

Point of View

# asian fixed income markets

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## Point of View

This point of view is part of an ongoing Investance research initiative into regulatory change impacting the global financial services industry.

To learn more about Investance or our research, visit us at [www.investance.com](http://www.investance.com) or contact John West +852 9817 0897 [jwest@investance.com](mailto:jwest@investance.com)

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# Asian Fixed Income Markets

The following explores where the Fixed Income markets are in Asia and the potential impact this may have on the established markets and what players will need to be considering in the coming months and years.

The growth of the markets in Asia is a well-known story, however, there are times when a whole region or group of markets reach a size that they start to lead events rather than simply follow. This is a turning point that suddenly changes the landscape and with it the need

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*This is a turning point that suddenly changes the landscape and with it the need for investment*

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for investment, management and control. What we are seeing is the start of that process and as such, empirical evidence is starting to suggest that the balance of power is also heading east.

There is clearly a need to develop a larger and more diverse group of investors and the main area of growth in terms of financial institutions, who are the main consumers of fixed income product, is in Asia. This, combined with the likely reductions in proprietary trading activities of the banks and the reduced inventories driven by the Volker rule and other regulatory factors, will force firms to find secure buyers and distribution channels that previously were not deemed necessary. This if nothing else is likely to be one of the main catalysts for change.

## What evidence is there for a material shift?

With a wide range of markets, products and a somewhat disparate set of data it is not always obvious when a turning point has been reached, but there have been a number of indicators in 2011 that highlight some significant shifts that are likely to not only continue but strengthen materially over the coming months and years.

There is clearly a greater need right now and probably well into the future to secure new clients to distribute to, with the emerging markets and Asia in particular looking the most promising.

As is common though in order to cultivate these new clients, exposure to and active participation in local currency markets will in many cases be a necessity.

Examples of this shift can be seen in a number of areas, such as:

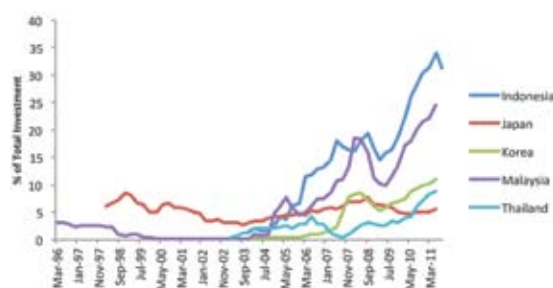
- Strong capital inflows into the Asian bond markets as investors look for higher yields, backed by comparatively strong economic growth figures. There is also the draw of potential weakness in the US Dollar and Euro helping to pull funds into these markets.
- Some improvements in country credit ratings, Indonesia for example, contrary to most movements in the developed economies.
- Continued growth in local currency bond issuance, which in some markets has continued to see growth in excess of 5%.
- The increasing view amongst investors that the emerging markets in Asia offer a level of safe haven exposure as compared to some developed markets. USD denominated corporate bonds issued by local corporations are becoming popular with Asian investors as they gain the currency and interest rate exposure, but reduce their credit risks away from overseas issuers.
- Turnover has increased in most East Asian markets, highlighting the shift.

- Continued developments that enhance transparency and help to open up markets, increase liquidity and investor access. Recent events such as in Singapore where in July 2011 SGX commenced trading in Singapore Government Securities.

These are merely a few recent examples, which add weight to the argument. What is clear though from a number of sources is that Asia is no longer the shortest leg on the stool and is heading very rapidly towards being as complex and active as the established markets in Europe and the US. Given growing domestic market activities and the strength of a number of regional and local players, a delay in investment at this time could prove costly in a short to medium term.

*A delay in investment at this time could prove costly in a short to medium term.*

A further example of the growth in fixed income markets in Asia:



**Figure 1:** Foreign Holdings in Local Currency Government Bonds.

Source: Asian Development Bank

## What should be done, and when, to avoid missing this opportunity?

If your business model involves having a strong or growing fixed income business or if you are planning to move into this area, then moving sooner rather than later will pay dividends. Investment being redirected from the developed markets makes a much more compelling argument than has been the case in the past.

Clearly there are a number of challenges facing institutions globally, high amongst them involving pricing issues for internal valuation purposes, new yield curve benchmarks, capital charges and greater risk transparency. Additionally, there is the added complexity and cost of developing future clearing mechanisms to meet legislation mandating clearing of vanilla swaps. However, even taking into account the impact and costs associated with this, there are few areas that offer the chance for greater revenue returns than exist in the Asian region.

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### *Few areas offer greater revenue returns than the Asian region.*

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A growing percentage of change resources will continue to be allocated to Asia and the barriers to entry will potentially become even higher for those entering late. Involvement in local currency bond markets can also be complicated given the clearing and settlement aspects alone, as they are numerous and unique to each location.

Equally, with mandated execution of certain types of swap through a Swap Execution Facility (SEF) in other regions, banks are required to allocate considerable resource to preparation and infrastructure investment so as to build a connectivity layer sufficiently flexible to support the various messaging protocols required around their fixed income business.

Many firms may look to prioritise investment in technology in Asia so as to achieve faster price calculations, a consistent market risk approach across desks and increased efficiency and transparency in pricing.

This allows them to capture further market share in Asia rather than spend heavily on technology to establish themselves as a market leader in other regions more hindered by regulatory reforms.

## Conclusion

Timing as always is the key, but there is clear evidence that the shift is fully underway and is likely to forcefully continue in the coming years. Given the time and investment needed to establish an efficient operation in the region, we would recommend that serious consideration be given to this area.

A revamp of existing procedures and booking flows may also be warranted, especially in some of the larger domestic markets, which show some of the

best promise, in terms of margins and returns. Either investment in existing infrastructure or potentially looking at outsourcing large parts of the back office function all seem viable, as available providers do now exist in the region. Clearly none of this is either straight forward or simple to implement, however missing this opportunity and arriving late into the game could prove extremely costly.

**For feedback or questions about this research paper, contact the author:**

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## About Investance

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