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## **Developing Efficient Domestic Capital Markets**

**Presented by:**

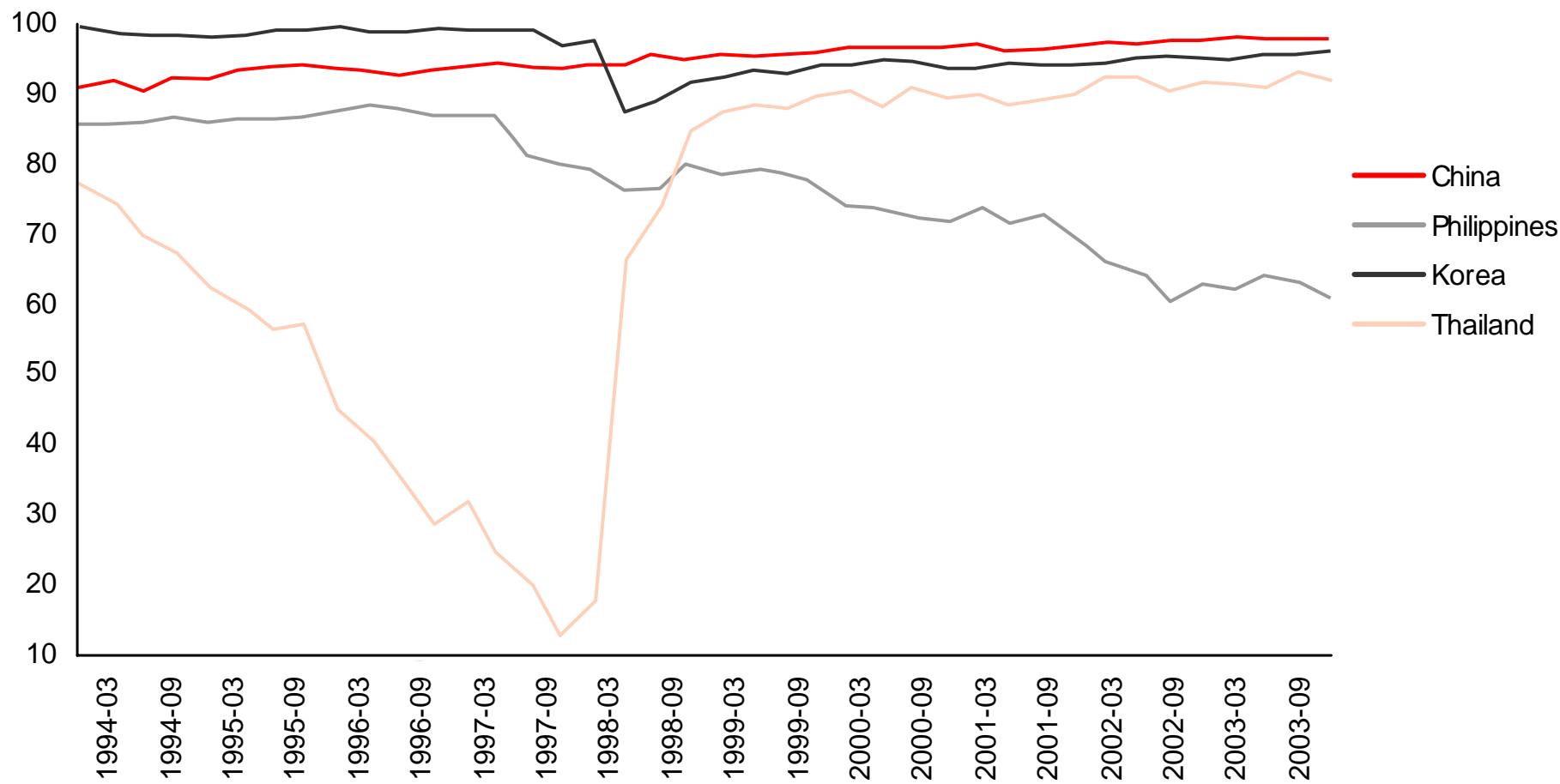
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**Financing the City: New Approaches to Local Currency Financing,**  
**Istanbul, Turkey**

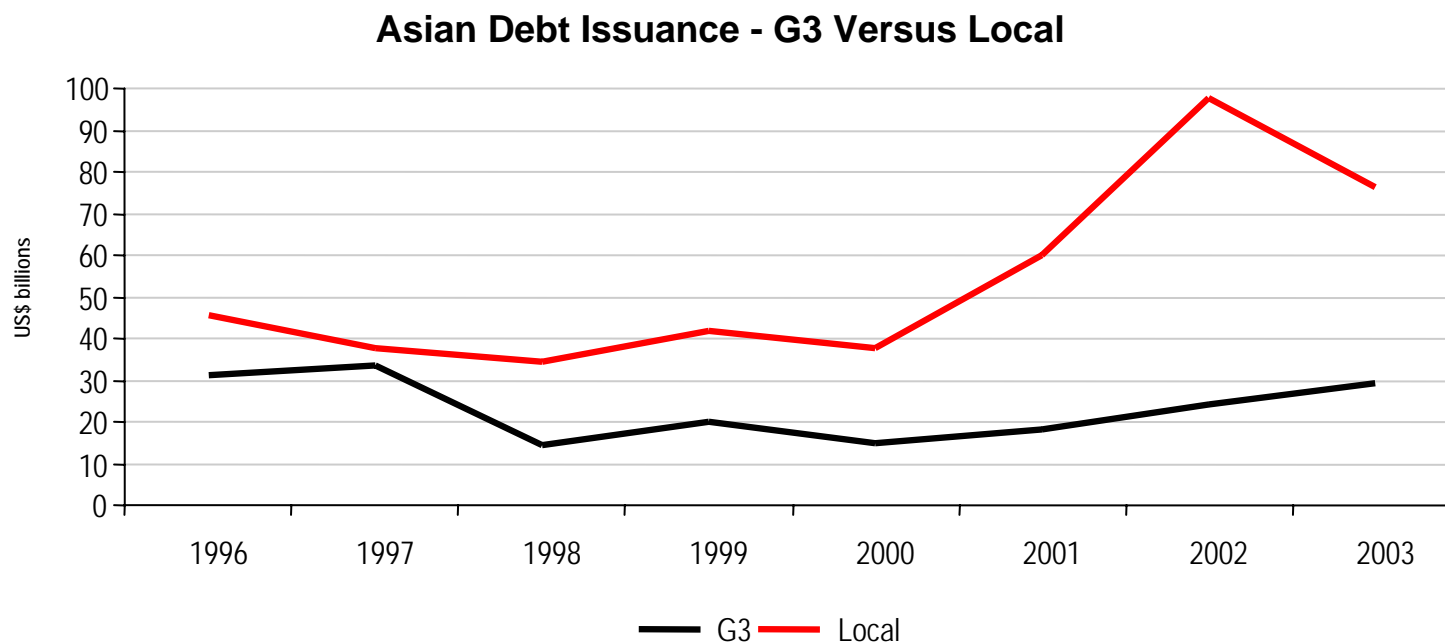
**May 3, 2005**

**HSBC** 

# Asia - Domestic share of marketable government debt



# Asia's Burgeoning Domestic Markets

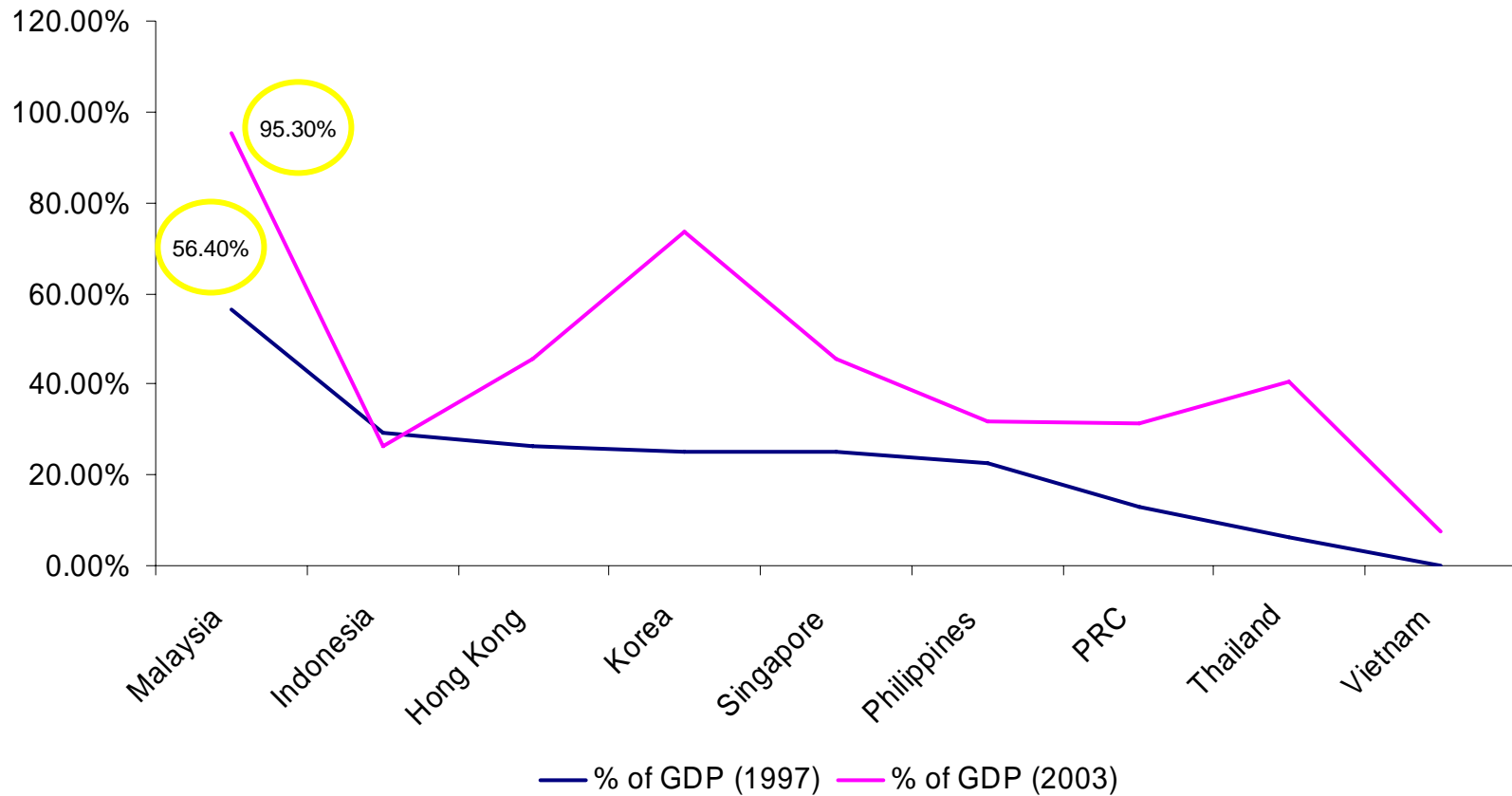


Source: Thomson Financial & HSBC  
G3 ex-JPAU, incl. Samurai & Yankee; Local Currency ex-JPAU, incl. CDs

- Domestic bond market growth driven by liquidity and government initiatives
- Asia's domestic markets are too diverse to be considered a 'Regional' market
- Clear need to direct development away from divergence and towards convergence











# Size of East Asian Local Currency Bond Markets

## Local Currency Bond Markets (% of GDP), 1997 v 2003



Source: HSBC, ADB ERD working Paper Series No. 63

# What is Asia's Credit Profile?

Countries		Foreign Currency Ratings			Local Currency Ratings			Changes in Ratings Since 2000	
		Moody's	S&P	Fitch	Moody's	S&P	Fitch	Foreign Currency	Local Currency
	<b>Singapore</b>	Aaa	AAA	AAA	Aaa	AAA	AAA	↑ Aaa / AAA / AA+	↑ Aaa / AAA / AAA
	<b>Taipei China</b>	Aa3	AA-	A+	Aa3	AA-	AA	↓ Aa3 / AA+ / A+	↓ Aa3 / AA+ / NR
	<b>Hong Kong</b>	A1	A+	AA-	Aa3	AA-	AA+	↑ A3 / A / A+	↑ A1 / A+ / AA+
	<b>China</b>	A2	BBB+	A-	NR	B+	NR	↑ A3 / BBB / A-	-
	<b>South Korea</b>	A3	A-	A	A3	A+	AA-	↑ Baa2 / BBB / BBB	↑ Baa1 / A / A-
	<b>Malaysia</b>	Baa1	A-	BBB+	A3	A+	A	↑ Baa3 / BBB / BBB	↑ A3 / A / A-
	<b>Thailand</b>	Baa1	BBB	BBB	Baa1	A	A-	↑ Ba1 / BBB / BBB-	↑ Baa1 / A- / BBB+
	<b>India</b>	Baa3	BB	BB+	Ba2	BB+	BB+	↑ Ba2 / BB / BB+	↓ Ba2 / BBB / BBB-
	<b>Philippines</b>	Ba2	BB	BB	Ba2	BBB-	BB+	↓ Ba1 / BB+ / BB+	↓ Baa3 / BBB+ / BBB
	<b>Indonesia</b>	B2	B	B+	B2	B+	B+	↑ B3 / CCC+ / B-	↑ B3 / B- / BB-

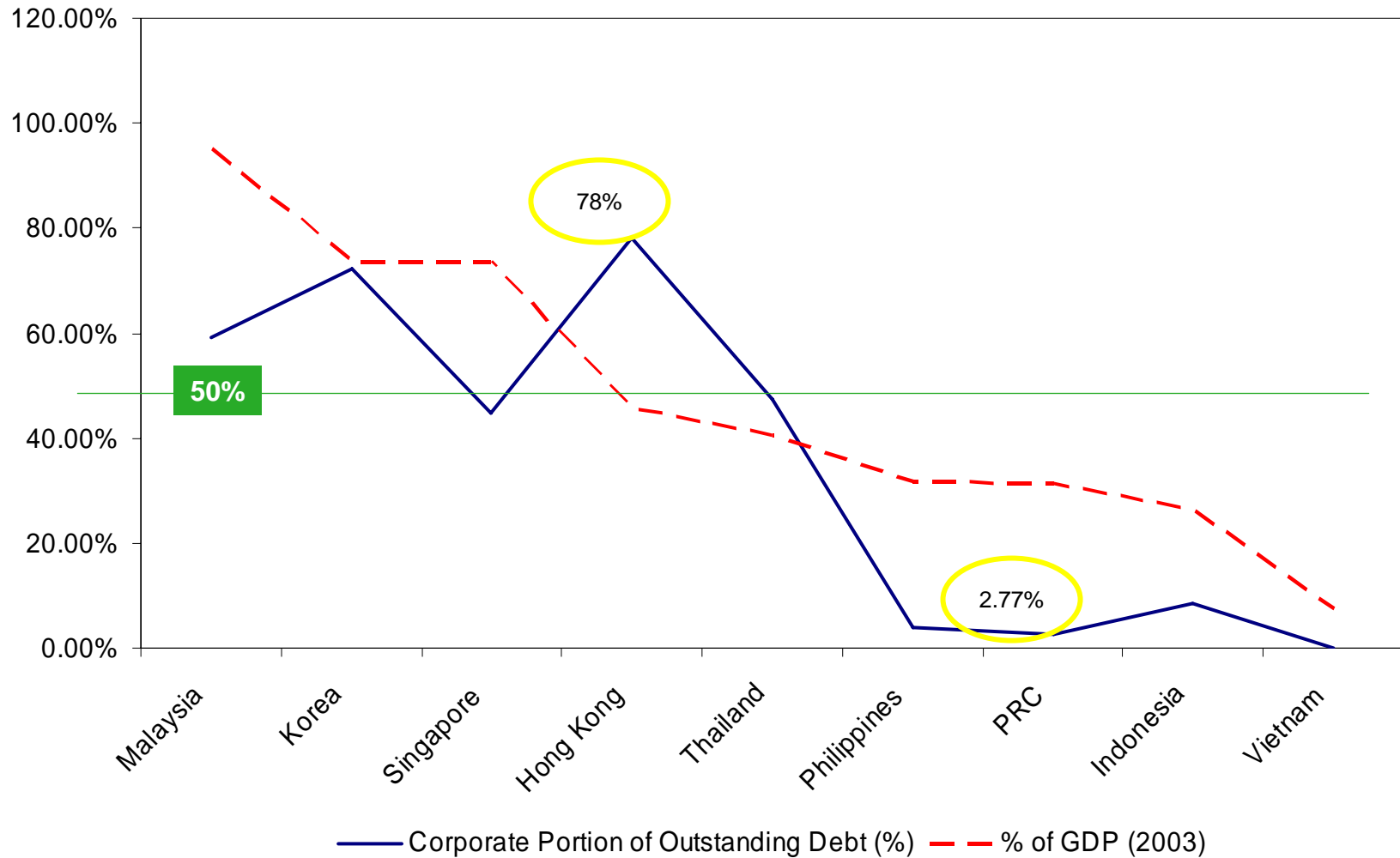
Note: All credit ratings stated are long term ratings

# What are Risk-Free Rates in Asia?

Country	1-year	2-year	5-year	7-year	10-year
<b>China</b>	2.77	3.58	4.52	4.78	-
<b>Hong Kong</b>	1.37	1.91	3.09	3.56	3.93
<b>India</b>	5.24	5.73	6.15	6.33	6.14
<b>Indonesia</b>	6.98	8.52	10.64	11.42	11.59
<b>Malaysia</b>	2.67	-	4.06	4.62	5.08
<b>Philippines</b>	9.96	-	12.30	12.77	13.47
<b>Singapore</b>	1.50	1.66	2.27	2.85	3.31
<b>South Korea</b>	3.55	3.62	3.86	-	4.24
<b>Taipei China</b>	-	1.35	2.21	-	2.87
<b>Thailand</b>	1.81	2.40	3.67	4.30	4.73
<b>Euro Government</b>	2.30	2.61	3.41	3.72	4.07
<b>US Treasury</b>	-	2.47	3.37	-	4.15
<b>Yen Government</b>	0.04	0.15	0.70	1.06	1.53

Source: Bloomberg, Chinabond (14 Sep 2004)

# Relative Size and Corporate Portion of Domestic Bond Markets



Source: HSBC, HK Institute for Monetary Research

# Asian Local Currency Bond Market – Post-Asian Crisis



- Greater focus on developing local currency bond markets on both national and regional levels
  - ✓ Ideally, Asian countries should strive to achieve a regional securities framework that encourages increased capital flow within the region and recycles this ample liquidity within Asia, to the ultimate benefit of the Asian economies.
- Regional bond market development initiatives
  - ✓ ASEAN+3 (Asian Bond Market Initiative)
  - ✓ APEC Finance Ministers Meeting (APEC FMM)
  - ✓ Executives' Meeting of East Asia Pacific Central Banks (EMEAP)
  - ✓ Asia Cooperation Dialogue (ACD)

# Launch of the Asian Bond Fund



- The Asian Bond Fund (ABF1)

- ✓ Announced in 2003 as a joint effort of EMEAP economies to promote the development of local Asian bond markets
- ✓ EMEAP includes 11 central banks and monetary authorities : Australia, China, Hong Kong, Indonesia, Japan, the Republic of Korea, Malaysia, New Zealand, the Philippines, Singapore and Thailand
- ✓ Initial capital of US \$1 billion invested in sovereign and quasi-sovereign bonds

# Background of ABF2

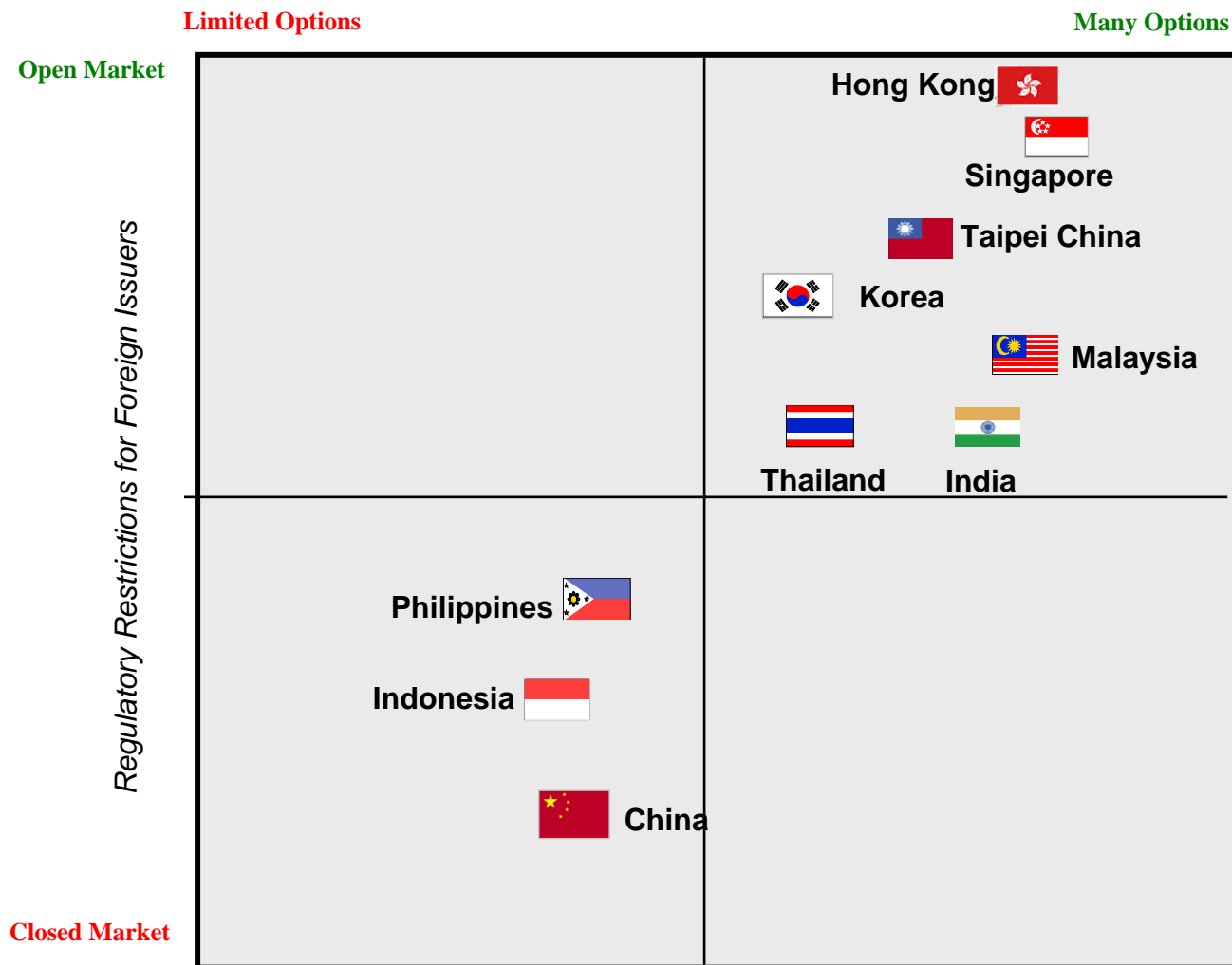
- ABF2 was announced in 2004
  - ✓ Expected launch mid-2005
  - ✓ Initial US \$ 2 billion of capital to be contributed from the 8 developing EMEAP economies, including China, Hong Kong, Indonesia, Korea, Malaysia, the Philippines, Singapore & Thailand
  - ✓ Fund would be allowed to invest in non-investment grade issues as well as high investment grade issues.

# Background of ABF2



- All of the following factors contributed to the establishment of ABF 2:
  - ✓ Growing need for regional economic and financial cooperation on back of sustained economic recovery and global influence in global economy post Asia financial crisis
  - ✓ Increasing need to allocate growing FX reserves away from USD assets and back to Asia assets, i.e., to fund local growth
  - ✓ Need to stimulate local bond market development via a specific product such as ABF2, which may require coordinated initiatives across all participating member economies
  - ✓ The success of ABF1 and the EMEAP organization, esp. its Working Group, sets up the foundation for purchasing the much more difficult and ambitious ABF2

# Funding Alternatives

Availability of Funding Options for Foreign Issuers

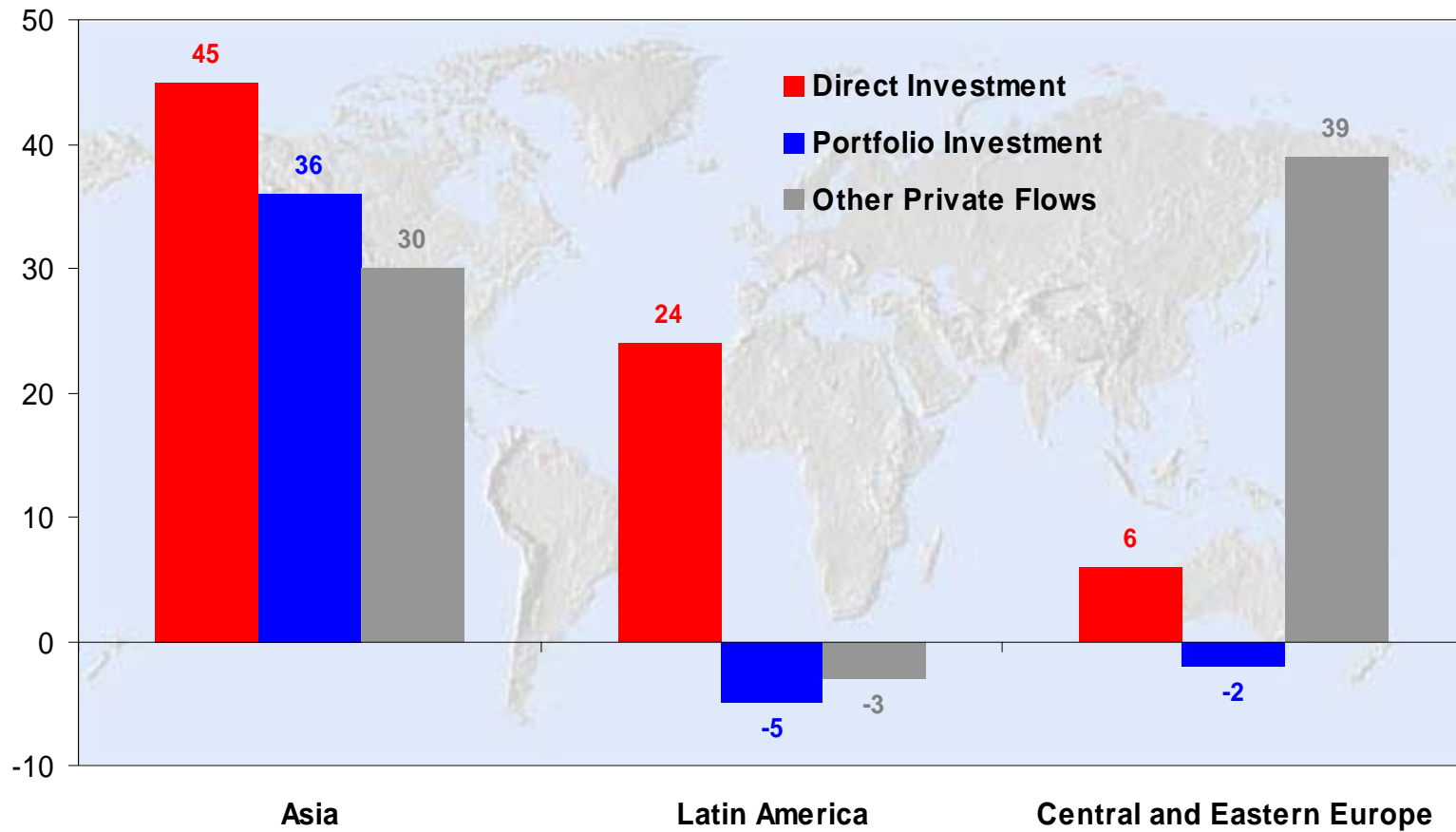


# Derivative markets increasingly well developed

COUNTRY (CURRENCY)	ONSHORE CURRENCY SWAP	ONSHORE INTEREST RATE SWAP	DOMESTIC FLOATING RATE INDEX	INDEX REFERENCE PAGE	
 Hong Kong SAR (HKD)	10Y	10Y	HIBOR	<u>TELERATE</u> 9898	} High Liquidity
 Singapore (SGD)	10Y	10Y	DOMESTIC SWAP OFFER RATE (SOR)	<u>TELERATE</u> 44178	
 India (INR)	3 - 5Y	3Y	o/n MIBOR	<u>REUTERS</u> MIBR=	} Medium Liquidity
 Korea (KRW)	10Y	10Y	91-DAY CD	<u>BLOOMBERG</u> KSDA4	
 Taipei China (NTD)	7 - 10Y	7 - 10Y	90-DAY CP	<u>TELERATE</u> 6165	
 Thailand (THB)	7 - 10Y	7 - 10Y	DOMESTIC SWAP OFFER RATE (SOR)	<u>REUTERS</u> THBFIX=TH	
 Indonesia (IDR)	3 - 5Y	3 - 5Y	DOMESTIC SWAP OFFER RATE (SOR)	<u>REUTERS</u> IDRFIX	
 Malaysia (MYR)	3 - 5Y	3 - 5Y	KLIBOR	<u>REUTERS</u> KLIBOR	} Low Liquidity
 Philippines (PHP)	5 - 7Y	5 - 7Y	3-mth or 6-mth PHIREF	<u>REUTERS</u> PHIREF	

# What Drives FDI in Asia?

(USD b)



Source: BIS 74th Annual Report

# Financing FDI in Asia: What are the Key Concerns?



- Hurdle rates commensurate with risks of host countries
- Economize on the amount of equity and inter-company loans
- Subsidiaries will have to borrow more on their own capacity and balance sheet, both locally and overseas, while generating sufficient returns to finance internally ongoing expansion
- Basel Capital Accord may increase cost of funds for Asian borrowers/ projects
- Capital-intensive sectors constrained by the inability to raise cheap capital locally
- Diversify sources of funds from local capital markets to expand local operations and manage currency and interest rate risks