Asian bonds are the interest-bearing obligations of Asian governments, corporations or financial institutions, wherever they are marketed or in whatever currency they are denominated. Asian bonds are defined by the residence of the issuer. But, many advocates and policymakers presume that Asian bonds will be denominated in Asian currencies. A regional bond market in Asia would be primarily defined as bringing together issuers and investors from Asia. The ASEAN+3 Finance Ministers’ process has established six working groups to tackle issues considered obstacles in promoting the Asian bond market under the banner of the Asian Bond Markets Initiative.

One of the lessons from the Asian currency crisis was that too much borrowing in US dollars increased the vulnerability of a country. When the direction of capital flows reverse, a country may find itself in a dollar-liquidity crisis, even though that country may be solvent. At the time of the crisis, massive capital outflows were possible because capital that had come in earlier was in short-term flows. A ‘double mismatch’—currency mismatch and maturity mismatch—characterised the problem of financial institutions and corporations in East Asia. In order to avoid another crisis in the future, Asian financial institutions and corporations have to develop a long-term funding source denominated in local currency to match investment needs. Local-currency denominated bond financing solves the double mismatch problem. There is little doubt that deep and liquid domestic bond markets will help reduce the severity of the double mismatch in the future. However Asian bond proponents argue that Asian regional bond markets could also mitigate the problem.

Although the importance of bond markets in the region has been recognised by policymakers, no concrete action has yet been taken. The issue rose to centre stage in policy discussions when it became a part of regional policy
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initiatives supported by Prime Minister Thaksin of Thailand in 2002. After his call for Asian bonds, several actions were taken both in the Central Bank Forum and the Ministry of Finance process. One such effort materialised as the Asian Bond Fund, established in June 2003 by eleven central banks in the region (the Executives’ Meeting of East Asia and Pacific Central Banks Group). The fund was established by foreign reserves contributions invested in dollar-denominated bonds issued by governments and government agencies in Asia. Since foreign reserves are used for this fund, riskier bonds are not included in the investment portfolio. Some sceptics point out that substitution of dollar-denominated US bonds by dollar-denominated Asian bonds may not have a strong impact to help issue Asian bonds in the local currency. In response, it has been proposed that when the next attempt to create a similar fund’s made the central banks should purchase local-currency denominated government bonds.

Other initiatives include several private sector and official sector proposals, encouraging issues of Asian local-currency denominated corporate bonds and asset-backed securities.

Proposals include the following aspects. In order to invite participation of investors from the countries in the region, domestic bondmarkets should be open to foreigners. Credit-rating companies in Asian countries should be encouraged to cover bonds of other countries in the region, either by research or by affiliation. Another idea is to bundle together some of the local-currency denominated bonds, so that currency and credit risks are diversified for investors.

Before the 1997–98 Asian crisis, government bondmarkets were very small and illiquid, largely because Asian countries were prudent in managing their government finances. In Korea, Malaysia, Singapore and Thailand, government bonds were not issued simply because they were not needed. In Malaysia and Singapore, large surpluses were recorded in public pension fund accounts. Including these public pension funds, the governments were running large surpluses. In Indonesia, the regular budget was largely balanced, while another budget for development projects existed, and official lending of multilateral institutions and bilateral sources financed the budget.

When the Asian currency crisis occurred in the summer and autumn of 1997, it quickly became the East Asian financial crisis, as many banks (with double mismatch) became insolvent. Foreign investors refused rollovers of short-term lending in US dollars, so that banks in the emerging market economies, most typically in Korea, had to find US dollars to meet their obligation. Foreign reserves were quickly depleted and the crisis deepened. Even the International Monetary Fund (IMF) program did not calm investors.
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This episode was pointed out as *prima facie* evidence of the desirability of bond financing in local currencies. Had borrowing of corporations and banks been denominated in local currencies, the US dollar liquidity crisis could have been averted. It is also often argued that if borrowings of corporations and banks had been in long-term bonds, even if they were denominated in US dollars, the acute dollar liquidity crisis might not have happened. The importance of having the domestic bondmarket was pointed out immediately after the East Asian financial crisis.

The scenery has changed dramatically in the wake of the financial crises of 1997–98. Several governments in the region were forced to issue a large amount of government bonds to finance fiscal deficits and bank recapitalisation. Even after increased bond financing, the bondmarkets in East Asia, both domestic and regional, remain relatively small, inactive and illiquid. An inefficient market is not attractive to global bond investors.

Since the domestic bondmarket was not emphasised as an important channel of government and industrial financing, market infrastructure is not well developed. Legal and regulatory aspects of bondmarkets in Asian countries have remained opaque. Protection of minority investors is questionable, and trading and settlement is costly. This, together with the low standard of accounting, auditing and disclosure, has hampered the supply of high quality corporate bonds. Weak corporate governance has also discouraged investors to hold corporate bonds in their portfolios. Most of all, a myriad of regulations on issuance and transactions of bonds has in effect closed the markets to foreign investors and borrowers, and left little room for bondmarkets to flourish in Asian financial systems.

There are several regional bondmarkets where, in theory, Asian borrowers can issue bonds denominated in their domestic currency as well as in major currencies, such as the Samurai and Shogun markets in Japan. In Hong Kong SAR and Singapore offshore markets, issuance and transactions of bonds can be carried out more efficiently than in many domestic markets.

In Singapore, there is an offshore Asian dollar market where Asian bonds, denominated in US dollars, are issued and traded. However, these markets were not active when compared to vibrant bondmarkets in the United States or in Europe. Potential needs for bond financing of Asian governments and corporations did not materialise in these markets, even after the East Asian financial crises.

If no action is taken, the current scope for Asian bondmarket development is limited. However, many consider that with careful preparation market infrastructure at national and regional levels, the issuance and trading of bonds by Asian governments and corporations will increase.
Overview

Park and Park (Chapter 2) propose a market-oriented approach to the development of Asian bondmarkets. According to the authors, domestic bondmarket deregulation and opening will facilitate and increase cross-border financial transactions in Asia. As domestic residents are allowed to hold foreign bonds and foreign borrowers to issue bonds in the domestic markets, some of these domestic bondmarkets will then develop features of full-fledged international bondmarkets. Competition amongst these markets will follow and result in the emergence of regional financial centres. The role of the official sector in this approach is, in essence, to develop regional bondmarket infrastructure.

ASEAN+3 has the lead in developing regional bondmarkets in Asia. The Finance Ministers’ process has established six working groups to devise plans for creating the necessary institutions’ and policy cooperation among the member countries for the development of efficient Asian bondmarkets. According to Park and Park, the member countries do not adequately address an issue critical to the bondmarket development—domestic financial reform. Unless regulations on cross-border lending and borrowing are eased and removed, it is not clear whether deep and liquid bondmarkets will come into existence. If domestic bondmarkets are fortified by domestic financial infrastructure, deregulated and opened to foreign borrowers and investors, many of the Asian countries would be able to mitigate maturity and currency mismatch problems. However, it is also true that these markets will not gain competitive strength vis-à-vis global bondmarkets unless the countries in the region join forces to construct regional financial infrastructure. Nevertheless, Asian bondmarket development should begin with domestic financial reform.

Ito (Chapter 3) defines the objectives of Asian bonds as overcoming the problem of double mismatch, providing channels for regional saving to be directed to regional investment and reducing over-reliance on the banking system. The secondary bondmarket should be encouraged, as well as bond issues themselves. Ito proposes Asian basket currency bonds as a means to promote bondmarkets in the region. Ito points out that the Asian Bond Fund established by the Executives’ Meeting of East Asia and Pacific Central Banks group in June 2003, does not achieve these objectives. The Asian Bond Fund invests in dollar-denominated bonds issued by Asian governments and institutions, which does not resolve the double mismatch problem. It also adopts a ‘buy and hold’ strategy so that the secondary market will not be stimulated. Central banks, using foreign reserves, would have a problem investing in corporate bonds. Therefore, channelling funds to corporations
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would not be achieved. Asian basket currency bonds issued against a collection of individual local-currency denominated bonds may be attractive to regional investors, overcoming informational asymmetry between issuers and investors.

Ito (Chapter 3) and Park and Park (Chapter 2) differ on issues related to the development of Asian bondmarkets, for example, on the significance of regional bias in portfolio preferences of Asian investors. Ito argues that there must be a natural preference among investors to purchase familiar products with less perceived risk. Home bias—investors from the United States holding too many American, dollar-based securities compared to the ‘theoretically’ calculated weight of the portfolio—is a well documented concept in finance literature. Ito thinks that Asians may prefer regional securities to domestic securities, considering the increasing familiarity with regional affairs and economic integration.

On the other hand, Park and Park argue that given non-transparency of corporate governance, unreliable accounting and auditing, and unreliability of corporate and even banking data, Asian investors may not have any informational advantage in buying Asian bonds. Park and Park focus instead on portfolio diversification. Several empirical studies have shown that most East Asian countries have displayed similar business cycles and share similar structural characteristics, which have in turn resulted in a high correlation of country risks in East Asia. As such, Asian investors cannot sensibly diversify by buying only Asian bonds. Capital account liberalisation has also increased opportunities for Asian investors to acquire more non-Asian bonds than before.

This argument is supported by the available data. The finance industry believes that a substantial portion of US dollar-denominated Asian bonds are bought and held by the investors of the issuing countries; cross-border holdings of these bonds in Asia are relatively small—there is home bias. However this home bias does not indicate the existence of regional bias. There is evidence of weak regional bias, as Park and Park demonstrate, in that the share of Asian bonds in the Japanese investors’ portfolio decreased from 2.8 per cent in 1996 to 1.4 per cent in 2002. During the same period the share of Latin American issues more than doubled from 8.2 per cent to 20.3 per cent.

Some of the little evidence there is for regional bias is shown in McCauley et al. (2002) who found that 46 per cent (or 44 per cent in weighted average) of new issues in Asian securities between 1999 and 2001 (71 bonds) had been initially allocated to Asia.

Park and Park point out that even when buyers at the initial offering of bonds are mostly Asian, the final buyers may be non-Asians. Eichengreen and Park (2004) also question whether there is anything more to the Asian bid than home country investors buying dollar bonds. So, the data presented
Regional bias, in the spirit of home bias, is still a theoretical concept. To those promoting market development, the apparent lack of evidence in investors' portfolios suggests the potential opportunity for Asian bonds and identifies the importance of regulatory obstacles.

Chapters 2 and 3 also differ on the role of the official sector in fostering Asian bondmarkets. Many advocates of Asian bonds, including Ito, think that the role of government in promoting Asian bonds is important. For example, it is important for market development that the government issues local-currency denominated bonds that are foreign-investor friendly, so that corporate bonds can be issued. Government cooperation is vital in harmonising regulatory and taxation regimes. In order to jump from bad equilibrium (a lack of investors causes no incentives to issue bonds; no bond issues causes a lack of interest among investors) to good equilibrium (deep regional markets; where issuers and investors meet), the role of government is enormous.

Park and Park propose that the role of the government be limited. They contrast a market-led strategy and a government-led strategy, and argue for the former. They also think that governments in the region will not be able to cooperate. However, market-led and government-led approaches in Park and Park are rather complementary. Making domestic markets deep and efficient is obviously very important. It is true that the government cannot do what the market will not, and the government cannot make the market buy where investors are not interested. The government should not push bonds that cannot be sold in the domestic market to foreigners. The wider the investor base, the deeper the market becomes.

The current lack of cooperation among governments may not mean that the government-led strategy is bound to fail or is inherently undesirable. Advocates of Asian bonds think that cooperation will come in the future. Some proponents have more optimistic assessments, precisely because they see benefits from success. In contrast, Park and Park point to the lack of cooperation for the expansion of the Chiang Mai Initiative among the ASEAN+3 members for the past four years as evidence of their assessment. The difference between Park and Park and Ito on this front reflects differences in judgment.

A third issue on which the two chapters put forward different views is related to whether Asian bondmarkets will help prevent future crises and whether they can change the current pattern of capital flows.

Ito supports the widely held view that a large share of long-term bonds denominated in local currencies in a country's foreign debt could reduce its
vulnerability to financial crises. For instance, countries with deep and liquid bondmarkets, open to foreign investors, will ward off financial crises better than those without. The main reason for this benefit is two-fold: having long-term financing as opposed to short-term financing, and having local currency liability rather than foreign currency liability. When a crisis hits one company/sector/region in one country, it is less likely to trigger a liquidity crisis to other companies/sectors/regions/countries. It is less likely to have a crisis contagion and a crisis spiral. A crisis (sharp depreciation/a burst of a bubble) causes panic, and panic causes liquidity crisis, and then the liquidity crisis deepens and broadens. It should be stressed that this reasoning does not depend on the behaviour of investors. Investors, Asian as well as others, may dump securities anyway, but the maturities are long and rollovers are less often, so that issuers will not be subject to acute liquidity shortage.

In contrast, Park and Park propose that the argument for less probable panic rests on misunderstandings and misconceptions.

There is a widespread presumption that the existence of well-developed regional bondmarkets in Asia would tend to reduce the share of foreign assets denominated either in the US dollar or the euro in East Asian, foreign reserve portfolios, and hence Asian savings, will remain in Asia to finance investment in the region. This presumption reflects the misunderstanding of the determinants of inter-regional capital flows between Asia and the rest of the world. There is also the misconception that well-developed Asian bondmarkets will be less susceptible to external shocks, as the majority of market participants will be Asian investors and borrowers...

Knowing that their withdrawal could set off a crisis and victimise themselves, Asian investors, unlike investors from outside of the region, will be more calculating in pulling their investments out of the region. The proponents of the Asian Bond Markets Initiative suggest that prudence in risk management and possibly regional altruism will help stabilise inter-regional as well as intra-regional capital movements, thereby setting up a sturdy shield against financial crisis and speculative currency attacks (Park and Park, Chapter 2:28-29).

What Park and Park are arguing is that it is inconceivable that individual investors think as a result of collective action, and collude, explicitly and implicitly, among themselves. Ito agrees that collusive behaviour, or regional altruism, should not be a base for promoting Asian bonds. But Ito claims that the proponents do not use the argument of ‘regional altruism’ as the basis of their argument. Instead, according to Ito, the advocates of Asian bonds promote Asian bondmarkets because they will reduce the probabilities of a crisis as they help overcome double mismatch and reduce reliance on banking.

Park and Park question whether deep and liquid Asian local currency bondmarkets help reduce vulnerability of East Asian countries to financial crises. First of all, susceptibility to crises depends more on economic
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fundamentals and efficient macroeconomic management, and not so much on the availability of long-term finance. When a financial crisis occurs, it is reasonable to assume that the reserves held in short-term assets such as Treasury bills will evaporate quickly; no new international financing including trade credits from either the short or long-term end of financial markets will be available; and outstanding long-term bonds will be degraded to junk-bond status. The country in question faces a foreign exchange liquidity crisis. Foreign creditors know that foreign reserves will soon be depleted as they are used paying for imports. These developments then force creditors to demand repayment as soon as their foreign currency-denominated obligations mature.

Park and Park also point out that the idea that Asian bondmarkets act as a buffer against financial crises is yet to be proven. If the currency mismatch in financing is as serious a problem as claimed, then Park and Park argue that Asian countries should develop and open their domestic bondmarkets before creating regional bondmarkets in Asia. There are also empirical studies showing that bank-based financial systems are no more likely to be susceptible to crises than market-based financial systems.

To substantiate their point, Park and Park consider a case where regional bondmarkets are as competitive as global bondmarkets. Then a question arises as to why those Asian borrowers who cannot issue local currency bonds in global bondmarkets will be able to do so in regional markets. What are the characteristics of Asian regional bondmarkets that can accommodate regional currency financing? The existence of regional bias, which is not evident, cannot be the answer.

Furthermore, the investor base of regional bondmarkets will be global. This means that substantial amounts of Asian currency bonds, issued in Asian bondmarkets, are likely to be held by non-Asian investors. Many exotic currency bonds (mainly central and eastern European) are issued and traded in the euro bondmarket including South African rand issues, whereas few of Asian currency bonds are issued. Why do Asian issuers not issue local currency bonds in global bondmarkets? Part of the answer lies in government regulation.

Park and Park think that having Asian bonds will not change the basic patterns of global flows of capital.

In fact, the construction of regional bondmarkets will not change to any great degree the pattern of inter-regional capital flows in East Asia in which East Asian countries import mostly safe capital from and export risky capital to the United States and Europe...The increase in the diversity and depth of Asian bondmarkets will not necessarily increase the share of Asian bonds in the aggregate East Asian asset portfolio as long as East Asia remains a capital exporting region (Park and Park, Chapter 2:29).
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Theoretically speaking, Park and Park's argument in terms of 'net' flows is correct. However, the argument has to be slightly different when we consider 'gross' flows. It is true that given current account surpluses, East Asian economies will remain capital exporters. However, Ito argues that 'gross' capital flows, currency denomination and maturity structure matter in crisis vulnerability.

Ito provides, as an example, a difference between 'net' and 'gross' capital flows. Let us consider the two cases: Asians export US$2 trillion capital and receive US$1 trillion capital; and Asians export US$1 trillion capital and receive no gross capital. In both cases, the net amount of exports is the same, US$1 trillion. In the first case, the following crisis scenario is possible. Suppose that non-Asian investors hold short-term dollar securities of, or loans to, Asian corporations. Moreover, suppose that gross capital exports from Asia were in terms of long-term investment, while gross capital imports from the rest of the world were in terms of short-term investment (dollar-denominated short-term bank loans).

Then a withdrawal of capital by non-Asians means refusing rollovers, causing a severe dollar liquidity shortage, and spilling over from corporations to banks to central banks. This is a mechanism by which even net capital exporters may fall into currency crisis. In the extreme case, Asian investors may not have to accept gross capital inflows at all, as in the second case. Then, Asian investors may not have to be subject to a sudden change in mood of non-Asian investors.

Park and Park agree that countries can run surpluses in both the current and capital accounts, and these surpluses have been added to East Asia's foreign exchange reserves, although such surpluses cannot be sustained for a long period. However, they disagree with the argument that Asian bondmarkets will reduce Asian borrowers' short-term capital imports from abroad. Even if Asian borrowers were able to issue Asian currency bonds in Asian bondmarkets, it is quite possible that non-Asians could hold substantial amounts of these Asian bonds. Furthermore, there is no evidence suggesting that Asian borrowers will be able to raise long-term funds in Asian bondmarkets, or that will not be able to in global bondmarkets. Park and Park emphasise that even Ito's extreme case of zero capital import does not shield the economy from the crisis. It is quite possible that domestic investors may start fleeing the countries when they see an impending crisis, causing a foreign exchange liquidity crisis.

At present, Asian central banks 'import' large amounts of safe US assets, as they are liquid and mostly risk-free. American and European investors also buy substantial amounts of risky Asian securities, whereas cross-border
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holdings of Asian securities in Asia are small. Why are Asians not buying the Asian securities that American and European investors are willing to buy? That Asian bondmarkets will change the current pattern of Asian investors' portfolio behaviour has yet to be proven.

Moreover, practically all of East Asia’s holdings of short-term Treasury bills are held in reserves. Given the need to diversify country risk, it is unlikely that Asian central banks can increase substantially the share of their holdings of Asian domestic currency bonds. Well-developed domestic bondmarkets could reduce the amount of imported capital, but regional bondmarkets may not, to the extent that they have the market structure and operations similar to those of global bondmarkets.

The investor base of Asian bondmarkets will be global. It will not make much difference whether Asians or non-Asians hold Asian long-term bonds. If a country fails to manage its economy properly so that it runs a large budget and current account deficit, exposing itself as a target of speculative attack, then a large share of long-term financing will not provide much comfort.

Ito does not use the gross capital flow argument for promoting Asian bonds. He acknowledges that while this argument is commonly heard, it is superseded by other more important arguments.

On currency basket bonds, Park and Park point out there are some practical problems that could make Asian basket currency bonds less attractive to investors.

Park and Park argue that Asian basket currency bonds are basically mutual funds with fixed portfolio weights investing in bonds with different currency denominations. As such, investors cannot adjust their portfolio weights even when the prospect of currency returns change. Even if investors prefer fixed portfolio weights, the optimal portfolio weight may differ with the base currency of the investor. It is impossible to create an Asian basket currency bond with weights that would satisfy investors with different base currencies. In response, Ito states that Asian basket currency bonds may still serve as a benchmark for a basket of Asian bonds, although they may not precisely match the optimal basket of many investors. Individual investors add or subtract particular Asian bonds in addition to a base holding of Asian basket currency bonds.

Park and Park argue that if a particular currency bond included in the Asian basket currency bond pool becomes suspect (in terms of currency return or credit risk), one has to dispose of the whole holdings of Asian basket currency bonds; in mutual funds it suffices to dispose of the suspect bond alone, saving on transaction costs. Ito states that this is a valid criticism, highlighting investors’ concerns, and pointing to the possible unattractiveness
of Asian basket currency bonds. According to Ito, this is why the basket should consist of bonds with the same, high credit rating. Park and Park think that in this case, it would not matter whether one holds Asian basket currency bonds or individual Asian bonds.

Park and Park argue that as far as diversification of currency and credit risks are concerned, the benefits of holding Asian basket currency bonds are not likely to be higher than those of holding a portfolio of individual country bonds. Asian currencies are highly correlated to one another and credit risks of Asian bonds also show a high degree of correlation due to synchronisation of business cycles of Asian countries. If Asian bonds are highly correlated in terms of currency and credit risks, it will not make much difference whether one invests in an Asian currency basket or in any single Asian country bond. Ito points out that correlations among Asian currencies tend to vary from period to period, and even if currency risk was as highly correlated, investors would prefer to diversify to minimise credit and political risks. Mutual funds in the United States invest in various State and municipal bonds, although the 'currencies' of the States or municipality are perfectly correlated with the federal currency, the US dollar.

Park and Park observe that Asian basket currency bonds are like structured notes, requiring financial engineering techniques to calculate the theoretical value, making them unattractive even to institutional investors. The calculation becomes more complicated as the number of currencies increases. This is why European currency unit bonds were not very successful; Asian basket currency bonds present an even larger problem. Unlike European currency unit bonds, each Asian basket currency bond has a different currency and credit composition, making investors calculate their value one by one. In senior/subordinated tranching in Asian basket currency–asset-backed security bonds, rating the senior bonds must be a nightmare for credit-rating agencies let alone credit-enhancement agencies. However, Ito thinks that given information and technological sophistication, theoretical values of multi-currency bonds could be easily calculated, and currency risks easily understood. Park and Park argue that no currency basket bond in history has ever been successful.

Ito acknowledges that if full diversification is optimal for investors and if that is what investors practise, then highly correlated currencies will not be demanded. However, the home bias proves that real world investors are not full diversifiers.

Park and Park believe that the idea of Asian basket currency bonds or currency basket bonds have potential benefits, especially when the structure is simple. For example, Asian basket currency bonds with government bonds
from two countries with the same or similar credit rating. Ito’s position is more inclusive, arguing for bonds of several countries to be put into the basket. The difference between the two views is judgmental—the proof will come with time.

Issues surrounding Asian bonds

The remaining chapters deal with credit enhancement and securitisation in helping to develop Asian bonds. In order for Asian bondmarkets to flourish, issuers have to find it less costly to issue bonds than alternative means of financing, while investors have to find bonds worth investing in. If credit rating is not available, investors become sceptical. A regional credit-rating company, or a network of credit-rating companies, will be desirable for regional investors. Even when credit rating is available, if ratings are low, investors will not be attracted to bonds. This is the view taken by Wong and Ho (Chapter 4). They consider credit enhancement as key to Asian bond developments. This view is reiterated by Rhee (Chapter 5), Tran and Roldos (Chapter 6) and Rhee and Stone (Chapter 7). Securitisation is emphasised by Wong and Ho (Chapter 4) and Tran and Roldos (Chapter 6).

Wong and Ho discuss the challenges of promoting corporate bond issues in Asia. They focus on the issue of credit rating. The authors argue, after examining recent issues, that corporate bonds in the region are typically rated below investment grade, and are not attractive to potential issuers and global investors.

For example, at the current credit rating, Asian corporations would be required to pay an 8 per cent spread over the US Treasury bonds. This would make borrowing costs much higher than the interest rate of bank loans. Therefore, it is important that the credit rating of Asian corporations be upgraded.

Taking US municipal bonds as an example, the authors argue that an AAA-rated insurer can enhance the credit of corporate bonds in Asia. Wong and Ho argue that credit insurers can reduce or spread risk by ‘overcollateralisation, diversification, reinsurance, securitisation and other techniques... A top-ranked bank can guarantee an Asian corporate bond by requesting collateral from the bond issuer for the guarantee provided’ (Wong and Ho, Chapter 4:103). The authors cite the benefits of such an arrangement as follows

- bond issuers can raise funds directly from the capital market
- bond issuers can build their reputation over time
- insured bonds are marketable
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- insured bonds can help the development of the market
- banks can diversify risk of concentration of bank lending to a small number of sectors/companies.

Securitisation is a good way to increase the variety and quantity of high-quality bonds. Collateralised loan obligation and collateralised bond obligation are identified as good sources of increasing the volume of high-quality securities. Korea has introduced a primary collateralised bond obligation guarantee program, with the Korea Credit Guarantee Fund. The Mortgage Corporation in Hong Kong SAR is another example. In the United States, residential mortgage loans are securitised through government-sponsored mortgage corporations. Wong and Ho propose to establish asset-backed security corporations with the support of Asian governments in dealing with bond and loan securitisation. On the investors' side, the authors propose that the government establish mutual funds to invest in the portfolio of Asian corporate debts. A model is the Hong Kong Monetary Authority’s purchase of equities in 1998 to avert a financial crisis in Hong Kong SAR.

Wong and Ho identify the following steps to promote corporate issues: credit ratings should be enhanced; securitisation should be promoted; and Asian bond funds should be encouraged. They argue that promoting credit insurers is key to building an industry of credit enhancement. They refer to credit insurers in the United States, that is, to private-sector actions. Developing institutions in re-insurance and the credit derivative market is key to spreading credit risks. Wong and Ho argue that credit insurers with related financial products will make corporate bonds in the region investment-grade. Another way to transform Asian corporate bonds is asset securitisation. A move to establish corporations to securitise assets—‘asset-backed security corporations’—is proposed. The asset-backed security corporations will standardise contracts and procedure, moving assets into asset pools. Then a transparent, investment-grade asset-backed security market will be born. A third way to promote corporate bonds is taken by investors. The first step is for the government to set up an Asian bond fund for Asian corporate bonds, and then to securitise government bond funds and create mutual funds that are sold to individuals and institutional investors. The Asian corporate bond fund will invest in investment-grade bonds—credit enhanced bonds—so that investors will not bear excessive risk.

Rhee (Chapter 5) describes the structure of bondmarkets in East Asia and recent movements toward building regional bondmarkets. Several bondmarkets in the region, such as Samurai bonds, Shogun bonds and Dragon bonds, are reviewed. Rhee first argues that Asians are increasingly issuing and purchasing debts in the Singaporean market, citing the evidence of
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McCauley and pointing out numbers of issues in onshore Singapore-dollar denominated bonds and the offshore Asian dollar market in Singapore. For the Singapore-dollar market, a total of 27 per cent of the issuers were from the Asia Pacific region, and the majority of foreign borrowers were from the United States. Most of the Singapore-dollar denominated debts were purchased by onshore Singaporean investors. In the offshore Asian dollar market, at least 40 per cent of the borrowers were financial institutions and corporations from the Asia Pacific region.

Rhee goes on to argue that using only a portion of foreign reserves might help the development of corporate bonds in the region—namely the recycling of funds. Rhee views the importance of regional bonds as stemming from credit enhancement and the Asian common currency. Rhee points out that the New Miyazawa Initiative, which was introduced by Japan to help Asian countries in the midst of credit crunch, had an element of credit enhancement, that is, the guarantee of Asian sovereign and quasi-sovereign bonds by the Japanese government. Rhee has a vision that a common currency in Asia would increase the regional bondmarket, just as the introduction of the euro integrated the European bondmarkets with reduction in the spread.

Tran and Roldos (Chapter 6) emphasise securitisation and credit guarantees. They also summarise measures needed to lay foundations for market infrastructure and legal framework. The authors review the history of legal change to enhance securitisation: Korea passed the Asset Backed Security Law in 1998; Thailand passed the Securitisation Law in 1997; and Malaysia created the National Mortgage Corporation in 1986. Credit enhancement is also identified as a good way to broaden investor bases.

According to Tran and Roldos, improving corporate governance and transparency, including accounting and auditing standards are identified as a high-priority measure for market infrastructure. Also establishing common financial disclosure and registration rules for bond issuers is important. Standardisation of bond contracts, underwriting standards, and clearing and settlement procedure are steps toward regional bondmarkets.

Tran and Roldos identify six areas of potential policy action and reform needed to strengthen the bondmarket. First, market infrastructure has to be laid out; improving corporate governance and transparency belongs to this category. Second, a legal framework has to be established; this is most important for securitisation. It is also important to establish bankruptcy law and foreclosure practices. Third, repo markets should be developed to add liquidity to the secondary market. Fourth, derivative markets should be developed. Fifth, allowing mutual funds and pension funds to invest in corporate bonds, and inviting foreign investors by gradually dismantling
capital controls should broaden investor bases. Sixth, protection of creditors’ rights and rating requirements will enhance transparency. The authors take lessons from pension reform and the establishment of a local credit rating agency in Chile that contributed the development of their bond market.

Rhee and Stone (Chapter 7) propose region-wide credit enhancement programs. They review studies on municipal bond banks in the United States. The municipal bond banks first appeared in Canada in 1956 and in the United States in 1970. The municipal bond banks enhance credit by pooling multiple municipalities’ issues into a single bond bank debt issuance. By pooling bonds, credit rating associated with the debt is changed. Municipal bond banks must have a strong credit rating to benefit from pooling bonds. Municipal bond banks can issue a large amount so that issues can be competitive. Municipal bond banks have helped municipalities without imposing financial burdens upon taxpayers.

Based on their research on the municipal bond bank model used in the United States and other western countries, Rhee and Stone believe that an application of this model to Asia could greatly help development of Asian bonds by reducing costs for issuers and making it more attractive to investors.

This book is the first of its kind, providing a focused, in-depth examination of Asian bonds. While discussion in the chapters may overlap slightly, the different approaches taken up by the authors collectively provides a comprehensive view of Asian bonds. If all the recommendations scattered in these chapters are taken, Asia’s move toward having robust financial markets is ensured.