

HAS DOMESTIC FINANCIAL  
DEVELOPMENT FOSTERED FINANCIAL  
STABILITY?

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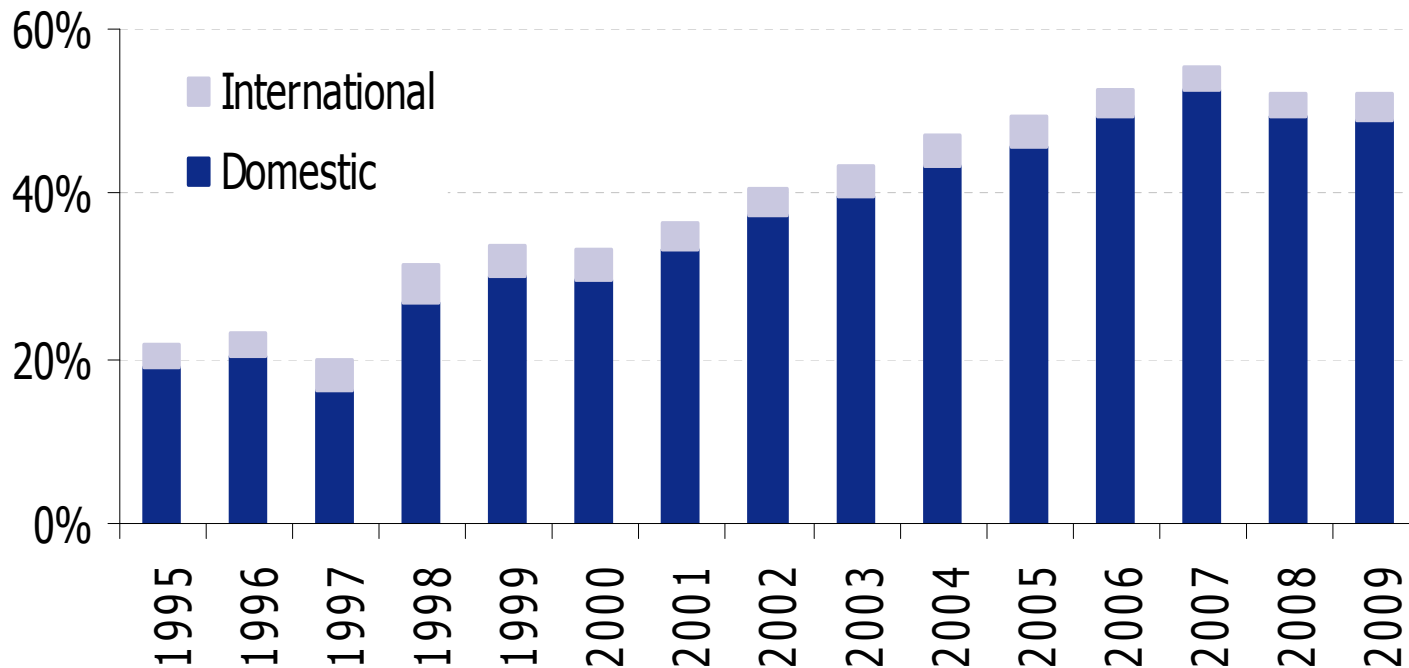
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IADB, 20 October 2009

1. Domestic bond markets have developed very rapidly during the last few years in the whole emerging world but particularly in Asia
2. The current financial crisis has served as a test of how helpful domestic bond markets can be to reduce vulnerabilities in emerging countries.
3. The answer would be “quite helpful but not perfect”

**Domestic bond issuances – when defined in a very broad sense (including CB sterilization bills etc) have grown substantially in Asia**

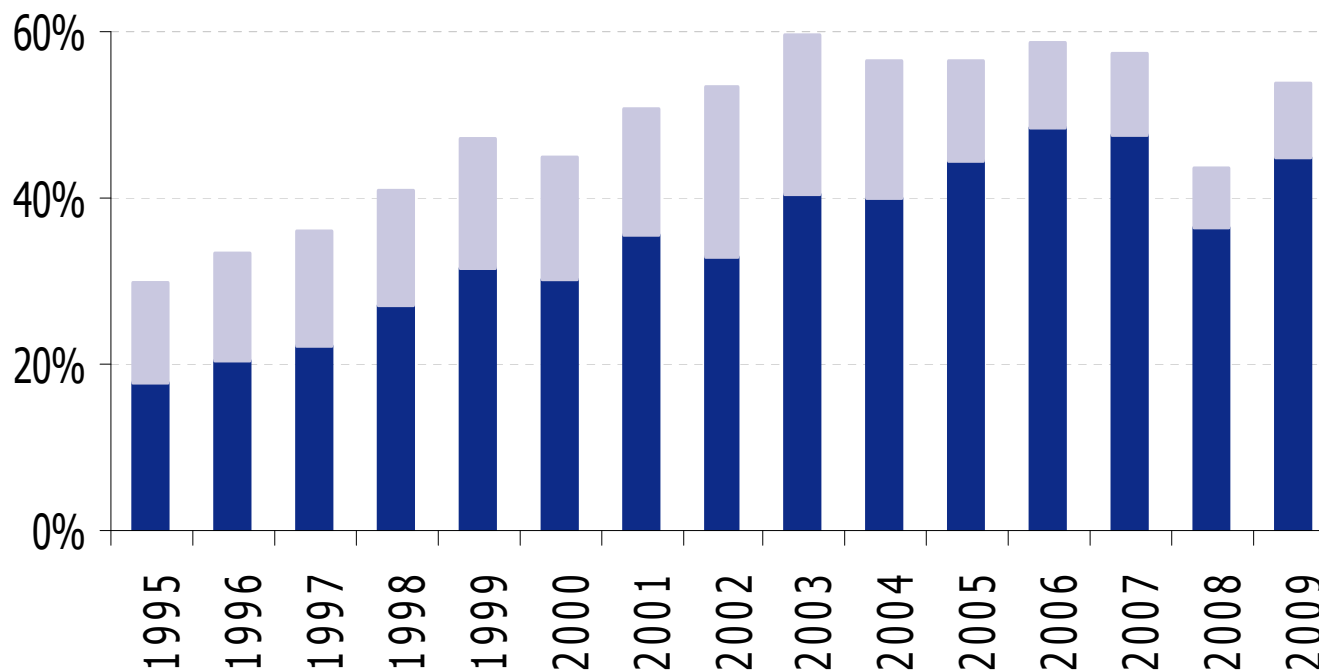
**Bond issuance (as % of GDP)**  
Asia



**Source: BIS**

**In Latin America international bond issuance has become less important over time. If anything the crisis has accelerated that process. Domestic bond issuance is still relatively lower than in Asia**

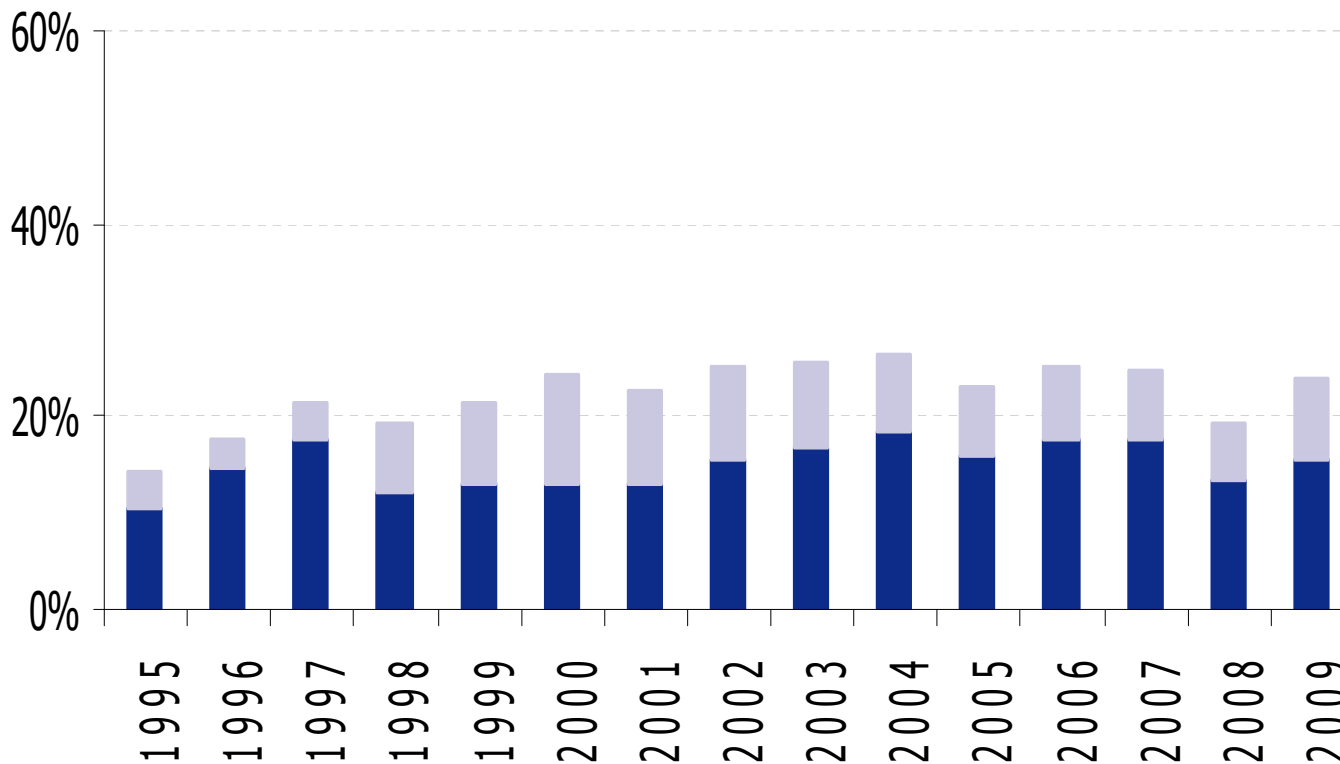
**Bond issuance (as % of GDP)  
Latin America**



**Source: BIS**

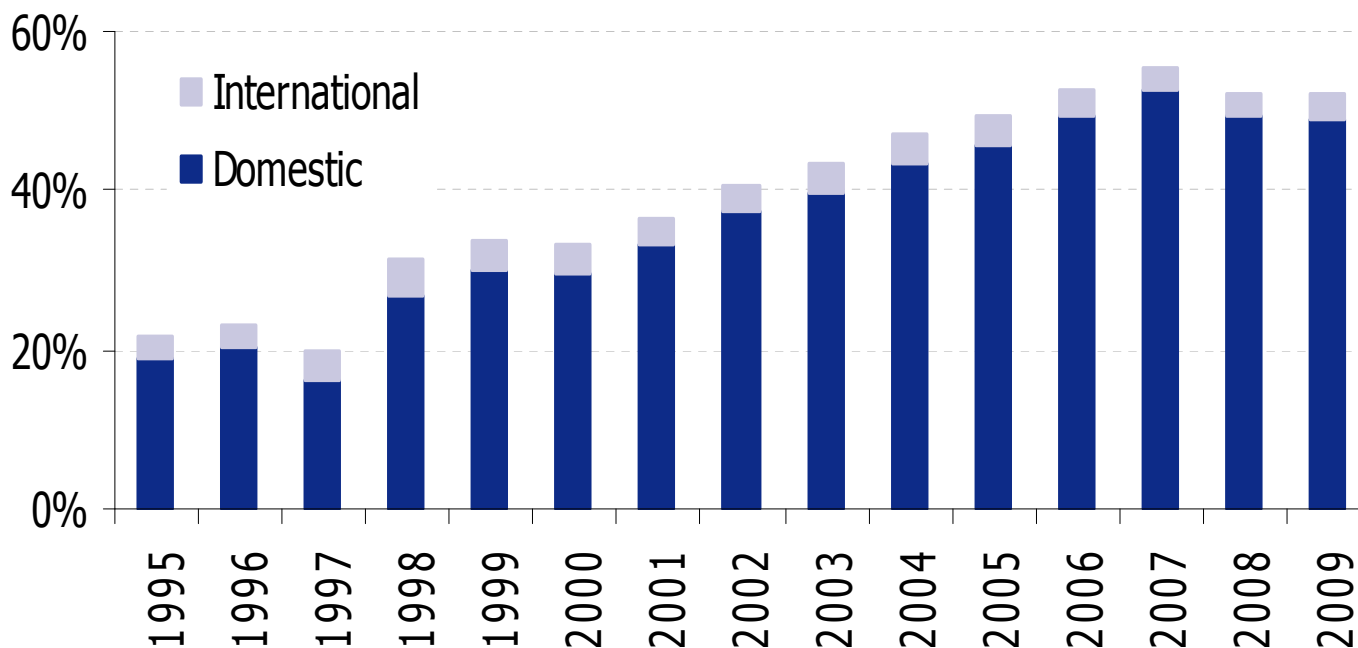
The case of Eastern Europe shows a much more stable pattern both in international and domestic bond issuance. In fact, most of the lending through cross-border bank lending

**Bond issuance (as % of GDP)**  
Central Europe



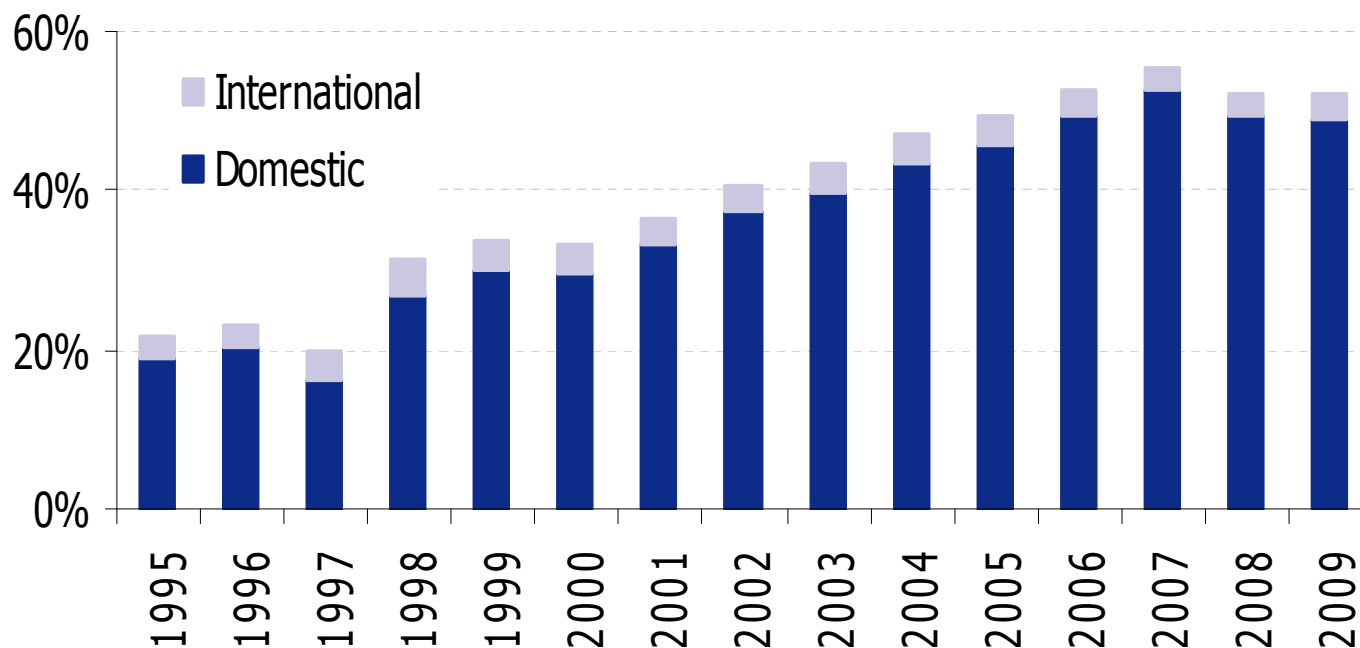
**Domestic bond issuances – when defined in a very broad sense (including CB sterilization bills etc) have grown substantially in Asia**

**Asia**

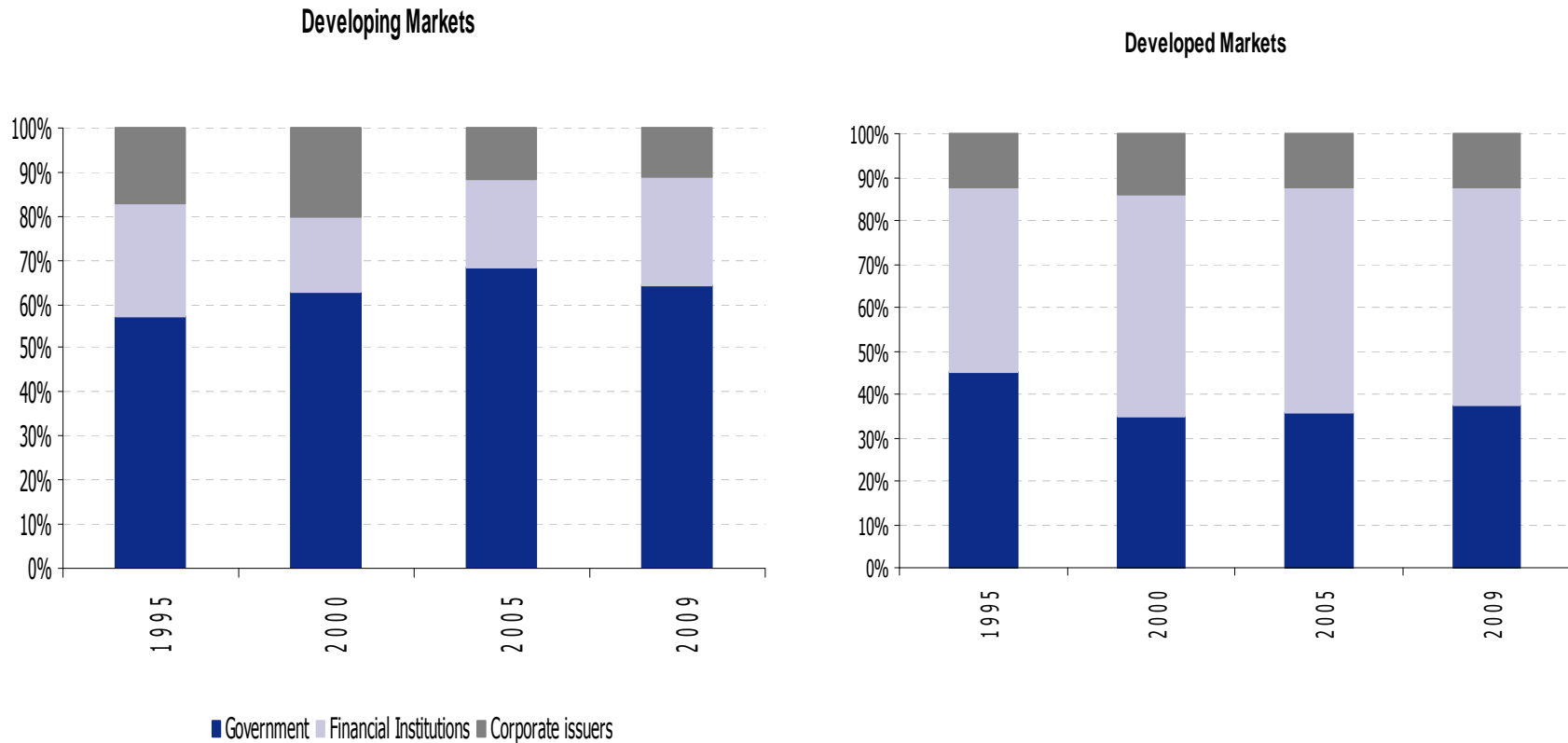


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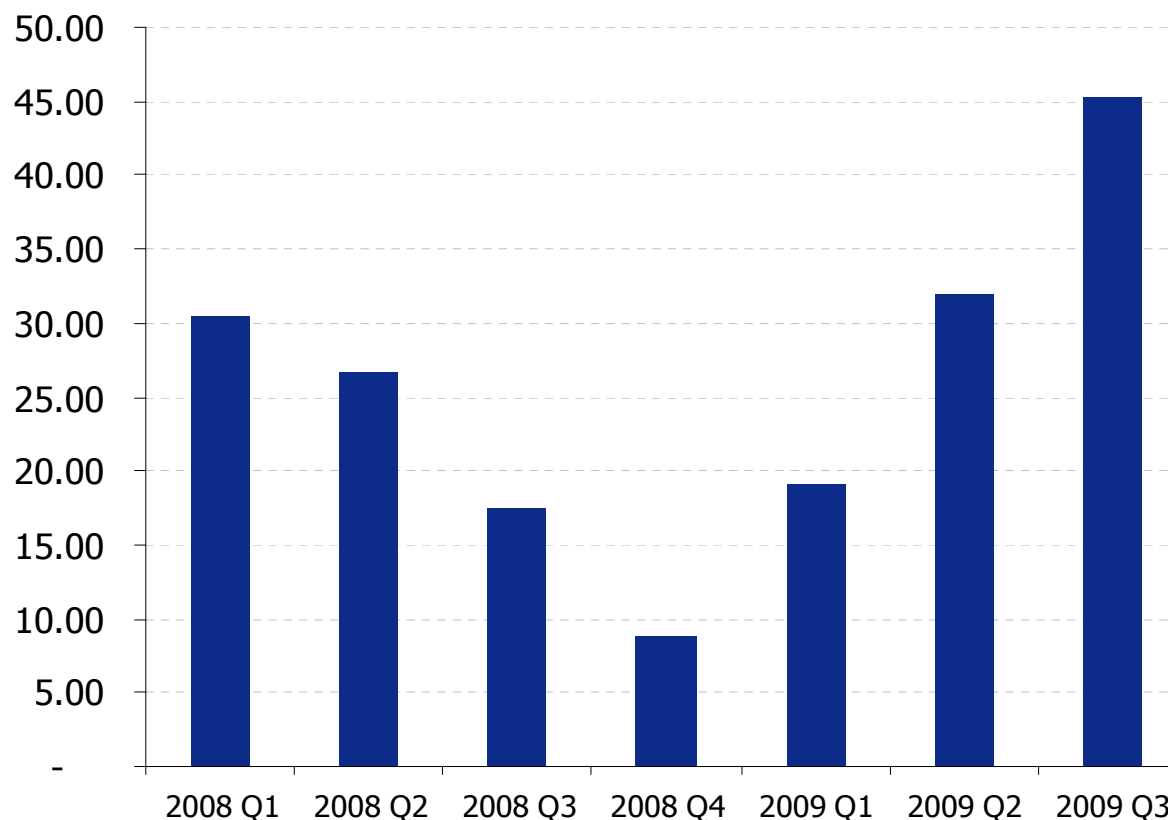


**The main issuer of domestic bonds continues to be the government without a clear descending trend as in Asia**



**Bond issuances halved right after Lehman but recover very quickly to even higher level than prior to the crisis**

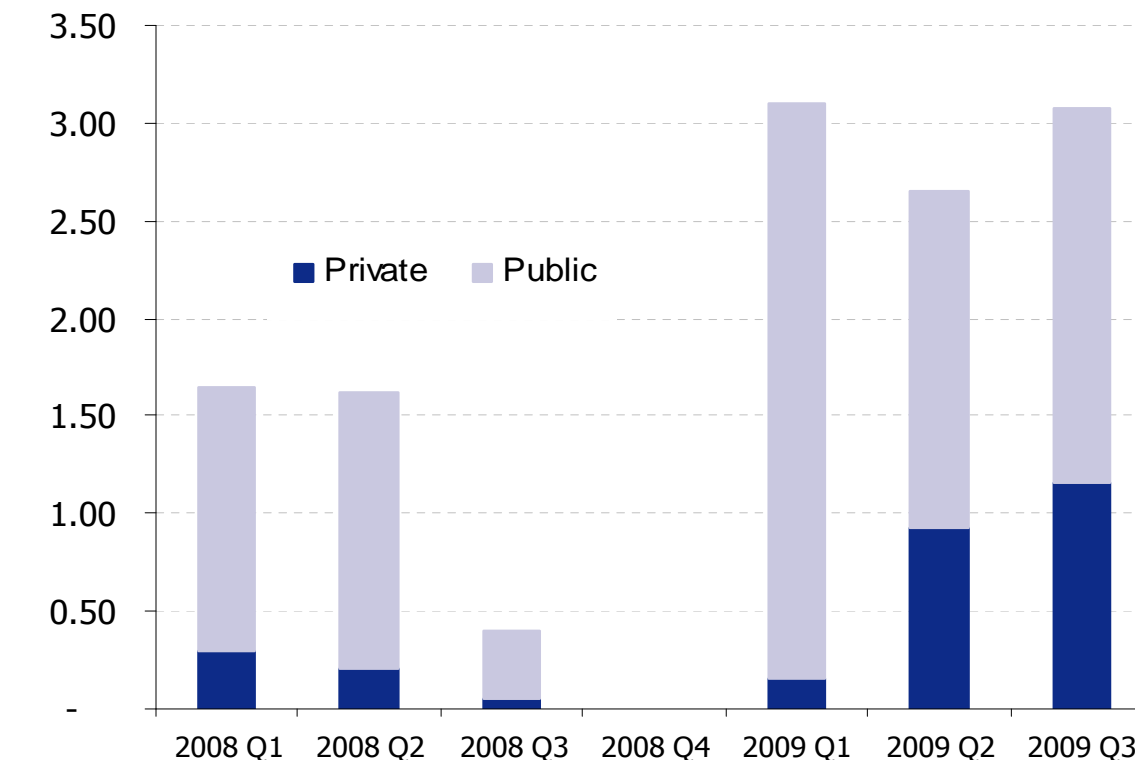
**Selected Emerging Economies: Bond Issuance\*  
(billions of euros)**



\* Brazil, Indonesia, Mexico, Phillipines, Russia and Turkey. Source: Dealogic.

**Indonesia could not issue at all in Q4 but recovered very quickly in Q1 2009. First only the public sector, then even the private sector**

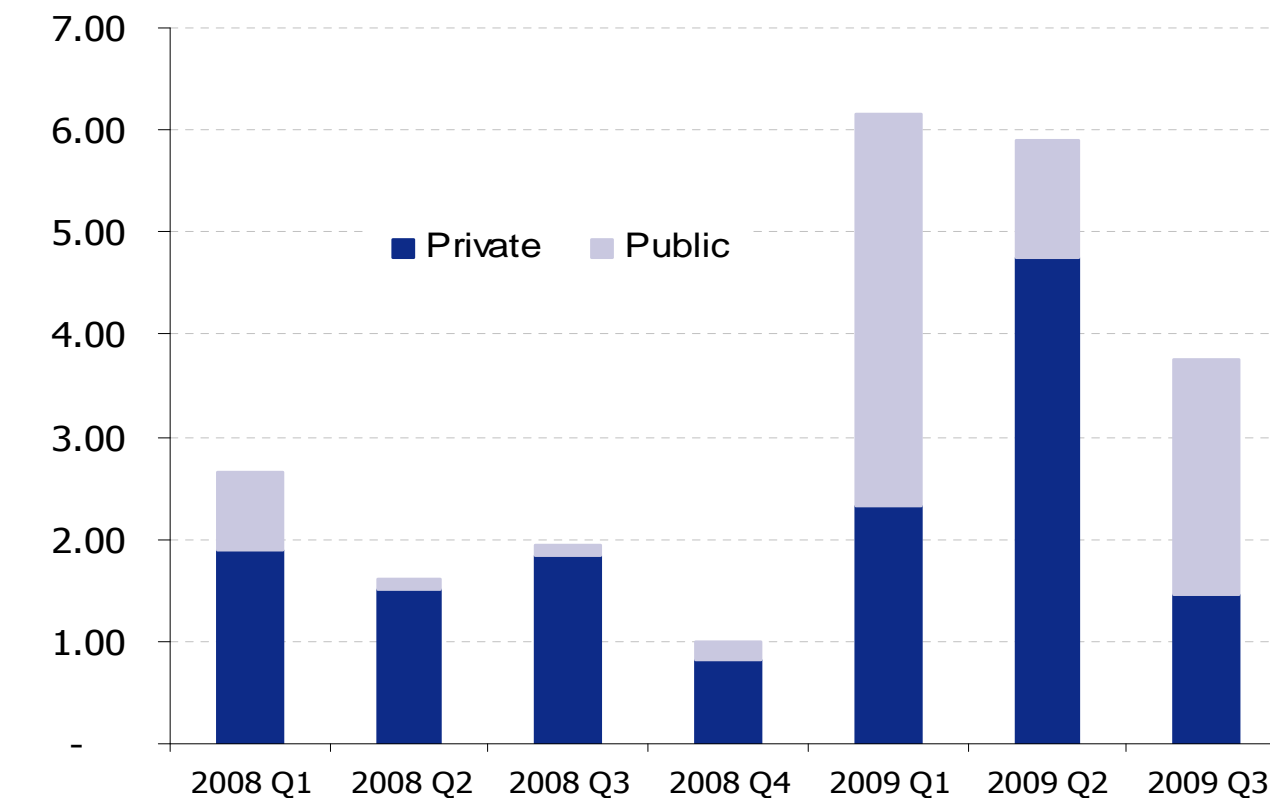
**Indonesia: Bond Issuance  
(billions of euros)**



Source: Dealogic

**The impact of the crisis on Philippines' domestic bond issuance has been much milder even for the private sector**

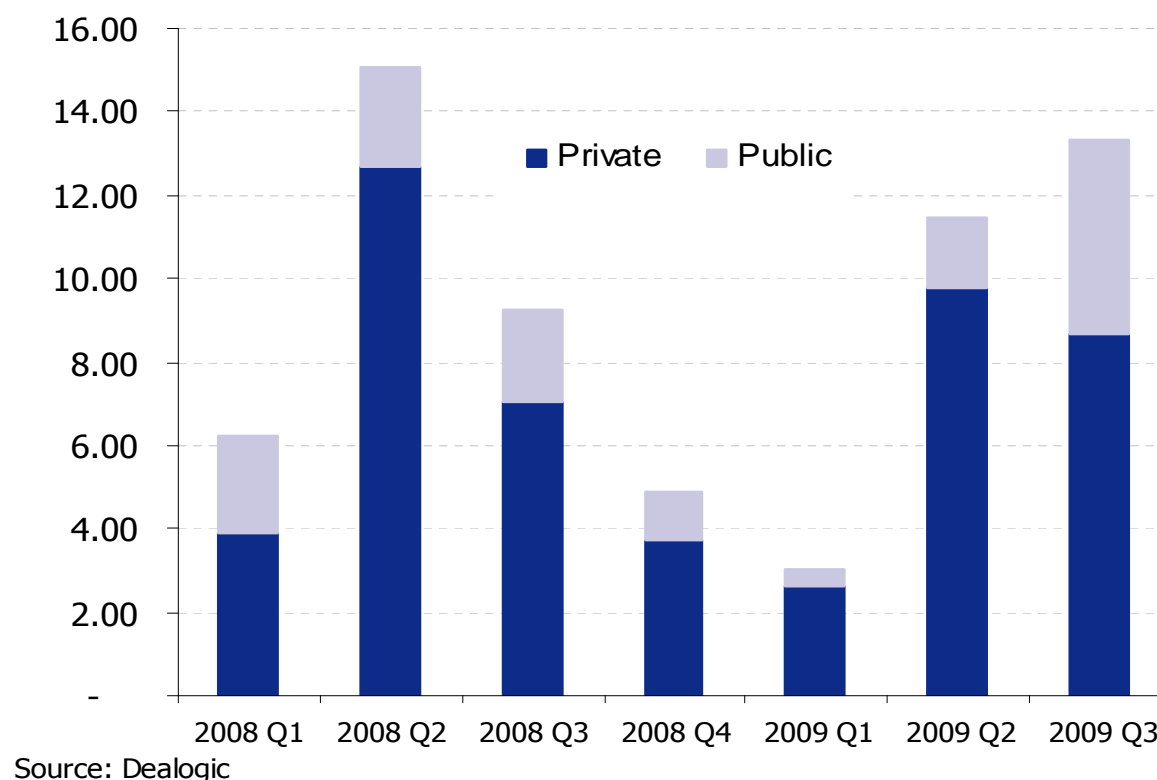
**Philippines: Bond Issuance  
(billions of euros)**



Source: Dealogic

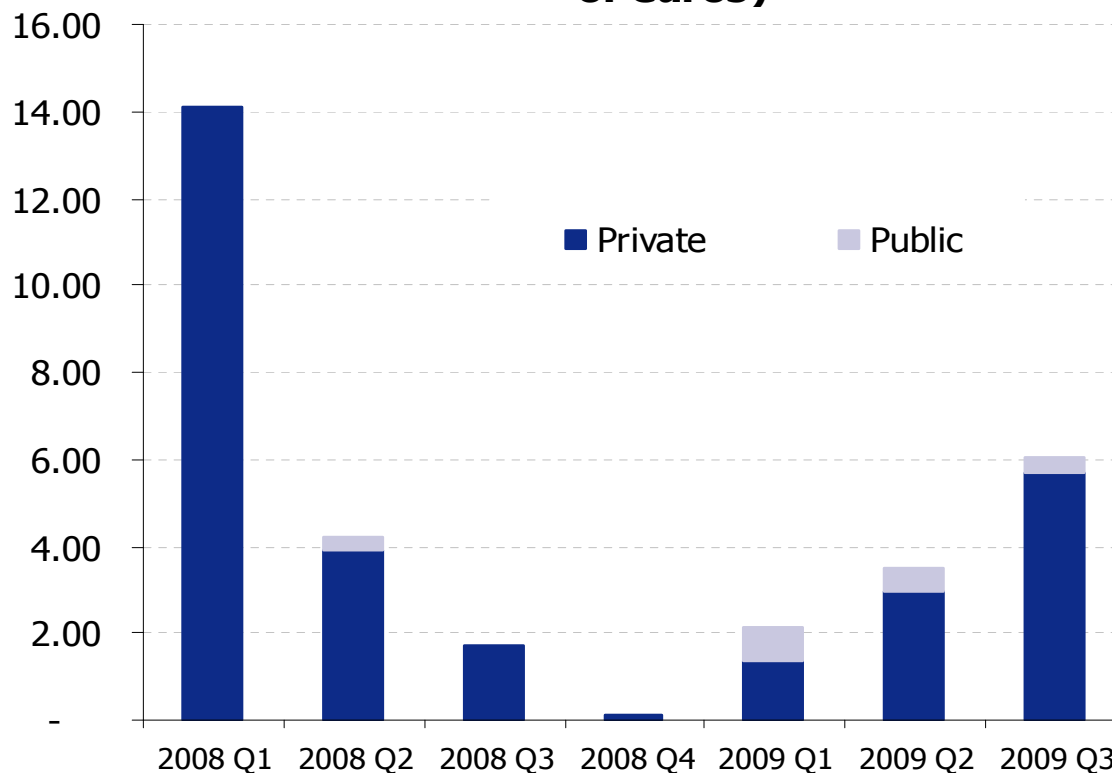
**The same can be said about Russia notwithstanding the severe problems the economy has been facing**

**Russia: Bond Issuance  
(billions of euros)**



**The crisis took longer to reach Brazil but the impact was acute on Q4 with a slower recovery than in Asia (or even Russia)**

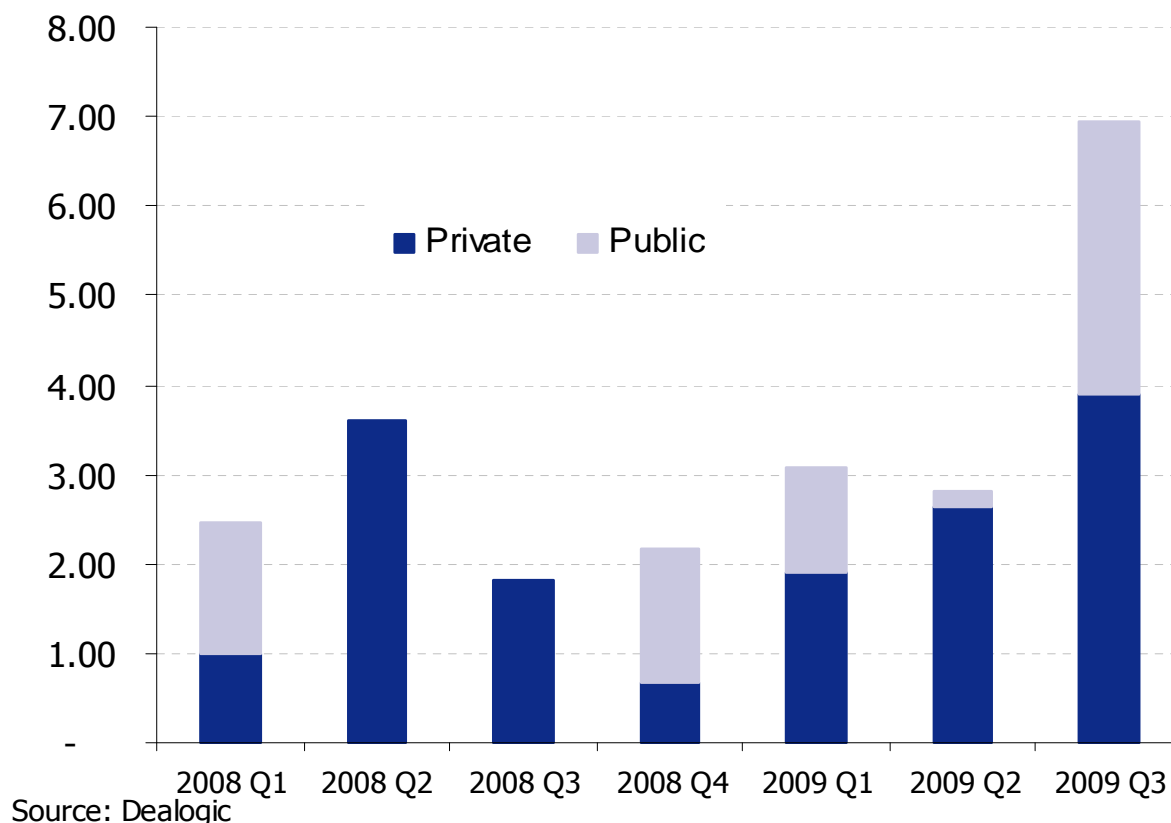
**Brazil: Bond Issuance (billions of euros)**



Source: Dealogic

**Interestingly, the impact of Lehman on Mexico's issuances has been more muted and the recovery of issuances faster**

**Mexico: Bond Issuance  
(billions of euros)**



- A big part of the improvement in debt developments in emerging countries comes from fundamentals (better fiscal)
- Switch to domestic debt has generally reduced the cost of financing but not always: Exchange rate developments relevant:

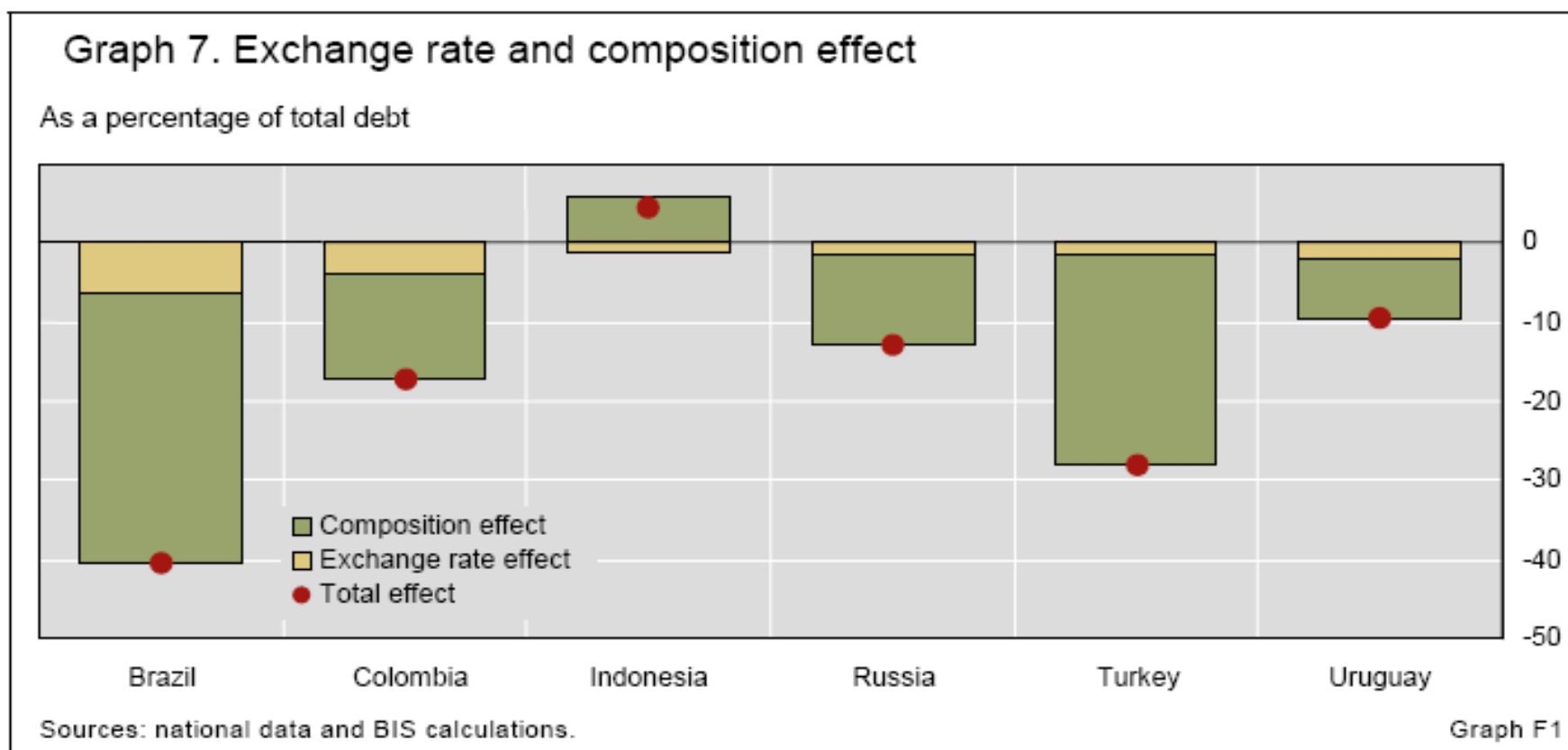
As a percentage of GDP

	Brazil	Colombia	Indonesia	Russia	Turkey
Year of crisis	2002	2003	2001	1999	2001
Net debt	-5.7	-5.8	-23.9	-81.5	-33.9
due to:					
Primary balance	-13.7	-7.3	-8.5	-34.4	-23.1
Shift to local currency debt	6.4	2.6	-2.3	-23.7	6.4
Exchange rate changes	-2.5	-2.7	-10.1	11.3	-0.9
$(r-g)^2$	4.1	1.6	-3.0	-34.7	-16.3

<sup>1</sup> Changes are computed from the year of crisis to 2005. <sup>2</sup> Average interest rate less the rate of GDP growth.

Source: Acevedo et al (2006).

**Still the impact of exchange rate developments on debt dynamics has been estimated to be smaller than changes in debt composition**

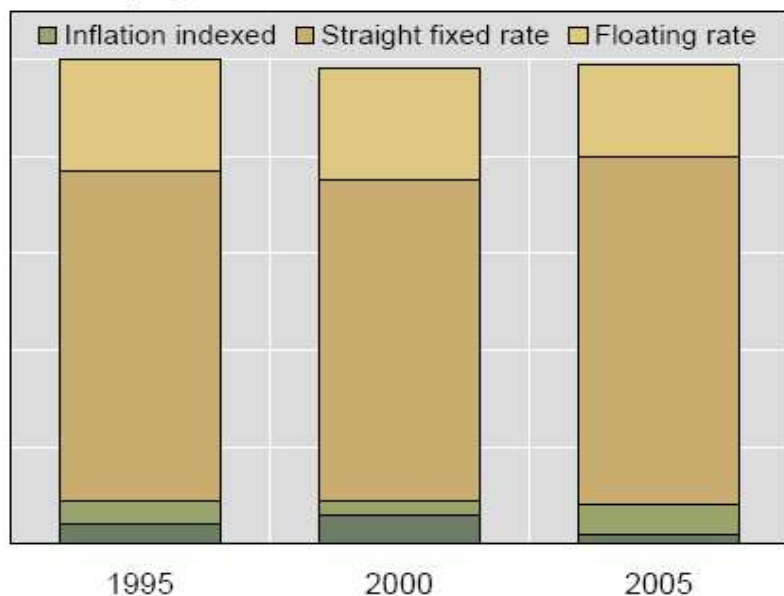


**Domestic debt composition has improved in emerging countries but still worse than in the developed world**

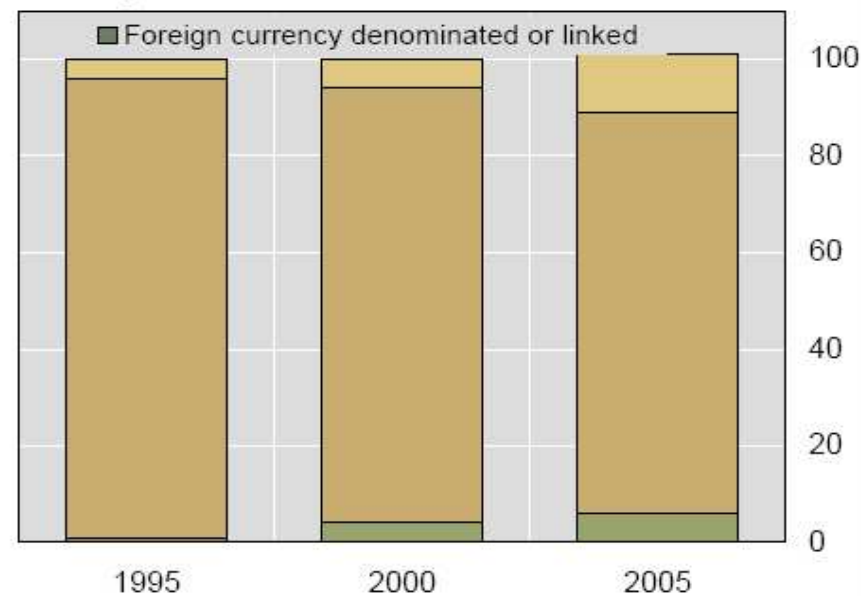
**Domestic bonds by instrument<sup>1</sup>**

As a percentage of total outstanding

**Developing markets**



**Developed markets**



<sup>1</sup> Includes bonds and notes. Regional totals are based on the countries listed in annex table 8 of the Working Group Survey. Totals do not add up to 100 % due to the exclusion of hybrid instruments. Ratios are calculated taking the central government and all other issuers as reported in Table 2d of the CGFS questionnaire.

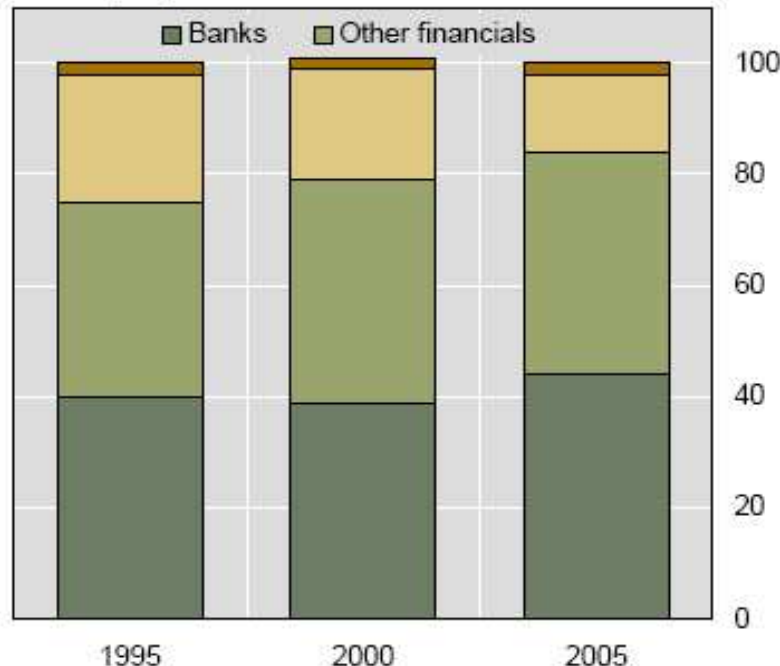
Source: Working Group Survey.

One risks is that banks concentrate an excessive share of domestic bonds

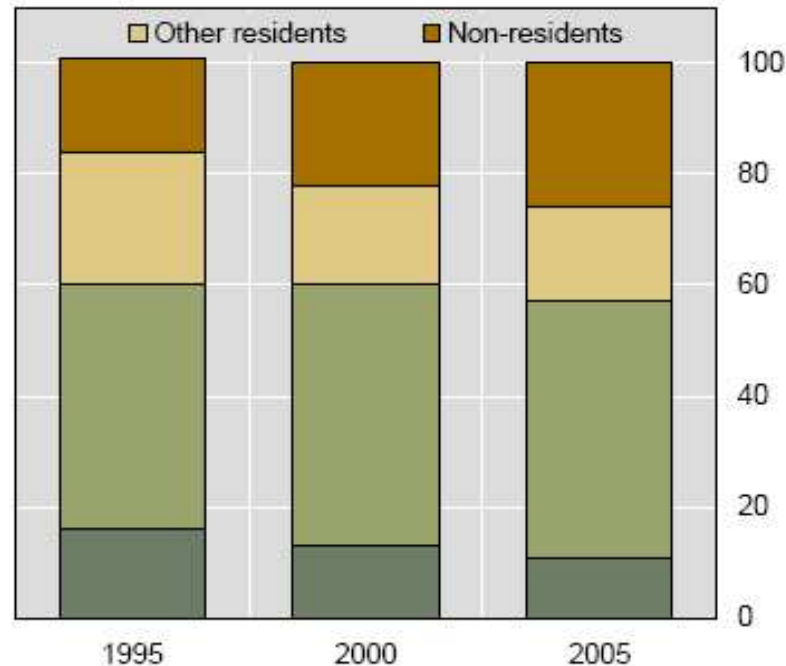
Graph 4: Holders of domestic securities<sup>1</sup>

As a percentage of total outstanding

Developing markets



Developed markets



<sup>1</sup> Includes bonds, notes and money-market instruments. Regional totals based on the countries listed in annex table 9 of the CGFS questionnaire. Ratio calculated taking the holders of central government and all other issuers securities reported in Tables 4a (money-market instruments) and 4b (bonds and notes) of the CGFS questionnaire.

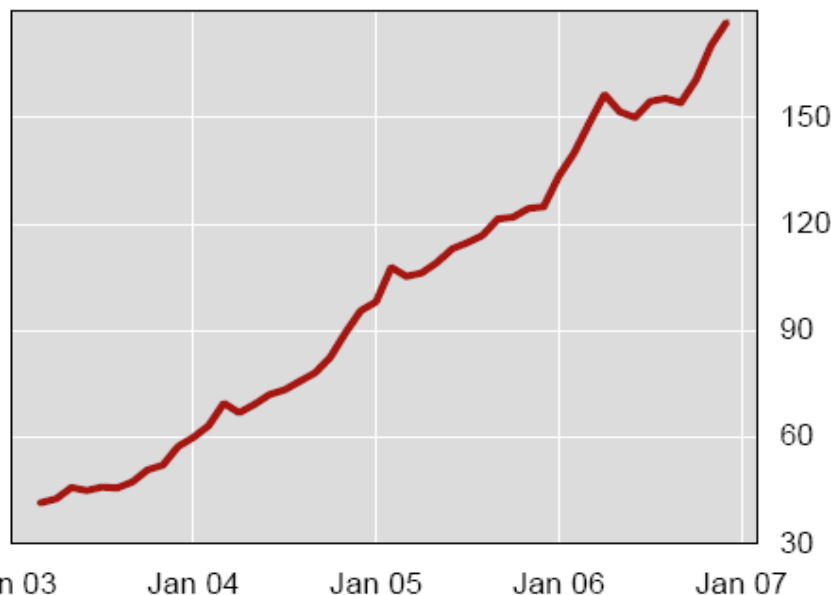
Source: Working Group Survey.

**The share of non-resident investors in domestic bond markets has increased rapidly, which could bring more volatility**

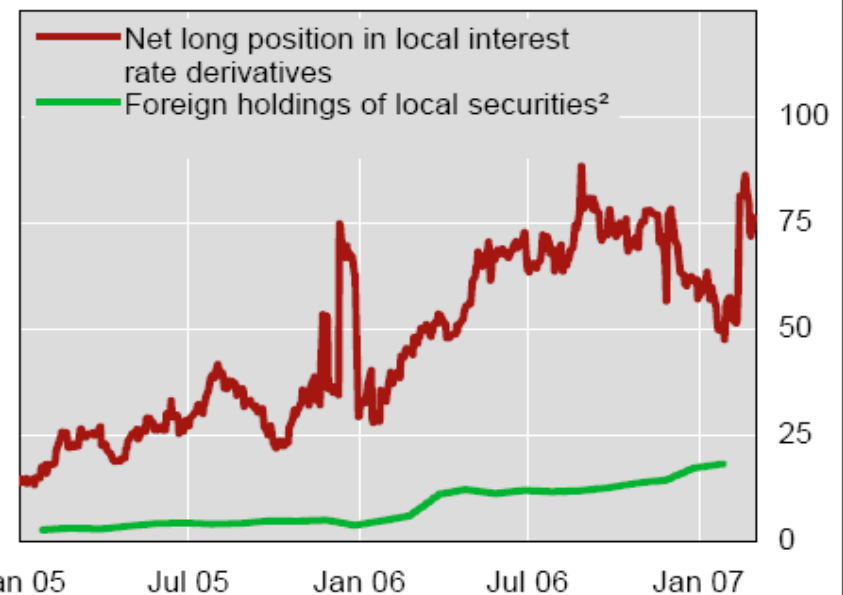
**Graph 5: Non-resident exposures to EME local currency bonds**

In billions of US dollars

**A. Total holdings of local currency debt<sup>1</sup>**



**B. Positions in Brazilian derivatives and debt securities**



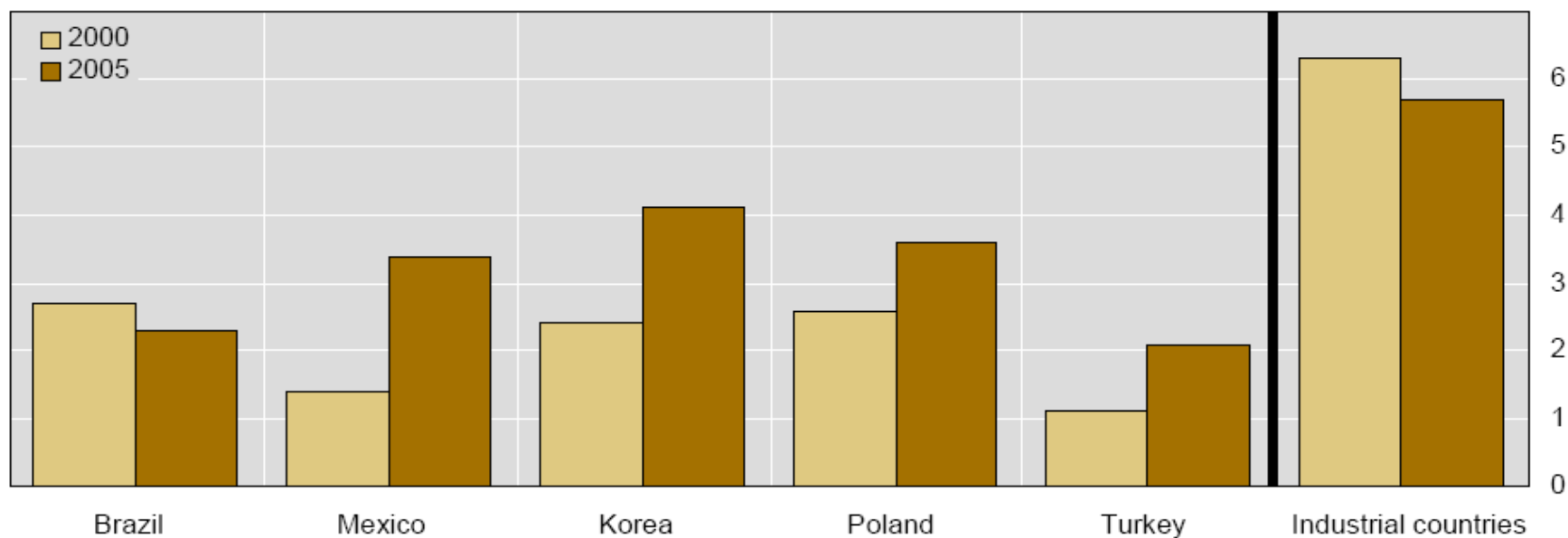
<sup>1</sup> Based on monthly data on Brazil, Czech Republic, Hungary, Indonesia, Malaysia, Mexico, Russia, South Africa and Turkey. <sup>2</sup> Linear interpolation of monthly observations.

Sources: Central banks; FRBNY.

The other one is the two short maturity of paper compared to developed world

Graph 3: Maturity of domestic central government debt outstanding<sup>1</sup>

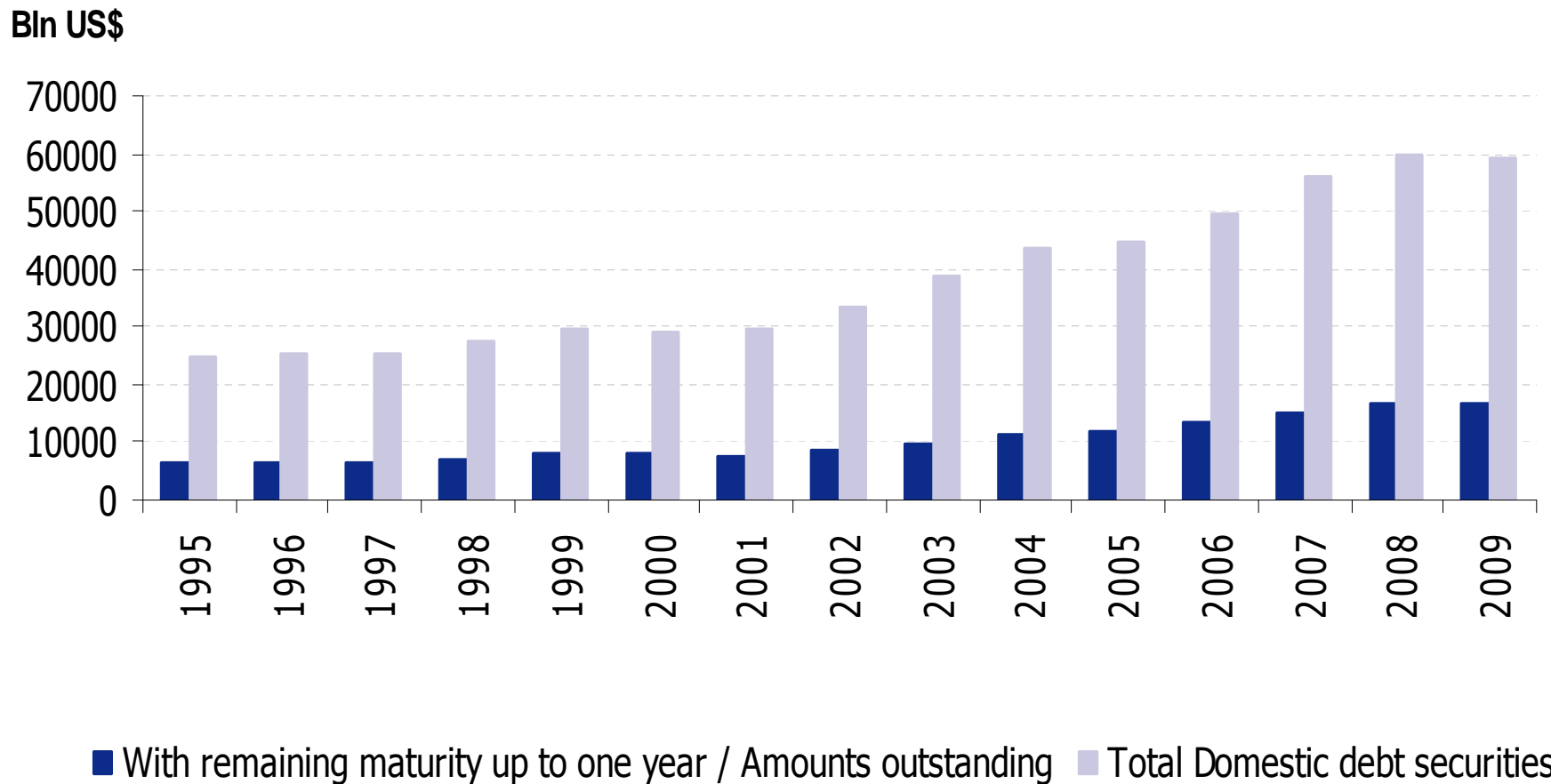
Remaining maturity in years



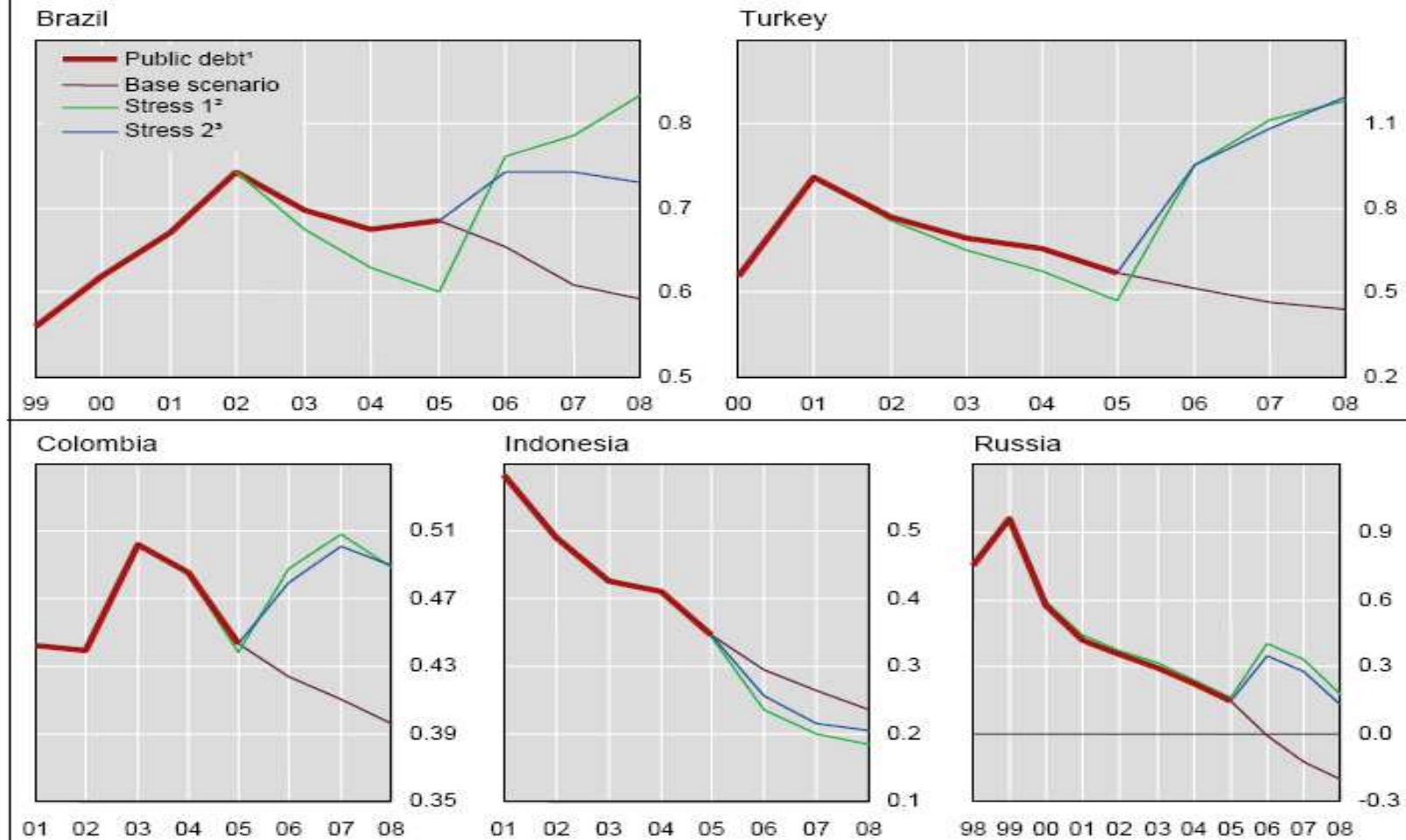
<sup>1</sup> Includes bonds, notes and money-market instruments.

Source: Central banks.

**Furthermore, there has been an additional increase in the share of short term domestic debt over time**



Graph 8. Base and stress scenarios



<sup>1</sup> Public debt net of reserves, as a percentage of GDP. <sup>2</sup> Stress under 2002 (2001 for Turkey and Indonesia; 2003 for Colombia) debt composition (counterfactual). <sup>3</sup> Stress under current debt composition.

Source: E. Alberola, C. Broto and A. Paloma, "An assessment for six emerging markets", Banco de España.

- 1. Domestic bond market development continues unabated in the emerging world.**
- 2. Asia is clearly a front runner with ad hoc policies (ABF I, II, etc) but not only**
- 3. Such movement from foreign currency to domestic currency bond financing is a clear plus in terms of financial stability although some issues remain:**
  - Concentration of holders (domestic banks, growing role of foreign investors)**
  - Two shorts-term oriented**

**THANK YOU  
COMMENTS WELCOME**