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2. The international debt securities market

Both gross and net issuance of international securities declined in the fourth quarter of 1999 after three quarters of record activity. Although an increase in the amount of debt needing to be refinanced supported gross activity, announcements of bonds and notes still declined by 25% (to \$310 billion). Meanwhile, net issuance fell by 37% (to \$193 billion). The slowdown in the fourth quarter may have reflected the earlier acceleration or postponement of planned issues because of concerns about possible market disruptions related to the millennium changeover. However, net issuance was nearly double the \$98 billion of the fourth quarter of 1998, when activity had slowed amid generally unfavourable market conditions and in anticipation of the introduction of the euro. For the year as a whole, gross and net activity in bonds and notes reached record levels, at \$1.6 trillion and \$1.0 trillion respectively (see the tables below). Issuing activity by emerging markets remained subdued, however, contributing about 3% to the total, far below the 11–15% share of 1993–97.

Although fixed rate issuance exceeded floating rate activity by a margin of two to one in gross terms, this was partly due to substantial refinancing of maturing fixed rate bonds and notes (\$136 billion). In

Main features of net issuance in international debt securities markets¹

In billions of US dollars

	1998	1999	1998	1999				Stocks at end- Dec. 1999
	Year	Year	Q4	Q1	Q2	Q3	Q4	
Total net issues	678.5	1,085.4	97.8	263.8	323.9	304.8	192.9	5,226.1
Money market instruments ²	9.8	68.6	– 11.5	35.1	– 8.0	22.8	18.7	260.0
Bonds and notes ²	668.7	1,016.8	109.3	228.6	331.9	282.0	174.2	4,966.2
Developed countries	573.0	1,014.6	86.0	240.6	295.5	296.3	182.2	4,371.4
<i>Euro area</i>	<i>211.7</i>	<i>438.1</i>	<i>28.6</i>	<i>97.3</i>	<i>126.5</i>	<i>129.0</i>	<i>85.3</i>	<i>1,696.8</i>
<i>Japan</i>	<i>– 18.1</i>	<i>– 2.0</i>	<i>– 1.2</i>	<i>– 0.8</i>	<i>1.8</i>	<i>2.8</i>	<i>– 5.8</i>	<i>330.9</i>
<i>United States</i>	<i>284.3</i>	<i>423.6</i>	<i>60.6</i>	<i>109.8</i>	<i>123.3</i>	<i>111.8</i>	<i>78.6</i>	<i>1,255.2</i>
Offshore centres	10.2	16.6	– 0.4	7.7	1.9	2.3	4.7	75.9
Other countries	40.2	32.2	– 1.6	3.0	21.0	1.8	6.5	404.5
International institutions	55.1	21.9	13.7	12.6	5.5	4.3	– 0.5	374.3
US dollar	409.4	470.1	55.3	138.1	151.3	113.8	66.9	2,433.4
Yen	– 27.2	– 12.0	– 6.3	– 12.7	– 3.1	6.4	– 2.6	528.0
Euro area currencies	221.3	522.3	29.6	114.9	135.8	159.0	112.6	1,512.1
Other currencies	74.9	104.9	19.2	23.5	39.8	25.6	16.0	752.7
Financial institutions ³	370.0	584.4	37.8	153.8	145.0	179.5	106.1	2,511.0
Public sector ⁴	181.8	199.1	39.0	50.7	78.1	29.1	41.2	1,428.0
Corporate issuers	126.7	301.8	21.0	59.3	100.8	96.2	45.6	1,287.1

¹ Flow data for international bonds; for money market instruments and notes, changes in amounts outstanding excluding exchange rate valuation effects. ² Excluding notes issued by non-residents in the domestic market. ³ Commercial banks and other financial institutions. ⁴ Governments, state agencies and international institutions.

Sources: Bank of England; Capital DATA; Euroclear; ISMA; Thomson Financial Securities Data; BIS.

Gross issuance in the international bond and note markets

In billions of US dollars

	1998	1999	1998	1999			
	Year	Year	Q4	Q1	Q2	Q3	Q4
Total announced issues	1,142.2	1,574.9	252.4	408.2	445.6	410.9	310.2
Floating rate issues	284.9	444.2	56.0	100.6	136.4	114.7	92.6
Straight fixed rate issues	810.1	1,088.0	185.6	295.7	294.5	289.3	208.6
Equity-related issues ¹	47.2	42.6	10.8	11.9	14.7	6.9	9.0
US dollar	587.8	674.2	124.8	197.4	193.9	171.0	111.9
Yen	72.8	111.9	19.7	17.5	24.9	35.0	34.5
Euro area currencies	319.3	609.6	65.9	147.6	175.1	159.7	127.2
Other currencies	162.4	179.2	42.0	45.6	51.7	45.3	36.6
Financial institutions ²	571.1	812.1	112.9	211.3	217.1	219.9	163.8
Public sector ³	321.9	347.3	82.5	99.2	104.5	71.6	72.0
Corporate issuers	249.3	415.5	57.0	97.7	124.0	119.5	74.4
Completed issues	1,137.4	1,579.5	253.0	379.9	443.2	400.5	355.9
Repayments	468.7	562.7	143.7	151.3	111.3	118.5	181.7

¹ Convertible bonds and bonds with equity warrants. ² Commercial banks and other financial institutions. ³ Governments, state agencies and international institutions.

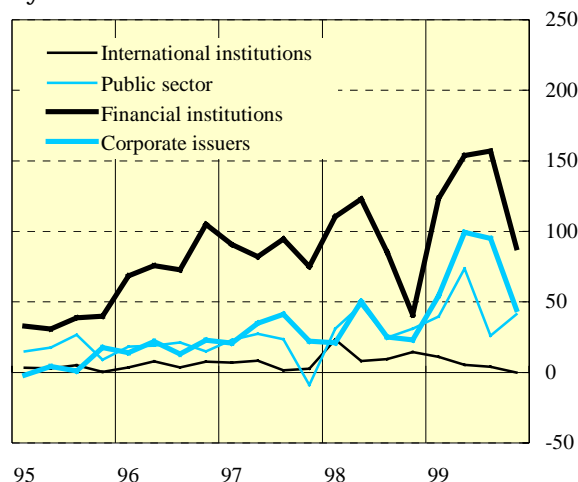
Sources: Bank of England; Capital DATA; Euroclear; ISMA; Thomson Financial Securities Data; BIS.

net terms, floating rate issuance rose to 63% of fixed issues, the highest proportion recorded since end-1997, when fixed rate issuance had collapsed during the Asian crisis. The sustained rise in long-term bond yields during 1999 seems to have induced the European private sector to turn to floating rate issuance continuously over the year, and in the fourth quarter this exceeded fixed issuance by a substantial margin. Other issues, however, seemed less affected by the rise in yields. North American private sector issuers, in particular, reduced the ratio of net floating/fixed rate debt from a high of 186% in the first quarter of 1998 to a low of 17% in the current quarter.

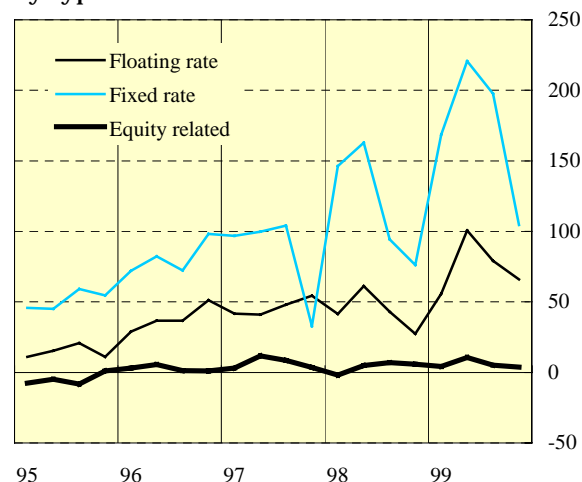
Net issues of international bonds and notes by sector and type

In billions of US dollars

By sector



By type



Sources: Bank of England; Capital DATA; Euroclear; ISMA; Thomson Financial Securities Data; BIS.

Net issuance of international debt securities by currency and residence region*

In billions of US dollars

		1998	1999	1998	1999
		Year	Year	Q4	Q4
Europe	US dollar	68.6	32.8	– 3.8	– 2.6
	Euro	156.5	425.8	24.8	93.6
	Total	254.0	536.1	21.3	99.6
North America	US dollar	257.2	383.8	59.0	71.5
	Euro	24.8	34.8	2.5	4.9
	Total	296.9	425.8	66.0	78.9
Others	US dollar	83.7	53.5	0.1	– 2.0
	Euro	39.9	61.8	2.2	14.0
	Total	127.6	123.5	10.5	14.3
Total	US dollar	409.4	470.1	55.3	66.9
	Euro	221.3	522.3	29.6	112.6
	All currencies	678.5	1,085.4	97.8	192.9

* Flow data for international bonds; for money market instruments and notes, changes in amounts outstanding excluding exchange rate valuation effects.

Sources: Bank of England; Capital DATA; Euroclear; ISMA; Thomson Financial Securities Data; BIS.

Industrial countries: the euro is ahead as the market in Europe grows faster

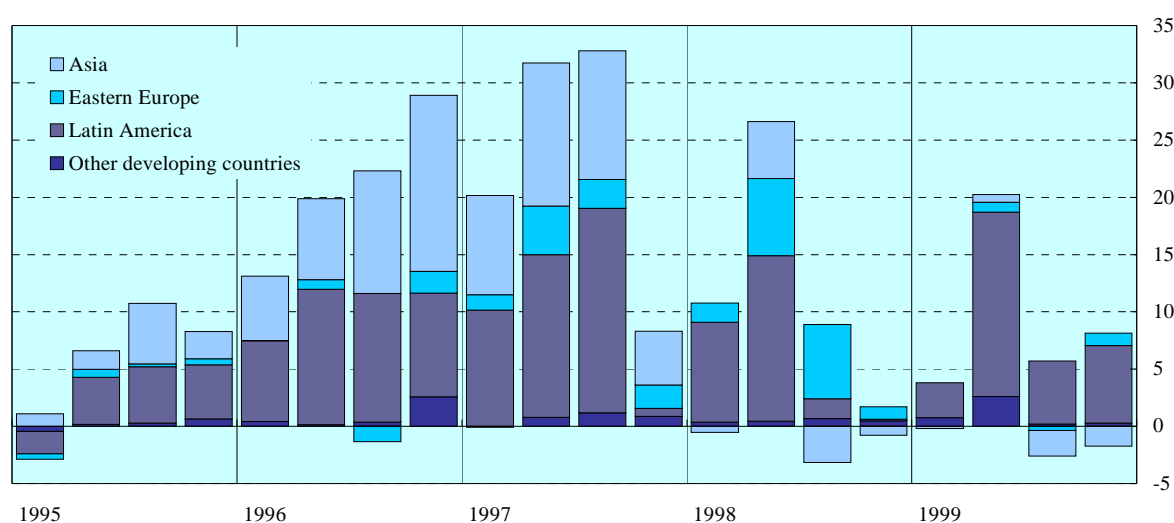
Looking at 1999 as a whole, a major theme was the introduction of the euro and its increasing acceptance as a currency of denomination for new issues. *Net* new issuance of international securities denominated in euros was \$522 billion, compared with \$470 billion in US dollars. The ratio of net financing in euros relative to that in US dollars grew steadily during the year, from 0.83 in the first quarter to 1.68 in the fourth. Since a larger stock of US dollar bonds had to be refinanced, *gross* issuance of US dollar bonds still outpaced that of euro-denominated bonds over the year, implying that issuers coming to the market for the first time and those expanding their net issuance were more likely to issue in euros.

The shift towards the euro can largely be attributed to European issuers. In comparison with 1998, entities resident in Europe increased their overall net issuance from \$254 billion to \$536 billion. European financial institutions led the move towards euro-denominated international securities, with commercial banks increasing their issuance in euros from \$81 billion for the predecessor currencies in 1998 to \$233 billion in 1999. By contrast, partly due to competition to establish benchmark status among US agency issuers, almost 40% of North American issuance was by government-sponsored enterprises (such as Fannie Mae), which issue virtually exclusively in the home currency. The largest issues in euros in the fourth quarter of 1999 were from Mannesmann Finance (\$2.5 billion), the European Investment Bank (\$2 billion) and a number of financial institutions in Germany, France and Italy. Compagnie de Financement Foncier of France issued the largest overall amount in euros (\$5.6 billion).

Borrowers resident outside the euro area were less interested in issuing in euros. North American entities increased their overall net issuance by a smaller amount (from \$297 billion to \$426 billion), with the ratio of euro to dollar issues remaining at around 10%. In the fourth quarter, the only announcement by a non-euro area entity to exceed €1 billion was a €1.5 billion seven-year note issued by Vodafone AirTouch PLC. In the case of other entities as a group (including those from emerging markets and international institutions), the ratio of euro to dollar net issues rose from 0.5 to 1.2, but the small amounts involved meant this shift had a relatively limited quantitative significance (see the table above).

International bond and note net issuance by emerging market borrowers*

In billions of US dollars



* Net issues based on the nationality of the borrower.

Sources: Bank of England; Capital DATA; Euroclear; ISMA; Thomson Financial Securities Data; BIS.

The shift towards new issuance in euros should not obscure the dollar's continued dominance in the stock of outstanding debt. At year-end, around 47% of outstanding international debt securities were denominated in US dollars and 29% in the euro and its predecessors, compared with 46% and 27% respectively at end-1998. Both gained "market share" from other international currencies, the yen in particular. The \$122 billion of yen-denominated issues in 1999 fell short of the \$134 billion in repayments, though the amount of outstanding yen securities rose in dollar terms because of the yen's appreciation. Its 14% July-August surge against the dollar provided investors with attractive overall return expectations. As a result, net yen issues were positive in the third quarter, after seven quarters of net repayments. This trend petered out towards year-end, however, as market expectations concerning the future course of the currency became unstable.

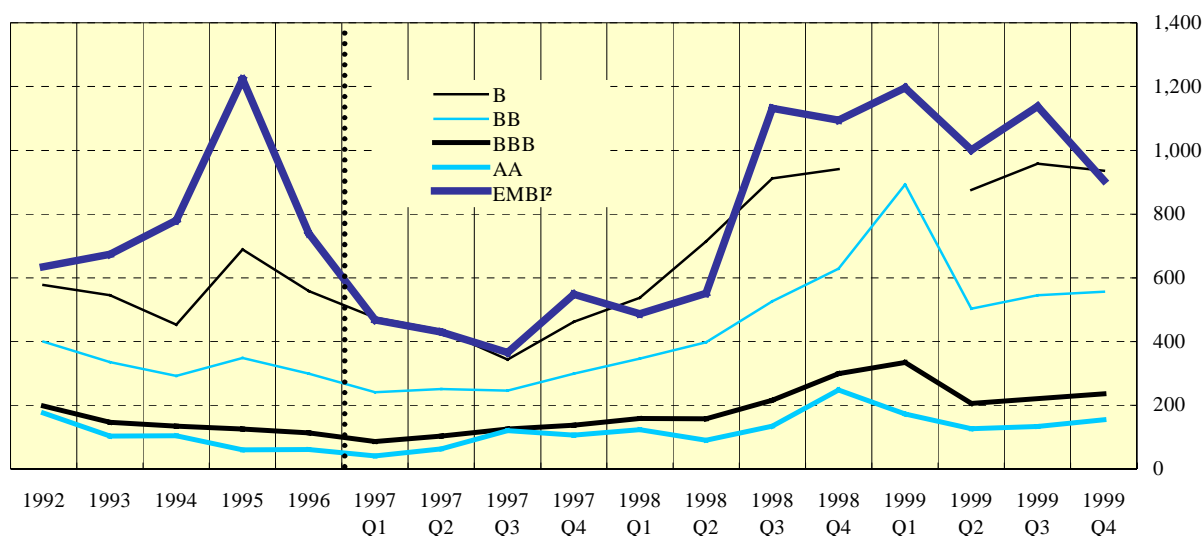
Emerging markets: spreads and early repayments limit net financing

Net 1999 securities flows to emerging markets, at \$32 billion, remained below those recorded in the previous year, when issuance had been hit by the Russian debt moratorium towards year-end. Most new issues had to be postponed again in the first quarter of 1999, as investors waited to see how Latin American economies would cope with the devaluation of the Brazilian real in January. This resulted in a surge of net issuance (\$21 billion) in the second quarter. Issuance fell to relatively subdued levels for the remainder of the year, as the possibility of some issuers defaulting on eurobonds was raised and Y2K concerns limited activity. Despite these uncertainties, a steady stream of *refinancing* was available to replace the \$12–15 billion of securities maturing each quarter during 1999.

As in previous quarters, flows to Asia and Latin America diverged sharply in the fourth quarter of 1999. In *Latin America*, issuance was dominated by central governments (\$5.5 billion) and private financial institutions (\$1.5 billion), while repayments exceeded new issues among non-financial corporates. For the year as a whole, however, central governments were important net issuers, selling \$22 billion. Argentina maintained its position as the largest net emerging market borrower in the last quarter (\$2.6 billion), despite adverse external conditions and a recession in the domestic economy. A substantial part of net issuance by Brazil (\$2.5 billion) and Mexico (\$1.2 billion) reflected central government issues of \$1.4 billion and \$0.6 billion, respectively, partly to finance Brady buyback operations (see below).

Spreads of rated bond issues in emerging markets, by credit rating¹

In terms of US dollars, 10-year maturity, in basis points



¹ Estimated credit spread on a 10-year rated bonds issued by emerging market economies over the benchmark industrial country government bond. No data available for B-rated issues in 1999 Q1. ² Emerging Markets Bond Index quarterly average.

Sources: Bloomberg; Capital DATA; JP Morgan; BIS calculations.

By contrast, net securities flows to *Asia* remained slightly negative during the fourth quarter, with net outflows of \$3.4 billion from the private sector not offset by new public sector borrowing of \$1.7 billion. For the year as a whole, with current account balances generally in surplus, net debt repayments by *Asia* rose to a high level. Only the Philippines increased their net borrowing (\$0.6 billion), mainly the result of \$1 billion of central government issues partly used to finance a Brady bond retirement.

Strong export growth in South Korea provided continuous current account surpluses over the year and suggested a robust recovery of the domestic economy. With foreign exchange reserves set to rise to \$74 billion by year-end, there was on aggregate no need for capital inflows, and large repayments (\$11.7 billion over the year) were possible. In the fourth quarter, in particular, repayments of \$2.5 billion of private sector bonds, coupled with limited new issuance by state agencies and financial institutions, resulted in a zero net securities inflow to the country.

Thus although there was a relative shift from intermediated financing by banks to direct securities financing, net securities issuance remained modest, both in absolute terms and relative to global issuance, with the share of emerging markets falling to 3% of global annual issuance, the lowest level seen since 1990. As noted above, substantial current account surpluses obviated any need for Asian countries to borrow. Demand by Latin American borrowers might have been greater, but was to some extent discouraged by the cost of borrowing, particularly for lower-rated issuers. Average primary market spreads changed little from the still comparatively high level established in the second quarter of 1999, as is evidenced by the graph above. The constancy of spreads paid is in apparent contrast with the relaxation of credit conditions in the secondary market signalled by the decline in certain national indices and in the Emerging Markets Bond Index (EMBI). This decline may, however, only be reversing the preceding rise in the index partially due to special factors. With the market starting to anticipate the possibility of an eventual default by Ecuador in July, the EMBI spiked up further in August as the country invoked a 30-day grace period to postpone interest payments due on \$5.9 billion

in Brady obligations, later defaulting on \$1.4 billion in Brady Discount bonds.⁸ Several governments (Mexico, Brazil and the Philippines) used this window of opportunity to buy back or swap Brady obligations in order to reduce interest payments or free up collateral. These transactions increased demand in the Brady market, thereby pushing up prices and depressing yields. Since the EMBI is heavily weighted towards Brady bonds, these developments would have tended to pull the index down again, independently of general credit conditions in the market. Thus it would appear to be premature to conclude from the fourth quarter decline in the EMBI index that the Ecuador default had no more than a passing effect on the borrowing conditions of emerging markets generally.

⁸ See *BIS Quarterly Review*, November 1999, pp. 5–6.