Nor Lyana Zainal Abidin | Economist | nlyanaz@bankislam.com.my

MONTHLY FIXED INCOME UPDATE (FEBRUARY 2025): Net Foreign Outflows amid U.S Tariff Worries

- **February saw the local bond market recorded net foreign outflow of RM1.1 billion, almost erasing the net foreign inflow of RM1.2 billion in the previous month**
- **UST yields plunged amid economic uncertainty and tariff concerns**
- **Domestic government bond yields remained relatively stable in February**
- **Both MGS and GII papers saw higher issuances in February**

February saw the local bond market recorded net foreign outflow of RM1.1billion, almost erasing the net foreign inflow of RM1.2billion in the previous month.

- Uncertainty derived from the potential US tariffs on Mexico, Canada and China led to some foreign outflows. However, strong domestic demand and the expectation of stable interest rates by Bank Negara Malaysia (BNM), kept the Malaysian government bond yield stable and limit further outflows. Overall, the accumulated total foreign holdings of Malaysia debt securities reduced slightly to RM275.2billion in February (Jan: RM276.4 billion).

- The net outflows were mainly contributed by Government Investment Issues (GII) at RM1.4 billion (Jan: +RM0.4 billion), followed by the outflows from Malaysian Government Securities (MGS) at RM0.2 billion (Jan: +RM1.6 billion) and Malaysia Treasury Bills (MTB) and Malaysia Islamic Treasury Bills (MITB) also registered net outflows of RM0.1 billion (Jan: -RM0.1 billion) and RM37.5million (Jan: -RM1.5 billion) in February. Meanwhile, corporate bonds remained on a positive territory with a net foreign inflow of RM0.6 billion (Jan: RM0.7 billion).

- With regard to composition, the share of foreign holdings to total outstanding in MGS shrank further to 33.1% (Jan: 33.7%). In addition, foreign holdings of GII and MTB contracted slightly to 8.7% (Jan: 8.9%) and 39.5% (Jan: 41.3%) in February. In contrast, the net inflows into MITB and corporate bonds expanded the share of their foreign holdings to 9.0% (Jan: 8.3%) and 1.9% (Jan: 1.8%). The foreign holdings' share of total outstanding declined to 13.2% in February (Jan: 13.3%).

- Total cumulative foreign holdings in the local bond market shrank to RM28.4 million for the first two months of 2025 but fared better relative to the cumulative net foreign outflows of RM6.3 billion from January to February 2024.

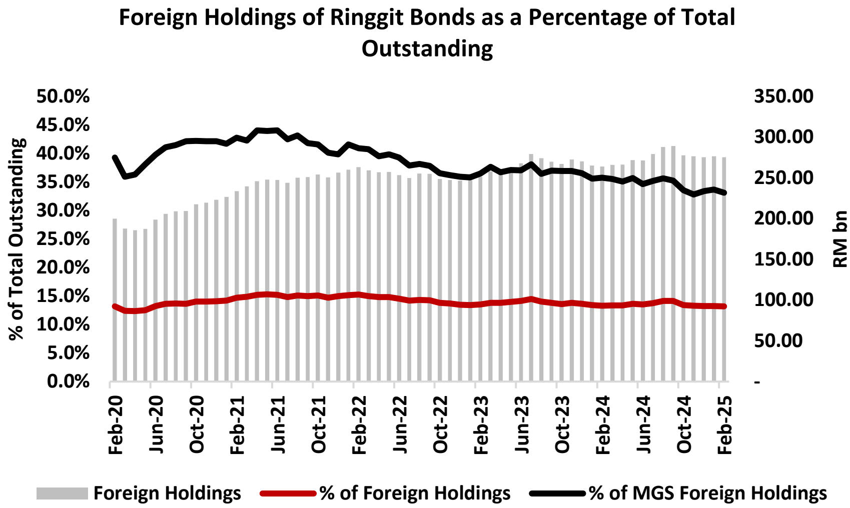
Table 1: Foreign Holdings of Malaysia Total Debt Securities

	Foreign Holdings (RM Billion)		Foreign Flows (RM billion)		Composition (%)	
	Jan-25	Feb-25	Jan-25	Feb-25	Jan-25	Feb-25
MGS	206.2	206.1	1.6	-0.2	33.7	33.1
GII	50.7	49.2	0.4	-1.4	8.9	8.7
PDS^	15.7	16.3	0.7	0.6	1.8	1.9
Others*	3.7	3.6	-1.6	-0.1	-	-
Total	**276.4**	**275.2**	**1.2**	**-1.1**	**13.3**	**13.2**

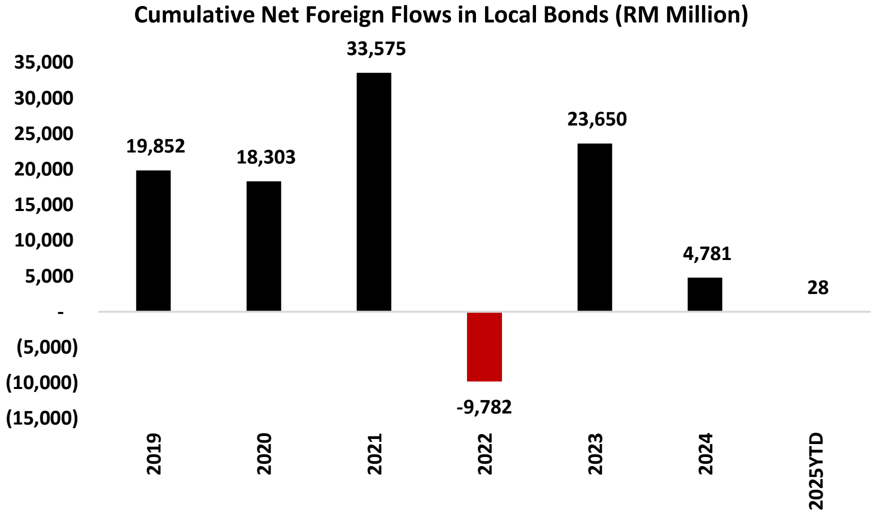
Sources: Bank Negara Malaysia (BNM), Bank Islam

^ Private sector conventional and sukuk

**Includes BNM notes and treasury bills (conventional and Islamic)*



Sources: BNM, Bank Islam

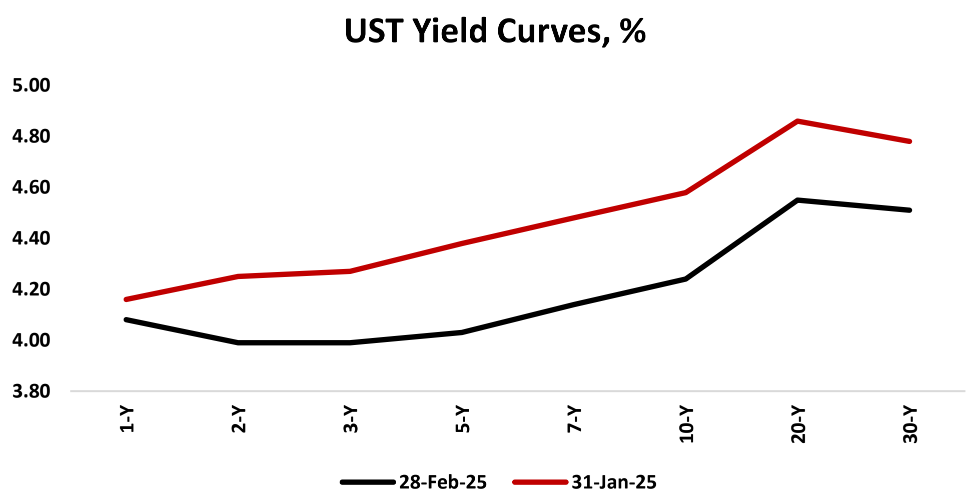


Sources: BNM, Bank Islam

UST yields plunged amid economic uncertainty and tariff concerns.

- Rising market anxieties over the economic outlook, fueled by uncertainty surrounding the impact of tariffs and aggressive government spending cuts, weighed heavily on U.S. Treasury yields in February. Concerns over slower growth and tightening fiscal conditions led to a broad-based decline in yields, which fell between 28bps and 34bps across the curve. Meanwhile, the Fed's preferred inflation gauge - the Personal Consumption Expenditures (PCE) index - rose at a mild pace, registering 2.5% in January and edging up slightly to 2.6% in February. This steady inflation trajectory reinforced market expectations that the Fed will implement two rate cuts in 2025, as policymakers navigate the delicate balance between economic growth risks and inflation control.

- President Donald Trump's aggressive trade stance is once again stoking fears of an economic slowdown. He has announced a 25% tariff on European goods and confirmed long-delayed tariffs on Mexico and Canada, exacerbating global trade tensions. In addition, the U.S. has imposed an extra 10% tariff on Chinese imports, further escalating the trade conflict. China, in response, plans to retaliate with tariffs of up to 15% on key U.S. agricultural exports starting March 10th, while also blacklisting 10 additional U.S. companies from trade and investment - deepening the rift between the two largest economies. Beyond trade, President Trump's renewed commitment to balancing the budget, despite a fiscal deficit exceeding 7% of GDP, has introduced fresh concerns over deep government spending cuts. Markets have taken note, with the prospect of tighter fiscal policy amplifying fears of slower growth and softer inflation. This has triggered a sharp decline in U.S. Treasury yields as investors anticipate weaker economic momentum and the potential for the Federal Reserve to step in with rate cuts. With mounting trade tensions, restrictive fiscal policies, and rising global uncertainty, the outlook for UST yields remains bearish in the near term.



Sources: Federal Reserve Board, Bank Islam

Table 2: UST Benchmark Yields (%)

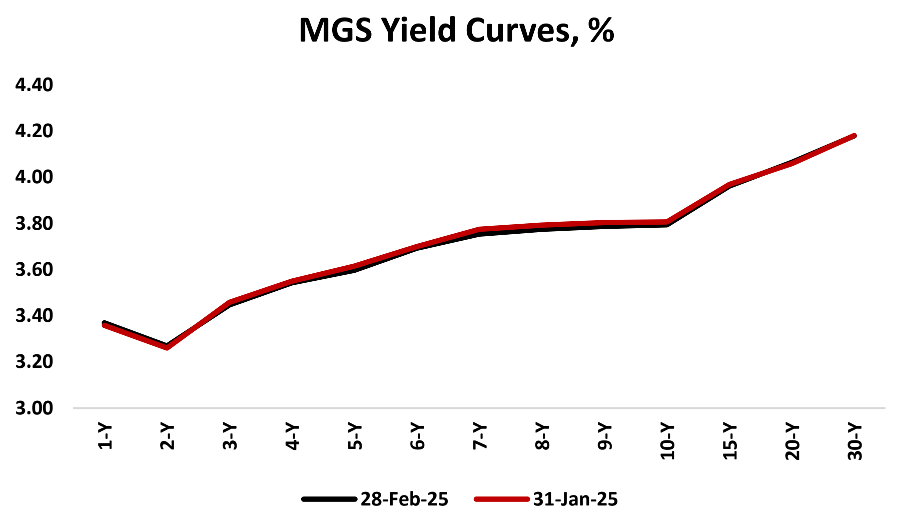
UST	Jan-25	Feb-25	Change (bps)
3-Y UST	4.27	3.99	-28
5-Y UST	4.36	4.03	-33
7-Y UST	4.47	4.14	-33
10-Y UST	4.58	4.24	-34
20-Y UST	4.88	4.55	-33

Sources: Federal Reserve Board, Bank Islam

Domestic government bond yields remained relatively stable in February

- Local govvies ended February on a slightly firmer note, with MGS yields along the 3Y15Y curve dipping marginally between 1bp and 2bps. Meanwhile, the 20Y MGS yield held steady at 4.06% for the month. The 10Y/3Y spread remained unchanged at 35bps, while the 10Y MGS/UST yield differential narrowed further into negative territory at -45bps (Jan: -77bps).

- On March 6th, as widely expected, BNM kept the Overnight Policy Rate (OPR) unchanged at 3.00% for the eleventh consecutive meeting. In its latest Monetary Policy Statement (MPS), BNM maintained a cautiously optimistic outlook for Malaysia's economic growth in 2025, following strong momentum in 2024. However, policymakers acknowledged potential risks stemming from U.S. trade developments and uncertain policy shifts. Given the evolving external landscape, BNM is likely to maintain its current policy stance, opting to closely monitor conditions rather than pre-emptively cutting rates. Its unchanged forward guidance reinforces a commitment to supporting both growth and price stability, suggesting that interest rates will remain steady through 2025 unless external risks materialize more significantly.



Sources: BNM, Bank Islam

Table 3: MGS Benchmark Yields (%)

MGS	Jan-25	Feb-25	Change (bps)
3-Y MGS	3.46	3.45	-1
5-Y MGS	3.61	3.60	-1
7-Y MGS	3.77	3.75	-2
10-Y MGS	3.81	3.79	-2
15-Y MGS	3.97	3.96	-1
20-Y MGS	4.06	4.06	0

Sources: BNM, Bank Islam

Both MGS and GII papers saw higher issuances in February

- Gross issuance of MGS/GII in February came in higher at RM19.5 billion (Jan: RM14.5 billion), lifted by the GII segment of RM10.5 billion (Jan: RM9.5 billion). In addition, MGS papers also registered higher issuance of RM9.0 billion in February from RM5.0 billion in the previous month.

- The government raised a total of RM15.5 billion via four public offerings, specifically the RM2.5 billion 30y reopening of MGS, the RM5.0 billion 7y new issue of GII, the RM2.5 billion 20y reopening of MGS and the RM5.5 billion 5.5y reopening of GII, while the remaining RM4.0 billion were raised through private placements. Robust demand from yield-seeking investors were evident in all four offerings, which ended with BTC ratios exceeding 2.0x. Of note, the 5.5y reopening of GII drew the highest BTC ratio of 3.2x.

Table 4: Auction Results (February 2025)

Issues	Amount (RM Million)	Amount Applied (RM Million)	BTC (x)	Private Placements (RM million)
30-yr Reopening of MGS 03/53 4.457%	2,500	5,901	2.4	2,000
7-yr Reopening of MGII 10/31 3.804%	5,000	14,333	2.9	-
20-yr Reopening of MGS 05/44 4.180%	2,500	7,468	3.0	2,000
5.5-yr New Issue of MGII (Mat on 08/30)	5,500	17,405	3.2	-

Sources: BNM, Bank Islam

Outlook

- The minutes from the January Federal Open Market Committee (FOMC) meeting, released on February 20th, reaffirmed the Federal Reserve's cautious stance on monetary policy. Policymakers signaled their readiness to keep interest rates unchanged in light of persistent inflationary pressures and ongoing economic uncertainties. Additionally, they expressed openness to pausing or slowing the pace of quantitative tightening (QT) until the debt-ceiling situation is fully resolved. Federal Reserve Governor Christopher Waller reinforced this stance, ruling out a rate cut at the upcoming March meeting due to insufficient evidence of inflation cooling and lingering trade policy uncertainties. However, he acknowledged the potential for rate cuts later in the year should inflation continue to trend downward. At the time of writing, the CME FedWatch tool suggests an 88.0% probability that the Fed will hold interest rates steady at 4.25%-4.50% during the March FOMC meeting.

- Domestically, BNM maintained the OPR at 3.00% during its second Monetary Policy Committee (MPC) meeting of 2025. We expect the central bank to keep rates steady throughout the year to support domestic demand, even as economic growth moderates. Malaysia's GDP is projected to expand at 4.7% in 2025, down from 5.1% in 2024, with the slowdown attributed to potential disruptions from U.S. trade restrictions. However, resilient domestic consumption and investment activity are expected to provide a buffer against external headwinds, allowing BNM to prioritize stability in its policy approach.