

3. The international debt securities market

The fourth quarter of 2002 witnessed a continuation of the recent marked slowdown in international financing in the international debt securities market. Against the backdrop of a slowdown in economic growth, especially in the

Main features of net issuance in international debt securities markets								
In billions of US dollars								
	2001	2002	2001	2002				Stocks at end-Dec 2002
	Year	Year	Q4	Q1	Q2	Q3	Q4	
Total net issues	1,348.3	1,024.1	339.4	309.7	344.2	185.1	185.2	9,218.9
Money market instruments ¹	-78.9	1.6	-9.3	-7.8	8.3	11.8	-10.7	438.0
<i>Commercial paper</i>	26.9	23.6	6.5	5.5	1.8	19.3	-3.0	292.2
Bonds and notes ¹	1,427.2	1,022.5	348.8	317.5	335.8	173.3	195.9	8,780.8
<i>Floating rate issues</i>	391.4	208.5	95.9	60.5	74.8	30.1	43.0	2,205.7
<i>Straight fixed rate issues</i>	996.4	801.7	237.5	253.5	247.1	146.5	154.7	6,263.1
<i>Equity-related issues</i>	39.4	12.3	15.3	3.4	13.9	-3.2	-1.9	312.1
Developed countries	1,261.4	956.3	324.8	285.5	326.8	169.4	174.5	8,124.4
<i>United States</i>	597.6	343.1	139.0	138.1	115.7	37.6	51.6	2,749.3
<i>Euro area</i>	551.2	473.9	147.9	128.7	154.3	91.4	99.5	3,591.2
<i>Japan</i>	-10.1	-21.9	-1.8	-10.2	3.2	-4.2	-10.7	258.2
Offshore centres	25.3	8.6	5.1	4.2	-0.2	0.3	4.3	106.9
Developing countries	45.4	37.3	8.3	12.0	10.8	5.7	8.8	549.0
Financial institutions	1,038.5	843.1	259.4	237.2	280.1	156.8	169.0	6,630.2
<i>Private</i>	959.6	721.5	242.8	216.7	243.7	120.8	140.4	5,705.8
<i>Public</i>	78.9	121.5	16.6	20.4	36.4	36.1	28.6	924.4
Corporate issuers	208.1	60.0	59.3	13.1	41.6	1.0	4.3	1,270.6
<i>Private</i>	171.7	58.0	49.6	19.4	41.3	-1.4	-1.2	1,053.3
<i>Public</i>	36.4	2.0	9.7	-6.2	0.3	2.5	5.4	217.3
Governments	85.5	99.2	19.5	51.4	15.7	17.6	14.4	879.5
International organisations	16.3	21.8	1.3	8.0	6.8	9.6	-2.5	438.5
<i>Memo: Domestic CP²</i>	-144.8	-100.1	31.2	-70.9	-65.8	-0.3	36.9	1,898.3
<i>of which: US</i>	-161.2	-98.0	28.3	-63.3	-57.0	0.2	22.1	1,342.9

¹ Excluding notes issued by non-residents in the domestic market. ² Data for the fourth quarter of 2002 are partly estimated.

Sources: Bank of England; Dealogic; Euroclear; ISMA; Thomson Financial Securities Data; national authorities; BIS.

Table 3.1

Gross issuance in the international bond and note markets							
In billions of US dollars							
	2001	2002	2001	2002			
	Year	Year	Q4	Q1	Q2	Q3	Q4
Total announced issues	2,306.3	2,116.1	554.1	607.1	571.1	436.9	501.0
Bond issues	1,349.8	1,181.3	338.7	376.0	315.8	212.1	277.4
Note issues	956.5	934.8	215.4	231.1	255.3	224.8	223.6
Floating rate issues	643.4	607.5	168.7	142.5	160.2	145.9	159.0
Straight fixed rate issues	1,590.7	1,464.6	359.1	454.9	389.5	286.1	334.1
Equity-related issues ¹	72.2	44.1	26.3	9.7	21.4	4.9	8.0
US dollar	1,131.9	992.4	243.6	311.0	258.4	200.7	222.3
Euro	841.6	811.8	221.3	228.8	229.3	163.6	190.1
Yen	125.3	90.2	26.2	16.3	25.8	23.5	24.5
Other currencies	207.5	221.7	62.9	50.9	57.6	49.1	64.1
Financial institutions	1,709.1	1,643.6	409.0	448.6	430.8	354.3	409.8
<i>Private</i>	1,478.7	1,386.3	352.7	392.5	363.8	295.2	334.8
<i>Public</i>	230.4	257.3	56.3	56.1	67.1	59.1	75.0
Corporate issuers	348.2	212.2	99.4	63.8	74.9	33.9	39.7
<i>of which telecoms</i>	135.6	45.8	35.7	11.9	16.1	7.8	10.0
<i>Private</i>	287.1	187.9	80.8	57.2	71.3	28.3	31.1
<i>Public</i>	61.1	24.4	18.6	6.6	3.6	5.6	8.6
Governments	174.2	174.2	30.9	68.6	44.9	28.3	32.4
International organisations	74.8	86.1	14.8	26.0	20.5	20.5	19.2
Completed issues	2,306.1	2,105.4	568.4	588.5	579.0	443.8	494.1
<i>Memo: Repayments</i>	878.9	1,082.9	219.6	271.0	243.1	270.5	298.2

¹ Convertible bonds and bonds with equity warrants.

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

Table 3.2

United States, net issuance was a low \$185 billion (Table 3.1). Not since the second half of 1998, a period associated with substantial market turbulence, has there been a comparable slowdown in net borrowing. Net issuance by private financial institutions in particular remained subdued. While total gross issuance rose 15% to \$501 billion between the third and fourth quarters (Table 3.2), record repayments during the fourth quarter kept net borrowing from rising.

The decline in corporate credit spreads during the fourth quarter of 2002 suggests that a reduced demand for funds by businesses was the primary cause for the continued weakness in net issuance. This lacklustre demand for funds reflected a reluctance on the part of firms to borrow more against the backdrop of a slowdown in global economic activity and greater uncertainty about economic prospects caused in part by heightened geopolitical risks. Nevertheless, credit conditions did remain tight for some borrowers, particularly issuers of lower-rated commercial paper.

Record slowdown in net issuance

Largest slowdown
in issuance ever ...

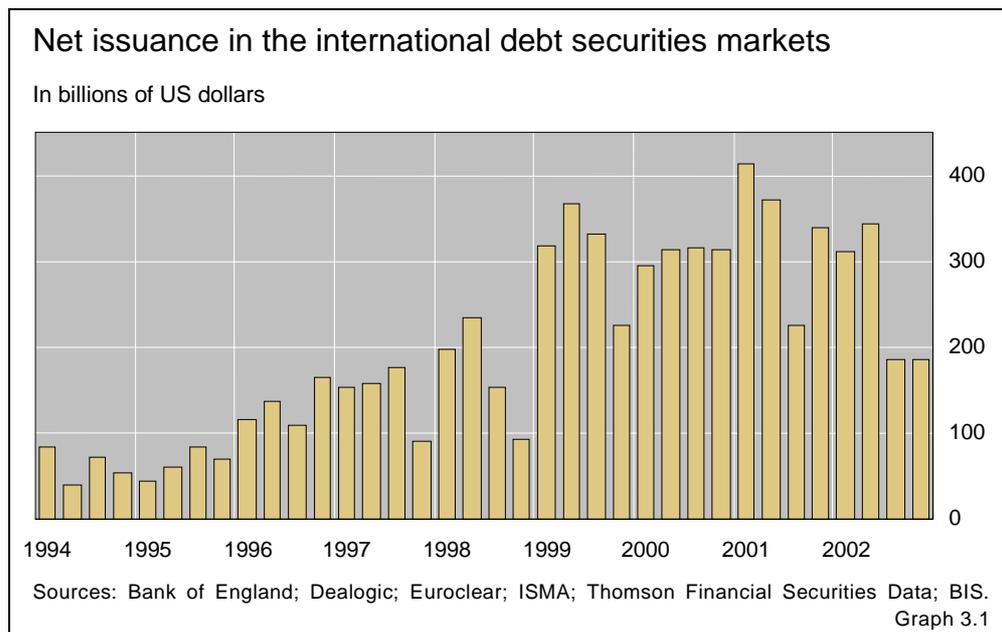
Over the course of the last six months of 2002, net issuance in the international debt securities market recorded what is arguably the largest sustained slowdown ever. The shortfall in issuance totalled nearly \$320 billion, relative to what would have prevailed if the rate of issuance witnessed during the second quarter had continued for the remainder of the year (Graph 3.1). The last time net issuance was below \$200 billion for two quarters in a row was the second half of 1998, when the Russian default and the near collapse of a major hedge fund led to severe financial market strains and a sharp rise in corporate credit spreads. In contrast, the more recent retrenchment in net issuance appears to be related to a global slowdown in economic activity and has occurred against the backdrop of a general decline in borrowing rates.

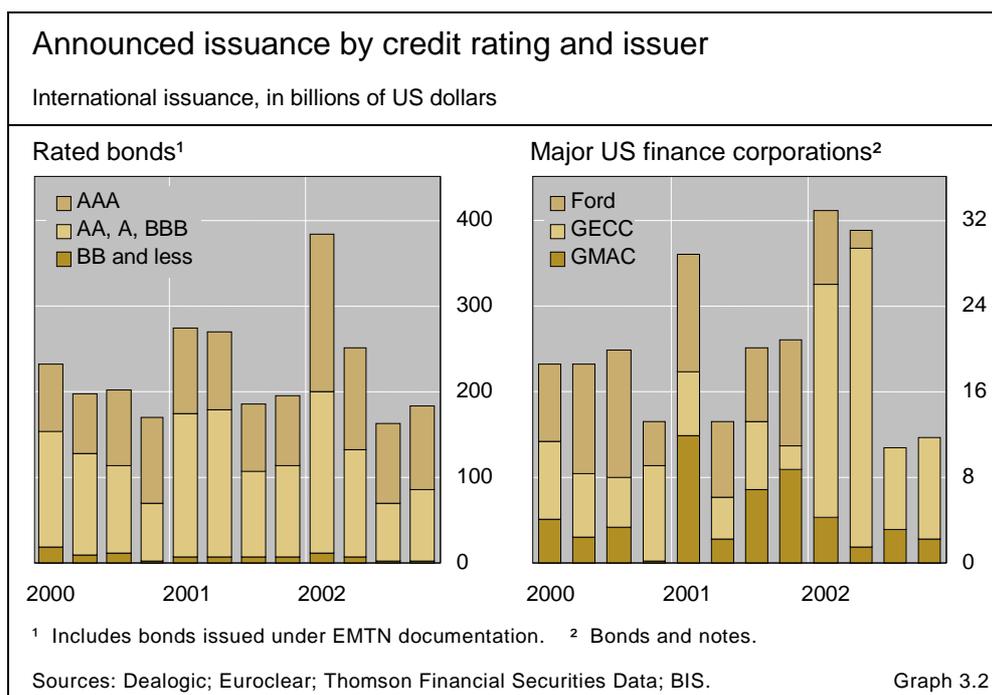
... masks
differences between
countries

The constancy of aggregate net issuance between the third and fourth quarters of 2002 masks differences in borrowing patterns across developed countries. Net issuance by US and euro area borrowers increased over the period. In contrast, net issuance by Japanese and UK borrowers contracted, in the latter case by 32% to \$20 billion. There were also some large declines in issuance within the euro area. Net issuance by German borrowers, for instance, fell by more than half to \$25 billion. The small rise in aggregate net issuance by developed country borrowers between the third and fourth quarters was more than offset by a fall in net issuance by international organisations. Their net borrowing fell from \$9.6 billion to -\$2.5 billion. For the year as a whole, however, net issuance by international organisations was up by 34% from the previous year.

Private sector borrowing remains subdued

Private financial institutions are the largest borrowers in the international debt securities market. Their net issuance during the fourth quarter of 2002, while





increasing 16% to \$140 billion, nevertheless remained substantially below the recent peak attained in the second quarter. In the United States, as the economy stalled, these institutions increased their net issuance only slightly between the third and fourth quarters, from \$42 billion to \$48 billion. The most recent figure is only 38% of the net issuance by these institutions during the first quarter of 2002. Gross issuance by the major US finance companies remained essentially unchanged in the fourth quarter after falling by about two thirds in the third quarter (Graph 3.2). This may in part have reflected an increase in borrowing costs for these companies. As discussed in the Overview, Ford Motor Credit and General Motors Acceptance Corporation were both downgraded in late 2002 because of significant shortfalls in their pension plans.

Weak issuance by private financial companies ...

Net issuance by Japanese and German private financial institutions was also weak, as concerns about prospective bank profits grew. In Japan, the government's apparent increased resolve to deal with the bad loan problem, accompanied by indications that this problem might be greater than previously thought, was associated with a slide in Japanese bank share prices and a sharp decline in net issuance by private financial institutions, from \$1 billion to -\$8 billion between the third and fourth quarters. This is the second largest contraction in the outstanding stock of international debt obligations of Japanese private financial institutions ever recorded. In Germany, a decline in borrowing by private financial institutions may have been associated with rating downgrades for some large banks. For the fourth quarter, net issuance of international debt securities by German private financial institutions was only \$7 billion, less than half the previous quarter's amount. For the year as a whole, their net issuance was only \$85 billion, \$63 billion less than was recorded during 2001. Data for the first three quarters of 2002 indicate that German financial companies, both public and private, also borrowed less

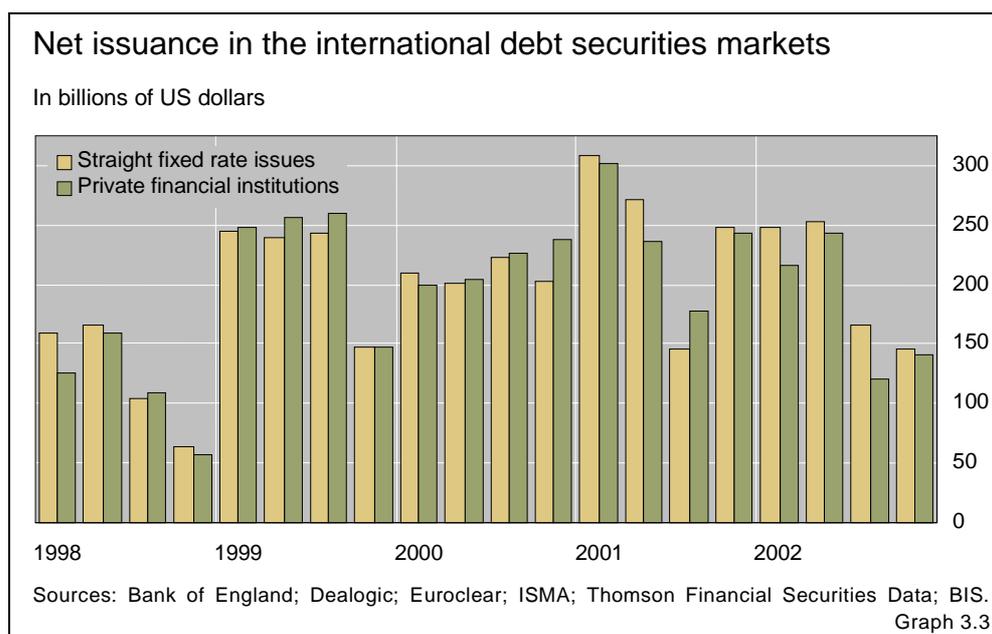
... especially Japanese and German banks ...

domestically. In the first three quarters of 2002, the stock of outstanding domestic debt securities of German financial institutions contracted by \$57 billion. This followed a \$178 billion decline for 2001 as a whole.

Historically, there has been a fairly tight relationship between net straight fixed rate issuance and total net issuance by private financial institutions (Graph 3.3). This is because a high and fairly constant proportion of net issuance by private financial institutions is in the form of straight fixed rate bonds and notes. It is therefore not surprising that net issuance of straight fixed rate securities peaked in the second quarter of 2002 and has fallen substantially since then. The largest straight fixed rate issue by a private financial company during the fourth quarter of 2002 was a €5 billion bond issued by Lehman Brothers.

Net issuance by private non-financial corporations did not recover in the fourth quarter and remained at -\$1 billion, about \$50 billion below that attained during the fourth quarter of 2001. The main reason for the year-on-year decline was a fall in net issuance by US private non-financial corporations. In the fourth quarter of 2001, these companies had been responsible for \$32 billion of net issuance, or almost two thirds of the total. In the fourth quarter of 2002, however, net borrowing by US private non-financial corporations was only \$1.5 billion, albeit up from -\$3.4 billion in the previous quarter. Reduced borrowing activity by telecoms operators was partly responsible for the longer-term fall in net issuance by non-financial corporations. In the fourth quarter of 2001, AT&T Corporation alone had been responsible for \$10.1 billion in gross issuance of bonds and notes, a quarter of total gross issuance by US non-financial corporations. In contrast, US telecoms operators were completely absent from the international debt securities market during the fourth quarter of 2002. Globally, gross issuance by telecoms operators fell by 72% to \$10 billion between the fourth quarter of 2001 and the last quarter of 2002. This to some

... and US private non-financial corporations



extent reflected efforts by telecoms operators to restructure their balance sheets and is part of an ongoing trend by businesses to reduce their leverage in the wake of rating downgrades (see the Overview).

Commercial paper market sees continuing difficulties

Credit conditions apparently remained tight for some borrowers in the commercial paper (CP) market as spreads on lower-rated CP remained at relatively high levels during most of the fourth quarter. Moreover, the majority of the increase in net issuance in the domestic CP market can be explained by seasonal factors. Most of the rise in net domestic CP issuance can be attributed to US borrowers, for whom the fourth quarter is usually a strong one for domestic CP issuance. Financial firms typically issue CP in December to finance drawdowns of bank lines of credit by corporate customers. Net US domestic CP issuance actually declined between the fourth quarter of 2001 and the last quarter of 2002.

Issuance by developing country borrowers recovers

Borrowing by developing country entities in the international debt securities market rose between the third and fourth quarters of 2002 as the cost of funds for these borrowers generally fell. Net issuance increased by 54% to

Emerging economies return ...

Net issuance of international debt securities by region and currency ¹								
In billions of US dollars								
Region/currency		2001	2002	2001	2002			
		Year	Year	Q4	Q1	Q2	Q3	Q4
North America	US dollar	525.5	310.1	121.3	126.4	93.5	37.7	52.5
	Euro	65.1	40.0	22.0	18.3	14.7	7.3	-0.4
	Yen	19.1	-7.2	2.6	-4.1	1.0	-1.5	-2.5
	Other currencies	7.2	12.5	0.5	3.5	6.0	-0.8	3.8
Europe	US dollar	56.4	73.4	15.3	6.6	44.1	5.1	17.6
	Euro	520.1	469.6	141.8	137.6	134.3	101.5	96.1
	Yen	-2.9	-26.3	-3.3	-12.6	-4.0	-7.1	-2.5
	Other currencies	72.4	88.8	28.5	17.0	31.3	24.3	16.1
Others	US dollar	70.6	46.3	7.6	23.2	12.4	5.6	5.1
	Euro	12.0	14.4	2.2	3.1	7.1	5.5	-1.2
	Yen	0.5	-8.8	0.9	-12.5	6.0	2.1	-4.4
	Other currencies	2.2	11.4	0.1	3.2	-2.3	5.4	5.1
Total	US dollar	652.6	429.8	144.2	156.2	150.0	48.4	75.2
	Euro	597.3	524.0	166.0	159.1	156.2	114.3	94.5
	Yen	16.7	-42.4	0.1	-29.3	3.0	-6.6	-9.5
	Other currencies	81.8	112.7	29.1	23.7	35.0	28.9	25.0

¹ Based on the nationality of the borrower.

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

Table 3.3

\$8.8 billion, albeit from an unusually low level. The increased issuance was almost entirely attributable to European transition economy borrowers; their issuance increased from $-\$0.3$ billion to $\$3.2$ billion. In contrast, net issuance by borrowers in developing Asia and the Pacific slowed to $\$4$ billion from $\$5.4$ billion in the previous quarter and, as was also the case in the third quarter, there was almost no new net borrowing by Latin American borrowers as a group.

... with large
Russian borrowing

Russian borrowers were responsible for half of the increased net issuance by entities from European transition economies. Total net issuance by Russian borrowers in the fourth quarter was $\$1.7$ billion, the result of $\$2.3$ billion in new announcements. This was the largest rate of gross issuance since the country's sovereign default in late 1998. The largest Russian borrower was OAO Gazprom, which floated $\$700$ million in two issues.

Although in the aggregate there was almost no net new issuance by Latin American borrowers during the fourth quarter, the region did witness a significant amount of gross issuance. Mexico, for example, had $\$2.3$ billion in gross announcements, which included the largest emerging market issue during the fourth quarter, a $\$1$ billion offer by Pemex that was priced at a spread of 335 basis points. In the wake of the presidential elections, Brazil enjoyed a marked improvement in investor sentiment. Although sovereign spreads remained wide, Brazilian borrowers were quick to return to international markets and floated $\$2.7$ billion in new announcements to refinance maturing debt. Two fifths of the total was due to a single borrower, a Brazilian financial company. In contrast, Venezuela has been completely absent from the international debt securities market since the Republic of Venezuela floated a $\text{€}250$ million note in December 2001 that priced at a spread of 710 basis points.

Brazil quickly
returns to
international bond
markets

Turkey also enjoyed a marked improvement in investor sentiment following national elections. Between mid-November and early December 2002, the Republic of Turkey floated $\$1.15$ billion in three bond issues, the largest of which priced at a spread of 780 basis points.

Cross-border holdings of securities top \$12 trillion

Philip D Wooldridge

Portfolio investments now surpass loans as the most important source of cross-border finance. According to the latest Coordinated Portfolio Investment Survey (CPIS) compiled by the IMF, total cross-border investment in debt and equity securities equalled \$12.5 trillion at the end of 2001. By comparison, the outstanding stock of cross-border loans and deposits totalled \$8.8 trillion. Foreign direct investment (FDI) amounted to a further \$6.8 trillion.

The 2001 CPIS collects information on cross-border portfolio investment by residents of 67 economies. It excludes FDI and instruments other than securities, in particular loans and deposits. The previous survey, in which 29 economies participated, was conducted in 1997, and beginning in 2002 the survey will be conducted on an annual basis. The methodology underlying the CPIS is similar to that for the locational banking statistics compiled by the BIS, making them useful complements. The locational statistics capture the cross-border assets and liabilities of deposit-taking institutions in 32 jurisdictions.

Total cross-border holdings of debt securities approximately doubled between 1997 and 2001, to \$7.4 trillion. The international debt securities statistics compiled by the BIS show the same rate of growth and a similarly sized end-of-period stock. This suggests that, at least at a global level, international issuance was a reasonable proxy for cross-border investment over the 1997–2001 period. The relationship between international investment and issuance, however, is becoming increasingly tenuous as more and more countries liberalise their capital accounts and financial markets. Moreover, there are important differences at a disaggregated level. At end-2001, reported cross-border holdings of emerging market debt securities were significantly lower than the outstanding stock of international debt securities issued by emerging market residents: \$297 billion, compared to \$516 billion. Part of the difference can be explained by investors domiciled in the country of the issuer purchasing bonds sold in the international market. For example, Asian investors hold almost half of the international bonds issued by Asian borrowers. Gaps in the coverage of the CPIS might also be a factor. Many participants in the CPIS had difficulty obtaining information about securities held by households with non-resident custodians. Furthermore, whereas issuance volumes are recorded at face value, investments are recorded at market value.

The importance of bonds as instruments for raising cross-border debt finance increased greatly relative to bank loans over the 1997–2001 period. In 1997, the outstanding stock of cross-border loans and deposits was more than twice as large as cross-border holdings of debt securities; by 2001, the stock of loans was only 20% larger. Equity securities also increased in importance relative to bank loans, although not relative to debt securities.

Banks themselves contributed to the shift from loans to securities. Banks stepped up their FDI and purchases of securities between 1997 and 2001. As a result, loans and deposits declined from 85% of cross-border assets booked by banks in the BIS reporting area to 76%. Banks' relative importance as investors in the international bond market declined over the 1997–2001 period. Nevertheless, as much as 30% of the \$7.4 trillion invested in foreign debt securities at the end of 2001 was held by banks.

Residency of borrower	Loans and deposits ^{1,2}		Debt securities ¹				Equity securities ¹	
			Total holdings ³		% held by banks ²		Total holdings ³	
	1997	2001	1997	2001	1997	2001	1997	2001
All countries	7,903	8,836	3,520	7,412	35%	30%	2,568	5,134
Developed countries	5,402	6,737	2,823	6,267	37%	30%	2,157	4,325
Euro area	1,699	2,390	1,111	2,917	43%	35%	811	1,811
Japan	840	444	152	194	42%	29%	242	334
United States	1,219	1,652	923	2071	36%	26%	428	998
Developing countries	946	712	319	297	30%	35%	232	300
Asia-Pacific	412	222	88	62	41%	50%	61	147
Europe, Middle East & Africa	272	271	72	94	32%	32%	53	62
Latin America	262	219	159	141	23%	31%	119	91

¹ In billions of US dollars unless otherwise noted. ² Cross-border assets of banks domiciled in the BIS reporting area. ³ Cross-border holdings of investors domiciled in economies participating in the IMF's CPIS.