

### 3. The international debt securities market

Gross issuance of bonds and notes in international debt securities markets increased by 24% in the first quarter of 2006, to \$1,221 billion (Table 3.1). This represented a historical peak, suggesting that access to international credit markets remained easy for borrowers and that financing conditions continued to be favourable. Important contributors to this growth during the first quarter were, from a geographical point of view, US entities and, from a sectoral perspective, corporate issuers. Although still small in comparison with other major industrialised economies, gross issuance by Japanese entities picked up markedly in the first quarter, reaching a level close to the previous historical peak. Gross issuance in emerging markets continued to grow at a brisk pace, increasing by 19% in the first quarter, as emerging market borrowers took advantage of persistently narrowing spreads.

Global net issuance of bonds and notes rose by 9% in the first quarter, to \$622 billion, the highest level ever recorded (Table 3.2). On an annual basis, the increase was 25% globally, with the United States and emerging markets posting particularly strong year-on-year growth rates of 126% and 45% respectively. Net issuance of bonds and notes also grew markedly among Japanese borrowers, totalling \$10.7 billion in the first quarter – more than the total combined amount during the previous six quarters. Euro area net issuance grew by a more modest 4%. However, this still implied a very high level of activity, given that the last quarter of 2005 had been a strong one.

#### Strong US issuance

Brisk pace of US issuance as financing conditions remain favourable

Despite an unusually busy fourth quarter among US borrowers (see the March 2006 *BIS Quarterly Review*), the first quarter of 2006 displayed a 34% increase in US gross issuance of international bonds and notes, bringing it to a level of \$327 billion. Net issuance also surged, by 25% to \$144 billion. These growth rates were high even after seasonal adjustment. Contributing to the strong activity may have been a desire among borrowers to lock in comparably cheap finance ahead of expected increases in interest rates, in an environment where global liquidity remained abundant.

The agencies remain important players in the US market

As in recent periods, the agencies played a dominant role among US issuers of international bonds and notes, accounting for 28% of US gross borrowing. However, in contrast to the recent past, there was no sharp

| Gross issuance in the international bond and note markets |                |                |              |              |              |              |              |
|---|----------------|----------------|--------------|--------------|--------------|--------------|--------------|
| In billions of US dollars                                 |                |                |              |              |              |              |              |
|   | 2004           | 2005           | 2005         |              |              |              | 2006         |
|   | Year           | Year           | Q1           | Q2           | Q3           | Q4           | Q1           |
| Total announced issues                                    | 3,289.0        | 3,839.4        | 1,077.3      | 978.7        | 798.0        | 985.5        | 1,220.8      |
| Bonds   | 1,779.5        | 2,045.4        | 596.6        | 516.7        | 434.1        | 498.1        | 704.8        |
| Notes   | 1,509.5        | 1,794.0        | 480.7        | 462.0        | 363.9        | 487.4        | 516.0        |
| Floating rate   | 1,248.9        | 1,465.2        | 335.2        | 411.8        | 273.5        | 444.6        | 444.1        |
| Straight fixed rate                                       | 1,982.8        | 2,331.6        | 725.5        | 560.4        | 518.0        | 527.7        | 759.8        |
| Equity-related <sup>1</sup>                               | 57.3           | 42.7           | 16.5         | 6.5          | 6.5          | 13.1         | 16.8         |
| US dollar   | 1,146.1        | 1,318.1        | 315.5        | 300.2        | 328.7        | 373.8        | 455.1        |
| Euro  | 1,595.7        | 1,838.3        | 568.9        | 533.7        | 307.1        | 428.5        | 567.4        |
| Yen   | 111.2          | 114.6          | 30.6         | 27.0         | 30.7         | 26.3         | 24.6         |
| Other currencies  | 436.0          | 568.5          | 162.3        | 117.9        | 131.5        | 156.8        | 173.7        |
| Developed countries                                       | 3,001.5        | 3,453.5        | 954.5        | 888.1        | 708.5        | 902.5        | 1,117.8      |
| United States   | 772.4          | 836.7          | 214.6        | 169.1        | 209.1        | 243.9        | 327.0        |
| Euro area   | 1,471.6        | 1,796.7        | 534.6        | 520.4        | 297.7        | 444.0        | 544.9        |
| Japan   | 62.0           | 53.7           | 13.8         | 12.4         | 17.2         | 10.3         | 23.9         |
| Offshore centres  | 38.7           | 50.2           | 11.2         | 13.3         | 12.6         | 13.0         | 10.2         |
| Emerging markets  | 151.7          | 229.8          | 83.3         | 49.1         | 47.2         | 50.2         | 59.6         |
| Financial institutions                                    | 2,678.4        | 3,176.9        | 842.1        | 814.6        | 684.0        | 836.1        | 978.6        |
| Private   | 2,273.6        | 2,748.8        | 696.6        | 682.2        | 612.5        | 757.6        | 865.0        |
| Public  | 404.8          | 428.0          | 145.5        | 132.5        | 71.6         | 78.5         | 113.6        |
| Corporate issuers   | 269.8          | 233.5          | 51.9         | 56.6         | 48.2         | 76.8         | 117.6        |
| Private   | 232.6          | 203.1          | 48.5         | 44.2         | 40.2         | 70.1         | 113.6        |
| Public  | 37.1           | 30.4           | 3.4          | 12.4         | 7.9          | 6.6          | 4.0          |
| Governments   | 243.8          | 323.2          | 155.0        | 79.3         | 36.1         | 52.8         | 91.4         |
| International organisations                               | 97.0           | 106.0          | 28.3         | 28.2         | 29.7         | 19.8         | 33.1         |
| Completed issues  | 3,292.6        | 3,826.1        | 1,017.0      | 1,021.2      | 775.5        | 1,012.3      | 1,148.6      |
| <i>Memo: Repayments</i>                                   | <i>1,747.2</i> | <i>2,005.6</i> | <i>521.3</i> | <i>512.6</i> | <i>531.4</i> | <i>440.3</i> | <i>526.4</i> |

<sup>1</sup> Convertible bonds and bonds with equity warrants.  
Sources: Dealogic; Euroclear; ISMA; Thomson Financial Securities Data; BIS.

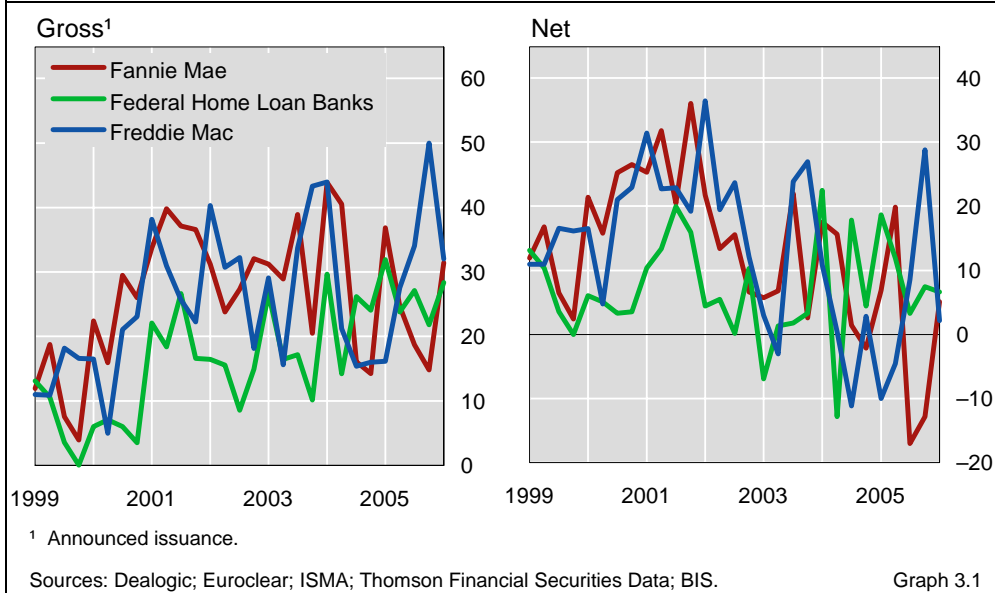
Table 3.1

divergence across the agencies: Freddie Mac issued international bonds and notes worth \$32 billion, while for Fannie Mae the amount totalled \$31 billion (Graph 3.1). Albeit similar in dollar terms, these figures implied a 36% drop for Freddie Mac but a 112% increase for Fannie Mae compared to the previous quarter. A similar pattern was evident in terms of net issuance, which for Freddie Mac fell by 92% to \$2.2 billion, while in the case of Fannie Mae it rose from -\$12.8 billion to \$5.1 billion. The return of Fannie Mae as a net borrower in the first quarter came as its capital surplus continued to grow beyond the level required by the Office of Federal Housing Enterprise Oversight (OFHEO).

The agencies made several further very large deals in the first quarter of 2006. For example, Freddie Mac issued three medium-term notes with a face value of \$5 billion each and one note valued at \$4 billion. In the case of Fannie

## US agencies' issuance of international bonds and notes

In billions of US dollars



Mae, the first quarter rise in borrowing also went hand in hand with an increase in the number of transactions.

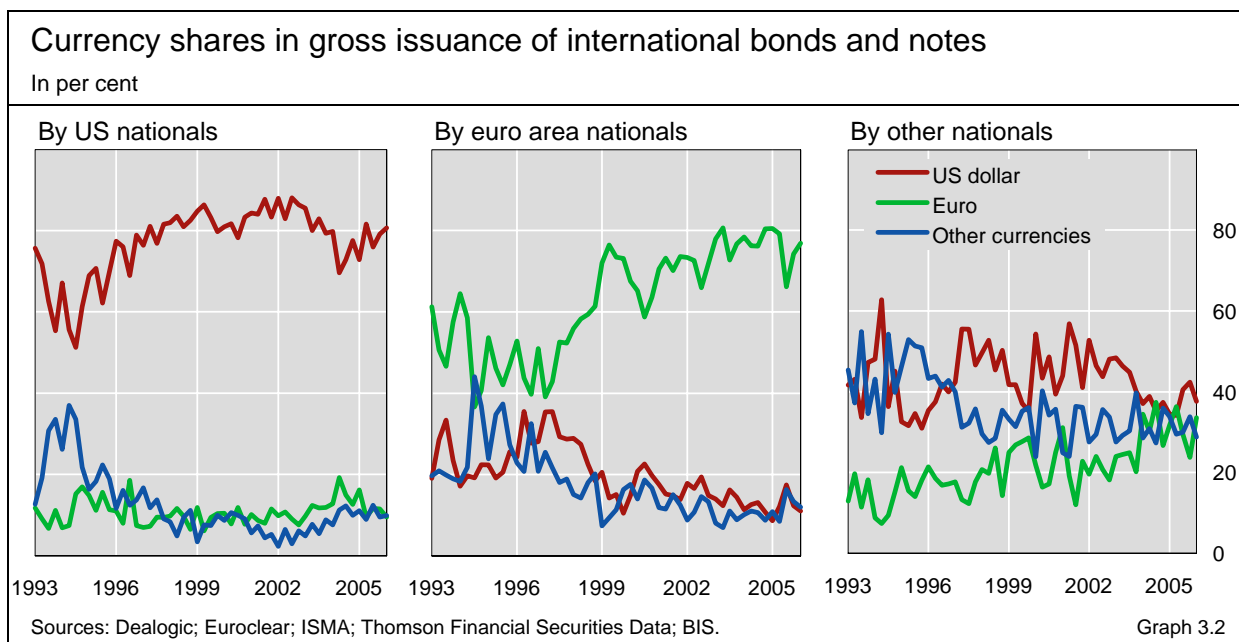
## Main features of net issuance in the international bond and note markets

In billions of US dollars

|                             | 2004    | 2005    | 2005  |       |       |       | 2006  | Stocks at end-Mar 2006 |
|-----------------------------|---------|---------|-------|-------|-------|-------|-------|------------------------|
|                             | Year    | Year    | Q1    | Q2    | Q3    | Q4    | Q1    |                        |
| Total net issues            | 1,545.4 | 1,820.5 | 495.7 | 508.6 | 244.1 | 572.1 | 622.2 | 14,778.0               |
| Floating rate               | 629.0   | 672.7   | 98.4  | 242.1 | 44.9  | 287.3 | 240.2 | 4,264.3                |
| Straight fixed rate         | 922.6   | 1,167.4 | 399.5 | 271.6 | 207.7 | 288.6 | 379.9 | 10,185.6               |
| Equity-related              | -6.2    | -19.6   | -2.2  | -5.1  | -8.5  | -3.8  | 2.0   | 328.1                  |
| Developed countries         | 1,427.8 | 1,671.8 | 461.7 | 475.9 | 199.6 | 534.6 | 569.9 | 13,153.8               |
| United States               | 224.4   | 273.9   | 64.0  | 48.9  | 45.4  | 115.6 | 144.4 | 3,602.2                |
| Euro area                   | 781.0   | 943.9   | 285.4 | 317.7 | 55.8  | 285.1 | 295.2 | 6,528.0                |
| Japan                       | 17.4    | 5.9     | 4.8   | -3.2  | 3.1   | 1.3   | 10.7  | 273.2                  |
| Offshore centres            | 19.0    | 26.9    | 2.8   | 8.4   | 8.8   | 6.9   | 5.2   | 179.3                  |
| Emerging markets            | 75.8    | 94.0    | 29.2  | 15.0  | 17.8  | 32.0  | 42.4  | 902.7                  |
| Financial institutions      | 1,298.8 | 1,584.0 | 394.8 | 446.1 | 230.2 | 512.9 | 495.2 | 11,135.4               |
| Private                     | 1,089.6 | 1,393.4 | 318.1 | 369.1 | 219.6 | 486.6 | 445.8 | 9,502.8                |
| Public                      | 209.2   | 190.5   | 76.7  | 76.9  | 10.7  | 26.3  | 49.4  | 1,632.6                |
| Corporate issuers           | 73.6    | 58.3    | 7.8   | 13.6  | -3.4  | 40.3  | 62.3  | 1,587.0                |
| Private                     | 55.8    | 57.2    | 15.9  | 6.7   | -5.0  | 39.6  | 61.8  | 1,354.5                |
| Public                      | 17.8    | 1.1     | -8.1  | 6.8   | 1.6   | 0.8   | 0.5   | 232.5                  |
| Governments                 | 150.2   | 150.4   | 91.1  | 39.7  | -0.7  | 20.3  | 60.0  | 1,513.5                |
| International organisations | 22.8    | 27.8    | 2.0   | 9.3   | 17.9  | -1.4  | 4.7   | 542.1                  |

Sources: Dealogic; Euroclear; ISMA; Thomson Financial Securities Data; BIS.

Table 3.2



Despite some concerns among market participants about the risk of an adjustment in the US dollar, the share of dollar-denominated fund-raising in the international bond market changed little. The share of US dollar issuance by US entities rose slightly, from 79% to 81%, mainly at the expense of euro borrowing (Graph 3.2). However, among nationals from other countries, an opposite trend was evident. As a result, the total share of US dollar issuance in the international market for bonds and notes dropped only slightly, from 38% to 37%, whereas euro-denominated borrowing rose from 43% to 46%. Continuing a previous trend, the fraction of issues denominated in yen declined further, reaching its lowest value ever at 2%.

US dollar-denominated issuance steady amidst dollar adjustment concerns

### Corporate borrowing surges

On the heels of a 59% increase in the last quarter of 2005, gross issuance of international bonds and notes by non-financial corporations climbed a further 53% in the first quarter of 2006, reaching its highest level ever at \$118 billion. In net terms, non-financial corporate issuance posted similarly impressive gains, surging by 54% to \$62 billion. This strength is noteworthy given past seasonal patterns, according to which first quarter net corporate borrowing typically is below average.<sup>1</sup> Contributing to the surge was heightened merger and acquisition (M&A) activity, as well as efforts by borrowers to lock in favourable rates.<sup>2</sup>

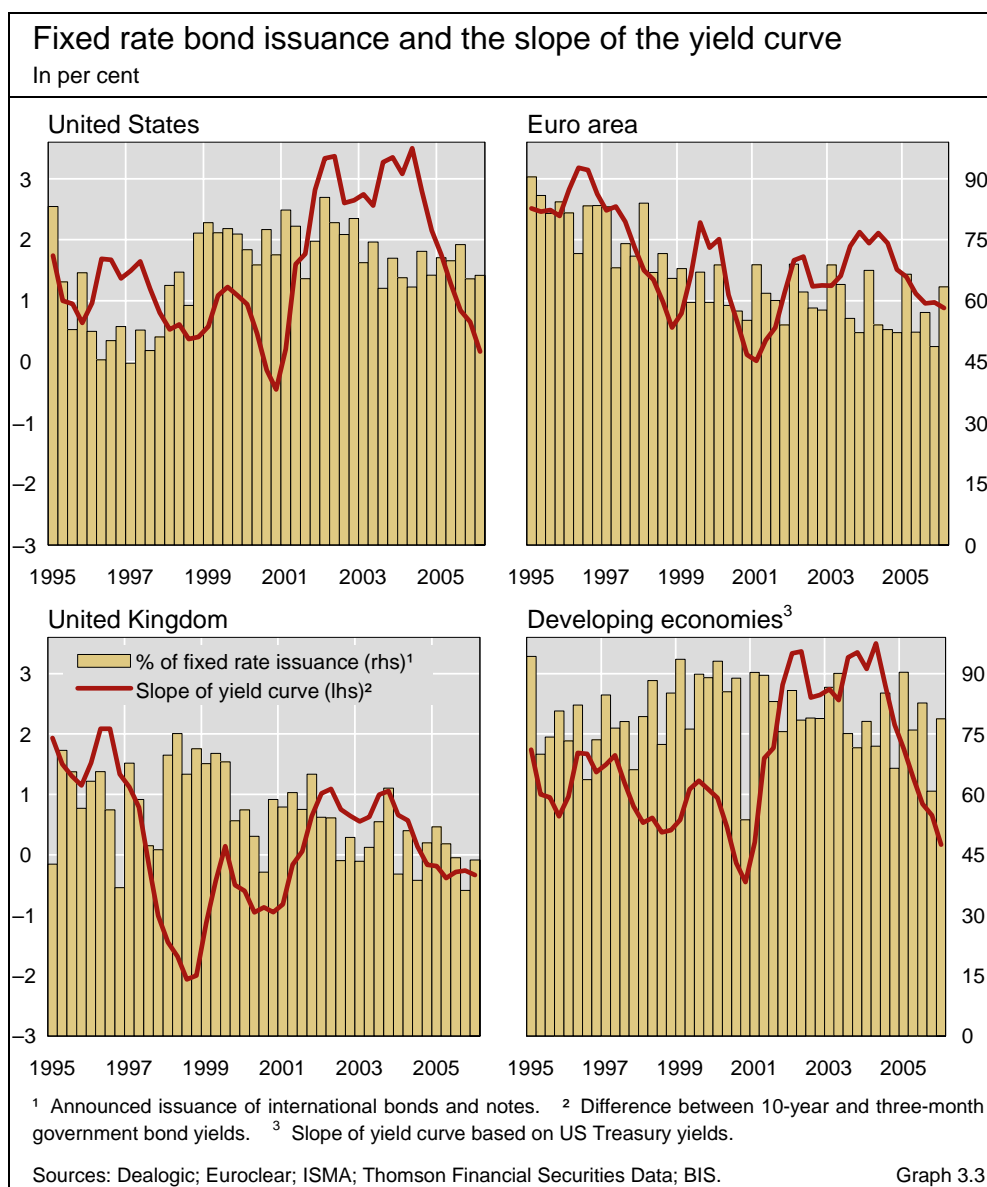
Record borrowing by corporates ...

... as M&A activity intensifies

Several large deals were in evidence. These included the issuance of two \$3 billion bonds by Cisco Systems (a five-year and a 10-year bond) and a \$3 billion bond by Home Depot. Notable large transactions by non-US

<sup>1</sup> See the box "Seasonality in international bond and note issuance" in the international debt securities section of the September 2005 *BIS Quarterly Review*.

<sup>2</sup> See the Overview in the March 2006 *BIS Quarterly Review*.



borrowers included that by Telefónica Emisiones of Spain, which issued a four-tranche medium-term note denominated in euros and sterling with a face value equivalent to \$7 billion. Perhaps indicative of the role of M&A activity in corporate bond issuance, the Telefónica deal was part of an ongoing programme to raise €15 billion of debt in order to refinance part of the company's £17.8 billion acquisition of British telecoms operator O<sub>2</sub>. More generally, high-tech corporations in the telecoms and computer sectors were active in the international market, with a handful of companies involved in transactions exceeding \$1 billion each, for a total of almost \$30 billion.

### Continued robust euro area activity

Euro area issuance remains strong ...

Gross issuance of international bonds and notes by euro area entities increased by 23% in the first quarter, bringing it to \$545 billion. In net terms, euro area borrowing grew by 4% to \$295 billion. This strong activity took place in an environment where market expectations of ECB rate increases intensified and the flattening of the euro area yield curve tapered off. Against this

background, it seems that euro area borrowers stepped up their efforts to secure cheap finance, as illustrated by the jump in the share of fixed rate bond issuance from 49% to 63%, although part of this increase may be attributable to seasonal factors (Graph 3.3).

Among individual countries, Germany accounted for the largest absolute increase in gross issuance, \$51 billion, followed by Spain (up \$32 billion). A couple of very large public sector deals contributed to the surge in German issuance. KfW Bankengruppe, a state-owned German financial institution, and the Federal Republic of Germany each issued bonds with a face value of €5 billion during the first quarter. KfW issued a number of other debt securities in the international market during this period, with the total amount exceeding \$21 billion, or around 40% of its 2006 borrowing target. Among Spanish borrowers, private entities accounted for the bulk of the activity, with four bond issues in excess of \$3 billion each made by private banks. While financial institutions dominated the market among Spanish borrowers, a notable non-financial borrower was Telefónica Emisiones with its aforementioned \$7 billion transaction.

... largely driven by German public sector borrowing ...

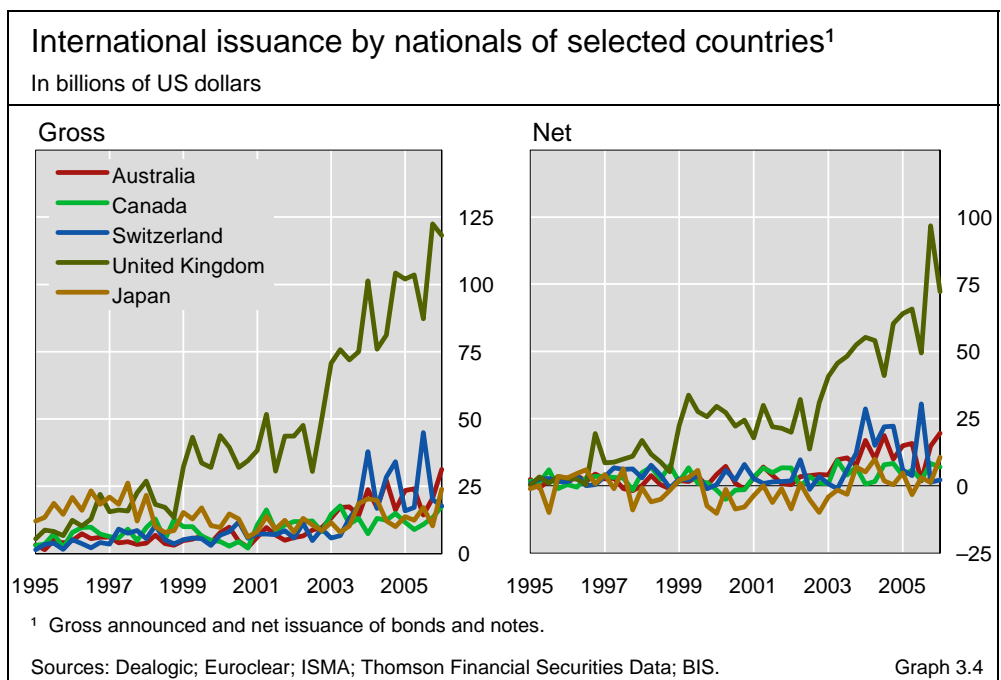
... and Spanish private fund-raising

### Pickup in Japanese issuance

Following a period of very weak Japanese presence in the international bond and note market, both gross and net issuance picked up significantly in the first quarter of 2006. Compared to the previous quarter, gross borrowing increased by 133% to \$23.9 billion, while net borrowing surged by a factor of eight to \$10.7 billion (Graph 3.4). The pickup in Japanese issuance coincided with a period in which news about Japan's economy was mainly positive and the Bank of Japan announced the end of its policy of quantitative easing.

Japanese issuance rebounds as the economic outlook improves

As in previous quarters, financial institutions continued to account for almost all the activity, at 91% of gross issuance, with corporates making up the



remaining portion. Japanese financial institutions also completed a number of very sizeable deals, the largest of which raised a total of \$4.2 billion. A notable transaction by a non-financial firm was the issuance of four convertible bonds at ¥50 billion each (total equivalent value \$1.7 billion) by Keystone Capital Corporation, a finance vehicle of Fuji Photo Film Co. Perhaps illustrative of the revival in Japanese business investment, the proceeds of this deal were earmarked to increase Fuji's production capacity.

Japanese  
borrowers cut their  
yen financing ...

... and turn to euro-  
denominated debt

At the same time as Japanese borrowers became more active in the international bond market, their share of yen-denominated borrowing dropped significantly, from 43% to 32% in the first quarter – close to the lowest levels seen in the past 10 years. Instead, Japanese borrowers turned increasingly to euro-denominated securities. This development might partially reflect changes in the relative strength of the euro vis-à-vis the yen, as issuance typically strengthens in currencies that appreciate.<sup>3</sup>

Among other developed economies, UK nationals reduced their borrowing somewhat following a particularly active fourth quarter (Graph 3.4). Australian borrowers were significantly more active in international bond markets, boosting their fund-raising by 51% in gross terms. An important factor behind this was a surge in issuance of residential mortgage-backed securities (RMBSs) by Australian banks, in an environment of declining spreads for such products. A number of very large deals of this type were concluded, including a \$4.1 billion equivalent transaction by the Commonwealth Bank of Australia, through its financing vehicle.

### High-yield borrowing rebounds

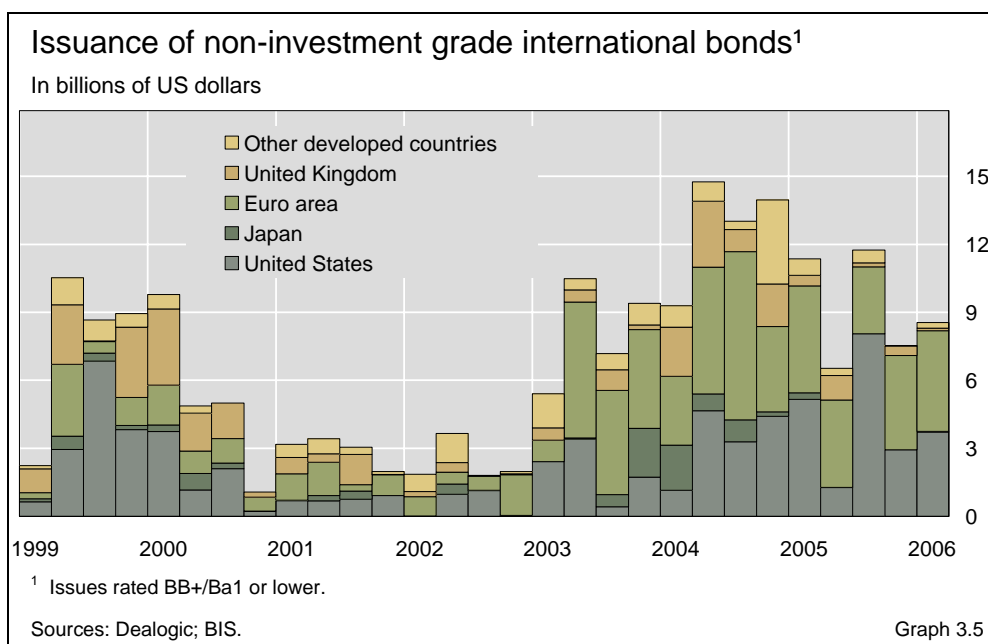
US borrowers  
behind rebound in  
high-yield segment

Gross issuance of high-yield international bonds and notes by borrowers in developed economies rose by 13% in the first quarter of 2006, following a decline in the previous quarter. This rebound was mainly the result of a 27% increase in borrowing by US non-investment grade borrowers (Graph 3.5). Elsewhere, high-yield issuance grew by 6% in the euro area but fell by 72% in the United Kingdom. After remaining absent for two consecutive quarters, Japanese borrowers returned to this segment, albeit in a modest way.

While the United States saw the largest increase in non-investment grade borrowing in the first quarter, euro area entities still accounted for more than 50% of the total amount issued in this segment. Notable deals were completed by Italian car maker Fiat, which issued a €1 billion bond, and by US-owned German cable TV operator lesy Hessen GmbH, which brought €1.35 billion worth of floating rate notes to the market in order to refinance its debt.

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<sup>3</sup> See the special feature "Currency choice in international bond issuance" by Benjamin H Cohen in the June 2005 *BIS Quarterly Review*.



## Issuance in emerging market economies continues to rise

Last year's record-breaking issuance of international bonds and notes by emerging market borrowers was followed by continued robust activity in the first quarter of 2006. Gross emerging market borrowing rose by 19% compared to the last quarter of 2005, reaching a new high of just below \$60 billion, while net borrowing jumped by 33% to \$42 billion – also a record level (Graph 3.6).

While improving fundamentals have underpinned this strength for some time, the recent brisk pace seems also to have been fuelled to some extent by the search for yield among international investors. Correspondingly, spreads on emerging market bonds reached new lows in the first quarter of 2006, whereas flows into mutual funds rose to record highs (see the Overview). The increasing risk appetite among investors may even have pushed emerging market spreads below levels that seem justified based on historical experience.<sup>4</sup>

Gross borrowing grew in all regions, with emerging Europe leading the field with a 39% gain. In net terms, the Africa and Middle East region posted the largest increase at 240%, reaching a total sum of \$11.6 billion. Net borrowing also rose in emerging Europe and Asia-Pacific, but fell in Latin America.

From a sectoral perspective, governments accounted for the lion's share of the increase. Government borrowing fuelled gross issuance across all regions, especially in emerging Europe (+130%) and the Africa and Middle East region (+107%). While corporate borrowers also played an important role in the latter region, they scaled back their funding in emerging Europe and Asia. At the same time, financial institutions had little impact on overall financing trends in emerging markets.

Emerging market issuance surges to record levels ...

... as the search for yield continues among investors

Strong activity in emerging Europe, Africa and the Middle East ...

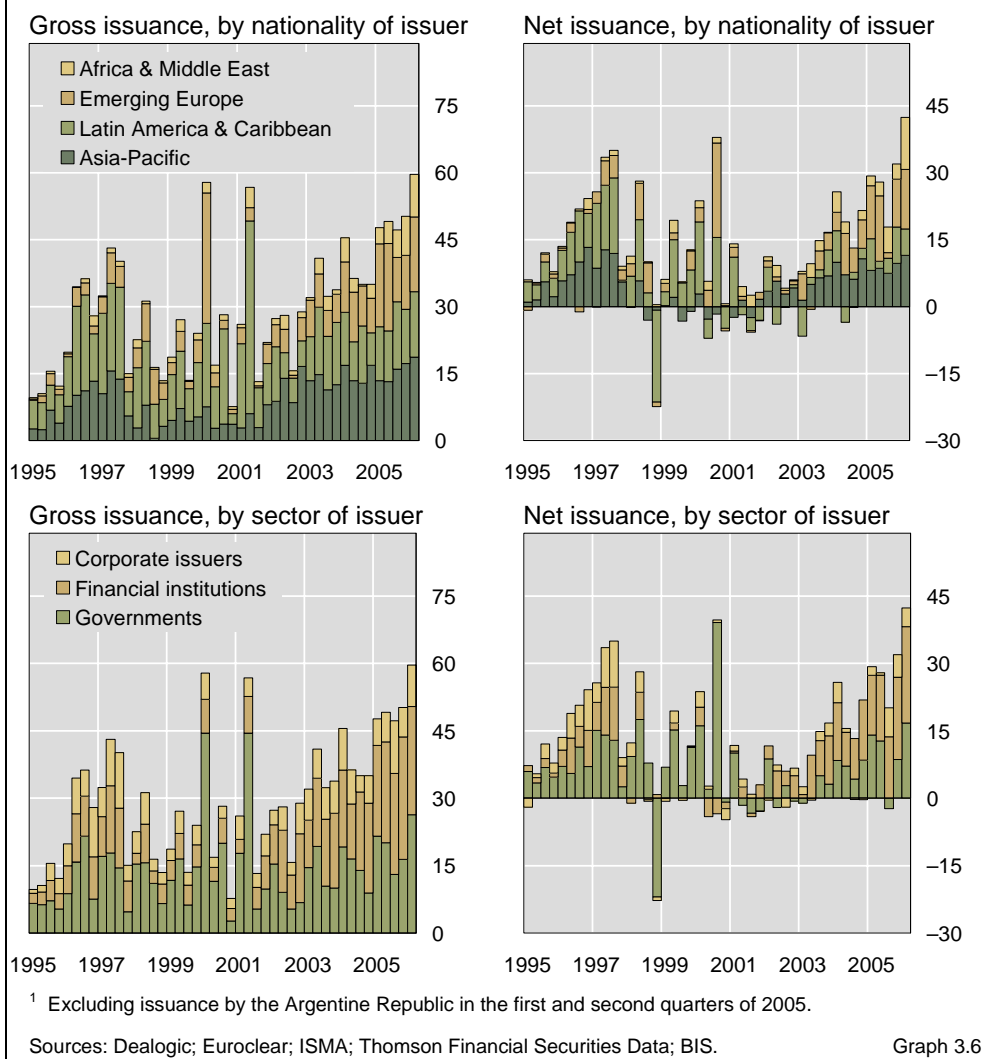
... largely driven by government borrowing

<sup>4</sup> See the Overview in the March 2006 *BIS Quarterly Review*.



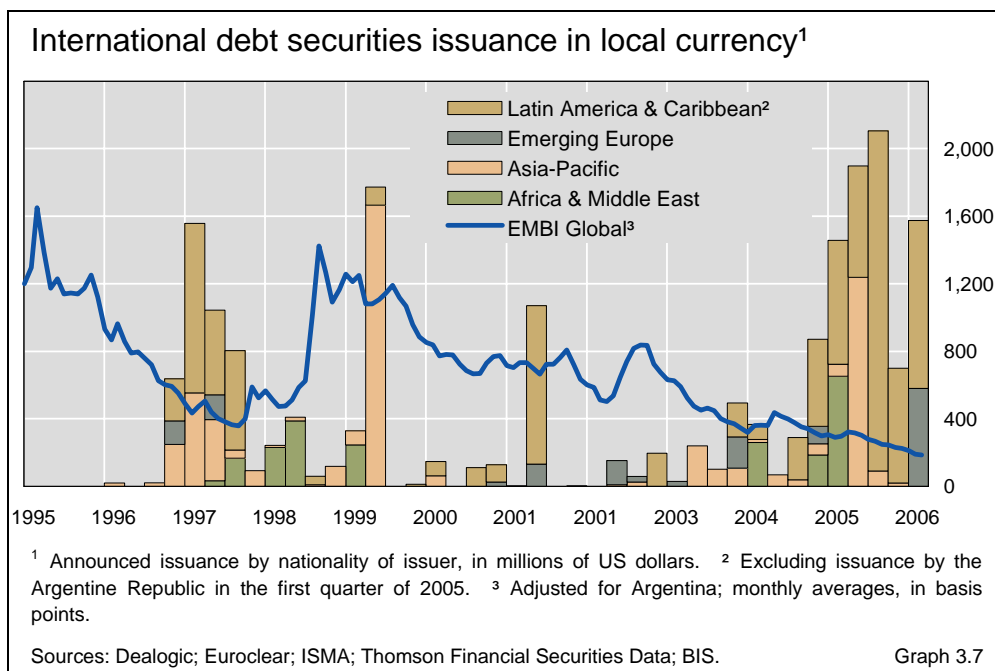
## International bond and note issuance by emerging market entities<sup>1</sup>

In billions of US dollars



Borrowing in the Africa and Middle East region was boosted by the restructuring of the debt of the Republic of Iraq, which brought a 22-year \$2.7 billion US dollar-denominated bond to the market. As in many other regions, M&A activity contributed to increased borrowing during the first quarter. Teva Pharmaceutical Industries of Israel, for example, tapped the market for a total of \$2.9 billion, in order to finance its acquisition of a US pharmaceutical firm.

Among emerging Europe borrowers, several large deals were concluded by governments. The Republic of Poland issued a 10-year €3 billion medium-term note, while the Republic of Hungary, the Slovak Republic and the Republic of Turkey each completed transactions in excess of \$1 billion. Sovereign borrowers were also active in Latin America, with the United Mexican States issuing a \$3 billion 11-year bond and the Federative Republic of Brazil a \$1 billion 31-year bond, among others. Another notable presence in this region was Mexican oil company Pemex, which raised funds totalling \$1.5 billion.



The Republic of the Philippines and the Republic of Indonesia carried out the largest transactions from Asia. At the very beginning of the year – well ahead of the political tensions that would later surface – the Philippines issued a 25-year \$1.5 billion bond and a 10-year €500 million bond at yields of 7.875% and 6.375% respectively. This represented two thirds of the Philippines’ 2006 borrowing target in the international bond market. Indonesia brought two \$1 billion bonds with maturities of 11 and 29.5 years to the market, in the midst of increasing political instability in Thailand and the Philippines. Despite these tensions in the region, the deal was successful, as evidenced by the pricing of the bonds and the fact that the issue was several times oversubscribed. The 11-year bond yielded 235 basis points above US Treasuries, while for the longer-maturity bond the spread was 264 basis points – around 140 basis points less than when Indonesia had issued 30-year debt in the last quarter of 2005. Contributing to this was strong demand from mutual funds, which bought over two thirds of the amounts offered.

Big deals by Indonesia and the Philippines ...

... despite political tensions in the region

The average maturity of international bonds and notes issued by emerging market entities rose significantly, increasing from 8.5 years in the previous quarter to 13.5 years. By contrast, in developed markets the average maturity fell slightly. The move among emerging market borrowers towards longer maturities was seen across all regions and types of borrower.<sup>5</sup> This could have reflected efforts to secure funds at favourable rates, as the likelihood of higher interest rates in developed markets as well as the risk of rising spreads may have been perceived as increasing. At the same time, it signalled a high demand for longer-dated emerging market paper among investors, pointing to a high appetite for risk.

Emerging market borrowers turn to long-term financing in favourable conditions

<sup>5</sup> For a discussion on the extension of the maturity structure of government debt in Latin America, see the special feature “Domestic bond markets in Latin America: achievements and challenges” by Serge Jeanneau and Camilo Tovar in this *BIS Quarterly Review*.

Local currency  
issuance bounces  
back ...

... as borrowers  
from emerging  
Europe return to  
this segment

Issuance of international debt securities in local currencies by emerging market entities rebounded in the first quarter of 2006, after a temporary lull in the previous quarter (Graph 3.7). The recovery in this market segment was due to a 46% increase in Latin American local currency borrowing, as well as the return of borrowers from emerging Europe to this segment after four consecutive quarters of absence. Overall, European entities raised \$580 million worth of local currency denominated debt, with the bulk of this attributable to Russian special purpose vehicle Red Arrow International Leasing PLC's issuance of rouble-denominated debt amounting to \$488 million, the proceeds of which would be used to acquire rolling stock to lease to Russian Railways. First quarter Latin American local currency borrowing was almost entirely due to Colombian peso financing by the Republic of Colombia, Mexican peso borrowing by Teléfonos de México SA de CV, and fund-raising in Brazilian reais by various Brazilian financial institutions.

