MGS Swayed by Rate Cut Expectations, While the UST Moved Lower

FIXED INCOME REVIEW: Jun-25



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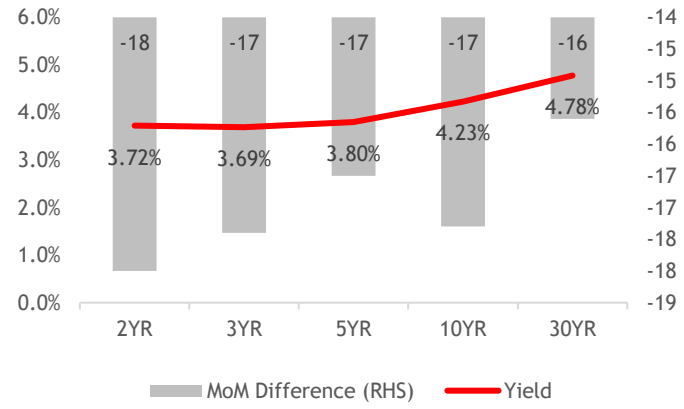
- UST yield curve shifted lower last month. The US Treasury (UST) yield curve shifted lower across all tenures, after the yields increased and peaked around mid-Jun-25 before moderating lower towards the end of the month.
- The MGS yield curve shifted lower on the back of OPR rate cut bets. The MGS yield curve shifted lower last month, tracking the movement in the UST yields, with the MGS declined across all tenor except for the 7-year yield, which did not move.
- We continue to expect the 10-year MGS to end the year around 3.50%. We recently updated our forecast for 10-year MGS, now expecting the yield to end the year at 3.50% for 2025.
- Foreign holdings of Malaysian bonds declined in Jun-25. Foreign holdings of Malaysian debt securities eased slightly in Jun-25, with foreign holdings of Malaysian bonds declining by -RM5.4b to RM296.6b (May-25: 302.1b).

US Treasury

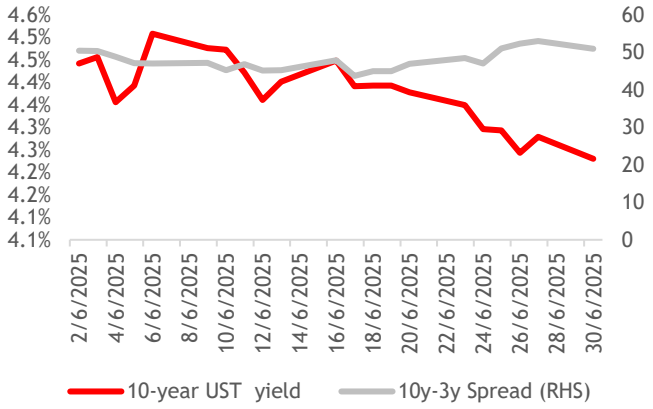
UST yield curve shifted lower last month. The US Treasury (UST) yield curve shifted lower across all tenures, after the yields increased and peaked around mid-Jun-25 before moderating lower towards the end of the month. In early Jun-25, the UST yield curve moved higher as investors adopted a risk-on mode after a US trade court ruled the Trump administration's sweeping tariffs illegal, citing the US President had overstepped his authority under the Emergency Powers Act. This initially raised expectations for better-than-expected growth trajectory, which were later revised because sentiment turned negative due to the escalating tensions in the Middle East between Israel and Iran. In addition to the heightened volatility in global financial markets, the shift towards safe-haven assets caused the UST to rally. However, the rally eased towards the end of the month as the geopolitical uncertainty subsided following a ceasefire and the emergence of trade deals between the US with China and India. Meanwhile, the Federal Reserve left the fed funds rate (FFR) target range unchanged at 4.25-4.50% but continued to signal a stagflation risk. The FOMC lowered its growth forecast and projected higher inflation and a slower rate cut for 2026 and 2027. However, nearing to the potential date of the rate cuts, the UST yields has been rallying lower as markets expectation for the fed funds rate path to have shifted lower, with analyst now anticipating only one to two rate cuts for the year (beginning in Oct-25), slower than three cuts projected back in Apr-25.

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



Source: Macrobond, MIDFR

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



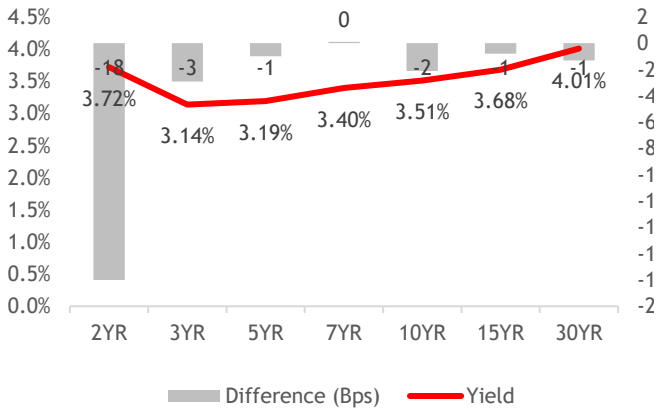
Source: Macrobond, MIDFR

UST yields may continue to move slightly higher in the medium term. As the US credit downgrade by Moody's continues to have its brunt on bond investors seeking long-term safe assets. The "Big Beautiful Bill" will cause further concerns on the US debt market, which is expected to add USD3.3t and the concern of swelling of debt. The US debt could increase to estimate around +134% of GDP by 2035, which may lead to even heightened concerns that interest on debt payment will increase further. 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 extension to Aug-25 on reciprocal tariffs offers a potentially positive development that could lead to lower price pressures than previously anticipated, based on the indication of a potential lower rate for trade deals. Consequently, we believe investors might adopt a risk-on approach in the short term, at least during this pause. 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 on 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

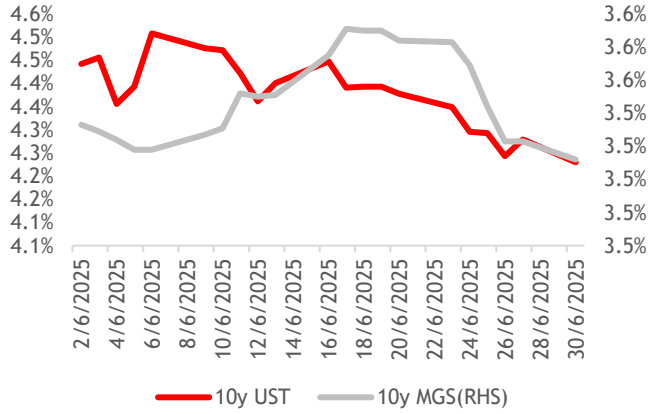
The MGS yield curve shifted lower on the back of OPR rate cut bets. The MGS yield curve shifted lower last month, tracking the movement in the UST yields, with the MGS declined across all tenor except for the 7-year yield, which did not move. The biggest decline was seen at the 2-year yield which moved lower by -18bps to 3.72% in Jun-25, while the 10-year yield declined by -2bps to 3.51%. The 10-year MGS was rather volatile between the 3.51% to 3.59% range, throughout the month, but averaged the month lower at 3.548% (May-25: 3.59%). Foreign money into the MGS market eased last month after the high inflows into the domestic bond market. The decline in the MGS yield curve last month was also driven by the market expectation for an OPR rate cut for the Jul-25 meeting and the weaker-than-expected inflation report. 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, as the movement in the MGS market was driven by domestic factors. The MOVE Index has slightly eased in Jun-25 compared to the May-25 level, indicating a lower volatility in the UST market as the eased in geopolitical uncertainty. On the back of foreign fund inflows, positive net issuance and slightly lower yields, the volume of government bonds traded declined to RM119.2b in Jun-25 (May-25: RM165.2b). In addition, the top 10 traded government bonds accounted for a slightly higher share of 61.3% (May-25: 58.7%) of total government bonds traded last month.

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



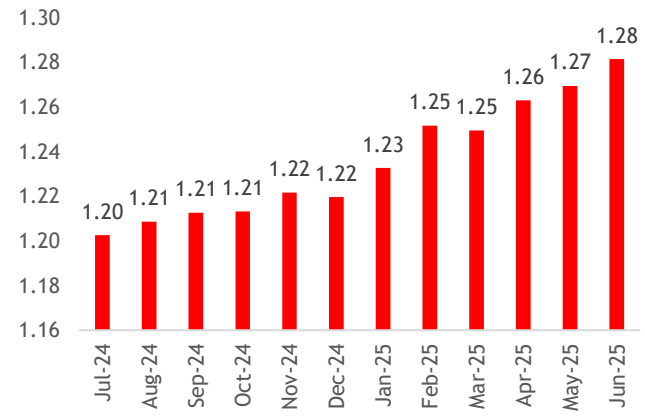
Source: Bloomberg, MIDFR

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



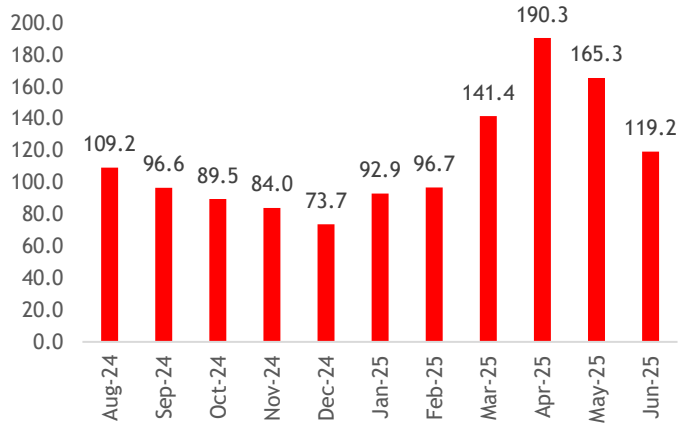
Source: Bloomberg, MIDFR

Chart 5: Outstanding Government Bonds (RM t)



Source: Bondstream, MIDFR

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



Source: Bondstream, MIDFR

Higher new MGS/GII issuance in Jun-25. Gross issuance of MGS/GII was higher at RM11.0b in Jun-25 (May-25: RM8.0b), with RM2.0b additional issuance (May-25: RM2.0B), from 1 issuance. Auction demand was relatively higher, with an average BTC of 3.05x (May-25: 2.72x), which was pulled higher from the strong demand of the 20 and 30- year auction being above 3.0x BTC. Meanwhile, the value of outstanding government bonds moved higher to RM1.28t at the end of Jun-25. The volume of government bonds traded in Jun-25 was also lower at RM119.2 (May-25: RM165.3), being the fourth higher in the past 12-months period.

We continue to expect the 10-year MGS to end the year around 3.50%. We recently updated our forecast for 10-year MGS, now expecting the yield to end the year at 3.50% for 2025. 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 +98bps, reflecting prevailing market expectations for a potential OPR rate cut. However, the latest OPR rate cut would ease the recent compressed spreads against the OPR, normalising the spreads. Meanwhile, we anticipate a near-term reallocation of capital flows towards the MGS market. This shift is expected to be further supported by increasing concerns regarding the US fiscal outlook, which could potentially divert capital away from the UST market. The latest rate cut by BNM has caused the interest rate differential between the fed funds rate (FFR) and the OPR, however, we do not expect further OPR cuts this year, but the FFR to remain on its rate cut trajectory, causing the closing of the differential to be further delayed. We still foresee the narrowing interest rate differential between the FFR and the OPR as a continuing key factor influencing this outlook.

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 in Jul-25—will further enhance investor confidence and attract more inflows into the MGS market. On another note, supported by stable and manageable inflation, Malaysia's growth fundamentals remain robust, particularly on the domestic front, despite concerns over the impact of higher tariffs and potentially weaker external demand. Still, risks persist. Delayed Federal Reserve rate cuts, a persistently strong US 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, commencing in Oct-25 but with uncertainty for Dec-25. This suggests potential downward pressure on UST yields, which would likely translate to lower MGS yield, but signs of MGS yield decoupling from the UST, the influence may be limited. Close monitoring of these factors is crucial for the Malaysian debt market outlook."

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

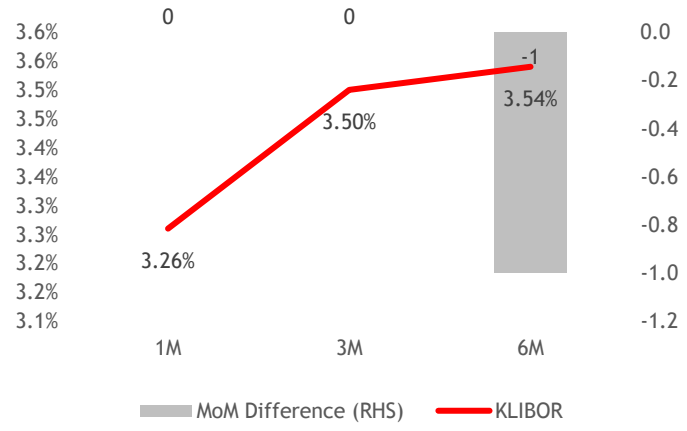
	1Q25	2Q25f	3Q25f	4Q25f
Exchange Rate, vs USD (average)	4.44	4.32	4.19	4.08
Exchange Rate, vs USD (end-period)	4.43	4.38	4.29	4.25
10Y Government Bond Yield (average)	3.79	3.57	3.51	3.50
10Y Government Bond Yield (end-period)	3.77	3.55	3.52	3.50

Source: MIDFR

Interbank Money Market

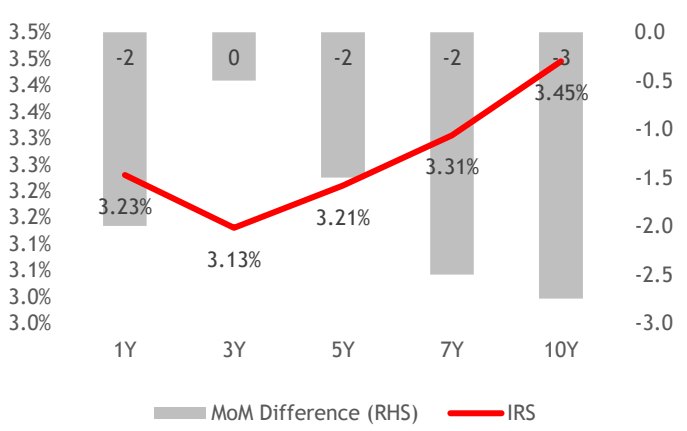
KLIBOR eased slightly lower in Jun-25. The KLIBOR interbank rate for the 1m and 3m was unchanged at 3.26% and 3.50%, while the 6m declined by -1bps to 3.54%, respectively. Meanwhile, the Jun-25 IRS market was also lower across the board, where the 1-year, 5-year, 7-year and 10-year declined by -2bps, -2bps, -2bps, and -3bps, respectively. Meanwhile, the 3-year IRS was unchanged at 3.13%. 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

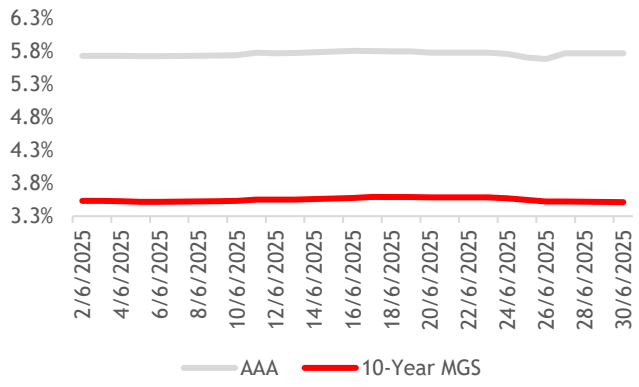
Lower volume of corporate bonds traded. The volume of traded corporate bonds was lower at RM19.9b in Jun-25 (May-25: RM20.6b), more than average of RM15.4b a month in 2024, and making the total traded in the 1HCY25 at RM103.3b. Like the MGS, corporate bonds rallied last month with yield for rated securities broad declined, especially in the medium to long end of the AAA rated falling by up to -24bps in the 10-year space. Within the non-rated securities, the yields also moved mostly lower, with the 1-year yield declining the most by -6bps to 5.711%.

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

	1Y	2Y	3Y	5Y	7Y	10Y
AAA	3.541	3.577	3.6	3.632	3.681	3.745
AA1	3.611	3.667	3.701	3.742	3.792	3.856
A1	4.292	4.5	4.712	4.98	5.224	5.573
BBB1	5.756	6.32	6.858	7.54	8.241	9.149
Non-rated	6.711	5.938	5.479	5.327	5.328	5.761
MOM Difference (bps)						
AAA	-9	-10	-13	-18	-23	-24
AA1	-8	-8	-10	-14	-18	-23
A1	-5	-5	-2	-2	-7	-8
BBB1	+1	+1	-0	+2	-4	-4
Non-rated	-6	+5	-3	-1	-0	+5

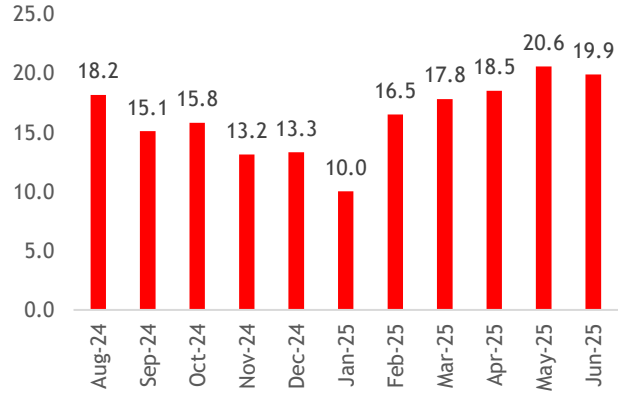
Source: Bondstream, MIDFR

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



Source: Macrobond, MIDFR

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



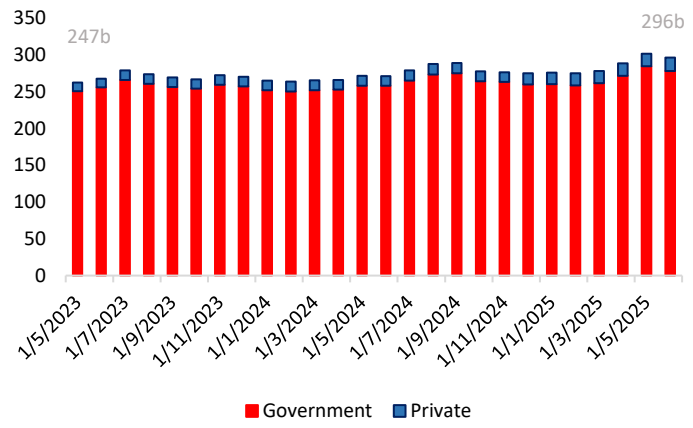
Source: Macrobond, MIDFR

Corporate bond yields tracked lower, following the MGS market. Market expectations shifted lower in Jun-25, as the government debt securities yields moved lower on the back of expectations of a rate cut in the Jul-25 meeting, despite the slowing down of foreign inflows into the debt market compared to the previous month. Therefore, given the anticipated decline in MGS yields, we project a similar downward trend for Malaysian corporate bond yields throughout the current year. This outlook is reinforced by the notable shift in market expectations observed in Jun-25, which led to a reduction in government debt security yields in Malaysia. Our internal analysis consistently demonstrates a strong and reliable correlation between the movements of corporate bond yields and MGS yields, further supporting our forecast for a synchronized decline across both segments of the Malaysian bond market. Conversely, several upside risks could lead to MGS yields remaining elevated for an extended period. These include the potential for renewed inflationary pressures originating from a more robust US economy. Furthermore, recent policy shifts by the Trump administration have already contributed to an increase in US Treasury yields, a trend exacerbated by broader concerns regarding long-term US creditworthiness. While market sentiment currently suggests a weaker medium-term economic outlook, this, coupled with a potential decline in the global growth trajectory, presents a significant downside risk to our current MGS yield projections. Therefore, diligent monitoring of these international and domestic factors will be paramount for accurately assessing the future path of Malaysian debt yields.

Foreign Holdings of Malaysian Bonds

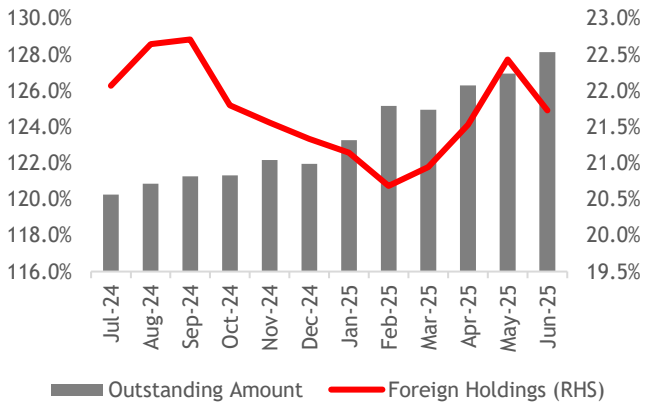
Foreign holdings of Malaysian bonds declined in Jun-25. Foreign holdings of Malaysian debt securities eased slightly in Jun-25, with foreign holdings of Malaysian bonds declining by -RM5.4b to RM296.6b (May-25: 302.1b). The latest reading in Jun-25 was still high and the second highest on record after the highest level reached last month. As a result, we estimate that the ratio of foreign holdings out of the total outstanding government bonds, including both MGS and sukuk, declined to 21.7% (May-25: 22.4%), below the pre-pandemic level (2018 average: 23.1%) and higher than 22.1% 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
16/06/2025	30-year Reopening of MGII 03/54	3QCY25	June	16/06/2025	3,000.00	2,000.00	3.30
30/06/2025	10-year New Issue of MGS 07/35	3QCY25	June	30/06/2025	5,000.00		3.01
04/07/2025	7-year Reopening of MGII 10/31	3QCY25	July	04/07/2025	5,000.00		2.92
15/07/2025	30-year New Issue of MGS 07/55	3QCY25	July	15/07/2025	3,000.00	2,000.00	-

Table 5: Top Traded Government Bonds

Stock Name	Traded amount (RM m)
MGS 1/2015 3.955% 15.09.2025	1,757.65
MGS 1/2015 3.955% 15.09.2025	1,550.52
MGS 1/2015 3.955% 15.09.2025	1,289.50
MGS 1/2015 3.955% 15.09.2025	1,253.60
MGS 1/2015 3.955% 15.09.2025	1,230.20
MGS 1/2024 4.054% 18.04.2039	1,207.03
GII MURABAHAH 3/2016 4.070% 30.09.2026	1,206.80
MGS 1/2015 3.955% 15.09.2025	1,193.43
MGS 1/2015 3.955% 15.09.2025	1,157.17
MGS 1/2015 3.955% 15.09.2025	1,041.91
Total	12,887.81

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