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Giving local currency bond market a boost

by Cheah Chor Sooi

LOCAL currency bonds will continue to play an important role in supporting resilience of the domestic economy and financial systems in Southeast Asia.

Transparency, though, could remain an issue for investors at a time of macroeconomic turbulence and policy uncertainty.

Against such a backdrop, stronger investor scrutiny on the region's local currency bonds is inevitable, given a spate of bond defaults over the past year.

A recent S&P Global Ratings' study of 265 of the largest listed corporate bond issuers (excluding financial services) in the region found that about 15% show signs of financial fragility based on public information.

"Despite the closer scrutiny, we expect the use of bonds will continue to grow in the financing mix of companies in Southeast Asia," S&P Global Ratings credit analyst Bertrand Jabouley pointed out in a study entitled *Credit FAQ: What Lies Ahead for Local Currency Bonds in Southeast Asia.*

According to Asian Development Bank data, aggregated local currency corporate bond markets in Southeast Asia have grown steadily at about 12% annually on average in the past decade compared with 8% average GDP growth in emerging and developing Asia during the period.

Growth in the corporate bond market was uneven across the region with the less developed markets having stronger growth in bond issuances: 13% in Malaysia (compared with an average growth in GDP of 5.3% in the past 10 years); 8% in Singapore (5.1%), 16% in Thailand (3.5%), 19% in Indonesia (6.4%), 32% in the Philippines (6.2%) and 58% in Vietnam (6.7%).

Bonds (the bulk of which are local currency bonds) account for about 35% of aggregated reported debt and have become an essential and permanent constituent of capital structures. Five years ago, bonds accounted for about only 30% of the 265 companies' debt.

In terms of value, the combined size of the corporate (industrials and financial services) bond markets for Malaysia, Thailand, Singapore, Indonesia, the Philippines and Vietnam reached almost US$350 bil (RM1.55 tril) as of Sept 30, 2016 compared with US$120 bil 10 years ago.

Elaborating further, the S&P Global Ratings' study opined that bond defaults may have been difficult to anticipate in Southeast Asia in light of often limited disclosure requirements or nascent regulations.

"As we expect market volatility across most asset classes to continue this year, we believe transparency and liquidity in local currency bond markets have become increasingly relevant to support investor appetite," suggested the study. "Therefore, growth in local currency bonds could slow down in the next 18 months because of investors' lending appetite reducing or becoming more demanding."

The study also listed some characteristics of Southeast Asia's four largest local currency bond markets, namely Malaysia, Singapore, Thailand and Indonesia:

- **Malaysia:** Heavy industries – often government-related – set the scene. National utility company Tenaga Nasional Bhd accounts for close to 10% of outstanding Industrial bonds. Infrastructure companies such as Pengurusan Air SPV Bhd (water) or DanaInfra Nasional Bhd (transportation) also represent a sizeable portion of debentures.
- **Singapore:** Real estate accounts for half of the market with a broad range of credit quality. While recurring revenues from real estate investment trusts can accommodate sizeable leverage, some small developers could face financial distress. The other main industries are exposed to global trade and macroeconomic conditions given Singapore's open economy.
- **Thailand:** Three companies, namely CP ALL Public Co Ltd, The Siam Cement Public Co Ltd and PTT Public Co Ltd (and subsidiaries) dominate the market (about 30% together), setting the scene for sector exposure. In parallel, the weight of services reflects the country's exposure to tourism flows.
- **Indonesia:** PT Indosat Tbk and PT Telekomunikasi Indonesia Tbk are the two largest issuers; hence, the big share of telecommunications in the local bond market, followed by infrastructure companies like PT Jasa Marga (Persero) Tbk, a toll road operator. Energy remains a large sector for the partly commodity-driven Indonesian economy. FocusM

Tenaga Nasional accounts for close to 10% of outstanding industrial bonds