ASEAN bond & treasury markets roundtable: Developing the debt market

PANELISTS:

Chong Kin Leong, executive vice president, finance, Genting

Chung Chee Leong, president/chief executive officer, Cagamas

Khoo Boo Hock, vice-president, operations, Credit Guarantee Investment Facility

Chu Kok Wei, group head, treasury & markets, CIMB

Arup Raha, chief economist, CIMB

Nor Masliza Sulaiman, global head, capital markets, CIMB

Esther Teo, head of fixed income, Affin Hwang Asset Management

Moderator: **Matthew Thomas**, contributing editor, *Asiamoney*

Asiamoney* (AM): *In the last panel, we focused quite a lot on the macroeconomic picture, considering the impact of the slowdown in China, rising rates in the US and the impact of greater ASEAN integration. This discussion will focus much more on the facts on the ground when it comes to bond issuance and investors. But the starting point for a lot of investors is going to be figuring out where rates are going, and figuring out where currencies are going. What should they expect?

Arup Raha, CIMB: Let me start with a story. Around September last year, we took an informal survey — we asked people: if you could choose what currency your salary would be paid in next year, what would it be? I have to tell you that very few people chose the ringgit at that stage. It is now the world's best performing currency, so predictions on these things should always be taken with a pinch of salt.

We certainly expected the ringgit to be weaker than it is now. We felt there were four big external factors that would

drive the ringgit lower. The first is interest rate expectations in the US. We started the year with the Federal Reserve expecting 100bp of increase, and the markets expecting 50bp. We're now at a point where the Fed expects to raise by 50bp, and the market expects it to rise by 25bp, or perhaps not to raise rates at all. As far as expectations are concerned, there has been a loosening of Fed's policy stance.

This feeds into the second factor: expectations of US dollar strengthening. The two things are obviously connected, and what people have perhaps got a little bit wrong is that expectation that although the bull run in the dollar is largely over, there is still going to be some strengthening. I still expect that, over the medium term, because of the policy divergence between the US and Europe, Japan and, to a certain extent, China.

The third factor was the weakness of the renminbi. We still think the renminbi will get weaker, largely because of what China is trying to achieve. They know that over the medium term, the Chinese economy is likely to slow, but they want to make sure it lands OK. The only way it lands OK is if there is continued stimulus; that is going to show in the value of the renminbi.

The fourth factor, and the real surprise for us, was the rally in commodity prices. We still expect commodity prices to be soften, although the major source of commodity price weakness is over. We are seeing signs of activity in the Chinese , we are seeing Chinese PMIs improve, housing numbers are getting better, but we think this is temporary.

If you take the four factors together, the outlook has not changed dramatically. That means we still expect US interest rates to go, the dollar to rally, the renminbi to be weaker, and commodity prices to be soft. That means that, from here, most likely, there is more downside to the ringgit than upside. We think a similar situation will play out for the Indonesian rupiah. I'd ask investors not to get too caught up in the numbers, but to think of the factors driving commodity values.

AM:*There are two factors to consider for people in this room: the first is making predictions about where rates and currencies are going to go. But the second part, arguably more important, is making sure they hedge these risks effectively when they have made the analysis. How flexible are the hedging options available to investors and issuers in the bigger ASEAN markets?*

Chu Kok Wei, CIMB: The big risk is that we analyse so much that we don't act. Volatility is a given. The short-term noise can be so loud that it crowds out the long-term view. We are going through a process of forcing our traders to write down the base case outlook and stick that on their screens. Volatility will be very loud around the base case, but that number always needs to be kept in mind. That is very important, otherwise traders are always second-guessing their actions, and saying, 'I should have done this, I should have done that.'

That, to me, is a very important framework to promote. Have a sense of where you expect markets to go before the volatility happens, don't make those estimates when the volatility is occurring. Because during the volatility, the whipsaws will be so violent that most of us can't think very straight at that time. You really need a bearing at that time.

In terms of the actual hedging products, there is enough available. Fundamentally, risks don't get far from currency exposure, interest rate exposure and, for some issuers, commodity price risks. In each case, most of the hedging flexibility is there for these markets. We are not lacking any innovative instrument that would change the situation for issuers; we are lacking a bit of action.

AM:*If the spread of products necessary for companies to hedge is largely there – at least in this market – is the liquidity sufficient in those products to ensure they can hedge without problems?*

Kok Wei, CIMB: Liquidity differs from market to market, but in many countries the situation is good. In Malaysia, across most asset classes, there is sufficient liquidity. In Singapore, the liquidity is fine. In Indonesia, FX hedging solutions are probably more liquid than rate or commodity solutions. There is sufficient liquidity in these markets; the important thing is market participants developing a very active framework to understand and work around market volatility.

Issuers complain at times that they are not getting a tight bid-offer spread in periods of illiquidity and volatility, but they need to understand that in such a market, the cost of not hedging can be much greater. Liquidity could improve, of course, but it is largely there. The key is for issuers to use the options available to them.

Esther Teo, Affin Hwang: The derivatives market in Malaysia is relatively OK compared to some other ASEAN countries. When you look at more sophisticated markets like Singapore, it becomes obvious that there is an inverse relationship between regulatory restrictions and market sophistication. The more regulators become relaxed about the rules, the more the market can grow and become more sophisticated in terms of the instruments available, or the market players that are able to participate. In Singapore, it is not just institutional money; private banks play a big role in developing the market as well. That helps create a more robust hedging environment.

In the ASEAN as a whole, we are still in our infancy in terms of derivatives and hedging solutions. A lot of us in this room are real-money, institutional investors. But how many of us look at hedging our interest rate risk? We are still in a very early stage of going in that direction, because there have been a lot of challenges for investors. Some policies, particularly at pension funds, need to be updated to get with the times. They often do not allow investment managers to hedge rate risk. This is starting to change, but it is a slow process.

In terms of the product availability: for interest rates we have the interest rate swap market, which is fairly liquid; for the FX market we have FX forwards, which are fairly liquid as well. In Affin Hwang we have started the process of hedging some of these risks in our portfolios since 2012, although at the moment a lot of our rate risk has not been hedged because we think rates are going lower. We have put some hedges in place to figure out the options, and make sure we can do it in future. FX hedging is perhaps more important for us, since FX volatility can eat away returns.

It is not just a question for investors, though. It is also very important for issuers to look at hedging the risks that arise when they issue bonds. We saw last year when the rupiah depreciated greatly, a lot of Indonesian issuers faced the risk of credit rating downgrades because they had issued dollar bonds without hedges. After that experience, a lot of issuers have learned to be proactive.

Chung, Cagamas: Cagamas practices a strict match-funding policy, meaning to say that all the loans we purchased are funded by bonds of matching size, duration and self-sufficient in cash flows. This has been the case since day one of Cagamas' operation. In the case where Cagamas issues foreign currency bonds, all the foreign currency exposure must be fully hedged and qualified for hedge accounting. The market options are actually available for issuers and investors at this point when it comes to hedging, it is just a question of pricing.

In terms of tenors, price discovery beyond 10 years is normally not efficient for hedging. We find that we can easily hedge the foreign currency and interest rate risk for tenors of around seven years, at the most. But a liquidity premium kicks in between seven years and 10 years and beyond 10 years hedging no longer seems efficient. This is something that should be of concern to issuers, because it limits our options.

Masliza Sulaiman, CIMB: We have witnessed a lot of adventurous corporates venturing abroad, arising from the fact that these Malaysian corporates are growing and hence getting more overseas exposure. We see a lot of rupiah exposure, a lot of dollar exposure, and a lot more diversity in terms of funding currencies. In the last few years, we have been placing emphasis on helping these corporates fund their operations abroad via a direct foreign currency funding or via a synthetic deal where they are funded in the most optimal currency via cross currency swaps and therefore eliminates their currency risk.

We are equipped in terms of looking at different ASEAN currency markets, as well as the G3 markets, so we are happy to run the analysis for our clients on the most optimal market to tap. This also takes into account the target size and tenure of an issuance and other objectives the issuers may have.

There are a lot of investors in Malaysia who have ventured abroad, often into the Indonesian rupiah market. This is commendable, and is the sort of development we need to see in this region. Some of these investors have accepted the currency risk, but we have also seen investors hedging their currency risk. We need both types of investors to develop cross-border flows.

AM:***In the very first event we did in this series four years ago, there was quite a long debate about capital flight and the risk of hot money from foreign investors. Given the changes we have seen in the global markets over the last year or so, in particular rates going up in the US, how much should that still be a concern to governments and other market participants?***

Boo Hock Khoo, CGIF: Things are very different now than they were at the time of the Asian financial crisis, but the noise around the markets sometimes does not make this distinction. People have long memories, but things have changed tremendously. Governments can certainly continue with the reform process but the baseline, as Chu says, needs to be confidence. You're going to have capital flight if there is no confidence, but if the base line talks about the competitive nature of the economy, the reduced reliance on oil, and the consumption story here in Malaysia, confidence will follow. The country is very different than it was in the run-up to the financial crisis.

Things have changed in other ways, as well. We used to have a negative view on printing money and on capital controls. But now quantitative easing is cheered and Haruhiko Kuroda [the governor of the Bank of Japan] is recommending to the Chinese that they tighten capital controls. Now we have negative interest rates: try explaining that to your parents. This is the new normal and it is a very different situation to what we have experienced in the past. These unusual policy levers did not exist a few decades ago, but they are now an option to policymakers across the region.

All of these tools should also be on the table for Asian governments, but confidence is the biggest factor. Governments need to ensure they have confidence from both domestic and international investors, and they can do that through reforms. The Philippines has done a great job in this regard. Vietnam is building confidence rapidly. Many ASEAN countries are on this trajectory.

AM:***The rise of quantitative easing has certainly represented a major addition to the policy options now at the disposal of governments across the globe. But the limits of this policy has also been displayed. Japan seems a prime example: massive quantitative easing and a programme of negative interest rates have had little impact on corporate confidence, investor confidence or even on the currency.***

Khoo, CGIF: That's a valid point. We're entering this uncharted territory. It raises the question: how negative will negative interest rates be? At some point, people will start taking cash out of the bank and keeping it physically. We live in very different, and very difficult, times today. It is becoming increasingly hard to look in the crystal ball and see where things are heading.

Arup Raha, CIMB: Monetary policy is not the only tool, and monetary policy may have reached its limits. The only similar experience we have had was the Great Depression. That led to the New Deal from FDR, but the world still did not recover fully; it took World War II to spark a recovery. Everyone spent money to fund the war, so there was co-ordinated – albeit not planned – fiscal stimulus worldwide.

A large part of the economics community has been saying for a long time that fiscal policy needs to play a larger

role. There have been policy mistakes. The US put into place a $800bn stimulus package, but the chief economic adviser at the time had asked for $1.4tr. Europe mistakenly went for austerity in 2011. Japan has raised the consumption tax, thinking that they were out of the bad times. Because of these policy mistakes, it is incorrect to put the entire onus on QE.

QE did what it was supposed to do, which was to keep the banking sector liquid and avoid a complete crash. Fiscal policy hasn't stepped up.

AM:*How attractive are the Malaysian and Indonesian debt markets right now? How easy it is for investors to find deals that meet their yield requirements?*

Teo, Affin Hwang: At the start of the year, we were very bullish on the Indonesian and Malaysian debt markets. The fundamentals of these countries are still strong.

Indonesia is moving in the right direction in terms of policies and infrastructure spending. Inflation is coming down. We expected the central bank to cut rates by 100bp this year, so far they have delivered 75bp. That was our biggest call for the year: to overweight Indonesian rupiah government bonds.

At this point our strategy with Indonesian government bonds is to buy on dips. We think the central bank will adopt a wait-and-see mode when it comes to further rate cuts, which makes it likely that the market will trade sideways for a while.

We do not hedge our rupiah exposure because the rupiah and the ringgit tend to move together, and the hedging costs are quite high. But that has paid off for us this year, since the rupiah has performed quite well.

Our strategy is fairly neutral at this point, but over the next few months there is a chance that Bank Indonesia could deliver more rate cuts, so we expect bond yields to go lower.

In the ringgit market, after the sell-off in the country last year, and the fall in commodity prices, the worst appears to be behind us. The ringgit has found some stability now, and for that reason we are more comfortable than we were last year.

It is worth mentioning that there are a lot of foreign investors in the ringgit bond market. They make up about 31% of the total government bond investor base, and even when the ringgit corrected by around 20% last year, we did not see huge outflows from these investors. The Asian Development Bank estimates that about 30% of these investors are central banks or sovereign wealth funds, which have a long holding period, and another 18% are pension funds in the ASEAN region. Japanese investors are also involved; these are long-term investors.

We think Bank Negara could cut interest rates in the second half of the year, so we are going long duration at the moment. Given what is going on in the world, the ASEAN region is a good defensive play at the moment, and in this space, we think Malaysia and Indonesia are the best picks at the moment.

AM:*How easy is it for issuers to hit their funding targets in this environment?*

Chong Kin Leong, Genting: We have not seen interest rates this low for such a long period of time before. We are constantly marketed to by banks who want us to turn to the bond market, but Genting holds a lot of cash, so we often have the ability to fund projects using internal cashflow as a starting basis.

But if we find there is a need to do funding, we typically approach the debt market. We look at matching the currency and tenor of our funding with our projects at the outset. Our projects are typically integrated resorts, power plants or plantations, and they require long-term funding because they do not reach maturity in the first five years. It takes about three years to develop and contruct an integrated resort. We usually raise money for tenors of five years, 10

years, or beyond. But many investors have a preference for shorter-term money at the moment.

That means we have a more limited investor base. That is compounded by the fact that our integrated resorts business is not shariah-compliant, so we cannot sell our bonds to Islamic investors.

Last year, we had issuances by our subsidiaries, Genting Plantations Berhad and Genting Malaysia Berhad. The plantation group was rated two notches below Genting Malaysia Berhad, but it managed to get a better yield. This was partly because of a timing difference, but it was also because of a more limited investor base for Genting Malaysia's paper. This is one of the issues we have experienced when turning to the markets.

Genting Malaysia has a $5bn MTN programme, from which MR2.4bn ($595m) has been tapped so far. There is still some ammunition left if need be, but the business is generating good cash flow. That is the always the first option for us, even if interest rates are low.

In the foreign markets, we have sold US dollar bonds and Singapore dollar bonds. That depends on the need of our projects. In many cases, where a greenfield project – for example, a power plant – is not able to get good ratings, there is still a good project financing market in the banking sector. Banks are willing to provide us loans out to 15 years. To be frank, not a lot of banks can allocate capital to these deals nowadays, because of Basel III, but we still find we can get better funding from banks for greenfield projects.

There is a lot more liquidity in dollars, meaning we sometimes need to turn to FX swaps to hedge our foreign currency risk. We would like to see more financing options in ASEAN domestic markets, which would relieve us from having to turn to the dollar market. But generally speaking, the capital markets are there, they are quite liquid, and we have had no great problem finding the funding that we want.

AM:*The intentions of Cagamas are a good litmus test for how Malaysian borrowers view the debt markets, given the regular funding of the company and its willingness to tap overseas markets. How does Cagamas make the decision between whether to tap the domestic or foreign debt markets?*

Chung, Cagamas: In the ringgit market, Cagamas is the largest issuer of private debt securities since 1987. We have issued a total of MR292bn worth of bonds and sukuk. The support from investors in this room and, also outside of this room has been tremendous. But some investors are starting to approach their limits. This is partly because of Basel rules, and the Single Counterparty Exposure Limit (SCEL) imposed by Bank Negara Malaysia for financial institutions, and and partly due to internal limits. There are still a lot of investors out there that can buy Cagamas paper, but this is something for us to consider. It is one reason why we are so active in exploring new markets.

The establishment of multi-currency EMTN programme provides us the opportunity to tap any market we find the most efficient in terms of pricing, as well as liquidity. When a bank comes to us and wants to sell us a portfolio of loans, we will need to evaluate the advantage of issuing in ringgit compared to foreign currencies as well as the foreign currencies available.

The driving factor when we weigh up these different funding currencies is volatility. We look at the benchmark yield curve, the spread, and the cross-currency swap. Then we look at liquidity, the depth of the market. Finally, of course, there is a question of timing. Because Cagamas operates a match-funding model, timing is essential. If a bank wants to sell us a portfolio of mortgages today, we have to raise our funding today; we will not delay the funding aspect in the hope that a market gets more attractive.

Recently, we did a lot of Singapore dollar bonds. When we converted them to ringgit, it made economic sense, at least in the tenors we chose. We also issued Singapore dollar sukuk, making us the only foreign issuers in that market in the last two years. The investors are there in that market, but the pricing can be more expensive because of the limited hedging mechanisms in the Islamic finance market. We do synthetic funding in some cases to reap the

best benefits. That allows us to get the most optimal funding available.

AM:*Let's take a look forward and consider what needs to develop in the ASEAN debt markets in the future. What changes need to occur in this market to make your jobs easier?*

Teo, Affin Hwang: The ASEAN markets have come a long way. The bigger economies like Singapore, Malaysia, Indonesia, Thailand and the Philippines have relative well-developed banking systems, relatively well-developed government bond yield curves, and mature and reasonably deep markets that are able to provide the liquidity and pricing transparency needed to build corporate bond markets. But outside of Malaysia and Singapore, the corporate bond markets in these countries are still at a low stage of development.

In Malaysia the corporate bond market is worth around 31% of GDP, and in Singapore it is over 20%. But in Indonesia it only 2% of GDP, in the Philippines it is about 6%, and in Thailand it is in the teens. These countries are still stuck on a banking-centric model. We need to work further on a regional approach to improve these markets. We need to see deep and liquid corporate bond markets across the region.

Even in Malaysia, there is room to grow. The market is relatively well-developed, but only the big, well-known borrowers offer liquidity to investors. There is not a very diversified investor base here; it is largely dominated by big institutional investors who tend to take the same sort of view.

Access to information within the ASEAN region could also improve. We're interested in buying Indonesian rupiah corporate bonds, but where can where we get information about these bonds and how they have traded in the past? In Europe or the US, that would be easy. But in a lot of countries in this region, the information is not readily available.

Sulaiman, CIMB: Increasing the diversification of investors is definitely going to be an important step and is something we have been working on. We have tried to bring different local currency investors across the borders. For example, we have helped Malaysian and Thai investors invest in the Indonesian rupiah bond markets. It is a bit harder in the ringgit market, because the spreads are lower but also because there is not a great deal of diversity among the issuer base. That means single borrower limits get hit quite quickly.

Chong, Genting: I share Esther's view that while markets are liquid and strong in Malaysia and Singapore, there could be a lot more development that can be done elsewhere. It is partly a reflection of the access foreign investors have in these markets. Foreign investors hold around 30% of government bonds in Malaysia; they see Singapore as safe-haven. But when we look at a market like Indonesia, trying to borrow rupiah in the domestic market can sometimes be quite challenging. It is often much easier – and cheaper – to borrow in dollars and swap the proceeds to rupiah.

There has been a tendency in Indonesia for local corporations to enter and settle their contracts in US dollars. That means there is a parallel funding source in the market there. The government is trying to move these deals towards more rupiah-denominated contracts. That will take some time. But in order for it to be fully achieved – and to help companies like us fund – we need more developed local bond markets.

Chung, Cagamas: In 2012, we looked at our mandate and considered how we can complement Malaysian banks that are operating within the region. We explored how we can replicate the model we have in this country and apply it to other countries where Malaysian banks are operating. We got some interest and had exploratory meetings with regulators from Thailand and Indonesia. They were supportive of the idea of a Malaysian entity issuing in these markets. But there were other impediments in place meaning that we could not, until today, do these deals yet.

One of the restrictions that got in our way was a restriction on foreign ownership of properties. There was also a restriction on non-residents lending to residents. Investors in Thailand and Indonesia were keen to buy Cagamas

paper, but they couldn't because we were unable to issue in these currencies at the moment. These are factors that should be considered if we intend to allow for more cross-border issues.

Going back to the point Liza was making earlier about bringing foreign investors into this market, there seems to me to be more interest now. We have seen interest from investors in the UK and many other countries in Asia. These investors previously concentrated on the government bond market, but they are now increasingly looking towards corporate papers, particularly the stronger rated credits.

Khoo, CGIF: Increasing cross-border flows is a work in progress, and there are many issues. Withholding tax on interest in many countries is a problem. It doesn't apply in Malaysia, because we don't have withholding tax on bond coupons. But it is certainly something we want governments in the ASEAN region to think about when it comes to attracting foreign investors.

In terms of the Malaysian market, I can tell you what I would like to see. I remember the first slide I put together on risk aversion in the ringgit bond market was in 2003. We were losing one rating notch every 18 months or so; we had a BBB market at one time, but then investors started to focus on single-A names. Today, 90% of issuers in this market are AA or above.

If you look in Thailand, it's the reverse: only 10% of issuers are AA and above. The market here is, of course, larger in volume. But the variety of issuers does not compare well. We should look seriously now at this point. We cannot celebrate a market that consists almost entirely of AA and above credits. We need to press the red button now and look at what we can do to address this. The development to allow unrated bonds to be traded is positive as most developed markets allow for this. But unrated bonds are not alternatives to the lower rated papers. How can an unrated bond be better than a single A or BBB rated bond?

Sulaiman, CIMB: I would love to see more single-A issuers in this market. We've encouraged this but unfortunately we have seen a mismatch of pricing expectations at where the banks are willing to fund issuers and what investors would expect from a A-rated corporate bond. The other issue we have heard from investors is the minimal liquidity of the single-A market which is naturally lower than the double-A market. That definitely reduces appetite for single-A credits.

MARC [the Malaysian rating agency] is looking at a partial rating methodology, where lower-rated borrowers can obtain credit enhancement from a third-party. The question for investors is whether they are willing to accept lower yields with an enhanced credit rating and let the guarantor banks pocket the guarantee spreads or alternatively purchase the bonds on a standalone basis and benefit from the high returns if they are comfortable with the underlying standalone credit? It's a tricky question, and comes down to the balance of liquidity versus the credit spread.

Teo, Affin Hwang: I totally agree that we need more single-A issuers in Malaysia. Pricing is clearly a concern for issuers. There is also a limited pool of investors who can go into the single-A market, so that represents a challenge to the development of the single-A segment of the market. But is something we need to work on.

Chung, Cagamas: Single-A issuers need to pay an excessive premium for illiquidity. One of the things that we looked at previously was to have a credit hedging mechanism in place, which should help both the issuers and investors. But now the government has issued guidelines on unrated issuance, the credit hedging mechanism may not be viable in the long-run. That is why we have not pursued this idea. We still need to explore further to see the best way to stimulate the single-A bond market.