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3. The international debt securities market

Aided by steadily declining long-term interest rates, a gradual global recovery, and a market environment receptive to a broad range of credit exposures, borrowers continued to issue international debt securities at a strong pace in the third quarter of 2004. Issuance of short- and long-term instruments, net of

Main features of net issuance in international debt securities markets

In billions of US dollars

	2002	2003	2003		2004			Stocks at end-Sep 2004
	Year	Year	Q3	Q4	Q1	Q2	Q3	
Total net issues	1,010.4	1,472.3	303.6	458.9	520.9	351.9	324.6	12,778.7
Money market instruments[1]	1.7	75.3	–33.0	49.2	34.9	4.4	17.5	621.2
Commercial paper	23.7	83.3	–25.5	48.7	8.8	–3.4	25.8	445.3
Bonds and notes[1]	1,008.7	1,397.0	336.5	409.7	486.0	347.5	307.1	12,157.5
Floating rate issues	197.9	392.1	98.0	153.4	154.5	167.4	132.8	3,278.3
Straight fixed rate issues	800.7	983.9	234.2	240.6	338.4	172.4	177.0	8,523.4
Equity-related issues	10.2	20.9	4.3	15.7	–6.8	7.7	–2.7	355.8
Developed countries	944.5	1,365.3	281.3	434.9	485.3	321.1	293.3	11,408.8
United States	328.5	274.3	90.4	97.7	125.6	6.8	41.7	3,245.8
Euro area	479.1	768.7	124.6	223.4	231.7	216.1	139.2	5,531.2
Japan	–22.7	–1.0	–3.7	7.9	6.5	11.0	0.7	282.5
Offshore centres	8.1	16.3	0.4	9.1	0.9	5.1	9.8	147.9
Emerging markets	36.9	67.4	19.5	19.0	24.6	18.6	14.5	694.3
Financial institutions	832.4	1,188.2	256.4	409.6	418.2	285.9	295.8	9,469.1
Private	697.1	983.3	209.8	349.2	340.7	237.5	233.6	7,982.2
Public	135.4	204.9	46.6	60.4	77.5	48.4	62.2	1,486.9
Corporate issuers	55.1	113.1	21.7	40.9	7.2	11.3	10.5	1,517.6
Private	44.3	94.9	18.0	37.2	–0.4	7.8	10.2	1,267.7
Public	10.8	18.2	3.7	3.7	7.6	3.5	0.2	249.9
Governments	102.0	147.8	23.0	12.5	85.5	47.6	11.3	1,264.2
International organisations	20.9	23.2	2.4	–4.2	10.0	7.0	7.1	527.8
Memo: Domestic CP[2]	*–99.1*	*–41.0*	*–36.6*	*8.2*	*57.9*	*–21.7*	*0.8*	*1,927.1*
Of which: US	*–91.4*	*–81.3*	*–22.3*	*–1.5*	*47.8*	*–26.8*	*6.7*	*1,316.4*

[1] Excluding notes issued by non-residents in the domestic market. [2] Data for the third 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	Q3	Q4	Q1	Q2	Q3
Total announced issues	2,099.2	2,887.3	656.9	712.3	983.1	770.8	754.7
Bond issues	1,164.7	1,612.9	343.6	405.0	570.3	404.4	409.5
Note issues	934.5	1,274.4	313.3	307.3	412.8	366.4	345.2
Floating rate issues	602.4	963.8	241.2	257.6	338.0	307.8	302.9
Straight fixed rate issues	1,454.0	1,835.4	388.9	428.1	627.7	444.7	440.6
Equity-related issues[1]	42.8	88.1	26.8	26.6	17.4	18.3	11.2
US dollar	985.0	1,172.4	285.8	268.6	357.2	257.4	260.6
Euro	806.3	1,289.1	271.8	316.9	478.8	379.6	370.6
Yen	88.3	102.9	24.5	29.0	29.3	33.8	23.6
Other currencies	219.7	322.9	74.8	97.7	117.8	100.0	99.9
Developed countries	1,891.9	2,623.4	602.8	657.4	907.4	696.2	683.3
United States	648.2	739.6	184.7	173.7	249.4	167.8	172.5
Euro area	866.1	1,294.5	275.5	326.1	439.3	356.3	324.4
Japan	40.3	48.3	10.2	18.5	20.4	19.8	12.9
Offshore centres	22.1	31.6	6.2	11.0	7.1	7.8	13.8
Emerging markets	100.9	139.7	33.1	33.8	44.9	36.5	35.4
Financial institutions	1,631.6	2,281.0	536.2	593.8	788.4	604.3	633.9
Private	1,361.3	1,913.8	451.1	506.5	660.9	515.4	519.7
Public	270.3	367.2	85.1	87.3	127.5	88.9	114.1
Corporate issuers	211.5	271.2	67.0	68.8	62.0	72.3	62.6
Private	187.3	220.7	53.6	56.5	52.4	60.6	57.5
Public	24.2	50.5	13.4	12.3	9.5	11.7	5.1
Governments	171.8	242.6	39.0	39.6	109.1	63.9	36.1
International organisations	84.3	92.5	14.7	10.1	23.7	30.3	22.2
Completed issues	2,098.3	2,868.4	684.1	735.3	934.0	797.7	706.5
Memo: Repayments	*1,089.6*	*1,471.4*	*347.6*	*325.6*	*448.0*	*450.2*	*399.4*

[1] Convertible bonds and bonds with equity warrants.

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

repayments, totalled \$325 billion, down from \$352 billion in the second quarter (Table 3.1). This small decline reflects reduced activity by borrowers in the euro area, Japan and the emerging economies, which was not fully offset by increased borrowing by entities located in the United States and offshore centres. Patterns at the level of gross issuance were similar (Table 3.2). For the seventh quarter in a row, both net and gross issuance exceeded the respective figures for the year-earlier quarter. Preliminary data suggest that strong issuance continued in October 2004, with a recovery in gross borrowing by Europe and emerging Asia. Among emerging economies, the generally favourable financing conditions enabled infrequent borrowers to come to the market and facilitated a continuation in the recent trend towards longer maturities.

European issuance slows, but euro activity remains strong

European issuance declines …

Net issuance by borrowers in western European economies declined by 26%, from $295 billion in the second quarter to $220 billion in the third, reflecting both a decrease in new issuance and an increase in repayments. Most of this was accounted for by reduced issuance by borrowers in the euro area, particularly Italy and Spain. In part the slowdown was caused by reduced government borrowing, which is typically lower in the second half of the year. However, euro area corporations and financial institutions also cut net borrowing. Among non-financial corporates, net issuance fell from $16 billion in the second quarter to less than $3 billion in the third. Gross issuance by euro area corporates dropped to its lowest level since the fourth quarter of 2002, although this was partially offset by increased borrowing on domestic markets. In October 2004 however, preliminary data suggest a recovery of about 13% in gross issuance by euro area borrowers.

… but the euro's share is unchanged

Despite the decline in euro area issuance in the third quarter, the share of the euro in international securities market activity was essentially unchanged (Table 3.3). The euro was used in 48% of completed issues in the third quarter, compared with 49% in the second, while its share in issuance net of repayments fell from 63% to 61%. In part this reflects the persistence of a

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

In billions of US dollars

		2002	2003	2003		2004		
		Year	Year	Q3	Q4	Q1	Q2	Q3
United States	US dollar	291.4	215.5	75.8	75.4	102.9	–26.0	8.5
	Euro	39.8	47.5	14.1	14.5	13.6	21.5	16.2
	Pound sterling	2.3	11.7	1.8	7.2	3.5	5.1	10.7
	Yen	–6.2	–1.5	–1.7	0.8	1.3	1.5	0.8
	Other	1.2	1.0	0.4	–0.1	4.3	4.7	5.6
Euro area	US dollar	36.1	87.9	23.0	24.9	18.2	34.8	10.0
	Euro	416.5	646.1	97.8	180.8	191.9	159.0	116.5
	Pound sterling	18.4	17.5	3.5	5.4	6.6	15.6	5.4
	Yen	–16.1	–12.1	–3.2	0.4	1.5	3.3	0.5
	Other	24.2	29.4	3.6	12.1	13.7	3.3	6.7
Others	US dollar	90.9	165.2	43.6	49.3	53.9	47.4	45.3
	Euro	66.4	140.2	28.1	37.0	71.3	40.8	66.7
	Pound sterling	41.8	70.9	11.7	26.2	21.6	22.6	12.7
	Yen	–20.9	9.4	–2.0	10.6	2.5	10.7	3.1
	Other	24.6	43.6	7.1	14.6	14.3	7.5	15.9
Total	US dollar	418.4	468.6	142.4	149.5	175.0	56.1	63.8
	Euro	522.8	833.8	140.0	232.2	276.8	221.3	199.4
	Pound sterling	62.5	100.1	17.0	38.8	31.7	43.3	28.8
	Yen	–43.3	–4.3	–6.9	11.8	5.2	15.5	4.4
	Other	50.0	74.0	11.2	26.6	32.3	15.6	28.1

[1] Based on the nationality of the borrower.

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

relatively low level of US dollar-denominated issuance from entities located in the United States (see below). It also results from a greater use of the euro by borrowers outside the European Union, particularly financial institutions based in Switzerland and Australia.

Limited recovery of US issuance

While new financing on the international debt securities market by US entities rose in the third quarter compared with the second, it remained significantly below its levels of late 2003 and early 2004. Completed gross international securities issuance by US borrowers, at $240 billion, was essentially unchanged from the second to the third quarter. After adjusting for the cancellation of $20 billion in defaulted WorldCom debt in the second quarter,[1] net issuance expanded from $27 billion to $42 billion because of a decline in repayments. The net figure was roughly a third of the level of the first quarter of 2004, and well below the $69 billion average quarterly net issuance recorded in 2003.

US housing enterprises borrow less …

The slow pace of US issuance in the second and third quarters was due mainly to reduced international borrowing by the large housing enterprises, Fannie Mae and Freddie Mac. Gross issuance by these two institutions fell to $35 billion in the third quarter of 2004, compared with $63 billion in the second. On a net basis, combined issuance by the two was negative in the third quarter, with negative net issuance of $12 billion by Freddie Mac outweighing positive net issuance of $4 billion by Fannie Mae, compared with combined net issuance of $14 billion (almost all of it by Fannie Mae) in the second quarter. This slowdown in net international borrowing by the two institutions mirrors that in their net debt issuance in the US domestic market. The move to more measured balance sheet growth started well before Fannie Mae and its chief regulator reached an agreement in late September, in which Fannie undertook to increase its capital level over the coming months.

… while corporate issuance rises

Among US non-financial corporations, fund-raising on international markets continued at a healthy level in the third quarter. Net issuance rose to $8 billion from $5 billion (after the impact of the WorldCom cancellation is removed) in the second quarter and $4.5 billion in the first. Completed gross issuance jumped from $18 billion in the second quarter to $28 billion in the third, the largest amount since the second quarter of 2002. This echoed an increase in domestic gross issuance, from $121 billion in the second quarter to $161 billion in the third.

Speculative grade issuance robust

As in previous quarters, low-rated borrowers hastened to take advantage of favourable borrowing conditions, marked by narrow credit spreads and

[1] In the BIS securities statistics, the cancellation of defaulted debt is treated as an early repayment. As a result, Table 3.1 reports $6.8 billion in net issuance by US entities in the second quarter.

decreasing aggregate default rates, as well as investors' willingness to accept greater exposure to credit risk in an environment of low nominal yields on safer investments. Announced international issues by sub-investment grade borrowers in the developed countries reached nearly $13 billion in the third quarter, a record amount and a small increase over the previous quarter. As a result, their gross issuance in the first three quarters of 2004 already exceeds that for the whole of 2003 (Graph 3.1).

The high third quarter figure masks a slowdown in private sector issuance relative to the second quarter, since it includes $6 billion in euro- and US dollar-denominated debt issued in July as part of the German government's securitisation of its bilateral claims on Russia. However, the volume of announcements excluding this transaction, while less than announced issuance in the second quarter, exceeds both announced issuance in the first quarter and the average quarterly level of issuance for 2003.

In contrast to the first half of 2004, telecommunications and technology companies were relatively less active in the third quarter. The most prominent private sector issuer was Enterprise Products Partners of the United States, a natural gas transportation and storage company, which announced four US dollar issues totalling $2 billion at maturities ranging from three to 30 years in late September. As in previous quarters, leveraged buyouts also fuelled supply, such as a 10-year €335 million bond from Grohe of Germany in early September.

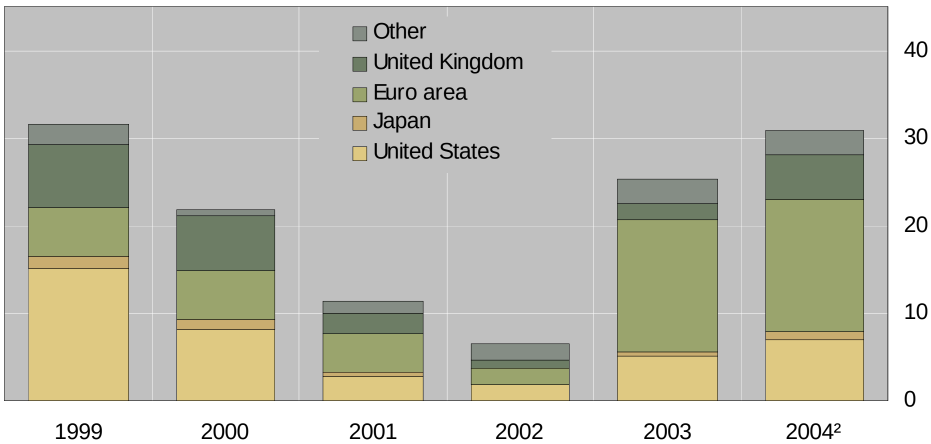
Stable interest rate environment supports fixed rate structures

US dollar borrowers move to fixed rates …

The share of announced US dollar-denominated non-convertible bond and note issues that used fixed rate structures rose to 72% in the third quarter, compared with 67% in the second and 66% in the first. This may have been a

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] Issuance through September 2004.

Sources: Dealogic; BIS. Graph 3.1

reflection of the more settled interest rate environment in the third quarter, when markets shifted from the expectation of a rapid pace of monetary tightening by the Federal Reserve to anticipating a more gradual approach (see the Overview on page 1). Investors, accordingly, were more willing to lock in current interest rate levels, rather than trying to gain exposure to possible increases in money market yields through floating rate investments. Borrowers, who generally have better access to swaps and other means for hedging interest rate movements than do investors, were happy to accommodate this shift.

… as do corporate borrowers in euros

The picture in the euro-denominated market is more complicated. Among non-financial corporate issuers in euros, the use of fixed rate structures in non-convertible bond and note issuance rose from 64% in the second quarter to 69% in the third. In the euro-denominated market as a whole, however, the fixed rate share fell to 47%, compared with 50% in the second quarter and 64% in the first. In part this resulted from a seasonal fall in borrowing by governments, which tend to issue predominantly fixed rate debt. It also reflected an increase in floating rate borrowing on the part of financial institutions, particularly public sector banks. For the past several years, euro area financial institutions have boosted their floating rate borrowing in the second half of the year; the reasons for this are unclear.

Investors remain receptive to emerging economies

Strong issuance by emerging market borrowers …

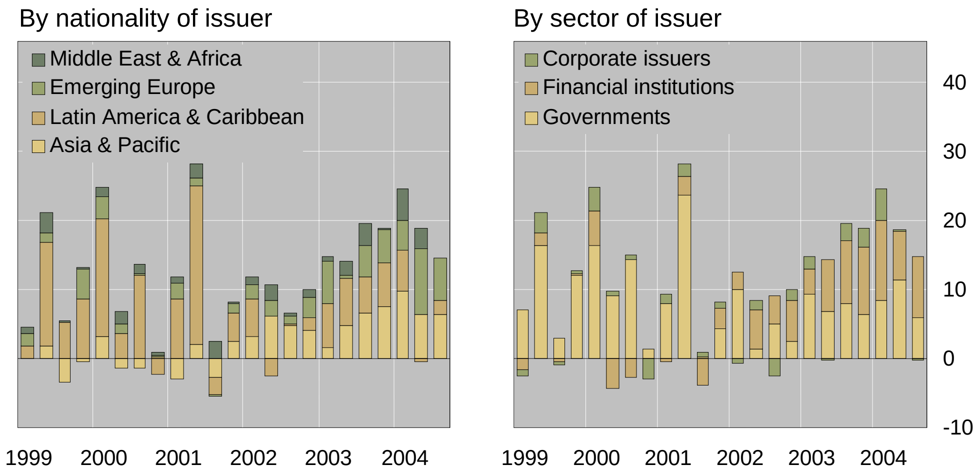
Backed by a gradual decline in credit spreads, which by the end of September had almost reached the historical lows seen in January 2004, fund-raising activity by emerging economies remained strong in the third quarter. With a total of $38.7 billion of announced new issues, gross issuance is on track to reach the record set in 1997.

New issues exceeded repayments by $14.5 billion, compared with $18.6 billion in the second quarter and a quarterly average of $16.9 billion in 2003 (Graph 3.2). The slowdown in net borrowing, however, was accompanied by narrow credit spreads and continued investor receptivity to low-rated issues. This suggests that the decline reflected not a loss of market access, but rather a reduced need for external finance, as most countries continued to enjoy stable current account and fiscal positions.

Borrowing in Asia was mostly driven by financial institutions. Supported to a large extent by Chinese and Korean public sector entities, net issuance by financial institutions amounted to $3.9 billion of the total of $6.4 billion. A few sovereign issuers also raised sizeable amounts. After an absence of over one year, the Republic of Korea launched a $1 billion 10-year bond in September. In view of the country's high level of foreign reserves, the issue reflected the government's intention of providing a pricing reference for other Korean borrowers rather than a need for foreign currency funding. The Republic of the Philippines, a more frequent participant in international debt securities markets, raised a total of $1.4 billion through issuance of two US dollar-denominated bonds and one denominated in euros. However, because of growing concern among investors about increasing government debt levels, the sovereign was

International debt securities issues by emerging market entities

Net issuance, in billions of US dollars



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

faced with higher funding costs than a year ago. A $300 million 10½-year bond, for example, was launched in September with an annual yield to maturity of 9.37%, equivalent to 497 basis points over a comparable US Treasury bond. By contrast, a similar placement made in October 2003 was priced at a spread of only 401 basis points. This increase stands out against the general narrowing trend in emerging market spreads; the JPMorgan EMBI Global spread, for example, fell from 442 to 418 basis points during the same period of time. With total issuance in 2004 so far amounting to $4.1 billion, the Republic of the Philippines is by far the region's busiest sovereign borrower.

... Russian financial institutions ...

In emerging Europe, net borrowing was for the most part fuelled by Russian financial institutions and by sovereigns. Despite the recent banking crisis and the troubles of the large oil company Yukos, Russian financial sector entities – mainly banks and finance vehicles associated with the oil, gas and mining industries – continued to be well received by investors. These borrowers accounted for $2.6 billion of the region's total net issuance of $6.1 billion. The strong presence of Russian financial institutions has been a regular feature of international debt securities markets for two years now. While sovereign issuers from emerging Europe were also present in the market, volumes did not reach the unusually high levels of the previous two quarters, when issuance had been stimulated by 10 countries' accession to the European Union on 1 May. The Republic of Turkey, the most active sovereign borrower from the region in recent years, continued to tap international debt securities markets. A recent upgrade by Standard & Poor's (to BB–), improved economic fundamentals, and investors encouraged by the prospect of future EU membership contributed to relatively low funding costs. In September, a €600 million five-year bond was launched with an annual yield to maturity of 5.75%, equivalent to a spread of a mere 238 basis points over a comparable German government bond as opposed to 680 basis points for a similar placement made in January 2003. Later the same month, a $1 billion 10½-year bond was brought to the market with a yield to maturity of 7.58%. At 333 basis points over a comparable US Treasury bond, the bond was priced 117 basis points tighter than a similar instrument issued a year earlier. The Republic of Cyprus was also well received when it came to the market with a €500 million 10-year note in July. Benefiting from the country's newly acquired status as an EU member and the fact that its A2/A rating is one of the highest among the new entrants, the issue was priced in the region of only 20 basis points above a comparable German government bond. Another notable sovereign placement was made by Ukraine in the form of a $500 million five-year instrument.

… and Latin American governments

After turning negative in the second quarter, net issuance in Latin America was positive in the third. The increase from –$0.4 billion to $2.0 billion was driven by Mexican and Brazilian financial institutions and a handful of sovereign issuers. Corporate sector net borrowing in the region remained negative for the second consecutive quarter, as repayments – especially by Brazilian entities – continued to exceed new issuance. In a sign of investors' continued receptivity to a broad range of credits, the list of sovereign issuers included not just familiar names, such as Brazil and Mexico (each of which announced $2 billion in new issues), Venezuela ($1.5 billion) and Colombia ($500 million, tied to the Colombian peso), but also a number of infrequent borrowers. In July, the Government of Jamaica launched a €200 million bond with a maturity of eight years, the country's longest-maturity euro-denominated issue yet. With an annual yield to maturity of 11.1% at launch, roughly 700 basis points above a comparable German government issue, the bond offered investors a higher yield than that of other B-rated sovereign borrowers in the region such as Uruguay and Venezuela. Later the same month, the Oriental Republic of Uruguay issued a 7.4 billion Uruguayan peso ($250 million equivalent) bond tied to the US dollar, with a maturity of one and a half years. The Republic of Guatemala came to the market in late September with a $330 million 30-year bond, shortly after a similar placement of $286 million by the Republic of El Salvador.

Emerging market issuers extend maturity

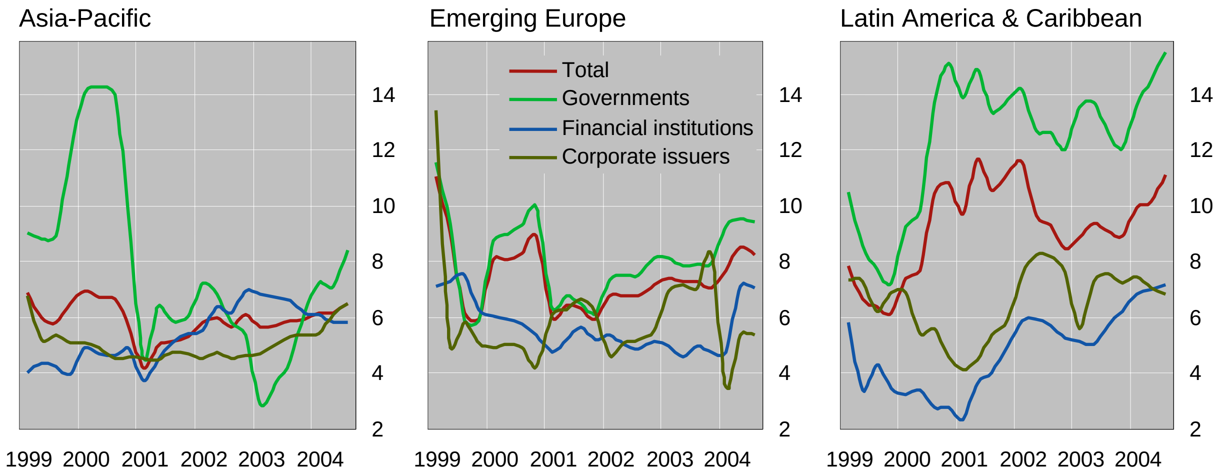
The favourable financing conditions that have prevailed through most of 2004 have enabled emerging market borrowers not only to raise significant amounts in international debt securities markets, but also to extend the maturity of their debt (Graph 3.3).

Emerging markets borrow at longer maturities …

Although the average maturity of emerging market international debt instruments peaked at 9.4 years in the first quarter of 2004, maturities during the second and third quarter remained high by the standards of the recent past. For the first three quarters of 2004 as a whole, announced issues – including money market instruments – by emerging market entities had an average maturity of 9.0 years, compared with 7.8 years in 2003 and 7.2 years in 2002. This extension of maturity has for the most part been fuelled by governments (mainly sovereign issuers). In the first three quarters of 2004, government placements had an average maturity of 12.2 years, compared with 9.8 years in 2003.

Average maturity of emerging market debt issues

In number of years; four-quarter moving average



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

… especially Latin American sovereigns

Increasing maturity can be observed across most regions and sectors. The most significant lengthening of maturity has occurred in Latin America, particularly among sovereign issuers. Several 30-year bonds have been successfully sold by Latin American sovereigns. As a result, the average maturity of Latin American government issues has gone up from 12.1 years last year to a record 16.5 years for the first three quarters of this year. In emerging Europe, an increase in maturity for all issuers over the same period from 7.0 years to 8.8 years was driven partly by sovereign issuers and partly by financial sector entities, predominantly Russian financial institutions associated with the oil and gas sectors. The rising trend in the Asia-Pacific region can for the most part be traced to longer-maturity borrowing by the Korean corporate sector and by the Republic of the Philippines.