



**FACTORS THAT AFFECT YIELD SPREADS OF MALAYSIAN BONDS**

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**FINAL REPORT**

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**(HONS) FINANCE**

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**JOHOR.**

**DECEMBER 2014**

## ACKNOWLEDGEMENT

Assalamualaikum WBT,

Alhamdulillah, all praise to Almighty Allah S.W.T, the most beautiful, merciful and the most benevolent for giving the strength, healthy and patience in order to complete this project paper on time as it is required by Faculty of Business Management.

I would like to express my greatest appreciation to people who are involved in this project which help us in giving some advices and support. I would like to take this opportunity to thanks my respectful lecturer, Miss Norhasniza binti Mohd Hasan Abdullah for her valuable advices and guidance in finishing this research for a better result.

Lastly, I want to thankful to my family and friends who help me in completing this research paper. I want to express my gratitude to the director of UiTM Kampus Segamat for giving me permission to use the library and all other facilities available in the campus.

## **ABSTRACT**

This paper aims at finding out the impact of macroeconomic variables on yield spreads between conventional and real return bonds in Malaysia. The variables considered are Kuala Lumpur Composite Index (KLCI), interest rate (IR), money supply (M2) and inflation rate (INF). The sample of this study comprises of 32 observations each of the independent and dependent variables on a quarterly basis over 8 years period from 2006 to 2013. Methodology used for this study is by using natural logarithms with time series data sourced from Data Stream. Thereafter, econometric tests are to be conducted to observe the relationship of the macroeconomic variables to the yield spreads of bond market in Malaysia. Interactive software package E-view would be used for testing and analysing the data collected. The study is an attempt to investigate the relationship of the chosen macroeconomic variables towards yield spreads of conventional and real return bonds in Malaysia. The results of this research paper would provide us either positive relationship or negative relationship between macroeconomic variables and yield spreads.

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## **CHAPTER 1: INTRODUCTION**

### **1.1 BACKGROUND OF STUDY**

In order to fulfill the massive funding needs for the country's development, government started issuing bonds in 1970s. By the mid 1980s, a new financing pattern was emerged since there was a shift in public policy. The public policy is to consolidate public sector activities and promote the private sector as the engine of growth since the private sector had assumed a more important role in the strategic development of the Malaysia economy.

During that period, the ratio of bank credit to gross domestic product was high at 149% due to the large portion of financing needed by the private sector because it relied on banks loan, which had in turn prompted the government to pursue the development of the corporate bond as a key strategic priority. The domestic bond market has developed significantly in terms of size, efficiency and the array of available debt instruments since the introduction of Bank Negara Malaysia's Guidelines for the Issuance of Private Debt Securities in January 1989.

The Malaysian bond market can be categorized as being in a developing phase because the progress achieved has rendered that the bond market has an influential avenue for economic growth. It can be said as a viable alternative for capital formation. The bond market can be effectively growth when the borrowers can have substantial influence over the structure of a proposed bond issue with varying risk appetites and vast number of potential investors.