

# How have local currency bond markets weathered the financial crisis?

Some outcomes of the 2<sup>nd</sup> joint Bundesbank-IMF-World Bank international workshop on implementing the G8 Action Plan for developing local bond markets in Emerging Market Economies and developing countries, Frankfurt am Main, 12 and 13 November 2009

4th OECD Forum on African Global Debt Management

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# Overview

- I. Background and objectives of the workshop
- II. Financial crisis and local currency bond markets – the “global picture”
- III. Financial crisis and EM regions
- IV. Challenges ahead

## Background and objectives of this workshop

- The Workshop *supports the implementation of the G8 Action Plan*
  - The results of this workshop will be articulated in a progress report.
  - Accordingly, the workshop is focused on a comprehensive stocktaking on progress made and future work programme by different country groups and relevant international institutions.
- Special topic 2009: How did domestic bond markets weather the *financial crisis* in different country groups – new experiences and challenges ahead?
- To *bring global initiatives* and the main donors *together to enhance transparency* and to use potential synergies in providing global support.
  - What are the main consequences of the financial crises for global support to develop local currency bond markets in these country groups?
  - What lessons can be drawn for the future work programmes of relevant international institutions?
- To *strengthen the international network*

## Financial crisis and local currency bond markets – the global picture

- **Local currency bond markets weathered the financial crisis quite well**
- **They served as a “spare tyre” in some EMEs and developing countries**
- **... when refinancing in international bond markets was costly and bank loans limited**
- **But they proved vulnerable to the worldwide systemic shock**
- **Foreign investor base is not broad and diversified enough in many EMEs to provide sufficient macroeconomic liquidity in times of tension**

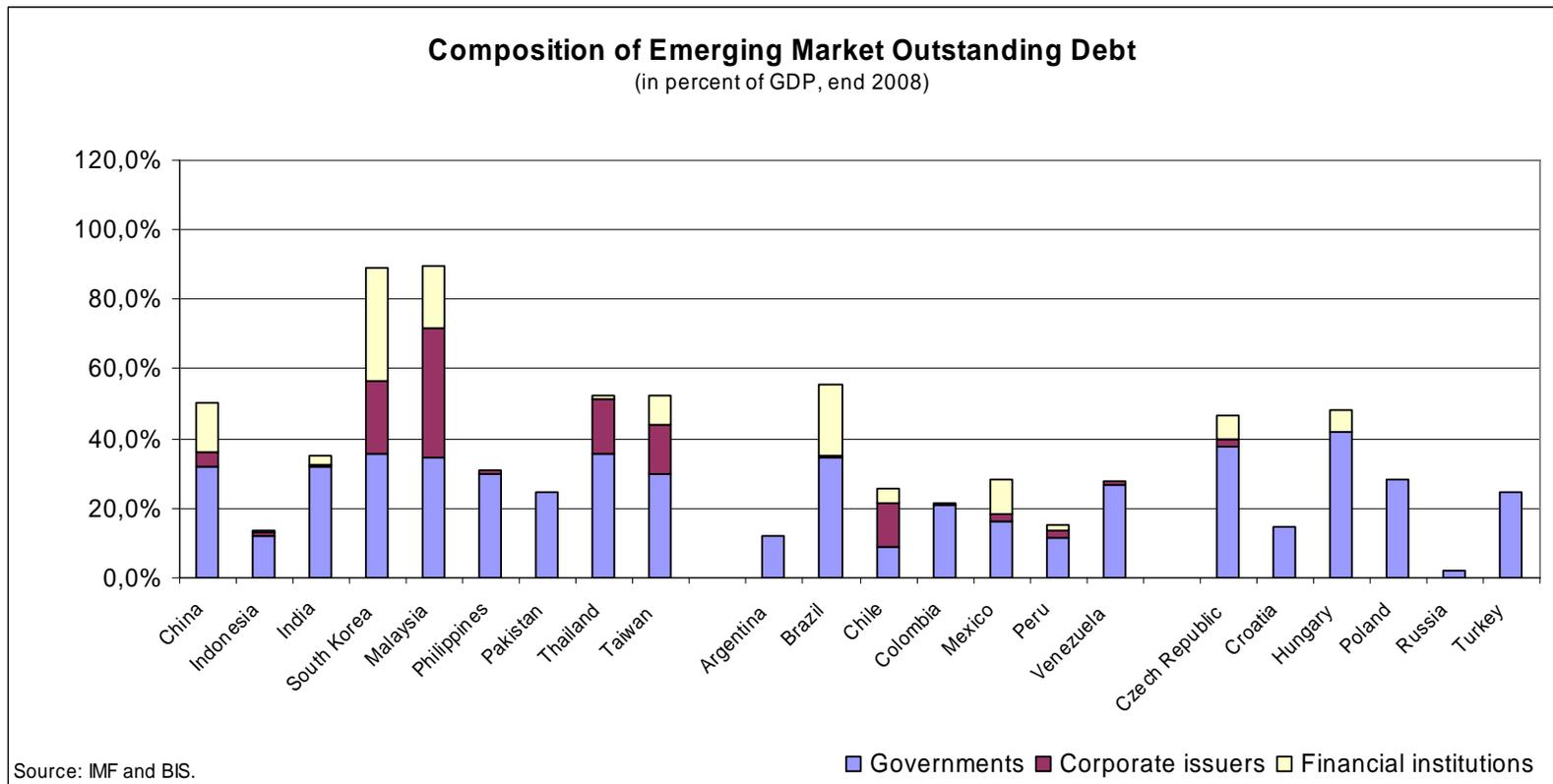
## The “global picture”

- **Domestic investor base has not “filled the liquidity gap”**
- **Macroeconomic developments and differences in stability did not matter much in explaining investors’ response**
- **Empirical research shows no significant effect on cross-country differences**
- **Responses by international investors have been marked predominantly by a flight from illiquid markets despite differences in credit ratings (Philip Turner; BIS)**

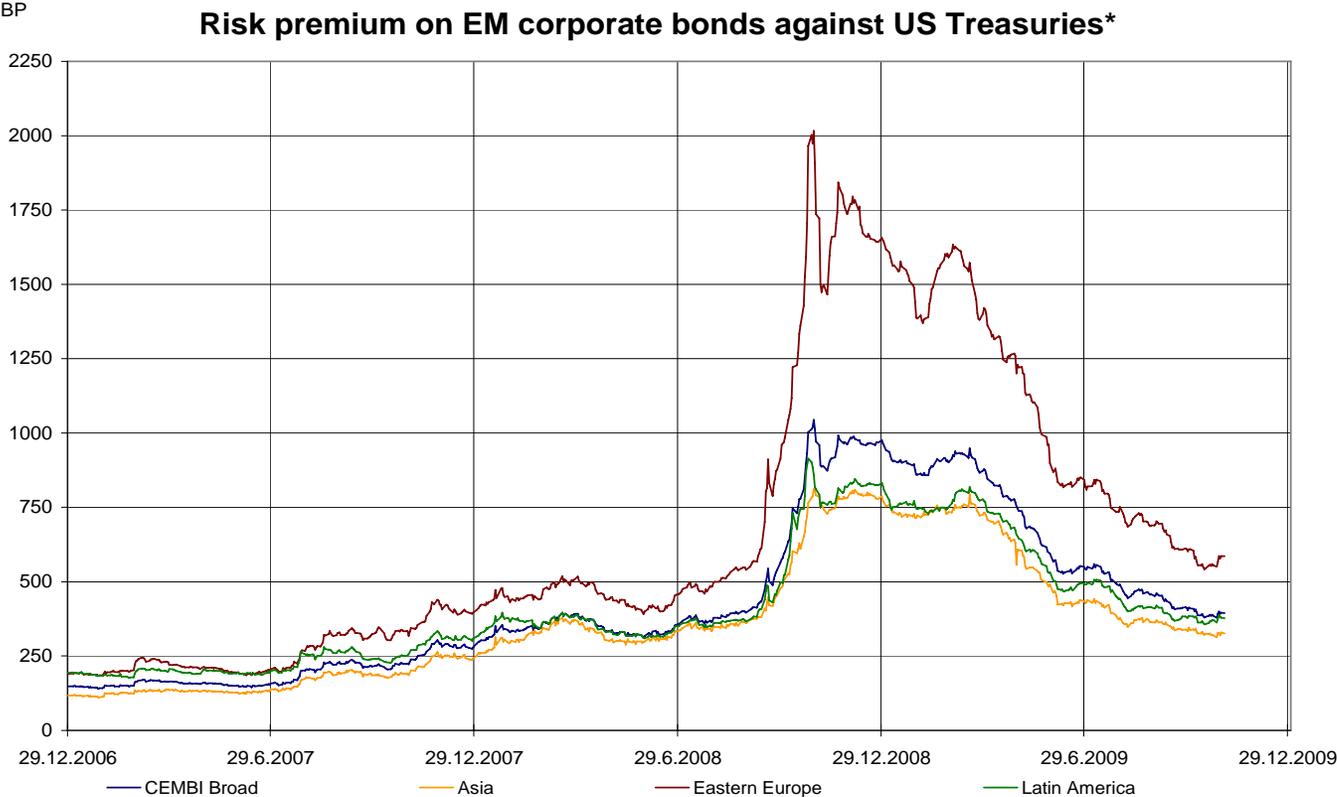
## The “global picture”

- **In principle, developing local bond markets supports many of the recommendations of G20 in response to the financial crisis – inter alia**
  - Contributes to constraining contagions
  - ... to constraining spill-over effects into the real economy
  - Supports global rebalancing
  - More diversified financial systems proved more resilient to external shocks
  - Broadens the range of fiscal policy in response to financial crisis
- **Therefore, financial crisis did not reveal necessity to reprioritise recommendations of the G8 Action Plan or actions.**

# Most of these principle advantages are related to corporate bond markets – but these are underdeveloped



# Risk premiums near pre-crisis levels



Source: JP Morgan. \*JP Morgan Corporate Emerging Markets Bond Index (CEMBI); contains corporate bonds and bonds of financial institutions.

## Financial crisis and EM Asia

### According to ADB analytical work

- **Continued reforms are bearing fruit – bond markets have shown resilience during current crisis**
- **Emerged as a key source of funding for governments and corporates**
- **In the first half of 2009, bond markets rose sharply after a significant decline in fourth quarter of 2008**
- **Banks turned to bond markets to strengthen their capital with subordinated debt**

## Financial crisis and Latin America

- **Financial systems in LAC weathered financial crisis much better than in earlier periods and ...**
- **... local bond markets proved to dampen financial tensions**
- **2009 bond market levels approaches pre-crisis levels**
- **Most important structural trends**
  - Reduction in foreign currency exposure and significant progress in lengthening maturities
  - Increasing reliance on domestic debt markets by governments and the private sector;

## Financial crisis and Latin America

- Growth of total outstanding debt securities is driven mainly by domestic debt
- governments (international) indebtedness has been reduced since 2004
- Growing and more diversified investor base in LAC
  
- **Latin American Countries are least affected by the financial crisis within EMEs in terms of the value of financial assets (-6%) and ...**
  
- **... in terms of reductions in capital inflows (-2% as a share of GDP).**
  
- **(IADB, Center for Financial Stability, Argentina)**

## Financial crisis and African countries

- **The international financial crisis has heavily affected *African countries***
- **but in some countries, such as Egypt, South Africa – and on a lower quantitative level – Kenya and Ghana**
- **improved conditions in the domestic markets proved to stabilise financial tensions**

## Challenges ahead in African countries

- **The World Bank Group: Further successful promoting of ESMID, which, in particular, meets the challenges for developing long-term oriented bond markets**
- **Challenges ahead are best reflected in African Financial Market Initiative's, MFW4A's and AfDB's strategic priorities – inter alia**
  - Further strengthening of the legal and regulatory framework,
  - promoting regional initiatives,
  - broadening the database and statistical capacity building,
  - expansion of primary markets;
  - stocktaking and research on current payment systems,
- **Results from the bond market mapping study reinforced these strategic priorities**
  - This study reflects the fragmentation of the market, predominance of government bonds and limited corporate bonds, limited issuance capacity, narrow investor base, predominant “buy and hold strategy”.
- **Ongoing projects by the AfDB are focused, in particular, on developing bond market infrastructure.**

## Broadening the database

- **Working Group on Securities Databases (reconvened in response to the G8 Action Plan in 2007) ...**
- **... and, in particular, the IMF, BIS and ECB, have recently published part I of the Handbook of Securities statistics,**
- **which provides a compilation guide for collecting and presentation of securities statistics.**
- **The next step is the creation of bond holder statistics (part II of the Handbook).**
- **ECB coordinates the production of Part II of the Handbook;**
- **timetable:**
  - first draft will be available end of 2009;
  - meeting of Review Group of about 50 countries;
  - spring 2010: publication.
- **The programme and timetable is available on the IMF website**  
<https://www.imf.org/external/np/sta/wgsd/index.htm> .
- **The Work Programme of the WGSD also contributes to the implementation of the G20 report on “Financial Crisis and Information Gaps”.**  
<http://www.imf.org/external/np/g20/110709.htm> and  
<http://www.financialstabilityboard.org/index.htm>

## Tentative conclusions of the workshop

- **EMEs have successfully developed local currency bond markets.**
- **At least in some EMEs, they played a stabilising role, provided a spare tyre, contributed to constraining systemic risks and contagions etc.**
- **No significant need to reprioritise recommendations of the G8 Action Plan or priorities.**
- **Work on developing local bond markets is supportive also with regard to G20 recommendations. Implementation of G8 and G20 Action Plan can generate stimulating effects on each other.**
- **Broadening and diversifying the investor base remains a key challenge, underlined by the financial crisis.**

# Tentative conclusions of the workshop

- **Broadening the database remains top priority.**
- **Open question: Are there new experiences for the sequencing of capital account liberalisation and developing bond markets?**
- **OECD: Significant increase of budget deficits in advanced countries are challenging for local currency bond markets in EMEs and developing countries in 2010**
- **In-depth analysis is necessary,**
  - in particular, better understanding of bondholder strategies
  - on influence of changing financial structures and changing response patterns of financial markets critical,
  - closer network of research on this field could be fruitful.
- **New experience – even countries with stable macroeconomic framework heavily affected.**
- **How are local currency bond markets in EMEs and developing countries affected by exit strategies in advanced economies?**

# References

**Presentations of the 2<sup>nd</sup> joint Bundesbank-IMF-World Bank international workshop on implementing the G8 Action Plan – *Lessons from the crisis and progress made in developing local currency bond markets in Emerging Market Economies and developing countries*, Frankfurt am Main, 12 and 13 November 2009 - [http://www.bundesbank.de/finanzsystemstabilitaet/fs\\_dokumentation.en.php](http://www.bundesbank.de/finanzsystemstabilitaet/fs_dokumentation.en.php)**

## **Here in particular:**

- Philip **Turner** (BIS): How have local currency bond markets in EMEs weathered the financial crisis?
- Bernd **Braasch** (Deutsche Bundesbank): Local currency bond markets – lessons from the crisis.
- Noy A **Siackhachanh** (ADB): Bond Markets in Emerging Asia.
- Juan **Ketterer** (IADB): Lessons from the financial crisis and progress made in developing local currency bond markets in emerging market economies and developing countries.
- Pablo **Souto** (CEFS): A new era for Latin American Domestic Bond Markets.
- Andre **Amante** (Banco Central Do Brasil): Lessons from the Crisis and Progress made in Developing Bond Markets in Brazil.
- Nontle **Kabanyane** (AFMI): Reinforcing confidence in African domestic bond markets.
- Carlotta **Saporito**: Coordinating Bond Market Development Efforts in Africa.
- Clemente **Del Valle** and Evans **Osano** (The World Bank Group): Efficient Securities Markets Institutional Development Initiative.