Gregory D Sutton

+41 61 280 8421
greg.sutton@bis.org

3. The international debt securities market

A sharp fall in net borrowing by euro area entities was responsible for reduced fund-raising through the international debt securities market in the third quarter of 2003. Turbulent market conditions appear to have played an important

Main features of net issuance in international debt securities markets

In billions of US dollars

	2001	2002	2002		2003			Stocks at end-Sep 2003
	Year	Year	Q3	Q4	Q1	Q2	Q3	
Total net issues	1,346.6	1,009.6	179.4	182.2	355.3	347.4	298.6	10,710.7
Money market instruments[1]	–78.9	2.3	11.8	–10.0	55.4	3.7	–33.2	492.7
Commercial paper	*26.9*	*23.7*	*19.3*	*–3.0*	*46.8*	*13.3*	*–25.5*	*347.2*
Bonds and notes[1]	1,425.4	1,007.3	167.6	192.2	300.0	343.7	331.8	10,217.9
Floating rate issues	*390.8*	*198.9*	*25.3*	*39.6*	*–41.6*	*–28.0*	*–14.1*	*2,230.0*
Straight fixed rate issues	*995.5*	*798.2*	*145.2*	*155.2*	*341.2*	*371.2*	*341.9*	*7,657.4*
Equity-related issues	*39.1*	*10.2*	*–2.9*	*–2.6*	*0.3*	*0.5*	*4.0*	*330.5*
Developed countries	1,259.6	946.2	164.5	171.8	330.9	315.7	277.1	9,500.4
United States	*595.6*	*329.2*	*33.9*	*48.8*	*54.7*	*29.2*	*88.1*	*2,935.4*
Euro area	*546.5*	*480.2*	*93.4*	*100.3*	*212.5*	*208.3*	*125.1*	*4,468.5*
Japan	*–11.5*	*–22.4*	*–5.3*	*–10.2*	*–3.0*	*–1.8*	*–3.4*	*254.9*
Offshore centres	28.1	8.3	–1.1	4.7	2.3	4.3	0.4	121.2
Developing countries	42.6	34.2	6.9	8.7	13.0	12.0	19.4	601.1
Financial institutions	1,039.4	835.5	151.7	168.7	273.8	247.2	255.6	7,769.0
Private	*954.8*	*699.0*	*114.0*	*132.1*	*225.6*	*199.1*	*212.0*	*6,587.1*
Public	*84.6*	*136.5*	*37.8*	*36.6*	*48.2*	*48.1*	*43.7*	*1,181.9*
Corporate issuers	208.3	54.0	–0.1	2.1	15.9	32.0	19.0	1,394.8
Private	*170.0*	*53.3*	*–1.6*	*–3.8*	*10.6*	*30.3*	*18.9*	*1,156.0*
Public	*38.3*	*0.7*	*1.5*	*5.9*	*5.2*	*1.7*	*0.1*	*238.7*
Governments	82.6	99.2	18.6	14.5	56.5	52.9	22.3	1,058.9
International organisations	16.3	20.9	9.1	–3.0	9.1	15.4	1.7	488.0
Memo: Domestic CP[2]	*–128.8*	*–104.4*	*8.7*	*23.4*	*11.9*	*–29.8*	*–38.3*	*1,835.1*
Of which: US	*–144.7*	*–91.4*	*0.2*	*23.8*	*–15.7*	*–41.9*	*–22.3*	*1,290.2*

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

Sources: 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	2002		2003		
	Year	Year	Q3	Q4	Q1	Q2	Q3
Total announced issues	2,305.3	2,100.6	434.9	490.4	757.9	755.9	681.0
Bond issues	1,348.8	1,165.2	210.1	266.2	435.3	424.7	370.9
Note issues	956.5	935.5	224.8	224.3	322.6	331.2	310.1
Floating rate issues	642.9	603.2	144.1	157.0	123.3	126.6	132.3
Straight fixed rate issues	1,590.2	1,454.7	285.9	325.2	616.6	612.7	522.6
Equity-related issues[1]	72.2	42.8	5.0	8.2	18.0	16.6	26.1
US dollar	1,131.3	985.9	200.4	218.9	332.1	281.4	285.9
Euro	841.4	806.7	163.9	184.9	330.7	370.2	289.4
Yen	125.2	88.3	21.6	24.5	23.3	26.0	25.3
Other currencies	207.4	219.7	49.0	62.2	71.8	78.4	80.4
Financial institutions	1,710.9	1,633.2	352.7	401.3	583.0	570.2	562.4
Private	*1,471.6*	*1,361.3*	*291.6*	*320.7*	*488.5*	*467.0*	*473.1*
Public	*239.3*	*271.9*	*61.1*	*80.6*	*94.5*	*103.2*	*89.3*
Corporate issuers	348.4	210.2	34.0	40.2	54.7	77.7	64.4
Of which: telecoms	*135.6*	*45.9*	*7.8*	*10.1*	*23.5*	*6.6*	*7.0*
Private	*285.7*	*186.2*	*28.4*	*30.7*	*39.6*	*70.6*	*53.2*
Public	*62.7*	*24.1*	*5.6*	*9.5*	*15.1*	*7.1*	*11.2*
Governments	171.2	172.9	28.3	31.1	81.6	79.4	38.9
International organisations	74.8	84.3	20.0	17.9	38.7	28.6	15.3
Completed issues	2,305.1	2,100.2	441.6	495.6	716.9	727.1	678.8
Memo: Repayments	*879.7*	*1,093.0*	*274.0*	*303.4*	*416.9*	*383.5*	*347.0*

[1] Convertible bonds and bonds with equity warrants.

Sources: Dealogic; Euroclear; ISMA; Thomson Financial Securities Data; BIS. Table 3.2

role in the slowdown. Issuance was particularly weak in August, a month that saw heightened interest rate volatility. However, the decline proved to be transitory, as issuance rebounded in September to its second highest monthly rate ever. Nevertheless, because of the slowdown in August, aggregate net issuance fell by 14% in the third quarter to $299 billion (Table 3.1). Gross issuance in the international bond and note markets also contracted over the period, by 10% to $681 billion (Table 3.2).

The decline in fund-raising by euro area entities was partially offset by greater net borrowing by others. For instance, emerging market borrowers stepped up their net issuance in the international debt securities market, against the backdrop of a series of rating upgrades. In July, both Turkey and Venezuela received upgrades from Standard & Poor's, and both countries subsequently borrowed heavily in the international debt securities market. Many more emerging market countries received credit rating upgrades in October. Russia's sovereign debt rating was raised to investment grade by Moody's, a remarkable development for a borrower that had defaulted as recently as 1998.

US financial institutions also raised their net issuance in the third quarter, as economic growth in the United States picked up markedly. This helped to push net issuance of US dollar-denominated securities to $138 billion, roughly equal to that of euro-denominated securities. This is the first time in two years that net dollar issuance has been at least as large as net euro issuance.

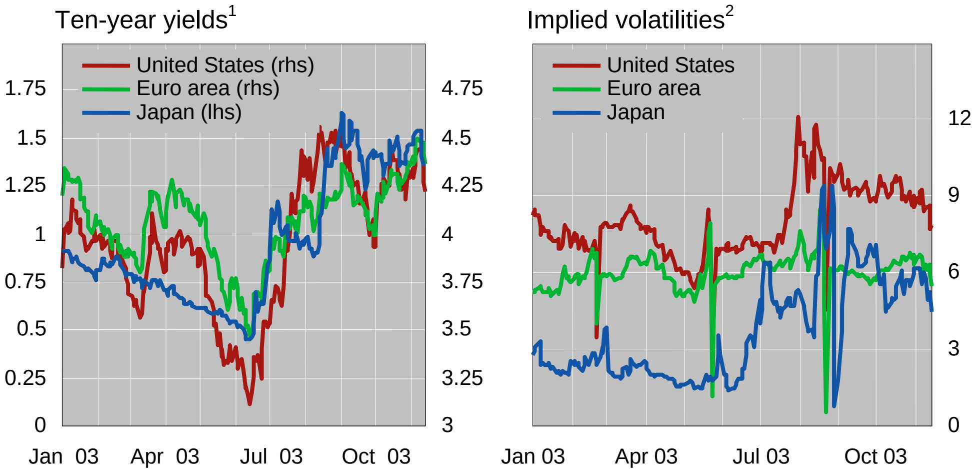
Global bond market sell-off disrupts fund-raising

Heightened interest rate volatility in August …

… coincides with a sharp fall in issuance

The global bond market sell-off that began in mid-June, the largest since 1994 and discussed in detail in the last issue of this *Review*, affected issuance plans in the international debt securities market. Long-term government yields in the major markets rose sharply over the 10-week period following the start of the sell-off (Graph 3.1). However, the effect on financing decisions was to some extent mitigated by the fact that credit spreads remained relatively stable and rates were at or near historical lows prior to the start of the sell-off. At first, interest rate volatility in the euro area and the United States did not grow significantly. Towards the end of July, however, interest rate volatility, as measured by the forward-looking volatility implicit in options on government bond futures, increased in the United States and in the euro area. In the case of the United States, the rise was dramatic, and volatility remained elevated during the entire month of August, although by the end of the month it had declined substantially from the peak attained in late July. In the euro area, in contrast, interest rate volatility returned to more normal levels by mid-August. Against this backdrop, announced issuance of international bonds fell markedly in August, to only $69 billion (Graph 3.2). Although August is usually a slow month, issuance was a long way below what would have been expected on the basis of the typical seasonal pattern exhibited by the market.

Government bond markets



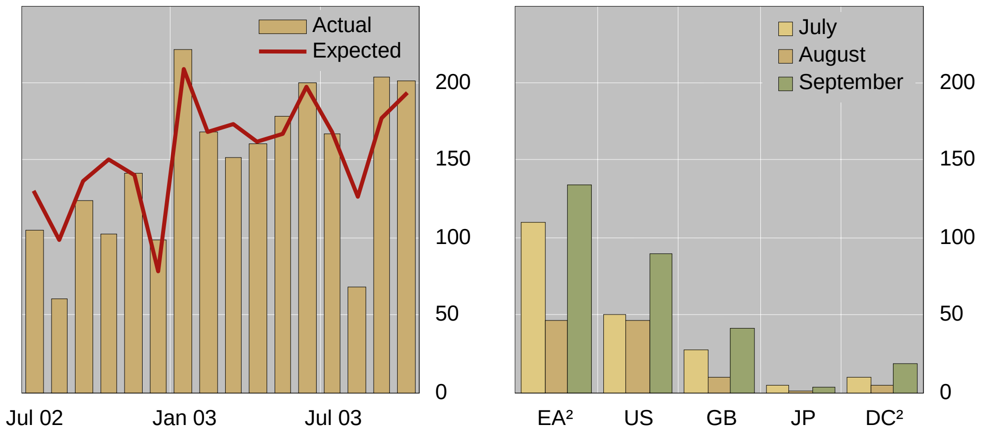
[1] In percentages. [2] Price volatility implied by the price of the at-the-money call options on 10-year government bond futures contracts.

Source: Bloomberg. Graph 3.1

Announced issuance of international bonds and notes

In billions of US dollars

Actual and expected[1] bond issuance | Issuance in 2003 Q3, by nationality



[1] Computed from the seasonal pattern of monthly percentage changes in issuance. Assumes that the natural logarithm of deseasonalised gross issuance follows a random walk over the near term. Includes bonds issued under EMTN documentation. [2] EA = euro area; DC = developing countries.

Sources: Dealogic; Euroclear; ISMA; Thomson Financial Securities Data; BIS. Graph 3.2

Nevertheless, the fall in issuance proved to be transitory. Total announcements of international bonds rebounded strongly in September and October, as interest rate volatility in US and euro area government bond markets declined. Indeed, on a seasonally adjusted basis, issuance in September exceeded that in May, the month immediately preceding the start of the recent bond market turmoil. The strong issuance in September and October probably in part reflected issuance originally planned for August that was postponed until interest rate volatility had fallen back from heightened levels.

Issuance rebounds in September

The weakness of issuance in August was a general phenomenon. Between July and August, announcements of international bond and note issues by euro area borrowers fell by 57%, those of UK borrowers by 64% and those of Japanese borrowers by 78%. Announcements by US borrowers also slowed over the period, by 7%. However, the relatively small decline in issuance by US nationals between July and August might understate the impact of the global bond market sell-off on US fund-raising. Announced issuance by US nationals rose sharply in September to almost double the July amount. This suggests that robust US economic growth led to a greater demand for funds by US businesses over the course of the third quarter. When compared to issuance in September, August was a weak month for US fund-raising.

The rebound is widespread

A higher level of gross issuance in the international bond and note markets in September was also a general pattern. In addition to increased borrowing by US nationals, euro area, UK and Japanese borrowers also stepped up their fund-raising in that month. The relative strength of US borrowing helped to push total net issuance by US entities for the third quarter to $88 billion, three times the amount recorded during the second quarter. Greater borrowing by US financial institutions was the main reason for the upsurge. Their net issuance more than tripled to $75 billion in the third quarter. In the case of euro area nationals, however, the rise in September was not sufficient to offset the slowdown in August. Consequently, net issuance by euro area nationals contracted to $125 billion in the third quarter from $208 billion in the previous one. In percentage terms, the largest decline was for German borrowers, whose net borrowing fell by 60%. Dutch and French entities also reduced their net fund-raising between the second and third quarters, by 55% and 38% respectively.

Greater US borrowing supports dollar issuance

The shift in fund-raising from euro area nationals towards US nationals was associated with a pronounced change in the currency composition of net borrowing. Net issuance of euro-denominated securities in the international debt securities market declined by 40% between the second and third quarters of 2003 while that of US dollar-denominated securities rose by 82% (Table 3.3). In the third quarter, both currencies accounted for about $140 billion each in new funds raised. This was the first quarter in which net issuance of US dollar-denominated securities was at least as large as that of euro-denominated securities since the third quarter of 2001. This occurred in spite of a sharp slowdown in US dollar borrowing by non-US residents in August. In that month, net US dollar issuance by these borrowers declined by 39% from its July pace.

Dollar issuance matches euro issuance

Net issuance of international debt securities by region and currency[1]

In billions of US dollars

Region/currency		2001	2002	2002		2003		
		Year	Year	Q3	Q4	Q1	Q2	Q3
North America	US dollar	522.0	297.0	35.0	48.2	38.0	25.9	71.5
	Euro	63.9	39.4	7.2	0.4	15.7	6.5	14.9
	Yen	18.8	–7.4	–1.5	–2.5	0.0	–1.8	–1.6
	Other currencies	10.4	12.1	–1.8	4.5	1.8	7.6	6.1
European Union	US dollar	46.7	68.5	4.2	16.6	39.7	30.7	43.1
	Euro	522.4	464.0	101.5	92.8	204.3	212.3	116.0
	Yen	–2.2	–26.2	–6.5	–2.7	–4.5	–3.2	–3.5
	Other currencies	70.5	86.1	26.7	13.9	28.8	27.2	18.4
Others	US dollar	82.4	53.7	6.2	8.1	19.5	19.3	23.5
	Euro	10.7	18.4	5.4	–0.1	6.5	13.2	8.5
	Yen	0.1	–10.1	–0.5	–3.7	–1.6	1.9	–1.8
	Other currencies	0.8	14.1	3.4	6.9	7.0	8.0	3.6
Total	US dollar	651.2	419.2	45.4	72.8	97.3	75.9	138.1
	Euro	597.1	521.9	114.2	93.1	226.5	232.0	139.4
	Yen	16.6	–43.7	–8.4	–8.9	–6.1	–3.2	–6.9
	Other currencies	81.7	112.3	28.3	25.2	37.6	42.7	28.0

[1] Based on the nationality of the borrower.

Sources: Dealogic; Euroclear; ISMA; Thomson Financial Securities Data; BIS. Table 3.3

The increase in net issuance of dollar-denominated securities probably reflected in the main the greater borrowing by US financial institutions noted above; however, currency movements may also have played a role. In particular, the pronounced decline in the value of the dollar since October 2000, especially vis-à-vis the euro, may have been a factor supporting elevated dollar issuance. The perception of continued dollar depreciation might lead entities whose base currency is not the US dollar to shift to dollar-denominated borrowing. Moreover, between October 2000 and October 2003, the yield on the US 10-year Treasury note actually fell by about 140 basis points, further reducing US dollar fund-raising costs. Since the start of 2003, slightly more than two years after the dollar peaked against the euro, there has been a greater tendency for non-US nationals to issue US dollar-denominated securities, although there was a sharp slowdown in such issuance in August. The rebound of such issuance in September took place even as foreign purchases of US Treasury and agency securities dropped sharply (see the box on page 33). In the case of EU nationals, this culminated in $43 billion in net dollar-denominated issuance in the third quarter of this year. Outside the European Union, non-US and non-Canadian entities had $24 billion of net dollar-denominated issuance. This included $8 billion in net borrowing by Australian nationals alone, the result of many small and medium-sized dollar-denominated issues.

The increased preference of non-US nationals for issuing US dollar-denominated securities helped to push gross issuance of yankee bonds to a high level in the third quarter of 2003. As reported by Dealogic, gross issuance of such bonds reached $12 billion in the third quarter, a 24% gain over the recent record set in the second quarter. A sharp rise in yankee issuance by EU, South African and Brazilian entities more than offset a decline in issuance by Canadian nationals.

Rating upgrades back greater developing country borrowing

Developing country entities sharply increased their fund-raising through the international debt securities market between the second and third quarters of 2003. Their net issuance expanded by 62% to $19.4 billion, the largest amount of new funds raised since the second quarter of 2001. This occurred even against the backdrop of a switch from net positive to net negative flows into US mutual funds specialising in emerging market debt (Graph 3.3). At the same time, the greater borrowing was highly concentrated, with Russian and Taiwanese entities alone accounting for a $5.9 billion rise in net issuance.

As in the industrial world, the global bond market sell-off temporarily disrupted fund-raising by developing country borrowers. Announcements of international bonds and notes by developing country entities fell sharply in August, but September witnessed a rebound in issuance. September also saw most of the largest issues by emerging market borrowers during the third quarter. This included a €1 billion seven-year bond floated by the Republic of Hungary.

Flows into US bonds versus flows into US dollar bonds

Robert N McCauley

When the US Treasury announced in mid-November that international purchases of US bonds had dropped sharply in September, the dollar sold off. Netting out estimated principal payments on asset-backed securities (ABSs), September may have seen net non-official purchases of US bonds fall to zero. A widening US current account deficit and feeble ex ante demand for US bonds was thought to be a recipe for dollar decline (barring a surge in demand for US equities).

This box distinguishes between international purchases of US bonds and such purchases of dollar bonds. The former can take the form of a cross-border purchase of a US Treasury, agency or corporate bond, and should be captured by the Treasury International Capital (TIC) reporting system. But international purchases of dollar bonds issued by non-residents of the United States can also take place in the eurodollar market and thus not be captured by the TIC system.

Foreign purchases of US bonds and issuance of US dollar bonds by non-US residents

	Foreign purchases of US bonds								Issuance of US dollar international bonds and notes by non-US residents			
	Treasury		Agency		Corporate		Total		Total		Excl yankee bonds	
2003	Total	Official	Total	Official	Total	Official	Total	Official	Gross	Net	Gross	Net
May	41.1	15.2	32.0	2.5	27.4	0.1	100.5	17.8	50.1	21.1	40.8	22.6
Ex ABSs[1]	41.1	15.2	26.0	...	24.9	...	92.0	...	…	…	…	…
June	44.0	16.5	7.0	–2.6	22.8	0.7	73.8	14.6	55.3	26.4	47.7	19.5
Ex ABSs[1]	44.0	16.5	1.3	...	20.3	...	65.3	...	…	…	…	…
July	44.7	12.3	11.8	–0.1	26.4	0.4	82.9	12.6	48.8	28.6	44.6	27.6
Ex ABSs[1]	44.7	12.3	5.4	...	23.8	...	73.9	...	…	…	…	…
August	25.1	–1.0	8.9	0.4	16.9	0.4	50.9	–0.2	27.8	17.4	27.4	17.5
Ex ABSs[1]	25.1	–1.0	1.9	...	14.6	...	41.6	...	…	…	…	…
September	5.6	8.1	–3.2	3.0	19.8	0.5	22.2	11.6	52.1	23.6	49.4	23.2
Ex ABSs[1]	5.6	8.1	–8.6	...	14.6	...	11.6	...	…	…	…	…

[1] Excluding estimated repayment of asset-backed securities.

Sources: Federal Reserve Bank of New York; US Treasury; BIS.

Normally, international purchases of US bonds provide a good indication of demand by international asset managers for dollar bonds. On the one hand, the overwhelming majority of bonds sold by US issuers are dollar-denominated. On the other hand, most holdings of dollar bonds by non-US residents take the form of US bonds. For instance, in early 2000, about three quarters of foreign official holdings of US dollar bonds were invested in US bonds.[①]

As the accompanying article makes clear, however, September was not a normal month. With the sell-off in bond markets, international issuance of dollar bonds fell in August only to rebound in September. This pause in issuance reflected the natural hopes of treasurers that the sell-off would reverse itself, as well as the discount offered by underwriters for bonds to be issued into volatile markets. After this pause, issuers played catch-up in September, and issuance and hence foreign purchases of international dollar bonds were strong that month. This observation does not support the inference drawn from the US Treasury data that non-resident investors lost their appetite for dollar bonds in September. While international purchases of dollar bonds issued by residents of countries other than the United States do not directly finance the US current account deficit, they do suggest that international portfolio managers continued to buy dollar bonds during this period.

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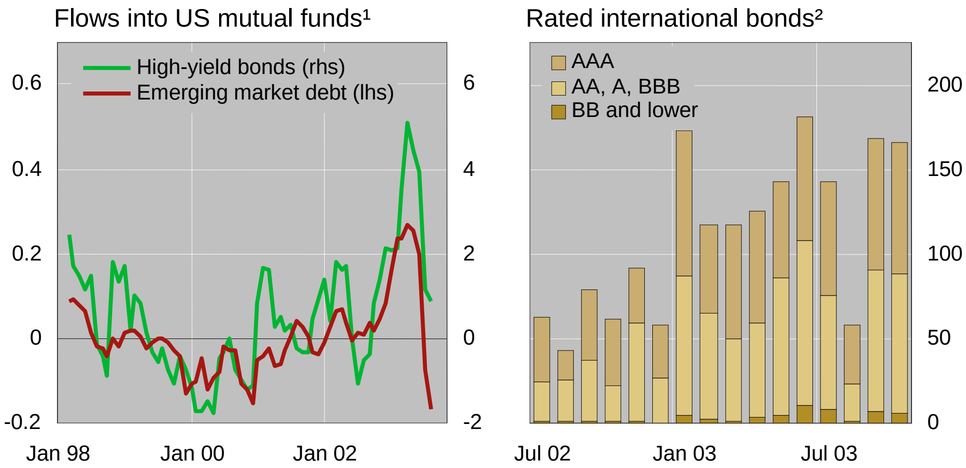
① Estimated as identified holdings of Treasury, agency and corporate bonds divided by the sum of such holdings and unidentified holdings of dollars, taken to be dollar bonds issued by non-US residents. See R McCauley and B Fung, "Choosing instruments in managing dollar foreign exchange reserves", *BIS Quarterly Review*, March 2003, Table 1.

Major financing flows

In billions of US dollars



[1] Three-month moving averages. [2] Includes bonds issued under EMTN documentation.

Sources: Bloomberg; Investment Company Institute; Dealogic; BIS. Graph 3.3

Turkey and Venezuela borrow heavily

The largest emerging market issues during the third quarter were those by the governments of Turkey and Venezuela. In late July, both countries received one-notch upgrades from Standard & Poor's, to B and B– respectively, and subsequently borrowed heavily in the international debt securities market. On 24 September, the Republic of Turkey raised $1.25 billion with a 10-year fixed rate bond that carried a coupon of 9.5%. On 7 August, the Bolivarian Republic of Venezuela issued a seven-year fixed rate bond with a face value of $1.5 billion that carried a coupon of 5.375%. The proceeds from this issue were used to retire Brady bonds. These issues helped both countries attain positive net issuance in the third quarter, $0.4 billion in the case of Turkey and $1.6 billion in the case of Venezuela. This was the first quarter in which Venezuela had had positive net issuance since the fourth quarter of 2001.

Russia achieves investment grade status

There were other important upgrades during the period under review. In October, Standard & Poor's raised Malaysia's foreign currency rating to A–, Thailand's to BBB and Indonesia's to B. In the same month, Moody's raised Hong Kong SAR's external rating by two notches to A1 and Russia's also by two notches to Baa3. This was the first time that Russian sovereign debt had received an investment grade rating. Shortly after the upgrade, Sberbank, a state-owned Russian savings bank, raised $1 billion with a three-year floating rate note that carried a spread of 196 basis points over Libor.

The People's Republic of China was also upgraded in October, following the resumption of rapid economic growth in that country, and shortly afterwards tapped the international market for funds. After a setback in the second quarter caused by the outbreak of SARS and uncertainties related to the war in Iraq, growth in Chinese real output reached 9% (year on year) in the third quarter. In mid-October, Moody's raised China's sovereign rating to A2 from A3. On 29 October, the People's Republic of China issued $1.5 billion in both dollar- and euro-denominated bonds in the international market, the first such issues since May 2001. The US dollar-denominated part of the package, a 10-year bond, was priced at a spread of only 53 basis points over a comparable maturity US Treasury, about the same pricing as that achieved by US agency debt.

Latin American entities borrow less

Against the backdrop of sluggish economic growth, net issuance by developing country entities in Latin America declined slightly between the second and third quarters of 2003, from $5.3 billion to $4.1 billion. Increased net issuance by Venezuelan entities was more than offset by lower Brazilian and Mexican net borrowing. In the case of Brazil, whose sovereign spread widened by approximately 200 basis points between mid-June and early August, net borrowing by nationals fell to $3.6 billion in the third quarter from $5.1 billion in the previous one. There was, however, a subsequent narrowing of the country's sovereign spread on speculation that Brazil might also be upgraded. On 22 October, in response to these favourable market conditions, the Federative Republic of Brazil raised by 50% a planned $1 billion sovereign issue of seven-year notes. The $1.5 billion package of US dollar-denominated bonds priced with a yield to maturity of 9.68%.

There was a much sharper decline in Mexican fund-raising in the international market in the third quarter. Net issuance by Mexican entities fell from $3 billion in the second quarter to –$0.7 billion in the third. The fact that the rebound in economic activity in the United States during the third quarter failed to spill over into Mexico may have played a role here.

Mexico issues 20-year fixed rate peso bond

A significant development concerning Mexican fund-raising is that the Mexican government is substituting domestic for international borrowing. In late October, Mexico successfully tapped the domestic market for new funds when the Ministry of Finance carried out its first auction of a 20-year fixed rate peso-denominated bond in the domestic market. This is the first time in the country's history that fixed rate instruments have been issued with a 20-year maturity in the domestic market. After the auction, the government signalled its intention to cut its foreign debt by $500 million next year by continuing to increase the proportion of domestic debt in its portfolio. This helped to send yield spreads on US dollar-denominated Mexican sovereign bonds to record lows.

Lower-rated issuers postpone plans in the face of volatility

After falling in August …

The recent bond market turmoil was also associated with a fall in the amount of lower-rated issues placed in the international bond market. Announcements of bonds rated below investment grade declined to $0.8 billion in August, the lowest amount since December 2002 and $7 billion less than in July. To some extent, this was a reflection of the reduced fund-raising activities by developing country entities discussed above; they issued $2.5 billion of high-yield bonds in July but floated no such issues in August.

… high-yield issuance rebounds in September …

High-yield issuance in the international bond market rebounded in September along with issuance more generally. At $7.2 billion, issuance in this category was about the same as in July. Developing country entities were responsible for 76% of the total. For the third quarter as a whole, there was $15.6 billion in non-investment grade issuance of international bonds, down slightly from the $18.7 billion posted in the second quarter. Among the largest of these issues from developed country entities during the third quarter were three five-year bonds floated by Vivendi Universal, a $975 million US dollar issue, a €605 million euro issue and a €500 million euro issue. As a result, Vivendi was by far the largest developed country issuer of high-yield bonds in the third quarter.

Issuance of investment grade bonds also rebounded in September and October. After falling by 58% to $57.2 billion between July and August, announcements of bonds rated investment grade rose to about $160 billion in September and October, 19% higher than the amount for July. The total included two fixed rate US dollar-denominated bonds issued by Ford Motor Credit, a $1 billion five-year bond and a $2 billion 10-year bond. These were the first fixed rate, dollar-denominated issues by the company in over a year.

… as does issuance of investment grade bonds

The rating downgrade of DaimlerChrysler and associated turmoil in the secondary market for motor industry debt do not appear to have significantly affected the ability of this firm to raise funds in the international market. On 21 October, Standard & Poor's reduced the long-term credit rating of DaimlerChrysler to BBB from BBB+, with a negative outlook. As discussed in the Overview, there followed a period of dramatically higher secondary market spreads on the bonds of the automobile companies and their related finance subsidiaries. On 6 November, however, DaimlerChrysler tapped the international market for $2 billion. This 10-year fixed rate US dollar issue priced at a spread of 215 basis points over the comparable maturity US Treasury security.

DaimlerChrysler unfazed by downgrade

A repayment bulge in early 2004

A fall in scheduled repayments of bonds and notes in the international debt securities market in the third quarter of 2003 was associated with a slowdown in gross issuance. After rising for several quarters, scheduled repayments had peaked at $396 billion in the first quarter of 2003 (Graph 3.4). The peak was followed by two quarters of declines, with scheduled repayments falling to $324 billion in the third quarter. This was associated with a 10% drop in gross issuance of international bonds and notes to $681 billion between the first and third quarters.

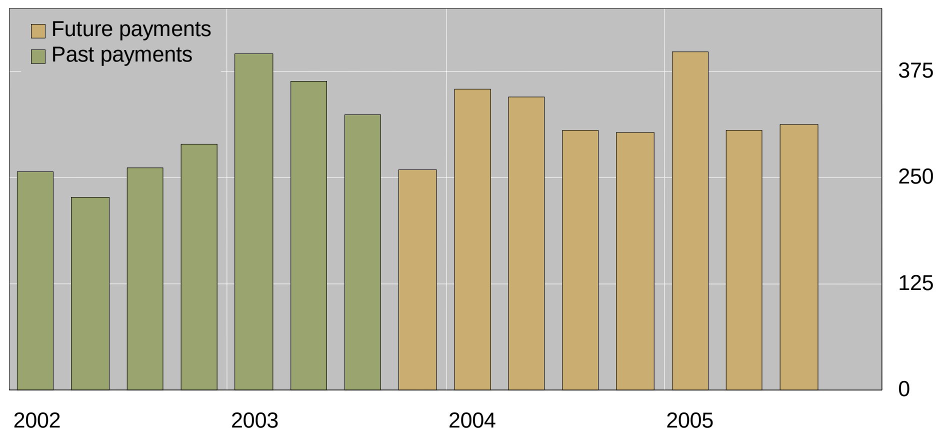
Scheduled repayments fall …

Scheduled repayments are forecast to decline further in the fourth quarter before picking up again next year and reaching a peak in early 2005. In the first quarter of 2004 scheduled repayments are projected to rise to $354 billion. Bonds and notes issued in 2001 and 2002 and coming to maturity in the first quarter of 2004 account for about half of this total. Scheduled repayments are expected to continue to rise further in the first quarter of 2005 to about the same level achieved in the first quarter of this year. In the earlier period, the bulge in repayments was financed by a shift to straight fixed rate bonds and notes from floating rate issues, which occurred against the backdrop of dwindling government yields and narrowing credit spreads. In contrast, early 2004 is unlikely to supply as favourable an environment for refinancing unless interest rates move down from current levels.

… but are projected to pick up next year

Scheduled repayments of international bonds and notes

In billions of US dollars



Sources: Dealogic; Euroclear; ISMA; Thomson Financial Securities Data; BIS. Graph 3.4

After remaining essentially flat in the second quarter at $16.5 billion, gross issuance of convertible bonds shot up by almost 60% to $26.1 billion in the third quarter. This figure includes a €5 billion convertible bond announced by the Kreditanstalt für Wiederaufbau in early July, the largest convertible issue on record. A unique feature of this particular convertible is that it is exchangeable into shares of Deutsche Telekom AG. There was evidently strong demand for the issue, as the issue amount of €5 billion represents an 11% increase over the initially planned €4.5 billion offer.