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Adviser: India Recognizes Need for Corporate Bonds

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By NATASHA BRERETON-FUKUI

SINGAPORE -- The Indian government recognizes the need to develop the country's corporate bond market, and it could move faster than China in taking such steps, an adviser to India's finance minister said in an interview.

Eswar Prasad, a former International Monetary Fund official, noted that a more developed corporate bond market would make it easier to absorb capital flows, instill more competition in the banking sector, and provide a less-volatile alternative to equities for overseas investors.

While there are powerful reasons to make such reforms, Mr. Prasad said there had been reluctance from the central bank to move forward aggressively, and turf battles among regulators over who will take primary supervisory roles.

"There is a very strong incentive in India right now to push forward the corporate bond market developments, so you can re-attract foreign investors," Mr. Prasad said, highlighting appetite for infrastructure financing.

"Given that India has a greater need for financing [than China], especially with the sort of current-account deficit it's running, maybe we'll see more action in India." He said he expected India's current-account deficit to exceed 4% this year.

The Reserve Bank of India is currently seeking feedback on proposals from a central-bank working group on how to create a more liquid and developed debt market.

Three people familiar with the matter said Thursday that China was considering relaxing restrictions on short-term bond issuance by some companies.

Under Chinese law, a company's outstanding bonds can't exceed 40% of the value of its net assets. But in practice, regulators allow triple-A rated state-owned companies to go beyond this limit when calculating bond-to-net-asset ratios by excluding bill offerings with maturities of a year or less.

China is considering permitting all firms with at least double-A ratings to enjoy that exception, the people said.

Mr. Prasad, who previously led IMF missions to China, said China--like India--faces regulatory hurdles, from the perspective of whether it has the capacity to deal with a vibrant corporate bond market. There is also resistance from banks, who see bond market development as a threat to their privileged position in the Chinese economy, he said.

He tipped Beijing to allow big, mostly state-run institutional investors to play a greater role in the market, while continuing to restrict issuance to major state-owned companies, enabling the authorities to keep some control.

In India, private-sector banks are likely to be expected to take on a greater role than at present, Mr. Prasad said.

While such steps are important, both countries have much more to do to improve their banking systems, he said.

"I think corporatizing the public banking system [so it behaves more based on profit objectives] is a big priority in India, and getting risk management and corporate governance improved is a big priority in China," Mr. Prasad said.

—Wang Ming and Khushita Vasant contributed to this article.

Write to Natasha Brereton-Fukui at natasha.brereton@dowjones.com