Local currency bond issues by international financial institutions[1]

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Abstract

Issuing medium to long-term local currency bonds rather than short-term foreign currency-denominated bonds could help emerging market economies to lower external vulnerabilities. IFIs contend that their own local currency bond issues help to develop domestic bond markets and thus support the reduction of external vulnerabilities. IFIs may indeed support the international integration of domestic bond markets through their local currency bond issues: by helping to develop the legal and regulatory framework for local currency bonds issued by foreigners, by transferring financial know-how to the domestic financial sector, by providing an example in terms of best practices in bond issuance and by helping to initiate a process of developing the yield curve. However, the main initiatives must come from the domestic governments themselves: in particular, they need to implement and maintain conducive macroeconomic policies and financial market policies (including the legal and regulatory framework and the market infrastructure) to attract foreign issuers and foreign investors. Structural reforms to stimulate the creation of pension funds also help to develop the domestic investor base. Given the significant staff resource requirements of a (domestic) market-opening IFI-issue, IFIs should be selective in choosing the markets they want to enter as a first foreign issuer. Some IFIs may also need to analyse more systematically the potential impact of their local currency bond issues on the development and integration of domestic bond markets. Local currency bonds are but one device (and perhaps not the most important) for IFIs to help develop domestic bond markets. Therefore, a broader analysis of how IFIs could support the development of domestic bond markets (including the scope of technical assistance, the compilation and dissemination of relevant data, and risk mitigation instruments like partial guarantees) may also be warranted.

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1. Introduction

The financial crises of the last decade revealed the significant risks that are associated with foreign currency-denominated debt. Local currency bond markets are seen as an important means to reduce the share of such debt and risks, and a number of emerging market economies (EMEs) have made significant efforts to develop their local currency bond markets. By now there is also a growing literature on how these markets can be advanced.[3]

Some international financial institutions (IFIs)[4] have been issuing local currency bonds for some time and consider their local currency bond activities as a potentially important contribution to domestic bond market development. This potential contribution has so far received little attention in the literature. This paper therefore presents some data on the local currency bond issuance activity of IFIs and discusses the IFIs' potential role in the development of domestic bond markets based on a review of the literature.[5]

2. Data on IFIs' local currency bond issues[6]

IFIs issue local currency bonds when they offer a cost-effective funding opportunity, as a means of funding their lending in local currency and/or to help develop domestic bond markets.[7] [8] In 2005/FY 2006, the IFIs reviewed here raised up to *one-third of new borrowings* through issues in EME currencies. And by the end of 2005/FY 2006 up to *16½% of total outstanding borrowings* had been raised through issues in EME currencies. It is likely that most of the IFIs' borrowing in local currency was done foremost because it was a *cost-effective way of raising funds*. While all of the IFIs have been diversifying their local currency bond issues among EMEs from different regions, some currencies dominate among the EME currencies chosen for issuance. For example, in 2005/FY 2006 the South African rand was the most important or second most important EME currency in terms of volumes (new and

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[3] See, for example, World Bank (2001), BIS (2002, 2005a, 2005b, 2006a, 2006b), IMF (2005a, 2006); ADB (2006); and IADB (2006).

[4] The following paper focuses on the Asian Development Bank (ADB), the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB), the Inter-American Development Bank (IADB), the International Bank for Reconstruction and Development – World Bank (IBRD) and the International Finance Corporation (IFC).

[5] In the following, the terms "local" and "domestic" are used as synonyms and refer to developing and emerging market economies.

[6] For a more detailed description of IFIs' local currency bond issues, see Appendices 1 and 2. Data presented here covers information up to end 2005/FY 2006.

[7] The ADB, for example, notes in its Annual Report that its "primary borrowing objective is to ensure availability of funds at the lowest possible cost for its operations. Subject to this objective, ADB seeks to diversify its funding sources across markets, instruments and maturities … Also, in 2005 ADB pursued the objective of contributing to the development of regional bond markets and of providing local currency financing for ADB's private sector operations through local currency bond issues." See ADB (2005), p 12. Other IFIs use similar wording.

[8] It should be noted that IFIs generally emphasise that not only local currency borrowing but also local currency lending contributes to the development of domestic capital markets. The EIB, for example, points out that IFIs that act both as local currency lenders and bond issuers channel domestic financial savings to companies that cannot (yet) tap domestic bond markets directly. They thus act as financial intermediaries which may in itself contribute to the development function of the domestic bond market. For a discussion of IFIs' lending in local currency as a means of helping to develop domestic capital markets see EIB (1999), p 3, Hoschka (2005b), EBRD (2006a and 2006b) and IFC (2006).

outstanding borrowings) for all IFIs reviewed here.[9] The fact that some EME currencies are so dominant in terms of volumes supports the contention that cost-effectiveness is the primary motive for local currency issuance. [10]

When IFIs issue local currency bonds with the purpose of developing the domestic bond market, they often take a regional focus. IFIs have then often been the first, or among the first foreign entities, to issue in a particular local currency.

As regards the format, IFIs have launched local currency bonds as "traditional" foreign bonds, Eurobonds and global bonds.[11] Whether "traditional" foreign bonds, Eurobonds and global bonds have the same impact on domestic bond market development will be discussed in chapter 5, but it should be noted that some IFIs mainly refer to their domestic or global bond issues rather than the Eurobond issues when discussing their market development impact.[12]

Of the IFIs reviewed here, the *Asian Development Bank* and the World Bank were the first to issue a local currency bond in a domestic market, when in 1970 they launched Yen-denominated bonds in then-still-emerging Japan (the so-called "Samurai bonds").[13] After the Samurai bonds, the ADB continued to focus on Asia, with a "first wave" of "traditional" foreign bonds in the 1990s (Hong Kong, Korea and Taiwan), and a "second wave" starting in 2004 (India, Singapore, Malaysia, Thailand, China and the Philippines). In most cases the ADB was the first foreign issuer in the respective local currency in the domestic market.

The *European Bank for Reconstruction and Development* took a special interest in central and eastern Europe, starting in the mid-1990s and issuing bonds in the currencies of Hungary, the Czech Republic, Poland, Russia, Estonia and the Slovak Republic. Unlike the ADB, the EBRD has typically (but not exclusively) issued local currency bonds in the

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[9] In 2005/FY 2006, five out of the six IFIs reviewed here raised between one-third and two-thirds of new borrowings in EME currencies through issues in South African rand. And as of end 2005 (end FY 2006 in the case of the IFC), the IFIs had raised between 20% and 60% of total outstanding borrowing in EME currencies through issues in South African rand.

[10] It should be noted that the composition of new bond issues per currency may change significantly from year to year. Nevertheless, the South African rand has been an important issuing currency for IFIs for several years. Another important currency in terms of volumes has been the Hong Kong dollar.

[11] A *"traditional" foreign bond* is issued by a foreign entity in the domestic market in whose currency the bond is denominated. "Traditional" foreign bonds are issued under the regulations of the domestic market. Many have been nicknamed, for example, "Yankee bonds" (for US-dollar bonds issued by a non-US entity in the US market), "Samurai bonds" (for a yen bond issued by a non-Japanese entity in the Japanese market) etc. A *Eurobond* is issued outside the domestic market in whose currency the bond is denominated. Eurobonds are typically underwritten by an international syndicate, free from national regulations, and cleared through a pan-European clearing system. *Global bonds* are a hybrid that can be offered in several markets simultaneously.

[12] Domestically and globally issued local currency bonds represent a much smaller share in new and outstanding borrowings than all EME issues. The South African rand issues, for example, were predominantly, if not exclusively, Eurobond issues.

[13] The ADB's Samurai bond was a privately issued bond that was followed in the same year by a publicly issued bond from the World Bank.

international markets as Eurobonds or global bonds. However, the EBRD was also the first issuer of Hungarian forint bonds in the Hungarian market (in 1994 and 1996). Most recently (in 2005) it became the first foreign issuer to launch a rouble bond in the Russian market.

The *European Investment Bank* has focused on new EU member states and on accession and acceding countries, with a "first wave" in the 1980s (Spain, Portugal and Greece), a "second wave" beginning in the mid-1990s (the Czech Republic, Hungary and Poland) and a "third wave" starting in 2003 (the Slovak Republic, Malta, Slovenia, Bulgaria and Turkey). In Spain, Portugal and Greece, bonds were issued in the domestic markets; in the Czech Republic, Hungary and Poland, issues were placed in the domestic and in the international markets; and in the Slovak Republic, Malta, Slovenia, Bulgaria and Turkey, all bonds have so far been issued in the international markets. The EIB emphasises that it was the first foreign issuer of bonds denominated in Portuguese escudos and Greek drachmae in the respective domestic markets and of bonds denominated in Hungarian forints and Bulgarian levs in the international markets.

The *Inter-American Development Bank* did not start issuing local currency bonds with the explicit objective of helping to develop domestic bond markets until 2004 and has since focused on Latin America (Mexico, Colombia, Brazil and Chile). The Mexican bond has been in global format, the other bonds have been in Eurobond format. The Mexican peso bond was also the first international bond issue in this currency in the domestic capital market under the new financial regulatory framework adopted by Mexico in 2003.

The *World Bank* has been issuing bonds in the currencies of EMEs of all regions, traditionally as Eurobonds and more recently in domestic or global format. The IBRD emphasises that it was the first foreign issuer of bonds denominated in Korean won, Mexican and Chilean pesos, Brazilian reals (FX linked) and Turkish lire in the Eurobond markets.

Finally, like the World Bank, the *International Finance Corporation* does not take a regional focus when it issues local currency bonds for the purpose of helping to develop domestic bond markets (or for other purposes). It issues in domestic and international markets. The IFC emphasises that in many cases it has been the first, or among the first foreign issuers, of local currency bonds in the domestic and international markets. Most recently (2005), it became the first foreign issuer of bonds denominated in Peruvian nuevos soles, Moroccan dirhams and Chinese renminbi in the respective domestic markets (the renminbi bonds being issued in partnership with the ADB).

3. Limitations to IFIs' local currency bond issuance

As reported above and in Appendix 1, the share of IFIs' new and outstanding borrowings raised through issues in local currencies is in most cases much smaller than the share raised through issues in currencies of advanced countries. The limited share and the concentration (in terms of volume) on some EME currencies (as on the South African rand in

2005/FY2006) are primarily the result of requirements in their charters and of their borrowing policies, including asset liability management.[14]

The IFIs' charters, for example, typically demand that IFIs have the *approval of the member country* in whose currency the bond is denominated and in whose domestic market they intend to issue. (The ADB and the IADB must also obtain the approval of the relevant countries so that the proceeds from their borrowings may be exchanged for the currency of any member without restriction.) Some IFIs may also be able to issue local currency bonds only if *cross-currency swap markets* already exist. For example, some IFIs' charters prevent them from taking on exchange rate risks (this is, for example, the case for the World Bank and the IADB). In the absence of opportunities for onlending the local currency raised at financial terms attractive to the client, these IFIs then need to swap all issuance into any of the currencies demanded on loans by their borrowers. Others may not be obliged to swap all local currency into hard currency but often undertake currency (and interest rate) swaps simultaneously to a bond issue. This also reflects local borrowers' preference for US dollar-denominated loans (a situation which may however be changing). The IFC, for example, in FY 2006, swapped all non-US dollar (medium and long-term) borrowings into US dollars.[15] Similarly, the ADB, in 2005, swapped the proceeds from all borrowings with the exception of those from issues in Philippine pesos and Chinese renminbi (as well as Japanese yen) into US dollars.[16] Furthermore, and as already mentioned, the IFIs' primary borrowing objective is typically to *ensure availability of funds at the lowest possible cost* for their lending operations. Subject to this key objective, IFIs try to diversify their sources of funding across markets, instruments and maturities. Finally, if local currency bonds are issued to fund direct local currency lending, *suitable projects with local currency financing needs* have to be available.[17]

The IFIs' charters and borrowing policies thus result in minimum requirements for IFIs to be able to issue in local currency. These minimum requirements typically include tax exemptions, domestic rating exemptions, broad investor access, low risk weighting, and reserve eligibility (see Box 1 below).

[14] Information on IFIs' borrowing policies can be found on the capital markets', treasuries' and investor information sections of IFIs' external websites and in their annual reports and financial statements.

[15] See IFC (2005).

[16] See ADB (2005).

[17] García/Dalla (2005), for example, note that, if the supranational is unable to lend simultaneously and on similar terms, it will incur a carrying cost. This would make such a transaction less attractive from an overall institutional funding objective. See also EIB (2005b), p 23.

Box 1. MDBs' requirements for issuing local currency bonds[18]

(i) *Tax exemptions.* Confirmation that interest payments by the MDB and its paying agents will be exempted from withholding taxes. This requirement is based on the fact that MDBs are granted tax-free status in their member countries.

(ii) *Domestic rating exemptions.* Since MDBs are typically rated by all three major international rating agencies, securing an additional domestic rating adds little additional value for investors.

(iii) *Broad investor access.* The ability of all major domestic institutional investors, including insurance companies and pension or provident funds, to invest in the MDB bonds increases the distribution and liquidity of bonds, lowering funding costs.

(iv) *Risk weighting.* Risk weightings of MDB bonds should be no more than 20% in line with current Bank for International Settlement guidelines ("Basle 1"). Under the new "Basle 2" guidelines this risk weighting will be reduced to 0%.

(v) *Reserve eligibility.* Similar to government bonds, MDB bonds may be eligible to be counted against statutory reserve and liquidity requirements imposed on financial institutions. This privilege broadens distribution to include commercial banks and typically improves liquidity of the bonds.

4. Potential benefits of IFIs' local currency bond issues on domestic bond market development[19]

Proponents of IFIs' local currency bond issues generally emphasise that IFIs may help to develop domestic bond markets through the following channels:

(1) IFIs may help to develop the *legal and regulatory framework for foreign issues* by directly providing technical assistance, thus creating the basis for local currency bond issues by foreigners in the first place.[20]

(2) IFIs could also more directly transfer *financial know-how* to and stimulate competition in the domestic capital markets by involving domestic financial intermediaries in the issuing process together with international banks.

(3) By adopting *best practice standards* (for instance, in terms of documentation and execution), IFIs may serve domestic companies and banks as an example and thus "crowd them in" to issue local currency bonds.[21]

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[18] The box is taken from Hoschka (2005b), p 9. The EIB requires the signing of a Framework Agreement that covers the legal personality of the EIB, the treatment of EIB bonds and the access to the markets. The EIB, in particular, requires EIB bonds to enjoy the same status as government bonds. See EIB (2005b), p 13.

[19] The following chapter does not discuss partial guarantees by IFIs for local currency bonds issued by domestic private entities.

[20] See, in particular, García/Dalla (2005), p 7, as well as EIB (1999), p 3 and EIB (2005b), pp 5 and 22.

[21] See, for example, EIB (1999), p 3.

(4) By regularly issuing in a domestic market IFIs may also provide *liquid benchmark bonds* which are also a prerequisite for domestic corporations and banks to issue local currency bonds.

(5) IFIs' local currency bonds may have a *signal effect:* By issuing local currency bonds, IFIs – which are well-known issuers in international capital markets – may contribute to strengthening the confidence in the stability and safety of the domestic bond market and thus bring the presence of local currency bond markets to the attention of other *foreign issuers* and to *foreign investors*:

Foreign issuers are attracted to local currency bond markets because these markets can provide a funding base diversification and a cost-competitive funding option (sometimes after swapping the proceeds into another currency) and may serve to establish a strategic presence in the local economy (this last motive also interests multinational companies that want to fund their operations in the host country).[22] Proponents of IFIs' local currency bond issues contend that in some cases foreign issuers' attention may need to be drawn to these attractions through IFIs' local currency bonds. Foreign issuers for their part may contribute to deepening financial markets and fostering innovation through the development of new asset classes and financial instruments.[23]

As regards the effect on *foreign investors* in local currency bond markets, proponents of IFIs' local currency bond activities claim that high-rated bonds issued by IFIs (and other foreign issuers) are often a precursor to foreign investors participating in the government and domestic corporate and bank debt markets. The main argument is that, when foreign investors first consider investing in a new market, they prefer initially to decouple the credit risk decision from the currency risk decision.[24] Foreign investors for their part would, in particular, contribute to a more diversified investor base for local currency bonds.

(6) IFIs may catalyse and complement the government yield curve and thus contribute to an *extension of the yield curve*.[25] The potential to issues and invest in medium to long-term bonds reduces the risk of maturity mismatches. Furthermore, if EMEs want to reduce their external vulnerabilities, they should be particularly interested in diversifying the investor base. The availability of a yield curve that extends over a wide range of maturities would be an important contribution to this end.[26]

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[22] See Herrera-Pol (2005), p 5.

[23] Like the IFIs other foreign investors may of course also provide an example to domestic issuers and provide diversification opportunities to domestic investors.

[24] See, for example, EBRD (2005), p 3.

[25] See, in particular, García/Dalla (2005), p 8 and EIB (1999), p 3. In countries with fiscal surpluses, local currency bond issuance by foreigners may even substitute as benchmark issues at the margin when the government reduces its borrowing programme. See Hoschka (2005a), p 24.

[26] The EBRD emphasises that IFIs may also contribute to developing a money market reference rate, which may be missing in some EMEs (see also chapter 5).

(7) IFIs may also help develop *local derivatives markets* and *secondary local bond markets*.[27] One venue would again be for IFIs to provide technical assistance. But through their local currency issuance and swap activities IFIs may also contribute more directly, in particular, to local derivatives market development (see chapter 5).

(8) Finally, IFIs' local currency bonds may provide domestic *investors* with an opportunity to *diversify their portfolios*.

5. Assessment of the impact of IFIs' local currency bonds on domestic capital markets

Before trying to assess whether the claimed positive impact of IFIs' local currency bond issues on domestic bond markets do indeed materialise, two preliminary remarks are warranted.

First, there have so far only been a *few studies* to assess IFIs' local currency issuance activity on the development of domestic bond markets. To the author's knowledge, only one study is publicly available, the Evaluation Report of the EIB's Operations Evaluation Unit on "The Impact of EIB Borrowing Operations on the Integration of New Capital Markets", which dates back to 1999. In this report, the EIB analyses ex post the impact of EIB borrowings in Spanish pesetas, Portuguese escudos and Greek drachmae on the development of the bond markets in Spain, Portugal and Greece.[28] Furthermore, the Asian Bond Market Initiative (ABMI) Working Group 4 on the Issuance of Bonds Denominated in Local Currencies by MDBs, Foreign Government Agencies and Multilateral Corporations, in 2003, conducted a survey on supranational issuance in ASEAN+3 countries and held a seminar on bond issuance by supranationals. However, neither the survey nor a report on the seminar is publicly available (only a short summary report is posted on the ABMI's external website[29]). Finally, a paper in the ADB's working paper series reviews the experience of five East Asian economies with local currency bonds issued by foreigners.[30]

Second, while most IFIs issue local currency bonds as *"traditional" foreign bonds* and as *Eurobonds and global bonds* (see chapter 2 and Appendix 1), few comment on whether they consider Eurobonds to have the same potential impact on domestic bond market development as "traditional" foreign bonds.

The decision whether to issue in the offshore markets (ie Eurobond issues sold to foreign investors) or in the domestic market is of course not only determined by considerations of market development. As mentioned before, most IFIs are required by their charters to have the consent of the member country in whose currency the bond is denominated and/or in

[27] See EIB (1999), p 3.
[28] See EIB (1999).
[29] See ABMI (2005).
[30] See Hoschka (2005a).

whose market they intend to issue. Historically, especially prior to the vast liberalisation of markets that took place in the 1990s, most member governments allowed IFI issuance in their currency only in the offshore, not in the domestic markets. One reason may have been that they wanted to shield their domestic bond markets from crowding out or that they wanted to limit the volatility of capital flows. On the other hand, foreign exchange controls may restrict issuance in the offshore markets (or could result in foreign borrowers issuing separate, non-fungible tranches of bond issues: one tranche for domestic investors and another tranche for offshore investors). This was, for example, the case when the Philippines and Korea first opened their bond markets to foreign issuers.[31] Cost-effectiveness may also be an important reason to issue offshore.[32] Offshore issues may also offer the opportunity to place a larger issue in local currency with longer maturities with the help of foreign investors when the domestic investor base is still shallow.

While there are reasons for and benefits to IFIs' issuance in the offshore markets, their Eurobonds may have a more limited and indirect effect on developing the domestic bond market. In particular, there may be fewer incentives for the respective government to change the laws and regulations for foreign issuers, a fact which would limit the scope for the international integration of the domestic market.[33] Eurobonds could still serve domestic entities as an example in terms of applying best practices, but only a few domestic private entities will be able to issue offshore. Issuance in the offshore markets may also fragment liquidity.[34] Some IFIs also emphasise that by issuing in the domestic market, they establish their credit in the domestic market, which makes it easier for them to provide structured finance products linked to their credit (such as partial credit guarantees and securitization) which may also contribute to domestic bond market development.

Despite the possible drawbacks with regard to bond market development, some IFIs still consider issuance in the offshore markets as a means to get into the discussion with the local authorities and to familiarise foreign investors with the local currency.[35]

Now on the potential benefits of IFIs' local currency bond issues.

(1) Legal and regulatory framework for foreign issues: According to their own reports, some IFIs have indeed at times provided considerable technical assistance to help develop the legal and regulatory framework for foreign issues when they issued an inaugural local

[31] See Herrera-Pol (2005), p 8.

[32] Many IFIs note that international investors may have a higher appreciation/valuation of IFI credit than domestic investors and may also prefer settlement via international clearing systems where EuroClear and Clearstream have no domestic market links to facilitate international investors' participation.

[33] The EIB, for example, points out that the opening of the "traditional" foreign issues market in Portugal may have inspired domestic bond market reforms. See EIB (1999), p 9.

[34] The EIB found that in Greece the development of the euro-GRD markets may have limited the growth of the "traditional" foreign issues market (Marathon market). See EIB (1999), p 7.

[35] Some IFIs contend that global issues are the ones that could have the greatest development impact for countries that are interested in making their domestic markets broader, deeper and more liquid and in bringing international investor participation to them.

currency bond in a particular domestic capital market ("inaugural" defined as the first issue in a given domestic capital market by a foreign entity). One recent example is the EBRD's 2005 inaugural rouble bond issue in the Russian capital market. As the EBRD points out, Russia's federal law on the securities market of 1996 did not establish the regime for foreign issuers, and legal and regulatory requirements were "onerous, unclear or conflicting". Regulations concerning the listing and disclosure requirements for foreign issuers were similarly non-existent. The EBRD started in 1999 to provide technical and legal expertise to develop the framework for the issuance of long-term local currency bonds. The EBRD then issued its first rouble bond in the domestic market in 2005 (a 5-year floating rate note).[36]

While many of the EMEs that have wanted to open their domestic markets to foreign issuers have first allowed IFIs to enter and have accepted the technical assistance provided together with the inaugural issue, there are also alternative approaches. For example, in Asia, the process of opening domestic markets to foreign issuers was supported by the Asian Bond Market Initiative (ABMI) and its Working Group 4. Following discussions on the impediments and constraints facing supranationals in issuing bonds in East Asia, several countries in the region issued relevant regulations and guidelines to enable supranationals to issue bonds in their domestic markets (it should be noted that the ADB was involved in these discussions of the ABMI's WG).[37] Still other EMEs have opened their markets to IFIs and other foreign issuers simultaneously. However, whether other foreign issuers issue primarily in the offshore markets or also in the domestic market and what implication that has for domestic bond market development has not been investigated.[38] [39]

(2) Financial know-how: Several IFIs report that they have involved domestic financial institutions in the issuing process. The EIB, for example, initially used a system of rotation amongst the domestic investment banks for lead-management and book-runner mandates and combined local with international banks. It later introduced a system of competitive bidding. The World Bank and the EBRD also emphasise that in their Chilean peso, Mexican peso, Colombian peso and Malaysian ringgit (IBRD) and its rouble bond issues (EBRD) they worked with international and domestic partners in the issuing process, facilitating the transfer of know-how to domestic financial intermediaries.

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[36] See EBRD (2006a), p 11 ff. (The EBRD has since followed up on this inaugural issue with two more issues in the Russian domestic market in April 2006 and in September 2006; these issues have also been 5-year floating rate notes.) Other examples include the IADB ("…we have invested considerable staff time in operations that are playing a pioneering role in Latin America's financial markets." See IADB (2004a), p 3) and the IFC ("During the last two years, IFC has been working closely with the Moroccan authorities to prepare for this transaction." See IFC press release on the launch of the Moroccan dirham bond in 2004).

[37] See also García/Dalla (2005).

[38] For a review of the opening of EMEs' domestic markets to foreign issuers see also Herrera-Pol (2005).

[39] The question may be whether effective technical assistance requires the issuance of an inaugural bond by IFIs.

(3) Best practice standards: By adopting best practice standards, IFIs may indeed provide, for example, reference documentation to other foreign as well as domestic institutions, although both (2) and (3) are hard to measure.

(4) Liquid benchmark bonds: In its review of experience in Spain, Portugal and Greece, the EIB emphasised that in both Spain and Portugal it had created a number of larger benchmark bonds through the application of re-opening techniques to enhance the attraction of the market for foreign issues. As this example shows, whether IFIs can indeed provide liquid benchmark bonds depends not least on their borrowing policies: they have to be willing and able to regularly issue in a particular currency in a domestic market. In addition, whether IFIs' bonds can serve domestic entities as a benchmark is an open question, since IFIs' high rating quality is not readily comparable with the rating quality of local borrowers, which could limit their role as a benchmark.

(5) Signal effect for other foreign issuers and investors: Whether or not the signal effect of IFIs' local currency bonds is important to attract other foreigners to issue local currency bonds would have to be demonstrated by analysing the development of the "traditional" foreign issues market as well as the Eurobonds and global bonds markets after the inaugural or first international issue by an IFI. The EIB did this for Spain, Portugal and Greece in 1999. It concludes that its first foreign issues "created the ("traditional") foreign issues market insofar as a number of other foreign borrowers followed them" and "the EIB initiated and supported an important process of image and confidence-building, which has put these countries and their currencies on the map for international investors".[40] Hoschka (2005a) also reviews the development of local currency bond issuance by foreigners in Japan, Hong Kong and Singapore and concludes for East Asia that "IFIs' local currency bond issues may … have stimulated the market for foreign issues".[41] But even if foreign issuers are attracted to the local currency market after its opening by an IFI, this may just be the effect of its attractiveness (diversification, cost-effectiveness, strategic issues, see above).

Could the signal effect help attract new foreign investors? This is difficult to say, since there is so far no consolidated international database on the composition of investors in local currency bond markets. Thus, none of the studies reviewed here have tried to demonstrate whether foreign investor participation increased following IFIs' launch of local currency bonds. Existing data indicate that foreign investor participation in local currency bond markets has risen in recent years. But as in the case of foreign issuers this increase in foreign investor participation does not indicate that IFIs' signal effect is indeed needed to attract foreign investors. The recent increase may just be a result of the improved fundamentals in EMEs and, at least to some extent, of the "search for yield" by investors from mature markets.[42]

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[40] See EIB (1999), p 12.

[41] Hoschka (2005a), p1 ff.

[42] Thus, it is not clear, whether indeed foreign investors see IFIs' local currency bonds as a precursor to an investment in local currency bonds issued by domestic entities. Some investors may continue

Whether and, if so, to what extent other foreign issuers and investors follow IFIs' inaugural or first international issue(s) is largely the result of the local government's decisions and actions, a fact which is also recognised by IFIs. Indeed, they generally emphasise that the major impulse must come from the domestic authorities and that they must show a strong will to implement and maintain financial market policies that are conducive to the international integration of the domestic bond market. This includes bringing the legal and regulatory framework (in particular securities and capital markets regulation) and the market infrastructure (in particular clearing and settlement systems, disclosure and documentation requirements etc.) up to international standards. As regards the legal and regulatory framework, the EIB, for example, finds some evidence that the buoyant development of the "traditional" foreign issues market in Portugal compared to Greece and, even more so, to Spain was due to Portugal's decision to fully liberalise the market shortly after its opening to supranationals.[43] As mentioned before, one reason why local governments may be reluctant to open the market to all foreign issuers relates to "crowding out". Whether or not there could be a case of crowding out depends on the borrowing requirements of domestic entities and the stage of development of the domestic market.[44] Last but not least, macroeconomic conditions need to be conducive to long-term bond markets (from the issuers' as well as the investors' point of view).[45]

While the local governments' decisions and actions are decisive, the IFIs' efforts would also be wasted if they entered the market at the wrong stage of development: The EIB, for example, notes that IFIs' borrowing operations can be expected to have a neutral impact if the domestic bond market is already functioning well, especially if there is an active market for fixed medium and long-term bonds. There is also likely to be little scope for a positive development impact if the market is not yet "ripe" technically and institutionally for receiving external assistance through IFIs' borrowing activities.[46] IFIs should also consider whether crowding out could be an issue in the market they intend to enter (see above). Finally, it may even be undesirable to attract foreign investors, in particular short-term investors, to local currency bond markets that do not yet have a developed domestic investor base and a sufficient degree of asset diversification.

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to prefer the currency risk over the credit risk, while others may prefer the credit risk over the currency risk.

[43] See EIB (1999), p 7. The *International Financing Review* (*ifr)* also notes that "the supranational development agencies' efforts to issue such bonds definitely lay the groundwork for future deals, but those efforts are so often wasted because future deals never arrive … Why? Because the local government won't give permission." See ifr (2005).

[44] Hoschka (2005a), p 25, points to another potential problem: there may be concern that currency swaps by IFIs and swap-driven issuance by other foreign issuers may have an adverse impact on exchange rate volatility. However, for this argument to apply the volume of local currency bonds issued by foreigners compared to the daily market volume in the exchange market would have to be large. In addition, in domestic capital markets that experience excessive capital inflows IFIs' swapping of the local currency may also be beneficial in "sterilising" the liquidity effect of such inflows.

[45] For an assessment of why foreign investors are attracted to local currency bonds see Burger/Warnock (2004) and Zarutsky (2005).

[46] See EIB (1999), p 8.

(6) Developing the yield curve: Only the EIB has so far tried to assess the effect of its local currency bonds on the development of the domestic yield curves in Spain, Portugal and Greece by reviewing the evolution of maturities of its own and the governments' local currency bonds over the time it had been active in the relevant domestic markets. The EIB concludes that it did indeed initiate a process of extending the yield curve, at least in Spain and Portugal.[47] However, the EIB also emphasises that in all three countries the relevant governments took over issuing bonds with longer maturities[48] and that in all three countries the role of domestic institutional investors increased considerably, thus creating a virtuous circle of increased supply of and demand for medium to long-term debt. It should also be noted that, in recent years, governments in EMEs have become increasingly aware of the need to develop the yield curve. Thus, today, there may be less need for the IFIs to jumpstart this process.

It should be noted that in some cases developing the short end of the market may be as important as developing the long end. The EBRD, for example, emphasises that in the context of its inaugural rouble bond issue in 2005 the regulatory adjustments also included the establishment of a new money-market index, the Moscow Prime Offered Rate (MosPrime). According to the EBRD MosPrime has already developed into a transparent, credible and accurate money-market interest rate benchmark, which has contributed to greater transparency and consistency in the pricing of corporate loans, has encouraged long-term syndicated corporate lending and mortgage-lending and is now beginning to serve as an index for the pricing of derivatives, including interest rate swaps and futures. The EBRD's 5-year floating rate note was the first MosPrime-linked issue in the Russian market.

(7) Local derivatives markets and secondary local bond markets: The lack of developed derivatives markets and liquid secondary bond markets is often cited as an impediment to a further development of local currency bond markets. The development of these markets would therefore be an important contribution to domestic bond market development.

As regards the development of liquid secondary bond markets, the EIB – the only IFI that has so far tried to analyse the effect of its local borrowing activities on secondary local bond markets – concedes that it had been unsuccessful in all three countries (Spain, Portugal and Greece) in developing these markets, mainly because the countries concerned had a limited technological infrastructure to manage secondary market operations. According to the EIB local authorities had concentrated their efforts on modernising their government securities markets, while the stock exchanges, which were largely responsible for developing other segments of the bond market, were occupied with modernising the equity markets. Thus, the

[47] See EIB (1999), p 12.

[48] The EIB emphasises: "Government debt managers in all countries made considerable efforts, quite successfully, to extend the yield curve for fixed-rate government securities, usually following the flotation by the EIB and other MDBs of medium-term fixed rate bonds." See EIB (1999).

secondary market trading moved immediately to the international OTC market, and clearing and settlement largely took place in the European clearing houses EuroClear and CEDEL.

As regards the development of local derivatives markets, the World Bank emphasises that when IFIs started issuing Spanish peseta bonds and wanted to swap the proceeds into US dollars, they first did so via back-to-back operations with international and domestic banks operating in Spain. Banks which wanted to match these long-term, fixed-rate Spanish peseta liabilities started to originate long-term, fixed-rate Spanish peseta assets in the form of commercial real estate loans and other corporate assets. When flows started growing banks began to take positions which according to the World Bank in fact started the Spanish swap market. (The World Bank points to a similar evolution in Colombia and Peru in early 2000.) Another more recent positive example of an IFI contributing to the development of local derivatives markets could be the EBRD's contribution to the establishment of a money-market index, the MosPrime rate, in Russia. As noted above, according to the EBRD MosPrime has developed into a benchmark that could serve as an index for the pricing of derivatives.

Of course, IFIs may also help to develop the local derivatives markets by providing technical assistance. The EBRD, for example, has worked to clarify the derivatives' environment including the recognition of swaps and netting in the Czech Republic, Hungary, Poland and Slovakia. It has also provided comments and proposed derivatives legislation in Russia. Finally, the EBRD regularly runs technical sessions on risk management instruments to corporates, public officials and stock exchanges that are launching derivatives contracts. Similarly, the IFC emphasises on its external website that it "works closely with market counterparts and government regulators to extend the availability and liquidity of these [derivatives or swap] markets".[49]

(8) Providing diversification opportunities to domestic investors: Most IFIs provide information on (primary) investors for individual local currency bond issues.[50] Accordingly, IFIs' local currency bonds have often been placed with domestic (in particular, institutional) investors and have thus provided them with an opportunity to diversify their portfolios. However, the overall effect on financial market stability largely depends on the number and volume of IFIs' issues. (Local currency bonds by other foreign issuers would also provide domestic investors with an opportunity to diversify their portfolios; however, the effect on financial market stability depends on domestic investors understanding the risk they would take on.)

6. Conclusion

As emphasised earlier, only a few publicly available studies have so far tried to assess the potential impact of IFIs' local currency issuance activity on domestic bond market development, and they review the experience of IFIs' issuance in the 1980s and 1990s. To draw lessons and give recommendations it would clearly be useful to have more and more

[49] See also EIB (1999), p 3, and EIB (2005b), p 5.
[50] See press releases about individual IFI issues on these IFIs' external websites.

recent impact studies, including a systematic analysis of the development of the markets for local currency bonds by foreign issuers ("traditional" foreign bonds, Eurobonds and global bonds), of foreign investor participation and the yield curve after an inaugural or first international local currency bond issue by an IFI.

Nevertheless, some preliminary lessons may be drawn. By providing technical assistance to reform the legal and regulatory framework for foreign issues, IFIs have indeed opened the market for local currency bonds to foreign issuers in several cases. While some EMEs have opened their markets to IFIs and other foreign issuers simultaneously, whether other foreign issuers prefer to issue in the international market and what implications this has for domestic bond market development would have to be investigated. Similarly, the domestic financial sector that has been involved in the local currency bond issue process has likely profited in terms of financial know-how. IFIs' issues may also have provided domestic issuers with an example, for instance in terms of documentation and execution.

The benchmark capacity of IFIs' local currency bonds, however, may be limited because of the IFIs' higher credit rating compared with local issuers. Liquid benchmark bonds also require repeated issuance and the re-opening of issues. Furthermore, whether the "signal effect" is really needed to attract other foreign issuers or foreign investors is questionable. So far, no study has systematically analysed the development of the foreign issues markets or of foreign investor participation after an inaugural or first international IFI issue. In any case, whether or not the foreign issues market develops after an IFI's issue and whether foreign investor demand increases depends on the attractiveness of the local currency bond markets to issuers and investors, a situation which is largely determined by the local government's decisions and actions (macroeconomic and financial market policies, including the legal and regulatory framework and the market infrastructure,) and the international (in particular, interest rate) environment.

IFIs may help to develop the yield curve, but, again, the IFIs' effectiveness largely depends on the local governments' support (see above as well as government policies, for instance, pension reforms, that affect the development of the domestic investor base). While there is so far no evidence that IFIs have been able to contribute to the development of liquid secondary bond markets, there is some evidence, although so far mainly anecdotal, that their issuance activity (together with technical assistance) may contribute to the development of local derivatives markets. Finally, according to the information which many IFIs provide on individual local currency bond issues, these have often been placed with domestic (in particular, institutional) investors. Thus, IFIs' local currency bonds have been providing domestic investors with an opportunity to diversify their portfolios, which contributes to financial market stability, although the overall effect on financial market stability largely depends on the number and volume of IFIs' issues.

Given the significant staff resource requirements of an inaugural issue, IFIs should be selective in choosing the markets they want to enter. In particular, they should consider

launching an inaugural issue only with full government support and carefully consider the stage of development of the market (to avoid wasting their efforts and creating undesirable effects). Some IFIs may also have to develop more detailed borrowing policies. Borrowing policies should address *inter alia* the issues of whether and how to involve the local financial industry in the issue process, whether or not to re-open issues and cost and benefits of issuing in the domestic market versus in the offshore markets. IFIs should also regularly review their experience with local currency bonds.[51] Given that local currency bonds are but one device (and perhaps not the most important) for IFIs to help develop domestic bond markets, there may also be a need to analyse more broadly how IFIs could support domestic bond market development. A broader discussion could cover the scope of technical assistance and capacity building measures, data compilation and dissemination by IFIs and the effectiveness of risk mitigation instruments (such as partial guarantees)[52].

[51] The EIB's Operations Evaluation Unit in its 1999 Evaluation Report presented ten lessons/recommendations for future EIB borrowing operations in new markets, which are reproduced in Box 1, Appendix 3.

[52] For a discussion of the latter issues see, for example, WEF (2006).

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Data on local currency bond issuance by IFIs[53]

Since the impact of IFIs' local currency bond issues on the development of domestic bond markets may depend *inter alia* on the number, size and characteristics of individual operations, this appendix presents some more detailed information on IFIs' local currency bond issues. The information is for the most part taken from the capital markets' or treasurers' sections of the external websites of the relevant IFIs and from their latest annual reports.

Asian Development Bank (ADB)

Since its establishment in 1966 the ADB has issued bonds in 23 markets. It was among the first of the IFIs to issue a local currency bond in a domestic market when it launched the so-called *"Samurai bond"* in ***Japan*** in ***1970***. This was the first issue by a foreign and supranational entity in the Japanese yen market.[54] In the 1990s the ADB issued local currency bonds in *Hong Kong* (*1992*[55]), ***Korea*** (***1995***, the so-called "*Arirang bond*") and ***Taipei*** (also ***1995***).[56] The "Arirang" and the new Taiwan dollar bonds were again the first issues by a foreign and supranational entity in these domestic bond markets. In ***2004***, the ADB launched local currency bonds in the domestic bond markets of ***India***, Hong Kong and *Singapore* (a simultaneous benchmark issue) as well as ***Malaysia***. And in ***2005***, the Bank issued local currency bonds in the domestic markets of ***Thailand***, ***China*** (the so-called "*Panda bond*") and the ***Philippines***. With the Indian rupee and Malaysian ringgit issues in 2004 and the Thai bath, Chinese renminbi and Philippine peso bonds in 2005, the ADB was again the first foreign issuer and the first supranational issuer in the respective domestic markets (in the case of the Panda bond the ADB was the first foreign issuer together with the IFC, see below).[57]

In 2005, the ADB raised *US$4.0 billion* in medium and long-term funds,[58] of which *23.3%* (or US$924 million) were raised through issues in four EME currencies (South African rand, Chinese renminbi, Thai baht and Philippine peso); *6.8 %* (or US$270 million) through issues in the currencies of the three emerging Asian countries. Total outstanding borrowings[59] at the

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[53] Data presented here cover information until end 2005/FY 2006. Inaugural or first international issues are marked in bold letters.

[54] The ADB's Samurai bond was a privately issued bond that was followed in the same year by a publicly issued bond from the World Bank.

[55] According to Herrera-Pol (2005), Hong Kong allowed foreigners to issue in Hong Kong dollars in the late 1980s, starting with IFIs. However, there is no information on which IFI was the first foreign issuer.

[56] For a record of local currency bond issuance by multilateral development banks (MDBs) and other foreign issuers in selected Asia-Pacific economies (Japan, Hong Kong, Australia, Korea and Singapore) see also Hoschka (2005a), p 4 ff.

[57] A list of local currency bond issues by the ADB with details on individual issues (as of December 2004) can be found on its external website: http://www.adb.org/Bond-Investors/bp-local.asp.

[58] Borrowings per year are reported in US dollars or the euro equivalent at the issue date.

[59] Principal; includes short-term borrowings; before swaps; net of unamortised discounts/premiums and transition adjustments; embedded derivatives and FAS 133 adjustments.

end of December 2005 amounted to *US$24.5 billion*, of which *6.7%* (or US$1.6 billion) had been raised through issues in nine EME currencies (South African rand, new Taiwan dollar, Hong Kong dollar, Chinese renminbi, Singapore dollar, Indian rupee, Malaysian ringgit, Thai bath and Philippine peso); *4%* (or US$971 million) through issues in the currencies of the eight emerging Asian countries. In terms of volume (new and outstanding), the South African rand was the most important local currency. [60]

European Bank for Reconstruction and Development (EBRD)

Unlike the ADB, the EBRD issues local currency bonds not only as "traditional" foreign bonds but also as Eurobonds and global bonds. Since its establishment in 1991, the bank has issued in 30 different currencies, including the currencies of the following countries of operation[61]: *Hungary* (first issue in *1994*), the *Czech Republic* (first issue in *1996*), *Poland* (first issue in *1998*), *Russia* (first issue in *1998*), *Estonia* (first and so far only issue in *1999*) and the *Slovak Republic* (first issue also in *1999*). Of these local currency issues the Hungarian forint bonds in 1994 and 1996, and the Russian rouble bond in 2005 were in the domestic markets; the Czech koruna, Estonian krona, Polish zloty, Slovak koruna as well as other Hungarian forint and Russian rouble bonds were Eurobonds or global bonds. With the ***rouble bond*** in ***2005*** the EBRD was the first foreign issuer in the Russian market.

The EBRD has also issued in "exotic" currencies (ie currencies of countries that are not countries of operation), including the Hong Kong dollar, South African rand, Korean won, Singapore dollar, Turkish lira, Mexican peso and new Taiwan dollar. The bank has also pioneered bond issues linked to the Turkish lira and to the Brazilian real.[62]

In 2005, the EBRD raised *€1.7 billion* in medium and long-term funds, of which *34.4%* (or €576 million) were raised through issues in four EME currencies (South African rand, Russian rouble, Mexican peso and new Turkish lira), *8.5%* (or €142 million) through issues in the currency of the one country of operation. Total outstanding debt[63] at the end of December 2005 stood at *€14.9 billion*, of which *16.5%* (or €2.5 billion) had been raised through issues in nine EME currencies (South African rand, new Taiwan dollar, Czech koruna, Russian rouble, Hungarian forint, Mexican peso, new Turkish lira, Slovak koruna and Polish zloty); *2.5%* (or €371 million) had been raised through issues in the currencies of the five countries of operation. As in the case of the ADB, in terms of volume, the South African rand was the most important local currency.

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[60] For recent new and outstanding borrowings of the IFIs reviewed here see Tables 1 and 2 of this Appendix.

[61] Countries of operation are Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Georgia, Hungary, Kazakhstan, the Kyrgyz Republic, Latvia, Lithuania, FYR Macedonia, Moldova, Poland, Romania, Russia, Serbia and Montenegro, the Slovak Republic, Slovenia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

[62] A list of publicly issued bonds by the EBRD with details on individual issues can be found on its external website: http://www.ebrd.com/markets/issuance/index.htm.

[63] Evidenced by certificates; principal at nominal value; includes short-term debt issuances that the bank raises for cash management purposes); before swaps.

European Investment Bank (EIB)

Like the EBRD, the EIB (established in 1958) issues local currency bonds in the domestic and in the international markets.[64] The EIB has taken a particular interest in issuing bonds in the local currencies of new EU member states: In ***1988***, the EIB issued its first *Spanish peseta* and ***Portuguese escudo*** bonds in the domestic markets of Spain and Portugal (the so-called "*Matador*" and "*Caravela bonds*") and in ***1994*** it launched its first ***Greek drachmae*** bond in the Greek domestic market (the so-called "*Marathon bonds*"). The Caravela and Marathon bonds were the first issues by a foreign and supranational entity in the Portuguese and Greek domestic markets. In the case of the Matador bonds the EIB was one of the first foreign issuers (the first was EUROFIMA).[65] In all three countries the EIB also introduced domestic debt issuance programmes.[66] The EIB continued its focus on new EU member states and accession countries[67] in *1996* when it issued its first *Czech koruna* bond in the international market. Only one year later the EIB launched its first domestic debt issuance programme in Hungary and issued its first *Hungarian forint* bond in the domestic market in *1998*. The Czech koruna and the Polish zloty debt issuance programmes were established in 1999 and 2001 (the Czech koruna programme was also augmented in 2003). When the Hungarian forint became convertible in June **2001**, the EIB was also the first foreign issuer to launch a **Hungarian forint bond** in the **international market**. In ***2003***, the EIB issued its first *Slovak koruna* bond; and in *2004*, the *Maltese lira***,** the *Slovenian tolar*, the ***Bulgarian lev*** and the *Turkish lira* were added as currencies of issuance. Whereas issues in Czech korunas, Hungarian forints and Polish zlotys were made in the domestic and in the international markets,[68] issues in Slovak korunas, Maltese lire, Slovenian tolars, Bulgarian levs and Turkish lire were made only in the international markets.[69] The Slovenian tolar and the Bulgarian lev bonds were the first issues in these currencies by a supranational entity; the tolar bond was also the longest dated tolar issue in the international market; and the lev

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[64] On its external website the EIB does not distinguish between "traditional" foreign bonds, Eurobonds and global bonds but only between issues in the domestic markets and issues in the international markets.

[65] Herrera-Pol (2005) points out that IFIs have also been the first foreign issuers in the currencies from the former emerging capital markets of Norway, Finland, Denmark and Sweden. With the exception of the Finnish markka bond from the IFC, IFIs' external websites do not provide any further information on these issues.

[66] Debt issuance programmes (DIPs) are contractual framework agreements between an issuer and a group of banks containing the regular issue documentation which is normally included in a new issue prospectus. Under a DIP, an issuer is authorised to make several issues with equal or different interest and maturity features within the limits of the total amount and the timeframe (of one or more years) stipulated in the DIP. See EIB (1999), p 19 (Glossary). The EIB notes that the use of these programmes results in considerable cost and time savings insofar as each new issue requires only the preparation of a "pricing supplement".

[67] The countries that joined the EU on 1 May 2004 are the Czech Republic, Cyprus, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovenia and the Slovak Republic. Currently, acceding countries are Bulgaria and Romania, and accession countries are Croatia and Turkey.

[68] Not all issuances in these currencies were conducted under the domestic debt issuance programmes.

[69] The first Turkish lira bond was a US$79 million synthetic bond issue. The synthetic format had to be used because the large denominations of the TRL could not technically be handled by the international settlement systems. This difficulty was overcome on 1 January 2005 when the Turkish lira was redenominated by converting TRL 1 million into one new Turkish lira (TRY).

bond was the first ever lev bond in the **international market**. Over recent years the EIB has become one of the largest non-government issuer in the region.

In addition to its activities in the new EU member states and accession countries, the EIB also wants to build up its presence in the capital markets of the European Union's partner countries in the Mediterranean region that benefit from the EIB's Facility for Euro-Mediterranean Investment and Partnership (FEMIP). Thus, the EIB recently issued a synthetic bond in *Egyptian pounds*. [70]

Finally, the EIB has also issued in Botswana pulas, Brazilian reals (both synthetic issue), Hong Kong dollars, Mexican pesos, Russian roubles (synthetic issue), South African rand and new Taiwan dollars.[71]

In 2005, the EIB raised *€52.7 billion* through 362 transactions across 15 currencies: *4%* (or €2.1 billion) were raised through issues in five EME currencies (new Turkish lira, South African rand, Hungarian forint, Mexican peso and Polish zloty), *3.2%* (€1.7 billion) through issues in the currencies of the new member and acceding countries.[72] Total outstanding debts[73] at the end of December 2005 stood at *€248.3 billion*, of which *3.2%* (or €7.9 billion) had been raised through issues in 12 EME currencies (South African rand, new Turkish lira, Hungarian forint, Czech koruna, Hong Kong dollar, new Taiwan dollar, Polish zloty, Mexican peso, Slovak koruna, Bulgarian lev, Maltese lira and Slovenian tolar); *1.9%* (or €4.8 billion) had been raised through issues in eight currencies of EMEs that are either new member states, accession or acceding countries or FEMIP countries. In terms of new borrowing volume, the new Turkish lira was the most important currency; in terms of outstanding borrowing this role fell to the South African rand (closely followed by the Hungarian forint, the Hong Kong dollar and the Czech koruna).

Inter-American Development Bank (IADB)

The IADB, established in 1959 started issuing local currency bonds in 2000. Between 2000 and 2004, it issued in various local currencies, including Hong Kong dollars, Hungarian forints, new Taiwan dollars, Polish zlotys and South African rands.[74] Recently, in ***2004***, the

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[70] The FEMIP was launched in 2002; territories and countries benefiting from the FEMIP are the Gaza Strip, the West Bank, Israel, Jordan, Lebanon, Morocco, Syria, Tunisia and Turkey.

[71] A list of recent issues by the EIB with details on individual issues (beginning January 2003) can be found on its external website: http://www.eib.eu.int/investor_info/. Further information can be found for each individual FY in the relevant statistical reports; for FY 2005 see http://www.eib.eu.int/publications/publication.asp?publ=252.

[72] The EBRD's stated objective is to raise between 85% and 90% of total funding through issues in its three core currencies (euro, pound sterling and US dollar); in 2005 88% of total funding was raised through issues in these core currencies.

[73] Evidenced by certificates; before swaps.

[74] Within its Euro Medium-Term Notes (MTN) Program, introduced in 1995, the IADB had also issued local currency bonds in South African rand (1996 and 1997), in Czech korunas (1997), Greek drachmae (1998 and 1999), Russian roubles (1998), Portuguese escudos (2000) and Polish zlotys (2000) in the international markets. In 1998 die IADB also issued a new Taiwan dollar bond which was the largest issue by a supranational in this currency.

IADB also began issuing bonds in the local currencies of Latin American countries.[75] Its first ***Mexican peso*** bond was issued as a global bond and represented the first international bond issue in the domestic capital market under the new financial regulatory framework adopted by Mexico in 2003.[76] In the same year, the IADB issued its first *Brazilian real* bond and its first *Colombian peso* bond. The Brazilian real bond was issued in the form of a registered global bond and the Colombian peso bond was issued in Eurobond format.[77] The IADB emphasises that the bonds denominated in Mexican pesos and Brazilian real were the largest ever (in these currencies) executed by an international issuer. In *2005*, the IADB launched its first *Chilean peso* bond (in Eurobond format).[78]

In 2005, the IADB issued bonds with a total nominal value of *US$4.9 billion*, of which *16.3%* (or US$803 million) were issued in the currencies of four EMEs (Mexican pesos, South African rand, Colombian pesos and Chilean pesos); *10%* (or US$496 million) were raised in the three Latin American countries' currencies. Total outstanding borrowings[79] at the end of December 2005 stood at *US$46.4 billion*, of which *3.9%* (or US$ 1.8 billion) had been raised in the currencies of seven EMEs (Mexican pesos, South African rand, Brazilian real, new Taiwan dollars, Colombian pesos, Hong Kong dollars and Chilean pesos); *2.4%* (or US$1.1 billion) were raised in the four Latin American currencies. In terms of volumes (new and outstanding) the South African rand was the second most important currency.

International Bank for Reconstruction and Development – World Bank (IBRD)

Since its inception in 1944 the World Bank has offered bonds and notes in over 42 different currencies. During the last decade, the World Bank has issued in 15 "non-core" or EME currencies of all regions: in Eastern Europe in Czech koruna (1995), Greek drachmae (1997), Polish zlotys (1997), Slovak koruna (1997), Hungarian forints (2002) and Turkish lira (2004); in East Asia in Philippine pesos (1997), Korean won (1997) and Malaysian ringgit (2005); in Africa in South African rand (1996); and in Latin America in Mexican pesos (2000), Chilean pesos (2000), Brazilian real (2002) and Colombian pesos. The World Bank traditionally issued bonds in non-core currencies as Eurobonds, however, more recently it has been issuing in domestic and global format: the issues in Malaysian ringgit and Colombian pesos were domestic issues, the issue in Korean won was an issue with a domestic and an offshore tranche. The Bank emphasises that it was the first foreign issuer in several EME currencies, including the ***Korean won*** in ***1997***, the ***Mexican peso*** and the ***Chilean peso*** in ***2000*** and the ***Brazilian real*** in ***2002*** (an FX linked note) in the Eurobonds

[75] Bonds were issued under the IADB's Global Debt Program.

[76] The global format enables settlement through EuroClear and Clearstream for international investors, and Indeval in Mexico. The bond was issued under New York law and listed in the Mexican and London stock exchanges.

[77] The Brazilian real bond was subject to selling restrictions in Brazil, unlike the preceding Mexican peso bond.

[78] A list of selected recent IADB bonds with details on individual issues (beginning July 1999) can be found on its external website: http://www.iadb.org/fin/list_bonds.cfm.

[79] Medium and long-term borrowings; before swaps; net of SFAS 133 bond hedge basis adjustments and unamortised discounts.

market. In 2004, the World Bank also became the first foreign issuer to announce bonds denominated in the new Turkish lira.[80]

In fiscal year 2006 (1 July 2005 to 30 June 2006) total new medium and long-term funding amounted to *US$9.5 billion*; *9.1%* (or US$860 million) were raised through issues in four EME currencies (South African rand, Mexican pesos, New Turkish lira and Hungarian forints). In terms of volumes the South African rand was the most important EME currency. Total outstanding medium and long-term borrowings[81] amounted to *US$ 88.7 billion*, of which US$56.3 billion had been raised in US dollars, Japanese yen and the euro.

International Finance Corporation (IFC)

The IFC (established in 1956) started borrowing in its own name in the mid-1980s and has so far borrowed in 34 currencies. Many of these were the currencies of EMEs at the time the IFC first borrowed in them. The IFC lists under its "Emerging Markets Leadership Issues" domestic issues in *Spanish pesetas* (*1988*), *Hong Kong dollars* (*1992*), *Finnish markka* (*1998*), *Colombian pesos* (*2002*), *Peruvian nuevos soles* (*2004*), *Malaysian ringgit* (*2004*), *Moroccan dirhams* (*2005*) and *Chinese renminbi* (also *2005*); and hybrid/international issues in *Greek drachmae* (*1994*), *Portuguese escudos* (*1995*) and *Singapore dollars* (*1998*). For Euro ("offshore") issues the list comprises the *Czech koruna* (*1996*), *Polish zloty* (*1996*), *Slovak koruna* (*1996*), *South African rand* (*1996*), *Philippine peso* (*1997*) and *Russian rouble* (*1998*).

The IFC emphasises that it was the first, or among the first, non-residents to issue in many currencies including Spanish pesetas, Hong Kong dollars, Colombian pesos, Malaysian ringgit, Portuguese escudos, Greek drachmae and Singapore dollars in the respective domestic markets; and in Czech korunas, Philippine pesos and Polish zlotys in the Eurobond markets. The IFC also notes that the Malaysian ringgit issue was the first local currency borrowing by a supranational under Islamic finance principles and that the **2005** issues in **Moroccan dirhams** and **Chinese renminbi** were the first issues by a foreign and supranational entity in these domestic markets (in the case of the domestic RMB bond together with the ADB; see above).

In fiscal year 2006 (1 July 2005 to 30 June 2006), the IFC borrowed *US$1.8 billion* in the international capital markets; *15%* (or US$270 million) were raised through issues in two EME currencies (Chinese renminbi and South African rand). Borrowings outstanding[82] in FY 2006 amounted to *US$16.2 billion*, of which *11.2%* (or US$1.8 billion) had been raised through issues in the currencies of seven EMEs (South African rand, Hong Kong dollars, Colombian pesos, Chinese renminbi, Malaysian ringgit, Moroccan dirhams and Peruvian

[80] A list of selected recent World Bank bonds with detailed information on individual issues (beginning September 2001 and as of December 2005) can be found on its external website: http://treasury.worldbank.org/Services/Capital+Markets/index.html.

[81] Principal at face value; before swaps; net of premiums/discounts.

[82] Market borrowings, principal at face value, before swaps, net of unamortised issue premiums and discounts.

nuevos soles); 4.2% (or US$672 million) had been raised through issues in EME currencies other than the South African rand and the Hong Kong dollar.

Table 1. New borrowings (before swaps)

		ADB [1]	IADB [2]	IBRD [3]	IFC [4]	EBRD [5]	EIB [6]
		2005	2005	FY 2006 (1 July 2005 to 30 June 2006)	FY 2006 (1 July 2005 to 30 June 2006)	2005	2005
		in US$ million equiv. [8]	in US$ million equiv. [8]	in US$ million equiv. [8]	in US$ million equiv. [8]	in € million equiv. [8]	in € million equiv. [8]
		medium and long-term borrowings	medium and long-term borrowings at face value	medium and long-term borrowings	borrowings	medium and long-term funds	borrowings signed and raised
Australian dollar	AUD	./.	1.111,0	2.537,9	./.	./.	756,0
Bulgarian lev	***BGN***	***./.***	***./.***		***./.***	***./.***	***./.***
Canadian dollar	CAD	./.	./.	10,7	./.	./.	./.
Chilean peso	***CLP***	***./.***	***66,0***		***./.***	***./.***	***./.***
Colombian peso	***COP***	***./.***	***72,0***		***./.***	***./.***	***./.***
Czech koruna	***CZK***	***./.***	***./.***		***./.***	***./.***	***./.***
Euro	EUR	./.	./.	176,8	36,0	325,0	19.637,0
Hong Kong dollar	***HKD***	***./.***	***./.***		***./.***	***./.***	***./.***
Hungarian forint	***HUF***	***./.***	***./.***	***28,6***	***./.***	***./.***	***236,0***
Icelandic kronur	ISK	./.	79,0	48,8	./.	./.	243,0
Indian rupee	***INR***	***./.***	***./.***		***./.***	***./.***	***./.***
Japanese yen	JPY	368,0	199,0	731,0	252,0	166,0	1.423,0
Malaysian ringgit	***MYR***	***./.***	***./.***		***./.***	***./.***	***./.***
Mexican peso	***MXN***	***./.***	***358,0***	***299,7***	***./.***	***65,0***	***183,0***
Moroccan dirham	***MAD***	***./.***	***./.***		***./.***	***./.***	***./.***
New Taiwan dollar	***TWD***	***./.***	***./.***		***./.***	***./.***	***./.***
New Turkish lira	***TRY***	***./.***	***./.***	***147,5***	***./.***	***29,0***	***1.375,0***
New Zealand dollar	NZD	338,4	1.086,0	2.113,5	72,0	511,0	1.135,0
Norwegian krona	NOK	./.	./.		./.	./.	38,0
Peruvian soles nuevos	***PEN***	***./.***	***./.***		***./.***	***./.***	***./.***
Philippine peso	***PHP***	***45,5***	***./.***		***./.***	***./.***	***./.***
Polish zloty	***PLN***	***./.***	***./.***		***./.***	***./.***	***73,0***
Pound sterling	GBP	./.	./.		./.	./.	11.681,0
Renminbi	***RMB***	***123,6***	***./.***		***144,0***	***./.***	***./.***
Russian rouble	***RUB***	***./.***	***./.***		***./.***	***142,0***	***./.***
Saudi Arabian riyal	***SAR***	***./.***	***./.***		***./.***	***./.***	***./.***
Singapore dollar	***SGD***	***./.***	***./.***		***./.***	***./.***	***./.***
Slovak koruna	***SKK***	***./.***	***./.***		***./.***	***./.***	***./.***
Slovenian tolar	***SIT***	***./.***	***./.***		***./.***	***./.***	***./.***
South African rand	***ZAR***	***654,3***	***307,0***	***384,5***	***126,0***	***340,0***	***251,0***
Swedish krona	SEK	./.	./.		./.	./.	174,0
Swiss franc	CHF	./.	./.		18,0	./.	709,0
Thai baht	***THB***	***100,8***	***./.***		***./.***	***./.***	***./.***
US dollar	USD	2.335,0	1.659,0	3.002,9	1.152,0	97,0	14.785,0
Sum		**3.965,5**	**4.937,0**	**9.492,1**	**1.800,0**	**1.675,0**	**52.699,0**
Sum EMEs		**924,2**	**803,0**	**860,3**	**270,0**	**576,0**	**2.118,0**
Share EMEs in total		**23,3**	**16,3**	**9,1**	**15,0**	**34,4**	**4,0**
Subsums [7]		269,9	496,0	475,8	144,0	142,0	1.684,0
Share of subsums in total		6,8	10,0	5,0	8,0	8,5	3,2
				(Sum includes US$930 million in other currencies)			

[1] ADB Quarterly Treasury Reports; US$ equiv. at ADB's exchange rates effective on the date on which the terms of the borrowing were determined by the President/Vice-President/Treasurer.
[2] IADB Annual Report 2005.
[3] Treasury data 2006 (trade date basis).
[4] IFC Annual Report 2006. Figures are rounded.
[5] EBRD external website; Figures are rounded.
[6] EIB Annual Report 2005.
[7] Subsums are sums for emerging Asia in the case of the ADB, for Latin American countries in the case of the IADB, for countries of operation in the case of the EBRD and for new member, accession and acceding countries as well as FEMIP countries in the case of the EIB. For the IFC a subsum is computed for EMEs excluding Hong Kong and South Africa.
[8] For borrowings in US$ or € equiv.: at exchange rates applicable to the time of issuance if not otherwise stated.

Table 2. Outstanding borrowings (before swaps)

		ADB	IADB	IBRD	IFC	EBRD	EIB
		31 December 2005	31 December 2005	end FY 2006 (30 June 2006)	end FY 2006 (30 June 2006)	31 December 2005	31 December 2005
		in US$ million equiv.	in US$ million equiv.	in US$ million equiv.	in US$ million equiv.	in € million equiv.	in € million equiv.
		summary statement of borrowings (incl. short-term); principal outstanding [1]	medium- and long-term borrowings [2]	medium- and long-term borrowings	outstanding market borrowings, principal [3]	debts evidenced by certificates (includes short-term debt issuance); principle outstanding [4]	debts evidenced by certificates (includes short-term debt issuance); principle outstanding
Australian dollar	AUD	1.781,1	5.035,0		397,0	939,7	2.365,1
Brazilian real	***BRL***	***./.***	***321,0***		***./.***	***./.***	***./.***
Bulgarian lev	***BGN***	***./.***	***./.***		***./.***	***./.***	***51,1***
Canadian dollar	CAD	516,8	2.664,0		276,0	36,8	400,7
Chilean peso	***CLP***	***./.***	***70,0***			***./.***	***./.***
Colombian peso	***COP***	***./.***	***113,0***		***235,0***	***./.***	***./.***
Czech koruna	***CZK***	***./.***	***./.***		***./.***	***138,0***	***1.232,4***
Danish krona	DKK	./.	./.		./.	./.	53,6
Euro	EUR	1.300,4	3.747,0	10.798,0	475,0	1.615,1	97.603,5
Gold bullion		./.	./.		./.	138,7	./.
Hong Kong dollar	***HKD***	***167,6***	***97,0***		***552,0***	***./.***	***715,0***
Hungarian forint	***HUF***	***./.***	***./.***		***./.***	***81,1***	***1.265,5***
Icelandic kronur	ISK	./.	79,0		./.	./.	241,4
Indian rupee	***INR***	***111,1***	***./.***		***./.***	***./.***	***./.***
Japanese yen	JPY	3.779,3	2.798,0	13.677,0	4.174,0	2.691,0	7.082,9
Malaysian ringgit	***MYR***	***105,8***	***./.***		***136,0***	***./.***	***./.***
Maltese lira	***MTL***	***./.***	***./.***		***./.***	***./.***	***23,3***
Mexican peso	***MXN***	***./.***	***625,0***		***./.***	***67,4***	***191,0***
Moroccan dirham	***MAD***	***./.***	***./.***		***114,0***	***./.***	***./.***
New Taiwan dollar	***TWD***	***213,2***	***152,0***		***./.***	***453,1***	***693,0***
New Turkish lira	***TRY***	***./.***	***./.***		***./.***	***31,4***	***1.449,9***
New Zealand dollar	NZD	319,2	2.382,0		242,0	576,1	1.576,1
Norwegian krona	NOK	./.	./.		./.	./.	425,8
Peruvian soles nuevos	***PEN***	***./.***	***./.***		***46,0***	***./.***	***./.***
Philippine peso	***PHP***	***31,2***	***./.***		***./.***	***./.***	***./.***
Polish zloty	***PLN***	***./.***	***./.***		***./.***	***14,0***	***621,5***
Pound sterling	GBP	316,1	2.319,0		1.712,0	2.607,5	58.797,5
Renminbi yuan	***RMB***	***123,9***	***./.***		***141,0***	***./.***	***./.***
Russian rouble	***RUB***	***./.***	***./.***		***./.***	***121,9***	***./.***
Singapore dollar	***SGD***	***120,3***	***./.***		***./.***	***./.***	***./.***
Slovak koruna	***SKK***	***./.***	***./.***		***./.***	***16,1***	***105,1***
Slovenian tolar	***SIT***	***./.***	***./.***		***./.***	***./.***	***16,7***
South African rand	***ZAR***	***677,1***	***450,0***		***589,0***	***1.529,6***	***1.501,6***
Swedish krona	SEK	./.	./.		./.	./.	954,9
Swiss francs	CHF	525,3	760,0		91,0	./.	2.958,0
Thai baht	***THB***	***97,5***	***./.***		***./.***	***./.***	***./.***
US dollar	USD	14.267,9	24.821,0	31.855,0	6.980,0	3.827,8	67.957,6
Sum		**24.454,0**	**46.433,0**	**88.751,0**	**16.160,0**	**14.885,3**	**248.283,2**
Sum EMEs		**1.647,8**	**1.828,0**		**1.813,0**	**2.452,6**	**7.866,0**
Share EMEs in total		**6,7**	**3,9**		**11,2**	**16,5**	**3,2**
Subsums [5]		970,7	1.129,0		672,0	371,1	4.765,5
Share of subsums in total		4,0	2,4		4,2	2,5	1,9

Sum includes US$ 32.4 billion in other currencies

Source: Annual Reports.

[1] Net of unamortised discounts/premiums and transition adjustments; embedded derivatives and FAS 133 adjustment.

[2] Net of SFAS 1333 bond hedge basis adjustments and unamortised discouts.

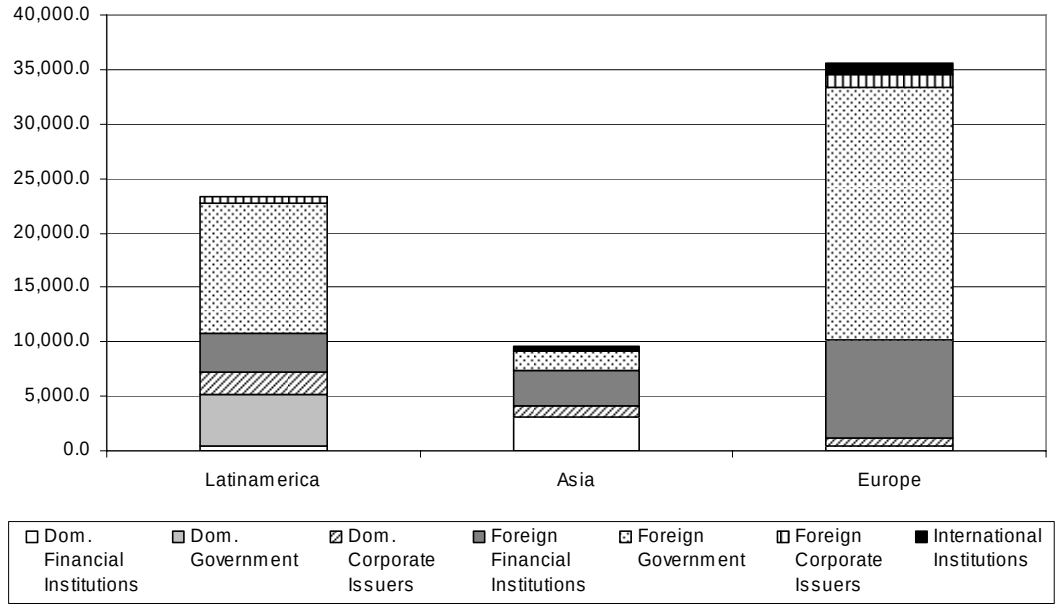
[3] Net of premiums/discounts.

[4] Nominal value.

[5] Subsums are sums for emerging Asia in the case of the ADB, for Latin American countries in the case of the IADB, for countries of operation in the case of the EBRD and for new member, accession and acceding countries as well as FEMIP countries in the case of the EIB. For the IFC a subsum is computed for EMEs excluding Hong Kong and South Africa.

International bonds and notes: breakdown by regions and sectors of issuers for 2006:

Figure 1: International bonds and notes: breakdown by regions and sectors of issuers
(in millions of US dollars)



Currencies include: the Brazilian real, the Chilean peso, the Colombian peso, the Mexican peso and the Peruvian new sol; the China renminbi, the Indonesian rupiah, the India rupee, the Korean won, the Malaysian ringgit, the Philippine peso, the Thailand bath and the new Taiwan dollar; the Czech koruna, the Hungarian forint, the Polish zloty, the Russian rouble and the new Turkish lira; and the South African rand.

Figure 2: International bonds by currency: breakdown by country and sector of issuers (Latinamerica)
(in millions of US dollars)

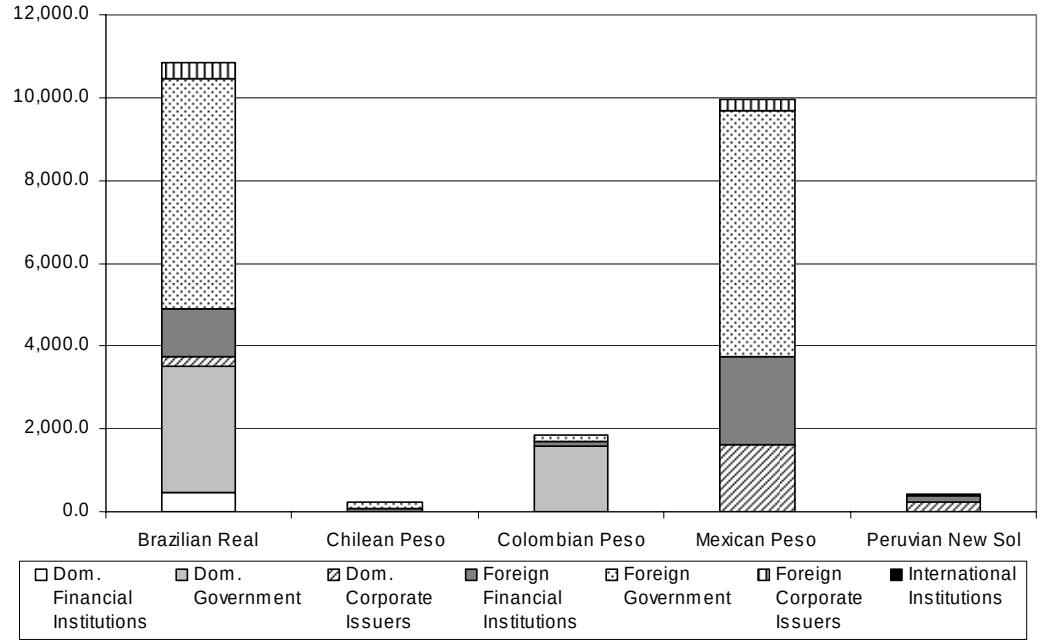


Figure 3: International bonds and notes by currency: breakdown by country and sector of issuers (Asia)
(in millions of US dollars)

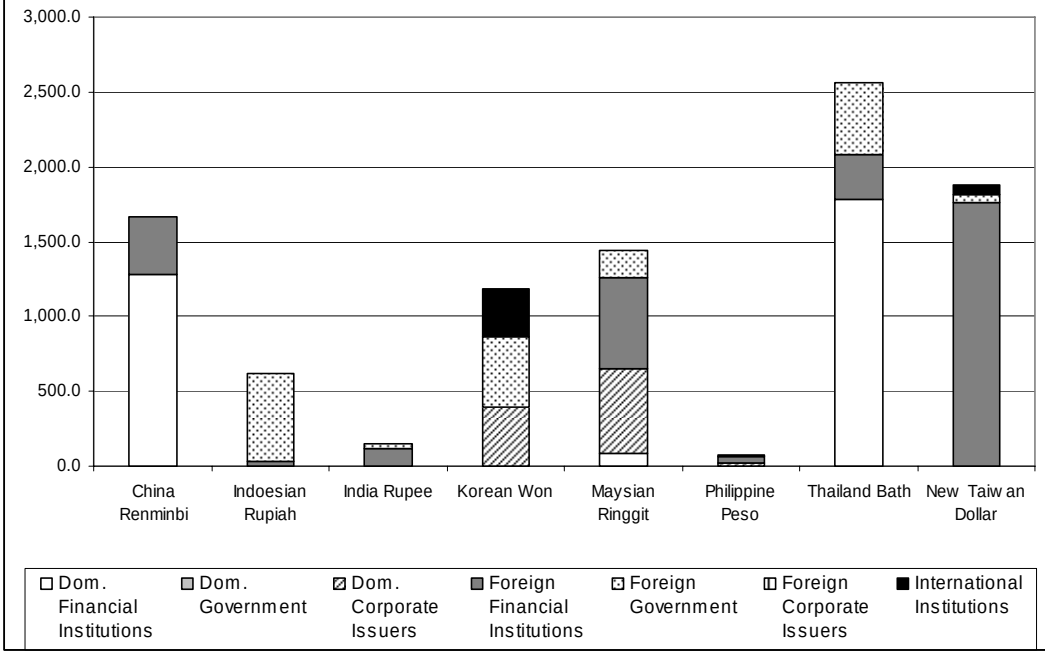
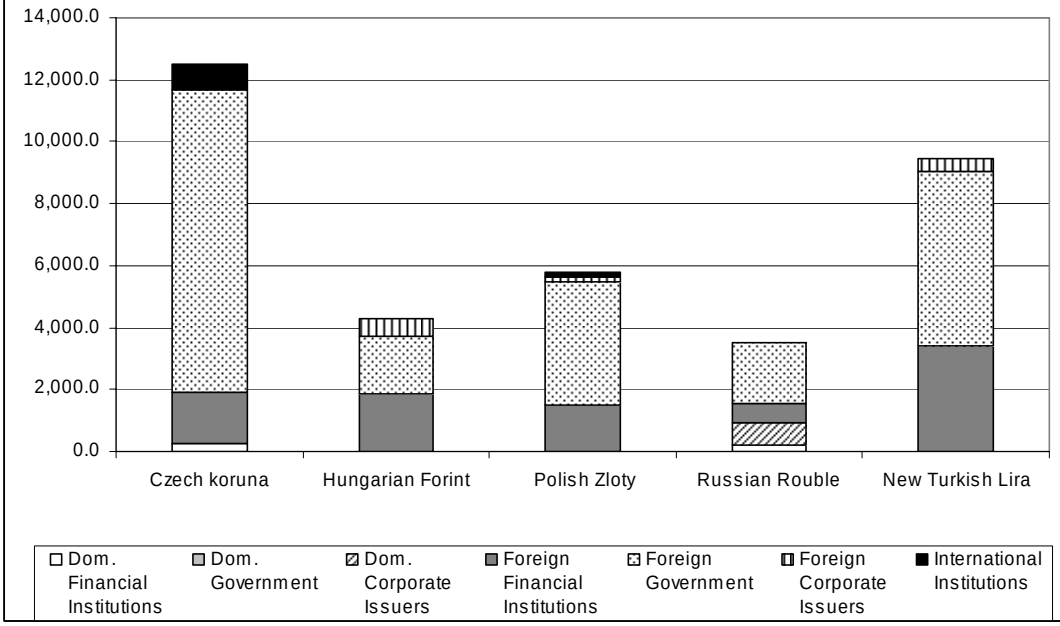


Figure 4: International bonds and notes by currency: breakdown by country and issuers (Europe)
(in millions of US dollars)



Source: Dealogic, Euroclear, ICMA, Thomson Financial Securities Data, BIS. The data has been kindly provided by Swapan Pradhan (BIS).

Box 1. Recommendations for future EIB borrowing operations in new markets[83]

- The one overriding lesson to be learned from this exercise is that the EIB and other MDBs would benefit from formalising their borrowing policies to include integrating new bond markets with the international capital markets …
- 1. The EIB should publicise more systematically than hitherto its bond market development policies and the way in which it makes its contribution, taking into account the need to contain borrowing costs.
- 2. The EIB should verify how it can best co-ordinate local bond market borrowings with local-currency lending operations in developing countries, in order to be able to operate as a domestic financial intermediary …
- 3. … the EIB should study each market in detail … and identify weaknesses and strengths before entering the local market with its own bond issues …
- 4. The EIB should try to co-ordinate and integrate as much as possible its own potential contributions to the evolution of the bond market with the reform and development plans of the authorities and the financial community of the country concerned.
- 5. EIB contributions to broadening the bond market by designing innovative debt instruments and extending the yield curve should be discussed with the government debt manager to co-ordinate the issue of fixed-rate medium and long-term bonds with the government's own borrowing program to gain support for the EIB's attempt to create liquid benchmark bonds.
- 6. … the EIB should explore with local investment banking industry to what extent tailor-made issues with special interest rate and return features could attract more institutional funds into the local bond market. It should also explore with local savings banks or other banks with large branch networks whether there is scope for special retail issues …
- 7. The EIB should make a particular effort to create efficient secondary markets in its own benchmark bonds with the country concerned. This may require special agreements with local investment banks to provide, on a continuous basis, at least indicative, if not firm quotations for EIB benchmark bonds on local, or locally used automated screen networks …
- 8. Progress on bond market development should be reviewed from time to time at joint meetings between the EIB and the local authorities, and preferably also with representatives of the financial community ...
- 9. Appropriate budgetary allocation should be foreseen for these activities in new markets, whose efficiency is a prior condition to the effective use of foreign development financing at large.

[83] See EIB (1999), p 17 f. EIB's Operations Evaluation Unit in its 1999 Evaluation Report presented ten lessons/recommendations for future EIB borrowing operations in new markets.