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Asiamoney-CIMB ASEAN Bond & Treasury Markets Round Tables

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ASEAN growth in an uncertain world

Malaysia and Indonesia, two of the biggest economies in the ASEAN region, are being forced to adjust to a new global landscape. Demand from China is falling, US rates are creeping up, and commodity revenues are becoming increasingly unreliable. The transition towards sustainable growth in the future is essential for these countries, and essential for the continued development of their capital markets. Asiamoney sat down with a panel of leading experts from both countries to discuss how they can best navigate the path ahead.

Panelists:

Tatsuya Higuchi, chief fund manager, fixed income division, Mitsubishi UFJ Kokusai Asset Management Co., Ltd
Boo Hock Khoo, vice-president, operations, Credit Guarantee Investment Facility
Chu Kok Wei, Group head, treasury & markets, CIMB
Arup Raha, chief economist, CIMB
Scenaider C.H. Siahaan, director of budget finance strategy and portfolio, Ministry of Finance, Indonesia
Nor Masliza Sulaiman, global head, capital markets, CIMB
Dato Siti Zauyah, deputy secretary general, Ministry of Finance, Malaysia

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

Asiamoney* (AM): *The starting point of this discussion has to be the economic environment, because clearly that is going to effect both pricing and appetite for ASEAN bonds. What is the economic outlook for Malaysia at this point?

Siti Zauyah, Malaysia: If you compare the world's GDP growth with Malaysia's over the last few years, we have achieved a commendable growth rate. The economy grew by 6% in 2014 and 5% in 2015. This year, against a backdrop of estimated global GDP growth of 3.4%, we estimate that we will be achieving growth of between 4% and 4.5%, under the assumption that the price of crude oil will be between $30 and $35 a barrel.

For the coming years, we are quite confident in achieving growth. We have well diversified sources. Growth is likely to be fuelled by all major sectors except agriculture, because of the El Nino phenomenon. We have registered a trade surplus for 220 consecutive months. Our big trading partners are China, the European Union, the United States, and elsewhere. Despite the slowdown in China over the last few years, our exports to China have actually been growing; they still want to buy more from Malaysia. This demand from China, as well as from the EU, provides a buffer against the decline in export prices.

We have private consumption and private investment as the key drivers of growth. But at the same time, we are expanding our service sector, putting emphasis on tourism, health tourism, and education. There are many infrastructure projects, including the MRT, LRT and Pan Borneo. There is plenty of reason for investors to be optimistic about Malaysia's future.

Masliza Sulaiman, CIMB: A good gauge of confidence is to look at where CDS prices are trading. From a one-year high of around 240bp, five year sovereign CDS for Malaysia has now settled around 150bp. There has clearly been a tremendous boost in terms of perception and confidence among international investors.

AM: *How accurate is the perception among some international investors that there is, perhaps, an over-reliance on oil revenues from the government?*

Siti Zauyah, Malaysia: The government of Malaysia has realised the uncertainty of revenues from the commodity base. Since 2010, we have been diversifying away from a reliance on oil revenues; this is part of our long-term strategy. In 2009, oil-related sources made up around 40% of our revenues, but in 2015 we were able to reduce that to 21.5% of GDP growth. That is a remarkable achievement. We did this by focusing on key fiscal consolidation measures, such as increasing tax compliance, looking at stringent auditing of tax, reviewing tax incentives – and, importantly, introducing the goods and services tax.

Subsidies have taken up a lot of government revenues. But we have now removed the sugar subsidy, we have rationalised the fuel subsidy, and we have increased the tobacco excise duty. We had to do that in a gradual phase. We cannot remove all of our subsidies in one go, so we are phasing them out. In 2014, there was a 50% hike in electricity tariffs and a 90% hike for the petrogas sector. In 2015, we introduced what we called the managed float pricing system, which removed the subsidy for oil. This has reduced our operating expenditure on subsidies by 32.6%.

It just happened that oil prices dropped significantly last year. We do need to find means to reduce our fiscal deficit, because we are committed to the idea that our fiscal position will be balanced by 2020. The global situation may have an affect on our strategy of achieving that, but we are still committed to the target. We have recalibrated our 2016 budget to make sure we can still meet our 3.1% fiscal deficit target.

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SITI ZAUYAH, Ministry of Finance, Malaysia.

AM: ***What is the outlook for the Indonesia economy? And in that context, how do you best calibrate the DMO's funding plan?***

Scenaider Siahaan, Indonesia: During 2015, we had growth of 4.8%, which is below our potential. In 2016, we will be achieving growth of around 5.3%. The contributors to this growth are largely the same as last year's: household consumption, government expenditure, and investment. We are also hoping to see some increase in exports and imports, but this is not an anchor necessary for Indonesia to achieve its growth target.

Indonesia, rather like Malaysia, has been going through a major adjustment, moving from a commodity-based economy to a manufacturing-based. Indonesia will process raw materials, and export them with more value-added. That will help us weather the downturn in commodity prices. From fiscal point of view, the emphasis now is on securing purchasing power for Indonesian people and providing fiscal incentives for businesses to encourage more investment to do the processing of materials.

In 2016, we're looking at a fiscal deficit of around 2.15% of GDP, so the total gross issuance is around Rp540tr ($41bn). We will issue around 25% to 30% of such gross issuance in the global market, while the rest will be raised from the domestic rupiah market. Even though the volatility in global markets is very challenging, we believe we will manage this funding plan without much of a problem. Retail investors will be an important source of demand. They are much less affected by global concerns. We have built up this investor base over the last few years, so we are now reaping the dividends.

All markets, especially emerging markets, are being forced to weather the global trends. But in some countries, such as Indonesia and Malaysia, too, we see that growth is very stable now. We are working towards 7% GDP growth in 2019; and the strategy to get there is to increase private sector participation, with the government concentrating on infrastructure, education, and health.

AM: ***How important is infrastructure development for making the most of Indonesia's economic growth – and how large should the government's role be in this area?***

Siahaan, Indonesia: We believe that, at this point, the government needs to simplify the process. We need to reduce bottlenecks; reduce some of the price hurdles for investors in, for instance, maritime projects; and help overcome some of other issues for private sector involvement. That can mean providing tax allowances, or even tax holidays for businesses that meet some criteria. We believe that by doing this, the participation of private sector investors in the sector will be enhanced.

The government will take a stronger role in those infrastructure projects that are less financially reliable; private sector investors can take the lead role in projects that are more financially healthy. That is the grand idea for the development of Indonesia's infrastructure.

AM: ***One of the things that people talk about when it comes to infrastructure funding is the greater role of the bond market. But it seems that for years, it has remained little more than a talking point. It is still not a major – or even a minor – source of funding in some countries in the region. What role can bond markets play in infrastructure over the medium-to-long term?***

Boo Hock Khoo, CGIF: It's interesting to speak about this in Malaysia, because Malaysia has a successful project bond market. We have had project bonds since 1993. Non-recourse bonds can go out to 20-plus years; the bond market is playing a critical role. It is often not spoken about but when it comes to the size of the deals here and the long tenors available, the reality is that many other countries in ASEAN would love to have just a fraction of this capacity.

Around the region, what we see are mostly just government bonds and corporate bonds. Except Malaysia, the project bond market is often completely absent. It is critical towards financing infrastructure, to my mind, because when you have long-term, fixed rate local currency funding in place, the projects become less risky. They don't have to face refinancing hurdles along the way.

Many of the projects in these countries are funded by bank loans, so after five years or 10 years the debts have to be refinanced. One of the consequences of limiting refinancing risk is to amortise the debt repayment more rapidly. As the unit rate has to be bumped up because you have to make repayments as soon as you can, infrastructure meant to be used may end up being too expensive for the users. This is why in some countries, toll roads are more expensive per kilometre than they are in Malaysia. When you stretch the financing term out, you can bring the unit rate down and people can actually afford to use the infrastructure. Due to this, it is very important that we have project bonds support the development of infrastructure.

In many other countries in the region, we have a paucity of long-term savings. We have relatively large EPF contributions in Malaysia, which cannot be touched until contributors reach 55 years of age. There is no such capacity in many emerging economies. That means savings tend to end up intermediated through the banks, and besides equity, no-one is really investing in long-term instruments despite rolling over short-term deposits year in and year out.

I'm very excited about Indonesia's potential. One thing is very clear: Indonesia has tremendous fiscal capacity to support infrastructure investments right now. The long-term savings are not sufficient but if the Government can build up long-term savings, we will see quite a different landscape going forward.

There are around 625m people in the ASEAN region. Many will move into cities. They will get more affluent and will need better infrastructure to be in place. If there's something certain in an uncertain world, you can be sure that the bulk of these people will need water, telecommunications, transportation, and certainly power in the coming years. It is critical for us in Malaysia, as a relatively well-developed economy, to think about how we export our knowledge and our capabilities across the region.

BOO HOCK KHOO, CGIF.

AM: ***The question that naturally follows is how to export the long-term savings that exist in this country. What are the chances that Malaysian investors will help to fund infrastructure development in other countries in the ASEAN region?***

Khoo, CGIF: This is something we've talked to investors about a lot. Investors are tend to be fairly local currency-focused, perhaps with some exposure to G3 currencies. Rupiah, pesos, baht, dong: these currencies are quite thin in Malaysian portfolios. Investors should start looking into this region, and looking at the alternative assets that will come out from these markets. They need to start by examining the correlations between these different currencies and to figure out the risk. I imagine the opportunities are there; the region is growing quite rapidly. Should we stay on our shores or venture out.

Japanese investors should give us inspiration. A lot of those investors are looking into this region because, despite global volatility, the prospects for the ASEAN region remain quite bright. With a different perspective, this should lead to more intra-regional flows in the future.

The raw ingredient to cook the dish is there. The question is: are we ensuring the right utensils are in place for the chef to cook the dish? The utensils will be the whole domestic financial infrastructure. How do we efficiently channel domestic savings to domestic investments? This should come before we even go to the stage of thinking about channeling regional savings into regional investments.

CHU KOK WEI, CIMB.

Chu Kok Wei, CIMB: This is an important, and passionate, topic for me. Before we even talk about cross-border flows, we need to look at the macro picture. ASEAN domestic savings tend to be between 30% and 35% of GDP, depending on which country you look at. Use Indonesia as an example: that number will work out at around $250bn annually. No infrastructure financing, no matter how fast it happens, can consume that amount on any annual basis.

Bank loan financing will get more and more expensive. Banks are increasingly regulated by the Basel Committee and the G20. People ask what this will mean, and they often point to a lack of long-term savings in this region. But I beg to differ.

How many people are rolling over their one-year deposits every year for a decade? A very high proportion. If 10 years ago these investors were given a 10 year fixed deposit that gave them a reasonable return, they would have taken it. The raw material is in the system; all we are lacking is an efficient transmission mechanism. The more we look at the global regulation, the less likely it seems that the transmission mechanism will be bank balance sheets.

That is going to force the global capital markets to rise up, put the pieces of these

> *All markets, especially emerging markets, are being forced to weather the global trends. But in some countries, such as Indonesia and Malaysia, too, we see that growth is very stable now. We are working towards 7% GDP growth in 2019; and the strategy to get there is to increase private sector participation, with the government concentrating on infrastructure, education, and health.*

SCENAIDER C.H. SIAHAAN, Ministry of Finance, Indonesia.

puzzles together, and make things work. We already have the raw materials in different ASEAN countries.

Arup Raha, CIMB: I totally agree with Chu that domestic savings are critical if you really want to build infrastructure. It is now a matter of intermediating it effectively at the right price for investors. Infrastructure is going to play an increasingly important role. Look at the biggest Asian success story of the last two decades, which is clearly China. A lot of people think China's growth story was due to low wages, and that is partly true. But it was also due to backward and forward linkages, and that comes from infrastructure.

If some countries in the ASEAN region are going to have to reinvent themselves as manufacturing bases now that the commodities boom is over, the need for infrastructure becomes even more imperative. In other words: the need is certainly there, the domestic savings are there – it is now a matter of finding the right way to intermediate this, which requires the development of medium-to-long term bond markets.

Scenaider Siahaan, Indonesia: The need for infrastructure in Indonesia is around $350bn for the next seven years. From the budget, we have a space for around $25bn to $30bn, so the rest will be the financing from state-owned enterprises and, for the most part, from the private sector. The challenge is to mobilise these funds. Most of the money from banks is short-term; that does not match the funding needs of infrastructure projects. Capital market development is essential to help us fulfill our goals.

Sulaiman, CIMB: We are lucky in Malaysia that we have funds that are ready to commit to long-term infrastructure financing. Bonds made up around 32% of infrastructure financing in this market in 2015. The ability of investors to participate heavily in long-term infrastructure bonds was largely driven by the award of concessions with predictable cashflow for infrastructure projects. The sanctity of the concession contracts allows rating agencies to develop strong methodologies and assign credible ratings which in turn helps investors price these bonds accordingly.

It is not just pension funds and life insurance companies that participate in Malaysia's infrastructure bond market. Fund managers and corporate treasurers are also buyers of long-term project finance bonds facilitated by the liquidity provided in the secondary markets. Secondary market liquidity is another important component for a strong infrastructure bond market; it is not all just about concessions with predictable cashflow and the sanctity of the concession contracts.

To your question of whether Malaysian investors can participate in the infrastructure bonds of other countries in the region, I think the outlook is quite promising. We saw participation in the joint venture of PTT and Petronas a few years back. That was a long-term financing, and the goal was to raise US dollars. In the ringgit market we were able to facilitate a synthetic US dollar deal. In cases where there are sponsors in which local investors here are comfortable with, funding could potentially be raised in ringgit and swapped back into another ASEAN currency of their choice. By developing this possibility, many more projects can become economically viable for sponsors.

AM: ***We're in a situation now where the Chinese economy is losing steam and US dollar rates are moving up. Both of these factors, on their own, could have a big affect on many economies in the ASEAN region. How important are these two factors together for the outlook of the ASEAN region as a whole, and for particular economies within the region?***

Raha, CIMB: Very important. We are an externally-driven region; the main source of growth has been exports and we rely at least in part on foreign financing. But that does not mean these changes are necessarily a bad thing.

We have enjoyed a tremendous boom from China, which has clearly been of benefit to commodity producers like Indonesia and Malaysia. Obviously, China is slowing from here. It's a policy-designed slowdown, which is also including a rebalancing from investment to consumption. That has an implication for ASEAN economies, because the investment part is the more import-intensive part.

The rise of China has changed the face of manufacturing in Asia. The first step was undercutting other Asian economies, making China into the major manufacturing hub of the world. But now as China is moving up the value chain, it is ceding that role to the ASEAN region, especially to countries such as Vietnam. There is a restructuring taking place in this region because of the nature of this transition.

People talk about a hard or soft landing from China, and try to predict how tough things are going to be. But my view is that we have actually been experiencing the landing for the last five years; it is no longer something to be anticipated. If you look at the effect it has had in terms of investment, industrial production, exports, commodities, that is evident. But Malaysia has been resilient. So has Indonesia. We have been experiencing the landing, and although it has probably put us on a slower growth trajectory, it has also ensured we have become more resilient.

That is the Chinese part of the story. The US part of the story is that, although we obviously prefer lower US interest rates, we also want higher US growth. The two do not go hand in hand. If we're seeing a sustained rise in interest rates from the US that means that growth is going to come back – and at this point, we are still talking about very low interest rates. No-one is talking about interest rates going up to 3% or 3.5%.

The easiest way to think about US interest rates is to think about the idea of normal interest rates, or where rates should really be. If current rates were well below what normal interest rates should be, we would have seen rampant inflation over the last five years. But we haven't seen that.

We're in a very good scenario in the US right now where jobs have been added but labour force participation is also rising, so we're not getting pressure on wages. We may be hitting a sweet spot in the US economy where growth picks up. It is a potentially a win-win situation for the next six to nine months, so as long as we can get our external trade going. I'm optimistic. It seems I am one of the few people who is optimistic at the moment.

AM: ***Higuchi-san, how important are the local economic and credit stories to you when you look at the ASEAN region – and how important are these global factors?***

Tatsuya Higuchi, Kokusai Asset Management: We felt the first hike of US interest rate in December was just normalization; we do not think they can hike too much because of their low CPI numbers. In Japan, BOJ have introduced a negative cash rate. In Europe, central banks have done the same. As the result, many government bonds in developed

ARUP RAHA, CIMB.

countries are already trading with negative yield. It seems that US interest rates are unlikely to go up so much in this environment.

ASEAN bonds offer good value. Most countries in this region offer bonds with a higher yield compared to Japanese government bonds and European bonds, even compared to the US treasuries. As long as the currencies start to stabilize – and we have seen this recently –ASEAN countries should have more investment inflows from developed countries.

Regarding China, the growth rate is still OK. China became already the second largest country in the world, and the other large countries tend to have a very low growth rate. As the result of that, China could not print strong growth rate as before. But China is still going to print positive numbers even if we might see some slow down compared with previous years. There are some imbalances in Chinese financial markets that might force a devaluation of the renminbi. In this case, because of the high trade amount between ASEAN and China, ASEAN currencies might see some devaluation to adjust the value of currency. But it will not be a major change.

TATSUYA HIGUCHI, Kokusai Asset Management.

AM: ***What is the most attractive ASEAN debt market for you at the moment?***

Higuchi, Kokusai Asset Management: We prefer the Indonesian government bond market. Malaysian government bond market is also very attractive, compared to other countries in this region, and we are happy to see the stabilisation of rupiah and ringgit over the last few months. These are the two markets that stand out for us at the moment.

AM: ***How much are the changing environments in China and the US affecting the willingness of foreign investors – whether from those regions, from Europe, or even from Latin American – to come in to the ASEAN region's debt markets?***

Khoo, CGIF: We often generalise about investors. In reality, there are different sets of investors. There are those that want to build factories, those who manage hot money; those who are long-term, those who are short-term. This region will grow faster than the global average for sure as the 625 million people in the ASEAN region move forward in the next few years.

Siti Zauyah, Malaysia: The fact that the US is trying to increase interest rates is not a major concern for us. Overall, foreign investors hold around MR180bn ($46.4bn) of Malaysian government debt. In the middle of last year, there was a lot of uncertainty around the US interest rate. We did see some fund outflows at that point, but it was actually quite minimal, around MR3bn – and once the US made the announcement, the funds came back. It only took about two months to return to the level we're seeing now.

We're not concerned that announcements from the US are going to lead to foreign investors pulling their money because the majority of non-resident holdings are long term investors, comprising asset management (44%), central banks (29%) and pension funds (15%).

Siahaan, Indonesia: The same thing happened in Indonesia. Before the Fed's interest rate announcement in December, investors were worried about how far rates would go up, and how quickly. But now the Fed has given investors confidence that interest rates will go up slowly; that has ensured much more stability in fund flows. We want interest rate normalisation to happen in the US, because it means normalisation is happening in the economy, too.

Raha, CIMB: It really depends on the particular circumstances of an economy when interest rates go up. If you look back to the second half of 2013, when we had the taper tantrum, Indonesia was pretty badly hit. But after the Fed raised rates in December, Taiwan cut rates the very next day, and Indonesia has cut three times since then. Anybody who is nervous would not do that.

The circumstances are different now. We have found a certain degree of stability. The current account has improved tremendously in Indonesia, and inflation has come down. Malaysia has attracted more long-term investment, which gives stability. These economies are much more stable. It is not simply a question of what is happening to rates in the US, it is also a question of how strong our domestic economies are, too.

Kok Wei, CIMB: There is too much attention paid to rising rates in the US. We need to understand only two terms in this environment: 'new normal' and 'tantrum'. I have a young son, so I know what a tantrum means. If you have given sweets to your son, is it possible to take them back? No. That's what global central banks have done. It is impossible for a normalisation to take back all the money that has flowed into the market through quantitative easing. Therefore, investors need to adjust to a new normal.

US rates at probably 0.50% or 1% will be considered normal; negative interest rates will be called expansionary monetary policy. That is the new world that we are living in. I can't help but wonder if the the ASEAN region is at a turning point right now with our high interest rates. If investors miss this opportunity, they might miss it for life.

Main Street is the US now; Wall Street is no longer the US. Silicon Valley may be great, but it does not hire the bulk of labour, and innovations in Silicon Valley are improving productivity so fast that labour has no bargaining power to ask for higher wages. We are in a structural low inflation environment right now. Low rates are the new normal and they are going to be exported globally.

MASLIZA SULAIMAN, CIMB.

AM: ***We have talked a lot about changes in the US and China, and how they are going to affect the ASEAN region. But there are also pretty seismic changes going on in this region too, in particular the development of the ASEAN Economic Community. I'd like to tackle this question in two parts. First, what should people expect from ASEAN financial integration?***

Siti Zauyah, Malaysia: The ASEAN Economic Community has come up with a blueprint for 2025; giving themselves ten years to work towards financial integration. That is a good start, and reflects the commitment of countries in this region to pushing forward in this area. They're working to encourage ASEAN members to liberalise their financial sectors, so we can ensure more market access and better penetration in regional insurance markets and capital markets.

But one thing we take note of is that not all ASEAN countries are at the same level of development. That is why the AEC is putting emphasis on financial inclusion and financial stability.

Financial inclusion is largely about educating people and improving financial literacy, as well as offering a wide variety of products and services. We're looking at establishing banking agents in remote areas. In Malaysia, this is partly happening through Bank Simpanan Nasional (BSN), a government-owned bank that is tasked with meeting the financial inclusion objectives of the government.

The other factor is financial stability. How can the AEC improve on supervision and enhance surveillance? That comes down a lot to the regulatory framework, to governance and to transparency. Greater transparency can give a lot of confidence to market players.

Siahaan, Indonesia: I'd just like to make one point on this subject: there can be no integration without a belief in diversity. This is what the ASEAN region has to go through, especially at the level of political leaders. Without a belief in diversity, there can be no synergy. We need to trust each other, build up communication, and respect the differences that exist among different countries. As long as this can be achieved, we can mobilise labour, trade and capital and develop together.

We need further standardisation of labour and of rules. But it is also about changing the mindset. We need to stop thinking about us as being competing countries within one region, and start thinking about us as one. If we do that, we can develop in a better and more fruitful way than what we have seen in Europe.

AM: ***Aside from financial integration, there are the broader questions about increasing trade flows, opening up new markets, and seeing the benefit of widespread openness in the markets for goods and services. How optimistic should investors be about the wider AEC project?***

Raha, CIMB: In theory, it's a good idea. In practice, it may be another story. The devil here is going to lie in the details. If you take the easy part, which is tariffs, there are actually very few tariffs between ASEAN countries. That means on the trade side you're down to non-tariff barriers, which have a lot of vested interests and are not easy to overcome.

Even if you focus only on the financial sector when you're talking about integration, it is not easy. There are different banking systems, different regulations, and so on. When you look at employment governments want to protect their labour forces.

In theory, one production base, a large common market and huge economies of scale mean ASEAN integration is a very good idea. But in practice, it is going to be difficult to achieve, and is likely to take a lot of time. ■

Developing the debt market

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Domestic bond markets in the ASEAN region are still at vastly different stages of development, and often differ dramatically in terms of depth, sector diversity, and the rating demands of investors. That makes the job of increasing cross-border flows between these markets all the harder. But the opportunities are rife, and growing. Asiamoney sat down with a group of debt market experts to discuss how these markets can grow individually, and how they should grow together.

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 slow-down 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

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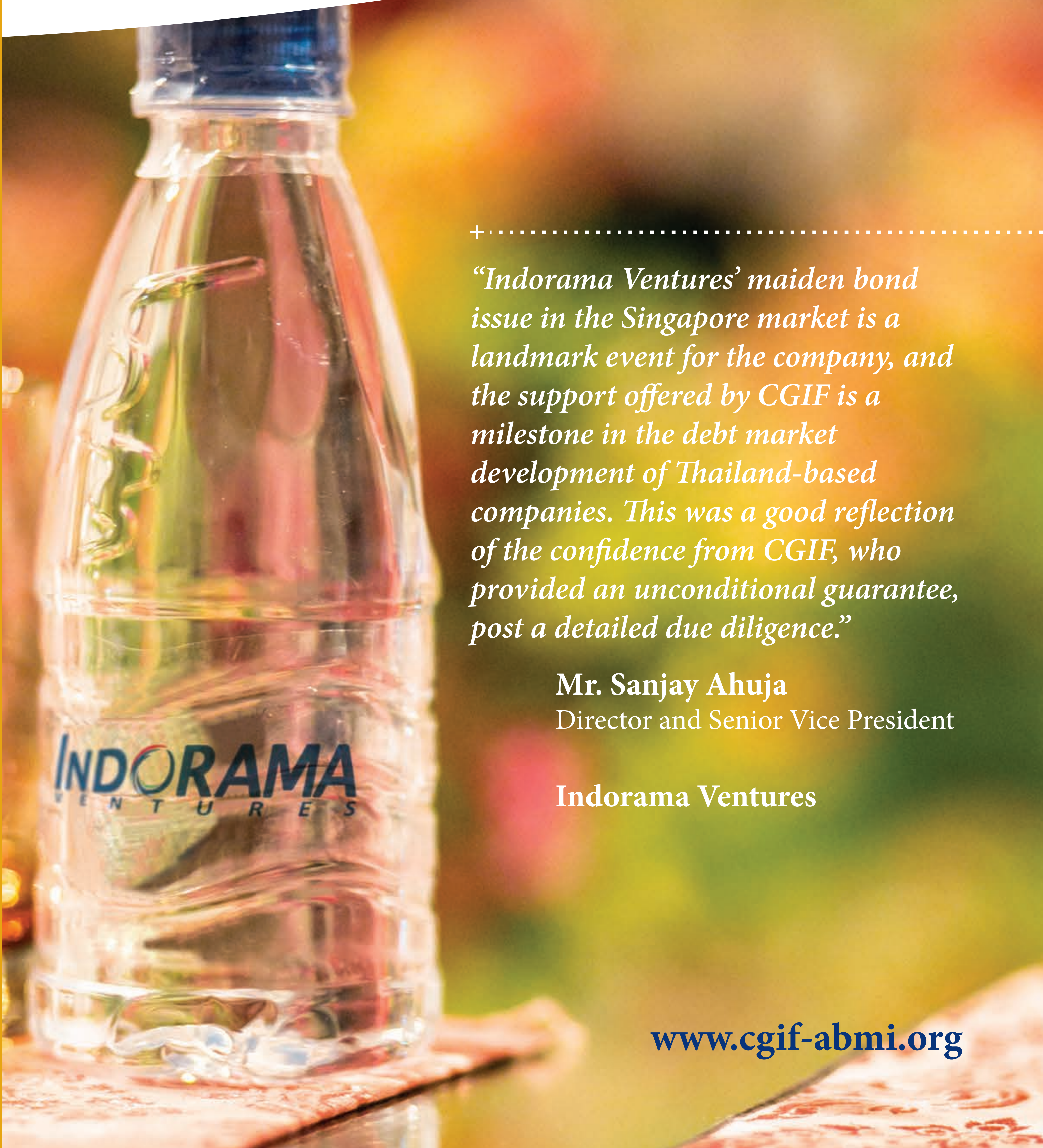

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Mr. Sanjay Ahuja
Director and Senior Vice President

Indorama Ventures

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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.


ARUP RAHA, CIMB.

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.


CHU KOK WEI, CIMB.

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

ESTHER TEO, Affin Hwang.

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

MASLIZA SULAIMAN, CIMB.

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

CHONG KIN LEONG, Genting.

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.


BOO HOCK KHOO, CGIF.

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

CHUNG CHEE LEONG, Cagamas.

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. ■

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