VIEWPOINT

By William Pesek

Debt markets are long overdue

Bubble warnings. Global imbalances. Political confusion. A possible Chinese slowdown. Terrorism risks. Nothing, it seems, can discourage investors in Asia these days.

Perhaps the best example is Thailand. Even though the country is being run by generals who can't seem to shoot straight, economically speaking, Thai stocks are at 10-year highs — exactly a decade after Thailand's devaluation in July 1997 set the meltdown in motion.

The Morgan Stanley Capital International Asia-Pacific index has risen 22 percent over the past 12 months, as clear a sign as any that Asia is again in vogue with investors.

Yet something unexpected is lurking in the shadows and threatening to cap Asia's stock party: bonds.

"Asia's equity markets have gone as far as they can go without a real bond market," Nicholas de Boursac, managing director of Asia Securities Industry & Financial Markets Association, said in a July 2 interview in Manila. "I don't think the region has made enough progress over the last 10 years — it's all a bit too underdeveloped."

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The dire need for world-class debt markets became clear at the height of the financial crisis, when underdeveloped financial systems left economies hypersensitive to surging interest rates, credit crunches and currency gyrations. Their absence exacerbated Asia's meltdown and investor panic.

Deep debt markets offer investors a haven when stocks get shaky. In 1997 and 1998, when investors dumped, say, Thai equities, property and other assets, they might have put that money in baht-denominated bonds instead of fleeing the economy.

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Traffic in Bangkok. Should investors in Thai stocks lose heart, they may find insufficient options in the nation's debt market.

For all the high growth rates in Asia, the region still lacks the shock-absorbing mechanism provided by liquid bond markets.

"We have seen a lot of important work to create these markets since the late 1990s — just not enough," said Dorodjatun Kuntjoro-Jakti, Indonesia's former coordinating minister for economic affairs.

Among other things, livelier debt markets would reduce companies' reliance on banks for loans, making for more efficient allocation of wealth and risk. Asia also is facing another "mismatch" scenario, de Boursac said. In 1997, the region imploded because plunging markets created a mismatch between exchange rates and foreign-currency debt payments. Another example featured long-term construction projects being funded with short-term debt.

Now, Asia faces a similar challenge with rising equity values and an underlying market infrastructure that may not support the optimism.

There are other basic problems, too. The savviest of investors can often be at a loss to fathom the ins and outs of Asian debt. The markets are still highly fragmented and come with steep learning curves. Efforts to deepen, link and publicize them are very much a work in progress.

Progress has been made. In April 2005, the Asian Development Bank started the AsianBondsOnline Web site, a step-by-step guide on the mechanics of buying and trading Asian securities.

There is also the so-called Asian Bond Fund. It's an initiative by central banks to pool a few billion dollars to buy U.S. dollar bonds issued by the region's governments and local-currency debt of economies like China, Hong Kong, Indonesia, Malaysia, the Philippines, Singapore, South Korea and Thailand.

The creation of pan-Asian bond funds is making it easier to buy debt without the hassle of dealing directly with individual countries and issuers. That eliminates red tape, uncertainties and regulatory headaches. It also makes it easier to monitor bond yields and assess the level of risk throughout the region.

Such efforts will have two big payoffs in the long run. One, they will attract more capital to Asian debt, deepening markets, bolstering liquidity and lowering interest rates. Two, they will help Asia bring home some, if not all, of the trillions of dollars of savings parked overseas in assets like U.S. Treasuries.

Asia could use that money to support entrepreneurship and pay for better roads, bridges, ports and power systems, as well as education and health care. Amid rapid growth, it's easy to forget that more than two-thirds of the world's poor live in Asia.

The trouble is, Asia could use those benefits now. Countless companies that now borrow from banks would prefer to tap the capital markets for financing. Governments often crowd out private issuers. Asia has been slow to create the kinds of non-government markets like ones for mortgage- and asset-backed securities. Hedging investment positions can also be a challenge.

Given the breadth of Asia's financing and infrastructure needs, the region offers almost unparalleled opportunities for Wall Street's bond houses, investors and consultants.

Hence the presence of the Securities Industry & Financial Markets Association. The group is a combined effort of the Bond Market Association and the Securities Industry Association. In October, it opened an office in Hong Kong to help accelerate the development of the world-class debt markets Asia needs — and, of course, so its members can profit in them.

A debt market is good for investors and Asian consumers alike. It means more opportunities for entrepreneurs to expand and create jobs. In the long run it would help developing Asian economies focus more on ideas and innovation than on low-wage manufacturing. For richer economies, a debt market means allocating capital more efficiently and giving investors more reasons to stay in Asia.

"It's hard to overstate the good that could come from better bond capital markets," de Boursac said. "A decade after the crisis, it's long overdue."

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