

Emerging Sovereign Bond Markets NEWS

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China**BoC positive towards downside on long-term bond yields in future**

9 October 2010

Provided by: [Xinhua's China Economic Information Service](#)

BEIJING, Oct. 9 (Xinhua) – **Bank of China said in a research report that it still eyes chances for downturn on domestic long-term bond yields.**

"Up to now, we can not see sufficient negative factors to press down mid- and long-term bonds price", held Dong Dezhi, fixed-income analyst with BoC.

For one thing, China's economy is likely to extend a mild weakness in near future despite disputes over whether the economy is going through its worse phase still exist now, said Dong.

For the other, consumer price index (CPI), a major inflation weathercock, will tide over in quarter four after hitting record high expected in quarter three, added Dong.

China foreign debt jumps 24 percent in Q2

9 October 2010

Provided by: Reuters News

BEIJING, Oct 9 (Reuters) - **China's short-term foreign debt jumped 24 percent in the March-June quarter, possibly indicating speculative money inflows in anticipation of a stronger yuan.**

The rise, to \$343.8 billion, might also be a reflection of lower dollar borrowing costs, according to analysts.

Short-term foreign debt made up 66.9 percent of China's total debt, up from 62.3 percent at the end of March, the State Administration of Foreign Exchange said on Saturday.

In April, the regulator cut the short-term foreign debt quota for 2010 to prevent "abnormal" capital inflows.

China's overall foreign debt rose 16 percent to \$513.8 billion at the end of June. China's foreign exchange reserves are almost five times larger, underscoring the country's strong external financial position.

This was one of the reasons cited by Moody's Investors Service on Friday for its decision to put China's government bond rating under review for a possible upgrade.

Of the total debt, 72 percent is denominated in dollars, up 4.3 percentage points from the end of 2009, the regulator said on its website, www.safe.gov.cn.

(Reporting by Kevin Yao; Editing by Alan Wheatley)

Indonesia**Indonesia sees 210.6 trln rph bond issuance in 2011**

11 October 2010

Provided by: Reuters News

*** Net 2011 issuance 126.6 trln rph, vs 107.5 trln rph 2010**

*** Budget deficit in 2011 seen at 1.8 pct of GDP**

JAKARTA, Oct 11 (Reuters) - **Indonesia's government sees gross bond issuance of 210.6 trillion rupiah (\$23.58 billion) next year, 0.5 percent higher than a previous target, a finance ministry official said on Monday.**

Agus Suprijanto, head of the fiscal agency at the ministry, told Reuters this was to cover a budget deficit now seen at 1.8 percent of GDP or 124.3 trillion rupiah, up from a previous target of 1.7 percent of GDP.

He said net bond issuance would be 126.6 trillion rupiah, slightly higher than an earlier state forecast of 125.5 trillion and versus 107.5 trillion rupiah this year.

A parliamentary committee has agreed on the government's planned issuance, though a final decision is likely to be taken at a plenary hearing in parliament.

Previously the government had said it plans 209.5 trillion rupiah of gross debt issuance next year.

Indonesia cut bond issuance this year by 15 trillion rupiah, because of higher government revenues leading to a lower than expected deficit. The finance minister told Reuters last month the deficit would not go over 1.7 percent of GDP.

The reduced borrowing plans this year, combined with easing inflation last month, have renewed inflows into the bond market, with yields at record lows and foreign investors holding a record 28 percent of the total tradeable bonds.

Investors are betting on prospects for sovereign ratings upgrades to investment grade, amid strong economic growth and increased political stability.

(Reporting by Telly Nathalia and Aditya Suharmoko;
Editing by Neil Chatterjee)

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Mongolia

Russia, Mongolia sign memorandum on debt settlement – Pankin

11 October 2010

Provided by: [Interfax: Russia & CIS General Newswire](#)

WASHINGTON, Oct 11 (Interfax) - **Russia and Mongolia have signed a memorandum concerning settlement of Mongolia's debt to Russia, Deputy Finance Ministry Dmitry Pankin told journalists on the sidelines of the fall session of the International Monetary Fund (IMF) and the World Bank in Washington.**

"We have signed a memorandum with them addressing the debt issues. So far there has been no agreement but the memorandum has been signed. The minister (Deputy Prime Minister and Finance Minister Alexei Kudrin) signed the memorandum before leaving for Washington. It's a memorandum of general principles, that we are progressing toward a settlement," Pankin said.

Mongolia's debt to Russia amounting to roughly \$180 million stems from a loan Russia made to Mongolia to pay up its participation in the Mongolroostsvetmet joint venture. Mongolia did not respond to Russian invitations to negotiate the debt until the second half of 2009, when talks began, although initially there was little progress.

That debt is just 2% of the amount Mongolia owed Russia in 2003, when Moscow forgave 98% of total debt. Ulan Bator had proposed that Russia write off the \$180 million as well, but Moscow reckons that Mongolia is in a position to repay the loan from the profits of Mongolroostsvetmet.

(Our editorial staff can be reached at eng.editors@interfax.ru)

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Interfax: Russia & CIS General Newswire

Pakistan

Cancel Pakistani debt: Oxfam

15 October 2010

Provided by: The Age

SOME of the world's wealthiest countries are getting much more from Pakistan in debt repayments than they gave to help victims of the floods that recently devastated the country, according to Oxfam.

The aid agency has called for Pakistan's debts to be waived because of the massive relief and reconstruction costs it faces, reckoned to be \$US45 billion (\$A45.6 billion).

Pakistan's foreign debt is estimated to be \$US55

billion and it is expected to pay nearly \$US3 billion in repayments this year. Foreign governments have committed about half that amount to Pakistan's flood relief effort.

But Oxfam says only about a third of the United Nations Pakistan flood appeal has actually been funded.

The call for debt cancellation coincides with a meeting in Brussels today of the Friends of Democratic Pakistan, an international group that includes Australia.

Oxfam says France, Japan, South Korea and China — all members of the group — have received much more money from Pakistan in repayments than they have given in response to the flooding.

France got \$US62 million in debt payments in the first nine months of the past financial year.

"More than 15 times its direct contribution to the flood response," Oxfam says.

"Japan received \$US111 million, more than five times its contribution. South Korea received four times as much, and China three times as much."

About 1600 Pakistanis were killed and about 20 million displaced after the unprecedented floods.

"Pakistan needs aid and its debts dropped so that families can get back to their land and rebuild their homes and their lives," Oxfam campaign head Consuelo Lopez-Zuriaga said.

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The Age

Pakistan's Domestic Debt Swells To Us\$56.4 Bln

13 October 2010

Provided by: [Asia Pulse](#)

KARACHI, Oct 13 Asia Pulse - **Pakistan's outstanding stock of domestic debt soared by 4.52 per cent or Rs210 billion (US\$2.4 billion) during the first two months of the current fiscal year, according to the State Bank of Pakistan (SBP).**

Domestic debt reached a record level of Rs4.86 trillion (US\$56.4 billion) during the period, from Rs4.65 trillion on June 30, 2010, due to a significant rise in budget deficit.

Hike in debt was mainly driven by unprecedented rise in fiscal deficit for the last financial year (FY10) which increased to 6.3 per cent of Gross Domestic Product (GDP) against 5.2 per cent of GDP in FY09.

The floating debt during the period under review rose by Rs194 billion to Rs2.59 trillion during the 2MFY11 compared with Rs2.39 trillion in June 2010, while the unfunded debt increased by Rs23.6 billion to Rs1.48 trillion as compared to Rs1.45 trillion.

However, permanent debt declined by Rs7.4 billion in 2MFY11 to Rs787 billion during the period under review.

The floating debt raised through T-bill auctions stood at Rs1.31 trillion in 2MFY11 while the

second component of floating debt, MTBs for replenishment, increased by Rs113 billion to Rs1.28 trillion in the period under review.

(The Financial Daily)
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Asia Pulse

Philippine

Five-year bond rates sink

13 October 2010

Provided by: [Manila Standard](#)

Rates of five-year Treasury bonds dropped by over 100 basis points in Tuesday's auction on prospects of a more robust economic growth rate in the third quarter.

Finance Undersecretary Gil Beltran said favorable macro-economic indicators such as declining inflation and record-low interest rates boosted demand for government debt notes and pushed yields lower.

The economy may have expanded more than 7 percent last quarter and full-year growth will likely beat the government's 6-percent target as investor confidence improves, Beltran said.

The five-year Treasury bonds fetched a rate of 5.007 percent, 136.8 basis points lower than 6.336 percent in the previous auction. The rate was the lowest level since at least 1996, according to official data. Bids ranged from a high of 5.043 percent and a low of 4.95 percent.

Beltran said the release of the latest exports data showing a 36.6-percent growth in August would continue fueling the growth in the gross domestic product.

"We are looking forward to a good GDP growth for the third and fourth quarters of the year. At least for the third quarter, (the numbers should be) very good at 5 to 6 percent. It could even be higher than 7 percent for the third quarter," said Beltran.

GDP grew just 1.1 percent in the same quarter last year when the country was reeling from the impact of the global financial crisis. Beltran said GDP growth should exceed 6 percent this year.

He said low yields on government debt were likely to be sustained for the rest of the year, although there could be a slight uptick toward the end of the year due to Christmas spending.

The notes were oversubscribed with tenders hitting P18.115 billion, with the Bureau of the Treasury sticking to the original offer size of P8 billion.

"It's an economy that is riding on the crest of strong economic growth. We are seeing declining interest rates, higher GDP growth and declining inflation. All the fundamentals are okay," said Beltran following the auction. "This is a very rare occasion. Everything seems to be going in the right direction."

He said investor confidence was driving

economic growth.

"The private sector is taking advantage of the good fundamentals. We would see more spending but on the side of the private sector, particularly in construction, since government is constrained with its tight resources," said Beltran. With Bloomberg

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Manila Standard

South Korea

S.Korea says no withholding tax plan for foreigners' bond buys

11 October 2010

Provided by: [Reuters News](#)

SEOUL, Oct 11 (Reuters) - **South Korea does not plan to re-impose a withholding tax on bond investments by foreign investors, a senior finance ministry official said on Monday.**

Earlier, other finance ministry officials said the ministry had not discussed such steps.

Financial Service Commission Chairman Chin Dong-soo was quoted by local online news provider Yonhap Infomax as saying: "That's not our jurisdiction, but we will discuss it with related ministries", after a lawmaker argued that the country needed to remove the withholding tax exemption on bond investments by foreigners.

(Reporting by Lee Shin-hyung, writing by Cheon Jong-woo; Editing by Chris Lewis)

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Thailand

Thailand: 15% tax for foreigners on bond income

14 October 2010

Provided by: [Thai News Service](#)

Section: Economy - **Thailand's cabinet has approved the MoF proposal to impose a tax on bonds purchased by foreign investors.**

Effective 13 Oct, foreign investors have to pay 15% withholding tax on interest income and capital gains. The withholding tax on bonds was suspended in a bid to attract foreign investment in bonds since 2005. Thai corporates pay only 1% but Thai individuals pay the 15%.

Govt to boost outflows and help SMEs

In addition to the above tax measure, the cabinet also directed govt. agencies to accelerate budget disbursements in foreign currencies. In 4Q10, the govt plans to spend Bt49bn in foreign currency for investment.

Moreover, the govt requested state banks to assist SMEs in terms of liquidity support and

hedging.

If the baht strengthens, there will be more measures

The tax imposition will be the first of many future steps to stem capital inflows, as confirmed by the finance minister who said additional measures could be introduced if there is evidence of speculation (without defining speculation). We believe the pace of baht acceleration in the coming months could still prove too rapid, inducing more measures from the govt. Indeed, the measures introduced today were deliberately mild with a view to tighten things further in the future.

Finance Ministry in the forefront, BoT takes a back seat

This time, the Finance Ministry seems to have hurriedly introduced the tax measure in which implementation could prove bumpy in the coming weeks. The BoT can take a back seat on the currency issue and can justify stepping back from costly intervention and sterilization. We believe the BoT had been willing to allow the baht to appreciate relatively freely to begin with. BoT can raise interest rates but not this month. The tax (and other measures) to discourage capital inflows could, in principle, give the BoT a freer hand to raise interest rates as necessary. However, we believe the govt. has persuaded the BoT to refrain from hiking rates at the upcoming MPC meeting on 20 Oct. In our view, should the baht appreciate at a slower pace in the coming months, the BoT could press ahead with a rate hike at the last MPC meeting for the year on 2 Dec.

(Phatra Securities: 13 October 2010)

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EUROPE

Hungary

Budapest mayor says city cannot be financed without gov't intervention

13 October 2010

Provided by: MTI - EcoNews

Budapest, October 13, 2010 (MTI-ECONews) - Istvan Tarlos, the new mayor of Budapest, told a news conference on Wednesday that the city would not be able to plug its revenue gap and service its debts without the central government stepping in.

Mr Tarlos, who has asked the state audit office to examine the city's finances, said he would meet Prime Minister Viktor Orban next week to discuss the situation. He said it was not only a matter of financing but whether the state should take over certain responsibilities from the municipality.

"The situation is exceptionally worrying; day-to-day operations are not endangered but the 2011

budget is," he said.

Mr Tarlos said the biggest source of "fear" concerned debt-ridden municipal transport company BKV, whose debts, plus depreciation of assets not replaced on time, are reckoned to exceed an earlier estimate of HUF 400bn.

BKV said in its business plan that its debts were likely to reach HUF 81bn in 2010.

He said he would negotiate with Mr Orban on whether BKV's operations might be combined with those of the state railway company MAV and long-distance bus operator Volan, with the state and the city council taking joint responsibility. Streamlining at the company is also on the cards, he said.

"An examination of why there are as many people in the office as bus drivers will be made," he said.

A separate investigation into the fourth metro line will also be undertaken, Mr Tarlos said, adding that he did not want to halt the investment. But one question mark hanging over the project is whether it will be possible to complete it since today it is not known whether the city has enough funds available, he said. (HUF 100 = EUR 0.3659)

ekh/emon

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Poland

Poland to launch roadshow for JPY bond issue in late November - MinFin official

14 October 2010

Provided by: PAP Market Insider

Warszawa, October 14, 2010 (PAP) - Poland will go on a roadshow to market its November-planned JPY-denominated bond issue in the second half of November, Finance Ministry's public debt department deputy head Anna Suszynska told PAP.

"What we are planning now is a road show, i.e. meetings with investors," Suszynska said. "The departure is planned for the second half of November."

The bond issue date and supply will depend on the feedback from investors, according to the MinFin official.

"Today, preliminary information that we have suggests that a November issue is very likely," she said.

The JPY issue should not exceed last year's JPY issue, which amounted to JPY 44.8 bln, deputy Finance Minister Dominik Radziwill told reporters.

"Samurai bond issue, which should take place in the second half of November, will not be bigger than last year's issue on the Japanese market," Radziwill said. "The issue will most likely be divided into two tranches with different

maturities."

Poland wants to be present on the JPY market due to the long-term character of Japanese investments, "the so-called buy-and-hold investors" who "don't withdraw their means quickly."

The roadshow will also decide on the tenor of offered bonds, Suszynska said.

"The investment strategy that we presently see on the Japanese market in terms of tenors is 3-5 years," she said.

Deputy Finance Minister Dominik Radziwill said in September that the supply of samurai bonds, to be issued probably in November, will be similar to previous such issues and will amount to around EUR 0.5 bln.

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PAP Market Insider

Poland eyes reducing 2011 public debt by 1.3% of GDP thanks to improved liquidity management – MinFin

11 October 2010

Provided by: [PAP Market Insider](#)

Warszawa. October 11, 2010 (PAP) - **Poland expects to reduce the public debt in 2011 by PLN 19.7 bln or some 1.3% of GDP thanks to improving the management of public finance sector's liquidity by locating funds of sector's units in the state bank BGK, draft amendment to the public finance bill published Monday by the Finance Ministry shows.**

"The estimate of consolidated effects of the regulation, exclusively on the account of improving liquidity management, on the public debt level in 2011, indicates it will be possible to lower the debt by some 1.3% in relation to GDP," the justification to the amendment shows. "A similar estimate regarding the effects of improving liquidity management, shows that public finance sector's result will improve by PLN 362 mln in 2011."

At the end of 2009 public finance sector units held some PLN 23.7 bln or 1.8% of GDP at their disposal, the draft also shows.

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PAP Market Insider

Romania

Romania sells less debt, sticks to yield cap

11 October 2010

Provided by: [Reuters News](#)

*** Sells about a third of plan at regular 7 pct yield-cap**

*** Higher inflation outlook could complicate yield battle**

BUCHAREST, Oct 11 (Reuters) - **Romania sold about a third as much as planned in one-year**

treasury bills on Monday, sticking to a yield cap of 7 percent, but analysts warned a higher inflation outlook may further complicate their issuance plans.

Despite upward pressure on yields due to uncertainty over Romania's fiscal tightening measures, the ministry has refused almost all bids above 7 percent since May, which has led to lower issuance and some failed bond tenders.

Central bank data showed the finance ministry sold 371 million lei (\$121.2 million) on Monday, compared with a planned 1 billion lei. Most of the paper the ministry has sold has been at maturities of six-months and one-year - pushing back a crunch on liquidity in the hope that its situation will improve by next year.

Data on Monday showing inflation rising to 7.8 percent on the year in September, above market expectations, added to the case for a rise in central bank interest rates early next year.

That would complicate matters for debt managers by raising the base cost of short-term borrowing as well, although most analysts still believe the central bank will likely keep interest rates unchanged until at least early next year.

"The elevated inflation complicates the outlook of public debt managers since it may have increased rate hike expectations," ING Bank Romania said in a note.

One-year paper was trading at around 7.1 percent on the secondary debt market, analysts said.

Analysts have said European Commission funds recently disbursed as part of Romania's 20 billion euros IMF-led aid deal would help the ministry cover its needs while it refuses bids for above 7 percent.

The ministry also plans to issue euro medium term notes (EMTNs) on foreign markets as early as this month. So far this year, it has sold just under 29 billion lei domestically.

(Reporting by Luiza Ilie; Editing by Patrick Graham)
(\$1=3.061 Lei)
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Russia

International financial crisis turned into sovereign debt crisis - Russian finance minister

14 October 2010

Provided by: [RIA Novosti](#)

MOSCOW, October 14 (RIA Novosti) - **The international financial crisis has turned into a sovereign debt crisis, Russian Finance Minister Alexei Kudrin said on Thursday and called on European states to change their fiscal policies.**

"A heated debate on a possible transformation of the financial crisis into a sovereign debt crisis took place about a year ago. The latest events showed that the transformation has in fact

happened," Kudrin said at a Russia-EU dialogue meeting.

He said that state debt has risen due to anti-crisis spending, while "growing state default risks lead to financial market destabilization."

He also said it was necessary to carry out "an urgent fiscal correction in the most vulnerable countries" and compile medium-term programs of fiscal consolidation in all developed states.

"Though the International Monetary Fund has been advocating the idea for rather a long time, success in that area is still limited," Kudrin said. He also said that dragging feet on fiscal consolidation until markets started to get worried was dangerous, pointing at Greece as an example.

"If the same scenario repeats in a larger country, consequences may prove to be more lamentable not only for the country but for the whole international economy," Kudrin said.

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RIA Novosti

LATIN AMERICA

Argentina

Bond markets have long memories - ask Argentina

9 October 2010

Provided by: [Irish Independent](#)

WHEN Argentina's financial crisis hit there was rioting in the streets of Buenos Aires for a month, but unrest in international debt markets was to last a whole lot longer.

Back in 2001, an economically crippled Argentina boldly announced to the world that it was "suspending" payments on its \$132bn (€95bn) debt pile.

The decision triggered shockwaves. Two years later, Argentina's government began efforts to restructure some \$75bn of the internationally defaulted bonds, offering those who had loaned money 25c for every dollar. A flurry of lawsuits followed, and Argentina was effectively locked out of the international bond markets for almost a decade.

Even when the country got its first fundraising away earlier this year, it had to pay investors an interest rate of 12.5pc, which puts Ireland's recent 6.5pc interest rate into perspective.

"People are still talking about Argentina and the Russian default of 1998," said one source. "The bond markets have very long memories."

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Irish Independent

Argentina debt spreads narrow to 28-month low

13 October 2010

Provided by: [Reuters News](#)

*** Debt spreads tighten to lowest level since June 2008**

*** Local bonds up 1.2 percent, buoyed by global context**

By Walter Bianchi

BUENOS AIRES, Oct 13 (Reuters) - Argentina's debt spread over comparable U.S. Treasuries tightened to its lowest level since June 2008 on Wednesday as local bond prices rose in tandem with other emerging markets.

The spread shrank to 562 basis points, according to the JPMorgan EMBI+ index, as U.S. interest rates hit rock bottom and investors sought higher yielding paper elsewhere.

Expectations Argentina's peso will remain stable over the coming months have also increased the allure of local assets, traders said.

Argentine sovereign bonds climbed an average 1.2 percent in over-the-counter trade in Buenos Aires, according to Reuters pricing data. The peso-denominated Par bond climbed 3.4 percent to an ask price of 42.70.

Gustavo Ber, an economist at Estudio Ber consulting group, said government bonds are drawing strong interest because their high yields overstate the risks associated with the paper.

"That's why Argentine bonds are outperforming even other emerging market debt, which is where investors are seeking returns in a world where interest rates are next to nothing," Ber said.

Emerging market currency and debt markets were buoyed on Wednesday by growing expectations the U.S. Federal Reserve's measures to prop up the economic recovery will increase flows into developing nations. For details, see Argentina's dollar-denominated 2017 bonds hit their lowest yields yet at around 8 percent. Ber said that could spur the government to issue new debt on global markets for the first time in over eight years.

The government had planned to issue \$1 billion in the 2017 paper in June in conjunction with a \$12.2 billion debt swap aimed at cleaning up remnants of a \$100 billion default.

But officials shelved this plan after the market tanked, saying they would wait until they could issue debt at a yield below 10 percent.

In late September, however, President Cristina Fernandez said her government was not interested in issuing foreign debt at rates between 8 and 8.75 percent, reiterating the country does not need the money.

(Writing by Luis Andres Henao; Editing by Hilary Burke and Andrew Hay)

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Nigeria

The Country's Public Debt Rises to U.S.\$25.8 Billion

12 October 2010

Provided by: [All Africa](#)

Oct 12, 2010 (This Day/All Africa Global Media via COMTEX) -- **Nigeria's total public debt rose 21 per cent last year to \$25.8 billion, the Debt Management Office (DMO) said yesterday Bloomberg which quoted the DMO to have disclosed this in its annual report, said the figure represented 13.8 percent of the nation's Gross Domestic Products (GDP).**

It stated that external debt increased 6.2 percent to \$3.95 billion while domestic debt increased to \$21.8 billion from \$17.7 billion a year earlier.

"After securing a debt write-off pact with the Paris Club of 19 creditor nations in 2006, Nigeria has focused its international efforts on concessional loans from institutions such as the World Bank and the African Development Bank, the debt office said in the report. Nigeria has repaid \$12 billion to creditors and had another \$18 billion written off to cut the debt from \$35 billion," Bloomberg said.

The report revealed that 85 per cent of Nigeria's public borrowing last year was from the domestic market, while 15 percent came from abroad, whereas local component climbed from 83 per cent in the previous year.

The total value of bond sold last year amounted to N694 billion (\$4.6 billion) and the report explained that the feat was recorded as a result of, "increasing appetite of its burgeoning investors."

The objective of the debt management strategy is to "maintain the sustainability of the total debt profile," the Director General, DMO, Mr. Abraham Nwankwo, was quoted to have said.

It added, "Oil and gas account for 90 per cent of the country's export earnings and 16 percent of GDP, according to the National Bureau of Statistics.

Nigeria's economy is expected to grow 7.8 percent in 2010, up from 7 percent last year, driven by non-oil industries such as agriculture."

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All Africa

RPT-Emerging bond boom at new highs as funds play FX quake

11 October 2010

Provided by: [Reuters News](#)

LONDON, Oct 8 (Reuters) - **An unprecedented boom in emerging market local currency debt is set for new records this year, as money managers flee low-yielding developed markets in search of higher returns, rising exchange rates and strong balance sheets.**

As major economies such as the United States and Japan mull more money printing and prolonged zero interest rate policies fund managers are scrambling to increase exposure to emerging debt to ride resulting dollar and developed currency declines.

World finance leaders are seeking to tamp down simmering currency tensions at this week's meetings in Washington but concerns about asset bubbles and capital curbs from countries seeking to stem the flood have so far done little to hold investors back.

What were once considered ultra-risky assets are becoming the most sought after securities of 2010.

Over half the \$40 billion flows to emerging bond funds so far in 2010 have gone to debt issued in currencies such as the Chilean peso and Indonesian rupiah, dwarfing the old record of \$5 billion set in 2007, according to fund tracker EPFR Global.

Investment bank JP Morgan puts the figure even higher at \$36 billion, versus \$24 billion that has gone this year to emerging dollar bonds. In countries like South Africa and Brazil the influx has been astounding -- 2010 flows to local debt are up 400 percent and 800 percent respectively from year-ago levels.

Michael Power, global strategist at Investec Asset Management says his company's emerging local bond fund has ballooned to \$3.5 billion from just \$100 million a year ago.

"When you talk to clients about diversifying into emerging bonds, it's like pushing an open door," Power says. "It's not a question of whether to hold EM in your portfolio, but how much."

The impetus for the boom is clear. Much of the tidal wave of liquidity unleashed by G3 nations' monetary and fiscal stimulus is flowing to where the returns are -- average yield on JP Morgan's local currency bond index is 6.3 percent versus 4.5 percent on emerging dollar bonds and a measly 2.3 percent earned on 10-year U.S. or German government bonds.

But what really is tipping the scales is the prospect of currency appreciation. For a Boston fund manager sitting on a pile of depreciating dollars, buying South African bonds makes a lot of sense, given the rand has strengthened 7 percent this year to the dollar, and is likely to rise further.

As global policymakers trade accusations of engaging in currency wars, the rally in the high-yield currency world continues -- from the Taiwan dollar to the Brazilian real, currencies are at multi-year highs versus the greenback.

"(Emerging) currencies look attractive when you have so many (developed) central banks explicitly or implicitly trying to weaken their currencies....The boom will continue as long as monetary policy at the Fed and Bank of Japan continues to be loose," says Kieran Curtis, fund manager at Aviva in London.

Power agrees, adding that 70 percent of the alpha generated by Investec's EM fund is due to FX moves and only 30 percent from yield differentials.

Returns on JP Morgan's local debt index are 17 percent, topping most mainstream asset classes. CAN IT CONTINUE?

JP Morgan, which owns the most widely-used GBI-EM and EMBI emerging debt indices, appears to think the move to local debt is part of a structural change in investment patterns.

The bank said in a note this week that assets indexed to the GBI-EM are growing faster than any other emerging bond class, posting a four-fold rise since 2007 to \$80 billion. In short, local currency debt is now almost a quarter of all indexed emerging bonds, up from under 10 percent just three years ago.

GBI-EM benchmarked assets could rise to \$235 billion over the next two to three years, JP Morgan added.

Fears of an asset bubble are premature, investors say. A key indicator is the EM debt-to-GDP ratio which is steady despite five percent-plus annual growth rates, showing bond issuance is also growing, Aviva's Curtis notes.

But there are headwinds. Positioning looks extreme for one while the liquidity explosion is bad news for future inflation. There are fears that U.S. quantitative easing may not happen after all. And there may be more capital controls -- Brazil for instance this week doubled its 2 percent levy on debt inflows.

"When capital has flowed in, the market will be vulnerable to capital outflows," said Sam Finkelstein, head of macro strategies at Goldman Sachs Asset Management.

But he adds: "I think the risk of extremely punitive capital controls is low. Many countries aspire to have their currencies used for global trade and by global reserve managers."

And despite a 2 percent tax on foreign portfolio inflows, average monthly flows to Brazilian bonds actually rose this year to \$2.4 billion from \$0.7 billion in 2009, analysts at Standard Chartered pointed out.

"The biggest risk that would have the largest effect would be a change in policy from the Fed and BOJ," Curtis said. "But it's not our base case scenario."

(Editing by Toby Chopra)

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ANALYSIS

Global Govt Debt Levels Are on 'Explosive path

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Bloomberg

Public debt in some of the world's largest economies is on an "explosive path" as ageing populations and the cost of fighting the financial crisis erode government finances, Standard and Poor's said yesterday.

Based on current fiscal policies, median net debt as a percentage of gross domestic product in 49 economies accounting for more than two-thirds of the world's population will rise to 245 per cent by 2050, the ratings company said in an e-mailed report in London. That compares with a 2007 forecast of 148 per cent.

Budget deficits and sovereign debt have ballooned worldwide after governments spent trillions of dollars in stimulus to revive growth. In Europe, mounting fiscal problems forced Greece to seek a European Union-led bailout in May, while Irish and Portuguese borrowing costs have soared on concern that they may also need aid.

S&P estimates that the current median debt level of the 49 countries in the survey, which includes most members of the European Union, as well as the US, China and Australia, is about 36 per cent of GDP.

As ageing populations drive up costs for pensions and other social services, increases in debt will likely lead to sovereign-rating downgrades unless governments change their fiscal policies, it said.

"Population ageing will lead to profound changes in economic growth prospects for countries around the world," S&P said in the report. "The erosion in sovereign ratings will start in 2015, when hypothetical ratings on a number of highly rated sovereigns come under pressure."

Spending pressure will push up government debt to about 750 per cent of economic output in Japan by 2050, around 590 per cent in the Netherlands and 510 per cent in Greece, S&P said. The average government deficit may climb from a current level of 4.5 per cent of GDP to more than 6 per cent by the mid-2020s based on current fiscal policies, it said.

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