

3. The international debt securities market

The second quarter of 2003 witnessed continued strength in fund-raising through the international debt securities market. Aggregate net issuance was \$346 billion (Table 3.1), essentially unchanged from the previous quarter. This

Main features of net issuance in international debt securities markets								
In billions of US dollars								
	2001	2002	2002			2003		Stocks at end-Jun 2003
	Year	Year	Q2	Q3	Q4	Q1	Q2	
Total net issues	1,346.9	1,010.5	340.5	179.3	182.2	355.1	345.6	10,266.2
Money market instruments ¹	-78.9	2.3	8.3	11.8	-10.0	55.4	3.4	518.7
<i>Commercial paper</i>	26.9	23.7	1.8	19.3	-3.0	46.8	13.1	367.9
Bonds and notes ¹	1,425.8	1,008.2	332.2	167.5	192.2	299.8	342.2	9,747.5
<i>Floating rate issues</i>	390.8	198.9	74.1	25.3	39.6	-41.7	-27.6	2,215.3
<i>Straight fixed rate issues</i>	995.8	799.2	245.6	145.2	155.2	341.1	369.3	7,210.6
<i>Equity-related issues</i>	39.1	10.1	12.5	-3.0	-2.6	0.3	0.5	321.6
Developed countries	1,259.9	946.3	325.6	164.4	171.8	330.4	314.4	9,091.0
<i>United States</i>	596.7	337.2	115.7	35.6	48.5	61.3	30.6	2,865.1
<i>Euro area</i>	550.9	471.1	153.5	91.0	98.1	212.8	206.5	4,256.7
<i>Japan</i>	-10.1	-23.5	3.2	-6.2	-10.2	-4.0	-2.7	249.1
Offshore centres	28.2	8.3	0.3	-1.1	4.7	2.3	4.3	119.1
Developing countries	42.6	35.0	7.8	6.9	8.7	13.2	11.7	577.4
Financial institutions	1,037.5	834.6	277.3	151.6	168.7	273.1	246.2	7,396.9
<i>Private</i>	955.1	714.2	240.7	115.8	141.0	203.2	176.7	6,262.5
<i>Public</i>	82.4	120.4	36.6	35.8	27.7	69.9	69.5	1,134.3
Corporate issuers	207.6	55.8	40.7	0.9	2.1	16.4	31.2	1,358.1
<i>Private</i>	171.3	53.8	40.5	-1.6	-3.4	10.6	30.3	1,123.5
<i>Public</i>	36.3	2.0	0.3	2.5	5.5	5.8	0.9	234.6
Governments	85.5	99.2	15.7	17.6	14.5	56.5	52.9	1,032.5
International organisations	16.3	20.9	6.8	9.1	-3.0	9.1	15.3	478.7
<i>Memo: Domestic CP²</i>	-125.8	-104.8	-70.6	5.1	27.2	-0.6	-18.0	1,923.5
<i>Of which: US</i>	-144.6	-91.4	-56.5	0.2	23.8	-15.7	-41.9	1,312.5

¹ Excluding notes issued by non-residents in the domestic market. ² Data for the second quarter of 2003 are partly estimated.

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

Table 3.1

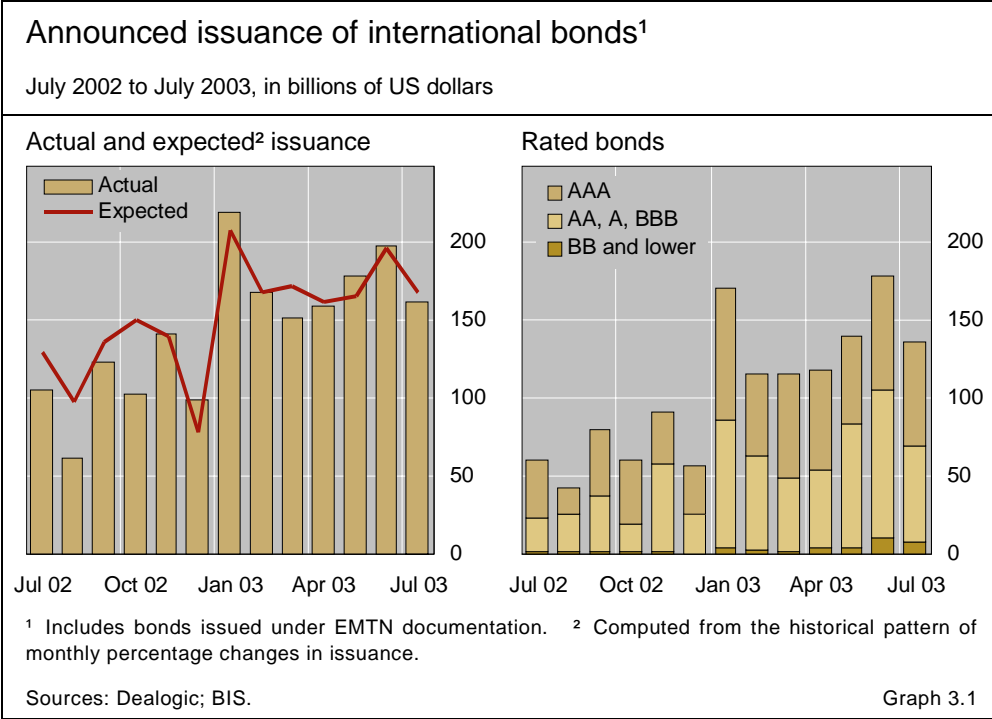
brought net issuance for the first half of the year to \$701 billion, an 8% increase over the figure for the first six months of 2002 and a substantial rise over the weak activity of the intervening period. The search by investors for higher yields, prevalent during most of the second quarter of 2003, led to greater demand for credit products. This demand was met with ample new supply from euro area borrowers, making up for a sharp fall in net issuance by US entities. Borrowers also continued to take advantage of historically low long-term interest rates to lengthen the maturity of their debt. Net issuance would have been even higher during the second quarter had it not been for record repayments. The quarter saw defaults and early repayments on callable and convertible debt that totalled \$19 billion.

The greater demand for credit products created a favourable environment for lower-rated issues. Emerging market borrowers in particular continued to benefit from receptive international capital markets during most of the second quarter. Their fund-raising through the international debt securities market remained fairly robust, as spreads on high-yielding sovereign debt fell to levels last seen in the late 1990s. The quarter also saw a sharp pickup in speculative grade issuance by developed country entities.

Borrowers shift to longer-term debt as geopolitical risks wane and investors seek higher yields

The waxing and waning of recent geopolitical risks had a discernible impact on the international debt securities market, but gross issuance over the quarter nevertheless hit a record high. Associated with the outbreak of war in Iraq was a lower than expected rate of gross issuance in the international bond market (Graph 3.1). Gross issuance usually increases slightly between February and

Gross issuance at an all-time high



Gross issuance in the international bond and note markets

In billions of US dollars

	2001	2002	2002			2003	
	Year	Year	Q2	Q3	Q4	Q1	Q2
Total announced issues	2,305.3	2,100.6	569.1	434.9	490.4	757.6	784.2
Bond issues	1,348.8	1,165.2	313.9	210.2	266.2	435.0	454.5
Note issues	956.5	935.5	255.3	224.8	224.3	322.6	329.7
Floating rate issues	642.9	603.2	160.2	144.1	157.0	123.1	140.4
Straight fixed rate issues	1,590.2	1,454.7	388.9	285.9	325.2	616.5	627.4
Equity-related issues ¹	72.2	42.8	20.0	5.0	8.2	18.0	16.4
US dollar	1,131.3	985.9	256.5	200.4	218.9	332.1	286.5
Euro	841.4	806.7	229.3	163.9	184.9	330.4	388.6
Yen	125.2	88.3	25.9	21.6	24.5	23.3	26.1
Other currencies	207.4	219.7	57.5	49.0	62.2	71.8	83.0
Financial institutions	1,708.2	1,632.0	429.3	352.7	401.3	582.3	594.9
<i>Private</i>	1,471.3	1,375.9	361.9	293.4	329.0	464.7	464.2
<i>Public</i>	236.8	256.0	67.4	59.3	72.3	117.6	130.7
Corporate issuers	348.2	211.5	74.5	34.0	40.2	55.0	78.6
<i>Of which: telecoms</i>	135.6	45.9	16.1	7.8	10.1	23.0	6.6
<i>Private</i>	287.2	186.6	70.9	28.4	31.1	39.6	71.3
<i>Public</i>	61.0	24.9	3.6	5.6	9.0	15.5	7.3
Governments	174.2	172.9	44.9	28.3	31.1	81.6	80.1
International organisations	74.8	84.3	20.5	20.0	17.9	38.7	30.7
Completed issues	2,305.1	2,101.2	576.2	441.6	495.6	716.7	724.8
<i>Memo: Repayments</i>	879.3	1,093.1	244.0	274.1	303.4	417.0	382.6

¹ Convertible bonds and bonds with equity warrants.

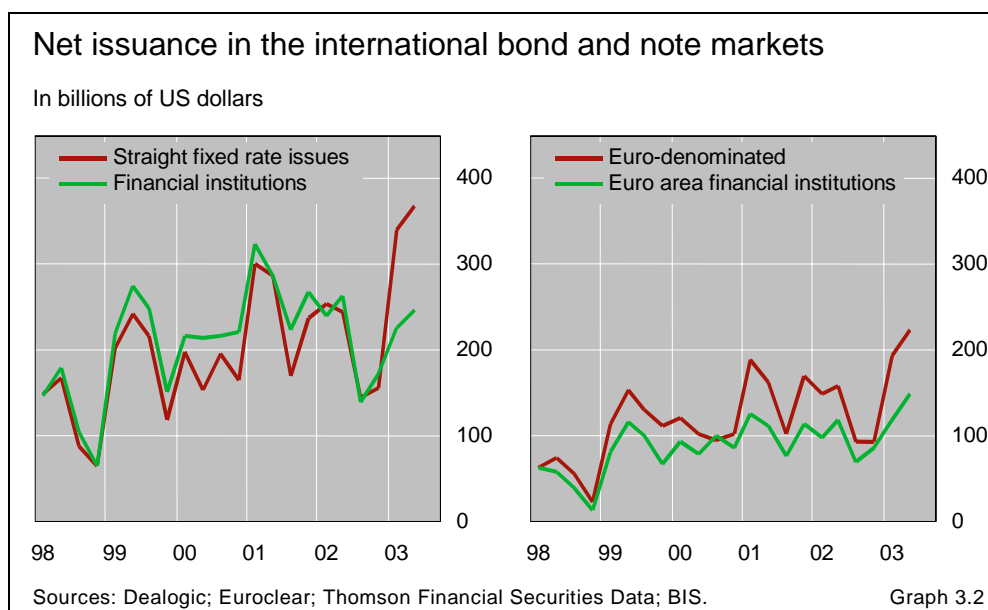
Sources: Dealogic; Euroclear; ISMA; Thomson Financial Securities Data; BIS.

Table 3.2

March but in 2003 it actually fell during that period, although, at \$151 billion, announced issuance was only \$21 billion below that implied by the seasonal pattern of monthly changes. Moreover, the rapid military victory permitted a quick return to expected rates of issuance in April, and the earlier shortfall was partly made up by greater than expected issuance in May. For the second quarter as a whole, gross announced issuance of bonds and notes was \$784 billion (Table 3.2), a further increase over the record level set in the previous quarter.

An important factor underlying these developments was the continuation of global investors' search for yield. There was a large decline in net short-term fund-raising in the international debt securities market, consistent with the view that borrowers were taking advantage of historically low long-term interest rates to lengthen the maturity of their debt. Net issuance of money market instruments contracted to \$3 billion from \$55 billion in the previous quarter. This was the result of a sharp fall in net issuance of international commercial paper (CP) from an unusually high level in the first quarter. Net domestic CP

Borrowers lengthen
debt maturity



issuance also fell, from $-\$1$ billion to $-\$18$ billion, although a marked drop in net CP issuance by US companies was partly offset by a rise in net issuance by Japanese businesses.

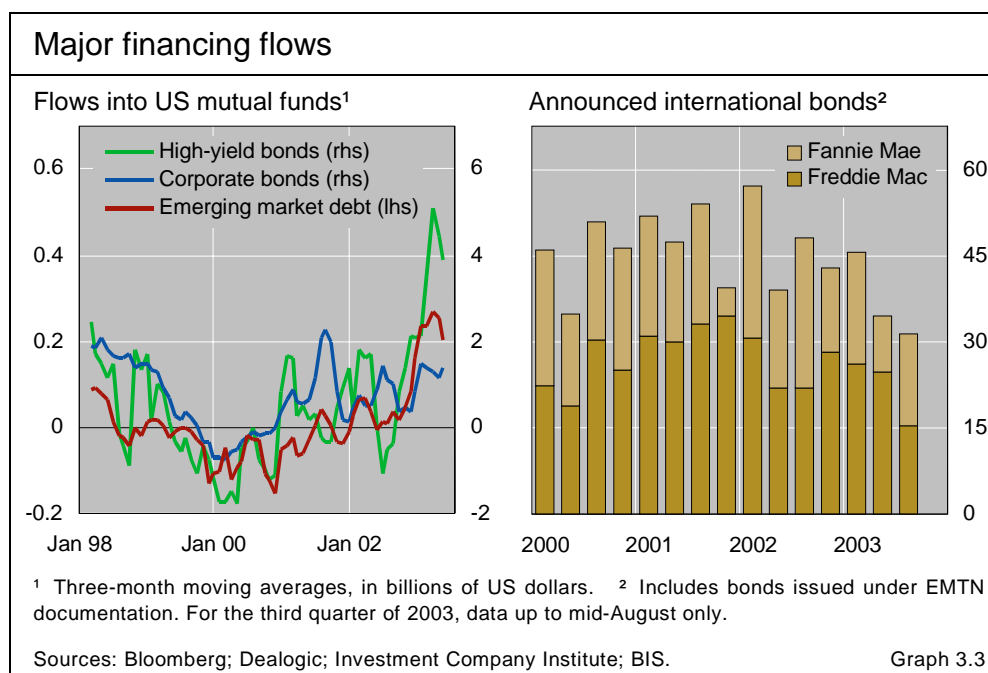
The decline in net issuance of money market instruments was partly offset by increased net borrowing in the form of longer-term, fixed rate securities. Net issuance of straight fixed rate bonds and notes rose by $\$28$ billion in the second quarter to $\$369$ billion (Graph 3.2), an all-time high. This rate of net issuance is substantially greater than one might have expected, given the historically fairly tight relationship between net issuance of straight fixed rate securities and net issuance by financial institutions. In contrast, net issuance of floating rate bonds and notes remained negative for the second quarter in a row. This occurred despite a 14% rise in announcements of floating rate bonds and notes to $\$140$ billion in the second quarter of 2003, as a high rate of repayments in this instrument category kept the net issuance figure negative.

Record fixed rate issuance

Developing country borrowers gain from strong investor demand

Emerging markets were among the biggest beneficiaries of the global search for yield that characterised most of the second quarter of 2003. Flows into US mutual funds specialising in emerging market debt were large (Graph 3.3), and spreads on high-yield sovereign debt fell to levels last seen in the late 1990s. Emerging market borrowers responded to these favourable issuance conditions and continued to tap the international debt securities market for new funds. Their net issuance during the second quarter was $\$12$ billion, about the same as in the first quarter, but substantially above levels seen in 2002. A $\$3$ billion increase in net issuance by borrowers in developing Asia and the Pacific was more than offset by a $\$6$ billion fall in net issuance by borrowers in developing Europe. Net issuance by Latin American borrowers was steady at $\$5$ billion. The two largest emerging market issues during the second quarter were a $\text{€}1.25$ billion 10-year bond floated by the Republic of South Africa and a $\$1.5$ billion US dollar issue by Mexico.

Emerging markets benefit from the hunt for yield ...



In Latin America, a decline in net borrowing by Chilean and Peruvian entities in the second quarter of 2003 was more than offset by a \$3 billion increase in net issuance by Brazilian borrowers. Mexico's net borrowing also rose, by 30% to \$3 billion. This was accomplished through \$4.4 billion in new announcements. In addition, during May and July, Mexico conducted two Brady bond buyback operations, one for \$3.8 billion of US dollar-denominated bonds and another for \$1.2 billion of European currency denominated bonds. The funds used in these buybacks stemmed from both accumulated liquidity from earlier financial operations of the federal government and a \$2 billion syndicated loan (see "International syndicated credits in the second quarter of 2003" on page 25). This action resulted in Mexico becoming the first sovereign borrower to completely liquidate its outstanding stock of Brady bonds.

It was Korean and Chinese borrowers that were responsible for most of the rise in net borrowing for the Asia-Pacific region. In the case of China, net issuance rose to \$0.6 billion in the second quarter of 2003 from -\$1.0 billion in the previous quarter, while Korea's net issuance increased to \$1.9 billion from \$0.8 billion. On the other hand, net issuance by Thai entities remained at essentially zero for the third quarter in a row. There was nevertheless a significant development concerning Thai borrowing: in the second quarter, the Kingdom of Thailand issued \$300 million of US dollar bonds, the first dollar issues by the central government since April 1997.

Lower-rated issues find receptive market

Lower-rated borrowers from developed countries also took advantage of the search for yield and the resulting decline in credit spreads. Gross issuance of speculative grade international bonds from developed country entities increased by more than 150% to \$8.8 billion in the second quarter. Combined with \$9.6 billion in speculative grade announcements from emerging market

... as do other lower-rated borrowers

entities, this raised aggregate speculative grade gross issuance to \$18.4 billion, up from \$7.8 billion in the previous quarter. This occurred despite a sharp fall in gross issuance by telecoms operators, from \$23 billion to \$7 billion. Speculative grade issuance continued to rise throughout the second quarter, reaching \$10.5 billion in June, the highest level since March 2000.

There was also a marked expansion in investment grade issuance in the international bond market throughout the course of the second quarter of 2003. After remaining fairly constant during February, March and April, announcements of bonds rated BBB and higher increased by \$21 billion in May and by an additional \$32 billion in June. This greater investment grade issuance was not associated with larger fund-raising by Fannie Mae and Freddie Mac, the US housing agencies. Their combined gross issuance in the international bond market, as reported by Dealogic, fell by 24% to \$35 billion. However, preliminary data suggest that the decline will be reversed in the third quarter, as announcements during July and the first half of August already amounted to \$31 billion. Thus, the surprise management shake-up at Freddie Mac announced on 9 June does not appear to have affected the ability of the housing agencies to raise funds in the international market; although secondary market spreads on agency debt did widen briefly after 9 June, they fell back again later in the month. The largest new international bond issue by Freddie Mac following the announcement was a \$2.5 billion 10-year note that closed on 12 June and was priced at a spread of 68 basis points over the 10-year US Treasury yield.

Emerging market spreads began to rise in the second half of June, indicating some abatement in the search for yield (see the Overview). There followed a 65% decline in speculative grade issuance by emerging market entities between June and July. The heaviest emerging market speculative grade borrower in July was Brazil, with \$1.3 billion of gross issuance. In contrast, speculative grade issuance by developed country entities rose by 14% between June and July. The biggest developed country speculative grade borrower in July was Vivendi Universal, responsible for \$1.5 billion in gross issuance over two deals, the larger of which was a five-year note priced at a spread of 380 basis points. At \$7.2 billion, total speculative grade announcements, although down from the June figure, remained fairly robust in July. Total announced issuance of international bonds fell by 18% in July to \$162 billion, a slightly greater decline than the seasonal monthly pattern in issuance would have led one to predict.

Euro-denominated issuance reaches all-time high

Net issuance of euro-denominated bonds and notes in the international market reached a record high in the second quarter of 2003, rising by 15% to \$223 billion. In percentage terms, however, the increase was substantially less than that posted between the fourth quarter of 2002 and the first quarter of this year, when net issuance of these securities more than doubled. The rise reflected greater borrowing by both financial and non-financial entities from the

Investment grade
issuance rises

Speculative grade
issuance falls in
July

Euro-denominated
issuance increases
further

Net issuance of international debt securities by region and currency¹

In billions of US dollars

Region/currency		2001	2002	2002			2003	
		Year	Year	Q2	Q3	Q4	Q1	Q2
North America	US dollar	524.8	303.9	93.3	35.7	49.3	40.4	28.5
	Euro	65.1	40.0	14.7	7.3	-0.4	15.9	4.9
	Yen	19.0	-7.2	1.0	-1.5	-2.5	0.0	-1.7
	Other currencies	7.2	12.5	6.0	-0.8	3.8	3.5	7.6
Europe	US dollar	42.7	62.6	36.8	4.2	15.4	38.2	29.1
	Euro	521.5	463.7	133.0	101.5	93.8	203.9	213.3
	Yen	-2.5	-26.2	-4.7	-6.5	-2.7	-4.4	-3.2
	Other currencies	73.7	85.7	28.4	25.8	14.6	27.1	26.4
Others	US dollar	83.9	53.6	16.8	5.3	8.1	18.7	17.8
	Euro	10.5	18.2	8.1	5.4	-0.3	6.6	13.2
	Yen	0.1	-10.3	6.7	-0.5	-3.7	-1.8	1.8
	Other currencies	0.8	14.0	0.5	3.4	6.8	7.0	7.8
Total	US dollar	651.5	420.1	146.8	45.3	72.8	97.3	75.3
	Euro	597.1	521.9	155.8	114.2	93.1	226.4	231.4
	Yen	16.6	-43.7	3.0	-8.4	-8.9	-6.1	-3.0
	Other currencies	81.7	112.3	35.0	28.3	25.2	37.6	41.9

¹ Based on the nationality of the borrower.

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

Table 3.3

euro area. The largest non-financial corporate issuer in the second quarter was Volkswagen International, which borrowed €4 billion through the flotation of two euronotes. Siemens also floated a large issue in the second quarter, a €2.5 billion contingent convertible bond.¹ Euro area financial institutions were responsible for even larger flotations. The Kreditanstalt für Wiederaufbau, for instance, borrowed €5 billion with a single issue while DEPFA ACS Bank raised €3.5 billion, also with a single issue.

Higher net issuance of euro-denominated bonds and notes helped to push total net issuance of euro-denominated debt securities in the international market to \$231 billion, an all-time high (Table 3.3). A decline in net issuance of these securities by North American entities was partly offset by increased euro-denominated issuance from borrowers outside the United States and the euro area, which doubled to \$13.2 billion. The largest borrower in this category was the European Investment Bank, which floated a €5 billion 10-year bond. This was also the largest issue in the second quarter by an international organisation.

¹ A contingent convertible bond is a security similar to a traditional convertible bond with a strike price that is the cost of the stock when the bond converts into stock. However, in the case of a contingent convertible bond, there is another price higher than the strike price that the company's stock must reach before the conversion can be made.

Pension fund gap financed in international securities market

A significant development during the second quarter of 2003 was the placement on 26 June of a very substantial debt package by General Motors Corporation. Reportedly, the company intended to use most of the proceeds to fill a large shortfall in its pension plan which was partly to blame for its recent rating downgrades. The package was made up of \$8.2 billion in issuance by the parent company and an additional \$5.5 billion in gross issuance by its financing subsidiaries. This debt package even surpassed the unusually large fund-raising operation conducted by WorldCom in May 2001, comprising \$11.9 billion in bond offerings on a single day. To the extent that General Motors earns a higher tax-free return on its pension assets than the after-tax cost of the new debt, the deal will strengthen the firm's balance sheet. The largest of the issues, a \$3 billion 30-year bond, was priced at a spread of 400 basis points over a comparable US Treasury.

Borrowing to fill the pension gap ...

The \$8.2 billion of the General Motors debt package issued by the parent company helped to push net private US non-financial corporate issuance during the second quarter to \$4.3 billion, up from \$0.6 billion in the previous quarter. However, there was no accompanying increase in borrowing by US financial institutions, whose net issuance fell 58% to \$26 billion during the second quarter and was the main reason for the decline over the same period in overall net issuance by US entities. Issuance by non-US corporate entities rose significantly more than that of US entities in the aggregate. Net private corporate issuance by euro area countries, for example, grew from \$6.5 billion to \$24.3 billion, mostly due to greater borrowing by French entities, whose net issuance rose from -\$2.9 billion to \$12.1 billion.

... supports US non-financial corporate issuance