Evolving connections support a region’s growth ambitions
At NAB’s 2018 Asian Debt Capital Markets Conference, experts, issuers and investors zeroed in on the ‘megatrends’ bringing depth and dynamism to the regional bond landscape.

Bond market participants may be bracing for a period of higher volatility, but a more uncertain environment will do little to derail the megatrends creating opportunities in Asia Pacific for Australian and New Zealand issuers, and Asian investors alike – or the dynamism of an increasingly connected region.

This was the view shared by participants in National Australia Bank’s (NAB) 2018 Asian Debt Capital Markets Conference. Now in its fifth year, the event brought together a broad range of issuers and investors in the key financial centres of Singapore, Hong Kong and Tokyo to discuss the issues that will define debt markets in the months ahead.

Unquestionably strong Asian investor connectivity with Australasian issuers is structural in nature, and short-term market gyrations won’t turn back the clock, according to Brad Scott, Director Corporate Debt Markets Origination at NAB. “The most significant change to the way debt capital markets operate in this region is how critical Asian investors are to local issuers. Once Asia was a place issuers flew over on their way to the US; now we manage roadshows and deal launches around Asian time zones.”

With the global interest rate environment shifting and markets roiled by tensions over geopolitics and global trade, volatility is foremost on many issuers’ minds. But as Geoff McMurray, General Manager, Capital Management & CRO at chemicals firm Incitec Pivot Ltd, pointed out, “volatility is nothing new.” Rather than embarking on a full-scale retreat from the markets, firms are focusing on tightening management of their balance sheets and maturity profiles. Companies are also adopting nimbler issuance strategies, or looking to access investors directly.

“We’ll probably be seeing smaller, more frequent issues and rely more on private placements,” said Neil Bradley, Treasurer at Bank of New Zealand. “We’re working to try to maximise those opportunities.”

Periods of volatility also highlight the need for companies to cultivate diversity in their investor bases, issuers said. “It’s about making sure you have capacity in your funding markets and not just keeping yourself tied to one market where there’s no capacity to fund if things change,” Mr. McMurray said.

“There is value to global diversification,” agreed Mr. Bradley. “It’s very important to us.”
Wealth to put to work

As more Australian and New Zealand issuers seek to broaden their investor horizons, the transformation taking place on their doorstep means they don’t have to look far. Asia Pacific’s rapid growth has created pools of capital that investors are looking to deploy; by one estimate the assets managed on behalf of the region’s institutional investors will nearly double to US$10 trillion by 2025. And the outlook for the region is relatively bright, with growth in developing East Asia and the Pacific expected to top 6 percent this year – around double the global rate.2

Importantly, many of these investors have strong appetite for Australian and New Zealand debt. A recent poll of Asian and European investors by NAB and Asiamoney found that around a quarter had increased their exposure to Australian debt over the last 12 months, and that 64 percent had left their Australian bond allocations unchanged. In addition, 28 percent plan to increase their Australian bond portfolios over the next year.3

How are you planning to change your exposure to the market over the next 12 months?

- Increase (28%)
- Decrease (8%)
- I am not planning to change my exposure (64%)

Source: Asiamoney 2018

A region reshaped

As Cathryn Carver, Executive General Manager, Corporate & Institutional Banking at NAB pointed out, the growing presence of Asian investors in Australian and New Zealand debt markets is just one aspect of a more connected region. “We are continuing to see the blending of Asian, Australian and New Zealand expertise in our capital, trade and business flows,” she said. “In particular with capital flows we see this happening via the Australian bond and loan markets, where Asian investors make up a significant part of all transactions providing depth, diversity and liquidity.”

David Lowe, Senior Manager, Treasury at Newcastle Permanent Building Society said the firm had seen a “big influx of interest from Asia” recently, with a 20 percent rise in Asian investor participation in one issuance early this year, versus the 2-3 percent increases it had seen previously.

There are several factors that explain the appeal of Australian and New Zealand debt to the regional investor base. A track record of robust growth and stable governance play a role, as do the attractive yields offered by Australian and New Zealand credits. And as it has for issuers, diversification has emerged as a major driver, with 40 percent of the investors polled citing this as the main reason for planning to boost Australian bond holdings.

“We know that Asian investors appreciate the diversification opportunities that Australian and New Zealand corporates give,” said Melissa Gribble, Head of Capital Markets Origination at NAB. While the financial sector remains a favorite of investors – no surprise, given the strong balance sheets of Australian banks and other financials – there are other key sectors emerging where the interests of issuers and investors are increasingly aligned.

Infrastructure, education in focus

The infrastructure and property sector is a prime example. In essence, as Peter Jolly, Global Head of Research at NAB, noted, infrastructure in Australia is not keeping up with the rapid expansion of the population, “which is good, as it means opportunity for growth.”

In the housing market, David Rowe, Treasurer at Stockland, noted, “low interest rates and low wage growth, against a backdrop of rising house prices has influenced affordability. But we continue to see demand underpinned by strong population growth and economic factors, such as employment and expansionary monetary policy.”

This is not only spurring new developments but also encouraging the release of previously government-owned assets to the private sector, which is “good news for fixed income investors,” Clare Lewis, Director, Debt Markets Origination at NAB, said.

Education – now Australia’s third-largest export industry, Mr. Jolly noted – is another promising field, expanding almost 20 percent in 2016-2017. The links in the sector between Australia and the rest of Asia Pacific are a natural reflection of shifts in Australia’s student base, with China alone now accounting for 29.5 percent of the country’s international students.

Institutions like Australian Catholic University (ACU) are turning to the bond markets to finance development plans, often with social and/or environmental components. ACU helped fund several important research institutes, programs and the construction of green-star rated buildings by issuing through NAB in 2017, Australia’s first sustainability bond; combining social and green criteria, according to Mitch Srbinovski, ACU’s Associate Director of Financial Operations. The A$200 million issue was well received by Asian investors, who accounted for about a quarter of the total.

ACU Sustainability Bond, breakdown by geography

Source: NAB Debt Capital Markets Origination

NAB’s Mr. Scott, who executed ACU’s transaction, confirmed this key trend. “Australian universities remain in strong demand by Asian bond investors attracted by their high quality education and ‘AA’ credit standings, providing a competitive source of long-term funding for campus infrastructure upgrades.”

Beyond sectors, Asian investors are also increasingly open to different currencies, supporting issuer diversification goals. The NAB/Asiamoney poll showed a surge in investors’ exposure to euro-denominated Australian bonds, with roughly 45 percent of those surveyed holding euro exposure versus 19.7 percent last year. US dollar-denominated bond holdings have also risen, and issuers at the conference also noted increasing investor interest in US dollar-denominated Regulation S (Reg S) issuance, in line with the exploding popularity of the format in the region.

“Some years ago we didn’t think the Asian markets were mature enough for Reg S,” said Mr. McMurray of Incitec Pivot. “But the last couple of years these markets have been maturing and investors are willing to invest if the credit rating is right. We’ve done a Reg S transaction that was very successful. In terms of ranking markets Asia is now one of our highest priorities.”

4 http://www.afr.com/leadership/education-exports-are-worth-28-billion-a-year-nearly-20pc-more-than-we-thought-20171005-gyvc8v
5 http://www.xinhuanet.com/english/2018-03/07/c_137022654.htm
6 National Australia Bank 2018 DCM Conference Slide Pack
Meeting green ambitions

The interests of Australian and New Zealand issuers are also converging on sustainable assets. Environmental, social and governance (ESG) factors are becoming a significant consideration for many investors, with 25.8 percent of those in the NAB/Asiamoney poll intending to increase their ESG bond exposure in the next year—some by up to 25 percent. And of the investors planning to boost ESG bond holdings, almost half (43.75 percent) also intend to lift exposure to the Australian fixed income market. This is very much in line with what NAB sees as "an international trend around social and responsible investment," said Jacqueline Fox, General Manager, Capital Markets & Advisory, NAB. "That's something we've been watching very closely for a number of years. We have dedicated ESG specialists at our institution who work with a range of our customers. It's an important theme that we'll continue to see grow over time."

How are you planning to change your exposure to the ESG bond market in the next 12 months?

- Increase (26%)
- Decrease (8%)
- No change (66%)

Source: Asiamoney 2018

This represents a clear opportunity for the rising number of Australian and New Zealand corporates who, like ACU, have made sustainability a priority and are exploring green or social bond issuance. As Mr. Rowe of Stockland also noted, there is increasing investor appetite for ESG bonds and a growing recognition that "companies need to take ESG seriously."

"Investors are showing increasing interest in corporate issuers’ ESG policies and we've also seen a real pickup in interest in the last 12-18 months from Australian and New Zealand corporates in exploring issuing in ESG formats," said NAB’s Ms. Gribble. "Going forward we’re expecting a pickup in issuances from sectors that have so far been underrepresented from a specific funding perspective despite a strong focus on ESG initiatives, such as infrastructure and utilities."

Fundamental forces, now and in future

One looming question is whether the broadly positive factors creating a more integrated regional debt market—solid growth in Australia, New Zealand, and the rest of Asia Pacific; greater focus on diversification; the pressing need for infrastructure and a rising ESG emphasis—are vulnerable to volatility spikes or macroeconomic shocks.

The consensus at the event seemed to be while there may be short-term setbacks, the forces encouraging regional connections are too fundamental to be reversed completely. As Mr. Jolly noted, strong population and hence infrastructure growth is set to continue in New Zealand and Australia, while the push towards greener policies and renewable energy sources is an "important and meaningful trend" that represents a new source of growth region-wide. The Chinese economy, meanwhile, will be increasingly driven by consumer demand supported by a stable renminbi currency, said Christy Tan, NAB’s Head of Markets Strategy and Research, Asia.

This means the bonds between Australian, New Zealand and Asian issuers and Asia Pacific investors will continue to expand in future. "Investors will continue to seek out Australian assets for their yield, stability, consistency and sustainability," said Ms. Carver. "The depth and dynamism of the region’s investor base will stand issuers in very good stead; contributing to building infrastructure and helping to ensure vibrant communities."
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