

BROUGHT TO YOU BY CGIF

Developing Local Currency Bond Markets

Filling Asean's Infrastructure Financing Gap



Credit Guarantee &
Investment Facility
An Asian Bond Markets Initiative

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Infrastructure Financing's True North

The runaway infrastructure deficit in many emerging economies can be attributed to two simple causes: 1) an increasing need for infrastructure; and 2) the inadequate financing solutions available. And between these, clearly finding adequate financing solutions is more realistic than curtailing the demand for infrastructure.

Unfortunately today, the financing burden principally falls on the laps of governments and ultimately taxpayers. Both stretched, private sector participation is now more crucial than ever. The Asian Development Bank (ADB) estimates private sector financing will have to increase from US\$68 billion a year today to US\$250 billion a year, over 2016-2020, to fill the gap for developing Asian countries (ex-China).

Private sector financing—when dissected—reveals that while there is more than adequate equity contributors for “good projects” from sponsors and private equity funds, there are not sufficient debt providers to fund up to 80 percent of a project’s capital structure appropriately. Without long-term debt at fixed rates and matching currencies with the projects’ revenues, unsustainable solutions like dollar indexation are often deployed to pass on the financing risks to off-takers and governments to make a project “bankable”. Collecting local currencies to service foreign currency debt is untenable to both project companies and economies as proven by the 1997-1998 Asian crisis.

The sustainable solution is to turn to mobilising indigenous long-

term savings to fund infrastructure assets. This entails two critical steps—creating deep pools of long term savings, and developing the country’s local currency bond markets especially for non-recourse project bonds.

The first step is often not associated with infrastructure financing rather concerns on retirement and aging. Connecting the two makes perfect sense—with infrastructure assets providing conservative savers, stable returns devoid of the volatility far into the future. While most Asian countries are prolific savers, these savings, when intermediated by banks, are inefficient as a source of long-term debt financing needed by infrastructure projects. Therefore, the proliferation of provident funds and pension schemes, and the development of the life insurance sector are needed towards creating the necessary deep pools of long-term savings. Once these savings start to accumulate, they are often quite predictable based on the demographic profile of a country.

The next step will be to ensure they can be mobilised to finance infrastructure directly. The most efficient method is via the local currency project bond market. Towards this end, CGIF has been working to first develop local currency bond markets in the ASEAN region, and subsequently project bonds as an asset class within these. It is likely local bond investors will struggle to understand the intricacies of a project’s risks, and would need assurances like

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CGIF’s guarantee to venture into this space. For those more comfortable with the operations phase but not construction risks, CGIF’s Construction Period Guarantee can help as it falls away on commencement of operations.

These credit enhancement products, and the structuring skills behind them as well as the continued efforts to educate investors make up the important developmental interventions that will help mobilise long-term savings needed to finance projects.

CGIF alone cannot meet this challenge. Well-run, sovereign-backed guarantors can also play a role to build confidence, absorbing project risks not well-understood yet by the guardians of local long-term savings. There is now sufficient expertise and track record for such institutions in the region. Multilateral guarantors like CGIF, as well as the global reinsurers behind them, can further supplement their capacities taking the model of separating funding and risk taking/ participation to new heights. To rein in the infrastructure deficit, similar initiatives with larger capacities will be needed to join in this new journey northwards. ■