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INFRASTRUCTURE NEEDS DRIVE ASIAN CAPITAL GROWTH

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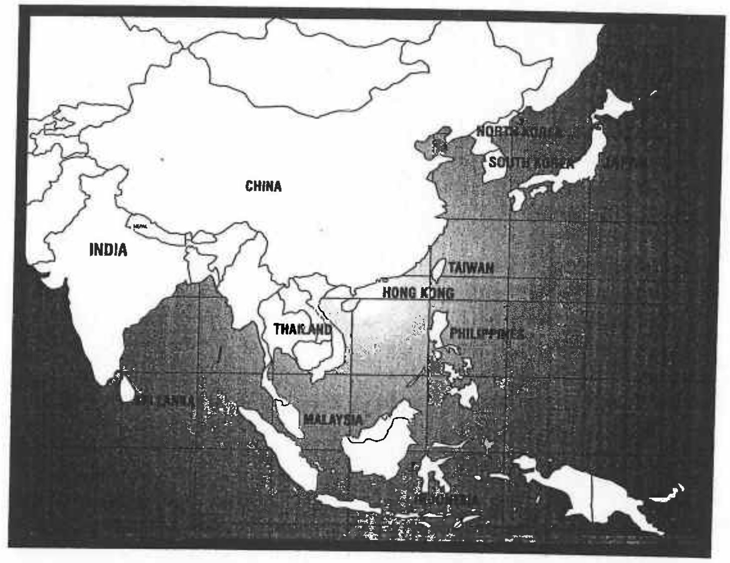
While east Asia's continued rapid development is expected to continue for the rest of this decade—how fast these economies grow and living standards improve will be in part determined by how much of the region's enormous capital needs are met.

The need for capital is clear. Infrastructure development alone may require more than US$1 trillion for all of Asia (excluding Japan) over the next decade, according to the Asian Development Bank. In addition, large Asian corporations, as they continue to grow to meet the needs of the region's more affluent consumers, will no doubt look to raise additional capital.

The voracious capital appetite of the industrializing Asian countries is bringing a financial revolution to the region as governments and companies look for new and diversified sources of money.

As a result, the amount of outstanding paper in the Asian debt markets (excluding



Japan) has more than doubled in the past five years to US$500 billion and could easily double again over the next few years. Taiwan's commercial paper market alone has US$10 billion in outstanding issues.

In 1987, Asian stock markets (excluding Japan) had total capitalization of US$200 billion. Today, they are capitalized at more than US$1 trillion.

Asia's high domestic savings have been, to date, an adequate source of capital for the region's booming economies. For example, China estimates that foreign capital finances only 10% of investment in 1994. Net savings between 1987 and 1992 amounted to US$95 billion. However, these same countries are expected to have a savings shortfall of approximately US$160 billion between 1993 and 1998 and consequently will be forced to depend more on foreign capital—including direct and portfolio investment—and to mobilize domestic savings more efficiently. This impera-

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tive is encouraging governments throughout the region to deregulate financial markets.

INCREASED LIBERALIZATION

Liberalization moves include the revamping of legal frameworks for issuance and investment in Malaysia and Thailand; the establishment of Securities Commission regulatory bodies in Malaysia and Thailand; tougher stock exchange listing requirements in Thailand; the easing of pension fund investment restrictions in Malaysia; new arrangements for the trading of domestic bonds in Thailand; and the accreditation of ratings.

INFRASTRUCTURE NEEDS

Economic development in Asia depends in no small way on the region upgrading its infrastructure as power and water shortages, overburdened communications systems, and transportation bottlenecks threaten to constrain growth.

China, for example, by most estimates needs to spend at least US$100 billion on modernizing its transportation system if it is to maintain its export-led economic boom. India, which has liberalized its economy over the past several years, is also looking to spend billions of dollars on infrastructure projects. For the whole of non-Japanese Asia, the World Bank has estimated that infrastructure spending must grow from an average of 4% of GDP to around 7% for Asian countries to maintain current economic growth rates.

And this is likely, with spending on telephones and power in Asia/Pacific forecasted to be the highest in the world for the remainder of the decade. At the same time, a multitude of new roads, airports, and mass transportation systems are being built or are in the planning stages.

MORE PRIVATE CAPITAL

Until recent years, much of the foreign funding for Asian infrastructure development has come from governments and multilateral lending organizations. That is changing as private capital is beginning to find its way into infrastructure projects. According to the World Bank, the private sector's share of investment in developing country infrastructure will double to 14% by the end of the decade.

In Asia, private sector investment in the region's infrastructure projects has taken several forms. In some cases, government utilities have been privatized. In others, projects are constructed on a build-operate-transfer basis in which the contractor builds a project and then keeps a fixed share of its revenues.

Privatizations in Asia have picked up steam in the 1990s. Leading the way is Malaysia, which has sold shares in, among other things, its national telephone and electricity companies, while shares in the Singaporean and Pakistani telephone systems were snapped up quickly by investors. To date, much of the infrastructure lending has come from commercial banks. While banks have made large-scale funding available for infrastructure projects, the contraints of the maturity profile of bank lending have attracted project sponsors to utilize the bond markets.

Infrastructure developers have also tapped the equity markets. Perhaps the most interesting offering to date was Shandong Power's share floatation on the New York Stock Exchange, which raised US$360 million for the Chinese power company. This was followed by Huaneng Power's US$630 million share offering.

Bond markets, which in some ways are a better fit for infrastructure projects because they require larger amounts of capital and long maturities, have also been coming into play.

China's finance ministry announced in late 1994 that it will issue US$10 billion in bonds over the next five years to fund infrastructure development.

BOND MARKET POTENTIAL

Although over US$13 billion was raised by Asian entities (excluding Japan) in the international bond markets in 1993, four times the US$2.7 billion raised in 1991, much of the issuance was by governments and large banks. With the exception of South Korean and Hong Kong firms, very few east Asian corporations are issuing bonds in part because the domestic bond markets in most countries are underdeveloped and commercial banks are relatively efficient in mobilizing domestic savings.

This is changing, however, in part because many companies are looking to raise substantially more money than they have in the past and they also wish to diversify their borrowing channels and lengthen their debt maturity profile, which can often be done cost effectively in the bond markets.

Asia's large corporations have built strong reputations due in part to the region's economic success. Their ability to tap international markets will be aided by credit ratings, often of investment grade.

While the crisis of confidence in the Mexican peso had repercussions in the east Asian markets, it is expected that the fundamental strengths of various east Asian economies and borrowers will in due course lead to a consolidation of market confidence.

CREDIT RATINGS TO GROW

By enhancing market transparency and assisting capital mobilization, credit rating agencies have emerged to play a critical role in the growth of bond issuance. In response to the increased demand for credit ratings in the region, S&P opened an office in Hong Kong in January 1995. S&P has forecast strong growth in rating activity in the region as borrowers such as banks and corporations look to tap the international bond markets and recognize that credit ratings can facilitate that process. At the same time, U.S. and European investors wanting to diversify their portfolios have become keenly interested in east Asian corporate, banking, project, and public sector debt. Aside from the bond markets, credit ratings are playing an increasing role in assessing large-scale syndicated bank loans and counterparty risk.

The region's potential was demonstrated in 1994, as S&P rated 21 new issuers, including seven in Hong Kong, five in China, and four in South Korea.

S&P expects the growth in ratings to continue in 1995 as project finance transactions come to the market, Hong Kong corporations diversify their funding sources, more Chinese borrowers tap the cross-border markets, and other east Asian entities continue their global search for cost-efficient and diversified sources of capital.