hike and stable inflation environment. Meanwhile, banks are the largest holders of GII with a 47% share at end-3Q2015, and will continue to favour the high-yielding GII for its structural demand.</p>
<b>Pension Funds (22%)</b>	<p><b>Net buyers.</b> In the past pension funds were the largest holders of MGS, but the appetite of pension funds on MGS has been decreasing and shifted to GII instead for yield pickup. Pension funds held about 22% of outstanding MGS and 39% of outstanding GII.</p>	<p><b>Moderate net buyers.</b> We expect continued structural demand from pension funds for strategic asset allocation. Domestic pension funds size continues to grow at healthy rate with EPF reporting net contributions of MYR11.1b in 9M2015, albeit slower than MYR17.6b in 9M2014. 2016 could be a challenging year with tepid outlook in economic growth and net receipt in contributions may slow, but the country's relatively young demographics and growing working population should remain supportive to fresh funds growth, plus potential repatriation of funds. Pension funds' demand will continue to show a preference toward GII and GG bonds over MGS given the yield pickup and majority of the demand is for buy and hold.</p>
<b>Insurance Companies (6%)</b>	<p><b>Marginal net sellers.</b> Insurance companies' ownership of government bonds has been low accounting for only 6% and 4% of total outstanding MGS and GII, respectively. The share of ownership continued to decline in</p>	<p><b>Marginal net buyers.</b> Insurance companies' asset allocation to government bonds is expected to remain low relative to the pace of asset growth. Insurers have a bigger role in the PDS market and we think such a trend will continue into 2016. Having said that, we think our expectation of higher duration supply in government bond market, if turns out to</p>

2015 as insurance companies were be true, may see domestic lifers turning to net buyers in marginal net sellers of MGS in 2016. 1H2015.

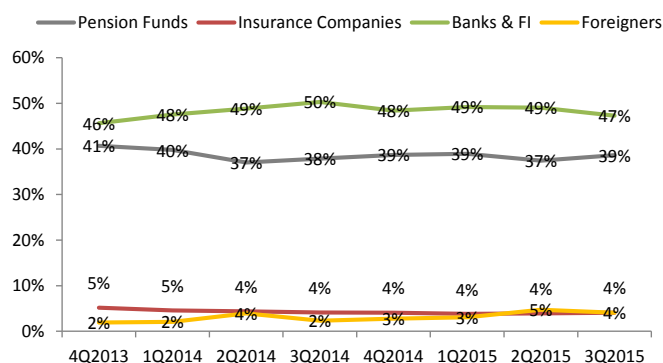
Figure 12: MGS ownership profile by type of investors



Sources: BNM, Maybank-IB

\*The share of ownership under "others" category is insignificant therefore not displayed

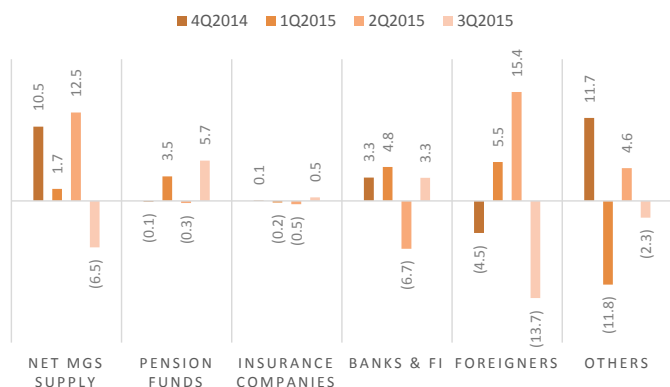
Figure 13: GII ownership profile by type of investors



Sources: BNM, Maybank-IB

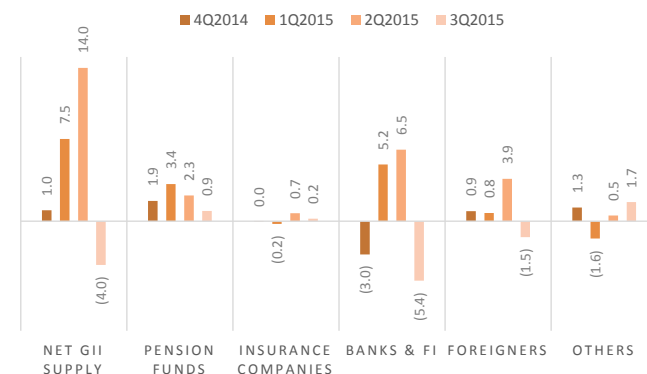
\*The share of ownership under "others" category is insignificant therefore not displayed

Figure 14: MGS - Foreigners and pension funds are major net buyers of MGS in 9M2015 (MYR'b)



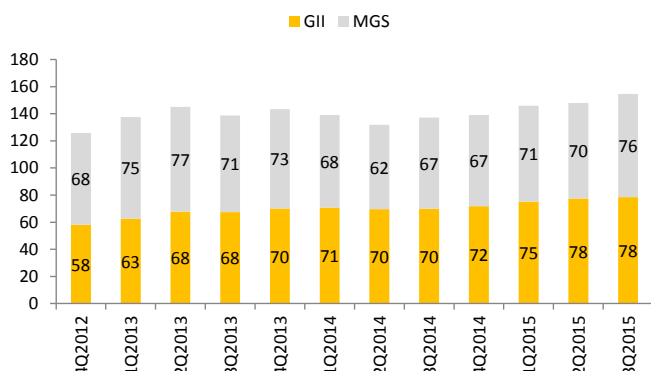
Sources: BNM, CEIC, Maybank-IB

Figure 15: GII - Banks and pension funds are major net buyers of GII in 9M2015 (MYR'b)



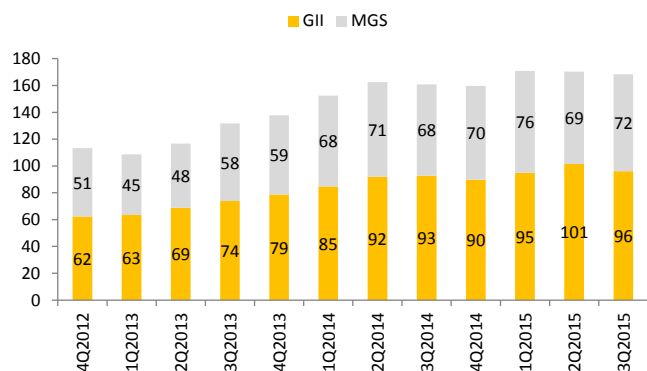
Sources: BNM, CEIC, Maybank-IB

Figure 16: Pension funds' holdings of MGS and GII (MYR'b)



Sources: BNM, CEIC, Maybank-IB

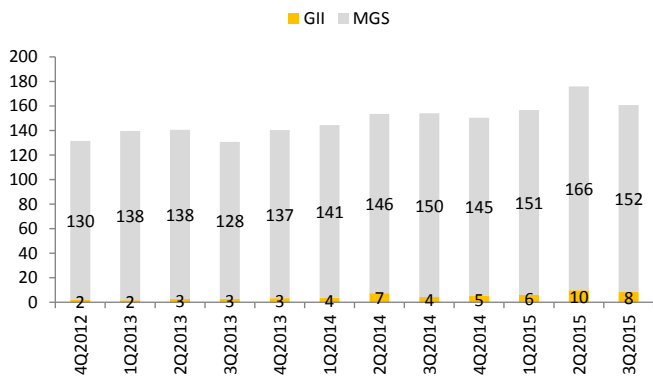
Figure 17: Banks and FIs' holdings of MGS and GII (MYR'b)



Sources: BNM, CEIC, Maybank-IB

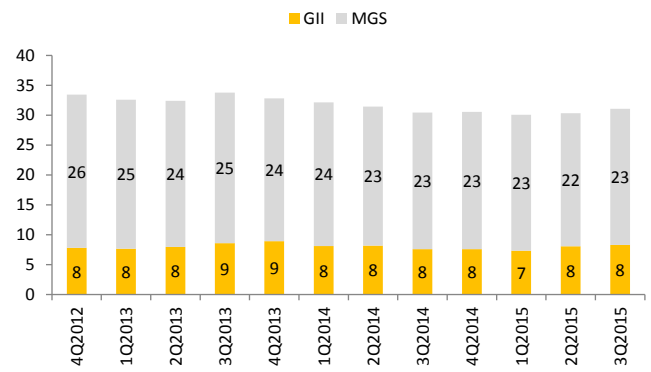


Figure 18: Foreigners' holdings of MGS and GII (MYR'b)



Sources: BNM, CEIC, Maybank-IB

Figure 19: Insurance companies' holdings of MGS and GII (MYR'b)

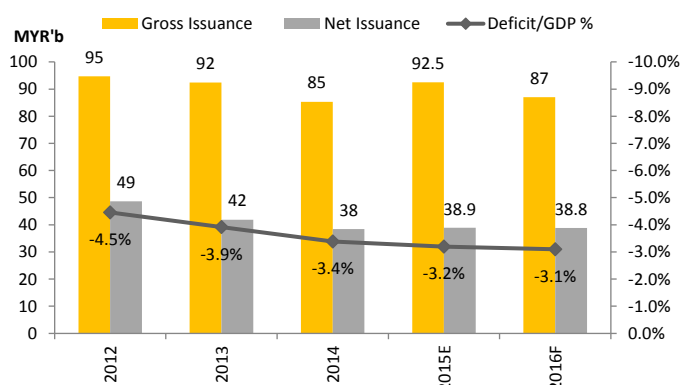


Sources: BNM, CEIC, Maybank-IB

## Government Bonds Supply Outlook

**2016: Moderate gross MGS & GII issuance.** We expect MYR87b of gross MGS and GII issuance in 2016 to finance MYR48.1b of government bond maturities and MYR38.8b of budget deficit. This is lower compared to MYR92.5b in 2015. Meanwhile, net supply is expected to be fairly flattish at MYR38.8b compared to our estimate of MYR38.9b in 2015. The overall supply profile is considered to be moderate.

Figure 20: Gross and net issuance of government bonds



Sources: BNM, CEIC, Maybank-IB

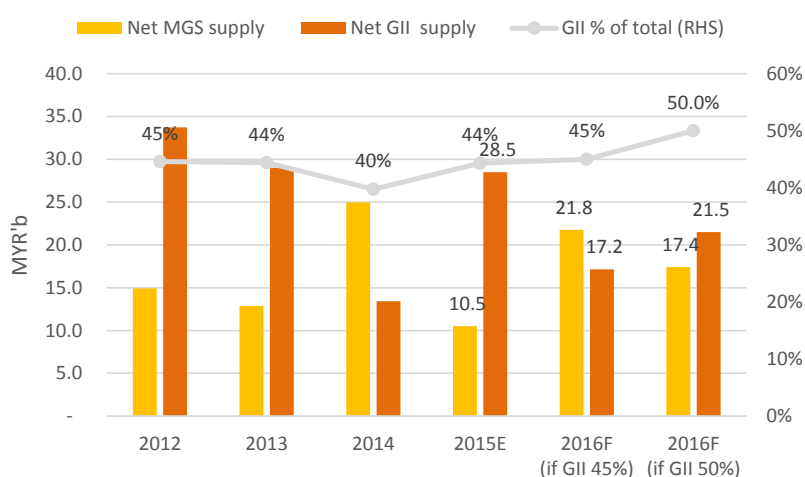
Figure 21: List of government bond maturities in 2016

Maturity	Stock	Amount (MYR'b)
8-Feb-16	PROFIT-BASED GII 6/2012 08.02.2016	7.0
15-Jul-16	MGS 1/2013 3.172% 15.07.2016	11.5
22-Jul-16	GII MURABAHAH 4/2013 22.07.2016	4.0
15-Sep-16	MGS 1/2006 4.262% 15.09.2016	14.7
15-Nov-16	PROFIT-BASED GII 3/2006 15.11.2016	11.0
<b>Total</b>		<b>48.1</b>

Sources: BPAM, Maybank-IB

**Higher net MGS supply.** On assumption of a 55:45 issuance ratio for MGS:GII, we expect gross/net issuance of MYR47.9b/MYR21.8b for MGS, and MYR39.1b/MYR17.1b for GII. This means that the net supply of MGS will be MYR11.3b higher YoY, although it could vary depending on the actual conventional vs Islamic issuance split. On chart below we show our estimate of net MGS/GII supply assuming a GII share of 45% and 50%.

Figure 22: Net MGS and GII supply and GII share of total

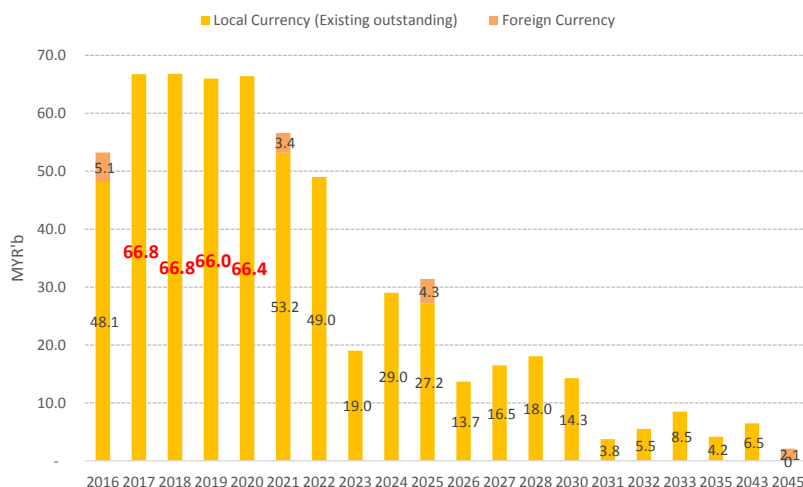


Sources: BNM, CEIC, Maybank-IB

**Concentration of maturities in 2017-2020.** The maturity profile of government bonds concentrate in year 2017-2020 with annual maturity of around MYR66-67b. This is considered heavy compared to MYR45.6 to MYR53.6b of maturities in 2011-2015. To smooth the bulky maturity profile, more debt switch will likely be conducted by swapping shorter-tenor bonds in the 2017-2020 bracket to longer tenor bonds. Without any debt switch and presuming that the government's yearly net financing

requirement to be around MYR40b, MGS & GII annual gross issuance would rise to around MYR105-120b per annum in 2017-2020, we estimate.

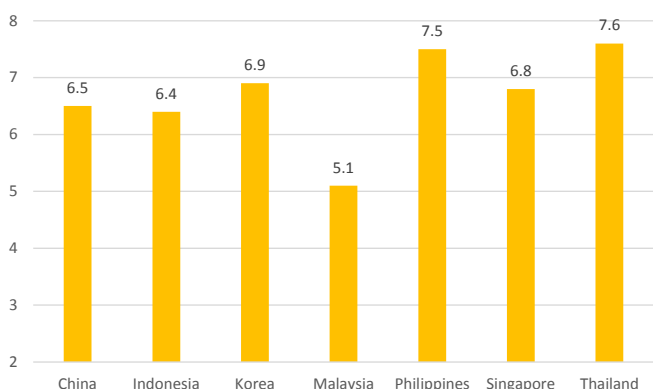
Figure 23: Government bond maturities concentrate in 2017-2020



Sources: Bloomberg, BPAM, Maybank-IB's estimate of maturity profile at end-2015

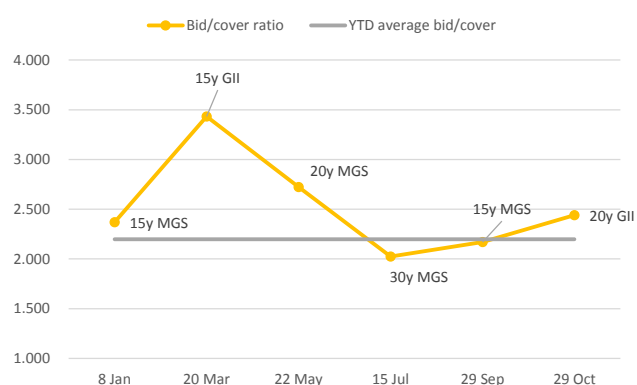
**Higher supply of duration.** By extending the supply of duration will help alleviate the concentration of maturities and refinancing risk. Going forward in the auction calendar, we expect to see more supply in the 15y to 30y bracket to offset a potential reduction of supply in the 3y to 5y bracket. From a bond market perspective, we think there is still headroom for the market to absorb higher duration supply as Malaysia's government bond market duration is low relative to peers and bid/cover ratios for long-tenor bonds were healthy. That said, the longer-end part of the curve is still susceptible to steepening risks depending on the actual increase in the issuance of long tenor bonds.

Figure 24: Relatively low duration of Malaysia's government bond market in comparison with regional peers



Sources: Bloomberg, Maybank-IB

Figure 25: Healthy demand on long-tenor bonds in auctions



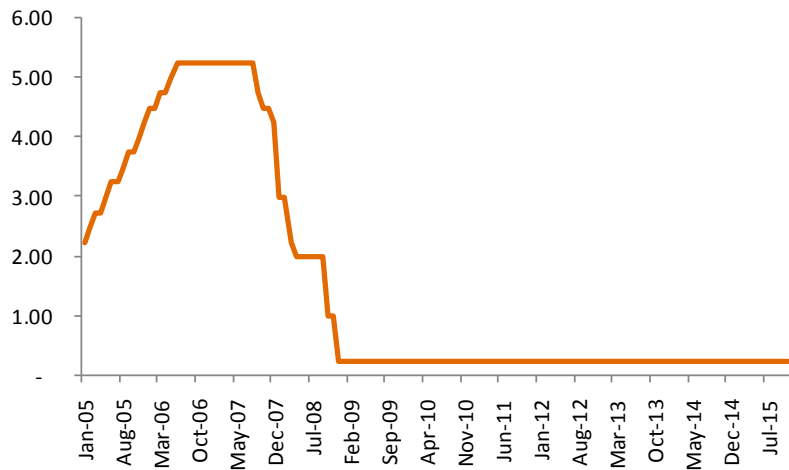
Sources: BNM, Maybank-IB

**USD sovereign bond issuance in 2016.** Next year we think it is likely to see the government issuing another USD bond for refinancing purpose given that the USD1.2b tranche of Wakala Global Sukuk is due to mature in July 2016. We expect an issuance size of around USD1.25-1.50b.

## Yield Curve Outlook - US Treasury

**Expect FFR hike in the Dec FOMC meeting.** The US Fed has decisively slashed the FFR from a high of 5.25% in Sep 2007 to a historical low of 0.25% in Dec 2008 during the global financial crisis. However, the Fed has apparently been very indecisive to start the tightening cycle. We expect a 25bps hike in the December. The US economy continued to expand at healthy rate, underpinned by strong jobs creation, moderate wage growth which is expected to tighten further and the expectation that higher inflation to follow eventually, seems to have strengthened the case.

**Figure 26: Historical US Fed Funds Rate**



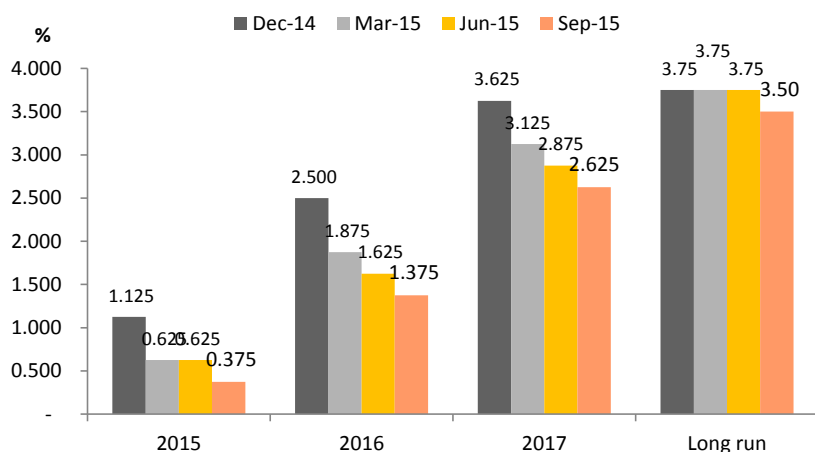
Sources: Bloomberg, Maybank-IB

**An additional 75bps increase in 2016.** The subsequent pace of FFR hike is expected to be very gradual compared to previous hike cycles. In the previous rate hike cycles: 1) between Jun 2004 and Jun 2006, FFR was raised by 4.25% (from 1.00% to 5.25%) in about 2 years' time, 2) between Jun 1999 and May 2000, the Fed raised by 1.75% (from 4.75% to 6.50%) in about one year's time, and 3) between Fed 1994 and Dec 1994, the Fed increased FFR by 2.25% (from 3.25% to 5.50%) in less than one year's time. This time round, though, the FOMC members have sounded cautiousness of not roiling the market nor derailing growth with the data-dependent clause.

**Fed dots may be revised lower, but market pricing already dovish.** Currently Fed dots, i.e. the medians of FOMC participants' view on the future level of FFR, guide for an interest rate level of 1.375% by end-2016 and 2.625% by end-2017. This means approximately 3 to 4 hikes (25bps each) in 2016 and an additional 5 hikes (25bps each) in 2017. But this is not a definitive guide as Fed dots can be revised upward or downward subject to the participants' view.

Interestingly, Fed dots were revised down in the past four FOMC meetings with projection materials. While there may be more downward revisions in 2016, the already dovish market pricing could mean that the future downward revision of Fed dots have majority been priced in. This led us to believe that any further rally in UST will be limited. Instead, we see the risk of UST yields correcting higher.

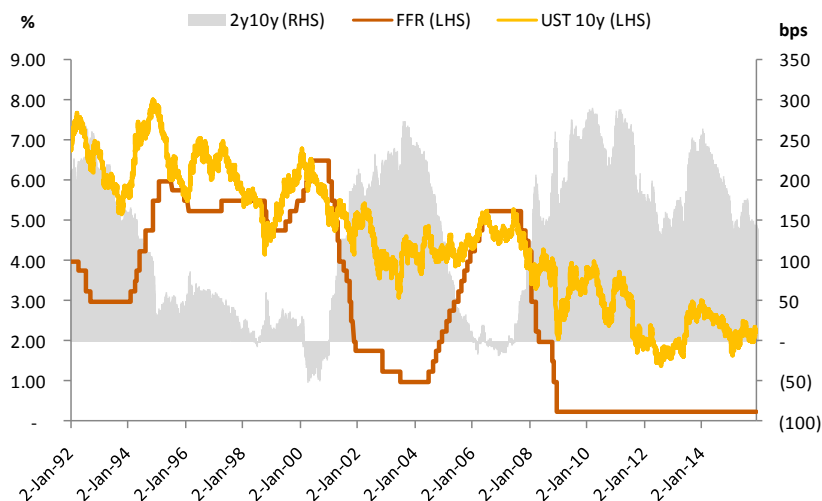
Figure 27: “Fed dots” were generally revised down in the past 4 meetings with projection materials



Sources: US Federal Reserve, Maybank-IB

**2016: UST curve to bear-flatten.** When the Fed begins rate normalisation, the UST curve is expected to bear-flatten with the front-end 2y UST yield rising faster than the 10y UST yield. This is because of the relative sensitivity of front-end UST to the change in interest rate. By end-2016, we expect the 2y UST yield to jump to 1.80% (current: 0.93%) and the 10y UST yield to rise to 2.80% (current: 2.23%), while the 2y10y spread to tighten to 100bps from 130bps as we write. Our quarterly forecasts for the 10y UST yields are: 1Q16: 2.50%, 2Q16: 2.60%, 3Q16: 2.70%, 4Q16: 2.80%.

Figure 28: UST curve along the 2y10y to bear-flatten in a tightening cycle



Sources: Bloomberg, Maybank-IB

## Yield Curve Outlook - Malaysia MGS & IRS

**Stable domestic macro outlook.** Domestic real GDP is expected to expand at a moderate 4.5% in 2016 albeit lower than the 4.9% in 2015, our economic research estimate. Growth will be supported by investments and less a drag on net external demand, both of which offset tepid consumption growth. We expect OPR to remain unchanged at 3.25% throughout 2016, while inflations to average higher at 3.0-3.5% range in 2016. Unless downside risk of GDP growth escalate with risk of breaking the 4.0% threshold, we see little incentive for the BNM to alter its stance on interest rate.

**Starting from a low base, easier impress?** We think this is true. The country was bogged down by a combination of negative events from depressed oil price, domestic political tussle and contingent liability issue, portfolio outflows risk and weak Ringgit. Markets should turn better by just having less negative headline news flows hence near-term supported.

**But external uncertainties abound.** Divergence of monetary policy of the US Fed vs the ECB. The MGS market is generally more affected by the US rates market. If our view of the bear-flattening of the UST curve holds, rising UST yields could eventually reduce attractiveness MGS on diminishing yield differentials plus a less certain currency outlook. China's RMB SDR inclusion is not without risks. While the SDR inclusion increases the demand on RMB as a reserve currency, there may be associated risks with less control over the capital account amid slowdown in China's economy. Our FX research forecast a gradual depreciation of USDCNY to reach 6.70 by end-2016. Weak RMB will have spill-over effect on regional currencies.

**2016: MGS curve likely trade sideways in the near term (next 1-2 months),** and perhaps well into 1Q2016 in a +/-15bps range. We expect the US Fed to hike in mid-Dec but with a reiteration of gradual path hence not roiling the rates market. Regional foreign bond flows should be moderately net positive and our FX research team forecast that USDMYR to reach 3.95 in 1Q2016. That said, we are not overwhelmingly positive, and **with our expectation of sideways trend we recommend selling on rally and buying on weakness.**

**...but as the year unfolds, we expect the MGS curve to bear-steepen by end-2016 because:**

**First, broad DM-EM themes favouring the former.** We think the medium to longer term (6-12 months) themes of improving DM prospects and more challenging EM economic outlook remain intact thus narrowing the DM-EM fundamental gap in the former's favour. As for the US rate hike, after an "observation period" post the first FFR hike, the US Fed may grow confident to take the normalisation path further with a higher yielding USD.

**Second, higher supply of duration.** We expect more supply of long-tenor bonds 15 years and beyond. While domestic institutions possess the depth and liquidity to absorb additional durations, **the MGS curve is still susceptible to steepening risks especially along the 10y to 30y, in our view.** If the curve doesn't correct in 1H2016, the steepening risks may become more apparent in the latter part of the year when market start pinning their focus on upcoming year's supply, which we expect to be heavier due to refinancing need, unless multiple debt switches are conducted to the extent that significantly trim the maturity profile.

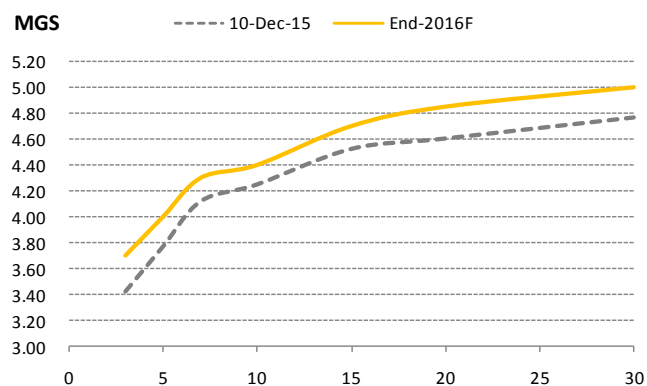
**Third, tail-risk events.** As the year unfolds, we do not discount the possibility of seeing the resurgence of EM risk-off sentiment, potentially on the ground of China slowdown. While it is not our base case that China to experience hard landing in 2016. Such a tail-risk event will continue to drive market sentiment and new data release that lead to the change in expectation will be sufficient to stir up volatility. If this happens, we think high foreign holding countries will be more at risk.

Therefore we are cautious against 2H2016 with upward-bias MGS yield targets: **3y: 3.70%, 5y: 4.00%, 7y: 4.30%, 10y: 4.40%, 15y: 4.75%, 20y: 4.85%, 30y: 5.00%.**

Our quarterly target level for the 10y MGS yield is as follows: **1Q2016: 4.30%, 2Q2016: 4.35%, 3Q2016: 4.35%, 4Q2016: 4.40%.** Specifically, we expect the 10y MGS yield to average 4.25% in 1Q16.

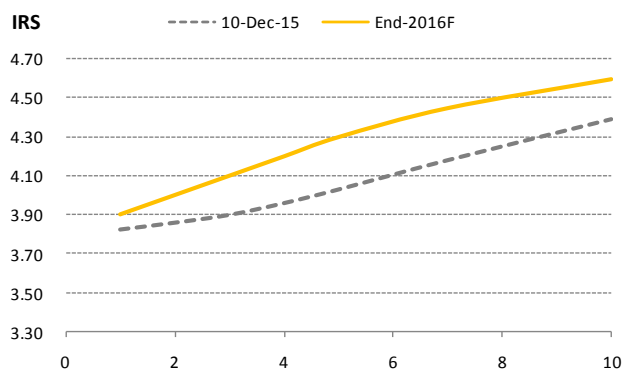
**IRS:** We have a similar view on the MYR IRS curve with the following targets by end-2016: **1y: 3.90%, 3y: 4.10%, 5y: 4.30%, 7y: 4.45% and 10y: 4.60%.**

Figure 29: MGS - Forecast of Yield Curve



Sources: Bloomberg, Maybank-IB

Figure 30: IRS - Forecast of Yield Curve



Sources: Bloomberg, Maybank-IB

## Private Debt Securities (PDS)

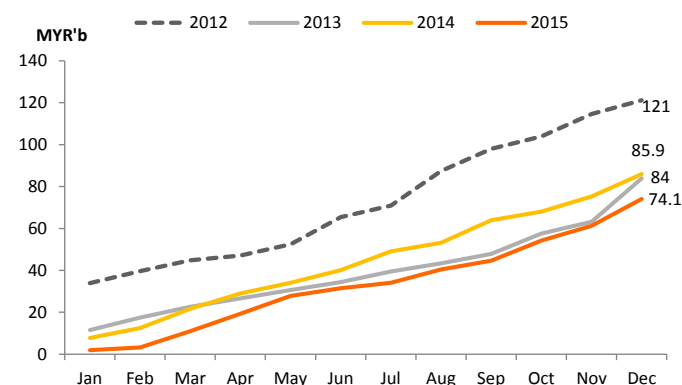
### PDS: Issuance & Outlook

2015 PDS issuance totalled MYR74.1b as at 11 Dec. Full year issuance is likely to settle in the region of MYR75-76b we reckon. Issuance activity increased in Nov-Dec largely due to the materialisation of the Jimah East Power bonds which raised MYR8.98b for the Project 3B power plant. Other notable large new supply in 4Q15 include a total of MYR3.3b Maybank Basel III compliant sub-debt, MYR3.1b Danainfra re-tap, MYR2.5b Rantau Abang (Khazanah's SPV) in two separate issuances, MYR1.2b MMC Corporation sukuk, MYR1.945b Prasarana sukuk and a total of MYR2.7b Cagamas bonds.

By rating, quasi-govvy and AAA-rated names accounted for 44.6% of total issuance, while AA segment took up 39.6%. By sector, majority of the issuance come from infrastructure/utilities and financial service sectors taking up a share of 41.7% and 24.5% respectively.

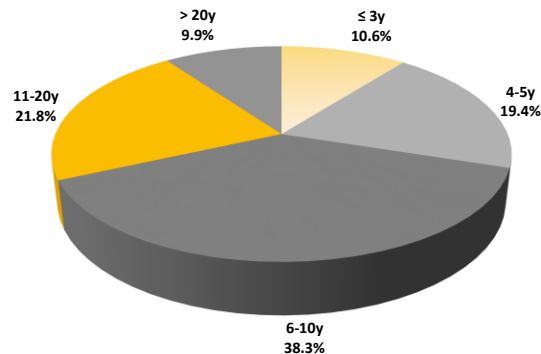
2016: Expect MYR70-75b gross supply. Next year, we expect flattish to slightly weaker supply of PDS in view of slower economic growth and the general market sentiment turning cautious toward expansion/capex spending. We pencil in MYR70-75b of gross supply in 2016.

Figure 31: Gross PDS Issuance - YTD as at 10 Dec 2015



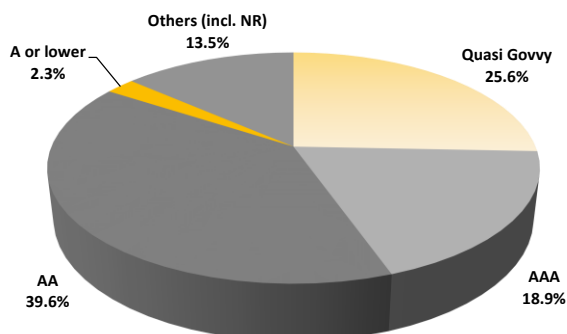
Sources: BPAM, Maybank-IB

Figure 32: Issuance by Tenor - YTD as at 10 Dec 2015



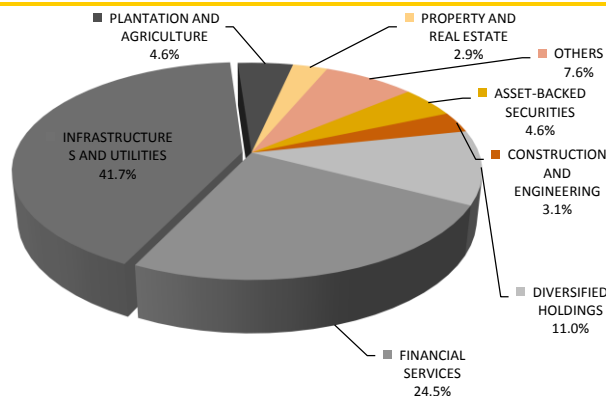
Sources: BPAM, Maybank-IB

Figure 33: Issuance by Ratings - YTD as at 10 Dec 2015



Sources: BPAM, Maybank-IB

Figure 34: Issuance by Sectors - YTD as at 10 Dec 2015



Sources: BPAM, Maybank-IB



PDS: Pipelines

Issuer	Currency	Facility (MYR'b)	Issued (MYR'b)	Unissued (MYR'b)	Rating
Alliance Bank	MYR	1.5			A1
Alliance Bank (T2 Subdebt)	MYR	2	0.9	1.1	A2
Aman Sukuk	MYR	10	6.58	3.42	AAA
Amlslamic Bank Bhd (Subordinated sukuk)	MYR	3	0.35	2.65	AA3
Axis REIT	MYR	3	0.265	2.735	AAA-AA3
Bank Islam	MYR	1	0.3	0.7	A1
Bank Rakyat (Imtiaz Sukuk II Berhad)	MYR	9	2	7	AA2
BGSM Management Sdn Bhd	MYR	10	6.02	3.98	AA3
Bumitama	MYR	2	1	1	AA3
Cagamas Bhd (IMTN)	MYR	20	11.477	8.523	AAA
Cagamas Bhd (MTN)	MYR	20	12.855	7.145	AAA
CIMB Bank (Tier-2 subordinated debt)	MYR	10	1.05	8.95	AA+
CIMB Group Holdings	MYR	10			AA
CIMB Islamic (B3 T2 Junior Sukuk)	MYR	5			AA+
CIMB Thai (Subordinated)	MYR	2	0.4	1.6	AA3
Danahfra Nasional Bhd (MRT)	MYR	21	20.7	0.3	GG
DRB-HICOM Berhad (Perp Sukuk)	MYR	2	1.04	0.96	A
EKVE	MYR	1			AAA
Gamuda Berhad (ICP/IMTN)	MYR	5	0.5	4.5	AA3
Golden Assets International Finance Limited	MYR	5	2.625	2.375	AA2(s)
Hong Leong Islamic Bank Berhad (Tier-2 subdebt)	MYR	1	0.4	0.6	AA2
IJM Corp Bhd	MYR	3	1.2	1.8	AA3
IOIP Capital Management (IOI Properties)	MYR	1.5	0.75	0.75	Not Rated
Khazanah (Danga Capital)	Multi	10	MYR4b/SGD0.9b		AAA
Khazanah (Rantau Abang Capital)	MYR	7	6	1	AAA
Khazanah (SRI Sukuk)	MYR	1	0.1	0.9	AAA
Kuveyt Turk (KT Kira)	MYR	2	0.8	1.2	AA3
Malaysia Building Society	MYR	3	2.955	0.045	AA1
Malaysian Re	MYR	0.25	0.001	0.249	AA3
Maxis Bhd	MYR	5	0.84	4.16	NR
Maybank (B3 AT1)	MYR	10	3.5	6.5	AA3
Maybank (Perp Senior MTN)	MYR	10	0.22	9.78	AAA
Maybank Islamic (Subdebt)	MYR	10	1.5	8.5	AA1
Midciti Sukuk Berhad	MYR	3	1.555	1.445	AAA
MMC Corporation Bhd	MYR	1.5	1.2	0.3	AA-
Mudajaya Corporation Berhad (CP/MTN)	MYR	1	0.36	0.64	AA3
Northport (Malaysia) Bhd (Sukuk Musharakah)	MYR	1.5	0.35	1.15	AA-
Pengurusan Air SPV Bhd (PASB)	MYR	20	12.21	7.79	GG
Petronas Dagangan	MYR	2		2	AAA
Point Zone (M) Sdn Bhd (KPJ)	MYR	1.5	0.8	0.7	NR
Prasarana (GG)	MYR	5	0.745	4.255	GG
Public Bank (Senior MTN)	MYR	5	1.4	3.6	AAA
Public Bank (Tier-2 Subordinated MTN)	MYR	10	1.95	8.05	AA1
Putrajaya Holdings Sdn Bhd	MYR	3	2.5	0.5	AAA
Sabah Credit Corporation (ICP & IMTN)	MYR	1.5	0.85	0.65	AA1
SapuraKencana (Multi-Currency Islamic MTN)	Multi	7	0.86	6.14	NR
Sarawak Energy Bhd	MYR	15	8.5	6.5	AA1
Scientex Bhd	MYR	0.5			Not Rated
SME Bank (Sukuk)	MYR	3	1.5	1.5	GG
Telekom Malaysia Bhd (ICP/IMTN)	MYR	3	2	1	AAA
Temasek Eksklusif Sdn Bhd (Gamuda CG)	MYR	1	0.5	0.5	AA3
TF Varlik Kiralama	MYR	3	1.16	1.84	AA3
Toyota Capital (CP/MTN)	MYR	2.5			AAA
TSH Sukuk Murabahah	MYR	0.15			AA-
UMW Holdings Bhd (Sukuk Musharakah)	MYR	2	0.44	1.56	AAA
WCT Holdings Bhd	MYR	1.5	0.6	0.9	AA-

Source: Various newspapers, online news articles, market talk  
 \* Maybank-IB's estimates

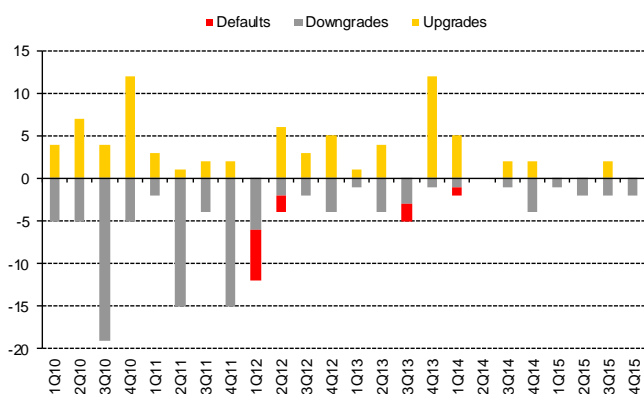
PDS: Credit Condition

4Q15 credit condition turned negative bias, with 2 downgrades and 2 outlook decreases. Alam Maritim Resources Bhd’s rating was cut to A/stable from A+ by MARC, citing weaker business profile as an OSV player. The rating agency had placed a negative outlook on the rating in its last review in Jan 2015. MARC also downgraded Tesco Stores (Malaysia)’s rating to AA- from AA and kept a negative outlook. But the rating action is premised on the weakening business and financial profiles of UK-based parent Tesco PLC and does not reflect credit condition in Malaysia.

WCT Holdings Bhd’s outlook was lowered to negative by MARC as credit metrics have deteriorated, especially gearing which stayed above 1.0x and negative operating cash flow for a third consecutive year. The outlook on UMW Holdings Bhd AAA rating was also revised to negative by RAM as it does not expect UMW’s weaker operating performance and financial profile to recover to previous levels in the near term. These negative outlooks coupled with another 4 earlier in the year, point to weaker credit fundamentals in the property, commodities and automotive sectors going into 2016.

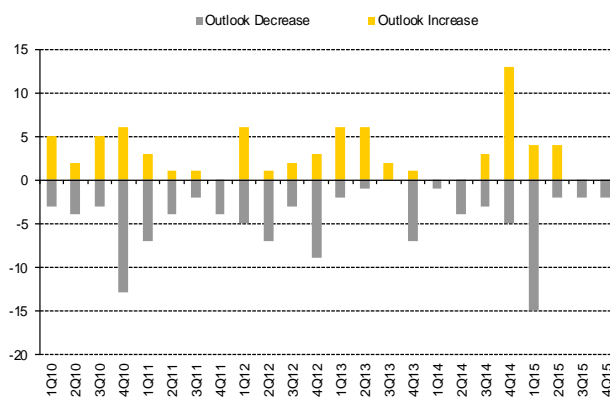
2016: We expect the broad credit environment to remain stable, but with risks of seeing a moderate increase in negative outlooks/downgrades. Overall, we expect credit spreads to stay broadly stable with volatility risks out of the MGS movements outweighing the risk of sharp widening in credit spreads. That said, investors may turn increasingly discerning on fundamentals and this could result in a more apparent divide in credit spread performance where strong names continue to receive strong support, but weaker credits may be penalised with widening risks.

Figure 35: Rating Upgrades vs Downgrades



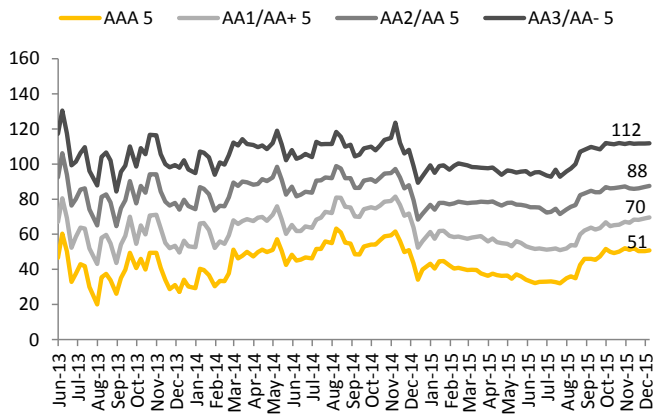
Sources: RAM, MARC, Maybank-IB  
 \*For years 2010-2011, defaults were classified as downgrades  
 \* 4Q15 is from 1 Oct to 10 Dec

Figure 36: Rating Outlook Revisions



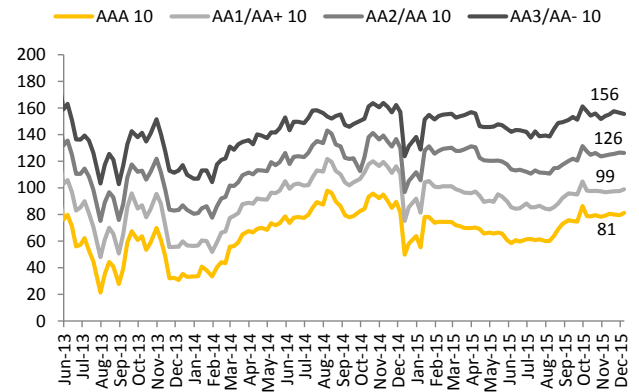
Sources: RAM, MARC, Maybank-IB  
 \* 4Q15 is from 1 Oct to 10 Dec

Figure 37: Credit Spread - 5 years



Sources: BNM Indicative, CEIC, Maybank-IB  
\*As at 7 Dec 2015

Figure 38: Credit Spread - 10 years



Sources: BNM Indicative, CEIC, Maybank-IB  
\*As at 7 Dec 2015

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