Indian Bond Market: Striking a Chord with Asian Peers

The Asian corporate Bond Market started developing rather late, after the Asian financial crisis in 1998. Prior to this, Asian bond markets were modestly developed and dominated solely by government issuances. The pace of development accelerated post the financial crisis in 2008 especially in economies like South Korea, Singapore and Malaysia who have extensively developed their bond markets in recent years.

The Indian bond market with particular reference to the corporate bond market is often touted to be under developed when viewed in line with the bond markets across the globe. There are demand and supply side issues. There are fewissuersin the market which translate into a lower supply for floating debt with a preference for bank loans, regulatory issues on disclosures and other related costs, stamp duty varying across states and so on. On the demand side traditionallyhigh Statutory Liquidity Ratio (SLR) that banks are required to comply with, regulatory asymmetry in treatment of loans and bonds, need to mark the portfolio to market etc.keep the demand for corporate bonds muted. Further the absence of a well-developed secondary market inhibits retail participants as exit is not easy.

Given the above, this study aims to put into perspective certain key aspects of the Indian bond market in the context of bond markets in other Asian countries. Asian economies included in the study are China, Japan, Indonesia, Hong Kong, South Korea, Malaysia, Singapore, Thailand, Philippines and Vietnam. While Japan is a different market, it has been included in this comparative study to provide possible benchmarks.

Five aspects of the bond market are covered in this study, covering

A. Aggregate bond markets
- The size and expanse of the bond market,
- The financing profile of the economy
- Turnover in the secondary market

B. Government bond market
- Foreign holding in domestic bond market
- The investor profile of the government bond market.

A. Aggregate bond markets

1. Size and expanse of the bond market

India ranks fourth in size among its Asian peers with a total bond market of US $812 billionas of March 2014 with a strong presence of Government bonds of $ 569 bn (30.4% in terms of GDP) and a relatively smaller corporate bond market of $ 242.5 bn (13% in terms of GDP).[1]Corporate bonds in all account for only 30% of total outstanding bonds in India. Interestingly, for almost all the countries, the bond market is dominated by the government sector. This is intuitive since a developed government bond market is often considered to be a pre-requisite for the development of the corporate bond market where interest rate benchmarks of GSecs are used to reckon the spreads.

[1]*Note: The data for India is as per the fiscal year (as of March '14) and for Asian countries is according to the calendar year (as of December '13)*

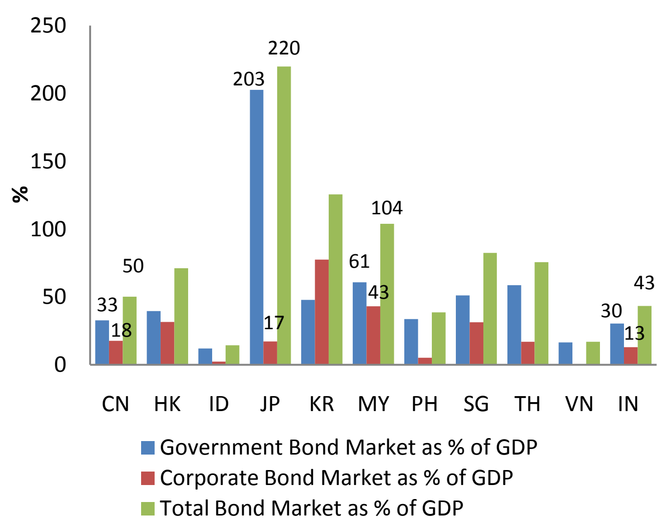
The table and exhibit below give an overview of the size of bond markets in Asian countries.

- The largest among the sample is Japan with $9,990 billion which is not asurprise since it has an extensive bond market analogous to those of western developed countries. However, the Japanese bond market is dominated by government bonds (92% of total). The corporate bond market is miniscule in comparison ($786 bn) and is only 17% in terms of GDP (government bonds in comparison are 203% of GDP).
- China stands ahead of India as it has the second largest bond market with net outstanding debt of $4,724 bn which is 50.3% of GDP, higher than India by 7%. The Chinese bond market also follows the conventionof government domination as corporates account to only 35% of the total bond market.
- South Korea is third with a size of $1,641 bn.However, it is an exception in the sample as it hasa larger corporate bond market relative to the government bond market. Corporate bonds account for around 61% of outstanding bonds in the country and was 125% of the GDP of the country suggesting the bond market is extensively developed for the size of the economy.
- Malaysia, Thailand and Singapore, the medium sized economies within this Asian group have a bond market worth $ 312 bn, $ 275 bn and $ 242 bn respectively. Hong Kong and Indonesia have a much smaller bond market at $ 195 bn and $ 108 bn.Vietnam is the smallest in the sample with a bond market size of $ 29 bn only.

Table 1: Size of the Bond Market* (in USD Billions)

Countries	Outstanding Government Bonds	Outstanding Corporate Bonds	Total Bond Market
China	3,072.6	1,651.7	4,724
Hong Kong	108.5	86.2	195
Indonesia	89.7	17.9	108
Japan	9,203.4	786.6	9,990
South Korea	626.1	1,014.9	1,641
Malaysia	182.4	129.7	312
Philippines	87.3	13.3	101
Singapore	149.6	92.1	242
Thailand	213.7	61.5	275
Vietnam	28.01	0.7	29
India	569.0	242.5	812

Exhibit 1: Bond Markets in Asian Countries as % of GDP



Source: ASIAN BONDS ONLINE, SEBI and Ministry of Finance
**Figures are as of December '13 for all countries and as of March '14 for India*

2. Domestic Financing Profile

This section gives an overview of the financing profile in these countries. Excluding the government sector, there are three sources of finance which is represented by outstanding bank credit, bonds and equity. Upon comparison, it is evident that some countries primarily rely on domestic credit and some look to equity as the important source of domestic financing. However, corporate bonds do not emerge as the preferred source for financing for any of the countries in the sample.

The table below depicts the nature of domestic financing in India and its Asian peers.

- Domestic credit (i.e. credit disbursed by banks) is the primary source for financing in China (73.9%) and South Korea (73.9%) followed by India which is second with a share of 71.5%.
- The role of domestic credit is less important in Hong Kong and Singapore which have a larger share for equity.
- For Indonesia and Malaysia, equity is still the preferred route followed by bank credit.
- In case of Thailand, bank credit has the largest share.
- Corporate bonds are not significant in these countries with India having a higher share with 18.4% followed by Malaysia with 12.4% and China, S Korea and Singapore with 8% each. Interestingly, relative to other countries, India lends the most through corporate bond issuances at 18.4% standing well above its peer countries in the sample. Hence, despite a smaller contribution of corporate bonds in India (in terms of outstanding issuances) relative to other countries, they play a larger role in satisfying the finance needs compared with other countries in the sample.

Table 2: Domestic Financing Profile (% share of total)

Country	Bank Credit	Corporate Bonds	Equity
China	73.9	8.0	18.1
Hong Kong	17.5	2.5	80.0
Indonesia	41.9	2.4	55.7
South Korea	73.9	8.0	18.1
Malaysia	40.1	12.4	47.5
Singapore	26.2	8.0	65.8
Thailand	51.1	6.3	42.6
India	71.5	18.4	10.1

Source: ASIAN BONDS ONLINE, RBI, ACE Equity

3. Turnover in the Secondary Market

The turnover ratio is the value of bonds traded in the secondary market to the total outstanding bonds. It is indicative of the liquidity in the bonds market as it captures the extent of trading in the secondary market relative to the amount of bonds outstanding. Hence, higher the turnover ratio, more active is the secondary market.

The table below gives an overview of the turnover ratios in the government bonds, corporate bonds and the aggregate bonds in the Asian countries.

- Japan has the highest turnover ratio of 4.56 with government bonds having a multiple of 4.9. The turnover in the corporate bond market is relatively lower at 0.3.
- India is second with a healthy turnover in the bond market at 3.46. There is a strong secondary government securities turnover of 4.7. India's position in terms of turnover is mirrored in the corporate bonds market as well with a turnover ratio of 0.67, which is still higher than that of Japan.

- China leads in the corporate segment with a multiple of 1.6. In fact, China has a turnover ratio of above 1 in both the segments.
- Thailand is third with a total turnover of 2.5, with a 3.1 turnover in government bonds and corporate bonds turnover being 0.26.
- While South Korea has a larger corporate debt market size relative to GSecs, the turnover ratio is higher for gilts at 3.73 compared with 0.54 for corporate bonds.

Table 3: Trading volume in the Secondary Market relative to bonds outstanding

Countries	GovernmentBonds	Corporate Bonds	All bonds
China	1.08	1.55	1.24
Indonesia	0.97	0.48	0.89
Japan	4.92	0.31	4.56
South Korea	3.73	0.54	1.76
Singapore	1.77	n.a.	1.10
Thailand	3.09	0.26	2.46
India	4.66	0.66	3.46

Source: ASIAN BONDS ONLINE, RBI
n.a.: Not available

The above analysis indicates that despite having a large bond market, countries like China and South Korea have a relatively passive secondary market as opposed to India which stands fourth in terms of the size of bond market, but is second with respect the turnover in bond market as a whole and also in the individual government and corporate bond markets.

Government Securities

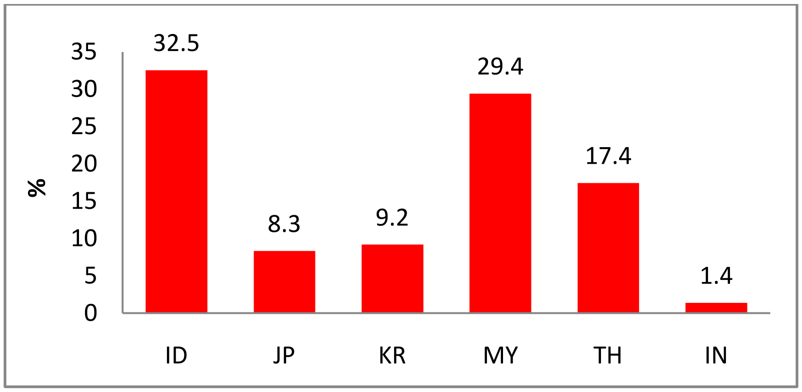
1. Foreign Holding in Government Bonds

Countries follow varying policies for foreign investments in government bonds ranging from China which adopts a very strict policy on this front to Indonesia and Thailand where Foreign Institutional Investments (FIIs) in government securities are encouraged with favorable policies for foreign investors.

- Non-resident investors do not require any approvals or registration for investing in government issuances in Indonesia. Given the easy access, it is not surprising that FIIs in government bonds are the highest in Indonesia at 32.5%. Malaysia is second at 29.4%. The government and regulatory bodies in Indonesia and Malaysia proactively work towards improving the market in terms of liquidity and enabling better access to all investors.
- Thailand which has a government bond market almost 1/3rd the size of the Indian government bond market, in effect has a contribution of 17.4% by FIIs in government bonds. Similar to Indonesia, the country allows direct and portfolio investments in the government securities with no restrictions.

The exhibit below provides a snapshot of the FIIs holding in government bonds in some of the countries.

Exhibit 2: Foreign holding in Local Government Bonds* (% of total)



Source: ASIAN BONDS ONLINE, RBI ** As of December 2013*

- Foreign holding in Indian government bonds is very low at 1.38% when compared with the above mentioned countries.
- In China, only qualified investors from an old program called the Qualified Institutional Investor Program and a more recent Renminbi Qualified Institutional Investor Program are permitted to invest in the domestic securities of the country with a very time consuming process for the same which further acts as a deterrent for foreign investors from investing in the government bonds.

2. Investor Profile of Government Securities

This section analyses the investor holding in government bonds in some of the countries included in the study. The investors of government bonds are broadly classified as the Central Bank, Government, banks, contractual saving institutions (such as insurance companies, pension funds etc.), FIIs and others.

The table below captures the investor profile in government securities for select Asian countries.

Table 4: Investor Profile in Government Bonds (as % of Total)

Country	Central Bank	Government (Sub)	Banks	Contractual Savings	FIIs	Others
China	-	-	77.1	5.4	-	17.5
Indonesia	4.5	-	33.7	17.0	32.5	12.3
Japan	18.6	8.5	33.4	22.9	8.3	8.3
South Korea	2.5	20.2	17.9	29.0	9.2	21.2
Malaysia	0.6	1.4	27.9	40.7	29.4	-
Thailand	6.7	1.2	11.9	50.2	17.4	12.6
India	16.0	-	38.2	26.6	1.4	16.3

Source: ASIAN BONDS ONLINE, RBI

- Central Bank holds the maximum government securities in Japan at 18.6% followed by India at 16%. Peer countries like Thailand and Indonesia contain a significantly lower Central Bank holding of government securities. It is even lower in Korea (2.5%) and Malaysia (0.6%). However, China stands out in the sample as the People's Bank of China does not invest in government securities.
- Being a regulatory requirement in most countries, banks are the largest investors in government bonds. In China, 77.1% of the government bonds are held by banks. India comes second with upto 38.2% of GSecs being held by them. In Indonesia and Japan as well around 33% of total government securities are held by banks. Thailand and South Korea have lesser holdings of GSecs by banks at 11.9% and 17.9% respectively.
- Contractual saving institutions such as insurance companies, pension funds and state and local government retirement funds are another set of important investors in the government securities market. Within the sample in the study, maximum investment in GSecs by contractual saving institutions is in Thailand at 50.2% followed by Malaysia at 40.7%. India is fourth at a substantial 26.6%. However in China these institutions hold only 5.4% of the total government securities.
- As in the earlier section, FIIs in government bonds are the highest in Indonesia and Malaysia. Thailand stands third at 17.4%. In India, FIIs invest only 1.4% in government bonds, being the least in the sample.
- Sub-Government holds a sizeable proportion of securities only in South Korea at 20.2%.

Key Takeaways for India

- The Indian bond market is reasonably large in Asia. However, like most other countries it is dominated by government securities. Going ahead, attention should be transfixed upon bringing about further growth and diversification in the corporate bond market since it is currently lagging in terms of value of outstanding bonds relative to peer countries.
  - Relative to size of GDP the overall bond market size needs to be improved as the ratio of 43% is low which is mainly due to the preference for bank finance.
- A critical positive is thatthe turnover in the Indian bond market is second only to Japan. However, this is primarily owing to the active secondary market for government bonds in the country. The secondary corporate bond market while being comparatively passive is still the second most active within Asian countries. Hence, while over all the secondary market trading appears healthy, the same for corporate bonds can be made more vibrant.
- Foreign investments in Indian government securities are far and away compared to other Asian emerging economies of Indonesia and Malaysia, which are smaller markets in comparison. This can be studied further and subsequently liberalized cautiously with a view to make this market more liquid.

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