

SECTION 4:

DEBT MANAGEMENT

- Overview
- Financing
- Federal Government Debt
- External Debt
- Public Sector Debt
- Outlook 2019

SECTION 4: DEBT MANAGEMENT

Overview

The Federal Government debt management objective is to minimise its funding cost in the medium- and long-term while managing risk exposure, and providing benchmark yield curve for the market. It also helps stabilise and supports an orderly debt and sukuk market operations. The debt is raised through conventional market instruments, namely Malaysian Government Securities (MGS) for long-term papers while Malaysian Treasury Bills (MTB) is short-term securities. The Islamic equivalents are long-term Islamic securities or Malaysian Government Investment Issues (MGII) and short-term Islamic securities or Malaysian Islamic Treasury Bills (MITB). In addition, Federal Government is also allowed to borrow in foreign-denominated currencies, either under project or market loans. The primary purpose of Federal Government debt instruments is to provide funds for development expenditure needs after taking into account the operating surplus. As for the Treasury bills, the proceeds are for the purpose of liquidity management.

Financing

In 2018, Federal Government **gross borrowings** are expected to reach RM112.9 billion or 7.9% of GDP, with RM53.3 billion for deficit financing while the balance of RM61.2 billion is for debt refinancing. **Domestic borrowings** remain as the main source, constituting 99.9% of the total gross borrowings while the external drawdowns remain minimal at 0.1%. Ample liquidity in the domestic financial market due to a deep and well-developed Malaysian bond market has enabled the Government to raise its borrowing requirements in local currency hence reducing Malaysia's direct exposure to foreign exchange and interest rate risks. Meanwhile, additional Treasury bills of RM2 billion are expected to be issued for the purpose of liquidity management.

In terms of domestic borrowings, MGII issuance is expected to be higher at RM63.8 billion or 56.5% of total gross borrowings (2017: RM53.5 billion; 46.9%). The increasing trend in the issuance of Shariah-compliant papers indicates continuous commitments to promote Islamic instruments, while providing avenue for investors' portfolio and risk diversification. Meanwhile, MGS issuances are expected to constitute 43.4% of total gross borrowings or RM49 billion in 2018. Within a decade, the share of MGII issuance has almost doubled compared to 27.3% in 2008.

The Government issues MGS and MGII with selections of different tenures, ranging from 3-year to 30-year papers to provide liquidity on a longer interval over the yield curve as well as develop a benchmark yield curve. Likewise, the Government has also progressed in issuing medium- and long-tenured (10 years and above) papers. Since 2017, long-term

Table 4.1. Federal Government Financing 2017 – 2018

	RM million		Share (%)	
	2017	2018 ²	2017	2018 ²
Gross borrowings	113,979	112,867	100.0	100.0
Domestic	113,916	112,800	99.9	99.9
MGS	60,416	49,000	53.0	43.4
MGII	53,500	63,800	46.9	56.5
Offshore	63	67	0.1	0.1
Market loans	-	-	-	-
Project loans	63	67	0.1	0.1
Repayments	73,571	61,187	100.0	100.0
Domestic	73,166	60,827	99.4	99.4
Offshore	405	360	0.6	0.6
Net borrowings	40,408	51,680	-	-
Domestic	40,750	51,973	-	-
Offshore	-342	-293	-	-
Net Treasury bills	-	2,000	-	-
Change in assets¹	-87	-353	-	-
Total deficit financing	40,321	53,327	-	-

1 (+) indicates a drawdown of assets; (-) indicates accumulation of assets.

2 Estimate.

Source: Ministry of Finance, Malaysia.

notes increased to more than half of total issuances. In addition, the issuance of papers exceeding 10-year tenure for both MGS and MGII is expected to increase to almost 60% in 2018, as compared with an average of 44.5% for a span of three year period from 2014 to 2016. This is in line with debt management strategy to reduce exposure to refinancing risks by lengthening the debt maturity profile and leveraging demand for long-term papers.

The Government received a total bid of RM185.8 billion for market issuances of RM81 billion during the first nine months of 2018. The oversubscribed issues recorded an average bid-to-cover ratio of above 2 times as demand was supported by strong local institutions and ample liquidity in the domestic market. Significant support was also observed by diverse investor base such as pension funds, institutional investors, insurance companies and banks. A majority of the bidding interest was skewed towards MGII papers which recorded an average bid-to-cover ratio of 2.316 times compared to MGS (2.234 times), reflecting an increasing acceptance of Shariah-compliant papers among investors.

In the first half of 2018, yields on 5-year MGS ranged between 3.502% and 3.908%, while the yields on 10-year stood within the range of 3.841% to 4.264%. Meanwhile, yields on 5-year MGII recorded between 3.770% and 4.040%, while 10-year MGII ranged between 4.125% and 4.349% during the same period. Generally, the yields on MGII are 5 – 30 basis points higher than those of MGS with similar maturity. It is anticipated that in a stable financial market, the additional demand from foreign investors could help to lower the MGS yields relative to those predominantly owned by domestic investors, including MGII. The much larger participation of foreign investors in the MGS market relative to the MGII market partly reflects the difference in the yield dynamics between these notes.

The upward trend in yields in the first half of 2018 was driven by a confluence of factors, mainly rising global yields due to expectation of a faster monetary policy normalisation

in the US and other major economies. As a pre-emptive move to prevent the build-up of risks from a low-interest-rate environment, Bank Negara Malaysia has increased the Overnight Policy Rate (OPR) by 25 basis points in January. This has also pressured the yields performance. Furthermore, yields increased as investors were cautious during the run up to the 14th General Election.

Yields began to ease towards the end of the third quarter of 2018 with the 5-year and 10-year MGS narrowing by 14 and 16 basis points, respectively, compared to end-June 2018. Meanwhile, yields on 5-year and 10-year MGII have narrowed by 9 and 13 basis points, respectively during the same period. The performance was mainly underpinned by domestic support as bid-to-cover ratios mostly kept sturdy at above 2 times.

Gross *offshore borrowings* for 2018 are expected to remain low in the absence of new market issuances. A total of RM67 million is expected to be drawn down for project loans from bilateral arrangement through Japan International Cooperation Agency to finance technical cooperation programme.

Federal Government Debt

As at end-June 2018, the **Federal Government debt** stood at RM725.2 billion or 50.7% of GDP, which is below the self-imposed limit of 55% of GDP. The debt comprised 97.1% of domestically-issued papers denominated in ringgit while the balance of 2.9% are from offshore borrowings mainly in USD. With ample liquidity and an advanced domestic debt market, the Federal Government borrowings and refinancing risk is manageable. In addition, given a small portion of foreign-denominated debt, the Government's exposure to foreign currency risk is minimal.

Federal Government debt instruments are governed under specific legislations. Conventional debt instruments such as MGS and MTB are issued under the Loan (Local) Act 1959 [Act 637] and the Treasury Bills (Local) Act 1946 [Act 188], respectively. In addition, Islamic securities, both MGII and MITB are issued

under the Government Funding Act 1983 [Act 275], which provides for Shariah-compliant fund raising instruments as approved by the Shariah Advisory Council. Both Act 637 and Act 275 authorise the Federal Government to raise funds within Malaysia for the Development Fund and refinance maturing debt.

Currently, both Acts stipulate that the statutory limit of the Federal Government outstanding debt via MGS, MGII and MITB instruments shall not exceed 55% of GDP. As at end-June 2018, the outstanding amount of these instruments stood at RM671.7 billion or 46.9% of GDP. As for non-ringgit denominated debt, the External Loans Act 1963 [Act 403] limits the cumulative Federal Government offshore borrowings up to RM35 billion. Meanwhile, Act 188 restricts the outstanding MTB at RM10 billion. As at end-June 2018, the outstanding offshore borrowings amounted to RM21.1 billion while MTB at RM4 billion. All these legislatives thresholds serve as a control mechanism to ensure prudent and sustainable debt management.

As at end-June 2018, *domestic debt* stood at RM704.1 billion, comprising mainly MGS (RM376.7 billion) and MGII (RM291.5 billion). MGS remain as the primary market debt instrument with a share of 52% of total Federal Government debt. Meanwhile, the share of MGII outstanding in the market increased by more

than two folds over the years from 13.9% in 2008 to 40.2% as at end-June 2018 due to the Government's continuous effort to promote Islamic instruments and positioning Malaysia as the international Islamic financial hub.

Treasury bills, namely MTB and MITB are short-dated securities with maturity ranging between 91-days to 364-days that are issued periodically for cash flow management. As at end-June 2018, outstanding Treasury bills recorded RM7.5 billion which accounts for 1% of total Federal Government debt. Another component of domestic debt is *Government Housing Sukuk* which remained at RM28.4 billion or 3.9% of the total debt. This debt instrument is still assumed under the Federal Government debt account after the corporatisation of Treasury Housing Loans Division in 2016, currently known as Public Sector Home Financing Board (LPPSA).

Offshore borrowings comprising market loans and project loans remain stable at RM21.1 billion. *Market loans* were entirely from series of USD-denominated global sukuk issued in 2011, 2015 and 2016. Meanwhile, the outstanding *project loans* amounting to RM5.6 billion are from existing bilateral and multilateral arrangements to finance specific programmes and infrastructure projects such as housing, sewerage and water reservoir.

Table 4.2. Debt Legislative and Administrative Guidelines

Rules	Statutory	Administrative
Borrowings are only to finance development expenditure	Loan (Local) Act 1959	Current balance always in surplus to ensure operating expenditure is financed by revenue
Domestic debt ceiling (MGS, MGII, MITB)	Not exceeding 55% of GDP Statute Paper 76 of 2009, Loan (Local) Act 1959 and Government Funding Act 1983	Self-imposed limit of 55% of GDP
Offshore borrowing ceiling	Not exceeding RM35 billion Statute Paper 77 of 2009, External Loans Act 1963	
Issuances of conventional Treasury bills	Not exceeding RM10 billion Treasury Bills (Local) Act 1946	
Limit of debt service charges (DSC)	Allocation for debt service charges are charged items and not required to be tabled to Parliament Federal Constitution Article 98 (1)(b)	DSC ≤ 15% of revenue or operating expenditure

Source: Ministry of Finance, Malaysia.

**Table 4.3. Federal Government Debt by Instrument
2017 – 2018**

	RM million		Share (%)		Share of GDP (%)	
	2017	2018 ¹	2017	2018 ¹	2017	2018 ¹
Domestic debt	665,572	704,101	96.9	97.1	49.1	49.2
Treasury bills	4,500	7,500	0.7	1.0	0.3	0.5
MGS	364,672	376,701	53.1	52.0	26.9	26.3
MGII	268,000	291,500	39.0	40.2	19.8	20.4
Government Housing Sukuk	28,400	28,400	4.1	3.9	2.1	2.0
Offshore borrowings	21,265	21,140	3.1	2.9	1.6	1.5
Market loans	15,580	15,527	2.3	2.1	1.2	1.1
Project loans	5,685	5,613	0.8	0.8	0.4	0.4
Total	686,837	725,241	100.0	100.0	50.7	50.7
<i>Memorandum item:</i>						
Non-resident holdings of ringgit-denominated debt securities	186,266	167,602	28.0	23.8	13.8	11.7

¹ End-June 2018.

Source: Ministry of Finance, Malaysia.

The demand for Federal Government debt instruments remains well-spread, with residents holding RM541.2 billion or 74.6% of the total outstanding debts, while the remainder are held by non-residents. The **domestic holders** primarily consist of large and long-term investors such as Employees Provident Fund (30%), banking institutions (29.7%), insurance companies (4.6%) and Retirement Fund (Incorporated) (3.2%). Despite the challenging external environment, **non-resident holders** continue to hold sizeable amounts of Federal Government debt papers, at RM184 billion or 25.4% of total outstanding debt. The main non-resident investors include long-term and institutional investors accounting for 14%, of which central banks, supranationals and sovereigns constitute 8%, pension funds (4.1%), insurance companies (0.7%) as well as multilateral and bilateral institutions and others (1.2%). Non-resident holdings of MGS accounted for 40.1% (end-2017: 45.1%) from the total MGS outstanding.

In line with good debt management practice, it is important to manage the debt maturity profile to minimise rollover risk. In 2018, after taking into account the scheduled market issuances for the year, the average time to maturity is expected to increase from 7.2 years in 2017 to 7.6 years. This is due to higher issuances of long-tenured papers, leveraging more competitive rates and investors' preference

for these papers. Thus, the maturity profile is more distributed with an increase in the share of outstanding debt papers of above 10 years, from 19.2% in 2017 to 23% as at end-June 2018. Subsequently, the composition of papers with maturity of five years and below is reduced to 45.5% (end-2017: 51.2%).

External Debt

Consistent with IMF's definition, **external debt** comprises both public and private sector debt, which includes offshore borrowings; non-resident holdings of ringgit-denominated debt securities; non-resident deposits; as well as other external debt. As at end-June 2018, the nation's external debt edged up to RM936.5 billion or 65.4% of GDP (end-2017: RM879.8 billion; 65%) due to increase in loans by the non-financial corporations segment to finance investment activity. However, the impact was partially offset by liquidation of domestic debt securities by non-resident investors.

Offshore borrowings, the largest component of external debt, increased to RM586.5 billion or 41% of GDP (end-2017: RM500.9 billion; 37%), due to additional short-term debt and public corporations' medium- and long-term debt. Additional financing was mainly raised for

**Table 4.4. Federal Government Debt by Holder
2017 – 2018**

	RM million		Share (%)		Share of GDP (%)	
	2017	2018 ³	2017	2018 ³	2017	2018 ³
Residents	484,043	541,181	70.5	74.6	35.8	37.8
Employees Provident Fund	195,979	217,887	28.5	30.0	14.5	15.2
Retirement Fund (Incorporated)	22,933	23,173	3.3	3.2	1.7	1.6
Insurance companies	31,166	33,277	4.6	4.6	2.3	2.3
Banking institutions	181,060	215,507	26.4	29.7	13.4	15.1
Development financial institutions	19,668	20,423	2.9	2.8	1.4	1.4
Other non-bank financial institutions	974	1,338	0.1	0.2	0.1	0.1
Others ¹	32,263	29,576	4.7	4.1	2.4	2.1
Non-residents	202,794	184,060	29.5	25.4	14.9	12.9
Fund/asset managers	81,666	72,751	11.9	10.0	6.0	5.1
Central banks, supranationals and sovereigns	61,388	57,926	8.9	8.0	4.5	4.0
Banking institutions	13,687	9,764	2.0	1.4	1.0	0.7
Pension funds	31,219	29,901	4.5	4.1	2.3	2.1
Insurance companies	5,466	5,083	0.8	0.7	0.4	0.4
Others ²	9,368	8,635	1.4	1.2	0.7	0.6
Total	686,837	725,241	100.0	100.0	50.7	50.7

¹ Include statutory bodies, nominees and trustee companies and co-operatives, securities placed by institutional investors at the central bank and unclassified items.

² Include nominees/custodians, individuals, non-financial corporations and unidentified sectors.

³ End-June 2018.

Source: Ministry of Finance, Malaysia.

**Table 4.5. External Debt
2017 – 2018**

	RM million		Share (%)		Share of GDP (%)	
	2017	2018 ³	2017	2018 ³	2017	2018 ³
Offshore borrowings	500,901	586,533	56.9	62.6	37.0	41.0
Medium- and long-term debt	290,995	293,915	33.0	31.4	21.5	20.5
Public sector	119,930	138,843	13.6	14.8	8.9	9.7
Federal Government	16,567	16,459	1.9	1.8	1.2	1.1
Public corporations	103,362	122,384	11.7	13.0	7.7	8.6
Private sector	171,066	155,073	19.4	16.6	12.6	10.8
Short-term debt	209,905	292,618	23.9	31.2	15.5	20.5
Non-resident holdings of ringgit-denominated debt securities	207,389	185,106	23.6	19.8	15.3	12.9
Medium- and long-term debt	196,074	176,370	22.3	18.8	14.5	12.3
Federal Government	182,855	164,954	20.8	17.6	13.5	11.5
Others ¹	13,220	11,417	1.5	1.2	1.0	0.8
Short-term debt	11,314	8,736	1.3	1.0	0.8	0.6
Non-resident deposits	91,093	85,625	10.4	9.1	6.7	6.0
Others²	80,386	79,224	9.1	8.5	6.0	5.5
Total	879,768	936,489	100.0	100.0	65.0	65.4

¹ Include private sector and public corporations.

² Comprise trade credits, IMF allocation of Special Drawing Rights and miscellaneous.

³ End-June 2018.

Note: Total may not add up due to rounding.

Source: Bank Negara Malaysia.

the purpose of managing financial resources within corporate groups and investment abroad for productive capacity. However, in terms of medium- and long-term debt, private sector debt declined to RM155.1 billion following lower net borrowing by the bank and non-bank. Meanwhile, the public sector offshore borrowings stood at RM138.8 billion or 9.7% of GDP, with the bulk of the borrowing by public corporation accounting for 88.1% while the remaining by the Federal Government. Consequently, given lower export earnings, the debt service ratio for offshore borrowings has increased to 4.8% (2017: 4.5%).

In contrast, *non-resident holdings of ringgit-denominated debt* securities declined to RM185.1 billion as at end-June 2018 or 12.9% of GDP (2017: RM207.4 billion; 15.3%), due to expectations of a faster pace of monetary policy normalisation in the US and the rise of global trade tensions. This has led to higher outflows of non-resident holdings, primarily in terms of Government securities which has declined to 23.8% of the total issuance (end-2017: 28.0%). Nevertheless, external debt were well-spread across different maturity profiles, comprising 48% of short-term papers while medium- and long-term papers constitute 52% of the total.

Public Sector Debt

Public sector debt comprises the debt obligation of all layers of the government including Federal Government, state governments, statutory bodies and non-financial public corporations (NFPCs), including sovereign guarantees given to public sector entities. As one of the prudent debt management features, the coverage of public sector debt is intended to be comprehensive to gauge the potential risk exposure to public finance. This will help the Government to undertake constructive and extensive measures in managing and reducing the debt.

As at end-2017, public sector debt stood higher at RM989.2 billion or 73.1% of GDP (end-2016: RM901.2 billion; 73.2%), with Federal Government as the largest component at RM686.8 billion or 69.5%. NFPCs debt rose to RM242.8 billion or 24.5% of total debt (end-2016: RM204 billion; 22.7%), while the remaining 6% are attributed to statutory bodies. The NFPCs debts are mainly for the purpose of investments in infrastructure projects, particularly mass rapid transit (MRT) and extension of the light rail transit (LRT) line. Meanwhile, the debt of statutory bodies increased to RM59.6 billion

**Table 4.6. Public Sector Debt
2016 – 2017**

	RM million		Share (%)		Share of GDP (%)	
	2016	2017	2016	2017	2016	2017
Federal Government	648,475	686,837	71.9	69.5	52.7	50.7
Domestic	624,822	665,572	69.3	67.3	50.8	49.1
Offshore	23,653	21,265	2.6	2.2	1.9	1.6
Statutory bodies	48,700	59,638	5.4	6.0	3.9	4.4
Domestic	48,700	59,638	5.4	6.0	3.9	4.4
of which: Guaranteed	48,700	59,638	5.4	6.0	3.9	4.4
Offshore	-	-	-	-	-	-
Non-financial public corporations	204,025	242,759	22.7	24.5	16.6	18.0
Domestic	123,893	149,065	13.8	15.1	10.1	11.0
of which: Guaranteed	123,893	149,065	13.8	15.1	10.1	11.0
Offshore	80,132	93,694	8.9	9.4	6.5	7.0
of which: Guaranteed	4,657	19,588	0.5	2.0	0.4	1.4
Total	901,200	989,234	100.0	100.0	73.2	73.1

Source: Ministry of Finance, Malaysia.

(end-2016: RM48.7 billion) mainly attributed to guaranteed issuances by LPPSA to fund civil servant housing loans and borrowings by Perbadanan PR1MA Malaysia (PR1MA) to finance housing projects.

Outlook 2019

Under the 2019 Budget, the Federal Government gross borrowing requirements are anticipated to be higher for deficit financing and refinancing of matured papers. Approximately, a total of RM70 billion is expected to mature in 2019, of which about 25% to be redeemed in the first half of

2019, reflecting a lower refinancing risk in the near term. Despite higher borrowing requirement, the average gross financing need to GDP in 2019 is estimated to remain well below the average IMF threshold of 15% for emerging economies. Meanwhile, the Government is also exploring to tap into international markets for portfolio diversification and new benchmarking purpose as well as stimulate financial market trading activities. Moving forward, the Government aims to gradually reduce its debt level, without jeopardising economic growth. Therefore, it is crucial to strike a balance between creating fiscal space and adhering to debt management rules to achieve these objectives.

Figure 4.1. Federal Government Debt Composition

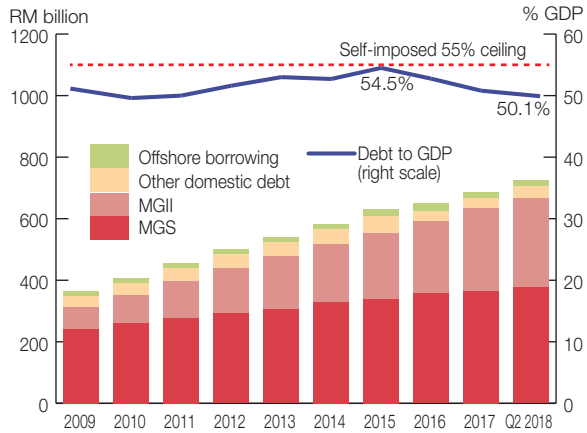


Figure 4.2. Issuance by Maturity

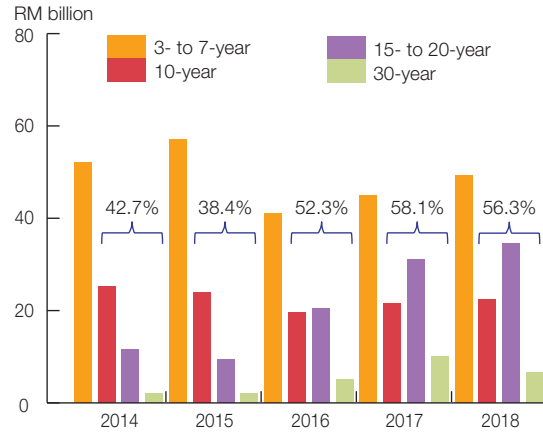
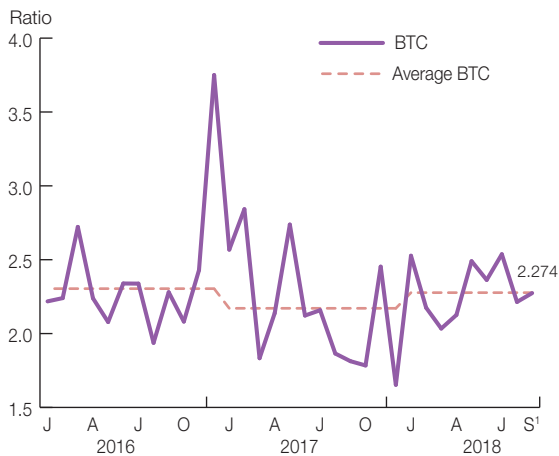


Figure 4.3. Bid-to-cover (BTC) ratios of MGS and MGII



¹ End-September 2018.

Figure 4.4. Federal Government Debt by Holder (End-June 2018)

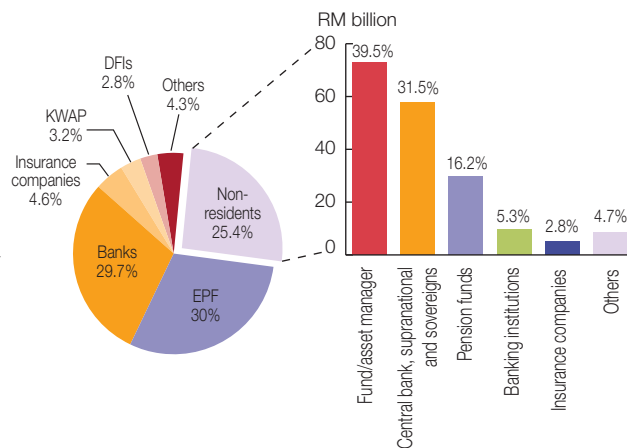
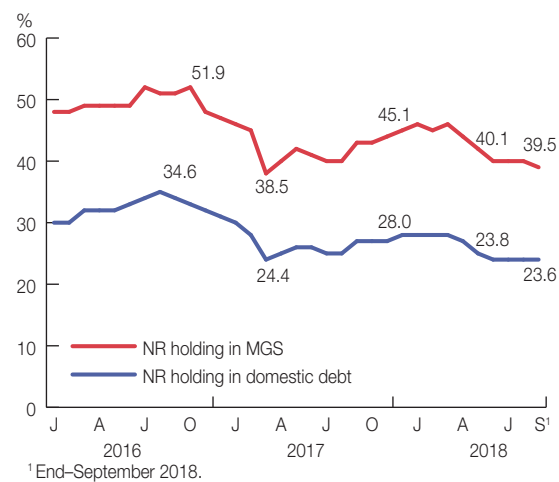


Figure 4.5. Malaysian Government Securities Yields



¹ End-September 2018.

Figure 4.6. Non-Resident Holdings of Ringgit-Denominated Debt Securities



¹ End-September 2018.

Source: Ministry of Finance, Malaysia and Bloomberg.