Financial Markets Committee (FMC) Meeting
28 November 2023
Bank Negara Malaysia

Summary

The meeting discussed recent financial market developments and reviewed progress updates and feedback on development initiatives, including those by the Principal Dealer Working Group and Islamic Financial Market Subcommittee.

1. Financial market developments and outlook

1.1. The meeting noted that recent market sentiment has been supported following a less hawkish Fed stance and cooling US inflation. The 10-year UST-MGS yield spread stands at around -55 bps, reflecting a significant narrowing from its peak of -88 bps in mid-October. This is expected to alleviate some of the pressure on the ringgit given that yield differentials have been a major driver of recent currency performance. The ringgit's performance for the second half of the year remains in line with regional peers with a small depreciation of 0.29%.

1.2. The meeting was updated on several concluded development initiatives in 2023. The launch of the Financial Markets Investor Portal (FMIP) in January has improved transparency and public accessibility to key information on the domestic financial markets, in support of informed decision-making. On the Islamic front, Collateralised Murabahah (CM), a form of Islamic repo, is on track to be prescribed as a Qualified Financial Agreement/Transaction (QFA/QFT) by the end of the year, providing crucial statutory assurance for its close-out netting provisions, on par with conventional repo.

1.3. Heading into 2024, members remain vigilant of further bouts of volatility amidst continually evolving interest rate expectations and an uncertain economic recovery in China. Nevertheless, domestic growth prospects remain robust on the back of the recent expansionary Belanjawan 2024, while the implementation of subsidy rationalisation will lend further support to the government's fiscal consolidation efforts.

2. Updates from Principal Dealer Working Group (PDWG)

2.1. The meeting endorsed the PDWG's proposal for an inter-Principal Dealer Electronic Trading Platform (ETP) which is expected to improve domestic bond market liquidity by facilitating larger trade sizes and enhancing operational efficiency through Straight-Through Processing (STP) and automated reporting.

2.2. The meeting emphasised the importance of full commitment by Principal Dealers to the identified ETP to reduce the risk of market fragmentation. To this end, members also requested the PDWG to seek the views of relevant stakeholders to identify potential concerns, ensure compliance with regulatory requirements and consistency with regulators' aspirations.

2.3. The meeting noted the PDWG's plans to issue a Request for Proposal (RFP) for the inter-PD ETP in Q1 2024, as well as discussions with BNM on proposed refinements to BNM's repo facility with the aim of enhancing PDs' core market making capacity.

3. Updates from the Islamic Financial Market Subcommittee (IFMC)

3.1. The meeting was updated on the IFMC's 2023 milestones, including the publication of the Liquidity Risk Exposure Draft on 23 August, the Islamic Collateralised Funding Exposure Draft on 2 October, the Shariah Advisory Council's (SAC) deliberations on anticipatory hedging for Islamic banks on 25 September and the inaugural issuance of Islamic repo via FAST on 21 November.

3.2. The meeting endorsed the IFMC's planned initiatives for 2024, which encompasses alternative instruments to Tawarruq-based transactions, sustainability-linked Islamic treasury products, and strategies to increase non-resident participation in the sukuk market. Members also acknowledged the need for a greater variety and supply of Islamic products to meet increased demand from asset managers.

4. Repo market conventions

4.1. The meeting was updated on BNM's collaboration with the Financial Markets Association Malaysia (FMAM) on standard repo market conventions, which were successfully issued in June 2023 and are expected to promote greater standardisation and transactional efficiency. The conventions comprise the immediate repayment of coupons received during the life of the repo back to the repo seller and the application of haircuts on a bond's dirty price to calculate the repo's initial proceeds.

4.2. The meeting was briefed on BNM's plans to adopt these conventions for its repo operations. A market-wide survey was conducted to gauge the industry transition time, which revealed that banks require up to 24 months for internal transition efforts, though no major challenges were expected.

4.3. The meeting endorsed the proposed implementation timeline of 2027, which provides for additional time required to amend the Global Master Repurchase Agreement (GMRA) between BNM and its repo counterparties, as well as enhancements to the Fully Automated System for Issuing/Tendering (FAST).

5. Inflation-linked products

5.1. The meeting was briefed on the assessment of the viability of inflation-linked products for the domestic financial market. While inflation-linked swaps were deemed to be too complex at the current juncture, inflation-linked bonds would provide benefits in terms of market diversification and hedging and are expected to attract natural demand from Malaysia's large pension fund industry and other long-term, "buy-and-hold" investors such as insurance companies. Members noted that interest from other types of investors such as asset managers would be conditional on sufficient liquidity.

5.2. FMC will continue to engage other stakeholders including the Ministry of Finance (MOF) and prominent pension funds for further discussion on the viability of inflation-linked bonds.

6. Updates on the Appointed Overseas Office (AOO) framework

6.1. Following the expansion of the AOO framework at end-2016, there was a steady increase in AOO's transactions. Two-way flows were recorded for ringgit settlements through AOOs, though with a higher proportion of inflows. In terms of transaction purposes, inflows were primarily driven by the settlement of portfolio investments and international trade, while outflows were attributed to the settlement of portfolio investments.

7. Updates on non-residents' participation in interest rate swap (IRS) flexibility

7.1. Non-residents participation in onshore IRS has grown post liberalisation in April 2021, which allows non-resident banks to trade ringgit-denominated IRS without any underlying commitment with any onshore bank or its Appointed Overseas Office (AOO).

7.2. Members discussed and attributed the recent stagnation in non-resident participation to a lack of central clearing for ringgit IRS, especially given non-residents' preference to settle derivatives trades via offshore clearing houses to minimise counterparty risks.

8. Reinvigorating Malaysia Overnight Rate (MYOR)

8.1. The meeting discussed potential strategies to reinvigorate the development of the Malaysia Overnight Rate (MYOR), including the publication of compounded MYOR averages and user guides in line with other jurisdictions. However, members noted that the current multiple-rate approach, with the continued existence of the Kuala Lumpur Interbank Offered Rate (KLIBOR), disincentivises the adoption of MYOR. In this regard, members suggested to explore the publication of an industry transition timeline following a market-wide survey.

8.2. Given the importance of a bank-led transition as the primary users of MYOR products, members also suggested to assess the potential for MYOR-based interbank money market transactions.

9. Capital Gains Tax (CGT) on the disposal of unlisted debentures

9.1. The meeting discussed considerations on the expanded scope of Capital Gains Tax (CGT) under the Finance (No.2) Bill 2023, which includes unlisted debentures. The imposition of CGT may negatively impact the valuation and attractiveness of instruments such as corporate bonds and commercial papers by reducing trading liquidity and introducing operational complexities. Members suggested to engage key stakeholders to better understand the underlying reasons for the expansion of scope.