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Global bond index exit risk spooks ringgit, shares

Analyst says currency's weakness transitory, funds may focus on Malaysia's accommodative monetary policy and robust economic fundamentals

BY **EE ANN NEE**
sunbiz@thesundaily.com

PETALING JAYA: The ringgit weakened as much as 0.36% yesterday to 4.1455 against the US dollar on fears over the possibility that Malaysia may be dropped from the FTSE World Government Bond Index (WGBI).

As at 5pm, the local unit was trading 0.15% lower at 4.1365 against the greenback. Over the past two trading days, it has depreciated 0.66%.

Meanwhile, on Bursa Malaysia, the FBM KLCI fell 8.56 points or 0.53% to 1,620.90 points against Tuesday's close of 1,629.46. Market breadth was negative with 661 losers and 208 gainers.

Top losers were led by heavyweights such as Tenaga Nasional, Malayan Banking and Petronas Dagangan, which slipped 24 sen, 21 sen and 16 sen to RM12.06, RM9 and RM24.94, respectively.

On Monday, FTSE Russell said it may drop Malaysian debt from the WGBI due to concern about market liquidity.

Malaysia is currently assigned a '2' on the WGBI and is being considered for a potential downgrade to '1' which will render Malaysia ineligible for inclusion in the WGBI.

The review is due in September, which includes potentially adding Chinese bonds into the index. It was reported that the review started in January to increase transparency in managing country inclusion to FTSE Russell global fixed-income indices. Malaysia's weight in the WGBI is less than 0.4%.

FXTM's newly appointed market analyst Tan Chung Han expects the weakness in the ringgit to be transitory, as Malaysia's resilient economy is still awaiting the next chance to make its case before the markets.

"The projected 4.3-4.8% GDP growth for 2019 remains higher compared to what many other major economies are expecting this year. However, sentiment surrounding the Malaysian currency is currently swayed by other factors which have led to the ringgit's recent weakness against the US dollar, including external risks such as US-China trade tensions and slowing global growth," he told *SunBiz*.

He said headlines about Malaysia's possible removal from the index may have lent itself to fund outflows, contributing to the ringgit's recent weakness.

"Even if it actually transpires (Malaysia's removal from WGBI), active funds may still focus on Malaysia's accommodative monetary policy stance and robust domestic economic fundamentals when making their investment decisions," Tan added.

However, Tan pointed out that according to central bank data, foreign holdings of Malaysian bonds rose during the first quarter of 2019, pointing to an increasing appetite for Malaysian notes.

Bank Islam chief economist Dr Mohd Afzanizam Abdul Rashid said the ringgit's weakness is a valid concern considering that Malaysia Government Securities (MGS) yields have come down quite considerably when the US Federal Reserve is expected to keep interest rates unchanged in 2019.

"If exclusion materialises, theoretically we could expect some impact on bond yields, especially by managers who track the FTSE index as their benchmark," he said.

Reuters quoted Morgan Stanley as saying that Malaysia could see outflows of almost US$8 billion (RM33 billion) if its bonds are downgraded by global index provider FTSE Russell.

Foreign investors have been reducing their Malaysian government bond holdings since late 2016 and, as of late March 2019, held US$37 billion, Morgan Stanley said.

Macquarie said as foreigners are already underweight on MGS in Malaysia, the outflows may be less.

"However, the implication would be larger for other index providers such as the JP GBI-EM and Bloomberg Barclays Aggregate. Just these two indexes alone could represent US$15 billion of outflows if Malaysia is excluded," it said in its sales commentary.

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