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China's $900bn OBOR project hits security potholes

By Elliot Wilson

Riots, terror attacks and a welter of security issues are stalling and undermining many of the infrastructure projects central to China's grandiose $900bn One Belt, One Road programme.

The Chinese government is determined to build a vast grid of railway lines, highways, pipelines and ports that slash the cost of shipping Chinese goods overland to Europe, and by sea to South Asia, Africa and beyond. But its hopes of rewriting globalisation in its own image are running into trouble.

In Myanmar, fishermen have protested after being banned from trawling a stretch of coastline earmarked for a $10bn special economic zone. The zone is being built by Chinese state-run Citic Group, which will construct a 770km pipeline pumping crude oil overland to China through the impoverished ASEAN state. China has also threatened to back out of building a $3.6bn dam in Myanmar after mass protests.

Similar problems have surfaced in Pakistan, where China is building ports, highways, railways and oil pipelines.Last week, two Chinese nationals working on a highway in the troubled region of Balochistan were shot dead by Islamic State terrorists.

THE START OF PROBLEMS

Experts say this is just the start of problems for a country unsure of its footing on the international stage — yet which touts itself as the arbiter of globalisation and aims, via OBOR, to influence the evolution of world trade flows and politics.

"Myanmar is just the start," says Andrew Polk, head of China operations at policy intelligence specialist Medley Global Advisors. "All the projects China does through OBOR are going to be big and disruptive, and this highlights the learning curve involved in operating in troubled places. They will run into trouble wherever they go."

Pakistan: security is a constant worry

Another challenge China faces is to

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OBOR, Bond Connect to be RMBi breakthroughs, say experts

By Noah Sin

The combination of China's One Belt One Road (OBOR) policy and Bond Connect system will allow the renminbi to be used more widely as an international investment and reserve currency, said experts at the Hong Kong Exchange's renminbi fixed income and currency conference last week. This could be a breakthrough in renminbi internationalisation (RMBi).

The Bond Connect, expected to be launched in July, is a system to connect the Chinese and international bond markets, allowing investors in each to access the other. However, when the system is launched, which could be as early as July 1, it will only permit trading flows into China — so-called 'northbound' trading.

"Southbound is unlikely to happen in the next couple of years, while the monetary supply outside China continues to be as loose as it is today," said Charles Li, chief executive of HKEX, at the conference on June 8. "But at some point when the interest rate environment changes, when the yield environment changes, when China is different, then the massive investors in China will also become participants in the international market."

Nevertheless, Bond Connect has raised the prospects of large capital inflows into China's market and is expected to hasten the full inclusion of Chinese bonds in key global investment indices.

But Ba Shusong, chief China economist at HKEX, said the greatest significance of the Bond Connect was promoting the renminbi as an investment currency.

"Without an open bond market, it's very difficult for the renminbi to truly become an international currency," said Ba.

Ba Shusong: hard for RMB to become international currency without open bond markets

"The next drive for internationalisation is to shift [the renminbi] from trade settlement [currency] to an investment as well as reserve [currency]."

Ba reckoned the Bond Connect would increase the amount

Continued on page 4

Asian bonds robust in face of rate hikes after long boom

It has been a long journey to the deep and diverse Asian bond markets of today, taking in the rise of China, the emergence of local currencies and the region's maturing dollar market. Now, investors and issuers are looking ahead to further Federal Reserve hikes and preparing for the next challenge.

By Adrian Murdoch

Bond markets have been so bullish that even Mongolia has been able to tap the markets twice in the past year

While Asia's loan markets may have changed only superficially, its bond markets bear almost no resemblance to how they looked 30 years ago. The emergence of China on to the world stage and into the international capital markets has changed the business beyond recognition.

"Greater China accounts for around 70% of issuance in the G3 Asia ex-Japan bond markets, from virtually zero even 20 years ago, when volume in was dominated by Korean issuers," says Derek Armstrong, head of Asia Pacific debt capital markets (DCM) at Credit Suisse in Hong Kong.

Dollar bond issuance has grown exponentially — from around $15bn in 2000 to $200bn last year, according to Credit Suisse — and there has been a noticeable shift away from 144A format to Reg S.

"Today the US dollar Reg S market is capable of supporting large, multi-tranche deals across the maturity curve," says Neil Arrowsmith, head of Asia Pacific syndicate at MUFG in Hong Kong.

This year, Deutsche Bank reckons 70% of Asian issuance will be Reg S only. Five to 10 years ago it was 50%.

"Asia has a much more active regional investor base, which is driving demand — more business is being executed in Reg S only — with volumes more than doubling over the last five years alone," says Jake Gearhart, Deutsche Bank's head of debt syndication and origination, Asia Pacific.

A decade ago, a roadshow would involve a day in Hong Kong, a day in London and a day in New York. These days, bankers often spend a day in Singapore and a day in Hong Kong. It is now the norm to have bond issues with no investors outside the region.

The Asian dollar market is receptive to a diverse range of issuers and provides for debt structures ranging from vanilla to subordinated, perpetual and hybrid structures in various forms and aimed at specific investor groups.

Among sovereigns, even Mongolia has been able to tap the markets twice in the past year, although its $500m issue in March 2016 had the dubious honour of the highest coupon on a sovereign bond since 2011.

Lots of the activity is driven by Chinese issuers, as their regulatory environment has become more conducive to funding through bonds, and issuers have more need for dollars to fund overseas expansion.

"We're also seeing much more activity in the corporate high yield market in the region, again most significantly from Chinese issuers and in the real estate sector," says Arrowsmith.

Since 2000, high yield issuance from Asia has risen from around $2bn to more than $20bn last year, according to Deutsche Bank.

THE RISE OF LOCAL CURRENCIES

But Asian bond markets have changed in other ways too. Most significant is the development of domestic currency bond markets.

These emerged in the wake of the currency crisis that was triggered in May 1997 by the Thai baht devaluation. The common habit before then of using short term dollar debt to fund long term investments whose returns were tied to the value of domestic currencies was an accident waiting to happen. A period of painful soul-searching and reform followed.

Local bond markets grew up and stopped being glorified syndicated loan markets. They have now become enormous.

"One of the most exciting things is the evolution of the China domestic bond market, the third largest in the world, and its gradual opening up to foreign participation for both issuers and investors," says Ashish Malhotra, global head of bond syndicate at Standard Chartered in Hong Kong.

At roughly Rmb48tr ($7.4tr), the Chinese bond market is nipping at the heels of the $11tr Japanese market, though it remains far behind the US's $35tr.

Growth in Asian bond markets has been driven by what bankers call the region's "notoriously diverse investor base". This is populated by local banks, private banks, life insurance companies and pension funds as well as local and international funds, and it is these that have wanted longer maturities.

"The need for income, in an environment where you have a lot of fixed income instruments in negative territory, is what is leading to the flows," says the head of Asian credit at one asset manager.

This is unlikely to change soon. "China will continue to dominate the market, though hopefully balanced out more by the emergence of certain southeast Asian and Indian markets that have room to grow," says Arrowsmith. "Bank liquidity has always been strong in Asia and certain local bond markets have also developed to provide a competitive local funding option."

RISKS AND RATE HIKES

But there is one dark cloud on the horizon: US interest rates, which tend to govern the level of dollar bond issuance in Asia. With one rate hike under the Federal Reserve's belt so far this year and a second likely soon, bankers are starting to worry about outflows.

Most believe, however, that any slowdown will be gradual. There is little sign of banks trimming their DCM teams. Rates are likely to remain below historical medians, while strong issuer balance sheets and regional economies should sustain an active debt capital market in Asia. Most importantly, the large issuance volumes in recent years will all need to be refinanced.

"We expect the markets to remain calm in the run-up to a potential US interest rate hike in June and see a healthy pipeline," says Armstrong. "A number of issuers are positioning themselves to access the market as part of liability management exercises before two more potential US rate hikes this year, and also many of the previous 2012 and 2013 deals are coming up for refinancing."

There are, as always, doom-mongers who argue that the tightening of US monetary policy, the increasingly domestic focus of US president Donald Trump and rising inflation could call a halt to the market's 30 year bull run. But not even those who predict a widening of Asian credit spreads or a disorderly sell-off of emerging market credits reckon that will be anything other than a bump in the road.

"These are good times to be a DCM banker in Asia!" says Malhotra. GM

Asia's loan market: overbanked but innovation is stirring

The Asian loan market hasn't exactly been a hotbed of inventiveness, but it's still seen some changes. Domestic markets, particularly China, have become vastly more active, while the balance of power has shifted towards local lenders. All, however, are struggling in a world of low margins and low volumes.

By Adrian Murdoch

Nothing in this world is certain, the old saw goes, apart from death and taxes. To that short list can be added the Asian loan market, which retains an old-fashioned, almost gentlemanly nature, which has changed very little over the last 30 years.

The market remains dominated, as it always has been, by cross-border lending in dollars. The only real change, joke regional bankers, is that rather than communicating by fax, they now do everything by email.

But of course there have been very significant changes. "The banks that were active in the Asian loan market have changed," explains Phil Lipton, head of loan syndications, Asia Pacific, at HSBC in Hong Kong.

"It used to be US and European banks mostly leading the deals. That changed in 2008 with a number of mergers, as well as some banks leaving the region. Now the market has shifted to local and regional Asian banks."

New kids on the block like the highly ambitious Chinese banks are happy to compress spreads. Non-bank investors also keep nipping at margins on the sidelines.

With more lenders chasing fewer deals, the traditional loan market has a gloomy feel, and plenty of its veteran participants now regard it as overbanked.

OVERBANKED AND UNDER-MARGINED

Last year, loan volumes dropped 9% year-on-year while the number of deals in the market fell 11%, according to Standard Chartered. That followed an already depressed 2015.

But obituaries for the loan market have been written far too often before. This time, too, will not be the end.

For a start, the market is not as resistant to change or innovation as critics make out.

In an echo of the way domestic bond markets took off in the aftermath of the Asian crisis in the late 1990s, domestic loan markets are now being widely acknowledged as a powerhouse.

Over the last couple of years, local currency lending has accounted for around 60% of regional loan volumes, according to Standard Chartered. The apparent speed of growth may be faster than reality, as renminbi activity in the 1990s, for example, must have been much higher than recorded, but the markets' importance now is not in doubt.

THE RISE OF CHINA

As Foster Lee, head of syndicated finance at China Minsheng Banking in Hong Kong, points out: "Renminbi loan demand is much bigger than it was before", because "the dynamic has changed".

Business in the region has become more China-related. When a European company is buying a Chinese company or a Chinese company is buying a European one, there is, invariably, a Chinese bank and loan involved.

"If you are doing a deal in London then you call Lloyds, if you are doing one in New York then you call JP Morgan, so of course if you are doing a deal in Shenzhen, you call a Chinese bank," explains one banker.

Several bankers complain that the pack of cards is stacked against Western banks. Chinese lenders have different credit requirements and are not regulated by Basel III requirements, which helps them compete. That will change sooner or later — over the next five to 10 years is the generally accepted assumption — and Chinese banks will have to recycle their balance sheets… but not yet.

TOUGHER AT THE TOP

If the market is indeed overbanked, then it is most overbanked at the top end of the market.

Canny lenders have moved down the credit curve to the next level of companies, which still have funding needs, but might have difficulties accessing the high yield bond market.

Fed chair Janet Yellen could bring the good times back to the Asian loan market

But what has changed most of all in the loan market over the last couple of years is innovation in loan products.

To take just two examples, it is worth having a look at United Asia Loan Funding, the region's first fully backed, actively managed cashflow CLO, marketed by SC Lowy and UOB Asset Management, as well as the emergence in the Australian market of term loan 'B' (TLB) deals for speculative grade borrowers.

The $400m United Asia Loan Funding was launched last year, intending to buy loans paying margins of 300bp and above. It has struggled to close, but is clearly a step along the right path.

Further back, Leighton and Apollo Global Management priced a A$359m ($265m) seven year covenant-lite TLB in May 2015, funded primarily by private debt funds and pension funds, which avoided exposure to volatile exchange rates. Until then, Australian borrowers had had to look to the dollar TLB market for longer term loan funding.

Neither product has exactly been a runaway success, but both are steps in the right direction and should help to deepen and broaden Asian loan markets.

BACKING BONDS

While there have been definite moves to integrate loan and bond markets in Europe and the US, as companies seek all their debt funding from a single desk, the integration process is at a much earlier stage in Asia.

The loan and bond markets, says HSBC's Lipton, can be "complementary" but are not always.

"When you have financial or political events in the region there is often a quick reaction in the bond and equity markets, but there can be a lag in the loan markets," he says.

This is not to say that convergence is not happening — it is just occurring at a slower rate.

"The movement is still in its infancy, but in the long term I would expect to see more integration in the two markets," says Andrew Ashman, head of loan syndicate for APAC at Barclays in Singapore.

What is holding back integration at the moment is fragmentation, geographies and currencies.

Ultimately, though, what's most likely to return the loan market to its former glory is events beyond its control.

As the Federal Reserve continues to raise interest rates, regional loan bankers will start to make something approaching decent returns again.

Then it could be back to business as usual. GM

OBOR security woes

Continued from page 1

meet expectations. Take Mongolia, a kind of OBOR branch line. It is only partially plugged into the main trade route, which links China with Europe via Russia and former Soviet Central Asia.

"Bypassing Mongolia is a mistake," said Munkhdul Badral, CEO of Ulaanbaatar-based consultancy Cover Mongolia. "It sends a sign that China is trying to exert control by forcing Mongolia to trade only with Beijing, using their trade routes. Beijing should build a third trade route that goes through us. True, a lot of Mongolians see OBOR as an easy way to make money by acting as a transit state, but this is also a chance for China to show that it is a good neighbour and to consider our needs as well."

Other Asian states see OBOR as a chance to build crucial infrastructure, and as a cost-effective way to embed local firms and banks into global supply chains.

Nayana Mawilmada, head of investments at Megapolis, a scheme to rebuild Sri Lanka's western provinces, believes that for OBOR to be a success, both local governments and China need to focus on projects that really matter.

"Some of the infrastructure funded by Chinese money in the past, including highways and an airport in the south [of the country], wasn't that useful, and left us with debts," he says. "OBOR is a chance to do this better — to plan properly and to build the infrastructure that Sri Lanka really needs. But the onus is on Sri Lanka to channel these resources properly — not on China."

Renminbi boost

Continued from page 1

of renminbi assets held by foreign investors. This would help create an ecosystem for renminbi internationalisation, increasing the number of renminbi financial products, such as hedging tools, to match foreign investors' new exposure to the currency.

BELT AND ROAD

Another part of that ecosystem is OBOR, China's flagship development initiative. Ken Chiu, director and regulatory adviser of the renminbi competence centre at BNP Paribas, said OBOR could move renminbi internationalisation to a new stage.

"In the early stages, China has focused on developing the offshore market," said Chiu. "Now, instead of creating an offshore renminbi market, China is building up a global renminbi value chain, for example, with the Belt and Road initiative."

Lian Ping, chief economist at Bank of Communications, agreed that OBOR would be crucial to the renminbi internationalisation project.

"With OBOR, quite a few projects will be financed in renminbi," said Lian. "This will make the renminbi an investment currency."

Lian also believes more commodities trade will be denominated in renminbi as OBOR takes off, since a lot of countries along the OBOR route are commodity exporters. But this could be a poisoned chalice, bringing new risks, both political and economic, to RMBi.

leading view

Anchoring the Philippine economy amid rough seas

By Amando M. Tetangco, Jr.

In light of increased global connectivity and in the aftermath of the global financial crisis, the role of central banks in emerging economies has evolved and grown in importance. Connectivity has heightened the possibility of contagion to EMs from external headwinds — interest rate movements in advanced economies, geopolitical tensions, gyration in oil prices and slowdown of major trading partners, among others.

PHILIPPINE SCENARIO

The Bangko Sentral ng Pilipinas (BSP) has been able to help keep the Philippine economy afloat amid these rough seas. This is evidenced by the Philippines' sustained and robust economic growth, averaging 6.3% during 2010-2016, one of the fastest in the world, while inflation has stayed low and stable.

> *"The guiding principle the BSP observes is sound and pre-emptive monetary policy and bank supervision. Sound, meaningful actions are based on data from the ground*

The guiding principle the BSP observes is sound and pre-emptive monetary policy and bank supervision. Sound, meaningful actions are based on data from the ground. Pre-emptive, because it is forward-looking, scoping the risks ahead and implementing appropriate measures.

In the case of monetary policy, being sound and pre-emptive includes assessing available tools (e.g. key interest rates, reserve requirements, term-deposit rates, etc.) and deciding which ones are apt for guarding against off-target inflation.

In the case of bank supervision, it means implementing regulations (e.g. capitalisation requirements and risk management) that help supervised institutions, individually and industry-wide, stay robust even if identified or unexpected risks materialise.

Being sound and pre-emptive also means having a financial stability perspective to overlay monetary and banking supervision policies. As such, the BSP policy tool kit is now enhanced to include macroprudential measures, to control systemic risk.

All these require balance, because while moving pre-emptively, the BSP also needs to ensure that its actions are carefully calibrated to avoid costly unintended consequences.

MILESTONES

In the area of monetary policy, we have enhanced our inflation-targeting framework. With sophisticated monitoring and forecasting tools, the BSP has better predicted price behaviour, leading to low and stable inflation that has benefitted consumers and investors.

In the area of bank supervision, a noteworthy achievement is industry growth on the back of prudent regulations. Calibrated implementation of Basel III principles and risk-based supervision has helped maintain stability of banks.

Now, the Philippine banking system is one of the most resilient in the world. It has reliably funded investment requirements of the economy, while keeping bad debts low and capitalisation levels sufficient.

In the areas of payments and settlements, as well as financial inclusion, milestones respectively include regulations that encourage the use of e-money with proper safety nets, and those that promote financial services for micro clients.

WHAT LIES AHEAD

The milestones reflect a strong BSP institution. And so, when I step down in July, after serving two terms as BSP governor, I am confident the BSP will continue to pursue its mandate of price and financial stability conducive to sustainable economic growth, even in the face of external headwinds and other risks whose potential impact authorities have yet to fully grasp. It cannot go wrong if it adheres to the principles of sound and pre-emptive policymaking.

While challenges await the next captain of the ship, it is safe to say that BSP will remain a pillar of strength of the Philippine economy, which is widely anticipated to remain one of the fastest growing in the region and the world. GM

Amando M. Tetangco, Jr. is Governor of Bangko Sentral ng Pilipinas (BSP)

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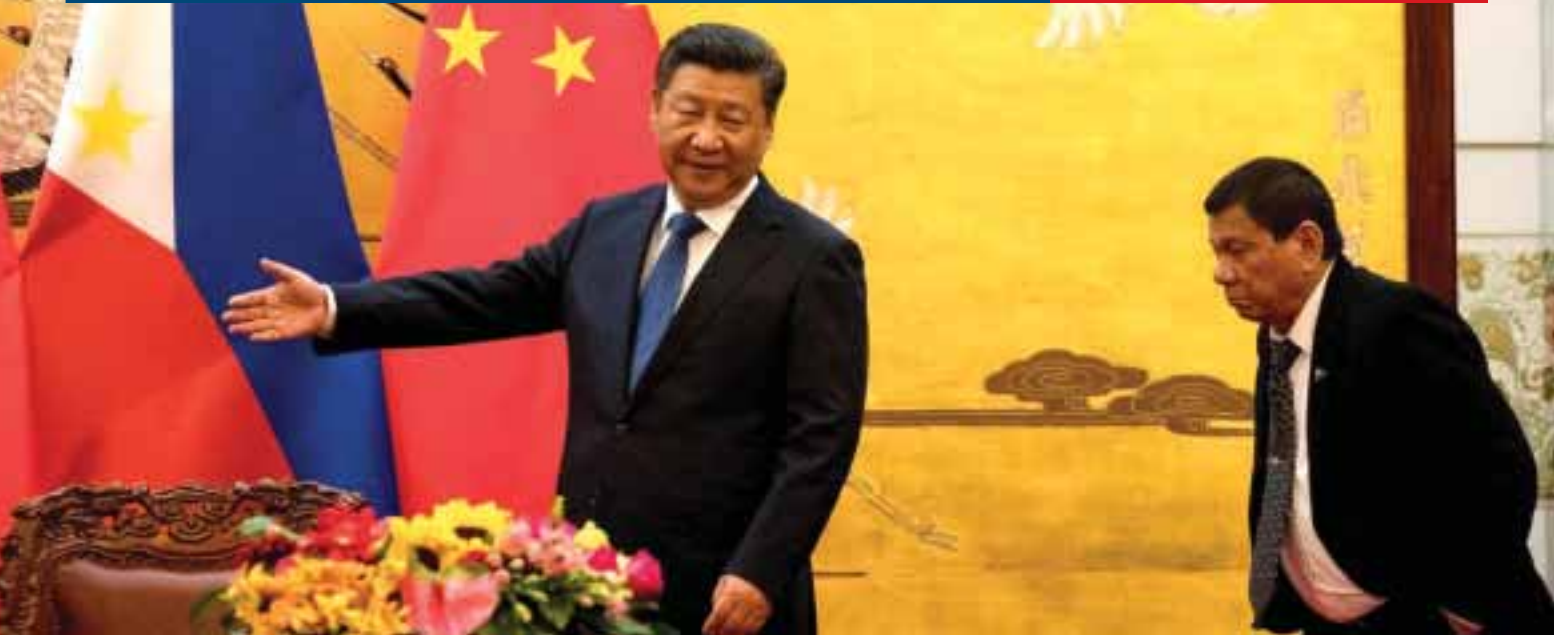

Duterte's US-Russia games cannot hide China's attractions

A year into his presidency, Rodrigo Duterte is, geopolitically speaking, impossible to pin down. One day the Philippines' leader is courting Donald Trump and the US, the next he is on a plane to Moscow to do deals with Vladimir Putin. Meanwhile, in the background is China and its $900bn One Belt One Road project, which could plug a hole in the Philippines' gaping $150bn infrastructure deficit.

Walk this way
Philippine president Rodrigo Duterte (right) and Chinese president Xi Jinping

By Elliot Wilson

That the world is burdened by political instability is hard to dispute. Over the past year, the UK has voted to leave the European Union, then endured a general election that left it more divided and confused than ever.

US citizens selected Donald Trump as their 45th president, based, it seems, in large part on the buccaneering businessman's debatable claim to be a world class dealmaker. And in France, the old political order all but collapsed in this year's presidential race, opening the door to the 39-year-old political novice Emmanuel Macron.

But amid all the flap and fury in large parts of the West, it's easy to overlook the astonishing rise of one the modern world's most effective political insurgents, Rodrigo Duterte. Barely a day goes by in which the Philippine president, elected to office in June 2016, fails to dominate news cycles at home and, often, across Asia.

As a presidential candidate, Duterte, like Trump, was coated in Teflon. Bad news just seemed to slide off him. When he threatened to kill thousands of criminals and pledged that his six year presidential term would be a "bloody" one, his supporters cheered, spurred on by his rough diamond mien and can-do attitude.

When he called his daughter a "drama queen" following her claims to have been raped, many shrugged — and voted for him anyway.

Since coming to power, Duterte has lost none of his power to shock, nor his ability utterly to flummox friends and enemies alike.

Geopolitically, he is impossible to pin down. Shortly after entering office, Duterte reacted to Barack Obama's criticism of his anti-drugs campaign by telling the then US president to "go to hell".

He then cosied up to Xi Jinping, before humiliating the Chinese president by releasing details of a private discussion regarding a longrunning bilateral maritime dispute. In June, after US special forces were called in to help remove Islamist militia from the southern city of Marawi, Duterte welcomed the support, then backtracked, claiming to be "not aware" of American boots on the ground.

SPLIT JURY

To some analysts, Duterte is little more than a carnival huckster, adept at playing to the audience, but ill suited to the rarefied world of global diplomacy. They see him as oblivious to the sheer weight of challenges facing a low-lying island chain imperilled by climate change. During his short time in office, the president has, critics say, focused too much on combatting criminality and too little on job creation and narrowing a yawning rich-poor divide.

But others see in the diminutive 71-year-old a complex and underrated character with street smarts, who started out as a lawyer before rising to serve seven terms as mayor of the country's third largest city, Davao.

Besides, dismissing him as an ingénu with no clear geopolitical outlook overlooks the fact that, from the start, Duterte has pursued what he describes as an "independent foreign policy" which harks back to the Cold War, when so-called 'non-aligned' states led by India, Egypt, Indonesia and Yugoslavia opted to remain neutral in the international arena, cleaving neither to the US and its allies, nor to the Soviet Union and its client states.

What is not yet clear is whether Duterte has the patience and savvy required to play a geopolitical long game with the 21st century's two superpowers, the United States and China.

Building a Brighter Future – One Mega-Project at a Time

The Philippines' leading investment bank, First Metro Investment Corporation, is helping build a bold new future for the country by arranging project finance for infrastructure projects that are transforming life for millions of people.

It was a milestone deal that was stunning in both its scale and ambition. The 33.31 billion pesos loan of Pagbilao Energy Corporation for a 400-megawatt coal generating unit in Quezon province was the largest peso-denominated project finance transaction seen in the Philippines in 2014.

The driving force behind the agreement involving a syndicate of seven lender banks was the country's leading investment bank, First Metro Investment Corporation, which led negotiations for the project and acted as mandated lead arranger.

It is an example of sophisticated project financing that would have been unimaginable just 20 years earlier when complex infrastructure projects in the Philippines were financed largely by foreign banks.

As the ink dried on the Pagbilao project, however, First Metro was already planning even bigger infrastructure projects that are seen to play a key role in the country's rapid social and economic development.

POWERING AHEAD

Within 12 months of the 2014 Pagbilao success, First Metro – an investor and lender to major infrastructure projects across the Philippines ranging from ports to water supplies since 2003 – was at the heart of three major new power financing projects.

First Metro engineered a 42.15 billion pesos loan package to fund the construction of a coal-fired plant in Quezon for San Buenaventura Power, drew up a 31.97 billion pesos loan package to fund a coal-fired plant for ThermaVisayas Inc., and arranged an 11 billion pesos loan facility for Panay Energy Development to create a clean-coal plant in Iloilo City.

The San Buenaventura loan, which surpasses the Pagbilao as the country's largest project finance facility entirely in local currency, financed the construction of the Philippines' first supercritical coal-fired power plant that cuts fuel consumption and emissions, and offers customers cheaper power.

The three projects showed definitively how key infrastructure projects could now be funded within the Philippines without the support of foreign banks and multilateral agencies, thanks to a maturing risk appetite and a willingness by domestic banks to embark on complex financing arrangements.

FORWARD THINKING

One landmark arrangement that sealed First Metro's reputation as a prime mover in capital markets was the 4.1 billion pesos project financing for Davao hydroelectric power plant operator Hedcor Sibulan, Inc. (HSI), a wholly owned subsidiary of Aboitiz Power Corporation.

The 2016 arrangement saw First Metro create an innovative new instrument – a project notes structure – to target a niche of non-traditional lenders including insurance companies, investment houses, and trust and treasury departments of banks.

First Metro experts took meticulous care to help each buyer understand the instrument and subjected HSI project notes to a rating exercise by the country's leading credit rating agency to give investors looking at infrastructure for the first time an extra level of comfort.

"The issue size may not be the biggest, but it was an important first step," said the banking group's head Justino Juan Ocampo. "We need to come up with these new products to deepen the capital markets."

HANDS-ON EXPERTISE

First Metro's expertise in project financing comes from intimate knowledge of the market. It is unique in being the only investment bank in the Philippines to make an equity investment in power.

The bank made a full-cycle investment in Global Business Power Corporation which today has the largest generation capacity in the Visayas island group at 859 MW – more than quadruple its launch capacity in 2003. The company fully divested this investment in 2016.

IMPROVING LIVES

One of the most symbolic and visible ongoing infrastructure projects to change the lives of people in the Philippines for the better is taking shape, thanks to the commitment and determination of First Metro.

The Metro Manila Light Rail network is being significantly expanded with the help of the 24 billion pesos, 15-year project loan for Light Rail Manila Corporation brokered by First Metro. The works will see the rail system extended by 11.7 km and ease the chronic commuter congestion in the Philippines' capital.

First Metro provided support to the winning consortium for the project and drew up competitive terms for the long-term debt financing as well as helping in delicate rights of way talks with local governments and communities.

For First Metro, two years of intensive talks, diplomacy, and hand-shaking have resulted in an intensely rewarding financing arrangement which will improve the daily commute of more than 300,000 Filipinos.

Today, First Metro is restlessly seeking out new challenges and opportunities to contribute to the growth and development of the Philippines, said the bank's president Rabboni Francis Arjonillo.

"We are constantly looking for new opportunities – projects that require structuring and will contribute positively to our country's development," he said. "There is huge liquidity in the market right now. Our challenge is to harness this excess liquidity to fund the growing infrastructure demands of our country."

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For his part, the Philippine president is happy to pay more than lip service to this pragmatic form of anti-ideology. In May, frustrated by an inability to buy precision armaments from the US (Duterte claimed they were needed to strike down homegrown Islamist terrorists; the US nixed the idea, fearing the arms would be used to prosecute his shoot-to-kill drugs war), the Philippine leader hopped aboard a flight to Moscow, where he purchased Russian-made laser-guided smart bombs.

Interviewed during his trip, Duterte denied any suggestion of anti-American antipathy. "I have nothing against America," he told Russian state television. "Trump is my friend. But my foreign policy has shifted. You treat me as if I'm your colony still, but we are an independent country, and I want my country to be treated with dignity. I want to deal with China and Russia. Russia will sell me weapons with no conditions."

TWO MASTERS

At one level, pursuing a truly independent foreign policy by playing Washington and Beijing off against one another makes a lot of sense. It is impossible to get away from the fact that the Philippines occupies a hugely significant place on the map. Manila is due west of Guam, a Pacific island state controlled by the US military. To the north of the Philippine capital lurks China, hemmed in by its own narrow maritime boundaries, and desperate to control the vast blue expanses of the western Pacific.

Yet if Duterte is genuinely committed to pursuing a truly independent foreign policy, he seems to be going about it a strange way. To some critics, rather than forcing the US and China to dance to his tune, he is bending his knee to both.

China has spent the past few years steadily making its presence felt in the South China Sea, building airstrips and self-contained townships on atolls, reefs and islets also claimed by the Philippines.

But while Duterte's predecessor, Benigno Aquino III, fought Chinese encroachment at every turn, bringing — and in 2016, winning — an arbitration case that undermined China's claims to the expanses of water to its east and south, the current Philippine president has studiously avoided criticising China's extraterritorial exercises.

That does not, however, mean he is willing to see his country sever its longstanding military and political ties with the US. In fact, the opposite is true. In January, Duterte's defence secretary, Delfin Lorenzana, said the US would significantly boost its military presence in the Philippines as part of an enhanced military agreement, agreed in 2014 but never formally ratified.

The pact will involve the construction of new barracks, warehouses and runways, and will enable US ships, aircraft and troops to dock and deploy at five bases scattered across the country.

CHINESE FUTURE

Yet it is hard to escape the notion that the future of the Philippines will be determined, for better or worse, by the health of its relations, not with a distant superpower laden with debt and nursing its own domestic grievances, but with its huge and newly assertive near neighbour.

China has overtaken Japan and the US in recent years to become the Philippines' biggest trading partner. It gobbled up $16bn of Philippine exports in 2016, according to the Observatory of Economic Complexity, a data tool created by the MIT Media Lab in Massachusetts — more than any other country.

China is also co-opting a willing Manila into a series of vast global initiatives. Last October, following Duterte's inaugural state visit to Beijing, the Bangko Sentral ng Pilipinas, the Philippines' central bank, added China's currency to its roster of official international reserves: another small step in the process of transforming the renminbi into a global reserve currency. And in 2014, the Philippines became one of 21 sovereign founder members, along with the likes of Vietnam, Pakistan and Mongolia, of the new Beijing-led Asian Infrastructure Investment Bank.

OBOR: PROJECT OF THE CENTURY

Finally, there is the big daddy: China's $900bn One Belt, One Road (OBOR) project, designed to rebuild Asia, and potentially the world, in its own image. OBOR was described in May by President Xi at a conclave of world leaders as the "project of the century" and as a force for peace "in a world fraught with challenges".

Grand words indeed — yet there is no denying the scale and burning ambition of OBOR. With a fractured Europe lacking cohesion and relevance and the United States withdrawing under Trump into a period of introspection and isolation, only China seems willing and able to pick up the baton of globalisation. It is building and funding highways, railway lines, ports, airports and pipelines to link China overland and by sea, with Europe, Central Asia, South Asia and the Middle East.

In theory, OBOR, as it was first imagined by the Chinese leadership, does not pass through the Philippines — nor any of the major economies of Southeast Asia. But the magic of the OBOR brand is that any major infrastructure project funded by Chinese lenders and built by Chinese contractors — a highway here; a new airport or dry dock there — is now inexorably linked, in the eyes and minds of the global public, to China's Belt-and-Road project.

China's genius here is to leave open the interpretation of OBOR, allowing any individual or institution, company or government, agency or supranational, to interpret it as they see fit. In the Philippines, it is widely viewed as a neat and logical solution to the country's woeful infrastructure.

The Philippines has a glaring infrastructure deficit, estimated at around $150bn by CEIC Data, and Chinese companies and banks are hard at work across the Philippines, building ports and railways, steel plants and smart cities, as well flood defences to protect the coastline against the ravages of tropical storms and the more insidious impact of climate change.

All of these projects, said HSBC economist Joseph Incalcaterra in a May 29 research note, will have a "sizeable positive impact" on an economy the bank reckons will grow by 6.5% in each of 2017 and 2018. GM

Major OBOR project list: The Philippines

Project	Sector	$bn	Impt Value, $bn	Chinese firm involved
Cabling manufacturing facilities	Telecom	3.0	0.8	Suli Group
Railway project (MOU)	Infra-Transport	2.5	1.0	China Railway Engineering Corp
Pulangui-5 Hydro Project	Infra-Energy	1.0	0.3	Power China Guizhou Engineering Corp
Nationwide Island Provinces bridges	Infra-Transport	0.8	0.3	Power China, Sino Hydro
Davao Coastline Port Development Project	Infra-Transport	0.8	0.3	
Steel plant	Heavy industry	0.7	0.2	Bayin International Investment
Pasig River Marikina River Manggahan Floodway	Infra-Transport	0.6	0.2	Sino Hydro
Cebu International and Bulk Terminal Project	Infra-Transport	0.3	0.1	CCCC Dredging Co

Source: Public source, HSBC

CEE pings loudly on China's economic radar

Chinese cash may never quite come to dominate the CEE region. But it is here to stay

By Elliot Wilson

To ardent followers of China's brand of economic diplomacy, it all seemed eerily familiar. It was November 2016 and a state-owned financial giant — in this case, Industrial and Commercial Bank of China — was trumpeting plans to roll out a vast new investment fund aimed at snapping up foreign assets and ploughing the nation's cash into ambitious and faraway infrastructure projects.

But the target wasn't the Middle East or the landlocked but resource-rich wastes of Central Asia. Nor was it sub-Saharan Africa or Latin America, recent recipients of so much of China's largesse. This time, China's leaders were going after a new quarry: the disparate assemblage of 16 nation states — some developed, ambitious and moderately wealthy; others mired in poverty or locked into a lower-middle-income holding pattern — that make up Central and Eastern Europe (CEE).

It seemed to catch the entire region on the hop, yet the announcement was all too real. Jiang Jianqing, chairman of ICBC, the world's largest commercial lender by assets, was on record, pledging to channel up to €10bn ($10.9bn) into leading CEE retailers, food manufacturers and high-end technology firms. Infrastructure would also get a boost, with the new outfit, Sino-CEEF Holding, set to invest billions of dollars into new roads, rail lines, airports and power plants. Jiang was quick to emphasise the willingness of the region's presidents and premiers to contribute generously to the new investment fund.

Nor is Sino-CEEF the only fund pumping mainland cash into regional projects. Back in 2015, a Warsaw-based investor, CEE Equity Partners, was handed $1.5bn by Export-Import Bank of China (Exim), one of a trio of China-controlled policy lenders, and told to go forth and invest. So they did. In the past 18 months the fund has bought shares in a raft of regional firms ranging from Slovakian lighting specialist JLR to Hungarian voice and data carrier Invitel Group.

WHY?

But why focus on a culturally diverse region stretching from the Baltics in the north to the Balkans in the south and from the elegant spires of Prague to Russian-occupied eastern Ukraine, which boasts few major multinationals, suffers from human and capital flight and lacks much in the way of natural resources. What is China's motive here? Why Central and Eastern Europe? Why now?

They are good questions. A booming bilateral trade relationship can hardly be the primary reason for China's belated interest. Mainland exports to the CEE accounted for 2.7% of all Chinese exports in 2015, according to the Observatory of Economic Complexity (OEC), a data tool created by the MIT Media Lab in Massachusetts. Compare that with the US (the destination for 18.4% of all mainland exports in 2015) or the European Union or Japan, which respectively accounted for 16.2% and 6.2% of all Chinese-made goods.

It's even harder to make a compelling case for ICBC's investment pledge when you drill down to a sovereign level. Poland, the CEE region's largest economy, accounts for around 0.6% of Chinese exports, reckons Tatiana Lysenko, chief emerging Europe economist at Standard & Poor's. For the Czech Republic, the region's second largest economy, that share falls to 0.2%. "Generally," notes William Jackson, an emerging-markets economist at Capital Economics, "CEE-China ties are a trifling matter. China makes up a small share of CEE exports and the CEE region makes up a small share of Chinese exports."

In truth, China's interest in a region that has, notes Chris Hartwell, president of the Centre for Social and Economic Research (Care), a Warsaw-based think tank, "spent 20 years re-orienting its trade links toward western Europe and away from [its former political masters in] Russia" is complex and nuanced.

On a purely commercial level, China's interest in Europe's eastern reaches

The end of the road
One Belt, One Road; the CEE is a major leg of the vision

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"The CEE is a region worthy of China's attention"

—Stefan Kawalec, Capital Strategy

"For China, the region presents an opportunity to ease excess capacity at home"

—Gu Hongfei, Central and Eastern European Centre for Asian Studies

"China's new emphasis on high-end technology, innovation and knowledge-based industries could be really beneficial for the CEE region"

—Chris Hartwell, Center for Social and Economic Research

is easy to explain. Mainland exports to CEE countries totalled $63.8bn in 2015, according to the OEC, while the value of goods travelling in the opposite direction was $10.8bn. Thus, China's export-to-import ratio with the CEE region that year was 593% compared to 355% with the United States, 228% with the UK, 218% with the EU and 211% with Africa.

That data is yet more eye opening when viewed at the sovereign level. The Czech Republic's trade deficit with China was a whopping 8.9% of GDP in 2015. Other regional states have lower, but far from insignificant, trade deficits with the People's Republic: Slovakia's stands at 5.2% of GDP, Estonia's is 4.5% and Poland's is 4.1%. Compare those to the trade deficits that major developed nation states run with China, from the US (1.8%), to France and the UK (1.2%), to Germany (0.6%). Little wonder, notes Stefan Kawalec, founder of Warsaw-based financial consultants Capital Strategy and a former chief economic advisor to the Polish government, that "the CEE is a region worthy of China's attention".

Slowly, then, a picture begins to emerge. At a very basic level, China views the region through the prism of trade. CEE states have little in the way of energy reserves or natural stores of commodities to offer China but it is teeming with ambitious and low-to-middle-income economies that are in the main democratic and open to free trade. And that makes them "natural destinations for Chinese capital, goods, investment and labour", says Gu Hongfei, an associate at the central and Eastern European Centre for Asian Studies, a Budapest-based think tank that draws together academics from 12 CEE and Asian states. "For China, the region presents an opportunity to ease excess capacity at home."

Others see a deeper vision at work, one that plays to the comparative advantages of both sides. Eastern Europe offers investors two genuine and compelling benefits: high levels of employee skill and low unit labour costs. China's own labour costs are rising fast as its economy gets older and richer but thanks to its vast foreign exchange reserves, which stood at just over $3tr at end-March 2017, it boasts vast pools of accessible and fungible state capital.

This, says Care's Hartwell, will result "not necessarily in a huge expansion of bilateral trade, but in an acceleration of investment from the Chinese side that will drive trade into the CEE, through it and beyond. China's new emphasis on high-end technology, innovation and knowledge-based industries could be really beneficial for the CEE region. There is a nice symbiosis there and it could drive innovation for all of Europe." Capital Strategy's Kawalec believes China is keen to use the region as an industrial base camp, manufacturing consumer goods and specialised high-end products at a lower cost before shipping them to wealthier western European markets.

CONNECTING THE DOTS

Then there's infrastructure. If there is one thing China does effortlessly well it is this. Mainland construction firms have in recent years built maritime toll bridges in Mumbai and highways in eastern Africa; future plans include new rail lines in Latin America, ring roads encircling Kazakh cities and a giant road and rail system linking western China with the Pakistan port city of Gwadar.

So it makes sense to fund and build infrastructure projects across Central and Eastern Europe, particularly when, as Capital Strategy's Kawalec notes, they help "facilitate the transport of Chinese-made products to European markets". Or, to put it another way, to convey goods made by mainland-owned factories located within European Union-area CEE states to the likes of Germany and France.

China's interest in the region varies from state to state, experts say. Larger regional economies such as Poland and the Czech Republic, boasting developed-world-level infrastructure, have less need of mainland cash to fund roads and tunnels. But Hungary, a country that has benefited in the past from Chinese aid and which is currently struggling to see eye-to-eye with the EU, is more likely to welcome mainland capital with open arms.

BALKAN FOCUS

Another likely target for China is the Balkans. "China wants Serbia to become a key logistics and transportation hub that can be used to convey Chinese-made goods to Europe and to open markets that might be closed or restricted," says Care's Hartwell. "China really has been targeting the underbelly of Europe in the Balkans, and Serbia is probably one of the largest recipients of Chinese tied aid. The Balkans seem to be more of a multiplier for them in terms of infrastructure."

Standard & Poor's Lysenko believes the need for China-originated infrastructure capital is greatest not in the non-EU western Balkans but in the Black Sea states of Bulgaria and Romania.

Focusing on poorer markets that mainstream capital often bypasses, rather than scattering cash to the wind in the hope that some of it will stick, makes good sense. After all, China is a newcomer to a region long dominated and influenced by Russia and the big economic beasts of western Europe. Infrastructure capital is also flowing into the region from Russia (which is funding two new €12.5bn reactors at a nuclear plant on the Hungarian stretch of the River Danube) and the EU, which is half way through a three-year plan to channel €21bn into Europe-wide (including CEE) infrastructure projects. In the short run at least, China will not have everything its own way.

OBOR — WRAPPING SOFT POWER AROUND HARD ASSETS

Encircling this entire discussion is an acronym that may come to define the 21st century. China's vastly ambitious One Belt, One Road plan, or OBOR, is often misunderstood, in large part because few outside China (and possibly very many living within its borders) do not, or cannot, grasp the project's ultimate intent.

Whether you view it as a genuine game-changer, a paper tiger or just a handy phrase designed to give China's globalisation plans focus and definition, no one can accuse it of lacking ambition. OBOR spans 65 countries, 60% of humanity, and more than 25% of the world's GDP. Its overland route, which starts in the Chinese capital, stretches eastward through Central Asia and Russia — whose own trade ties with China have improved markedly in recent years — and Poland, culminating at the great Dutch port of Rotterdam.

Paul Sheard, chief global economist at Standard Poor's, believes OBOR is all about "wrapping soft power around hard assets". He says it speaks to China's desire to achieve multiple goals, from increasing its global reach and influence, to boosting returns on its external financial assets, to winning over foreign markets and making them reliable and stable conduits for its capital and exports.

In this sense, Central and Eastern Europe is very much part of China's long term plans. A strong CEE region is cricial to the OBOR project and thus crucial to China's long term interests. Viewed in this light, the decision by major Chinese lenders such as ICBC and Exim to pump capital into a region far from the country and traditionally under the political, financial and cultural aegis of Russia, Germany and the EU makes an awful lot of sense. Chinese cash may never quite come to dominate the CEE region. But it is here to stay. GM

Indonesia's borrowers ready to reap rewards of deeper debt markets

As one of the fastest growing economies of all the G20 countries, Indonesia is on the up. Having taken some difficult decisions after coming to power in 2015, Joko Widowo's administration is reaping the rewards with growth accelerating, a budget deficit below 3%, and inflation tamed. The benign economic background has helped the Indonesian government become one of the most sophisticated sovereign borrowers in the international market. At *GlobalCapital*'s roundtable in Jakarta in early April, hosted by Standard Chartered, leading bankers and issuers gathered together to look at the impact of reforms to state-owned enterprises, potential US interest rate rises, and changes to tax laws on the potential to make a deeper, more effective debt market.

GlobalMarkets: Let's begin by talking about Indonesia's growth and growth prospects.

Aldian Taloputra, Standard Chartered: From the market's perspective the country has one of the fastest rates of growth of all G20 countries. Only China and India have faster rates of growth.

Since 2015 and the arrival of the new administration, the government has been trying to revamp the investment climate to move from a commodity-based economy to a more value added industry one.

It has forced the country to take some short term, bitter pills such as the not very popular policy of cutting the fuel subsidy, which resulted in higher inflation and forced Bank Indonesia to increase interest rates.

After those difficult measures, the economy now appears to be in a good position, having stabilised. We saw momentum begin to build in 2016.

For this year we believe the prospects are better. Commodity prices have started to show some recovery and although we don't expect oil to be back to $100 per barrel and revive strong investment in the mining sector, it at least provides relief because the economy is still heavily reliant on the commodity sector.

However, we believe reforms like infrastructure and structural reform will be the backbone of growth in the medium to long term. So, while the government probably thinks growth can be better, compared to other countries in the region and elsewhere, it is not at all bad.

Aaron Gwak, Standard Chartered: The Indonesian Republic recently conducted a number of roadshows in the US, London, the Middle East and Asia.

The reactions from institutional investors, globally, were very positive, not only on the economy, but also on the bond issuance programmes that the Indonesian Republic has been maintaining. And if secondary asset prices are any guide in terms of their satisfaction, one of the most recent issuances by the Republic of Indonesia — the $3bn dual tranche sukuk — is trading a good shade above par in today's market. Since the beginning of the year, from an asset price perspective, it is one of the best performing assets across the Asian curve.

Susiwijono Moegiarso, Indonesia Eximbank: The government is confident in its strong growth levels and is supported by the fact that Indonesia has become one of the three countries among G20 members with the highest growth rate in recent years. It will be challenging to achieve the 6% growth rate in 2018, for it will need not only growth from the domestic economy, but also a conducive global macroeconomy.

GlobalMarkets: Robert, when you are on your roadshows, what kind of questions are you fielding about the country's economy?

Robert Pakpahan, Republic of Indonesia: Regarding the performance of our economy in the eyes of our investors on our roadshows, most of them appreciate and think we are quite far ahead compared to many other countries.

Some of them even think that we should be able to achieve higher economic growth if we are willing to increase our borrowing and relax our spending limits. However, other investors are appreciative of our efforts and think we are doing the right thing because economic growth above

5% is quite remarkable at the moment compared to many other countries.

Investors have appreciated our prudence and our consistency to maintain the deficit below 3%. Last year the deficit was 2.46%, and then this year, according to our State Budget, it is set to be 2.41%. Maintaining the deficit below 3% is something that really is a positive point for the government and helps gain investors' trust. The debt to GDP level of 28% is also something that, according to investors, is comforting to them.

Investors also see positive signs from the direction of fiscal policy. We have addressed the subsidy issue. We are now addressing revenues through tax reform, which is now a priority. In terms of the spending side investors are quite happy with the direction we're taking but now they really want us to look at our revenue side because our tax ratio is quite low.

GlobalMarkets: Do any other of our issuers agree or disagree with this prognosis?

Orias Petrus Moedak, Pelindo III: From the market's perspective it's correct, but from the real sector — I come from the ports business side — the challenge is not about growth itself but how the wealth generated from that growth is distributed among the remote areas of the country. We are in Surabaya and we have the small islands in the southeast of Indonesia that really need to see the impact of that growth. East Java has had good growth — higher than the overall country's growth I think — but the present challenge is the eradication of poverty.

Iman Rachman, Pelindo II: One indicator of the growth is export-import growth. It is beginning to pick up and we have seen this in the cargo volumes over the last year. Another contributing factor is the development of our ports. We have to complete the work on our Kalibaru and Kijing ports by 2019. By having some of the big ports completed we will be supporting the growth targets of Indonesia.

Taloputra, Standard Chartered: That also reflects the regional growth in the eastern part of the country — as Orias said, it's faster than the national level, for instance. For example, Sulawesi was growing by close to 7% year on year in Q4 2016.

GlobalMarkets: We have seen fantastic conditions in global capital markets over the last three months. However, the wider world has many challenges. A new US administration, elections in Europe, a slowing China, a tightening Fed, trade deals in decline, geopolitical tensions in North Asia. But what are the key external risks as far as Indonesia is concerned, Robert?

Pakpahan, Republic of Indonesia: The depth of the domestic financial sector in Indonesia is one issue because it is not as deep as we would like it, at least when held up against the size of our economy. The total assets in the banking sector — such as savings, assets under management for pension funds, insurance etc — are not as high as in other countries. A result of this is that foreign ownership in the local currency equity and bond markets is high. This is a risk as it makes us vulnerable to money moving out of the country quickly when there is a big external event.

So all those risks you mentioned could be felt here in Indonesia through capital flight. This is why it is so important for us as a country to maintain very consistent and credible economic growth with the right direction of fiscal policy and also very stable monetary policy to make sure the effects of any external issue or shock are minimised.

So far we have shown that our fiscal policy is going in the right direction. We are addressing our spending. We are maintaining our deficit at a safe level while our monetary authority is maintaining stability. Inflation is now quite tame at a level of between 3% and 4%, the current account deficit also has been maintained at a level of below 2.5%.

GlobalMarkets: When you say the flows in and out are you referring to foreign ownership of government bonds or are you talking about all products across the financial sector?

Pakpahan, Republic of Indonesia: Both, and I'm really talking about hot money. We are not that concerned about foreign direct investment because that tends to stay in the country, but rather portfolio investment that tends to build up but then rush out when there is a problem.

Susiwijono Moegiarso, Indonesia Eximbank: The key external risks for Indonesia among others are: the global economy that has not fully recovered; the global financial market which is still highly influenced by uncertain policies of the US government; and China's rebalancing economics.

Silvano Rumantir, Mandiri Sekuritas: On the macro side a key external risk factor we see is China. China is the top three for both export destination as well as direct investment into Indonesia. Our sensitivity analysis shows that every 1% increase in China's economic growth has an impact of, or a contribution of 0.11% to Indonesia's economic growth If you look at Japan and US for us it's only half of China's impact.

Taloputra, Standard Chartered: If I have to choose between the risks mentioned earlier, the rate hike poses the biggest risk for the country, mainly because it runs a current account deficit that makes it rely on external financing.

AARON GWAK
STANDARD CHARTERED

ALDIAN TALOPUTRA
STANDARD CHARTERED

We have seen the vulnerability of the country decline in the last few years, given the prudent fiscal policy that Robert mentioned, as well as the monetary policy, which is very prudent. Bank Indonesia has not hesitated in increasing the interest rate to stabilise inflation and has become more flexible in managing the exchange rate. A more flexible exchange rate provides a buffer to external shocks.

However, we are still running a current deficit of around 1.8% of GDP. While this is a very manageable level — the safe level is 3% — there is a risk-off event it could trigger an outflow which would result in pressure on the currency.

GlobalMarkets: You wouldn't notice though would you, the impact of a rate rise by the Fed on your bonds? You issued after the rate rise and you have cheaper debt than you would have done

Participants:

Robert Pakpahan, director general of budget financing and risk management, Ministry of Finance, Republic of Indonesia

Aaron Gwak, head of capital markets, Asean, Standard Chartered

Aldian Taloputra, senior economist, Indonesia, Standard Chartered

Iman Rachman, finance director, Pelindo II

Orias Petrus Moedak, chief executive, Pelindo III

Silvano Rumantir, president director, Mandiri Sekuritas

Susiwijono Moegiarso, acting executive director, Indonesia Eximbank

Toby Fildes, managing editor, *GlobalMarkets, GlobalCapital*

the week before the rate rise, so explain that to me!

Pakpahan, Republic of Indonesia: The market had got a little ahead of itself and probably priced too much in ahead of the rate rise. After the FOMC announced the higher rate US Treasury yields declined. Sometimes this financial market confuses us all! But anyway, the government of Indonesia is happy. We launched the US dollar sukuk deal after the FOMC decision and we got a better deal than we would have done before the rate rise.

Sometimes it is difficult dealing with a Fed Fund hike, but in general we know the general direction of travel — the interest rate is going to increase. That's why one of the strategies of the government of Indonesia is to complete all of our international bond market activities in the first semester of 2017.

GlobalMarkets: Excellent timing nonetheless.

Gwak, Standard Chartered: Over my career I've wanted the issuer to have a little bit of luck in picking markets and windows. Sometimes there's obviously a general plan behind it, but sometimes it's just that particular day.

But what I've noticed through meeting with investors globally is that the fundamental appetite for Indonesia is very strong. So, yes, where the Treasuries trade on a particular day will influence the ultimate coupon and the price that Indonesia has to pay, but overall demand for Indonesia risk is robust.

Fundamentals I think do still play a big part and the fundamentals of Indonesia are currently in fashion.

GlobalMarkets: The Indonesian government has, of course, established itself as one of the most sophisticated sovereign borrowers in the international markets. How is this important for the development of debt capital markets in Indonesia?

Moegiarso, Indonesia Eximbank: It is very important as this reflects the credibility of the sovereign in the eyes of international investors. To develop our debt capital market, we still need influence from international investors' investment to attract domestic investors.

GlobalMarkets: What are the opportunities for other Indonesian borrowers to access the international markets?

Rachman, Pelindo II: We issued a global bond in 2015, a 10 and 30 year $1.6bn deal. We have a natural hedge because some of our income is in US dollars so that is why we can issue in dollars rather than solely Indonesian rupiah bonds. Secondly, our port development projects require longer term debt, which is not always available in the local currency bond markets but can be found in international dollar markets. Additionally our ratings are very similar to the government of Indonesia so we can issue at very similar rates to the sovereign.

Moedak, Pelindo III: Yes, it is fortunate for Pelindo II that they have long term contracts with US dollar income. Right now, for us, we cannot use the US dollar market because the exchange rate versus the rupiah is not favourable and our funding needs are in rupiah. So if port companies want to issue dollar bonds I think the challenge will be the exchange rate.

GlobalMarkets: Because it will need an expensive derivative.

Gwak, Standard Chartered: Asset-liability and length-maturity matching are some of the reasons why a lot of issuers, pan-region, look to the international bond markets to issue. It's a market where 30 year liquidity is plentiful, and in fact 30 year liquidity is sometimes more plentiful than shorter term liquidity.

GlobalMarkets: What role has the sovereign played in setting a benchmark for non-sovereign borrowers?

Pakpahan, Republic of Indonesia: Certainly one of the roles the government plays is to provide a reference to potential corporate borrowers when we issue in the dollar market.

Gwak, Standard Chartered: For example, Indonesia Eximbank was the most recent issuer and when they came to market, they very successfully priced at a premium of about 25bp-35bp over the sovereign. But the fact that it is referenced is really thanks to Robert and his team's efforts to establish a yield curve that is not only out there, but also actively traded and therefore a very good reflection of the current risk premiums that you need to pay.

Rumantir, Mandiri Sekuritas: From our perspective at Mandiri, obviously we deal with a lot of local corporates as well as State-owned enterprises [SOEs]. As Aaron said, the more established the sovereign curve is then the more reference is available for non-sovereign issuers.

Typically, with very few exceptions, the non-sovereign can only access tenors less than what the sovereign can access. Even Eximbank issued a seven year as opposed to a 30 year — not because they cannot, but they want to match on the LM side of things. If you look at the private sector corporates, the sweet spot is even less — five, maybe seven years. So clearly there is a direct role that the government is playing by becoming a regular issuer of local bonds.

GlobalMarkets: Despite the local currency requirements, can we expect the non-sovereign issuer base to continue to grow over the next couple of years?

Gwak, Standard Chartered: One of the things that we did hear being asked, when going out to meet with investors and through our trading platform, was the participation of SOEs in terms of issuance because it's been quite a while since the SOE sector has been prolific in issuance.

From an international investor perspective, now that we have a very liquid and well established yield curve for both conventional bonds as well as sukuk set by the Republic of Indonesia as well as the euro curve that it is building, why aren't more people taking advantage of it? We have a few that have very good liquid points in the market, but we just haven't seen more of it and investors are keen to see more of it.

Rumantir, Mandiri Sekuritas: The market has noticed that some of the previously regular non-sovereign SOE issuers have not been in the market for a few years — the Pertaminas, the PLNs, for example. Although I'm sure they're looking at the market on a regular basis, they have not been active recently. But we probably should look at this in a positive light, because, one: maybe they don't need as much liquidity from the external offshore bond market, and two, they have alternative sources of funding.

GlobalMarkets: Are the much-vaunted reforms that are coming into the SOE sector, by which I mean the consolidation of various industries, making people pause to see what's going to happen?

Rumantir, Mandiri Sekuritas: It depends on the industry sector. In the case of Pertamina, for example, obviously there's a global commodity price that is affecting their capex. Whereas, for Perusahaan Listrik Negara (PLN) the reasons are very different. It's very domestic. It's very budget-driven. It's very affordability-driven as well. So it very much differs between one SOE and the other.

Gwak, Standard Chartered: Liability management activities should also be considered as part of this discussion. Standard Chartered and Mandiri Sekuritas jointly helped Pertamina do open market repurchases of some of their bonds that were a little undervalued. It wasn't a huge amount but it was substantial enough.

GlobalMarkets: Robert, why have the SOEs been so quiet over the last couple of years?

Pakpahan, Republic of Indonesia: For Pertamina they don't have liquidity issues. They have had enough money over the last two years, despite declining oil prices.

PLN does actually need financing because it has got assignments to build 35GW of power capacity, although they got a loan from a multilateral, which might partly explain why they have not come to market yet. But I think soon they will come to the market.

Pelindo has come in, Eximbank has come in and we will see more come in.

If you look at the infrastructure development in Indonesia, around 40% will be handled by our state budget but around 25% will be built and financed by the SOEs. The state can help them with capital injections but they will need to go out and raise capital as well.

There is a lot to do — a lot of assignments have

already been handed out and will be handed out that will need private financing, such as power, toll roads, ports, water, airports, rail links.

So certainly, the demand for financing will be there. If the revenues are in rupiah then they will probably have to issue in local currency. But if they have some revenues in US dollars, like Pelindo and Pertamina have, they can issue in US dollars. But whether it's in the domestic market or the global market, soon we will see more and more demand to issue bonds.

Gwak, Standard Chartered: I agree with Silvano's earlier point about looking at it from a positive perspective, and as Orias has mentioned as well, I think there are a lot of liquidity alternatives to a dollar bond. Gone are the days when a dollar bond was the only option for Indonesia. Now there's quite a prolific domestic rupiah bond market that a number of construction companies, for example, have accessed, or are in the process of accessing.

And although the tenor hasn't yet extended all the way to that of the international bond markets, at least there's certainly some scope for that. And we shouldn't forget the loans and bonds discussion. The ability for banks to lend in domestic currency, as well as foreign currency onshore, has increased greatly in recent times.

GlobalMarkets: That brings us on to the standards and requirements and the concept of ratings. Aaron, what are the extra requirements for issuers contemplating international markets?

Gwak, Standard Chartered: International investors are obviously chasing one thing — yield. So the higher the yield the better. Obviously, there is a fine balance between yield and credit appetite. But in general, because there's an underlying demand for Indonesia as a credit, that's been very helpful. So even across different maturities, in fact, investors are very willing to participate.

Now, one of the things we have really yet to see, from a structural perspective, is corporate hybrids, a type of deal that gives equity accounting credit for corporates that issue perpetual bonds. But most of the Indonesian companies and especially the SOEs have quite prudent leverage policies and so are not really in a position to have to contemplate such deals.

Investors are generally incredibly liquid and looking for opportunities to invest.

GlobalMarkets: Does that mean their standards might drop a little?

Gwak, Standard Chartered: No, it's not so much a question of standards. It doesn't mean investors are willing to see covenants start to fall away. It's less from a demand pool perspective but more from a supply perspective.

GlobalMarkets: But let's say if there was that supply, what are the requirements the international investor will be needing from issuers?

Rumantir, Mandiri Sekuritas: It depends whether we're talking about first time issuers or repeat issuers. For debut issuance in the international markets by issuers that have access to domestic bond markets, it will still be an upgrade in terms of requirements, but it will not be as cumbersome as for a company that has never entered any bond market.

ORIAS PETRUS MOEDAK
PELINDO III

IMAN RACHMAN
PELINDO II

Rachman, Pelindo II: I have a quite interesting experience regarding roadshows. We did a non-deal roadshow after we issued in May 2015. Then last October we did a non-deal roadshow for the investors. Before we did the latest roadshow our pricing was below par while on other issuers' bonds the pricing was above par. However, once we had completed our non-deal roadshow we noticed our pricing had moved into line with others. We concluded that investors value communication with the issuer, and they like it on a frequent basis.

Gwak, Standard Chartered: That's right. The Republic of Indonesia is certainly a beneficiary of consistent investor outreach; they have been going out to meet investors on a regular basis, and at the same time, investors feel that there's a clear channel of access to information when required. This has been the mantra that Robert's team has consistently built for many years, even through some of the more difficult times for the economy. A few years ago when the economy was going through current account issues, it didn't stop them from going out to engage with investors. People remember that and obviously give them credit for that. So I absolutely agree that a consistent outreach and the fact that people feel comfortable that they can always access the management and get information they need, is key.

Moedak, Pelindo III: All the SOEs that want to issue foreign bonds can fulfil the requirements of international institutional investors. But another issue is the approval process for offshore borrowing. In the past we needed six high level officials including the central bank governor and maybe that made many Indonesians a bit reluctant to go through that process. Now I hear the process only requires three senior officials but I think that's still a challenge. I suppose it means that if the company really needs the financing then the management will be prepared to go through that process.

GlobalMarkets: Given the amount of funding that's going to be required over the next couple of years is that a process that people are happy with? Three is better than six I suppose.

Moedak, Pelindo III: If the company needs the funds then it will go through the process. It is a simple process, but it just needs time.

Pakpahan, Republic of Indonesia: The government is revising the regulations — they realise the need for the process to be simplified. But it is just trying to keep an eye on the amounts being borrowed — it is part of the risk management process.

GlobalMarkets: How do we go about making a deeper, more effective swap market?

Gwak, Standard Chartered: Unfortunately there is not a silver bullet solution — it will take time. But it is beginning to improve and it will certainly continue to improve going forward.

GlobalMarkets: Orias, you mentioned earlier that you would probably raise domestic currency bonds because your revenues are in rupiah. But if there was a deep and efficient swap market would you consider issuing in foreign currency?

Moedak, Pelindo III: When I was back at Pelindo II we discussed swaps and hedging. We agreed that if the total cost was close to the domestic market we would probably stick to the domestic market. Size is of course important though — if your requirement is over Rph10tr then you are better going overseas.

GlobalMarkets: We've mentioned ratings a fair amount so far, but is an international rating always necessary when contemplating international markets?

Gwak, Standard Chartered: In Asia more broadly, we have seen more unrated issuers come to market recently. Certainly, there have been a lot of Chinese names, the Lenovos of the world, for example, doing very big transactions in Reg S-only format on a non-rated basis.

For Indonesia, certainly from an SOE perspective, the rating has helped. Having said that, Standard Chartered was involved, in 2015, with

ROBERT PAKPAHAN
REPUBLIC OF INDONESIA

SILVANO RUMANTIR
MANDIRI SEKURITAS

Garuda when it did a highly successful unrated $500m sukuk.

So is a rating useful? Absolutely. But we are increasingly finding, especially for shorter tenor issuance, that liquidity is so deep and plentiful that those investors who require a rating are being outweighed by those who do not necessarily need a rating to invest, but are looking for more value.

GlobalMarkets: That presumably isn't necessarily a sustainable model, though. We've got very benign markets at the moment, but that can change very quickly.

Rumantir, Mandiri Sekuritas: As a general rule, the liquidity pool inherently shrinks when the issue is unrated. This is due to the simple fact that a large group of investors globally, and to some extent domestically, have an internal requirement for rated issuance. Having said that, there is also the private placement market or MTNs where liquidity is not as deep as the public market, but it may suit some unrated issuers.

Rachman, Pelindo II: One reason why we need a rating is that as an SOE we are sometimes audited by the state auditors. By having a rating for a global bond or local bonds it makes it easier for us to be compared with others and explain why our pricing is higher than the government's.

GlobalMarkets: Now, Standard & Poor's still has Indonesia at below investment grade. It doesn't sound like everybody's waiting for a full house of investment grade ratings to issue — demand is such that you could probably do deals whenever and wherever you wanted. But do you think it has had an impact?

Pakpahan, Republic of Indonesia: It may have had an impact — there are some funds that have internal rules that prevent them from buying us without an investment grade rating from S&P. But I must say that so far it feels like we have been treated as an investment grade issuer by investors, if you look at the high demand for our bonds and the pricing we have been able to command in the market.

GlobalMarkets: Indeed, you were able to attract a huge oversubscription for your recent sukuk despite not having an IG rating from S&P.

Taloputra, Standard Chartered: Most of the bond indices that fund managers follow already put Indonesia at an investment grade weighting. So, like the JP Morgan EMBI index, most conventional fund managers already treat Indonesia as investment grade. When S&P does upgrade the country we will probably see some additional inflow from non-conventional funds such as pension funds and insurance companies, especially from countries with low interest rates like Japan.

GlobalMarkets: What tax reforms could help the Indonesian bond market develop?

Pakpahan, Republic of Indonesia: The tax amnesty certainly should help because there has been more than Rph100tr of assets repatriated from outside Indonesia. I know most of these assets are still placed in the banking system. According to the law they have to stay invested in Indonesia for at least three years. Some of them are still in foreign currency. They're trying to find the instruments to channel out the asset. But slowly this money will be invested: some of it will go to bonds, either government bonds or corporate bonds. So there is potential there I think from the tax amnesty.

Other than that, there is also a simplification in the real estate investment trust sector, which in the past was subject to double taxation in Indonesia. Now the double taxation has been removed and it has reduced the tax burden significantly. That also may help capital markets, especially the liquidity in this type of instrument.

Moegiarso, Indonesia Eximbank: Perhaps some tax incentive mechanism can be considered for domestic investors, whereby the bigger amount of investment in the capital market, the bigger tax discount can be applied to the investment gain.

GlobalMarkets: Aaron, you mentioned hybrid bonds earlier. But what about high yield issuers? How responsive are international markets to high yield issuers from Indonesia?

Gwak, Standard Chartered: A case in point was Indika Energy's successful deal in early April, which was testament to the re-opening of the high yield market as a cost-effective source of funds for Indonesian corporates. Demand for Indonesia continues to be good and with the recovery of commodity prices in general, I think investors are becoming even more comfortable in putting money down.

GlobalMarkets: Do you expect to see a lot more over the next six months?

Rumantir, Mandiri Sekuritas: The honest answer is, we sure hope so: But the real answer is that corporates are reviewing their options very carefully. Some of the most sophisticated corporates are fully aware of what's happening in global markets. I think they are anticipating some asset reallocation, also in the equity side of the market — a flight to quality and more allocation to the US. We have seen a lot more high yield issuers from Indonesia in the last two or three months than we have in the last two years perhaps and all of them, I daresay, have met with very good responses.

You have companies who went through restructuring or who come from so-called depressed industries such as mining and they've been able to come to the bond market with flying colours. So, if that kind of market backdrop continues that is certainly going to motivate a lot of other corporates to either consider refinancing early or just take funding from the table before the market changes. This is especially true considering the dynamic on the Fed's policy stance, where the issue now is not only policy rate normalisation, but also the possibility of the Fed reducing its balance sheet.

GlobalMarkets: We've obviously had fantastic conditions the last two or three months and the realists in all of us do worry that markets can turn. Is there a sense that the markets will have to change sooner rather than later or can they carry on?

Gwak, Standard Chartered: In general it's difficult to say because, as you said, the realist in you will note that cyclicality is inevitable. It depends on just how long that cycle, or curve, can continue for. It doesn't seem to be a concern around liquidity per se, which would support the view that this will continue for quite a while. But if you take the view that sentiment unfortunately can move quickly, then that's what worrying more people.

GlobalMarkets: Is Indonesia more vulnerable to that quick shift in sentiment perhaps than other countries within its rating bracket?

Gwak, Standard Chartered: No, I don't think so.

Pakpahan, Republic of Indonesia: Looking at the general levels of appetite and activity, investors are quite consistent — they like our

credit. I remember the taper tantrum when there were outflows but things rebounded very quickly. Liquidity was always there and it was only a matter of months before things got back to where they were.

Rumantir, Mandiri Sekuritas: Market shocks will inevitably continue to be there. We can't be under any illusion that Indonesia will be totally isolated from market shocks. However, despite the 37% or 38% foreign ownership of government local currency bonds and roughly 50% of foreign funds in the IDX on the equity market, you have to look at the fundamentals.

This is evidenced by the support from the rating agencies — despite S&P's stance. Moody's and Fitch not long ago revised their outlooks on their already investment grade ratings to positive outlooks. This means that Indonesia's rating has the chance to be upgraded to BBB in the next six to 12 months.

GlobalMarkets: We've already mentioned sukuk and of course the sovereign recently did its blowout deal. But what can be done to further develop the market and broaden its appeal to both issuers and investors?

Rachman, Pelindo II: Yes, the issue with us, as I've mentioned earlier, is that our funding needs are around 13 to 15 years but the sukuk market's sweet spot is shorter than that, around seven years. Size is also an issue — I'm not sure the sukuk market could cater for large deals such as our $1.6bn global deal of 2015.

Gwak, Standard Chartered: You diversify when you want to expand the different pockets of demand you have access to. Which is what the Republic is doing. It has access to the US dollar conventional market, it has developed the sukuk market, it has developed the euro market, and the yen market. So it now has a very diverse pool of pockets of investors that it can tap into.

One of the things that have changed in the sukuk market, most recently, is the inclusion of Islamic deals into a lot of the bond indices. Previously, sukuk issues were not included in the EMBI, for example, but now they are. Indonesia's recent sukuk was the first that was issued on a primary basis that acceded into the index. If you look at the five year tranches, the spreads of the conventional and sukuk are flat.

Pakpahan, Republic of Indonesia: From the supply side the government of Indonesia has shown a persistence in continuously supplying sukuk both in local currency and in dollars. Sukuk now make up 29% of our total issuance.

GlobalMarkets: Do you expect yields to carry on falling in Indonesia, Robert?

Pakpahan, Republic of Indonesia: I hope and I want them to fall because one of the assignments given to me by the minister of finance was to lower our cost of financing! If we look at the economic fundamentals of Indonesia I think the yield should continue to come down for our issues, both for local currency and US dollars.

Economic growth is consistently stable and high, but the most important number is inflation which has declined dramatically since 2014. It is now slightly above 3%, which means now we have the right to ask for cheaper funding.

Gwak, Standard Chartered: Inflation and stability of the FX are contributing factors to a slow decline in yields. This begs the question of whether falling yields will put off some investors who are just chasing yield. But declining yields is a global trend so it's all relative.

SUSIWIJONO MOEGIARSO
INDONESIA EXIMBANK

GlobalMarkets: Orias, as a domestic issuer of rupiah bonds would you like to see foreign investors in your domestic deals? Would you care?

Moedak, Pelindo III: I think we just care about the money… but foreign investors coming in would be a good thing — it could create price tension. We are issuing bonds actually this year, we are aiming for Rph5tr in the domestic market. So foreign investors are most welcome!

GlobalMarkets: Is Indonesia in that sweet spot where the ratings are good but the yields perhaps slightly richer than similar credits?

Rumantir, Mandiri Sekuritas: At the end of the day, investors will calculate their risk-return analysis with other EMs. If we compare Indonesia with other EM local currency bonds, Indonesia's government bond yields have fallen on average 80bp year to date. The 10 year nominal yield and the real yield, by which we mean the nominal yield minus the inflation rate, for Indonesian government bonds are still very attractive, as Robert was mentioning. It ranks approximately number five — the same as last year compared to other EMs in both nominal and real terms. Moreover, the rupiah is currently one of the most stable EM currencies year to date. So there is merit for the government to ask for a bit more tightening or compression.

GlobalMarkets: But will much lower yields drive SOEs into the market? It's not so much a demand problem, more of a supply one — you don't necessarily need to borrow money at the moment.

Moedak, Pelindo III: Yes, it comes back to the needs and at present, despite excellent borrowing conditions, we have no real foreign currency borrowing need.

Gwak, Standard Chartered: One of the things we could see, for example, in the domestic bond markets is that as yields drop and people get more comfortable with the sovereign as a credit, then more foreign investors come into the local currency bond markets for corporates, including the SOEs. Basically going down the value chain, so to speak. It would be very positive if we, for example, saw more foreign investors coming into a Pelindo domestic currency deal. Those are some of the things that we have yet to see, but if that happens, it would be very encouraging and would be one of the results of a very sharp or constant depression of yields.

GlobalMarkets: Infrastructure finance is such a crucial issue for Indonesia, given the amount of investment required. How can we get the bond market involved?

Pakpahan, Republic of Indonesia: We will soon see an increasing number of SOEs and corporates issuing bonds because the infrastructure projects are now beginning to be started. In addition, we have the public-private partnership projects, which I also oversee. These are the non-budget infrastructure projects. Last year 16 PPP projects were signed. Six of them have already reached financial close. These include electricity, water, toll road and fibre optic PPPs. In the pipeline, there are 21 PPPs for this year. So the combination of the SOEs and corporates and the PPPs will create huge amounts of supply in the bond markets.

Gwak, Standard Chartered: The model of recycling of capital for infrastructure projects is something we hope to see more of going forward. Project bonds are certainly something that from an Asean Forum perspective is an important part of the agenda. We believe that investors looking for very long term investments would find it very attractive, especially because of the asset base that it has.

Rumantir, Mandiri Sekuritas: OJK [Indonesia's Financial Services Authority] last year introduced a rule to allow pension funds and insurance companies to invest in SOE corporate bonds to fulfill at maximum half of the 30% requirement for government bonds. So out of the 30% requirement 50% of that they can invest in SOE bonds. Now clearly this will help the SOE segment. Year to date, there is approximately Rph3.3tr of SOE infrastructure-related bond issuances and all of this has been oversubscribed and coupons have been relatively attractive. So I think the government is actively reviewing its policies to boost domestic participation in infrastructure and long dated instruments. GM

Elbech brings global view to AIIB treasury

Exclusive GM interview

Søren Elbech, recently appointed treasurer of the Asian Infrastructure Investment Bank, is one of the best known faces in the public sector bond market, having worked in it since 1991.

He has held senior funding positions at the Nordic Investment Bank, Norway's Eksportfinans and the Inter-American Development Bank, where he was treasurer. Since leaving the IADB in 2014 he has held positions at Vestas Wind Systems and Origin Markets, the capital market fintech firm, where he was an adviser.

It is still early days for the AIIB, which came into being on January 16 2016 as a multilateral development bank (MDB), focused on developing infrastructure and other sectors in Asia, including energy and power, transport and telecommunications, rural infrastructure and agricultural development, water supply and sanitation, environmental protection, urban development and logistics.

When the AIIB was unveiled, many saw it as a direct, Chinese rival to the Asian Development Bank and even the World Bank. But the AIIB's staff, including its respected president Jin Liqun, have been at pains to convey the message that the AIIB complements and co-operates with the existing MDBs to address Asia's daunting infrastructure needs together.

Recently seven more countries have joined up. Bahrain, Cyprus and Samoa as regional prospective members and Bolivia, Chile, Greece and Romania as non-regional prospective members bring the total approved membership to 77.

The interview below was conducted by Toby Fildes at the Euromoney China DCM Conference in Beijing in March. It has been updated where necessary.

How are you finding life in Beijing? You've been here since December 2016, having previously been based in Washington, DC, as head of treasury at the Inter-American Development Bank, and then more recently at Vestas. So how does New York Avenue in Washington compare with Financial Street, Beijing?

It's been a little less than six months I've been in Beijing and what a tremendous privilege. I come from a very small country called Denmark and my home town is Copenhagen. My last nine years I spent in Washington, DC, and now I'm in Beijing. I am pinching myself!

The timing of my relocation from Washington, DC to Beijing could not be better. It's happening at the same time as the United States is embarking on maybe a different path than they have in the past and China has an opportunity to maybe assume some of the role.

Let's establish what the AIIB is, what it has been set up to do and what it's done so far.

The Asian Infrastructure Investment Bank started official operations at the beginning of 2016 in Beijing with the purpose of providing financing for infrastructure and connectivity for Asia, a region where the financing gap in infrastructure is daunting. It is in the trillions of dollars.

AIIB has been set up to facilitate more of this financing, not only through its own lending and co-financing with other institutions, but also by using its risk-bearing capacity to hopefully unlock private sector participation in infrastructure projects across the region.

There are 57 founding member countries and, as we speak, we are seeing more member countries joining the bank. The subscribed capital of the bank is $100bn, with $20bn of that paid in over a span of five years.

In the first year of operations, we approved nine operations in total and $1.7bn of loans. Most of them were co-financing with other esteemed MDBs. We have currently 90 staff, in Beijing, so it's very early days as you can imagine.

And you were number 75?

I'm number 75 starting at the bank, yes! We expect to grow to approximately 1,000 staff by the end of the first 10 years of the bank, so by mid-next decade. It's very early days still, but we're here and we have already started disbursing, so we're starting to make an impact.

You mentioned the infrastructure financing gap and then your capitalisation. Borrowing, of course, is going to be a key part of what the bank does to help finance or fill in that infrastructure gap. You've been going for a year so far. Do you know your funding requirement yet?

Per se we don't have a funding requirement right now, because of the paid-in capital we are currently disbursing. But we will in the coming years have a real requirement in terms of filling the gap, once we have disbursed the capital. But in order to not shock the markets, I want to build up the presence of the bank in the market before it becomes a requirement. So you will start to see us borrowing in international capital markets as soon as we have attained international credit ratings and have established the fund documentation programme, hopefully before the end of this year.

You're working with the rating agencies as we speak?

We are.

And you expect to have a rating by?

The end of this year.

On attaining the ratings, will you aim to do short term MTNs first, or will you go out there with a big bang and do a 10 year dollar? What sort of issuer will you be?

That's an excellent question and I think it should be no surprise, given my past, that on my notepad I have a funding strategy mix of both very well established global benchmark transactions as well as more tailor-made, investor-driven, idiosyncratic MTNs. Of course, to get our name out in the market and get transparent pricing references for our name, we must and will establish, and look forward to establishing, a dollar global benchmark in these transactions.

Will you model yourself on a particular supranational institution?

AIIB is unique, as are our formidable peers among the multilateral financial institutions, so of course, there should be no doubt that we want to be established among that peer group, both in terms of being name recognised as well as the pricing. What it all comes down to, of course, is that it's not only the rating of the institution, but also the way we present ourselves to the market and our ability to attract a globally diversified investment base.

I presume a triple-A rating will be essential?

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A tough question. I'm not going to forego whatever the rating agencies are going to analyse us with. We will certainly queue for the highest possible rating they have.

You are, of course, essentially a new issuer in a world of very established supranational and agency issuers. What does that mean in terms of investor relations, getting up and running with them? Talk us through that process.

This is actually one of the more exciting parts of my job coming here. When I was first introduced to the possibility of joining the bank, which was back in October, my boss Thierry de Longuemar, the CFO of the bank, told me that the bank was at ground zero minus one. When I then joined the bank in December I could immediately see that was the case. We did not have a clearing bank agreement, we did not have Swift, we did not have a custodian. We are at the foot of the mountain. We have to get over all these obstacles and humps before we can actually establish a presence in the market.

So I have had to go back into my toolbox of a banker for things I haven't done in many, many years. Once we have these things behind us and then get international credit ratings, get our two-way CSAs set up and a global debt facility in place, we are then getting ready to actually start marketing the bank and embracing the markets.

Have you already done some soft sounding with key investors?

As we're not yet in a position to issue bonds, I wouldn't say we are meeting investors on a continuous basis, but we do have a dialogue with a few.

You mentioned pricing debt a little bit earlier. As an issuer will you be passing on the interest rate you get from the market to the end client?

The pricing policy the bank has for sovereign bank lending is as a spread, a fixed spread to Libor. Depending on the maturity of the loan, that spread can vary. The spread comprises not only a maturity premium and a risk premium, but actually also a projected spread, borrowing spread to Libor. For the time being it is Libor plus the spread, depending on the maturity of the loan. For non-sovereign debt lending it's market pricing as usual.

And will you be offering a buyback option for investors, a bit like the World Bank?

I'd say along the lines of our peers. We will expect that the arrangers of our bond issues will, of course, assume the role of providing secondary market liquidity for the bond issues and, of course, we will always be willing to put a price on our own debt, that goes without saying.

Will you have a funding programme with pre-agreed disbursements or will you also be selling bonds to finance specific projects?

That is a key question but it also might be a chicken and egg, or cart before the horse kind of question. At this stage, of course, we have to see how the markets develop. As we get into the market, I expect that the bank will be traditionally pursuing regular bond issuance and then through the treasury mechanism, providing that financing for our lending operations.

But we do take great note of the European Investment Bank's activities in project bonds and I will certainly learn from what is happening elsewhere to see if that is also the right thing to do for the bank's clients.

Are you hinting that there might be non-recourse project finance bonds?

I'm not ruling it out but I think we have to learn from what has already happened in producing the project bond streams in the EU before we can fully embrace that.

And you're right, there might be reasons why we can or can't do certain things. If it benefits the bank's clients, it's of course something I will and must look into.

You previously worked for the IADB, a development bank that wasn't just about infrastructure. Its mandate is very broad, including big social issues, trade, education, helping to alleviate poverty, for example. With the AIIB, the mandate is very much more focussed. How does this affect your approach to markets and investors?

We want to be recognised within this peer group of very formidable issuers, all of which have varying mandates. You're right that the AIIB's mandate will be infrastructure, so I think there's really no doubt as to what the purpose of the bank is.

And of course, that drives the way we will be approaching our partners, our peers and our investors, in terms of making sure that it is fully understood what the mission of the bank is, so that when investors get approached to buy our bond issues, they know what they're getting exposure to. That goes without saying. Investors will fully understand what they're buying if they buy AIIB or they buy one of the other MDBs.

Will your aim be for the AIIB to be a truly global issuer, selling your debt to the global investor base, or will you typically sell a large proportion of your funding programme to Asian markets and in Asian currencies, since the bank is based in China and has an Asian mandate?

The ambition clearly is to be a truly global issuer but as I said before, one doesn't exclude the other, not only in terms of global versus MTNs but also global versus regional. And we should not forget local currencies. Given the proximity we have to markets, not only Chinese but, of course, also other Asian markets, the bank will be looking to access these markets, not only because we're here, but also because there will be demand to provide local currency financing.

Many of the development banks around the world have, as part of their mandates, responsibility to develop local currency bond markets. Is that a mandate for the AIIB?

If it makes sense to fulfil the mission, if it makes sense for the borrowers of the bank, certainly we will do so.

In March I had the tremendous pleasure of signing the bank's first ISDA/CSA agreement with the International Finance Corp. Andrew Cross of the IFC and I were both quoted in the press release as saying that this was a way to unlock and provide more financing to infrastructure financing across the globe by collaborating with other institutions and utilising our joint expertise and access to markets. If local currency makes sense, we will of course do that.

You mentioned credit support annexes — regarding swaps, what are your thoughts about one-way versus two-way CSAs?

I have always been a big proponent of reducing structural risks in the market, so I was an early supporter of looking into two-way CSAs for supranationals.

With the AIIB at the beginning of its journey, we have the opportunity to start with two-way CSAs. I will, of course, caveat that by saying that we will only do it if it makes sense. I think it does make sense, but of course we have to review the case and then decide later this year.

Of course, I have taken note of the fact that several of our peers have ventured from one-way to two-way CSAs, I believe with positive results. So, with that in mind, I would not be surprised if AIIB also goes down that path.

To what extent will you be involved in the One Belt and One Road Project?

We certainly will be involved, although it's important to say that the bank was not set up exclusively for that, of course. As I said at the beginning, we are there to help finance infrastructure projects and connectivity across the region.

That intersects with OBOR, so when that happens, of course, we will be involved. Remember, the AIIB is not going to be the only financier of OBOR. So there will be co-financings, there will be projects where we will be the lead financier, so there certainly will be OBOR projects in our portfolio, I'm quite certain.

And where will the push to lend come from? Will it come from the Chinese government, being such a large shareholder?

It will come from a variety of different governments that will be involved in the project.

What's happening Saturday, June 17

For more information visit: www.aiib.org Join the conversation at: AIIB_Official and #aiib2017

9.00am – 6.00pm
Registration
Location: In front of the Main Gate (Outside, 3F, ICC)

9.00am – 11.00am
Governors' Official Session: **Roundtable Discussion on Financing Asia's Infrastructure Priorities** (members and observers)
Location: Tamna B (5F)

9.30am – 10.30am
Seminar II: **Bridging the Gap in Infrastructure Financing: Role of Banks and Public Funds**
Speakers: **Jin-Yong Cai**, Partner at TPG Capital based in Hong Kong; **Sung-Soo Eun**, CEO of the Korea Investment Corporation (KIC); **Abhay Rangnekar**, Managing Director, Standard Chartered Bank; **Najeeb Haider**, Principal Strategy Officer of the AIIB; **Pawel Samecki**, Vice/Deputy Minister of Central Bank of Poland
Moderator: **Kyung-wook Hur**, Senior Advisor of Bae, Kim & Lee LLC (BKL), Advisor in the AMRO Advisory Committee in Singapore
Location: Halla (3F)

10.45am – 11.45am
Seminar III: **Challenges and Breakthroughs in Promoting New and Renewable Energy Infrastructure in Asia**
Speakers: **Joo Heon Park** (welcoming remarks), President of Korea Energy Economics Institute (KEEI); **Sanjayan Velautham**, Executive Director of the ASEAN Centre for Energy (ACE); **John Byrne**, President, Foundation for Renewable Energy and Environment (FREE); **Nam-Hoon Kang**, CEO of Korea Energy Agency (KEA); **Xiao Wang**, Economist, AIIB; **Mahua Acharya**, Assitant Director-General, GGGI
Moderator: **Seung-Yun Nah**, Co-Partner of Oration
Location: Halla (3F)

11.00am – 12.30
Governors' Seminar II: **Financing Infrastructure in Asia**
Speakers: **Sri Mulyani Indrawati**, Minister of Finance, Indonesia & AIIB Governor; **Joachim Von Amsberg** Vice-President, Policy & Strategy, AIIB; **Shaukat Aziz**, former Prime Minister of Pakistan, Banker (Citibank), International Advisory Panel AIIB; **Amar Bhattacharya,** Senior Fellow, Brookings Institute; **Kevan Watts**, Vice Chairman, HSBC Banking Plc
Moderator: **Martin Soong**, Anchor, CNBC
Location: Yeongju (1F)

12.00pm – 1.30pm
Working Lunch: **Presentations on Korea's Technology and Capacities in Infrastructure Development**
Speakers: **Kee-Poong Park**, Chairman of International Contractors' Association of Korea (ICAK); **Jae-Wan Lee**, Chairman of Korea Engineering & Consulting Association (KENCA); **Yong-Jin Yun**, Vice President of DOHWA ENGINEEING Co., Ltd; **Seung-Kyu Han**, Team Leader of DAELIM; **Ahmad Abdelrazaq**, Vice-President of Samsung C&T Corporation; **Seung-Soo Han**, Vice-President of Doosan Heavy Industries&Construction; **Seok-Hong Lee**, CTO and Vice President of HYUNDAI E&C; **So-Hee Shin**, Vice President, Global Business Group of KT corporation
Location: Halla (3F)

1.30pm – 2.00pm
Business Leaders' Luncheon (by invitation)
Speakers: **Yongmaan Park**, Chairman, the Korea Chamber of Commerce and Industry (KCCI); **JongKu Choi**, Chairman & President of the Export-Import Bank of Korea
Location: Booyoung Hotel

2.00pm – 3.30pm
Seminar IV: **Partnership in Promoting Infrastructure Investment in Asia**
Speakers: **Changyong Rhee**, Director of the Asia and Pacific Department, IMF; **Steve Gross**, Senior Managing Director of Macquarie Infrastructure and Real Assets; **Laurence W Carter**, Senior Director of the Public Private Partnerships Group for the World Bank Group; **Jang Ping Thia**, Senior Economist of the AIIB; **Bambang P S Brodjonegoro**, Minister of National Development Planning (Indonesia)
Moderator: **Connyoung Jennifer Moon**, Chief Anchor, Arirang TV
Location: Halla (3F)

3.30pm – 5.00pm
Bank Seminar II: **Building Public Trust in Infrastructure Investments**
Speakers: **Sri Mulyani Indrawati**, Minister of Finance, Indonesia & AIIB Governor; **Roger Fiszelson**, Secretary General, Confederation of International Contractors' Associations (CICA); **Rizwana Hasan**, Bangladesh Environmental Lawyers Association (BELA); **Hamid Sharif**, Director General, Compliance Effectiveness and Integrity, AIIB; **Zoë Reiter**, Senior Project Leader, Transparency International
Location: Samda (3F)

5.30pm – 6.30pm
Dialogue with Management: **Transparency and Social Responsibility**
(NGOs and CSOs only)
Speakers: **Danny Alexander**; **Joachim von Amsberg**; **Jin Liqun**; **Laurel Ostfield**, Head of Communications & Development, AIIB; **D J Pandian**, VP Chief Investment Officer, AIIB; **AIIB Director General,** Compliance, Effectiveness & Integrity Unit, Policy & Strategy, Investment & Operations; **Civil Society Organisations**
Location: Halla Hall (3F)

7.00pm – 9.00pm
Dinner and cultural performance: **Jeju Night** (by invitation)
Host: **Governor of Jeju Special Self-Governing Province**
Location: Yeomiji Botanical Garden

We have already done some OBOR-related financing, but they were not driven by the Chinese government.

You left the IADB three years ago. How much have markets changed in the interim?
Some well known underwriters have, of course, either left the market or significantly scaled down, which means other entrants have come in and established themselves. It's been quite interesting for me to suddenly see some of the names I was used to talking to no longer picking up the phone, and then seeing some entrants that I just had never thought were going to be there. So I have had to adjust to that reality.

We talked about the two-way CSAs before. I think that been mainstreamed by the likes of, for instance, the IFC and Nordic Investment Bank, and I think that's very much welcomed. It's certainly not as contentious a topic as it was five years ago.

You mentioned fintech earlier and no doubt it is becoming extremely important. I do put a lot of emphasis on that. I'm an early adopter of a lot of technologies, so I'm pleased to see there are several initiatives in world bond markets to make them more automated, more transparent, more direct. I can only hope that that continues to bring down the distance between investors and issuers, but also to reduce transaction costs, which improves efficiency.

The last thing is, of course, the Market Abuse Regulations, for instance, in the European market, which is only going to increase the way the communication around bond issues is different from how it was three years ago.

But you'll still want to talk to a syndicate bank or an origination banker. You won't want them to be replaced by robots, will you?
No, but I've always said that when I did e-funding at Eksportfinans, 10 years ago, instead of having the same conversation with bankers about something as trivial as the price for a deal, it actually allowed you to speak much more about the value-add that both the bank and issuer were giving to the transaction, which investors you were going to be reaching, what was the next thing you should be focussing on.

So, for the same amount of time you allocated to a conversation with your bankers, it freed up time to speak more about the value-add instead of the value extraction.

Do you think markets are harder to approach now than three years ago? Do you approach the markets with some trepidation?
No. I love interacting with the market. I love interacting with peers, with bankers, with investors, with press like yourself, to understand what's going on with the market, what we're hearing, what are they seeing, to express my opinions and my convictions and then get responses, to learn more about what we should be doing next or what they are doing next to be able to adjust to the perceived reality.

So, no, I have never approached markets with trepidation. I don't think I would be starting now either! GM

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