The Asian debt default problem
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Asian balance sheets remain healthy and economic growth resilient despite the global credit crunch, but by one market measure, Asian bond issuers are an even worse risk than they were during the financial crisis a decade ago.

The credit problems that originated in the U.S. housing sector have led to much smaller asset write-downs in Asia than in Europe and the United States, yet the cost of insuring against Asian debt defaults, as measured by credit default swaps, has reached record high levels.

"Asian borrowers are asking: 'What's subprime? Why do I care? What's going on in New Jersey shouldn't impact the strength of my balance sheet,' " Fergus Edwards of UBS said.

One big problem, analysts say, is the relative lack of liquidity in Asian debt, compared with that in more developed European or U.S. markets, although hard data are hard to find in the opaque, over-the-counter credit default swaps market.

According to one default swap trader, global investors, when offered a choice between similarly rated issues, will more often than not plump for U.S. or European bonds over Asian debt because those are easier to sell quickly if the need arises. "Fundamentals-wise, Asia is definitely stronger than the U.S. or Europe," said the trader, who spoke anonymously because he was not authorized to speak to reporters. "But people still prefer to be in European or U.S. names because they are much bigger. Market liquidity is bigger and volumes are larger."

That helps explain why levels of Asian credit default swaps - which are priced in terms of percentage points above the London interbank offered rate - are well above the levels seen elsewhere in the world. The levels are also above those at the time of the Asian financial crisis, making it prohibitively costly for Asian issuers to raise money from overseas borrowers.

Any recovery in the region's credit markets depends on an easing in a global liquidity crunch in which Asia has played little part, compounding the frustration felt by investors.

Asian bankers said that clients were complaining about having to pay for U.S. problems.

"Asia is still strong," said the head of Asian debt capital markets for a major U.S. investment bank, who asked not to be identified discussing conversations with clients. "Credits are improving, economies are improving, balance sheets are improving, therefore borrowing costs should be improving."

The iTraxx Asia high-yield index excluding Japan, which tracks the cost of insuring against the default of 20 noninvestment-grade names like Hynix Semiconductor in South Korea, hit a record at about 6.60 percentage points last week.

That means that insuring $10 million in the underlying debt over five years would cost an investor about $660,000, more than triple the $210,000 paid in mid-October, when bond spreads started to shoot up as a result of the crisis.

In comparison, the iTraxx crossover index, which measures 50 similar "junk"-rated credits in Europe, hit about 5.80 percentage points last week.

Put another way, the iTraxx index for Asia is implying a five-year default probability of at least 30 percent, according to some calculations, or that more than six names will default in that period.

Many see no sense in that.

According to Standard & Poor's Ratings Services, none of the 12 defaults seen so far this year has come from Asia. Furthermore, Asia has seen only one rated issuer default in each of the

previous three years, and of the 114 rated issuers the agency sees at risk of defaulting, only three are Asian - G Steel and the paper producer Advance Agro from Thailand, and the Nasdaq-listed semiconductor firm ASAT Holdings from Hong Kong.

"It's a very difficult time for investors," said Clifford Lau at Pramerica Investment Management in Singapore. "The problem is that we are not trading at individual credit fundamentals. It's frustrating."

"There is a lot of value in the Asian fixed income market already, but there are so many uncertainties out there making investors only look to sell their bonds rather than pick up risk at the moment," Lau said.

With no end in sight for the global financial crisis, analysts say it will be difficult for Asian markets to recover on their own, even if economic growth in the region is expected to outperform that in Europe and the United States.

"We are not that exposed to subprime-related risk, but we are talking about global risk reduction, and no region or asset class is being spared," Lau said.

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