

# Rating Research Services

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## Executive Comment:

### Taiwan's Mild Economic Recovery Supports Moderate 2013 Bond Issuance Growth

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# Executive Comment: Taiwan's Mild Economic Recovery Supports Moderate 2013 Bond Issuance Growth

A mild economic recovery in Taiwan could fuel another year of high domestic bond issuance in 2013 but at a slower growth rate than in 2012. Taiwan's new bond issuance grew strongly in 2012 amid signs of economic improvement. But the European sovereign debt crisis, a tepid U.S. recovery, and a slow turnaround in most Asian economies are likely to limit domestic corporate demand to fund business expansion over the next few quarters. And investor appetite for local bonds could take some time to pick up again, particularly after a sharp increase in bond supplies over the past two years.

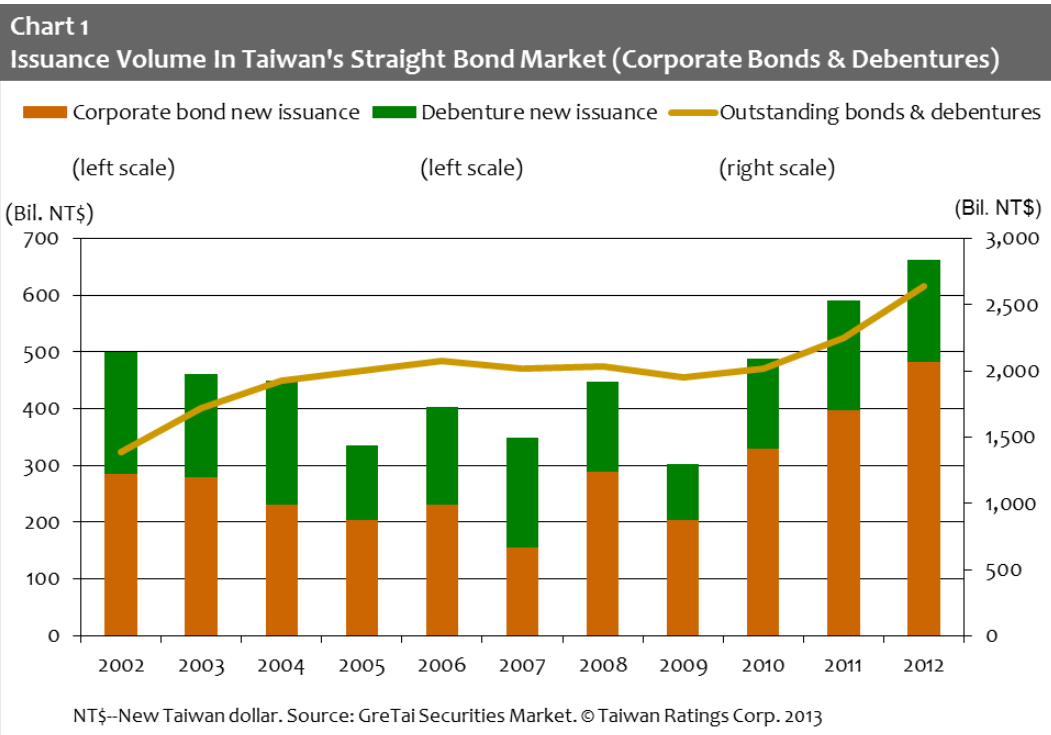
In addition, Taiwan Ratings Corp. believes credit spreads (the yield difference between five-year non-Taiwan government and government bonds) are unlikely to begin narrowing in 2013, given the still uncertain pace of global economic recovery. Credit spreads have widened slightly during the recent global financial market and economic turmoil, but local investors are likely to remain risk sensitive until there is firm recovery in the global and local economies. This will make it more difficult for local corporate and financial bond issuers with weaker credit worthiness to tap into the capital markets at a favorable borrowing cost. Indeed, the majority of issuers taking advantage of prevailing low bond yields over the past year were large companies with stronger credit profiles.

## Overview:

- Taiwan's new bond issuance volume is likely to remain strong with moderate growth in 2013.
- Higher-rated issuers should continue to dominate the local bond market, while lower-rated issuers continue to face obstacles to issue bonds at a favorable rate.
- Credit spreads are unlikely to narrow despite our expectation of a mild economic recovery.

## Growth In New Bond Issuances Will Be Slower Than In 2012

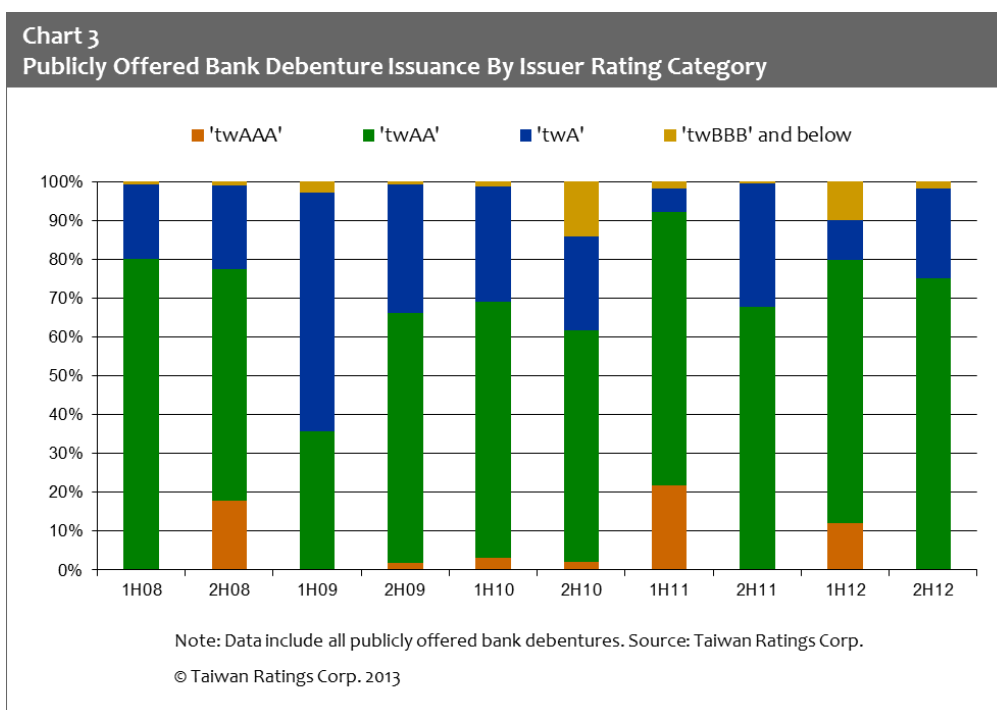
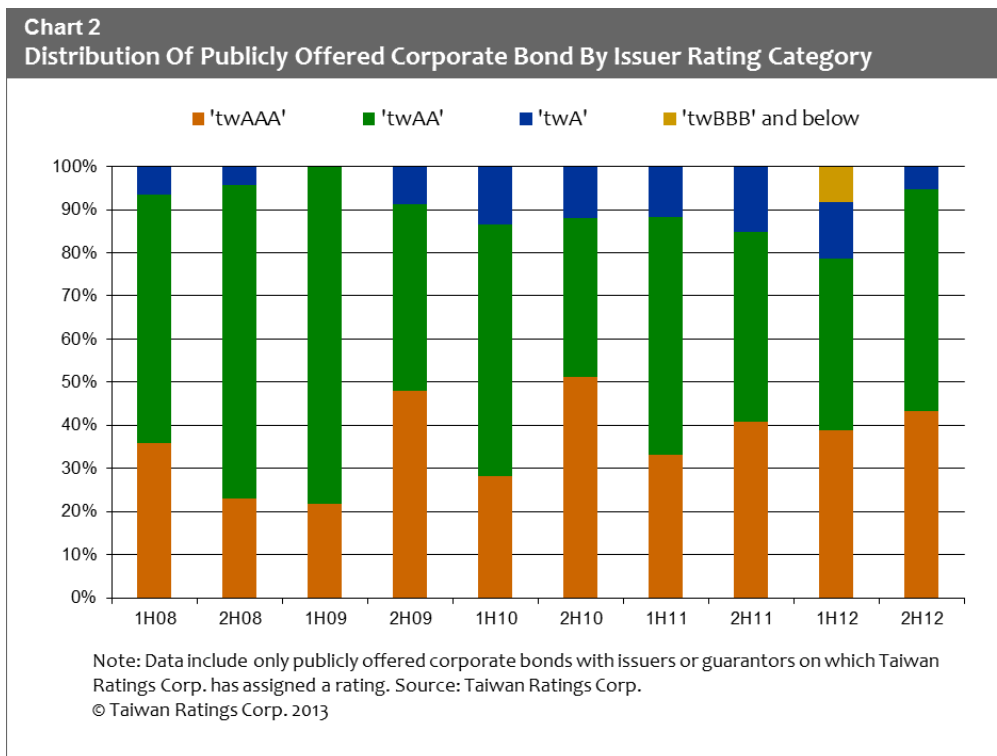
The volume of new bonds issued should remain strong in the first half of 2013, supported by a likely mild economic recovery in Taiwan, but the new bond market may grow at a slower rate than over the past few quarters. New bond issuances rose at a strong 21% and 20% in 2012 and 2011 respectively, boosted by low bond yields under the prevailing low interest rate (see chart 1). Standard & Poor's Ratings Services forecasts Taiwan's GDP to grow 3% in 2013 and rise to 3.2% in 2014. We believe a mild economic recovery will induce further capital expenditures and lift new bond issuance by local corporations.



Nonetheless, the pace of economic recovery remains highly volatile. This is likely to direct the attention of risk-averse investors to bonds from issuers with strong credit profiles, which in turn would limit total new issuance amounts in 2013. In addition, a mild rise in interest rates could accompany a potential mild economic recovery, and that would raise issuers' borrowing costs and further reduce the incentive to issue bonds to fund business expansion. Moreover, the issuance of financial debentures could also slowdown in 2013 due to the implementation of stricter regulatory requirements on local banks' subordinated debentures under the Basel III accord.

Stricter banking regulations under Basel III are likely to limit new debenture issuance to the purpose of meeting the regulatory capital requirement in 2013. Under Basel III, banks' subordinated debentures must embed several features similar to those of equities, which will likely result in lower ratings on debenture issues and higher funding costs. In addition, the Basel III accord places stricter requirement on banks' leverage. We believe this could somewhat limit growth in banks' debt funding over the next few quarters and reduce debenture issuance.

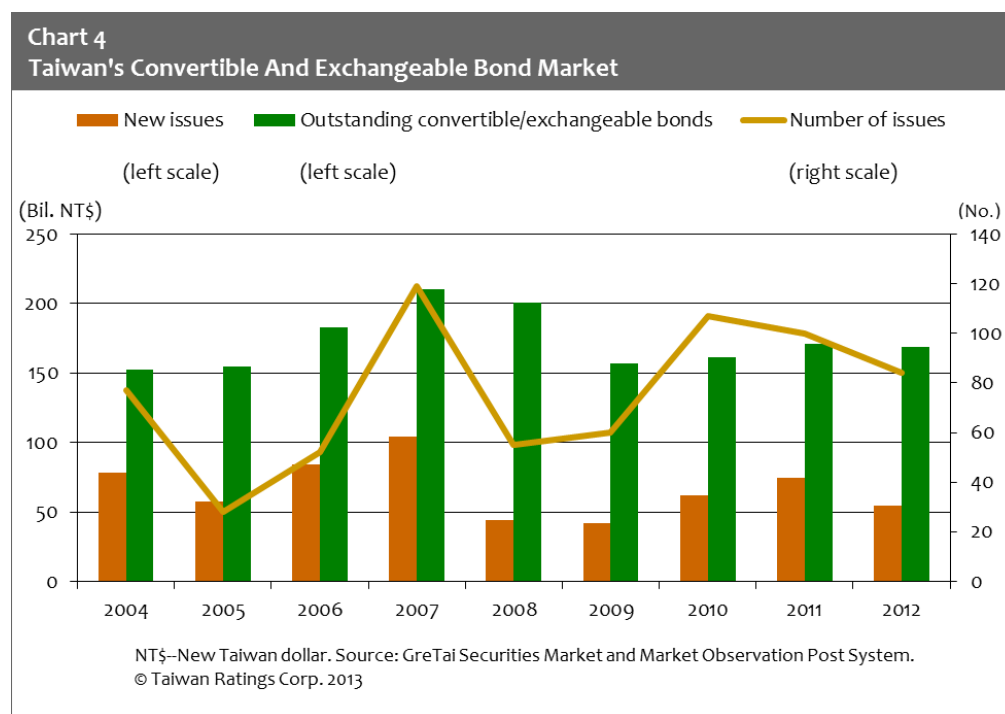
Higher-rated corporations will continue to dominate corporate bond issuances under the current climate of economic uncertainty and risk aversion. Over 95% of the corporate bonds on which we assigned ratings in the second half of 2012 received our 'twAA-' rating or higher, which included bonds that **Taiwan Power Co.** and other large corporations with strong credit worthiness issued. By contrast, there were very few issuances of bank debentures that we rated 'twBBB' or below. These issuances generally carried significantly higher bond yields, averaging 100-150 basis points (bps) above those of higher-rated bonds (see charts 2 and 3).



### Taiwan's Convertible Bond Market Is Unlikely To Fully Recover In 2013

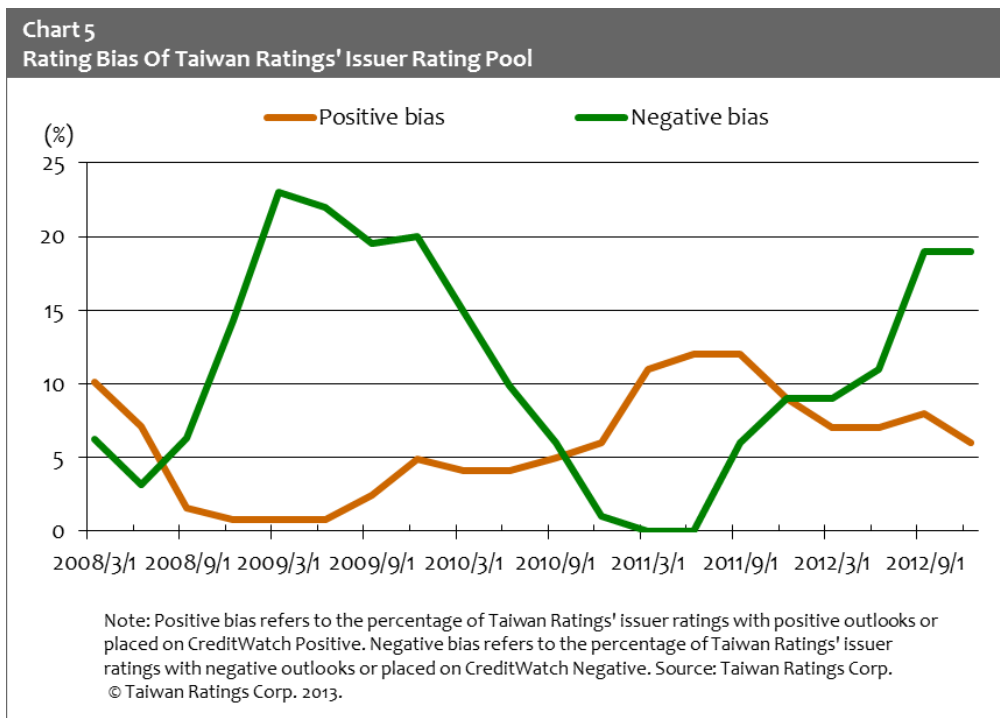
We don't expect Taiwan's convertible and exchangeable bond market to make a full recovery in issuance volume until local investors grow less risk-averse to issuers with weaker credit profiles. Convertible bonds offer holders the option to exchange the bond for a specific amount of the issuing company's preferred stock or common stock at a predetermined price, while the underlying asset of an exchangeable bond may be the preferred stock or common stock in a

subsidiary or affiliate of the company. Convertible bonds are mostly issued by emerging companies with good equity market outlooks but weaker credit profiles that make them less attractive to investors when markets grow more conservative. The number and amount of new convertible bonds issued in Taiwan in 2012 dropped by over one-quarter compared to that in 2011 (see chart 4).

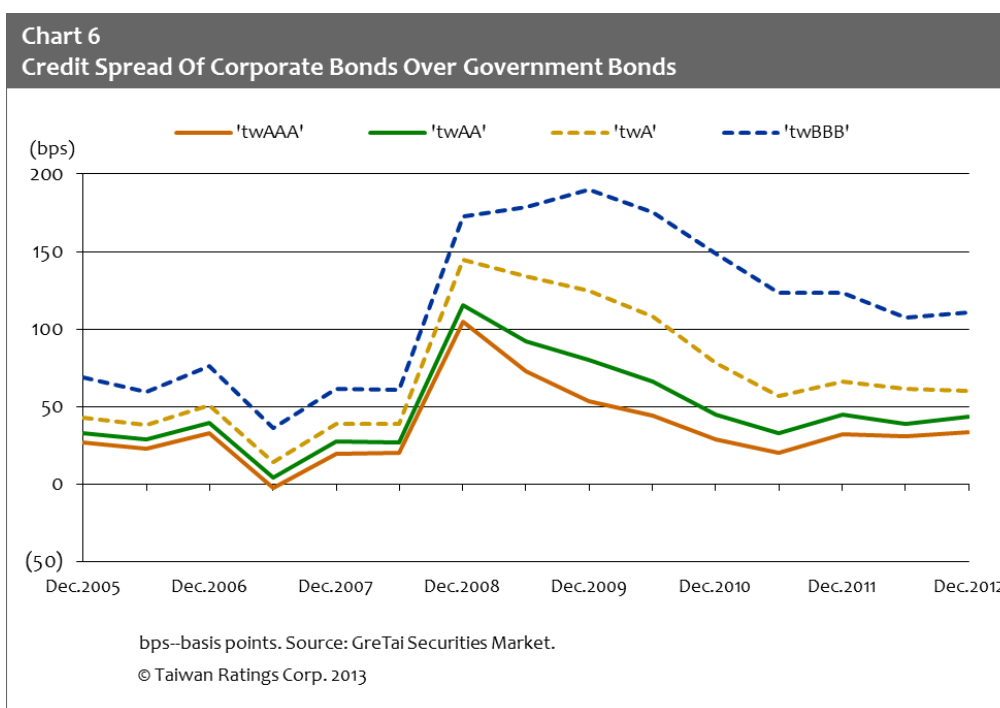


## Global Economic Uncertainty Results In A Negative Rating Bias With Widening Credit Spreads

Credit spreads are likely to widen further over the next few quarters amid the effect of growing global economic volatility on the credit profiles of local corporations and life insurers. Such economic uncertainty led to a significant increase in negative rating bias on our ratings pool in the second half of 2012, despite the low default level by corporate issuers and life insurers in recent years amid abundant market liquidity (see chart 5). The increase in our negative rating bias is more pronounced in corporate sectors that rely heavily on export activities, as well as life insurers with heavy exposure to global capital market volatility for their investment returns.



We expect credit spreads to remain noticeably higher over the next few years than they were before early 2008, when significant volatility hit the global financial markets. The spread between five-year corporate bonds (including debentures) and government bonds with the same tenor widened in the second half of 2012, due to growing market concern about the pace of global economic recovery (see chart 6).



## Taiwan's Strong Market Liquidity Lessens Most Bond Market Volatility

Strong liquidity in Taiwan's financial system is likely to alleviate much of the volatility in its bond market over the next few quarters despite still-significant uncertainty in the global economy. We believe uncertainty over the global economic outlook presents a degree of credit risk to Taiwan's export-sensitive corporate issuers as well as domestic life insurers dependent on higher overseas investment returns. Nonetheless, we expect the corporations and life insurers we rate to maintain adequate access to liquidity from Taiwan's competitive banking sector, thereby avoiding immediate financial stress in 2013.

## Related Criteria And Research

- **Taiwan Corporate And Financial Services Outlook 2013: Credit Prospects Maintain A Negative Bias**, rrs.taiwanratings.com.tw, Jan. 9, 2013
- **Global Corporate New Bond Issuance Topped \$3 Trillion In 2012—The Highest Amount Since 2009**, Jan. 9, 2013
- **Asia-Pacific Credit Outlook 2013: Corporate Ratings' Negative Bias To Persist Despite Likely Economic Upturn**, Dec. 6, 2012
- **Asia Pacific Feels The Pressure Of Ongoing Global Economic Uncertainty**, Sept. 23, 2012
- **Executive Comment: Taiwan's Weak Economy Could Slow The Local Bond Market's Recovery**, rrs.taiwanratings.com.tw, Aug. 30, 2012

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