

**Executive Comment:  
Taiwan's Bond Issuance  
To Rise In 2015 On Strong  
Growth In International Bonds**

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中華信用評等

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# Executive Comment: Taiwan's Bond Issuance To Rise In 2015 On Strong Growth In International Bonds



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New issuance volume in Taiwan's bond markets is likely to grow considerably in 2015 compared to the past 12 months. Support for a potential increase comes from high growth momentum for financial debenture issuances, stable refinancing needs in the island's corporate sector, and a growing market expectation of an interest rate hike over the next several quarters. Taiwan Ratings Corp. expects international bond issuances by domestic and foreign entities in Taiwan to remain the strongest growth driver in the bond market over the next year, supported by strong demand from local insurers. However, excess liquidity and intense competition in the banking sector could temper potential growth in new bond issuance.

In our view, credit spreads (the yield difference between five-year non-Taiwan government and government bonds) are likely to further narrow in 2015. This view is supported by our expectation of further improvement in the local and global economies. However, we expect the narrowing to remain at a slow pace as a result of a gradual slowdown in China's economic growth. Moreover, we expect the Taiwan government's benchmark rate to rise moderately in line with rising U.S. bond rates, which will lead to a rise in borrowing costs for issuers over the next few quarters. Nonetheless, liquidity remains strong in Taiwan's financial system and corporations and financial institutions have generally adequate access to funding, which should limit price volatility in bond market in the coming year.

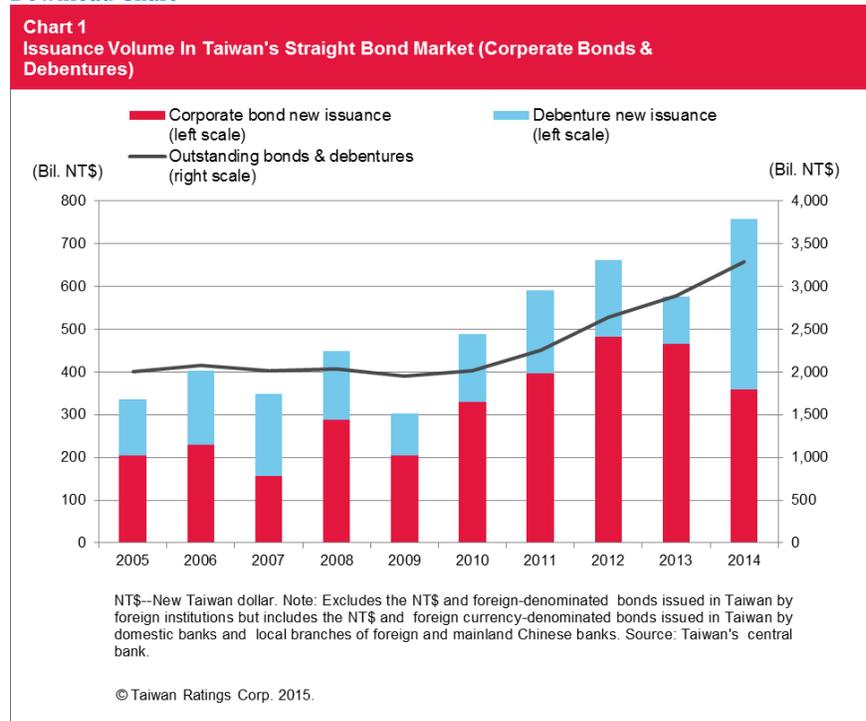
#### **Overview:**

- Taiwan's new bond issuance volume is likely to grow by 10%-15% in 2015, driven by strong growth from international bond issuance, and stable refinancing needs and capital requirements from domestic corporate and financial institutions.
- Higher-rated corporate bonds could continue to dominate by volume among our rated issue pool in 2015, but deregulation could boost the issuance of non-rated bonds.
- The improving global economic outlook could further narrow credit spreads but headwinds from slower economic growth in China and the eurozone could temper this.

#### **New Bond Issuance Volume To Grow By 10%-15% In 2015**

We expect the issuance volume for financial debentures to increase by up to 15% in 2015. Issuance volume grew a staggering 250% year on year in 2014, mostly as a result of strong growth in international bond issuances (mostly denominated in USD) in the second half of the year (see chart 1). This followed the government's launch of a financial import substitution program that removed investments in foreign-currency-denominated international bonds issued through domestic capital markets from insurers' assessments of overseas investments. We believe that rising demand for international bonds along with stable refinancing needs in the financial sector and the issuance of Basel III-compliant Tier II instruments will support moderate growth in financial debenture issuance volume this year, despite the high base in 2014.

Download Chart



*.....strong growth in international bond issuances helped push up financial debenture issuance by a staggering 250% year on year in 2014....*

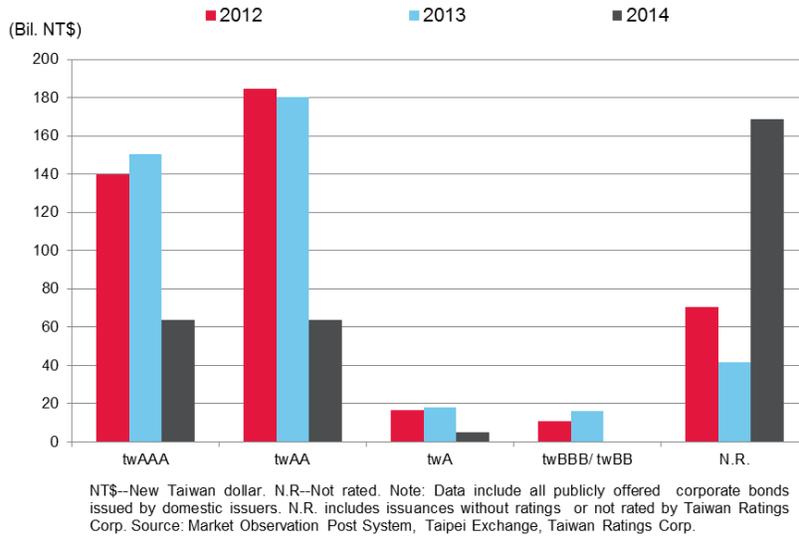
In the corporate sector, we expect bond issuance to grow by up to 10% this year, compared to a decline of over 20% in 2014, which we believe was due mainly to volatile issuance volume by several large entities that dominate domestic bond issuance. However, we expect the improving macroeconomic outlook to support the corporate sector's stable funding needs for capital expenditure and underpin momentum in issuance growth. We also expect corporates to experience higher refinancing needs in 2015 than in 2014, due to the higher amount of maturing corporate bonds. Meanwhile, Taiwanese corporates still have incentives to lock-in their funding costs at the prevailing low interest rate given the investment market's expectation of gradually rising interest rates later this year. Nonetheless, ample market liquidity in Taiwan could partly offset potential growth in new bond issuance because corporates could also source their funding needs through bank borrowing with attractive funding costs rather than through bond issuance.

**Higher-Rated Corporate Bond Issuances Remain Dominant In Our Rated Pool**

We expect corporate issue ratings of 'twAA-' or higher to continue to dominate our rated issue pool over the next year. In 2014, we assigned issue ratings of 'twAA-' or higher to over 95% of rated corporate bond issuances, including higher-rated bonds with strong creditworthiness issued by Taiwan Power Co., and the Formosa Plastics Corp. group (see charts 2 and 3). Following the removal of the regulatory requirement for an issue rating on corporate bonds in 2014, the volume of non-rated corporate bonds increased to 56% of total bond issuance in Taiwan that year, up from 10% in 2013. Nonetheless, over half of the corporate obligors issuing these non-rated bonds carried issuer ratings of 'twAA-' or higher.

Download Chart

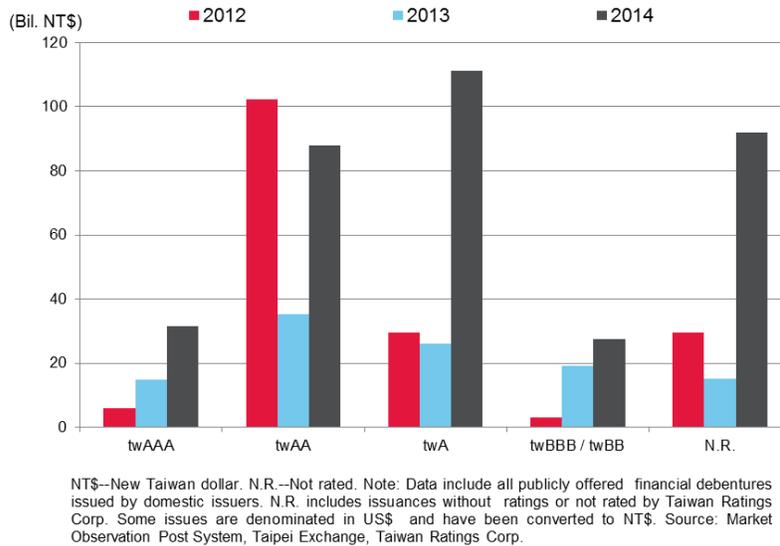
**Chart 2**  
Corporate Bond Issuances By Rating Category



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**Chart 3**  
Financial Debenture Issuances By Rating Category



© Taiwan Ratings Corp. 2015.

With regard to financial institution issue ratings, issuances rated 'twAA-' or above represented about 45% of rated financial debenture issuances in 2014. However this percentage has been in decline since 2012 and is likely to remain so over the next few years due to structural changes in the terms and conditions of subordinated debentures issued by financial institutions and not as a result of a change in bank credit profiles. Under the Basel III framework, Tier II subordinated debentures include a non-viability clause, which usually indicates that the issue rating will be clearly lower than the issuer rating even if the issuer maintains its credit profile following the debenture issuance.

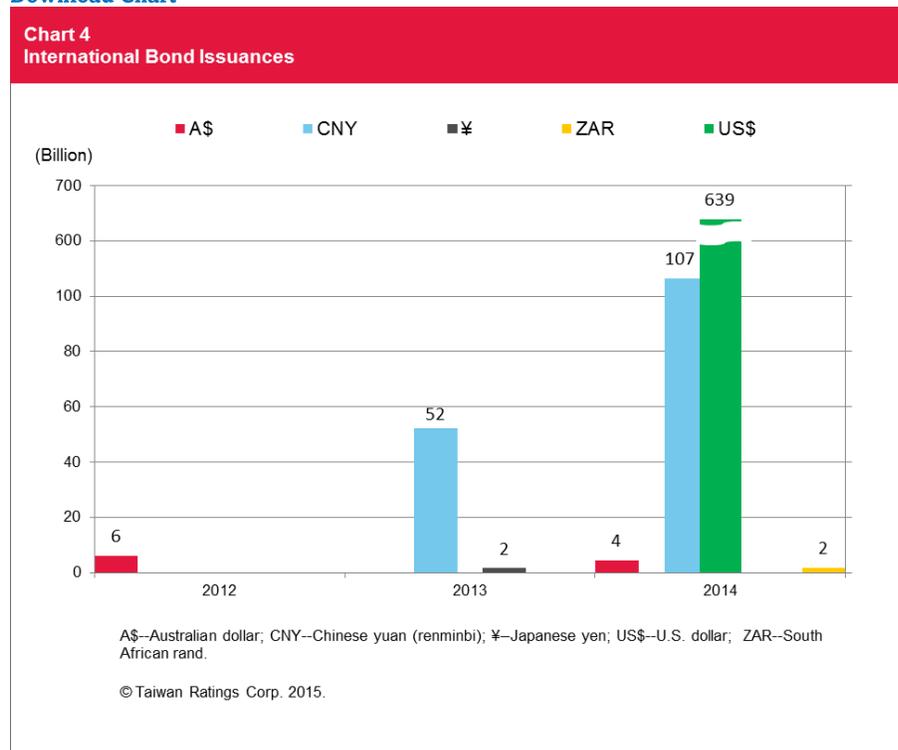
We believe that there is an important distinction to be made between an issue and issuer rating, despite the fact that many local investors use issuer ratings as proxies for issue ratings, or some investment guidelines are non-specific as to whether the ratings are on the issuer or issue. In short, an issuer credit rating generally indicates the likelihood that a company may default with regard to all its financial obligations, whereas an issue rating is based on a blend of default risk and the priority of a creditor's claim in bankruptcy associated with the specific debt being rated (see related criteria and research).

### **Regulatory Changes Continue To Drive High Growth In Foreign-Currency Bonds**

We expect international bonds issued by domestic corporations with offshore operations or overseas-based entities to maintain strong growth momentum in 2015, particularly for bonds denominated in U.S. dollars or Chinese renminbi. The main driver of this growth is the amendment to Taiwan's Insurance Act, effective since June 2014 and which allows life insurance companies--one of the most important investors in the market--to exclude their investments in international bonds when calculating their maximum permitted total foreign investments. The effect of this change is evidenced by the fact that in January 2015 alone, over NT\$30 billion of international bonds were issued, compared with about NT\$75 billion in full-year 2014.

In 2014, international bond issuances grew substantially to about 14 times the volume issued in the previous year (see chart 4). The majority of international bonds were issued following the amendment to the Insurance Act. The strongest growth came from USD-denominated international bonds issued mostly by domestic and foreign financial institutions in Taiwan. Chinese renminbi-denominated bonds (known locally as Formosa Bonds) also grew by over 100% year on year, mainly issued by corporations with operational exposure to China as well as the overseas branches of Chinese banks

Download Chart



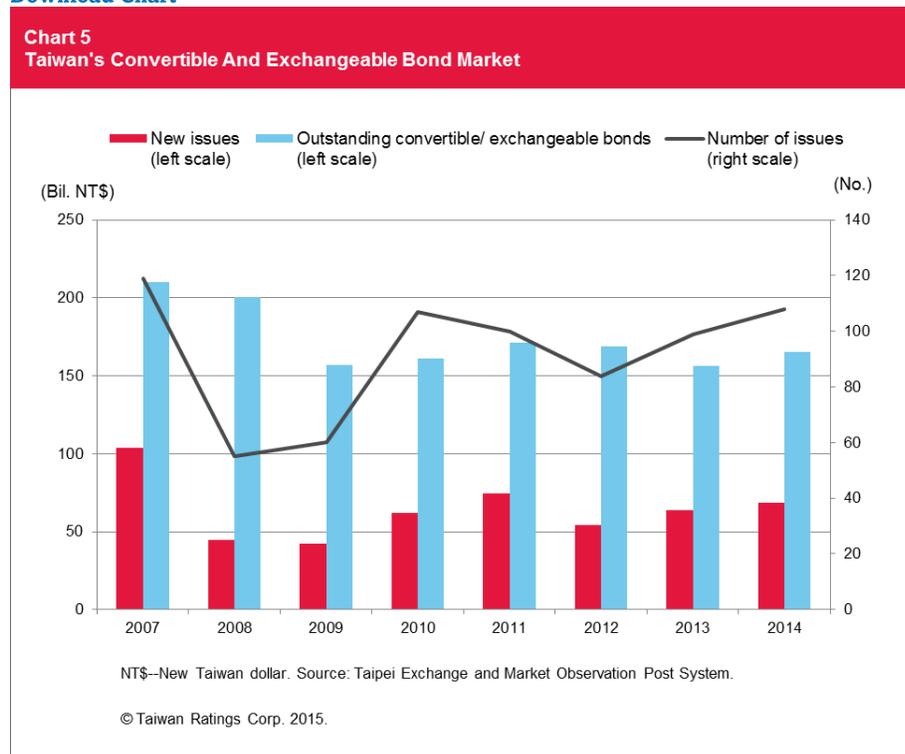
....international bond issuances rose almost 14 fold year on year in 2014...

In our view, the high issuance volume of international bonds is likely to sustain in 2015 underpinned by rising demand particularly from local insurers as well as due to competitive pricing for international bonds issued in the domestic market. The attractiveness of international bonds is also shown by the declining market size of money market funds in Taiwan which decreased to about NT\$740 billion in December 2014 from NT\$840 billion in May 2014, shortly before the Act was amended. We believe this decline is partly because international bonds now offer an attractive alternative for investors' asset allocation.

**New Convertible Bond Issuance Volume To Largely Sustain In 2015**

We expect convertible bond issuances in 2015 to be similar to the level in 2014, despite a relatively high and rising local equity market (see chart 5). Taiwan's convertible bond issuance market is mainly dominated by small-to-mid size entities with small issuance amounts for each transaction. But the rise in the stock index over the past year has been mainly driven by large-capitalization corporations that generally have lower incentives to issue convertible bonds. As a result, we do not expect strong growth in convertible bond issuance in 2015. However, we believe that the issuance volume will remain largely unchanged given stable demand and the role of convertible bonds as a funding alternative for small-to-mid size corporations.

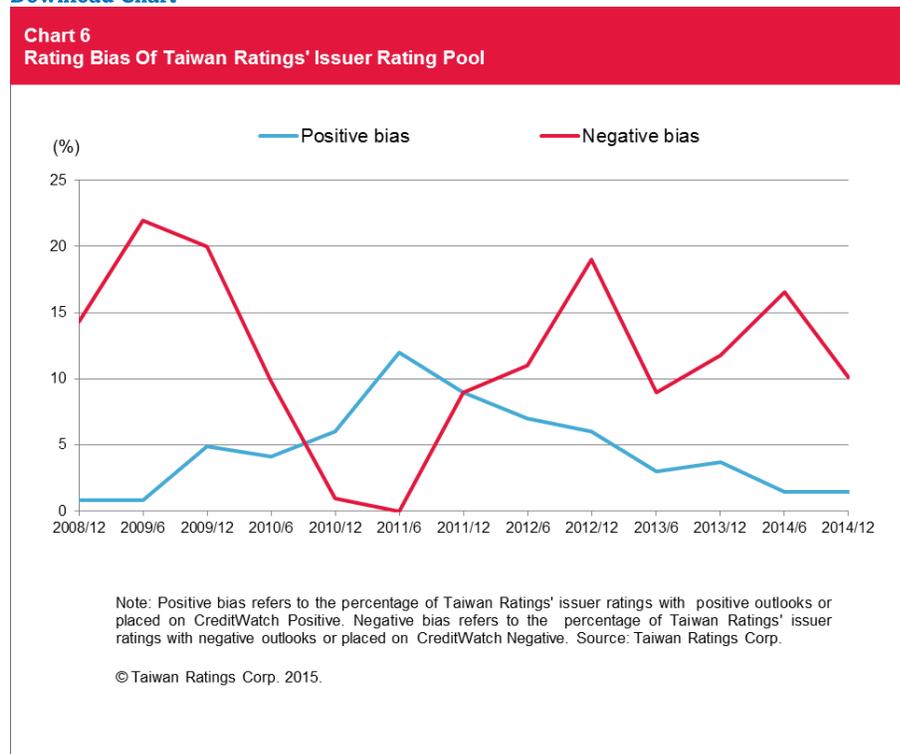
Download Chart



### Recovering Macroeconomy Supports A Dominant Stable Ratings Outlook

We expect the majority of our ratings on financial institutions and corporations to maintain stable rating outlooks over the next 12 months. We recently upgraded two corporations that previously had positive rating outlooks--**TECO Electric & Machinery Co. Ltd.** and **Cheng Shin Rubber Ind. Co. Ltd.** based on their improving credit metrics and assigned stable outlooks. As of the end of 2014, more than 90% of our ratings carried a stable outlook, which partly reflects our expectation of a gradual recovery in the global and local economy (see chart 6). About 6% of our rated pool carried a negative outlook at the same time. The negative outlook on credits in the financial institution sector primarily reflects the ratings outlook on their overseas parent group, whereas the negative bias on corporate credits is mainly due to the individual entity's weakening credit profile. We expect rating actions in 2015 to largely be the result of individual events, such as mergers and acquisitions or deteriorating credit metrics, rather than by systemic risks from macroeconomic or industrial perspectives.

[Download Chart](#)



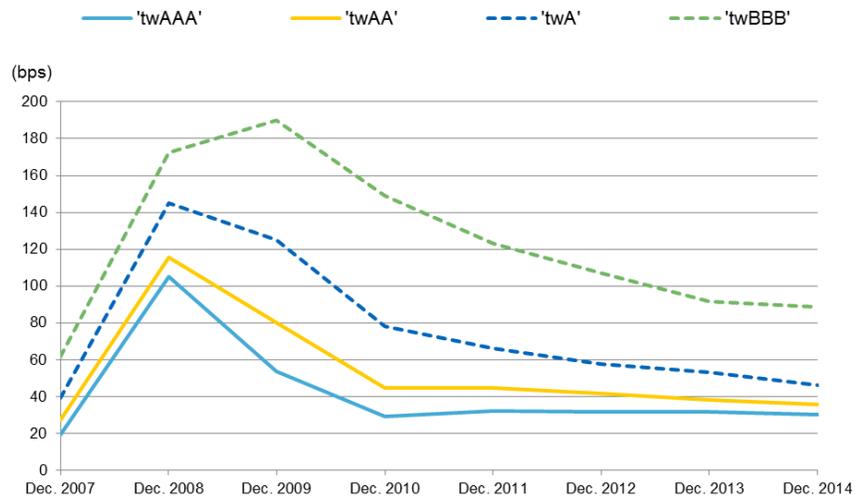
### Credit Spreads To See Limited Narrowing And At A Slower Pace Than In 2014

We believe that the credit spreads between five-year corporate bonds (including debentures) and government bonds will continue to narrow moderately in the coming year. This is supported by strong U.S. economic growth, a modest recovery in the domestic economy as well as our stable outlook on most industrial sectors and stable ratings outlook on more than 90% of our rated credits. Nonetheless, the narrowing of credit spreads is likely to be limited while local investors remain risk averse, particularly to lower-rated bonds. This is due to the investment risk from slower economic growth in China and macroeconomic headwinds in Europe. The borrowing cost for different rating categories was largely stable in 2014 (see chart 7). Meanwhile, we expect credit spreads to show some volatility over the next year, because any change in the direction of monetary policy could trigger higher volatility.

[Download Chart](#)

....strong U.S. economic growth, modest recovery in Taiwan's economy and our stable outlook on most industrial sectors and ratings suggest that credit spreads between five-year corporate bonds and government bonds will continue to narrow moderately in 2015...

**Chart 7**  
Credit Spread Of Corporate Bonds Over Government Bonds

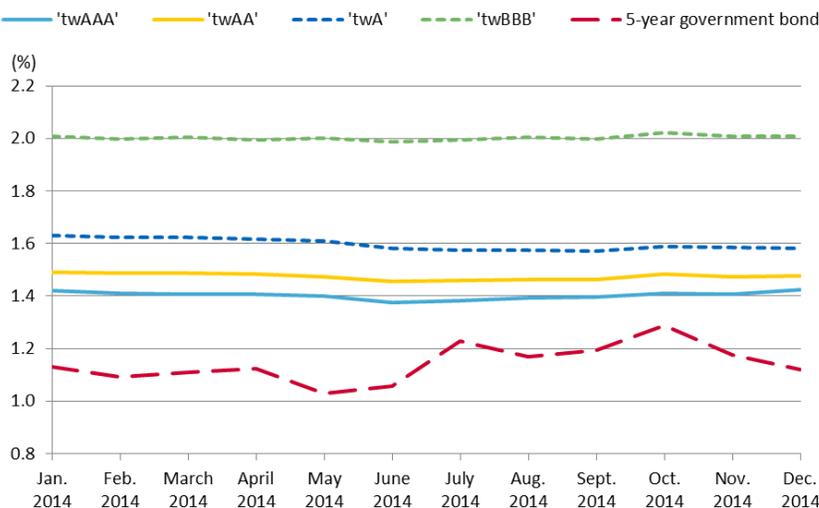


bps--Basis points. Source: Taipei Exchange.

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**Chart 8**  
5-Year Corporate Bond Yield Versus Government Bond Yield



Source: Taipei Exchange.

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In our view, the drop in Taiwan's 5-year government bond in the fourth quarter of 2014 was mainly due to the bond's correlation with the decline in the U.S. government bond yield (see chart 8 above). Nonetheless, we expect the local government benchmark rate to rise in line with rising global bond rates, which will in turn lead to a rise in corporate bond yields over the next several quarters.

The recent popularity of international bonds has brought additional competition to the corporate bond market, because international bonds are generally more attractively-priced than corporate bonds with comparable issuer credit quality. However, we do not expect corporate bond yields to rise significantly as a result of the increased competition.

### **Ample Liquidity And Strong Bank Competition Restrain Growth In Funding Costs**

Taiwan's bond market is mostly dominated by high-rated entities that have good bargaining power with banks over access to very low borrowing costs. Therefore, we don't expect to see a drastic rise in bond issuers' funding costs as long as there is ample liquidity and intense competition in the domestic banking sector.

## **Related Criteria And Research**

### **Related Research**

- **2015 Taiwan Credit Outlook: U.S. Economic Recovery And Lower Commodity Prices Support Stable Credit Profiles**, [www.taiwanratings.com](http://www.taiwanratings.com), Jan. 21, 2015
- **Credit Conditions: Slowing China Lifts Focus On Debt, Credit Risk, And Credit Cycles In Asia-Pacific**, [www.globalcreditportal.com](http://www.globalcreditportal.com), Dec. 5, 2014
- **Executive Comment: Taiwan's International Bond And Financial Debenture Markets Could See Higher New Issuance Volume In 2014**, [www.taiwanratings.com](http://www.taiwanratings.com), Sept. 4, 2014
- **Executive Comment: Taiwan's Bond Markets To Maintain Stable New Issuance Volume Amid Modest Economic Growth**, [www.taiwanratings.com](http://www.taiwanratings.com), March 6, 2014
- **Credit FAQ: How A Debt Issue Rating Differs From An Issuer Credit Rating**, [www.taiwanratings.com](http://www.taiwanratings.com), July 29, 2013

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