

# Local currency bond markets and financial stability

Conference on Global Financial Governance  
– Challenges and Regional Responses -  
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# Overview

**I. G8 Initiative on Local Currency Bond Markets in EMEs**

**II. Development of local currency bond markets**

**III. How have bond markets weathered the storm?**

**IV. Recommendations**

I.

**G8 Initiative on developing local currency bond markets  
in EMEs and developing countries**

# Initiative on developing local currency bond markets in EMEs and developing countries

## Background

- Financial stability concerns
  - In particular currency and maturity mismatches
  - Increasing global capital flows
  - Diversifying financial systems
  
- Economic growth
  - Long-term capital for economic growth
  
- Financial crisis has underlined the necessity to complete markets

## Benefits of developed domestic bond markets

- **Enables reduction of currency and maturity mismatches**
- **Diversified financial system – better absorption of external shocks**
- **Can serve as „spare tyre“ during the crisis**
- **Less volatility of capital flows**
- **Support management of capital account liberalisation**
- **Provide a „platform“ for fiscal and monetary authorities for stabilising measures during the crisis**

## Three „corner stones“ of G8 Initiative

- **G8 Action Plan**
- **Implementation Report**
- **Annual progress reports**

## G8 Action Plan on Developing Local Bond Markets in EMEs and Developing Countries

- ***Main objectives: Deepening local bond markets; furthering the development of corporate bond markets***
- ***Key recommendations:***
  - Strengthening market infrastructure and public debt management
  - Broadening and diversifying the investor base
  - Developing derivatives and swap markets
  - Broadening the investor base
  - Promoting regional cooperation
  - Developing bond markets in less developed countries, particular Sub-Saharan African Countries
  - Technical assistance

## Implementation Report

- **Cooperation with emerging market economies and developing countries**
- **Public and private sector of these country groups are invited to participate in every stage of implementation**
- **IMF and World Bank are asked to regularly report on the progress of the implementation**
- **Reports should be presented at yearly intervals**
- **G8 Finance Ministers will discuss these reports, if necessary**
- **IMF and World Bank will publish these reports**

# Implementation Report

- **Future work programmes of other relevant international institutions, countries and market participants should be included**
- **IMF and World Bank could organize international conferences to enhance transparency on international work programmes**
- **Therefore: This initiative is a world wide initiative with a high degree of consensus ...**
- **... which enable countries with different stages of development to participate and to cooperate**

# Progress Report

- **First Progress Report by International Monetary Fund, World Bank and Deutsche Bundesbank**

- ***Reflecting***

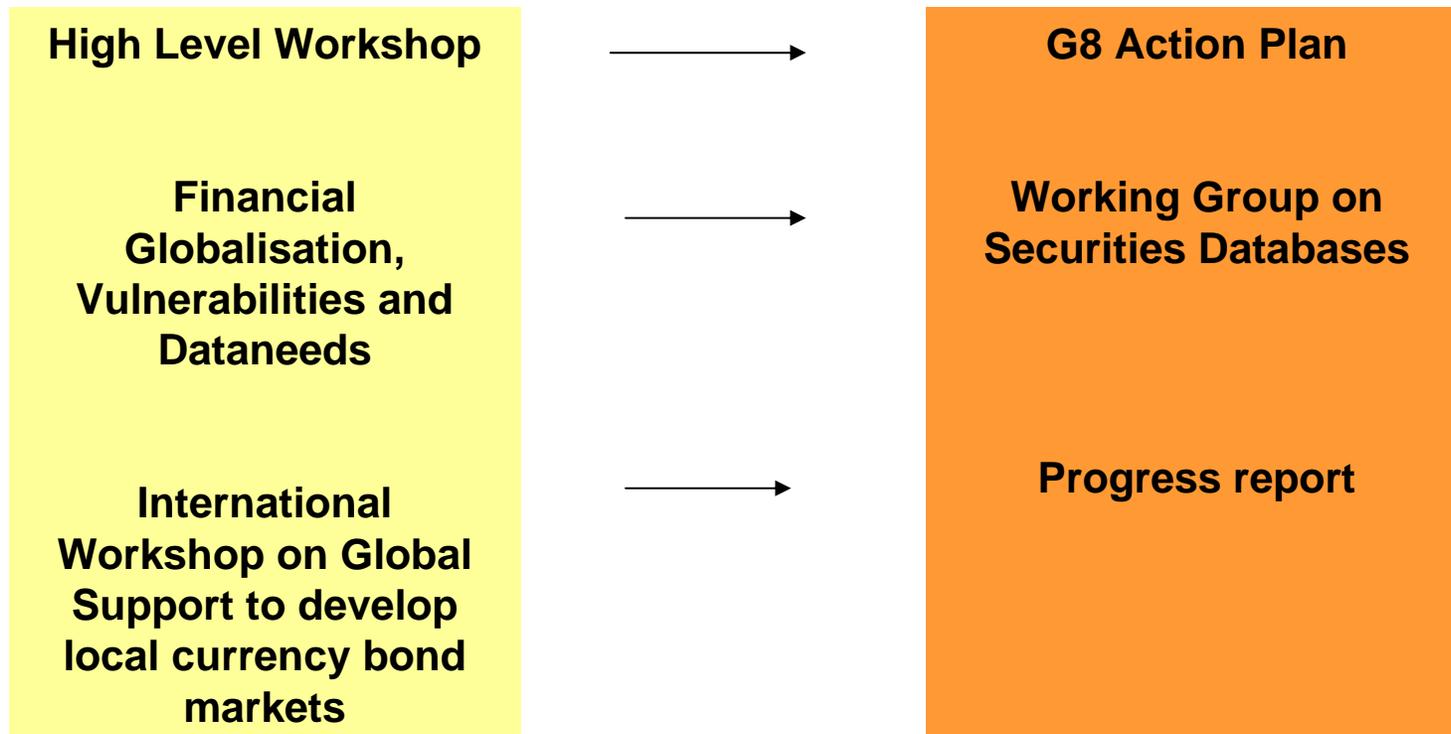
Main outcomes of the Joint BBK –IMF-World Bank International Workshop on "Implementing G8 Action Plan - Global support to develop local bond markets in emerging market economies and developing countries" (September 2008)

Results of a world wide survey to enhance transparency on global support to develop local currency bond markets in EMEs and developing countries

# Role of Deutsche Bundesbank

- **High level workshop (May 2007) on Developing local bond markets in Emerging Market Economies and Developing Countries, co-hosted with German Federal Ministry of Finance**
  - Results have contributed to G8 Action Plan
  - [http://www.bundesbank.de/vfz/vfz\\_konferenzen\\_2007.en.php#high](http://www.bundesbank.de/vfz/vfz_konferenzen_2007.en.php#high)
- **Conference on Financial Globalisation, Vulnerabilities and Dataneeds (January 2008), co-hosted with German Federal Ministry of Finance**
  - Results have contributed to the Future Work Programme for broadening the database
  - And in particular for the reconvened Working Group in Securities Databases
  - [http://www.bundesbank.de/presse/presse\\_aktuell.en.php](http://www.bundesbank.de/presse/presse_aktuell.en.php)
- **Joint BBK –IMF-World Bank International Workshop on "Implementing G8 Action Plan - Global support to develop local bond markets in emerging market economies and developing countries" (September 2008)**
  - Results have contributed to the first progress report of IMF and World Bank

## Results contributed to



## Next steps: Further joint BBK-IMF- World Bank Workshop in Frankfurt

### 2nd Joint BBK – IMF – World Bank International Workshop on “Implementing G8 Action Plan – Lessons From the crisis and progress made “ in Frankfurt am Main, 12 and 13 November 2009

- Results will support the drafting of the second progress report
- What are the responses of donor and relevant institutions to the financial crisis?
- Lessons to be drawn from the financial crisis for developing domestic bond markets in different country groups?
- Again world wide survey

## II.

### Local Currency Bond Markets in EME and African Countries

# Increasing weight of financial systems of EMEs

## Relative Weight of EME Capital Markets in 2007

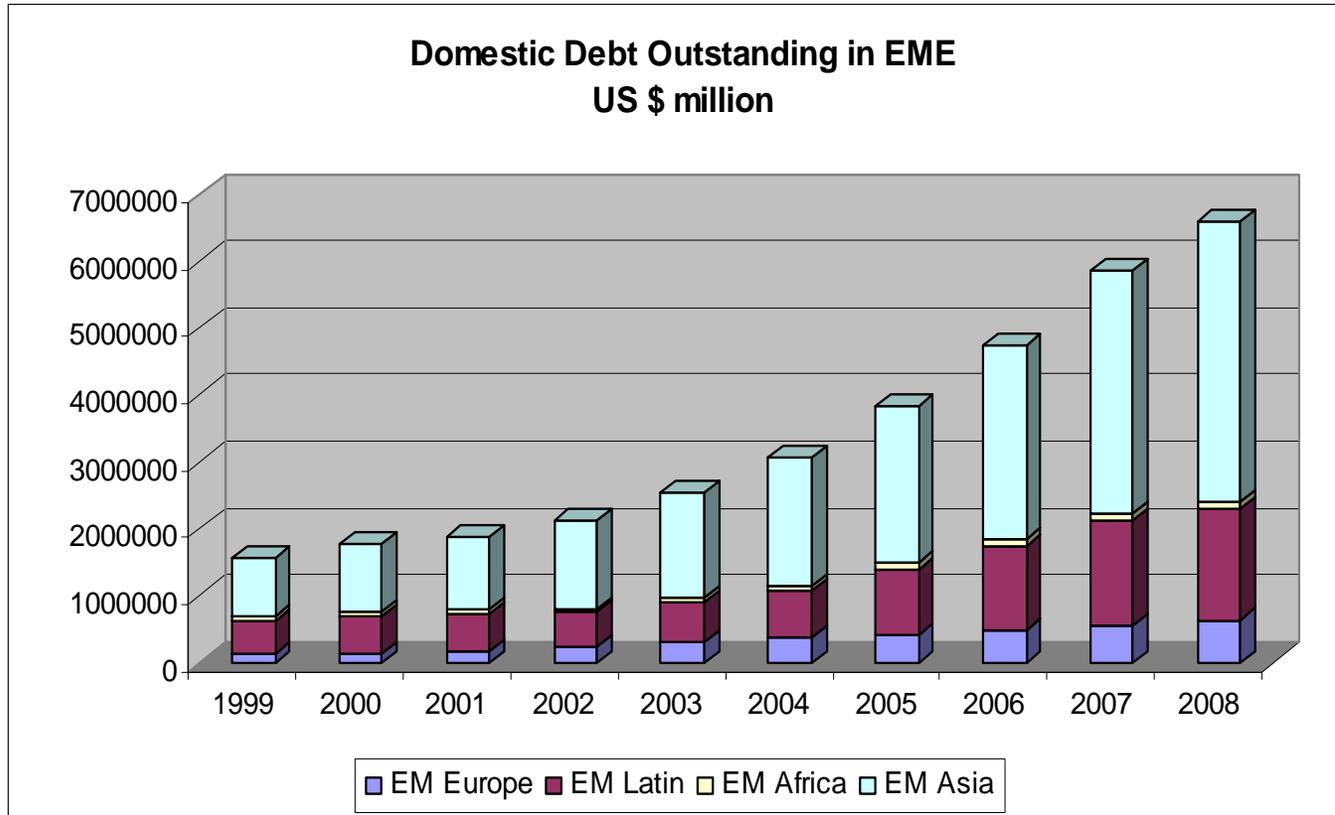
billions of \$

	GDP	Stock Markets	Debt Securities	Bank Assets	Capital Markets
World	54539	65106	79822	84785	229712
Euro Area	12202	10040	23024	30137	63461
United States	13808	19922	29879	11194	60996
Japan	4382	4664	9218	7839	21721
Emerging Markets	17278	20950	7820	15004	43774
Africa	1095	1182	166	646	1994

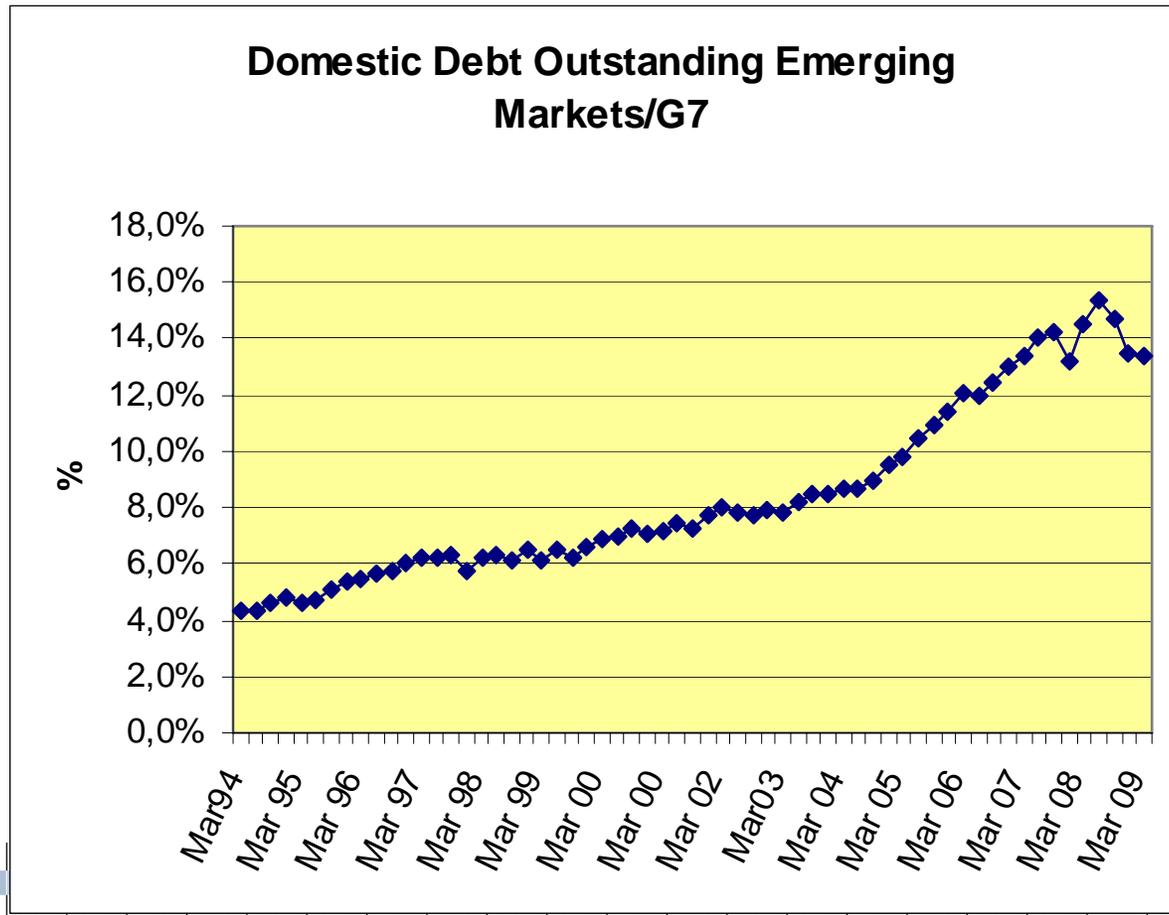
## in % of World

Euro Area	22,4%	15,4%	28,8%	35,5%	27,6%
United States	25,3%	30,6%	37,4%	13,2%	26,6%
Japan	8,0%	7,2%	11,5%	9,2%	9,5%
Emerging Markets	31,7%	32,2%	9,8%	17,7%	<b>19,1%</b>
Africa	2,0%	1,8%	0,2%	0,8%	0,9%
Africa in % of EME	6,3%	5,6%	2,1%	4,3%	4,6%

# ... and dynamic growth of domestic bond markets



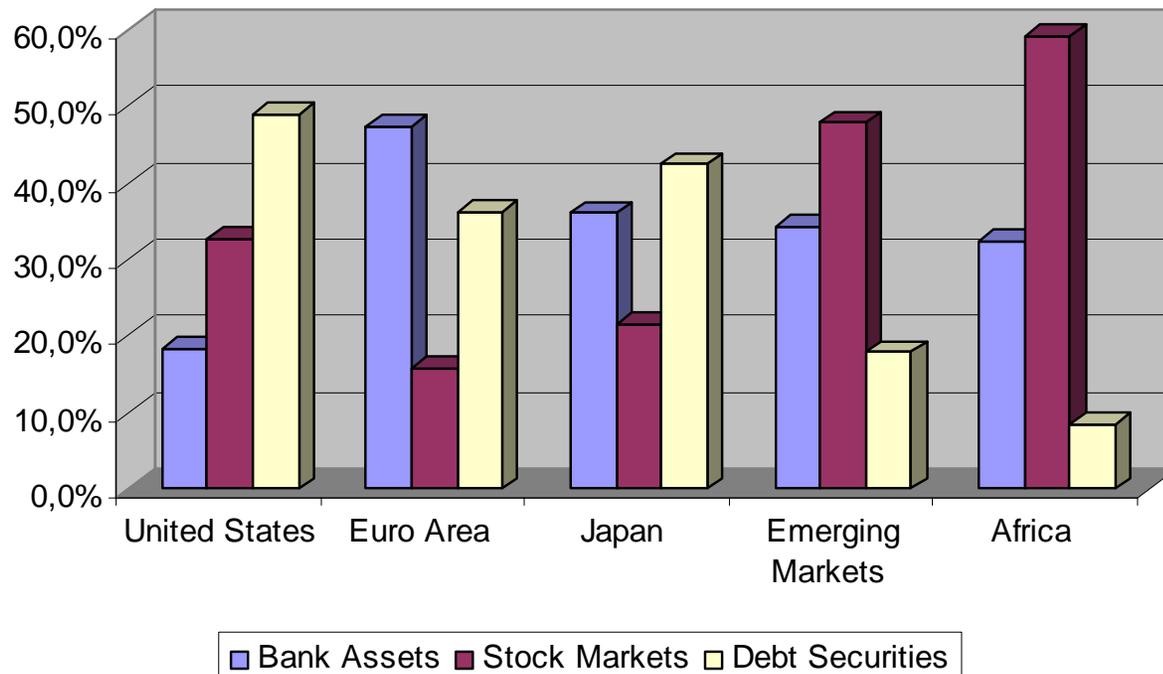
... also compared with G7 bond markets



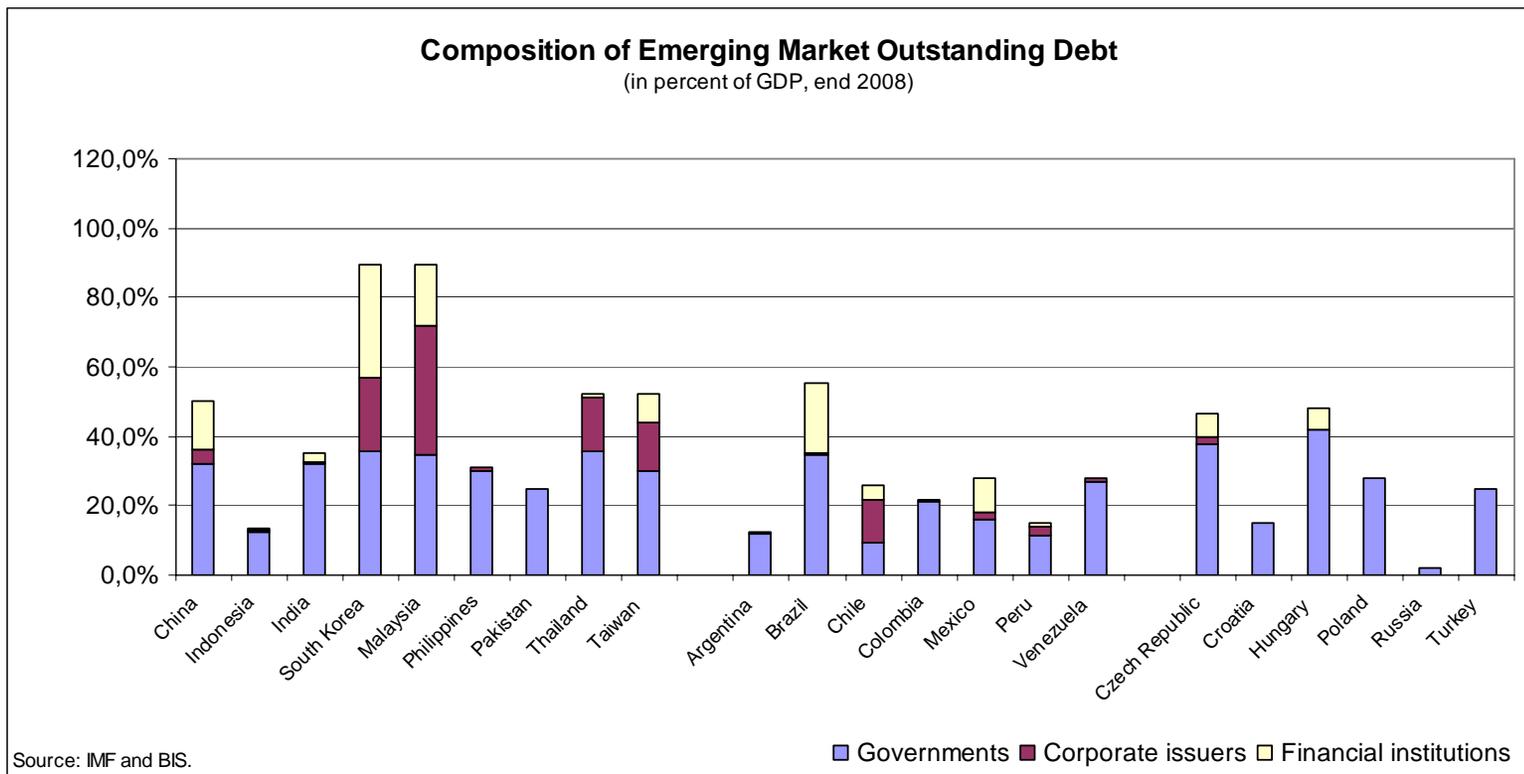
## ... but debt securities remain underdeveloped

<i>in % of GDP</i>	<b>Bank Assets</b>	<b>Stock Markets</b>	<b>Debt Securities</b>	<b>Capital Markets</b>
Euro Area	247%	82%	189%	520%
United States	81%	144%	216%	442%
Japan	179%	106%	210%	496%
Emerging Markets	87%	121%	45%	253%
Africa	59%	108%	15%	182%

**Structure of Financial System in EME 2007**  
*in % of capital markets*



# In particular, corporate bond markets are underdeveloped or non-existent



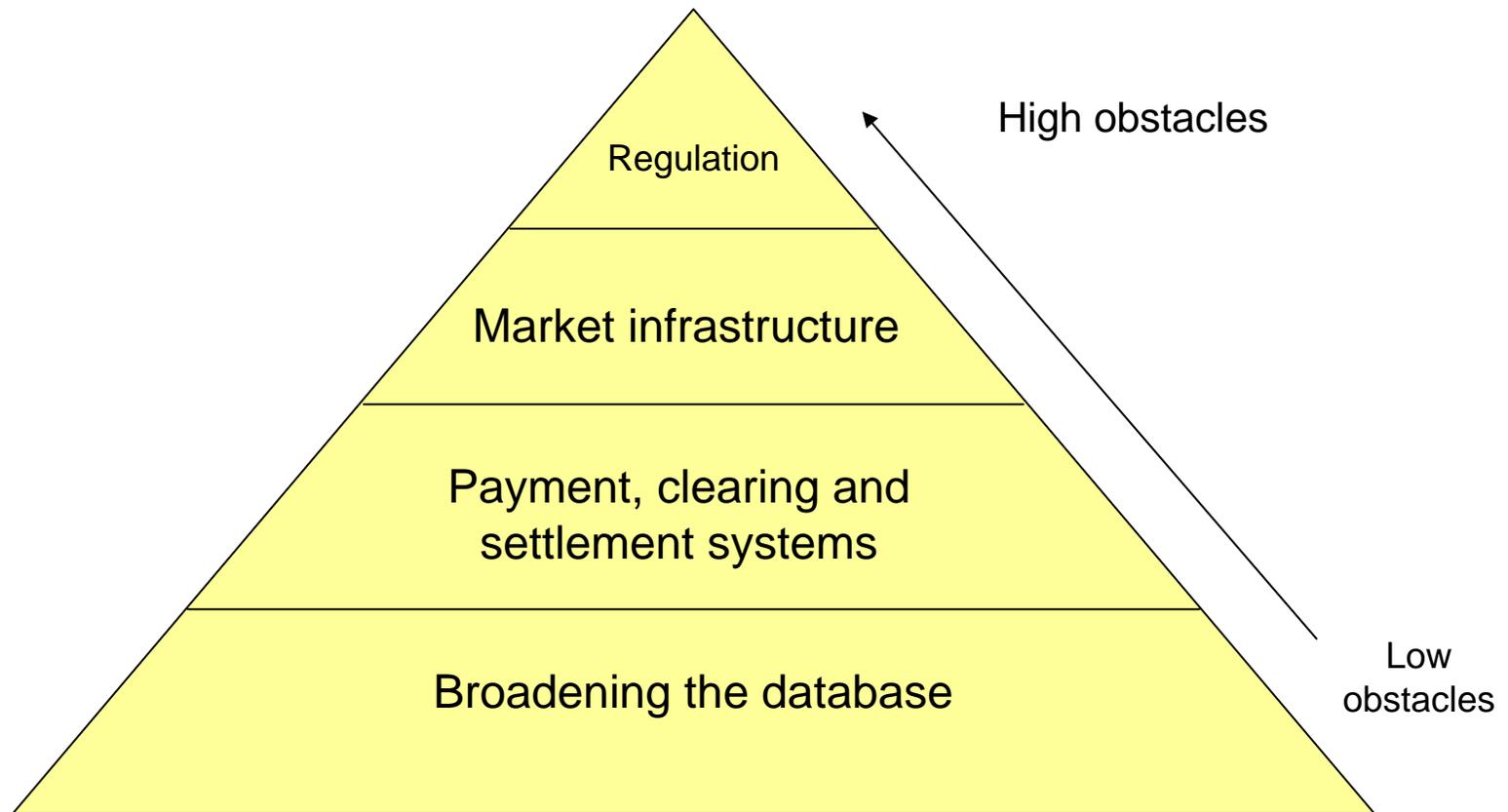
## Regional initiatives

### Asian Bond Market Initiative

- ABMI initiative by the Asian+3 – aims to diversify and increase the size of local bond markets
- Asian Bond Fund – investment scheme – developed by EMEAP for investing in sovereign and quasi-sovereign bonds
- Low entry threshold for investors and alternatives
- Removal of cross-border regulatory impediments
- Removal of tax barriers
- Medium term road map - developed by ADB together with Asean+3

- **Cooperation between AfDB and World Bank on ESMID Programme**
- **MFW4A – inter alia coordinating donor activities , enhances transparency on African Financial Market Development**
- **Enhanced regional cooperation in the Franc Zone**

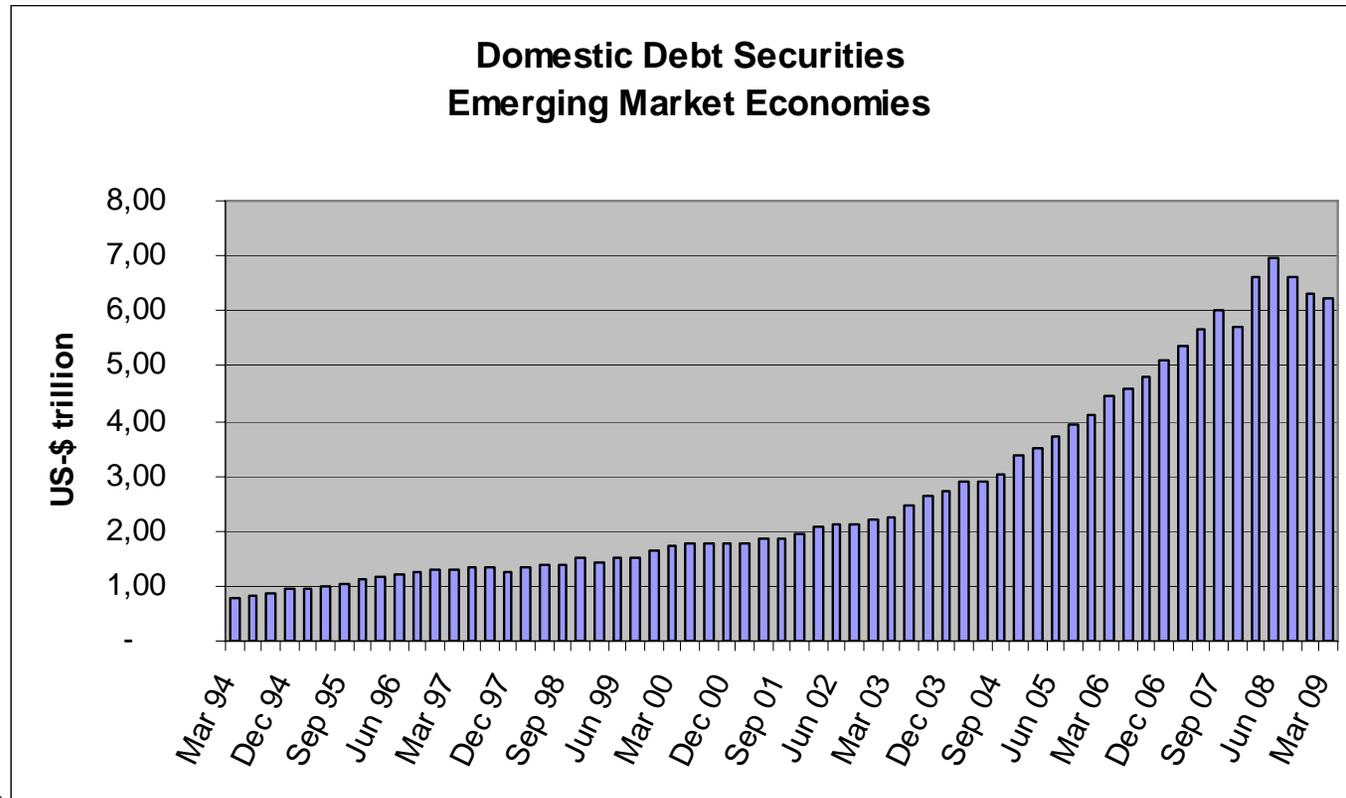
# Obstacles for furthering regional cooperation



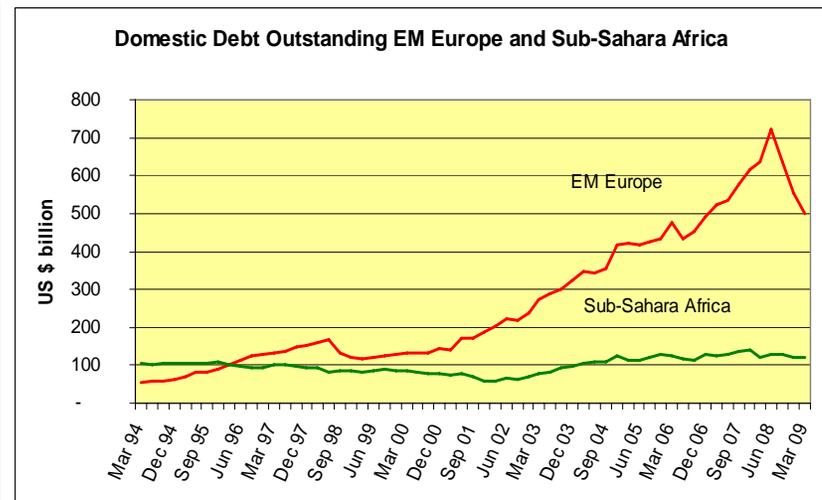
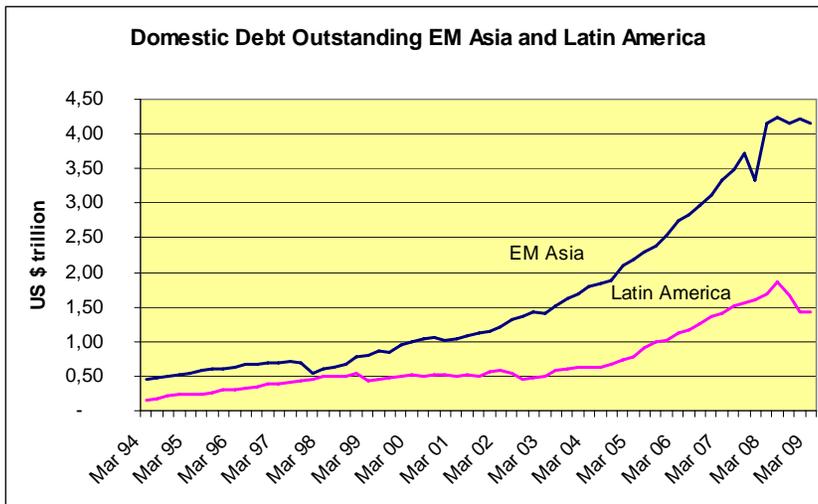
### III.

**How have local currency bond markets weathered the storm?**

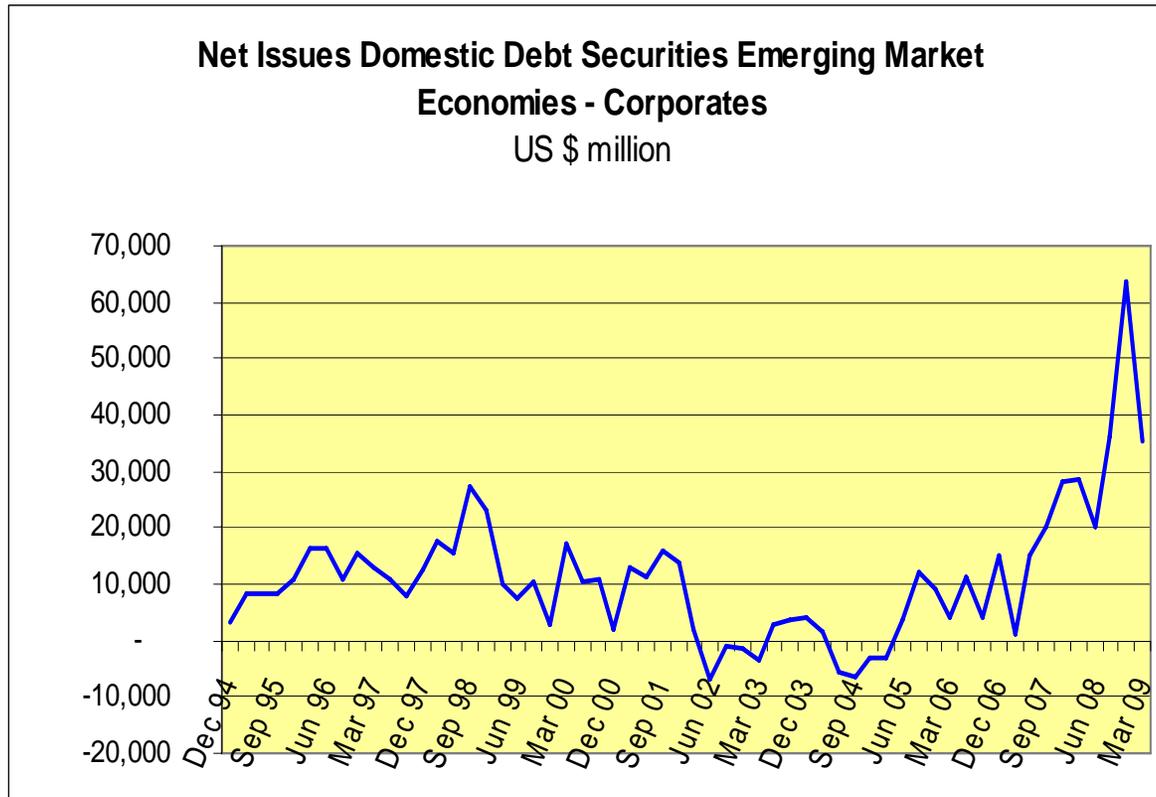
# Outstanding volume of domestic debt securities on high levels even during the crisis



# ... in particular in EM Asia and EM Latin America

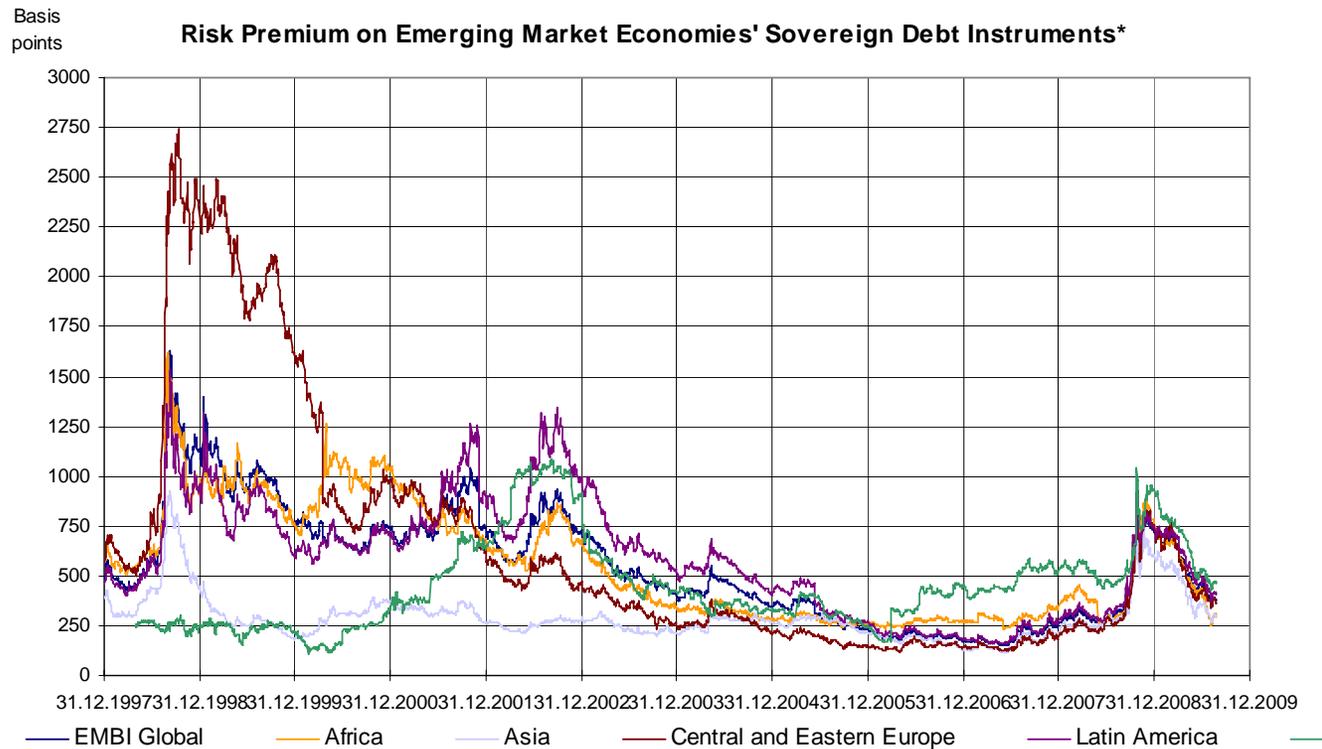


# ... net issues of corporate bond increased



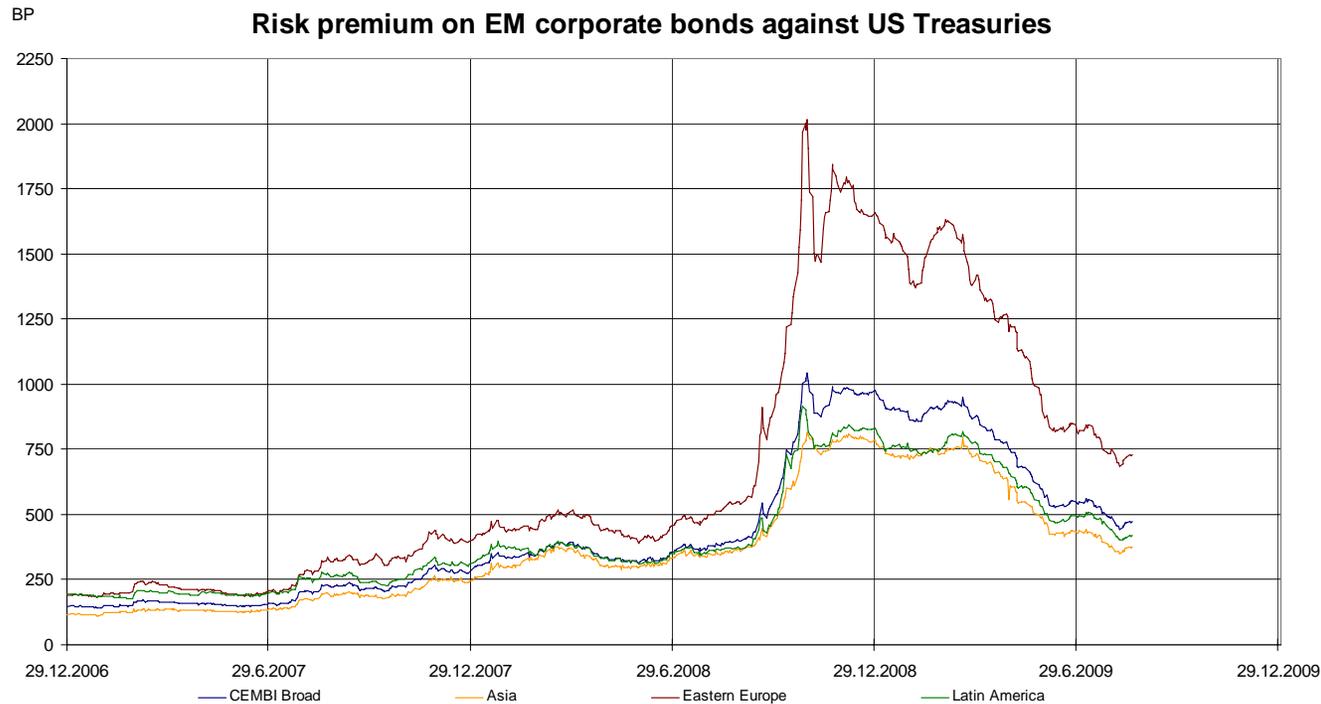
- In some countries ... there was continued issuance of local bonds.
- This is consistent with the view that local capital markets may have to some extent acted as „spare tyre“ during the crisis ...
- reducing vulnerabilities to declines in international bond markets.
- *„... while local currency bond markets could play a „spare tyre“ role and effectively substitute for foreign currency financing, in Latin America more work is needed to deepen these markets and to develop a liquid and diversified investor and issuer base.“*
- *„Financing problems in the corporate sector also indicate that the development of corporate bond markets remains a priority.“ (BIS, Quarterly Review, June 2009, p 66)*

# Spreads indicate stabilisation, near pre-crisis levels



Source: JP Morgan. — \* JP Morgan Emerging Market Bond Index; includes bank loans, Brady bonds and international bonds; spreads over US Treasuries.

# Spreads indicate stabilisation, near pre-crisis levels



Quelle: JP Morgan. \*JP Morgan Corporate Emerging Markets Bond Index (CEMBI); contains corporate bonds and bonds of financial institutions.

*In 2009, LCY bond issuance is expected to rise: (i) several governments use LCY bonds to help finance stimulus packages; (ii) government LCY bond sales will likely hold up on demand for safe-haven assets; and (iii) companies increasingly turn to LCY markets for refinancing and raising new funds.*

## IV. Recommendations

## Recommendations

### Local bond markets in the context of financial globalisation

- **Enhance research on global financial transmission mechanism**
  - Global factors are of increasing importance as determinants of national spread levels and variance; 50 % of spread variance in EME is influenced by global factors
  - a single common factor is able to explain a large part of the co-variation in emerging market economies' (EMEs) spreads observed in the last 4 years”
  - 80% to 90% of rating changes in EME are determined by two or three global factors
  - What matters more: global financial factors or national fundamentals for national financial markets development?

## Recommendations

### Local bond markets in the context of financial globalisation

- **Rebalancing effects and portfolio strategies of global players of increasing importance for global financial and real cycles**
  - Little differentiation between asset classes and country risks
  - One of the main explanations of why even countries with
    - a stable macroeconomic framework
    - stronger regulation and
    - an efficient market infrastructure
  - ... have been severely affected by this financial crisis
- **Enhance analysis on institutional investors and globally operating banks behaviour and cross border linkages**

## Recommendations

- **In-depth analysis of changing interdependence between financial and real sphere**
- **Is there a need to enhance international collaboration in research?**
  - Global, regional and national information
- **Have financial crisis changed necessities or priorities of regional cooperation?**

## Recommendations

- **Secure, that implementation of recommendations keep on track, build in mechanisms, which assure long-term political support**
- **Secure a high grade of international transparency, where international cooperation is necessary or desirable**
- **Consider different stages of development of countries or country groups**
- **A well balanced solution of global and national measures for furthering financial stability is necessary**