

## Maybe in March

- It has been half a year since Malaysia was put on a watchlist for a potential exclusion from the WGBI sovereign bonds index. This morning, FTSE Russell effectively said that it needs more time to decide.
- An outright exclusion could have risked a reallocation of about USD4bn of funds, or ~10% of foreign MGS holdings. Viewed against that scenario, the actual kick-the-can-down-the-road move is good news, undoubtedly.
- To be sure, until the next review in March 2020, the overhang is still going to be with us. However, the extended watchlist move might well be another impetus for further FX liberalization moves onshore.

### We need more time

*"FTSE Russell will continue to engage with market participants to understand the practical impact of recent initiatives announced by Bank Negara Malaysia to improve market liquidity and accessibility."*

With these words, FTSE Russell confirms this morning after US market close that Malaysia will be retained on the watchlist for potential downgrade from the so-called 'Market Accessibility Level' grading of '2' to '1'.

The downshift to the latter grade could have prompted fund managers who track the WGBI ("World Government Bond Index") to downsize the holdings of MGS ("Malaysian Government Securities") in their portfolios. Assuming USD 1 trillion of funds that benchmark themselves against this index and a weighting of about 0.4% for Malaysia, as much as USD 4 billion could have been viewed as being susceptible to portfolio reallocations. This would constitute close to 11% of the foreign holdings of MGS and just above 4% of total outstanding amount of MGS, as per end-August numbers.

Even as the depth of Malaysia's domestic financial markets and the long-term nature of some of the remaining foreign holdings of MGS would have helpfully countered the impact of any WGBI index exclusion, there are nevertheless likely to be at least some knee-jerk adverse reactions in the hypothetical scenario.

Hence, while the now-extended waiting period for the final decision would continue to feel like an overhang to the MGS market specifically and the overall Malaysian assets generally, the latest FTSE Russell announcement should still be seen as a slight net positive. Tellingly, MYR strengthened mildly by about 0.2% against the USD on the news, although it has since retraced alongside broader markets.

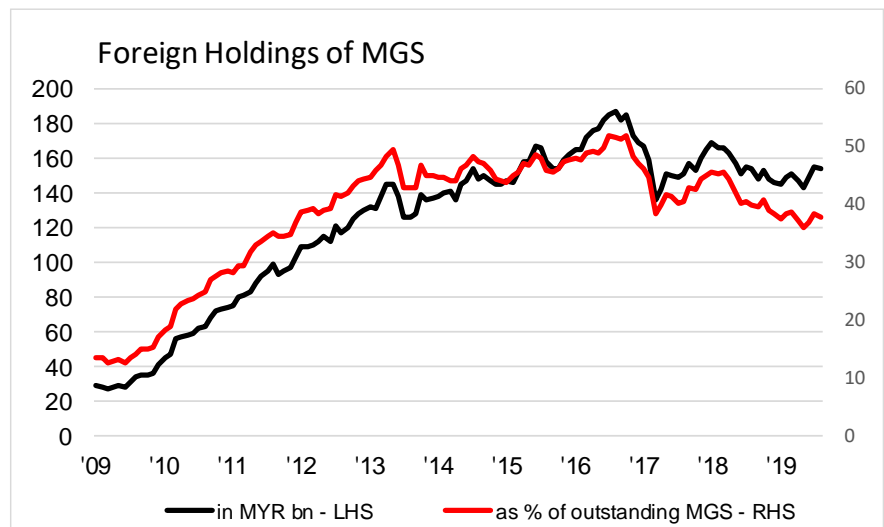
Moreover, the FTSE Russell's 'move of no move' might well come to be seen as dangling the carrots to entice further onshore FX liberalization moves by

## Malaysia

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the authorities, potentially. Already, BNM has been on the case actively, with its latest action to further liberalize the FX administration policies coming as recently as August 16<sup>th</sup>, allowing non-resident treasury centres to hedge on behalf of their related entities, for instance.

Ultimately, our base case is for a regulatory environment that is sufficiently welcoming for the index provider to tick the boxes on 'market liquidity' and 'accessibility'. This will then allow FTSE Russell to retain Malaysia on the WGBI, albeit at a slightly lower weight to accommodate China's inclusion.



Source: OCBC and Bloomberg

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