Asian and Russia Markets

The objective of the chapter is to provide an understanding of capital markets in the following countries:

- China
- Hong Kong
- Indonesia
- Malaysia
- Singapore
- South Korea
- Taiwan
- Thailand
- Russia

Market Overview

- State of the market (post-crisis)
  - Increased restrictions on flows of foreign exchange.
  - Fixed rate and narrow band pegging of currencies to the U.S. dollar, yet there is continued weakness of currencies relative to the U.S. dollar.
  - Lack of recovery, growth, and development of the individual countries' stock and bond markets.
  - Limits on the percentage of foreign ownership of companies in certain industries.

Exchange Rates Between Asian and Russian Currencies and U.S. Dollar

Currency	Symbol	Exchange Rate in January 1997	Exchange Rate in January 2003
Chinese yuan	CNY	8.3260	8.2775
Hong Kong dollar	HKD	7.7397	7.7994
Indonesian rupiah	IDR	2369.30*	8750
Malaysian ringgit	MYR	2.4900	3.800.00
South Korea won	KRW	854.07	1176.45
Singapore dollar	SGD	1.4061	1.7363
Taiwan dollar	TWD	27.477	34.571
Thai baht	THB	25.726	42.773
Russian ruble	RUB	5.6088*	31.80

*Data for Indonesian rupiah and Russian ruble in January 1997 are from Oanda Corporation.

TABLE 20.1

Source: *Exchange Rates*, Federal Reserve Bank of St.Louis, 2003.

Asian and Russian Market Indexes

Country	Representative Stock Market Index
China	Shanghai Composite
Hong Kong	Hang Seng
Indonesia	Jakarta Composite
Malaysia	KLSE Composite
Singapore	Straits Times
South Korea	Seoul Composite
Russia	Moscow Times
Taiwan	Taiwan Weighted
Thailand	SET

TABLE 20.2

China

- Factors in market growth:
  - Change to central planning system to a mixed market economy encouraging private enterprise
  - Integration into the world economy as a member of the World Trade Organization by:
    - Lowering tariff and non-tariff barriers.
    - Allowing foreign firms into the Chinese banking, insurance, and telecommunications industries.
    - Protecting foreign intellectual property rights.
    - Removing local content requirements on foreign manufacturers.

Chinese Stock Markets

- Shanghai Stock Exchange (1990)
- Shenzhen Stock Exchange (1991)
- A-shares
  - Only Chinese residents may purchase A-shares, denominated in renminbi (Chinese currency).
- B-shares
  - Initially sold only foreign investors only, Chinese residents are now allowed purchase B-shares.
  - Are not convertible to A-shares.
  - Dividends are paid foreign currencies.

Foreign Exchange

- Exchange controls
  - China's renminbi (yuan) is its only legal tender.
  - The State Administration of Foreign Exchange (SAFE must approve all foreign loans.
  - Foreign-invested enterprises (FIEs) must use a designated foreign exchange bank and receive SAFE approval for all capital account transactions.
  - Removing funds from the country (repatriation) requires the SAFE's approval.
  - Foreign companies must submit an annual Foreign Exchange Examination Report.

Hong Kong Stock Market

- Hong Kong Stock Exchange (HKSE)
  - 815 companies are listed on the Main Board.
  - Offers Growth Enterprise Market (GEM)
    - Provide capital-raising for companies not meeting listing requirements of the Main Board.
  - Two-session trading
    - Uses opening quotation rule to set ask/offer bids.
  - Hong Kong does not require withholding on interest or dividends and does not impose a capital gains tax.

Hong Kong Futures Exchange

- Equity index products
  - Hang Seng Index Futures and Options
  - Mini-Hang Seng Index Futures
  - MSCI China Free Index futures
  - Dow Jones Industrial Average futures
- Equity products
  - Stock futures and options
  - International stock futures and options
- Interest rate products
  - HIBOR (Hong Kong Interbank Offered Rate)
  - Three-Year Exchange Fund Note futures

Hong Kong's Foreign Exchange

- Hong Kong Monetary Authority (HKMA)
  - Quasi-central bank that issues or redeems bank notes against U.S.dollars to maintain its peg.
- Exchange characteristics:
  - No foreign exchange controls: unrestricted cross-border remittances allow Hong Kong firms to freely move capital and repatriate profits.
  - No restrictions on the conversion and remittance of dividends and interest.
  - No distinction between local and foreign companies and few limitations on direct investments.

Indonesian Stock Market

- The Jakarta Stock Exchange (JSX)
  - Established in 1991 and privatized in July 1992.
  - 302 companies are listed on the exchange.
  - Block trading, odd lot trading, and cross trading occur in a negotiated market separate from the regular market.
  - Has two trading sessions per day.
  - Regulated by the Capital Market Executive Agency.

Indonesian Foreign Exchange Market

- Foreign Exchange
  - Bank Indonesia maintains the rupiah's stability.
  - Transfers of funds are not restricted, but capital inflows require government approval.
  - The Foreign Investment Law permits foreign investors to transfer home all current after-tax profits, certain costs, depreciation, and compensation.
  - Bank Indonesia must approve loans from abroad to state-owned companies and foreign-invested companies in advance.

The Malaysian Stock Market

- Kuala Lumpur Stock Exchange (KLSE)
  - Had 874 listed companies as of February 2003.
    - 563 on the Main Board, 296 on the Second Board, and 15 on the Mesdaq.
  - Malaysian Exchange of Securities Dealing and Automated Quotations (MESDAQ;)
    - Specializes in growth and technology companies.
  - No longer linked to the Singapore Stock Exchange.
  - Has a two-session trading day.

Singapore Stock Market

- Singapore Exchange (SGX)
  - A result of the merger of the Stock Exchange of Singapore (SES) and the Singapore International Monetary Exchange Limited (SIMEX).
  - More than 500 companies listed.
  - First fully electronic and floorless exchange in Asia.
  - Securities products traded include equity and equity options, warrants, bonds, and depositary receipts.
  - Has a single-session trading day.

Singapore Foreign Exchange

- Singapore imposes no restrictions on foreign exchange.
  - Companies can borrow and lend in all currencies
    - Allows for free flows of capital and cross-border transfers of the Singapore dollar and other currencies.
  - There are no restrictions on local borrowing by foreign firms, except that the funds must be used locally.
  - Financial institutions must consult with the Monetary Authority of Singapore before extending Singapore dollar credit facilities to nonresidents.

Korean Stock Market

- Korea Stock Exchange (KSE)
  - Has regular session and an off-hour session.
  - Has a daily price change limit and circuit breakers.
  - Kosdaq (OTC) provides a computerized competitive trading system for small- and medium-sized enterprises and high-tech companies.
    - Online trading is popular for Kosdaq stocks

Taiwan Stock Market

- Taiwan Stock Exchange (TSE)
  - 584 companies were listed on the exchange in 2001.
  - Uses a single-session trading day.
  - An over-the-counter market began operation in 1994.
  - Taiwan Futures Exchange began operations in 1997.

Foreign Exchange in Taiwan

- Exchange features
  - There are no restrictions on outward remittances for trade-related transactions (imports or exports of goods and services).
  - All dividends,profits,interest,and principal can be removed from the country without restrictions.
  - Taiwanese corporations may remit abroad up to US$50 million per year and US$1 million per transaction without authorization.
    - Larger amounts must be approved by the Central Bank of China (CBC),Taiwan's central bank.

Thailand Stock Market

- Securities Exchange of Thailand (SET)
  - Securities and Exchange Commission (SEC) is responsible for the supervision and regulation of the primary market while the secondary market remains the responsibility of the SET.
  - Use a two-session trading day.
  - Price limits for daily trading allow prices to fluctuate in a range of 30% from the previous closing price.
  - Brokerage commissions are not regulated.
  - Introduced an automated trading system in 1996.
  - Short selling is now permitted.

Thailand Foreign Exchange

- The official currency of Thailand is the baht.
- The government has eased foreign exchange controls significantly in recent years by:
  - Having no restrictions on the inflow and outflow of funds for equity investment.
  - Allowing foreign shareholdings up to 49% in companies, and 25% ownership of banks and finance and credit institutions.
  - Allowing capital, loans, dividends, and interest to be freely repatriated.

Russian Stock Market

- Russian Trading System (RTS)
  - RTS-1 and RTS-2
  - An interregional over-the-counter system
- Moscow Interbank Currency Exchange (MICEX)
  - Lists government, corporate, hard currency, and municipal bonds.
  - Provides advice about Russia's economy and financial conditions as well as trading tips and information about stocks.
  - Offers insurance against investment risks in case of settlement fails.

Russian Stock Market (cont'd)

- Moscow Central Stock Exchange (MCSE)
  - Established in June 1997.
  - Lists domestic securities.

Russian Bond Market

- Sovereign (government) Eurobonds
  - Russian (Soviet-era) debt
- Ministry of Finance (MinFin) bonds
  - U.S. dollar-denominated bonds with 3 % coupon
- Sovereign ruble bonds
  - GKOs (Gosudarstvenniye Kratkosrochiniye Obligatsii) are short-term zero-coupon bonds.
  - OFZs (Obligatsii Federalnogo Zaima) are medium-term floating-rate bonds.

Russian Bond Market (cont'd)

- London Club debt
  - Represents restructured debt owed to London Club of commercial creditors.
  - PRINs (principal arrears notes)
  - IANs (interest arrears notes)

Foreign Exchange

- The official currency of Russia is the ruble.
- Crucial foreign exchange issues:
  - Dollarization of the domestic economy
  - Capital flight
- Exchange restrictions:
  - Russian banks must maintain reserves of 50% against risk exposure to offshore banks.
  - A tax on purchases of hard currency, which applies to individuals as well as corporations.

Latin American Markets

The objective of this chapter is to provide an understanding of current economic conditions and capital markets in Latin America's three largest nations:

- Argentina
- Brazil
- Mexico

Market Overview

- Oil prices increased in the early 1970s causing OPEC countries to amass large Eurodollar accounts in Eurobanks.
- Eurobanks had to lend funds to generate income to pay interest on the Eurodollar deposits.
- Less-developed countries (LDCs) borrowed the funds to foster economic development and to pay for oil imports.
- High oil prices in late 1970s again caused both inflation and unemployment in industrialized nations.
- Interest rates rose and a global recession caused a decline in demand for the commodity exports of LDCs.
- LDCs instituted financial reforms and restructured their loans using Brady bonds and debt-for-equity swaps.

Debt-for-Equity Swap

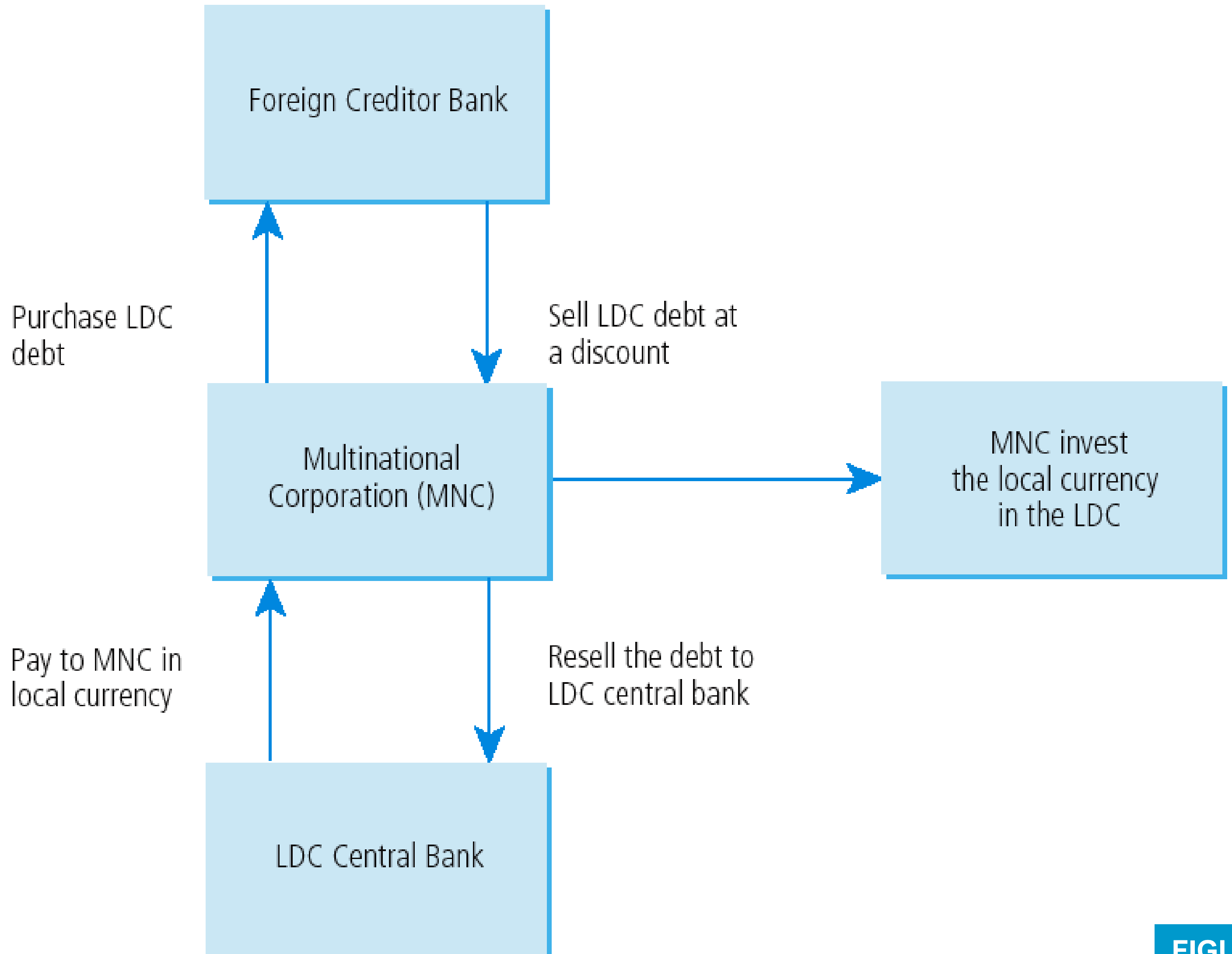

FIGURE 21.1

Currency Boards

- Currency board
  - A country sets its currency at par with another nation's currency such that interest rates will follow those of the country of the pegged currency.
  - **Advantage:** stabilization of the nation's currency by imposing discipline on its rate of money creation and keeping inflation low.
  - **Disadvantage:** the country is dependent on the policies of the country of the pegged currency.
  - **Disadvantage:** a country with a board can use only fiscal policy to influence its macroeconomy.

Dollarization

- Full dollarization
  - When a foreign currency has primary status as full legal tender, including government payments.
  - Any domestic currency plays only a secondary role..
- Semi-official dollarization
  - When a foreign currency is legal tender, but plays a secondary role to the domestic currency in paying wages, taxes, and everyday expenses.

Dollarization (cont'd)

- Benefits
  - Credibility the nation obtains.
  - Lower inflation
  - Faster growth
  - Deeper financial markets
  - Government budgetary discipline
  - Lower interest rates
- Disadvantages
  - Loss of the capability to implement an independent monetary policy
  - Loss of seigniorage from issuing currency.

Currency Board and Dollarization

Country	System Began	Currency System Based On
Currency Board		
Argentina	1991	U.S. dollar
Bermuda	1915	U.S. dollar
Brunei	1952	Singapore dollar
Bosnia	1997	Deutsche mark
Bulgaria	1997	Deutsche mark
Cayman Islands	1972	U.S.dollar
Djibouti	1949	U.S.dollar
Estonia	1992	Deutsche mark
Falkland Islands	1899	British pound
Faroe Islands	1940	Danish krone
Gibraltar	1927	British pound
Hong Kong	1983	U.S.dollar
Lithuania	1994	U.S.dollar

Sources: Z.Bogetic, "Official or full dollarization: Current experiences and issues," International Monetary Fund, 1999; S.H. Hanke and K.Schuler, "Currency boards for developing countries," working paper, 1999; J. Kahn, "U.S. and IMF welcome Salvador's adoption of dollar," *New York Times*, November 25, 2000.

TABLE 21.1a

Currency Board and Dollarization (cont'd)

Dollarization

Cook Islands	1995	New Zealand dollar
Cyprus,Northern	1974	Turkish lira
Greenland	Before 1800	Danish krone
Guam	1898	U.S.dollar
Kiribati	1943	Australian dollar,own coins
Liechtenstein	1921	Swiss franc
Marshall Islands	1944	U.S.dollar
Micronesia	1944	U.S.dollar
Monaco	1865	euro
Nauru	1914	Australian dollar
Northern Mariana Islands	1944	U.S.dollar
Palau	1944	U.S.dollar
Panama	1904	U.S.dollar
Puerto Rico	1899	U.S.dollar
Saint Helena	1834	British sterling
Salvador	2000	U.S.dollar
Samoa,American	1899	U.S.dollar
San Marino	1897	euro,own coins
Tuvalu	1892	Australian dollar,own coins
Vatican City	1929	euro,own coins
Virgin Islands,U.K.	1973	U.S.dollar
Virgin Islands,U.S.	1934	U.S.dollar

Sources: Z.Bogetic, "Official or full dollarization: Current experiences and issues," International Monetary Fund, 1999; S.H. Hanke and K.Schuler, "Currency boards for developing countries," working paper, 1999; J. Kahn, "U.S. and IMF welcome Salvador's adoption of dollar," *New York Times*, November 25, 2000.

TABLE 21.1b

Argentina

- Country characteristics
  - Population of 37 million
  - Per capita GDP of US$8,781 in 2001
  - Abundant fertile land and other natural resources
  - Politically and economically unstable
  - Suffered repeated economic setbacks from the spillover effects of the Mexican, Russian, and Brazilian crises.

Argentine Stock Market

- The Buenos Aires Stock Exchange (BASE)
  - The major stock market in Argentina was the first exchange in Latin America in 1854.
  - **Mercados de Valores:** a self-regulatory organization regulates brokers and brokerage firms.
  - **Cedears:** Argentine depositary receipts that represent shares or other securities of foreign companies in Argentina.

Brazil

- Country characteristics
  - Fifth largest country in the world with a population of more than 170 million.
  - Per capita GDP in 2001 was $2,923
  - Suffered from chronic inflation until the government adopted a new currency and a free-floating exchange rate.

Brazil's Per Capita GDP

Year	Per Capita GDP (U.S.dollars)
1990	3,180
1991	2,706
1992	2,544
1993	2,781
1994	3,464
1995	4,436
1996	4,809
1997	4,942
1998	4,755
1999	3,163
2000	3,493
2002	2,923

Source: Banco Central de Brazil.

TABLE 21.2

The Brazilian Stock Market

- Bolsa de Valores de Sao Paulo (Bovespa)
  - Has exclusive responsibility for stock transactions.
  - Has two daily trading sessions.
- National Trading Electronic System (Rio de Janeiro exchange)
  - Has responsibility for government bond transactions.
- Brazilian Clearing and Depository Corporation
  - Handles all clearing, settlement, and custody of trades executed in the cash, options, and forward markets.

Bovespa Settlement Summary

Date	Action
T+0	Trade date; last day for allocating trades among beneficial owners for options and forwards; last day for collaterizing positions in options and forward markets in other eligible assets different from cash.
T+1	Last day for trade allocation to the beneficial owner in the cash market; last day for providing cash collateral and margin requirements for options and forward markets.
T+2	Delivery of securities; at night,the Brazilian Clearing and Depository Corporation (CBLC) debits the shares from the seller's account and credits to the buyer's account. The securities remain blocked until the payment becomes final on T+3.
T+3	Last day for payment to CBLC; cash collateral charged to defaulters.
T+4	Last day for the clearing agent of the selling counterparty to provide for delivery, if securities have not been delivered on T+2.

Source: Sao Paulo Stock Exchange.

TABLE 21.3

Bovespa’s New Market Program

- **Only voting shares are listed.**
- **The company has a minimum free float of 25 percent of total capital.**
- **Any rights provided to majority shareholders in the event of the sale of the company will be extended to all shareholders.**
- **Financial statements adhere to U.S.generally accepted accounting principles (GAAP) or International Accounting Standards.**
- **The company must institute a lock-up period of six months before original shareholders can sell their shares.**
- **The company must give shareholders a minimum 15-day notice when it calls a shareholders’ meeting, instead of the 8 days required by Brazilian corporate law.**

Public and Private Debt in Brazil

Public Debt

Central bank bonds (Bonus do Banco Central, BBCs)	Discounted; 35- to 56-day maturity
Central bank notes (Notas do Banco Central, NBCs)	Issued as a monetary policy tool; 6- to 12-month maturity
National treasury bills (Letra do Tesouro Nacional, LTNs)	Discounted; 182-day maturity
National treasury notes Notas do Tesouro Nacional (NTNs)	Floating or fixed rate; 90-day to 12-month maturity
National treasury bonds (Bonus do Tesouro Nacional, BTNs)	Fixed rate; up to 25-year maturity
Privatization currency bonds.	Denominated in foreign currency and discounted. These are the restructured debt of a state-owned company. Investors receive company shares at redemption.

TABLE 21.4a

Public and Private Debt in Brazil (cont'd)

Private Debt	
Bank deposit certificates (CDBs)	Fixed or variable rate; minimum maturity of 30 days
Bank deposit receipts (RDBs)	Fixed or variable rate; minimum maturity of 120 days
Interbank certificates of deposits (CDIs)	Used as collateral for financial institutions' trading operations
Corporate debentures	Floating rate;maturity of at least 1 year
Eurobonds	Issued in foreign currencies outside Brazil

TABLE 21.4b

Mercosul

- Mercosul (Mercosur in Spanish)
  - A free trade association established by Brazil, Argentina, Paraguay, and Uruguay through the Treaty of Assuncion to eliminate tariffs and other trade barriers among members.
  - About 95 percent of all such trade is now tariff-free.
  - Chile was admitted as an associate member in 1996 and Bolivia in 1997.
  - Free trade agreements and preferential arrangements are under negotiation with other countries.

Mexico

- Country characteristics
  - Population of 101 million and a per capita GDP of $8,454 in 2001
  - Has suffered repeatedly from strong economic cycles and political crises.
  - Introduction of the Pecto program fostered macroeconomic stabilization.
  - The banking sector has been largely deregulated.
  - Restrictions on the convertibility of the peso into foreign exchange have been removed.

Mexican Stock Market

- Mexican Stock Exchange (Bolsa Mexicana de Valores, BMV)
  - Provides the infrastructure and services to handle the processes of issuing, offering, and trading securities.
  - All shares of Mexican companies must be registered.
    - Series A shares can be purchased only by Mexican nationals.
    - Series B shares may be owned by foreign investors.
    - Series C shares do not have voting rights.

The Mexican Fixed-Income Market

- Cetes
  - Bonds used to finance public spending and to control the amount of money circulating in the economy.
- Bondes
  - Federal government development bonds that are long-term debt securities issued to finance federal government projects.
- Udibonos
  - Investment unit bonds that are linked to inflation and backed by the Mexican federal government.

Foreign Exchange

- The Banco de Mexico floats the peso freely
  - Publishes a daily dollar–peso exchange rate (the interbank 24-hour sell rate).
  - Conducts monthly auctions of contracts for the right to sell a predetermined amount of dollars against pesos to the central bank.
  - Has no restrictions on domestic or foreign currency held locally by nonresidents.
  - Corporations, but not individuals, may have bank accounts in dollars.
  - No exchange controls on incoming equity capital.