MGS Decoupled from the UST as Selloff in the UST Intensified

FIXED INCOME REVIEW: May-25

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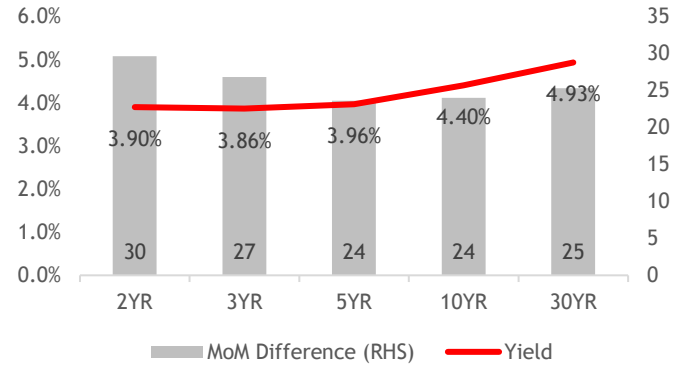


- UST yield curve shifted higher last month. The US Treasury (UST) yield curve shifted notably higher across all tenures, reflecting growing concerns over the US credit performance. Sentiment weakened following Moody's downgrade of the US sovereign rating, which raised doubt about the nation's fiscal sustainability. The situation was further compounded by the US House passing President Donald Trump's tax and spending bill.
- The MGS yield curve shifted lower on the back of higher foreign inflows into the MGS market. The MGS yield curve shifted lower last month, indicating a decoupling from the movement in the UST yields, with MGS yields declined across all tenor between the 3-year to the 30-year space. The biggest decline was seen at the belly of the curve as the 7-year MGS yield declined by -15bps to 3.40%.
- We now expect the 10-year MGS to move towards 3.50% target by year end. We update our forecast for 10-year MGS, now expecting the yield to move towards 3.50% by year-end 2025 (previous forecast: 3.60%).
- Foreign holdings of Malaysian bonds increased in May-25. Foreign holding of Malaysian debt securities increased in May-25, with foreign holdings of Malaysian bonds rising +RM13.4b to new high of RM302.1b (Apr-25: RM288.6b).

US Treasury

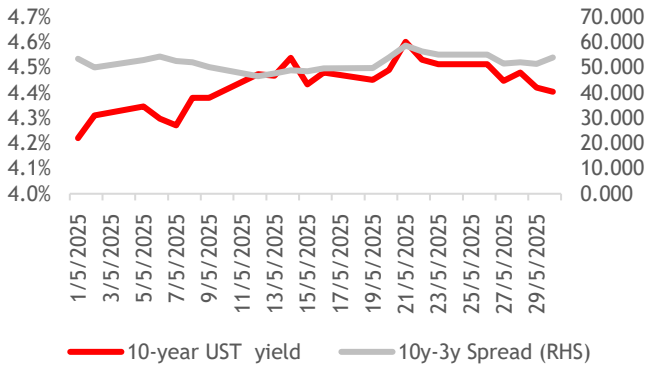
UST yield curve shifted higher last month. The US Treasury (UST) yield curve shifted notably higher across all tenures, reflecting growing concerns over the US credit performance. Sentiment weakened following Moody's downgrade of the US sovereign rating, which raised doubt about the nation's fiscal sustainability. The situation was further compounded by the US House passing President Donald Trump's tax and spending bill. The Congressional Budget Office (CBO) estimated that the legislation could add on an additional USD2t to the US national debt over the next decade. The combined effect of the rating downgrade and the projected surge in national debt has pushed bond yields higher and increased borrowing costs. This has left investors uncertain about the US long-term credit outlook, consequently triggering a sell-off in the UST market as investors sought better returns. Meanwhile, the Fed Jerome Powell has maintained a hawkish stance, warning that tariffs could lead to more persistent price increases. On the trade front, some positive progress from trade negotiations offered a glimmer of hope, easing the risk of significantly higher unemployment and elevated inflation. Despite this, market expectations for the fed funds rate path have shifted lower, with analysts now anticipating only one to two rate cuts for the year (beginning in Oct-25), a reduction from three cuts projected back in Apr-25.

Chart 1: UST Yields and MoM Difference (bps) end-May-25



Source: Macrobond, MIDFR

Chart 2: 10y UST Yield vs 10y-3y Yield Spread (bps) in May-25



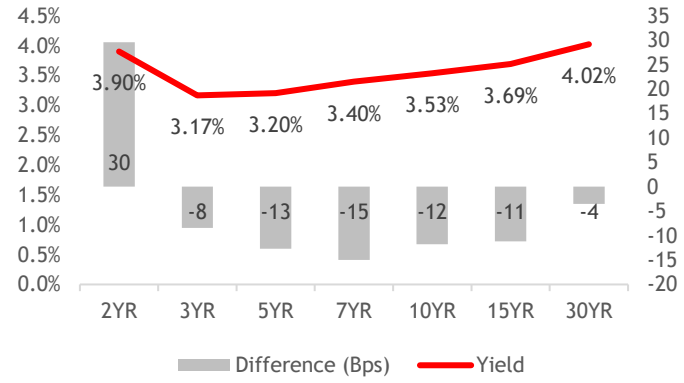
Source: Macrobond, MIDFR

UST yields may continue to move higher in the short run. The U.S. credit downgrade by Moody's, reflecting the weak expectation about the nation's fiscal trajectory, immediately translated into higher Treasury yields. This has led to the expectation that the US debt would increase to around 134% of GDP by 2035, which may lead to concerns that interest on debt payment to increase. In turn, Moody's estimated that the interest on debt to grow to 30% of the government budget (2025: 13.0%). As a result, market participants asked for higher yields for lending amidst concerns about the long-term debt sustainability. In addition, we acknowledge the persistent trade disputes and the imposition of tariffs on goods also caused concerns regarding a potential deceleration in the US economic growth and higher inflationary pressures. However, President Donald Trump's 90-day pause on reciprocal tariffs offers a potentially positive development that could lead to lower price pressures than previously anticipated. Consequently, we believe investors might adopt a risk-on approach in the short term, at least during this pause. Meanwhile, we recognise the recent rate pause and the willingness of China and the US to negotiate as a positive development for the global economic outlook. However, we remain attentive to the enduring inflationary pressures within the US. Changing government policies could exacerbate these pressures and a resilient labour market may present further challenges to the Fed in deciding for additional rate cuts. As sentiment improves, investors may become less cautious and shift capital from US treasuries to the equity market, which may support higher yields. However, the Fed is still expected to continue its rate cut path, albeit at a more delayed timeframe, with the first rate cut to be in Oct-25 and the second cut to be in Dec-25. Our baseline scenario anticipates the resumption of monetary easing in the 2HCY25, which will result in lower UST yields.

Malaysian Government Bonds

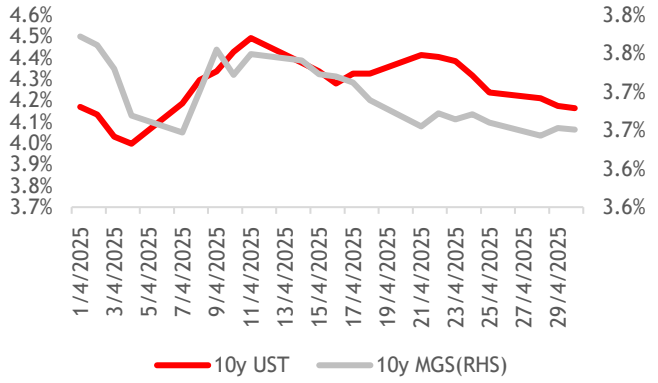
The MGS yield curve shifted lower on the back of higher foreign inflows into the MGS market. The MGS yield curve shifted lower last month, indicating a decoupling from the movement in the UST yields, with MGS yields declined across all tenor between the 3-year to the 30-year space. The biggest decline was seen at the belly of the curve as the 7-year MGS yield declined by -15bps to 3.40%. The 3-year yield moved lower to 3.17% in May-25, declining by -8bps, while the 10-year yield decreased by -12bps to 3.53%. The 10-year MGS was rather volatile within a tight range of 3.53% to 3.66%, throughout the month, but averaged the month lower at 3.59% (Apr-25: 3.69%). The decline of the MGS yield was also supported by the high inflows of foreign money into the domestic bond market, which led to the compression of the yield curve, on the back of the renewed interest towards the MGS market, notably due to the expectations of domestic factors such as OPR and inflation. However, the MGS market outlook remains tied to the global financial market dynamics, even though the volatility in the UST market had limited impact on the MGS last month. The MOVE Index continued to remain elevated, indicating the high volatility in the UST market since the US reciprocal tariff announcement, the fluid development from the changing trade policy and recently heightened concerns on the US credit outlook. On the back of foreign fund inflows, positive net issuance and slightly lower yields, the volume of government bonds traded declined to RM165.2b in May-25 (Apr-25: RM190.3b). In addition, the top 10 traded government bonds accounted for a slightly lower share of 58.7% (Apr-25: 60.5%) of total government bonds traded last month.

Chart 3: MGS Yield Curve and MoM Difference (bps) as at end-May-25



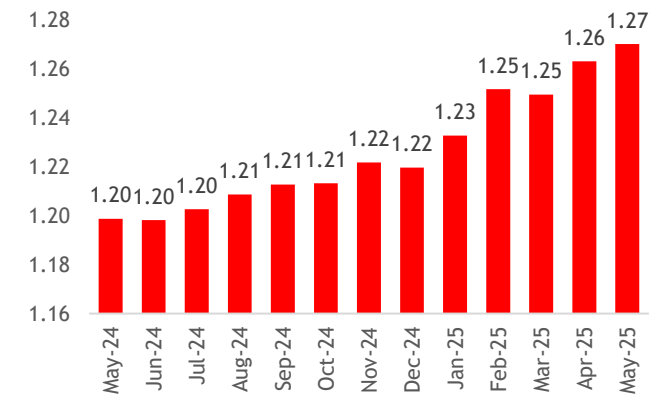
Source: Bloomberg, MIDFR

Chart 4: 10y MGS vs 10y UST Yields (%) in May-25



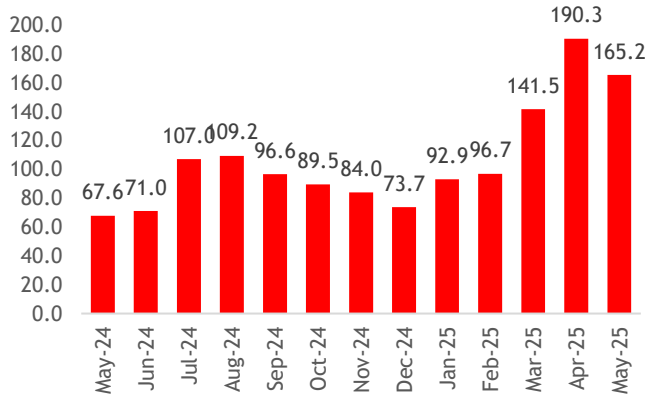
Source: Bloomberg, MIDFR

Chart 5: Outstanding Government Bonds (RM t)



Source: Bondstream, MIDFR

Chart 6: Volume of Government Bonds Traded (RM b)



Source: Bondstream, MIDFR

Lower new MGS/GII issuance in May-25. Gross issuance of MGS/GII was lower at RM8.0b in May-25 (Apr-25: RM13.0b), with RM2.0b additional issuance (Apr-25: RM3.0b), from 2 issuances. Auction demand was relatively lower, with an average BTC of 2.72x (Apr-25: 2.84x), which was dragged lower due to the weak demand of the 5-year auction with a BTC of 2.13x issuance. Meanwhile, the value of outstanding government bonds remained around RM1.27t at end-May-25. The volume of government bonds traded in May-25 was also lower at RM165.2b (Apr-25: 190.3b), being the second highest in the past 12-months period.

We now expect the 10-year MGS to move towards 3.50% target by year end. We update our forecast for 10-year MGS, now expecting the yield to move towards 3.50% by year-end 2025 (previous forecast: 3.60%). This revised projection is primarily driven by the currently compressed spread between MGS and Overnight Policy Rate (OPR) which reached +52bps versus a 2015-2025 average of +98 bps, reflecting prevailing market expectations for a potential OPR rate cut. We anticipate a near-term shift of capital flows into the MGS market, further supported by growing concerns over the US fiscal outlook, which could divert capital away from the UST market. Concurrently, Malaysia's sustained fiscal consolidation efforts, in line with its commitment to improve its fiscal position—highlighted by the recent decision to expand the Sales and Service Tax (SST) coverage effective from Jul-25—will further enhance investor confidence and attract more inflows into the MGS market. Additionally, we still foresee the narrowing interest rate differential between the Federal Funds Rate (FFR) and the OPR as a continuing key factor influencing this outlook. While Fed is expected to cut interest rates, we maintain our view that OPR will be kept unchanged at existing normal level. On another note, on the back of stable and manageable inflation, Malaysia's growth fundamentals also remained robust especially on the domestic front, despite concerns over the impact of higher tariffs and potentially weaker external demand. Still, risks exist. Delayed Fed rate cuts, a persistently strong U.S. dollar, and renewed inflationary pressures could sustain current MGS yield levels, especially in the short term. Conversely, futures market trends indicate global investors now expect a slower pace

of Fed rate cuts—only two this year, starting in Oct-25 but unclear for Dec-25. This suggests potential downward pressure on UST yields, which would likely translate to lower MGS yields, aligning with our end-2025 forecast. Close monitoring of these factors is crucial for the Malaysian debt market outlook.

Table 1: Quarterly Forecast for MYR and MGS 10-year yield

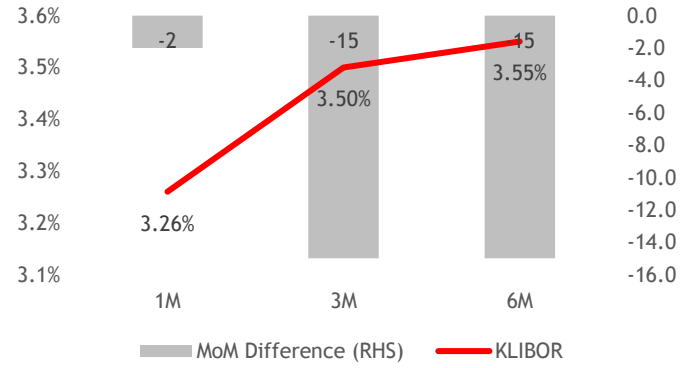
	1Q25	2Q25f	3Q25f	4Q25f
Exchange Rate, vs USD (average)	4.44	4.32	4.19	4.08
Exchange Rate, vs USD (end-period)	4.43	4.38	4.29	4.25
10Y Government Bond Yield (average)	3.79	3.57	3.51	3.50
10Y Government Bond Yield (end-period)	3.77	3.55	3.52	3.50

Source: MIDFR

Interbank Money Market

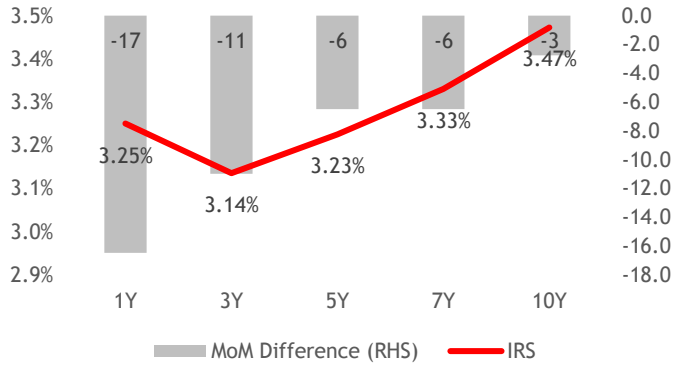
KLIBOR came down in May-25. The KLIBOR interbank rate for the 1m, 3m, and 6m declined by -2bps, -15bps, and -15bps to 3.26%, 3.50%, and 3.55%, respectively. Meanwhile, the May-25 IRS market was also lower across the board, where the 1-year, 3-year, 5-year, 7-year, and 10-year durations all declined by -17bps, -11bps, -6bps, -6bps, and -3bps respectively. The decline in the IRS rates also reflects a similar movement to the MGS yields.

Chart 7: KLIBOR and MOM Difference (bps)



Source: Macrobond, MIDFR

Chart 8: IRS and MOM Difference (bps)



Source: Macrobond, MIDFR

Corporate Bonds

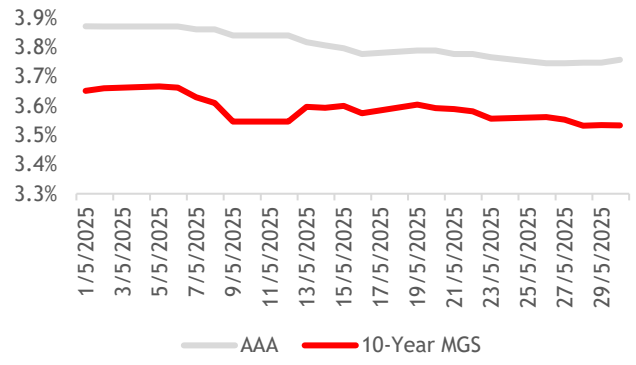
Higher volume of corporate bonds traded. The volume of traded corporate bonds was higher at RM20.5b in May-25 (Apr-25: RM18.5b), more than average RM15.4b a month in 2024. Like MGS, corporate bonds rallied last month with yields for rated securities broad declined, especially in the BBB1 space for the 2-year and above tenor falling by up to -80bps in the 10-year space. Within the non-rated securities, the yields also moved mostly lower, with the 5-year yield declining the most by -64bps to 5.975%.

Table 2: Corporate Bond Yield and MOM Yield Change as at End-May-25

	1Y	2Y	3Y	5Y	7Y	10Y
AAA	3.631	3.677	3.731	3.815	3.908	3.981
AA1	3.691	3.747	3.801	3.885	3.967	4.088
A1	4.342	4.549	4.73	4.999	5.29	5.65
BBB1	5.746	6.31	6.859	7.518	8.283	9.188
Non-rated	5.475	6.343	5.338	5.975	5.432	5.972
MOM Difference (bps)						
AAA	-10	-12	-14	-19	-23	-22
AA1	-12	-14	-16	-19	-22	-27
A1	-30	-38	-44	-54	-67	-78
BBB1	-28	-34	-43	-48	-66	-80
Non-rated	+130	-45	+18	-64	-10	-26

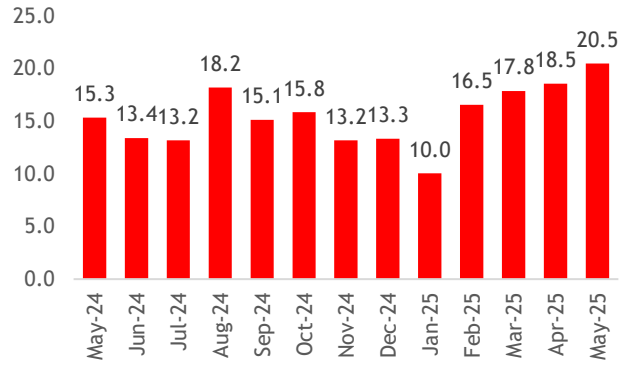
Source: Bondstream, MIDFR

Chart 9: 10-Year AAA vs 10-Year MGS Yields (%)



Source: Macrobond, MIDFR

Chart 10: Volume of Corporate Bond Traded (RM b)



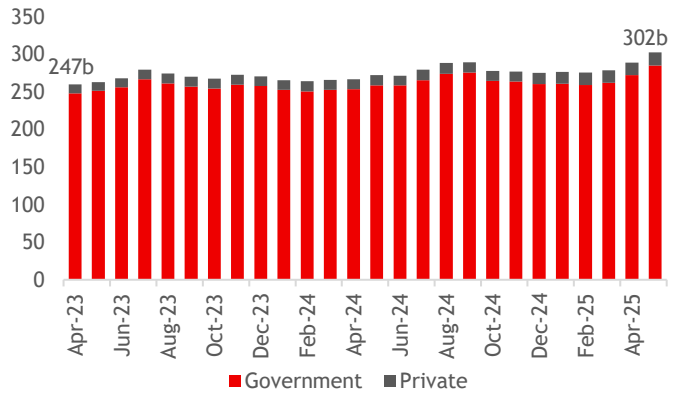
Source: Macrobond, MIDFR

Corporate bond yields moved lower, mirroring govvies. Market expectations shifted lower in May-25, as the government debt securities yields tracked lower on the back of foreign inflows into the debt market. Therefore, with MGS yields expected to fall, we predict a similar downward trend for Malaysian corporate bond yields this year. In May-25 saw a notable shift in market expectations, leading to lower government debt security yields in Malaysia. Our analysis confirms a strong, consistent link between corporate bond yields and MGS yield movements. Therefore, as MGS yields are expected to fall, we project a similar downward trend for Malaysian corporate bond yields throughout the year. This anticipated decline is likely to be bolstered by the projected return of foreign capital to the local debt market. Improved liquidity, especially in the 2HCY25, is highly probable as the US Fed is set to continue easing its monetary policy. However, several upside risks could keep MGS yields elevated for an extended period. These include renewed inflationary pressures stemming from more robust US economy. Additionally, recent policy changes by the Trump administration have already contributed to a rise in US treasury yields, exacerbated by concerns over long-term US creditworthiness. Concurrently, market sentiment points to expectations of a weaker medium-term economic outlook. This, combined with a potential decline in the global growth outlook, presents a significant downside risk to our current yield projections. Close monitoring of these international and domestic factors will be crucial for assessing the future trajectory of Malaysian debt yields.

Foreign Holdings of Malaysian Bonds

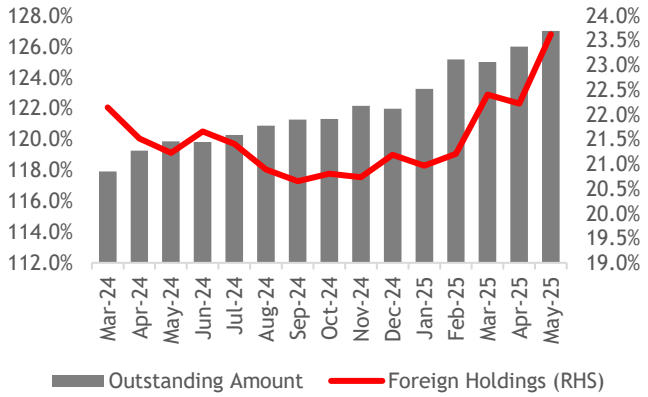
Foreign holdings of Malaysian bonds increased in May-25. Foreign holding of Malaysian debt securities increased in May-25, with foreign holdings of Malaysian bonds rising +RM13.4b to new high of RM302.1b (Apr-25: RM288.6b). The latest reading in May-25 was also higher than RM288.6b recorded in Feb-24. As a result, we estimated that the ratio of foreign holdings out of the total outstanding government bonds including both MGS and sukuk, increased to 23.6% (Apr-25: 22.2%), turning slightly above the pre-pandemic level, for the first time at least since Mar-24 (2019 average: 23.1%) and higher than 21.5% a year ago.

Chart 11: Foreign Holdings of Malaysian Bonds (RM b)



Source: Macrobond, MIDFR

Chart 12: Share of Foreign Holdings of MGS/GII



Source: Macrobond, MIDFR

APPENDICES

Table 4: MGS/GII Auctions Calendar

Tender Date	Issues	Quarter	Month	Issue Date	Issuance (RM million)	Private Placement (RM million)	BTC (Times)
8/1/2025	7-yr Reopening of MGS 07/32 3.582%	1QCY25	January	8/1/2025	5,000.00		2.80
15/1/2025	15.5-yr New Issue of MGII (Mat on 07/40)	1QCY25	January	15/1/2025	3,000.00	1,000.00	4.28
24/1/2025	3-yr Reopening of MGII 07/28 3.599%	1QCY25	January	24/1/2025	5,500.00		2.62
6/2/2025	30-yr Reopening of MGS 03/53 4.457%	1QCY25	February	6/2/2025	2,500.00	2,000.00	2.36
13/2/2025	7-yr Reopening of MGII 10/31 3.804%	1QCY25	February	13/2/2025	5,000.00		2.86
21/2/2025	20-yr Reopening of MGS 05/44 4.180%	1QCY25	February	21/02/2025	2,500.00	2,000.00	2.99
28/02/2025	5.5-yr New Issue of MGII (Mat on 08/30)	1QCY25	February	28/02/2025	5,500.00		3.16
10/03/2025	15-yr Reopening of MGS 04/39 4.054%	1QCY25	March	10/03/2025	3,000.00	1,000.00	3.02
14/03/2025	30-yr Reopening of MGII 03/54 4.280%	1QCY25	March	14/03/2025	3,000.00	2,000.00	3.08
28/03/2025	10-yr Reopening of MGS 07/34 3.828%	1QCY25	March	28/03/2025	5,000.00		1.67
08/04/2025	15-year Reopening of MGII 07/40	2QCY25	April	08/04/2025	3,000.00	1,000.00	2.89
15/04/2025	3-year Reopening of MGS 04/28	2QCY25	April	15/04/2025	5,000.00	-	3.46
30/04/2025	10-year New Issue of MGII 05/30	2QCY25	April	30/04/2025	5,000.00	-	2.00
14/05/2025	5-year New issue of MGS 04/35	2QCY25	May	15/05/2025	5,000.00		2.13
23/05/2025	20-year New issue of MGII 05/45	2QCY25	May	30/05/2025	3,000.00	2,000.00	3.32
10/06/2025	15-year Reopening of MGS 04/39	2QCY25	June	10/06/2025	3,000.00		2.86

Table 5: Top Traded Government Bonds

Stock Name	Traded amount (RM m)
MGS 1/2015 3.955% 15.09.2025	2188.17
MGS 1/2015 3.955% 15.09.2025	2164.72
MGS 1/2015 3.955% 15.09.2025	1733.56
MGS 1/2015 3.955% 15.09.2025	1723.54
MGS 1/2015 3.955% 15.09.2025	1363.19
MGS 1/2015 3.955% 15.09.2025	1312.3
MGS 1/2015 3.955% 15.09.2025	1252.76
MGS 1/2015 3.955% 15.09.2025	1252.4
MGS 1/2015 3.955% 15.09.2025	1249.78
MGS 1/2015 3.955% 15.09.2025	1238.48
Total	15478.9

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