

ASIAMONEY

The Asean Domestic Bond Markets Roundtable Series: Malaysia and Indonesia



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Malaysia's domestic bond market grew over MYR1 trillion (US\$322.8 billion) at the end of last year, clearing a hurdle that appears not to have slowed it down a bit. The market is, in many ways, a shining example to others in the region: corporate bond issuance is growing rapidly, the Islamic bond market is well-developed and foreign investors can get easy access to local companies. But there are still a lot of things that need to change in the market – not least of which is the reluctance of many investors to buy anything but the very best credits. ASIAMONEY talks through the issues with some of the highest-profile market participants in the country.

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Indonesia's bond market has enjoyed explosive growth. By the end of 2012, corporate bond volumes had jumped by 27.6% compared to the year before, according to data from the Asian Development Bank. And issuance has only continued to grow further this year.

It is not hard to see why bankers, investors and issuers are already excited by the market, but it's the potential of the next few years that really sets pulses racing. Financial institutions and big corporations know they can get strong liquidity in the market, but bond issuance has yet to be conducted by many of the country's corporates. That leaves a huge source of business ready to be deployed.

But Indonesia's bond market is not going to meet its potential without a few changes. Bank lending limits create an obvious source of bond supply, but the market is currently dominated by a small number of issuers. It is clear that more issuers and investors need to be brought into this market to help it reach its potential. ASIAMONEY talks to a distinguished panel about just how to make that happen.

EVENT PICTURES

17 Photographs from the Malaysia and Indonesia roundtables.

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BUILDING ASEAN'S BOND SUPPORT

The Association of Southeast Asian Nations (Asean) may be a politically fragmented collection of countries, but it is also a new economic powerhouse. Asean economies are among the fastest growing in the world, their ratings are on an upward trajectory, and their companies are becoming global titans.

The bond markets, however, are still lagging behind.

Asean corporations need more access – at realistic funding rates – to their domestic markets. But just as importantly, they also need access to the debt markets of their neighbouring countries.

This is something that Asean countries have pushed for at the highest level. The Asean+3 ABMI Bond Market Forum has been one of the most vocal – and important – supporters of greater cross-border flows between issuers and investors in the region. It is surely a worthy goal.

Those with long memories will remember the devastating effects of the Asian financial crisis in 1997, which left many companies shut off from global funding markets. These were, all too often, companies that had come to rely on global investors for funding.

But even those who did not experience the Asian financial crisis first-hand have had more recent reminders: the global banking crisis that accompanied the collapse of Lehman Brothers in September, 2008 or the recent European sovereign debt crisis that intermittently closed global funding markets. In both cases, global investors took a step back from the US dollar bond market – and in both cases, Asian corporations were almost entirely left out in the cold.

These experiences are palpable examples – not just to government officials, but to bankers and issuers – that Asian companies need to find a reliable source of investments.

BUILD YOUR OWN BASE

The most obvious way to do that is to rely on domestic investors. But the growth of Asean corporations across their borders means local currency funding will not be enough on its own.

Funding opportunities need to be opened up across the Asean region to make cross-border flows between different member states not just realistic, but attractive too. That is a big part of the motivation of this supplement.

Creating genuine cross border bond investor flows will not be an easy task to achieve. But it's a goal that everyone can get behind – and make no mistake, everyone will be needed to make it happen.

Regulators and government officials will need to create the initial framework to expand and develop markets. But it will be up to bankers, corporate funding officials and investors to use these expanded avenues. It is good news for Asean companies that this pressure has already yielded some pretty impressive results.

The formation of the Asean+3 ABMI Bond Market Forum just under a decade ago was the first big step needed. It opened up a place where the necessity of Asean bond market development could be discussed and created a forum of ideas where market participants could get a good sense of how that development would happen.

The forum has already enjoyed some success, particularly given the development of the Asean bond markets over the last 10. But more work lies ahead. Other investors need to be brought to the market, and more issuers need to consider the bond markets as a realistic funding option.

The potential for growth in the Asean bond markets is huge. Converting it into reality will not be easy, but it is necessary.

This supplement features the first two of a series of events on the Asean bond market sponsored by CIMB, covering the Malaysian and Indonesian debt markets. These markets face differing circumstances, but many key challenges – the need to unleash savings rates or improve secondary liquidity, for example – affect both these two and many other markets across the region.

This is perhaps the most valuable thing about dialogue between Asean bond market participants. The goal is to expand together and learn from each other. There may still be a lot more growth needed, and a lot more left to learn, but there can be little doubt that the Asean markets are on the right track.

Richard Morrow
Editor

Time to invite more borrowers to the party

Malaysia's domestic bond market grew over MYR1 trillion (US\$322.8 billion) at the end of last year, clearing a hurdle that appears not to have slowed it down a bit. The market is, in many ways, a shining example to others in the region: corporate bond issuance is growing rapidly, the Islamic bond market is well-developed and foreign investors can get easy access to local companies. But there are still a lot of things that need to change in the market - not least of which is the reluctance of many investors to buy anything but the very best credits. ASIAMONEY talks through the issues with some of the highest-profile market participants in the country.

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ASIAMONEY [AM]: *We are going to touch on a few of the key points of Malaysia's market and, in particular, how we develop the market further. But it is worth taking a moment at the start to acknowledge that Malaysia's bond market has already experienced a lot of growth over the last few years.*

LEE KOK KWAN, CIMB: The market has certainly grown and from my point of view growth will remain strong. There are about MYR1 trillion of bonds outstanding in the market, of which MYR462 billion are government bonds. But government debt is currently at about 52.9% of GDP (gross domestic product), and there is a cap of 55%, so as a result growth will be more muted as the government focuses on reducing its fiscal deficit.

On the corporate bond front, there is certainly room to grow for a few reasons. One is that GDP growth remains decent and corporate credit risks muted, as [Malaysian companies] are generating record levels of profitability and leverage is not high. Using the US market as a comparison, non-government debt is about 150% of GDP while in Malaysia it is only about 43%. Secondly, buy side money is not an

issue as the savings rate remains high at more than 32% of GDP and the constraint is mostly about supply of investible assets.

Also, Malaysia along with rest of Asean+3 [Association of Southeast Asian Nations, plus China, Japan and South Korea] learned in 1997/1998, and was strongly reminded in the 2008 global crisis and the 2011 European banking and sovereign crisis, that reliance on foreign currency funding is toxic for both the sovereign and corporates. The preference today for corporates and sovereigns around the region is to raise funding in domestic currency which is the third reason why growth will continue to be robust in the ringgit bond markets.

KIYOSHI NISHIMURA, CGIF: Asean borrowers have seen the dangers of relying on short-term foreign currency borrowing to finance long-term domestic projects, especially at the time of the Asian financial crisis in the late nineties. It is clear to everyone working in the Asean +3 that they need to develop strong domestic bond markets, especially corporate bonds. This is the reason why the CGIF was established. But as Asean companies have grown and become more



FOO SU YIN
RAM RATING SERVICES

regional, they should not entirely rely on domestic investors, and that is where we think CGIF can help.

We were established by the Asean + 3 governments and the Asian Development Bank to support the development of local currency markets in the region, and we have US\$700 million in paid-in capital to provide guarantees to issuers across the region. What we would like to achieve is to promote cross-border transactions between different Asean countries.

The reason this is important is that companies are growing much more regional, operating across a span of different Asean countries.



PHILIPP LOTTER
MOODY'S ASIA PACIFIC

That makes it sensible for them to have a capacity to fund in a variety of currencies outside of their home market.

AM: *But how do you expect the CGIF guarantee to play out for Malaysia? Are you expecting it to lead to Malaysian companies going to other Asean markets, or to Asean companies coming to fund in the Malaysian ringgit market?*

NISHIMURA, CGIF: We hope that both will happen. Malaysian companies are becoming more regional, and they are growing strongly. They are going to want to access overseas markets. But at the same time, there are lots of companies that want to raise money in Malaysia as one of the most developed corporate bond markets in the region, which find they do not have a strong enough rating to appeal to investors in the country. They can use a guarantee from the CGIF to appeal to investors on their first deal and, once investors have become familiar with them, perhaps they will be able to do a deal on a stand-alone basis in the future.

This is one of the key areas we want to develop. There is a lack of funding opportunities for lower-rated companies. It makes sense for them to use our guarantee because we are rated 'AA+' by S&P (Standard & Poor's) and 'AAA' by Malaysian rating agencies RAM and MARC. We can use these high ratings to help Asean companies overcome their barriers to cross-border expansion.

AM: *This ratings cliff is one thing that comes up a lot when you speak to bankers, investors or issuers in Malaysia. It would be good to hear from some of the investors on this point. How much of a problem for you is a lower-rated company coming to the market - and when will lower-rated companies be able to get more demand?*

TENG CHEE WAI, HWANG INVESTMENT MANAGEMENT: The reality of the market is that investors are yield-hungry, but everything is either 'Aaa' or 'Aa1', and everything is slapped with a guarantee. It is not very challenging to do credit analysis for domestic investors, because most of the time you are just taking government risk. That is not a healthy market.

While the market has developed and grown a lot over the last few years, there is still a need for us to grow beyond just looking at 'Aaa' or 'Aa1' issuers. We need to revisit the days when we had single-'A' names trading in the market, and when investors were prepared to take risks and be a bit more selective.

Is there a time when single-'A' credits will come back to the market? I think so. Because yields are so low right now, investors are all looking for a way to increase their returns. That means it is a natural time for the high yield market to develop. Investors are all on the look-out for high yield, and as long as we have some decent companies coming through, a lot of us will be willing to take high yield exposure. There will be appetite.

WAN KAMARUZAMAN BIN WAN AHMAD, KWAP: Over the last few years the role of real money investors has been very crucial in the development of the Malaysian bond market, and asset managers have grown leaps and bounds in terms of their assets under management. These real money investors are now very familiar with the bond market, and that has translated into higher trading volumes.

Most of the mandates that EPF (Employees Provident Fund) and KWAP have given to external fund managers are focused on ROI (return on investment), and therefore fund managers have to be very active in the bond market to meet their targets. This is a key reason why the Malaysian bond market has grown in such a way, and the role of pension funds is crucial.

It is not just about the economy growing. The growth of the pension fund industry – which over the last few years has been about double the growth of the economy – is really important. Other countries should look to the Malaysian model. We have real money investors coming into the market and trying to promote the deepening and the growth of the bond market. That is an important experience for all Asean countries.

STEVE ONG CHONG GAIN, PPAM: There is a concern in Malaysia over the insufficient funding for retirement. This is why the government has put in place the PRS (Private Retirement Scheme) to enhance the ability of individuals to prepare themselves for retirement. This – combined with the EPF – is going to have a significant impact on driving capital market growth, be it long-term debt or equity-backed securities.

Malaysians preparing for retirement need to know they can leave money management to the professionals, and they need to be confident of their PRS managers in providing for their retirement income.

AM: *That implies that the ratings cliff will not get better but worse. The more pension funds come to dominate the market, the smaller the percentage of the investor base will be willing to invest in lower-rated companies.*

ONG, PPAM: Well, the more investment schemes you have, the more chances there are for everyone funding in the market. Different investment schemes will offer different risk profiles so, in that sense, everyone will benefit from the added liquidity. But the reality is that there will not be a huge impact on the high yield market because there is simply no issuance. In the long-term, these schemes will become a key buyer for lower-rated paper. The problem is that right now, we just don't have the supply.

LEE, CIMB: In Malaysia, the development and supply of the lower-rated, higher-yielding bond markets will remain a problem. This is because bond investors require higher yields for lower-rated bonds – which they should – but banks are willing to lend to SMEs (small- and medium-enterprises) and lower rated corporates for cheaper rates, albeit for shorter tenors. As it is, Malaysian banks are lowly leveraged and sitting on excess liquidity especially after having a significant portion of the corporate loan book disintermediated to the corporate bond markets.

PHILIPP LOTTER, MOODY'S ASIA PACIFIC: I would echo some of the comments I've heard already. We rate more than 200 Asian corporations, many of which have issued in the international market and, of those 50% if not more are high yield. It is crucial to develop a deep, high yield market if you want local bond markets to develop and continue to absorb a lot of those savings rates across the entire risk profile of the ratings universe. It is certainly an issue of getting the right supply into the market but it is also, to take a step back, a question of creating a ratings culture.

There is a tremendous emphasis put on ratings and the division of investment grade and high yield. But what these markets really require is a deeper credit culture, with a greater breadth of opinion, and a very clear understanding of common standards of transparency and disclosure that allow investors to take their own view on the strength and risks of a credit. Investors wanting to gauge the risk of a particular company, or indeed the risk of their whole portfolio, should not be leaving that up to a few ratings agencies.

FOO SU YIN, RAM RATING SERVICES: I agree that the responsibility of understanding the credit quality of a bond lies with investors themselves, and the more opinions and sources of information we have in



LEE KOK KWAN
CIMB GROUP

the market, the better. But coming back to the high yield market, I think there are some contradictory opinions in the market.

A number of investors tell us that they want to buy high yield bonds, but there's no supply in the market. But then we also hear that when there is a chance of a deal rated below 'Aa3', there are no takers in the market. Sometimes we wonder, who is correct? What is the true picture?' That is something I have not received an answer to. I think it's still debatable whether there is a lack of supply or a lack of demand.

LOTTER, MOODY'S: My view is that when you look at the huge growth of high yield bonds we've seen internationally – and the corresponding growth in demand for that paper, particularly in Asia – it would



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be very surprising if there was not similar demand in the domestic market.

We have talked a bit about retirement planning, but it's worth adding that when you are trying to fund the retirements of young people who still have many years of work ahead of them, that cannot all be invested in 'Aa' and 'Aaa'. You need some more higher yielding options in the early stages of retirement planning.

AM: *It would be good to get the issuers' point of view on the comparison of offshore funding markets and the domestic market.*



**WAN KAMARUZAMAN
BIN WAN AHMAD**
KUMPULAN WANG
PERSARAAN

CHUNG CHEE LEONG, CAGAMAS: The company business is based on a liquidity model, which means we only issue bonds against underlying asset purchases. At this moment, our assets are mainly denominated in Malaysian ringgit, so that is our funding base. Notwithstanding, the company continues to monitor the comparative funding cost and distribution advantage in the international market against our domestic bond issues.

At present, we are better off issuing in the Malaysian ringgit market. For example, the current Cagamas five-year Malaysian ringgit issue is yielding 3.6% which is equivalent to 2.05% in US dollar terms, as compared to 2.08% yield on the outstanding Sime Darby US dollar bonds.

The yields that we offer in the domestic market are good enough, but we are not adverse to exploring opportunities in the international markets so we frequently compare the post-swap rates offered against our onshore equivalent when evaluating these deals. At the moment, most of our issuances would be more expensive in the dollar market, so we do not see the benefit of turning offshore. But we would certainly consider the offshore market in the future, though.

CHONG KIN LEONG, GENTING: We have issued in the relatively developed bond markets of Malaysia and Singapore, and we have also raised funds in other markets like Indonesia and the Philippines. When we looked at our position it was pretty easy for us to raise money in Malaysia and Singapore. The process is relatively simple. Indonesia and the Philippines' corporate debt markets are still in an early stage of development for international investors.

But one thing we noticed when we did issuance in ringgit and Singapore dollars was that there was a tendency for these bonds to be picked up primarily by domestic investors. Although we would like to market these bonds to more investors outside our country of issuance, we find that a lot of international investors tend to gravitate towards US dollar deals. This may be because they use dollars as a way to move in and out of deals very quickly. For example, we have tried to sell Malaysian ringgit bonds to investors in Singapore, but we didn't get much traction compared to what we would expect if we sold a US dollar bond.

Singapore is an interesting market to look at, and gives a good example of just how quickly markets can grow. A few years ago, there was very little activity in the domestic corporate bond market, but since the global financial crisis we have seen a real push to develop the market – and volumes have grown dramatically as a result. The demand we saw for our Singapore dollar deal largely came from private banks in Singapore. They can really drive the deal, but they tend to focus on only their local currency or US dollars. This is something I would like to see change. A lot of investors don't have a natural requirement for other Asean currencies, and we need to see the swap market develop more to bring them into the country.

AM: *What are the chances of cross-currency swap markets in Asia actually developing enough to bring in more investors?*

LEE, CIMB: The cross-currency swap market facilitates both bond issuances in MYR that are swapped to US dollars, largely for foreign issuers, and US dollar bond issuances that are swapped into MYR, mostly for Malaysian corporates. The economic proposition to issuers is between USD credit spreads, MYR credit spreads and the cross-currency interest rate swap basis, the latter of which can be volatile. But these transactions are opportunistic in nature, capitalising on relative pricing.

In most emerging markets the usual constraint is the lack of a cross-currency swap product suite, where the local currency inter-

est rate term structure leg is not well developed. This problem does not apply to the USD/MYR cross-currency swap market as Klibor interest rate swaps are liquid out to 10 years and as such there is a full range of USD/MYR cross-currency interest rate swaps – fixed to fixed, fixed to float, float to fixed and float to float [referencing US dollar and Malaysian ringgit interest rates] – that corporate issuers and investors can avail themselves to.

AM: The Iskandar Malaysia project in Johor is clearly going to be a huge development that will involve a lot of Malaysian and Singaporean companies. How much of this is likely to be funded in the local market, and how much will come from overseas investors?

AZHAR OTHMAN, UEM LAND: The foreign direct investment target for Iskandar is MYR300 billion by 2025. We already had around MYR100 billion by the end of March, and around 36% of that came from foreign investors.

Iskandar itself is still a Greenfield [site investment], and we are just reaching the tipping point where we are seeing the first developments become ready to open. The potential growth is huge there, and that opens up big possibilities for the bond market.

UEM Land just issued a MYR600 million *sukuk* [Islamic bond] to help us fund our project. That is just a beginning for us. There is a big chance we and our partners will be back in the bond market. The traditional lending schemes are very much limited, but there is much more potential in the bond market.

From our standpoint, we will still go with Malaysian ringgit, because there is no need to go offshore. There is a chance that you will see partners in Singapore fund their own contributions domestically, or even turn to the dollar market. But my view is that, as long as the ringgit market offers enough money to help finance the development of projects in Iskandar, then why not stay at home?

LEE, CIMB: Long-dated, local currency bond financing for infrastructure development has been a major success in Malaysia as banks are typically ill-equipped to provide such financing. Infrastructure projects typically do not generate any revenue until years later while the upfront cash outlay in terms of costs are very high and, as such, long-dated fixed interest rate financing is crucial. As such short term bank loans are not appropriate as banks are not equipped to offer long tenor loans as their customer deposit base usually does not go out longer than 12 month fixed deposits. This was made very clear in the 1997/1998 Asian financial crisis, when some companies were using short-dated bank loans to fund infrastructure projects.

The ringgit bond market is a key source of financing for highways, the water system, power generation and other infrastructure projects. The Malaysian institutional investor base today is quite sophisticated, as they are highly experienced and have developed significant expertise in evaluating deals and assessing credit risks based on cash flow projection and its reasonableness, safeguarding cashflows and ring-fencing the infrastructure asset from equity shareholders and other debtors.

There are many other new infrastructure projects that require funding, such as the MRT (Mass Rail Transit) project and new power plants. Iskandar is also a very big development project that requires significant amounts of funding.

AM: The Islamic bond market is still relatively small in Malaysia. Why is that?



CHUNG CHEE LEONG
CAGAMAS

KAMARUZAMAN, KWAP: Although *sukuk* [Islamic] bonds are a small part of our overall portfolio, it is growing in importance. We are trying to increase our presence in the Islamic bond space, and we have now got a specific global and domestic *sukuk* mandate.

Islamic bond mandates has been growing rather significantly on a global scale, and we are seeing a lot of support from our investors in the idea of investing in the global market. But the domestic market is very different. The yields are slightly higher in the domestic market than what issuers pay for conventional bonds, but the opposite is the case in the global market. The demand-supply mechanics are very different in the global market, but when pricing becomes more attractive



TENG CHEE WAI
HWANG INVESTMENT
MANAGEMENT



you will certainly see more Malaysian investors start to invest in *sukuk* bonds.

TENG, HWANG: For us, demand for bonds – whether *sukuk* or conventional – is really driven by our mandates. We are getting more and more *sukuk* mandates, but there is still a lot of indifference among investors over whether a deal is *sukuk* or not. There has been good growth in the global market, but not so much in Malaysia.

CHUNG, CAGAMAS: For each issue of *sukuk* we need to purchase an equivalent amount of Islamic financing to help us structure the deal, which in turn means that we are relying on banks to have enough Islamic financing on their balance sheets. But these banks also have more need for *sukuk* assets outside of the traditional Islamic financing, so that helps us get bigger demand for our bonds.

At this point, around 60% of our issuance has been *sukuk*, and that could continue to be the case for the next few years. There is increasing demand in the market for *sukuk*, and that makes it easier to do a deal, but in terms of pricing there is not actually much difference between conventional and Islamic, at least from our perspective.

OTHMAN, UEM LAND: There is not a major difference between *sukuk* and conventional bonds for us, except that you get a tax deduction when you sell a *sukuk* issue. That really helps us and, even though the pricing looks about the same it really makes *sukuk* bonds more attractive.

LOTTER, MOODY'S: From a credit point of view, we take a very similar approach to rating Islamic and conventional bonds. There is no real difference for us, as long as the structure does not add any undue credit risks. As long as the pledges undertaken are clearly linked back to the sponsor, and as long as you don't have potential defaults stemming from debate about *shariah* [Islamic law] compliance after the close of a transaction, then we see it as we would any other senior unsecured debt.

FOO, RAM: We take a similar view, in that we don't see a big distinction between *sukuk* and conventional bonds from a credit point of view. However, in our rating process, we also look closely at whether deals are *shariah*-compliant. We don't declare whether a deal is *shariah* compliant or not; that is not our role. But we do look at the structure, and if we think there are elements in there that could be seen as not *shariah*-compliant by others, then we will raise a query with the sponsors. They will then come back after that with a response.

AM: Could the CGIF be used just as easily for *sukuk* bonds as for conventional bonds?

NISHIMURA, CGIF: At this moment, we have not had any discussions with borrowers that want to use the facility for issuing a *sukuk* but there is no reason why it could not be used for Islamic bond issues. We are just a guarantor, not an issuer, so as long as the *sukuk* structure made sense to the issuer, then we would be happy.

LEE, CIMB: The Malaysian *sukuk* market will continue to grow, but the next big growth market will be Indonesia once the tax issue is sorted out with regards to the sale and leaseback of the underlying asset. There is a lot of work being put in to develop the Islamic banking and capital markets but much more is happening in the Islamic banking markets in Indonesia.

AM: It would be interesting to hear predictions from everyone on what is going to drive this market in the future. What are the key factors you're looking out for?

FOO, RAM: The fact that we have a very high savings rate will be a big driver of bond issuance over the next few years.

ONG, PPAM: Malaysia has just recently launched the PRS for the public to invest – in addition to EPF – for retirement. We are talking about appeal to a potential 13 million employed people who can contribute towards this long-term voluntary investment scheme.

Currently, the Private Pension Administrator (PPA) is planning an advertising and promotion (A&P) campaign to promote and educate the public on the need to save adequately for their retirement by putting additional savings into the PRS schemes. This A&P campaign will help us reach the 13 million target population nationwide and drive the enrolment rate for the PRS.

One of the unique features of the PRS is the default fund selection based on different age groups' risk and return characteristics which has a portion of the asset allocation invested in bonds. Hence, this will definitely add more liquidity into the bond market in time to come when the PRS contributors grow to a sizeable base.

Unlike the EPF, the investment management part for PRS is delegated to the current eight licensed PRS providers approved by the SC. As such, these eight providers will decide on their own asset allocations of the underlying equities and debt securities, based on the mandates of the respective PRS funds.

The PRS regulatory framework provides the governance and supervision of the PRS industry players. In addition, the PPA acts as the central administrator for all PRS members and also serves to protect and safeguard interests of its members.

LOTTER, MOODY'S: The fundamentals are all lining up to help further grow Malaysia's capital market. But for the market to expand, we do need a supportive credit culture. We need harmonisation of procedures, best practices, and by all means regulatory standards, but the last thing we need is harmonised opinion. It is important that there

is a disparity of opinions, but it is only from that disagreement that you really get a true market.

NISHIMURA, CGIF: Malaysia has been extremely successful in developing its bond market. It has been a showcase for the whole Asean region in how quickly a market can grow, and that market is helping Malaysia become a financial centre. But what the market needs is more diversity, not just in terms of products but also on the investor side.

Malaysia already has a very established institutional investor base, but it would be good to see retail investors grow in importance, and more foreign investors turn to the corporate bond market. That is what we need to help develop the high yield market, which in turn would open up new opportunities for Malaysian companies who cannot issue bonds due to a clear 'rating cliff' in the Malaysian bond market. Also the entry of different types of investors with different investment needs and strategies will help increase the liquidity in the bond market because the current market is dominated by buy-and-hold investors.

LEE, CIMB: Foreign demand, especially for government bond issuances, will likely continue to be strong as ringgit interest rates are not zero, GDP growth is robust and inflation is low. The question is how you start to move this foreign demand from the ringgit government bond market to the corporate bond market. That is one area we would like to see develop, but it is difficult to see foreign investors taking big positions in the corporate bond market anytime soon.

KAMARUZAMAN, KWAP: Over the last few years the bond market has grown significantly. That has led to a knock-on growth in the foreign exchange market, which has in turn grown the swap market. The importance of developing our domestic debt market has proven to be so big, and we should all hope that this development will continue.

There is a predicament here though. We talk about a lack of supply of high yield corporate bonds, but this is at least partly down to lack of foreign investor demand. We need to be cautious as we watch this market grow, since there is the chance of systemic risk if foreign investors become too sizeable a part of the investor base. That already applies to government bonds, but the more the corporate bond market grows, the more it will apply to corporate bonds as well.

TENG, HWANG: We have seen a great shift in terms of attitudes towards mutual funds. There are a lot of depositors that want to increase their returns, and in the past they would just go into the equity market as if that was the only option. But now we are seeing more of them go into the bond market. It makes sense for them – they want to increase their returns, but they also want to limit their risks. The growing appetite for fixed income among these end-investors is the key thing I am looking out for to help the market grow over the next few years.

CHUNG, CAGAMAS: There is vast potential for the bond market to grow, including the *sukuk* market. But the issue is the depth and breadth of this market. More than 90% of secondary bond trading in Malaysia comes from the government or quasi-government issuers, and from triple-'A' and double-'A' names. To have a more efficient bond market, we need more depth. That means more liquidity in the single-'A' and triple-'B' issues. The average yield differential between triple-'A' and triple-'B' credits is about 600 basis points (bp), and between triple-A and single-A it is about 380bp on a 10-year basis.



The main issue which dampens investors' participation in single-'A' or triple-'B' bonds is the lack of a hedging mechanism for investors to manage the credit risk. We need a hedging mechanism in place to allow investors to lay off some of this risk. That will help the market become more efficient and compress market spreads.

Right now, there is no point to issuing bonds if you're a single-'A' or triple-'B' borrower. The differential is just too high. This is not just because of credit; a big cause of this differential is the liquidity risk which translates into a high illiquidity premium. After investors buy these bonds, they realise that their chances of getting demand in the secondary market are pretty small. Liquidity is definitely an area we need to see develop. Increasing investor participation would reduce the illiquidity premium, and address not only the funding risk but also improve the funding cost to the issuers, yet still offer an attractive value proposition to investors.

One of our objectives is to help develop the capital market and we are currently working on an initiative to address this issue.

CHONG, GENTING: The nature of our business means our revenues are driven mainly by disposable income growth, and the growth of the middle class. That is an area that is not just boosting the bond market, but which is also having a direct impact on our business. But what constrains us is that we typically issue and place our bonds just to asset managers. There is not enough retail participation in the market at this point. The other option is that we try to place some of bonds to offshore markets but, as I mentioned earlier, there is not much appetite for Malaysian ringgit corporate debt among these investors.

OTHMAN, UEM LAND: Infrastructure funding has been a huge source of bond volumes, and this will not stop. We will see more and more developers in the Iskandar project turn to the bond markets. There is good demand there, and it is a sensible way of financing projects. Malaysia needs to create jobs in order to grow, and this is going to come from more of these projects. The bond market can help finance this.

KAMARUZAMAN, KWAP: We all need to work hand in hand together to develop the market. The real money investors are definitely there, and we're only waiting for the pricing mechanism to be much better than it is at the moment. There is just enough liquidity in the corporate bond market, but once banks start working to provide more liquidity, they will see a big boost in liquidity. The demand is there, but the bankers need to play their role.

AUDIENCE INTERACTION

AUDIENCE MEMBER: *Thailand has recently introduced a minimum holding period for its government securities. Do you think this would be a good policy to apply in Malaysia?*

LEE, CIMB: The main objective is to stem the increase in 'hot money' in the local currency government bond market. For Malaysia, Bank Negara has significant expertise in managing hot money flows as the 1997/1998 Asian crisis was so much more extreme than what the USA and Europe went through in 2008 and 2011, respectively. Today, Malaysia has ample FX (foreign exchange) reserves to accommodate sudden reversals of foreign holdings in the ringgit bond and equity markets and I don't think it is a major problem.

NISHIMURA, CGIF: It is rather fascinating to see how different markets in the Asean region actually are. We have already discussed how different Singapore is from the rest of the region, but it is an interesting question: why, in this part of the world, do markets need to be so fragmented? That is one of the challenges for this region: to integrate more, so there will be more diverse opportunities for both investors and issuers.

We have, for example, already discussed the rating cliff issue. But when you go to neighbour in Thailand you see they can issue pretty much anywhere on the rating scale. It's good to see that there are going to be more cross-border transactions, so these markets can start to impact each other. Malaysia has developed its bond market to a reasonable size, but still the market alone is too small. The way forward for Asean economies is to integrate their markets more.

AUDIENCE MEMBER: *Under the Securities Commission's (SC) existing guidelines, a bond needs to be rated in order to be transferrable. Since we all want the scope for unrated bonds to develop, should this rule be changed?*

TENG, HWANG: As was mentioned earlier, we need to continue to develop a credit culture and unrated bonds are a welcome part of that. We hope that the SC will relent, and allow unrated bonds to be freely traded in the market. We would look forward to participating in that part of the market if they did change that rule, but until we can start trading, it is impossible.

The rule is not the only problem; if it was cancelled the development of that part of the market would still be slow. But the rule needs to be changed before it can develop in any way.

LOTTER, MOODY'S: This debate highlights the risk of attaching investment or regulatory decisions to any single opinion. The solution though is not to have fewer ratings; it is to have more ratings. The developing credit culture that we've talked about is going to rely on investors doing their own credit work more, and as the

market deepens there will also be more ratings, whether internal or external.

FOO, RAM: We talk about trying to develop the single-'A' rated market, and we have already heard that there is a problem of supply. How are things going to be easier for unrated issuers? The likelihood is that the bulk of unrated deals would come from highly-rated issuers, not from high-growth companies that have never had a rating before.

AM: *Making unrated bonds transferable would be a positive step for a lot of people, but those bonds would face even worse secondary liquidity than the high-grade names that trade very infrequently. How do we improve secondary liquidity in the market?*

LEE, CIMB: Spreads seem to be higher but this is not real nor is it due to a lack of liquidity. There is no shortage of bids and offers get taken very quickly. There are no liquidity and spread problems on the bid side. The problem is on the offer side of the market where there are very few sellers. This is not a simple problem to solve as the savings rate is high at more than 30% to GDP where demand outstrips supply for investible assets and most investors are really long term buy and hold investors.

TENG, HWANG: It is very important to grow secondary liquidity, because it would give us a lot more options to source bonds, as well as to sell when we feel a deal has run its course. It's frustrating. It's not just Malaysia, though; even in Singapore this is a problem. But as we develop in the years to come and there are more markets, hopefully this problem can be solved.

CHONG, GENTING: It is not really a problem for us, because we are not really a frequent issuer. We do not need to look at market benchmarks too often, so the fact that we cannot get a realistic secondary quote on our bonds everyday is not a huge issue.

CHUNG, CAGAMAS: It would help the price discovery process if we had more secondary liquidity, but right now that is not really an option. Most investors that buy these bonds in the secondary market are still holding them five or 10 years later.

AUDIENCE MEMBER: *When are we going to see more products being added to the market? When you look to other Asean countries, for example, we have seen the development of inflation-linked bonds, but that has not happened in Malaysia.*

LEE, CIMB: I agree that we need to introduce more products, although I would argue that inflation-linked bonds would not be among the more useful products to add because inflation in Malaysia is low and well managed. But there are plenty more developments we need in this market such as further development in the securitisation, exchangeable and convertible bond markets.

CHONG, GENTING: We sold a ringgit-denominated convertible bond a few years ago which was priced at a negative yield. There was very little familiarity with that instrument among domestic investors, and because our underlying business is not *shariah*-compliant we had a very limited investor base domestically. That bond was one of the rare examples where we actually saw a big offshore bid – the vast majority of the deal ended up being sold to investors overseas. That was some time ago, but our experience was that it is hard to sell convertible bonds in the domestic market, and it made a lot more sense to go offshore. ▲

Making the grade

Indonesia's bond market has enjoyed explosive growth. By the end of 2012, corporate bond volumes had jumped by 27.6% compared to the year before, according to data from the Asian Development Bank. And issuance has only continued to grow further this year.

It is not hard to see why bankers, investors and issuers are already excited by the market, but it's the potential of the next few years that really sets pulses racing. Financial institutions and big corporations know they can get strong liquidity in the market, but bond issuance has yet to be conducted by many of the country's corporates. That leaves a huge source of business ready to be deployed.

But Indonesia's bond market is not going to meet its potential without a few changes. Bank lending limits create an obvious source of bond supply, but the market is currently dominated by a small number of issuers. It is clear that more issuers and investors need to be brought into this market to help it reach its potential. ASIAMONEY talks to a distinguished panel about just how to make that happen.

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SOUFAT HARTAWAN, HEAD OF FIXED
INCOME, INDONESIA, SCHROEDERS

ASIAMONEY [AM]: *The rupiah-denominated corporate bond market has enjoyed strong growth, even surprising some bankers who already had high hopes for the market. Why has the market grown so quickly – and do you see this as a continuing phenomenon?*

BASUKI SETYADJID, INDONESIA EXIMBANK: The growth of the rupiah bond market has been incredible to watch. It is partly being driven by greater appetite from investors, and by other factors, but the main reason is that companies simply need more funding. Indonesian corporations are becoming increasingly hungry for debt, and they cannot always be served by their bank lenders. The crucial role of the bond market is in serving the long-term financing needs of corporations.

Banks can provide financing of one to three years, and maybe even occasionally push out to five years, but corporations really need to go longer than that to support their businesses. They may require 10-year financing, or 15-year financing. In some cases, you see companies that even want to push their debt out as far as 25 years.

This is one of the main reasons Indonesia's bond market has been so bullish. There is a basic need to service corporations and it is a need that cannot be met elsewhere. It is also why I think the market will

continue to grow further. This is a complementary funding source to the bank loan market.

ILHAM W. SIREGAR, ASABRI: The bond market is looking very attractive right now, so it's good to see that these deals are ending up as loans. Investors are all hungry for this sort of paper.

Two or three weeks ago Dahlan Iskan, the minister of state-owned enterprises, invited us and other investors and state-owned companies to have a meeting. We discussed the domestic bond market, what sort of companies we are interested in investing in and a few other topics. The investors present all agreed that we were happy for these companies to turn to the market for long-term financing. It is good for both investors and issuers.

We are confident about the bond market – and that does not just apply to deals from state-owned companies. We are also hungry to invest in deals from large privately-owned companies and banks. From our view, those longer investments that go to the bond market are actually very attractive, so we're glad to see issuers choosing to come this way.



KIYOSHI NISHIMURA
CREDIT GUARANTEE
AND INVESTMENT
FACILITY (CGIF)

AM: *But isn't there still a big problem with the range of issuers? The last time the Asian Development Bank published its Bond Monitor report, the top 33 issues represented just over 80% of volumes in the market.*

SOUFAT HARTAWAN, SCHRODERS: We do not have a big range yet, and that is one thing we need to see change to develop the market. Indonesian investors have certainly been enjoying a very strong bull run in the domestic market over the last four years. The market has been fantastic, and investors have managed to get a relatively easy double-digit return every year. But this year it's going to be a different story.



ALAN GREENE
MOODY'S INVESTORS SERVICE

It is now becoming more difficult, and investors have to be more tactical. We want to get more exposure in the local credit market, but we need more diversity in terms of issuance. The market right now is dominated by the financial sector. Financial institutions issue more than 60% of rupiah-denominated corporate bonds. We want to see this change over time and see a true corporate bond market develop.

I'm confident it will change, though, because it should not be too difficult to bring more borrowers to the market. It is one of the cheapest markets they can get, it is flexible, and many companies would find that they have easy access to the market right now.

There is not any one sector that we need to see in the market; the best result would be if companies from a variety of sectors started seeing the bond market as a realistic funding option. We need to see more issuance from basic industries, from infrastructure companies and from the consumer sector.

Right now we are beginning to see pick up in terms of issuance from the property sector, which is good for us because government bond yields are giving us a negative real return. But hopefully that is only the beginning and we will see many more sectors in the market.

AM: *There does seem to be a captive investor base for Indonesian bond issuers, but on the other hand there is also a very liquid bank market. From an issuer's perspective, which market is more attractive? Should you always look at both markets to maintain diversity?*

JERRY FANDY, FIF GROUP: We always want a mix of funding sources because we know that debt markets are unpredictable. No-one can tell when conditions will be good in the bond market, the loan market or even the offshore markets. These markets will often move together but sometimes it is slightly easier in one market than it is in another, so you need to entertain a variety of funding sources.

It is not just loans versus bonds. We also have to combine a mix of amortising and bullet funding, as well as short-term and long-term. We have a funding plan of around US\$2 billion each year, so to meet that the local market is just one of our options.

One of the issues we would face if we decided to meet all of our funding needs just from local sources would be the banks' lending limits. Because we are a big borrower in the local market we are already coming up against these bank limits. That has made us actively look for bonds, as well as looking at the offshore market.

That is not the only area that could change. There are still some other things we are looking to see develop in the rupiah bond market. We have talked to a few bond underwriters and investors, and I get the sense that bond issuance needs to be modified so it can be absorbed by retail investors both in onshore market and offshore. That could make the secondary bond market become more liquid, which in turn would make it even more attractive to borrowers like us.

LEE KOK KWAN, CIMB: Across the Asean [Association of Southeast Asian Nations] +3 region the growth is mostly coming from the local currency bond markets. It became clear during the 1997-1998 Asian financial crisis that relying on foreign currency funding was toxic for both the sovereign and corporates, and I think the trend of development in the domestic debt markets will continue across the region.

Indonesia is growing strongly and the development is not simply in the form of more deals, or more issuers coming to the market. We are also seeing the size of individual deals getting larger and the term structure being extended from five year to seven year transactions.

Also as Jerry [Fandy] mentioned, single lender limits have become a problem for some borrowers, so there is definitely a need to source multiple funding avenues. That will of course include some offshore financing from both the syndicated lending and bond markets.

The potential of the rupiah corporate bond market is very strong, but we need to build the [market's] infrastructure to help the growth happen. The savings rate in Indonesia is 33% of GDP, while the corporate bond market is only 2% of GDP (gross domestic product). In the US, the [bond market] is in excess of 150% of GDP. That statistic alone shows you there is plenty of room for the market to grow. The issue is how to mobilise the vast amounts of domestic savings to fund and invest in the productive sectors of the economy efficiently.

Developing the retail bond market is a real possibility. Most of the bond issuers are already listed on the stock exchange, and if retail investors can buy the listed equity of these corporates they should certainly be allowed to buy bonds issued by the same corporate. After all, bonds are safer than equity.

There are many segments to develop, but from our perspective, the outlook for the rupiah bond market looks very good. Corporate profitability is at an all-time high and increasing, which reflects well on the outlook for credit risks

DENISE THEAN, RAM: Indonesia's local currency bond market is the fastest growing of the Asean five bond markets [comprising Thailand, Malaysia, Singapore, Indonesia and the Philippines]. The annual issuance has grown at compound annual growth rate of more than 35% over the last five years while outstanding size has grown at more than 30%.

Kwan mentioned that the corporate bond market is only 2% of GDP, but to add to that further: the entire domestic bond market is only 13% of GDP. In Malaysia and in Thailand, the bond market is worth more than 100% of GDP. This is partly just a function of maturity: the size of Indonesia's corporate bond market is about 15% the size of Malaysia's and it is about the stage that Malaysia was at during the late 1990s. It should be clear from these numbers that the growth potential in the market is huge.

The interesting thing is that a lot of foreign investors are very hungry to get exposure to bonds sold by Indonesian entities. We are seeing keen interest from domestic institutional investors in Malaysia, certainly, but there is plenty more besides that. Private bankers in Singapore for example have good risk appetite and are hungry for yield. For these accounts the market looks very attractive.

As long as we have such a variety of different investors trying to get exposure to the market, the growth potential will be strong.

AM: *One of the things that has surely helped that demand from international investors is the upward rating trajectory that Indonesia and other Asian countries are now enjoying. Moody's upgraded the sovereign to 'Baa3' at the start of last year. How has that impacted the credit standing of the country's bond issuers?*

ALAN GREENE, MOODY'S: Indonesia is now an investment grade country, and that's the majority view from ratings agencies. But whereas ordinarily you would expect that to lead to an uplift in individual companies, in fact the only ones that have been increased to investment grade are those that have clear state ties, such as Pertamina, which is state-owned, and companies in sectors like telecommunications, where there are other links to stronger backers.

None of the stand-alone ratings that we have for Indonesian corporations – whether it is a company like Adaro, which is rated 'Ba1', or in the single-'B' area where you have some of the property names – have seen an increase in their rating [as a direct result of the upgrade]. We do look at these on a global scale, so we compare companies to their global peers and at the moment they have not seen a boost.

Some corporations that have yet to come to the international bond market might be able to get an investment grade rating, but the companies with the natural US dollar flows – which tend to be resources companies – are not the strongest credits from a global perspective. The



upgrade has no doubt made investors more comfortable with the country risk, but it has not had a direct rating impact on many Indonesian companies.

We have seen some of the property companies come to the dollar bond market following the sovereign upgrade, and some of that is probably to do with the bank lending limits that have already been mentioned.

Pertamina's recent deal [a US\$3.25 billion dual-tranche bond issue sold in May] was an interesting issue. It's good from two points of view: on the one hand, it is obviously welcome simply as a means to develop the market – and it's a great sign for the sovereign, which relies on the dollar





ILHAM W. SIREGAR
ASABRI (PERSERO)

bond market for around 20% of its market funding – but for Pertamina, this was simply a great way to find the money it needs to fund its capital investment.

AM: *Let's get an issuer's perspective on the offshore versus onshore question. How does turning offshore compare to funding in the local market?*



JERRY FANDY
FIF GROUP

SETYADJID, INDONESIA EXIMBANK: When you compare two markets you need to look at more things than just the difference in pricing. For a lot of Indonesian companies the basic issue is the availability of funding. Pricing comparisons come second. If I need dollar funding, I can still sell a rupiah bond and swap it to US dollars. That is still absolutely cheaper than if I go overseas.

But the problem is that swap liquidity is not strong enough to cover all of the interest. It is difficult to find a counterparty for swaps of beyond US\$100 million. That means that even when offshore investors are demanding a higher price than we could get locally, we cannot fight them too much because we know they have a certain amount of power. The availability of funds offshore is a lot higher, so even though we have to pay more, it is still a better market for us.

LEE, CIMB: It is understandable that Indonesian companies sometimes need to go offshore for funding as they have tapped out their borrowing lines onshore. Sometimes they don't have a choice.

But there are risks to going offshore for funding that issuers need to bear in mind. The currency risk is very critical, but even when that is hedged mostly through the cross-currency swap market, the funding risks remain as foreign lenders are more prone to pulling funding lines as we saw in 1997/1998, 2008 and 2012. The more one relies on offshore markets for funding, the more vulnerable you are to shocks in other parts of the world.

The main push should be to develop the rupiah bond market. That will be the best result for everyone concerned, and will significantly reduce the systemic risks of the entire country on the downside. If there is no well-functioning corporate bond market, by definition the entire credit risks of the nation is concentrated in the banking system, from corporate borrowers to retail mortgage lending. We saw in 1997/1998 how dangerous it can be when the entire financing system of the nation seizes up, which we again witnessed in the West in 2008 and 2012

Legal and regulatory protection for investors is very critical to building investor confidence, which is key to developing the rupiah corporate bond market. Unlike equity investors, the only upside for bond investors is that they get paid their coupon and principal in full and on time. They don't have any other upside.

On the downside, bond holders' only recourse are the terms in the offering circular/trust deed and their ability to enforce covenants, collateral, sinking fund, ring fencing mechanisms of cash flows and so on, [using] the regulatory and legal systems to protect their interests. For example, do equity shareholders get wiped out before bondholders have to take a haircut and [are they] allowed to step in to own the company outright as per the terms in the offering circular?

Success in developing the corporate bond markets is very much a function of how well investors are protected based on the terms of the offering circular through both the regulatory and legal systems. As in any market, once there is demand the supply will come.

Banks are particularly crucial on two fronts in successfully developing corporate bond markets. The first point is for banks to be major investors of corporate bonds as structurally most of the nation's savings are deposited with banks and bonds are a clear corporate loan substitute.

For banks, the risks are the same between investing in bonds issued by corporates versus lending to the same corporate. In fact, it is actually safer from a credit risk perspective as the credit covenants of bonds are public documents with multiple bond investors facing the corporate issuer, so unlike with a bilateral corporate loan the borrower cannot just put pressure on a bank CEO [chief executive officer] regarding delinquency or enforcement of collateral or credit covenants. In Singapore, Thailand and Malaysia, banks can own more than 30% of corporate bonds.

This is a major part of the disintermediation process from the banking system. If banks own 30% of corporate bonds, by definition it means 70% of the corporate credit risk exposure has been dis-intermediated from the

banking system. As discussed, this significantly improves the resilience of the country's financial intermediation system on the downside.

The second critical role that banks play in developing corporate bond markets is to provide liquidity and be market-makers. A reasonably liquid bond market is absolutely crucial to developing investor confidence. It is banks that need to play this role as buy side investors are consumers of liquidity, not providers of liquidity.

However, for banks to provide liquidity, they need a proper functioning interest rate swap market to hedge off the fixed interest rate risk exposure in their corporate bond holdings, as otherwise they would suffer severe losses if interest rates were to spike up. These are some of the market developments that are crucial.

AM: *We're seeing more international investors coming into the Indonesian market, but much of that is going into government bonds. How attractive is the corporate bond market for local buyers?*

HARTAWAN, SCHRODERS: This is a good time for people to buy corporate bonds. Some of the paper out there can give you a 300bp (basis point) spread over government bonds. Part of the reason is perhaps that investors are asking for a greater risk premium to buy securities less liquid than government bonds. The spread between the two is not simply a function of credit risk, but also liquidity risk. Over time, as liquidity gets better, we are going to see spreads to the government tighten as well.

AM: *Indonesia not only has an enviable position in emerging Asia, it also has the largest Muslim population in the world. These twin factors ostensibly give the country a natural advantage in the heated competition among emerging nations to become a hub for Islamic finance. But sukuk [Islamic bond] issuance is still only a fraction of overall market and many market participants think this is unlikely to change soon. What is holding back sukuk issuance?*

THEAN, RAM: There are a lot of challenges for the *sukuk* market in Indonesia, but the main problem is the tax situation. Islamic finance in Malaysia has received a tremendous amount of attention and concerted efforts from the government and regulators in order to tilt the scales in its favour, and a big part of that has been in the creation of tax incentives and ensuring tax neutrality. This is not something we have really seen in Indonesia yet.

Despite the fact that Indonesian government officials have explicitly stated their intention to develop the market, they have still not put the entire ecosystem in place. That includes the intellectual side of the market – including the availability of skilled professionals with a deep understanding of the Islamic market – but really it applies to the whole gamut of the system. There are a lot of changes that need to be made before Islamic finance will really become a driving force in Indonesia.

There are signs this is happening already, albeit slowly. I understand that the sovereign *sukuks* from the Indonesian government benefited from a special legislation which tackled the tax issue. The question becomes whether a similar thing can be done for the corporate market. That would make a big difference. It really is the key issue at the moment.

HARTAWAN, SCHRODERS: The *sukuk* market is still too small to offer investors any confidence about liquidity; that is one of the other major issues.

We haven't got a dedicated *sukuk* portfolio at this point, but we do have a balanced *shariah* [Islamic law] fund that allows us to buy *sukuk*. The reason we haven't sold a pure *sukuk* fund is that the market simply hasn't grown to the point we want it to be, and the investor base is also small. There is very little liquidity, and although that means you get a



SOUFAT HARTAWAN
SCHRODERS

premium over regular bonds, the extra spread does not compensate us for the liquidity risk.

There is still a lot of hope this market will grow, however. We are not going to launch a *sukuk* fund any time this year, but we are watching for the market infrastructure to be established more.

FANDY, FIF GROUP: We haven't issued *sukuk* bonds yet, and the reason why is because there was simply no chance in the past. We would consider *sukuk*,



BASUKI SETYADJID
INDONESIA EXIMBANK

but for us it is really the same as a conventional bond – the comparison between the two comes down to pricing.

There are some extra difficulties with *sukuk* issuance, besides the pricing and the tax. One problem is unavoidable: the fact that it needs to be *shariah*-compliant means you need to take some time to speak to Islamic scholars, and that consumes your resources for some time. This is obviously not something you need to do for a conventional bond, and the ease of issuing has to be taken into consideration.

We are in a very good position so we do not need to issue *sukuk* right now. The market is, at this point, not really big enough. But we would certainly consider it in the future. We hold a lot of *shariah*-compliant assets, so it would not be too difficult for us.

AM: *Have you had discussions with the CGIF [Credit Guarantee and Investment Facility]? That would seem like a natural evolution for your issuance.*

FANDY, FIF GROUP: We have not had discussions with the CGIF, but actually last year we were offered a similar structure by a bank. The timing is not really good at the moment, but we are always open to discuss that possibility. We have roadshowed in Singapore before to market our Indonesian rupiah bonds and we got a good response, but we would like to build on that.

AM: *What sort of role can the CGIF play in developing funding opportunities for Indonesian corporations?*

KIYOSHI NISHIMURA, CGIF: We are a multilateral facility, rated 'AA+' by Standard and Poor's and 'AAA' by RAM. We have a very good credit standing, and we can give this credit to corporations in the region by offering a guarantee.

The Asean +3 governments decided to establish CGIF because they looked back to Asian financial crisis, and they learned the lesson about too much reliance on short-term foreign currency borrowing. When the currency crisis hit, and there was no foreign currency lending available, a lot of the local borrowers were hit by two mismatches: a maturity mismatch and a currency mismatch. These governments now realise they should develop their local currency bond markets,

For now, we want to focus on promoting cross-border transactions. The region has become a lot more integrated, and Asean companies are looking towards their neighbouring countries for growth. They need to diversify their funding sources when they move into the new market. But even when you're a very established company in one Asean country, it is difficult to go elsewhere.

One of the problems is the rating hurdle. Some companies will find their ratings will be capped at their sovereign's rating. But even when that is not a problem you are still trying to appeal to an investor base that does not really know you well. That makes it very likely you will be a higher funding cost than you could get in your home country. A lot of companies decide it is just not worth it – but that can change with help of CGIF guarantees.

We would like to support Asean companies that want to move into new markets in the region. That's the main plan. But we also want to help increase tenors in Asean bond markets. For example, in Indonesia most bonds are still up to five years [in terms of maturity]. The CGIF guarantee could, perhaps, be used by companies that have already issued bonds but have found a problem with pushing maturities out longer. With our help tenors can be extended up to 10 years.

The fast growth of this market is very good, but one of the things to watch out for is the concentration risk. In fact, about 30 issuers account for 80% of the Indonesian bond market. These big, repeat issuers – mainly financial institutions – really dominate. They are almost reaching the limit at which they will be able to issue in the local

market. They have a choice. Instead of relying on the domestic market, they should diversify their funding sources. Also more new issuers should be allowed to tap the bond market. In both fronts, CGIF guarantees can help more diversification in the market.

AM: *The major issuers have the chance to do a lot more offshore borrowing than do those smaller companies, including borrowing in other Asean markets. Will you be pushing overseas more in the future?*

SETYADJID, INDONESIA EXIMBANK: Exim Bank was formed under law, and all of our activity was stipulated under that law. That makes it very difficult of us to look for new ways of financing. It is our job to support the export industry in Indonesia, and our funding sources are clear in the law. We cannot not take deposits, and apart from cash injections from the government we need to be very active in entering the capital market, either local or offshore.

We have been busy, both in the domestic market and the international market. The most important thing for us is perhaps to introduce ourselves to new investors. That allows us to make sure that we can tap a variety of different markets.

KWAN, CIMB: It is the rupiah market where we will see the strong growth. The fundamentals are all in place – and the future looks very bright for the markets in this part of the world. Indonesian issuers will certainly want to fulfill some of their funding needs in the dollar market, but the domestic market is the one to watch.

AM: *This is only one of many events that Asiamoney and CIMB are planning to host on the developing Asean bond market and it is clear from the response we have seen so far that there is a lot of confidence in the market. But there are also a lot of hurdles to overcome: whether convincing borrowers to fund in other Asean markets, or bringing more investors into domestic debt markets, or utilising the high savings rates of Asean economies.*

There is clearly work being done to overcome these hurdles but, realistically, will Asean markets grow together or will they all develop at different paces, and even in different directions?

LEE, CIMB: The factors driving the growth are largely similar and it is just question of pace. Asean bond markets today are recognised as a credible asset class globally. Its economies are expected to continue growing reasonably most with GDP around 5% or higher, strong levels of FX [foreign exchange] reserves, high savings rates, ample liquidity and banks that are well capitalised with much lower leverage comparatively.

We also expect to see exponential growth in both real trade of exports and imports as well as investment flows within Asean and between Asean and China, South Korea and Japan. This development is very good for Asean economies as we become more diversified and less dependent on European and US economies as drivers of growth.

The direction of Asean bond markets will naturally follow and this growth will largely take place in the local currency bond markets as opposed to the US dollar funding markets. The lessons from 1997/1998 have been learnt and 2008 and 2012 were strong reminders how dangerous reliance on foreign currency funding can be. And there is really no need to depend on foreign currency funding when domestic savings are so high relative to the rest of the world and FX reserves well built.

There are also significant government initiatives through the ABMI [Asian Bond Markets Initiative] Asean +3 Bond Market Forum to develop the regional local currency bond markets focusing on cross-border issuance and cross border investing within the region so that Asean +3 is able to invest better in its own region. ▲



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