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3. The international debt securities market

Helped by a recovering global economy and easy financing conditions, financial flows in the international debt securities markets remained at record levels in the first quarter of 2004. Net issuance achieved a second consecutive quarterly all-time high of $517.9 billion (Table 3.1). Announced issuance of bonds and notes, inflated by the need to refinance a large amount of maturing

Main features of net issuance in international debt securities markets

In billions of US dollars

	2002	2003	2003				2004	Stocks at end-Mar 2004
	Year	Year	Q1	Q2	Q3	Q4	Q1	
Total net issues	1,011.4	1,470.4	357.7	349.6	303.4	459.8	517.9	12,051.5
Money market instruments[1]	1.7	75.4	55.4	3.7	–32.9	49.2	33.3	595.7
Commercial paper	23.7	83.3	46.8	13.3	–25.4	48.7	8.9	420.9
Bonds and notes[1]	1,009.7	1,395.1	302.4	345.8	336.3	410.6	484.5	11,455.8
Floating rate issues	198.8	392.7	66.7	74.1	98.1	153.9	154.2	2,961.9
Straight fixed rate issues	800.8	981.2	235.4	271.1	233.9	240.8	337.3	8,143.0
Equity-related issues	10.2	21.1	0.3	0.6	4.3	15.9	–7.0	351.0
Developed countries	945.5	1,364.4	330.6	316.7	281.1	436.0	482.0	10,743.1
United States	330.5	274.3	55.8	29.5	90.6	98.5	124.3	3,197.2
Euro area	479.1	768.7	211.9	208.2	124.9	223.8	231.3	5,119.9
Japan	–22.7	–0.8	–3.5	–1.8	–3.7	8.1	6.3	280.0
Offshore centres	8.1	16.3	2.8	4.0	0.4	9.1	0.9	133.1
Emerging markets	36.9	66.5	14.7	13.5	19.5	18.8	24.9	659.5
Financial institutions	833.4	1,189.3	274.0	248.1	256.5	410.7	414.0	8,849.5
Private	698.0	991.5	225.8	199.6	213.6	352.5	341.4	7,491.1
Public	135.4	197.8	48.2	48.5	42.9	58.2	72.7	1,358.4
Corporate issuers	55.1	110.6	16.1	32.2	21.4	40.9	7.4	1,489.7
Private	44.4	92.8	8.4	29.5	17.7	37.2	–0.2	1,244.0
Public	10.7	17.8	7.7	2.7	3.7	3.7	7.6	245.7
Governments	102.0	147.3	58.0	54.0	23.0	12.3	86.4	1,196.6
International organisations	20.9	23.2	9.6	15.3	2.4	–4.2	10.1	515.7
Memo: Domestic CP[2]	*–102.9*	*–45.9*	*13.3*	*–27.2*	*–37.0*	*5.0*	*33.0*	*1,913.0*
Of which: US	*–91.4*	*–81.3*	*–15.7*	*–41.9*	*–22.3*	*–1.5*	*47.8*	*1,336.5*

[1] Excluding notes issued by non-residents in the domestic market. [2] Data for the first quarter of 2004 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							
	2002	2003	2003				2004
	Year	Year	Q1	Q2	Q3	Q4	Q1
Total announced issues	2,099.3	2,884.4	759.1	755.9	657.2	712.3	1,018.0
Bond issues	1,164.9	1,610.0	436.5	424.6	343.9	405.0	606.5
Note issues	934.5	1,274.4	322.6	331.3	313.3	307.3	411.5
Floating rate issues	602.5	963.9	231.5	233.6	241.2	257.6	355.6
Straight fixed rate issues	1,454.1	1,832.5	509.4	505.8	389.1	428.2	645.6
Equity-related issues[1]	42.8	88.1	18.2	16.6	26.8	26.6	16.8
US dollar	985.0	1,169.5	332.8	282.2	285.8	268.7	368.5
Euro	806.3	1,289.1	330.4	369.7	272.0	317.0	495.3
Yen	88.3	102.9	23.4	26.0	24.5	29.0	29.3
Other currencies	219.7	322.9	72.4	78.0	74.8	97.7	125.0
Financial institutions	1,631.8	2,281.9	581.7	569.9	536.4	593.8	815.3
Private	1,361.2	1,920.0	488.6	467.7	455.3	508.5	688.3
Public	270.6	361.8	93.1	102.2	81.1	85.4	127.0
Corporate issuers	211.4	270.7	56.7	78.1	67.0	68.8	63.1
Of which: telecoms	46.0	54.8	23.3	9.5	8.0	14.1	11.6
Private	187.0	220.7	40.8	69.9	53.6	56.5	52.9
Public	24.5	50.0	15.9	8.3	13.4	12.3	10.1
Governments	171.8	239.4	81.6	79.2	39.0	39.6	109.6
International organisations	84.3	92.5	39.1	28.6	14.7	10.1	30.1
Completed issues	2,098.4	2,865.5	717.8	728.0	684.2	735.5	929.9
Memo: Repayments	*1,088.7*	*1,470.4*	*415.5*	*382.1*	*347.9*	*324.9*	*445.4*

[1] Convertible bonds and bonds with equity warrants.

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

debt, exceeded $1 trillion for the first time (Table 3.2). Sovereign borrowers, particularly in Europe and Latin America, were among the most active, while issuance by financial institutions in the United States and Europe remained strong. Among non-financial corporations, by contrast, gross issuance exceeded repayments by only a small amount. Borrowers tended to favour straight fixed rate issues, while the use of equity-related structures slowed.

Robust issuance was supported by a historically low level of credit spreads across virtually the entire credit spectrum. Even after widening somewhat in the course of the first quarter, spreads remained unusually low by the standards of the last five years (see the Overview on page 1). The narrow spreads in turn were a product of the "search for yield" among investors who were willing to adopt somewhat riskier exposures in the face of exceptionally low nominal yields on risk-free assets.

In April, issuance slowed in most sectors, amid widening credit spreads and increased uncertainty about the timing and implications of a shift to a less accommodative monetary stance in the United States. Preliminary data suggest that announcements of new issues in April were 38% below the monthly average of the first quarter. However, the strong pace of issuance by lower-rated corporates and by European emerging economies appears to have continued.

Financial institutions and lower-rated borrowers are active

Increased borrowing by financial institutions

Net issuance by financial institutions remained at historically high levels in the first quarter of 2004. Issuance exceeded repayments by $414 billion, compared with $411 billion in the fourth quarter of 2003 and a quarterly average of $297 billion in 2003 as a whole. Because of a sharp increase in scheduled repayments, gross issuance by financial institutions jumped, with announced issuance of bonds and notes rising to $815 billion from $594 billion in the previous quarter. Among the most active issuers were US housing finance agencies and European banks.

Non-financial corporations, on the other hand, raised relatively little in international debt securities markets in the first quarter. Net issuance was only $7 billion, compared with almost $41 billion in the previous quarter and a quarterly average of $28 billion in 2003. Announcements of new bond and note issues fell from $69 billion to $63 billion, despite a sharp rise in scheduled repayments.

Investment grade corporates shift to domestic CP …

The low level of corporate net issuance in the international market was balanced by an increase in the issuance of domestic commercial paper (by both financial and non-financial issuers). Net borrowing rose from $5 billion in the fourth quarter of 2003 to $33 billion in the first quarter of 2004. This was entirely driven by a surge in net CP issuance in the United States, to nearly $48 billion, after several quarters when the amount outstanding had shrunk. The slow pace of international bond issuance could signal that, in the early stages of a global expansion, firms are reluctant to releverage with long-term debt, preferring to fund a relatively high portion of investment through short-term debt and internal funds.

… but low-rated corporates borrow more internationally

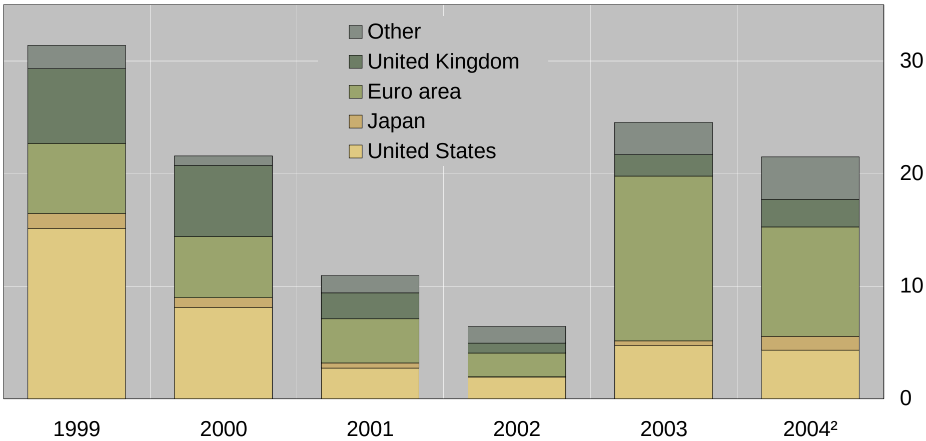
Lower-rated corporate issuers, however, continued to make use of international securities markets. Announcements of new high-yield bond issues by developed country borrowers in the first quarter totalled $5.4 billion, maintaining the strong pace of activity recorded in 2003 (Graph 3.1). As in previous years, about 70% of high-yield issuance was by non-financial corporations. Surprisingly, activity in the high-yield sector does not seem to have slowed in April despite the widening of credit spreads. A €1.3 billion 10-year B3/B-rated issue announced in April by SEAT Pagine Gialle, an Italian telephone directory company, was the largest euro-denominated high-yield issue to date.

Reflecting the upswing in the Japanese economy, net issuance of debt securities by Japanese borrowers was positive for the second consecutive quarter for the first time since 1999. Net issuance of $6.3 billion comprised $3.8 billion by financial institutions and $2.5 billion by non-financial corporations, divided more or less equally among the dollar, euro and yen.

Taken together, the data present a picture in which, in the context of a slow but steady global recovery, finance during the first quarter was extended to borrowers who had been capital constrained in the previous few years,

Non-investment grade[1] issuance of international bonds by developed country entities

In billions of US dollars, by nationality of issuer



[1] Issuers rated BB or lower. [2] Data for 2004 have been annualised based on the issuances during the first quarter.

Sources: Dealogic; BIS. Graph 3.1

including low-rated issuers, European homeowners, bank-financed enterprises and Japanese firms. At the same time, borrowers who had taken advantage of declining long-term interest rates and narrowing credit spreads in 2003, including investment grade corporates, focused on refinancing maturing issues and adjusting the maturity profile of their liabilities. In April, when markets grew more turbulent, investment grade issuers retreated, while lower-rated borrowers maintained or accelerated financing activities, hedging against the possibility that their market access might worsen in the near term.

More dollar issuers use floating rate structures

While the mix of vehicle currencies for borrowing in international markets remained roughly constant in the first quarter of 2004 relative to the previous quarter (Table 3.3), dollar issuers shifted towards floating rate issuance whereas euro issuers preferred fixed rates. Announcements of new dollar-denominated bonds and notes have tended to be approximately 25% floating rate and 75% fixed rate in recent years, but in the most recent quarter floating rate structures accounted for 35% of the total. As a result, the share of floating rate issuance in dollars was virtually identical to that in euros, which was 36% in the first quarter after averaging 39% since 2000.

It is not clear why dollar-based issuers would move towards floating rates at a time when long-term corporate yields were generally low, benefiting from gradually declining long-term risk-free rates and narrow credit spreads. The shift in the composition of the borrowing pool towards financial institutions certainly played a role, though these institutions themselves stepped up the use of US dollar floating rate bonds and notes in the first quarter of 2004, to 39% of announced issues versus 31% over the previous four years. The US

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

In billions of US dollars

		2002	2003	2003				2004
		Year	Year	Q1	Q2	Q3	Q4	Q1
North America	US dollar	297.1	218.9	38.0	26.2	73.8	81.0	97.4
	Euro	40.2	52.0	16.3	6.3	14.9	14.6	14.3
	Yen	–7.0	–1.9	0.6	–1.8	–1.2	0.6	1.3
	Other	12.3	25.1	1.9	7.6	6.0	9.6	11.8
European Union	US dollar	68.3	149.9	39.7	31.1	42.4	36.7	41.1
	Euro	462.6	742.2	203.5	212.4	116.6	209.7	221.3
	Yen	–26.2	–9.0	–4.5	–3.2	–3.5	2.2	1.9
	Other	86.1	117.2	28.7	27.4	17.6	43.6	32.8
Others	US dollar	53.8	97.4	20.2	19.4	25.7	32.2	33.9
	Euro	20.1	39.6	8.1	14.5	8.9	8.1	41.2
	Yen	–10.1	6.9	–2.1	1.9	–2.2	9.2	1.8
	Other	14.2	32.2	7.4	7.8	4.6	12.4	19.1
Total	US dollar	419.2	466.2	97.9	76.7	141.8	149.8	172.4
	Euro	522.9	833.8	227.8	233.2	140.3	232.4	276.8
	Yen	–43.3	–4.1	–6.0	–3.1	–6.9	12.0	5.0
	Other	112.5	174.5	38.0	42.8	28.1	65.5	63.7

[1] Based on the nationality of the borrower.

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

dollar-denominated yield curve was steeper than the euro-denominated yield curve during the period, with 10-year government bonds exceeding three-month rates by some 300 basis points in dollars compared with 200 basis points in euros, but the relative steepness of the two curves was little changed from what it had been for most of 2003. It is possible that US dollar issuers saw floating rate debt as a way to take advantage of cheap short-term funding before the Federal Reserve moved to increase short-term rates, with the expectation that relatively inexpensive long-term finance would still be available when the tightening cycle was completed.

Heavy international issuance by euro area sovereigns

Euro area sovereigns drive overall rise in net issuance …

By themselves, euro area governments more than accounted for the increase in overall net issuance in the quarter. Net issuance by sovereign borrowers in the euro area totalled $75.6 billion in the first quarter of 2004, compared with $6.8 billion in the last quarter of 2003. Announcements by this group jumped from $26 billion to $91 billion over the same period. To some degree, the high level of issuance was a seasonal phenomenon; euro area sovereign issuance has been concentrated in the first quarter in every year since 2000. Yet the amounts have grown steadily from one year to the next: from $23 billion in net issuance in each of the first quarters of 2000 and 2001, to $43 billion in the first quarter of 2002, and to $55 billion in the first quarter of 2003. The new issues in each case were overwhelmingly euro-denominated fixed rate eurobonds.

Italy (with $29 billion in net issues), Germany (with $16 billion, mostly by state governments) and Greece (with $14 billion) were the most active issuers of debt securities in the most recent quarter. Individual issues tended to be very substantial, with a view to encouraging liquidity; for example, the Italian government issued €4 billion in 30-year bonds in January, €5 billion in 10-year notes in February, and €8 billion in 16-year bonds in March.

… reflecting the further integration of European capital markets

To a large extent these figures reflect the ongoing development of European capital markets, as governments seek to take advantage of the common currency to broaden their funding base beyond their respective domestic markets. At the end of 2003, $608 billion in sovereign bonds of euro area governments was outstanding in the international markets, compared with some $4.9 trillion in domestic government securities in those countries. As euro-based investors move to increase the geographical diversification of their portfolios, sovereign borrowers, and particularly the governments of smaller euro area countries, have found it necessary to diversify their funding sources as well. The narrowing of investment banking fees in recent years has been another factor increasing the attractiveness of placing debt through underwriters on the international market rather than through direct auctions on the domestic market. The fact that the use of the international channel is concentrated among a relatively small number of euro area governments suggests that this process is still at an early stage of development.

The eurocommercial paper market continues to expand

Gross issuance in the market for eurocommercial paper (that is, commercial paper issued outside the borrower's home market) grew to $360 billion in the first quarter, compared with $333 billion in the previous one and a quarterly average of $300 billion in 2003. Much of the new paper was used to roll over outstanding issues, with the result that the net amount of new funding totalled only $9 billion. Some 11% of gross issuance was by non-financial borrowers, a figure only slightly higher than that in the US domestic market, where non-financial borrowers accounted for 9%.

Despite the relatively small share of euro-CP in overall net issuance, the growth of this market as a funding vehicle for working capital and as a destination for short-term investments is worthy of note. Commercial paper offers borrowers an alternative channel to short-term bank finance, and thus reduces the exposure of the financial system to transitory shocks that might hit the banking sector. The market is increasingly dominated by European borrowers; about 75% of gross issuance in the first quarter was by borrowers in developed European countries, compared with 66% in the first quarter of 1999. Over the same period, the share of issuance denominated in euros or pounds sterling rose from 38% to 66%. Like the increase in European sovereign issuance on the international markets mentioned above, the growth of euro-CP thus represents an important step in the development of European capital markets.

Continued brisk growth in emerging market borrowing

Benign financing conditions support emerging market borrowing

Borrowing activity in international debt securities markets by emerging market entities continued its upward trend in the first quarter of 2004. Total net issuance came to $24.9 billion, compared with $18.8 billion in the preceding quarter (Graph 3.2). Borrowers benefited from favourable financing costs, with spreads on emerging market debt having fallen to historical lows in January (see Graph 1.8 in the Overview). While emerging market spreads widened somewhat in February and March, in part under the pressure of strong issuance, they remained very narrow by recent standards.

The sell-off in emerging market bonds in April, however, resulted in a slowdown in issuance, with preliminary data indicating that announcements of new issues in that month were 25% below the average for the first quarter. The drop in announcements was evenly spread across Latin America, Asia, Africa and the Middle East. The pace of borrowing by entities in emerging Europe remained robust, reflecting positive investor sentiment ahead of the expansion of the European Union in May.

Asian entities were particularly active in the market in the first quarter. Total net issuance amounted to $10.7 billion, the highest level since 1997. Korean private sector entities – especially financial institutions – accounted for $4.6 billion, and another $2.1 billion was secured by the Taiwanese non-financial corporate sector. A number of Asian sovereigns also raised sizeable amounts. The Republic of the Philippines launched international securities totalling $2.0 billion. More than half of this amount, $1.18 billion, represented an exchange of various outstanding bonds, many of which are scheduled to mature in 2007–09, for a new fixed rate bond maturing in 2011. The Republic of Indonesia, upgraded by Standard & Poor's to B in October 2003 and rated CCC+ only a year ago, had a remarkably successful return to the international debt securities market. After an absence of seven years, Indonesia raised $1 billion through the issuance of a 10-year fixed rate bond on 10 March. Notwithstanding the sovereign's low credit rating, the issue was priced at a modest 277 basis points over 10-year US Treasuries, a tighter spread than for comparable issues by higher-rated sovereigns such as the Republic of the Philippines and the Republic of Turkey. Another successful return to the market, after an absence of more than six years, was that of the Islamic Republic of Pakistan, which on 19 February placed a five-year fixed rate bond with a face value of $500 million. Market participants reported unusually strong bids for Asian paper from US investors, though regional portfolios continued to take up disproportionate fractions of Asian issuance (see the box on page 23).

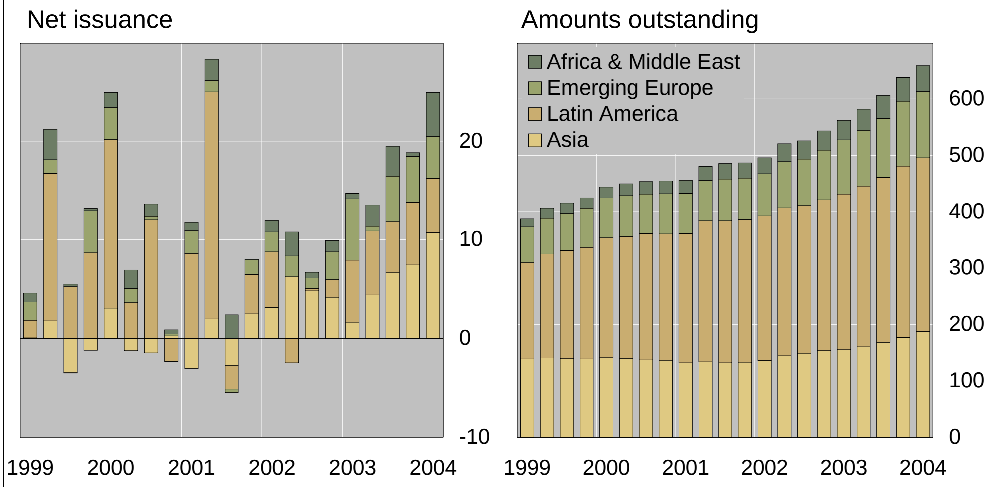
The Republic of Indonesia returns to the market

Low financing costs in early 2004 attract Latin American sovereigns ...

In Latin America, net borrowing was driven entirely by sovereign issuers taking advantage of the benign financing conditions at the beginning of the year. Notable placements – often of securities with a maturity of 20 or 30 years – were brought to the market in early 2004 by several sovereign issuers. Both frequent participants in international markets, such as the Federative Republic of Brazil, the United Mexican States and the Bolivarian Republic of Venezuela, and sovereigns with a more sporadic presence came to the market. The latter group included the Republic of Chile, the Republic of Costa Rica and the

International debt securities issued by emerging market entities

In billions of US dollar



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

Government of Jamaica, all of which took the opportunity to wrap up their entire projected external financing needs for 2004 in January and early February.

... as well as sovereigns in emerging Europe

Borrowing activity in emerging Europe was also predominantly accounted for by sovereign issuers. The heaviest borrower was the Republic of Poland, which raised $3.1 billion. A new €1.5 billion five-year issue in early January, the sovereign's most significant transaction at launch to date, was followed up in March when the existing benchmark paper in the 10-year segment was increased by €700 million to €3 billion, the largest sovereign issue in the region. In addition to this, the Republic of Poland became the first emerging market sovereign to issue paper in Swiss francs in over five years, by launching a five-year note with a face value of 400 million Swiss francs. Among private sector borrowers, the net issuance of $1.2 billion by Russian financial institutions is worthy of note. Previously, Russian private sector issuance on international markets had been dominated by big corporations, particularly in the mining and telecommunications sectors. The strong issuance by financial institutions, which comes on top of $4.2 billion in net issuance by this group in 2003, thus represents another stage in Russia's post-1998 return to international capital markets.

Other sovereigns in emerging Europe were also present in the market in the first quarter. In the beginning of the year, the Republic of Turkey locked in low funding costs by issuing both a $1.5 billion 30-year bond and a €1 billion 10-year bond in the course of a few weeks. Similarly, the Republic of Hungary covered one third of its planned 2004 issuance in international markets in early January through issuance of a €1 billion 10-year bond. Other significant placements in the first quarter were made by the Republic of Latvia (€400 million 10-year bond), the Republic of Lithuania (€600 million nine-year bond) and the Government of Ukraine ($600 million seven-year bond). Boosted by this strong activity by sovereign borrowers, gross issuance in emerging Europe reached an all-time high of $11.8 billion in the first quarter.

An increase in issuance by financial institutions in Israel, South Africa and the United Arab Emirates drove a record level of borrowing activity in Africa and the Middle East. The Israeli company Teva Pharmaceutical Industries Ltd raised the largest amount, $1.1 billion (through a financing vehicle in the United States), by means of two convertible bonds. The most substantial sovereign placement in the region was made by the Central Bank of Tunisia (which raises funds in foreign currencies on the state's behalf) with €450 million in seven-year fixed rate paper, the country's largest deal in euros to date.