THE INTERNATIONAL DEBT SECURITIES MARKETS – FEATURES AND TRENDS

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Abstract:
Until the 1960's, the domestic financial markets were relatively isolated from the international market. Only later on it happened that the markets spread across the more and more permeable borders and led to the appearance of Eurocurrencies. These in turns have stimulated the development of the international financial markets. This paper regards one of the components of the international financial markets: the international debt securities markets.

Key words: *international financial markets, international debt securities markets, Eurobonds, foreign bonds, Euro Medium Term Notes*

JEL classification: G15

Introduction

In his paper from 1978, Professor C. Kirițescu defined the international financial markets as being the „ensemble of operations by which the financing need coming from international financial institutions, governments, local administrations, foreign enterprises, is being met by the financing offer of banks, investors, insurance companies, pension funds and other capital owners in the long term." (Kirițescu, C., 1978, p. 82).

According to S. Cerna, the international financial markets are made up of (Cerna, S., 2002, p. 128-129):

1. The euro-credit market (comprising also the euro-currencies market, which is essentially an inter-bank market);
2. The international securities market (including foreign bonds, shares and Eurobonds);
3. The internationalized domestic markets;
4. The *off-shore* markets.

This paper refers largely to the international debt securities markets – Eurobonds and foreign bonds – not before presenting the historical context in which the Eurocurrencies and the Eurocurrencies market have appeared.

The Eurocurrencies have appeared in the early 1960's, in London, during the cold war, due to a context that led to intensified operations using American dollars in Great Britain and the rest of Europe. They became *Eurodollars*[1], meaning dollars used outside the issuing country. In the following years, the "*euro"* prefix became usual for all currencies being used outside the issuing country (for instance, the French franks deposited in German banks became euro-franks) and this led to the formation of considerably large markets.

The exchange of Eurocurrencies grew rapidly, as it offered banks a way to get around many of the national regulations applicable to transactions done using the national currency. The euro-currency markets were fed by the activity of the multinational corporations as well as by the recycling of the petro-dollars in the 1970's. Other factors that stimulated the growth of the Eurocurrencies markets have been: the European economic integration, the creation of *off-shore* zones, the increased international trade, but also certain political events that generated a fear that capital might be blocked in certain countries, etc.

In order for an operation involving currency to be considered a Eurocurrency operation, certain conditions referring to the "extraterritorial location, the management and utilization" (Cerna, S., 2002, p. 129):

- The utilized currency must not be the national currency of the country where the operation is taking place;
- None of the involved parties may reside in the country to whom the currency belongs;
- The bank involved may have only depositary rights over the currency, not property rights.

All of these conditions lead us to, as S. Cerna stated, the conclusion that de facto "*there are no Eurocurrencies, only external markets to internationally circulated currencies, meaning Euromarkets* (Cerna, S., 2002, p. 129).

K. Pilbeam defines the Eurocurrencies market as a market that involves attracting deposits and giving short term loans, operations not bound to national regulations of the currency in use, being realized by euro-banks (Pilbeam, K., 2006).

After the market of Eurocurrencies, came the market of Eurobonds, Euroshares and Euroloans (usually syndicated loans). As it implies attracting deposits and giving short term loans with a pay-back in less than one year, the Eurocurrencies market is part of the international monetary market, while the Eurobonds market is a component of the international capital market.

The Eurobonds market developed on the basis of sound economic growth within the European space. Its growth was stimulated by the so-called *Interest Equalization Tax* that was set up in July 1963 in the United States (and later on suppressed in 1974) meant to stop non-residents from getting dollar loans and which determined the major companies to seek financing in USD outside the American territory, for instance in Europe. Another push was given by the USA Regulation issued by the *U.S. Office of Foreign Direct Investment - OFDI* in the year 1968, by which the American Companies were restricted from re-investing their profits abroad. This meant that expansion abroad could only be funded from US dollars circulating outside of the US territory, or eurodollars.

In the meanwhile, several multinational companies and also state authorities began using these markets to contract loans for funding large investment projects. Their flexibility gave server companies the possibility to find the necessary means of financing that, for various reasons, were unavailable on the domestic markets.

A Eurobonds issue can be defined as a large size debt (min. 25 Mio. USD) contracted by the governments, multinational corporations or financial institutions, usually through a intermediation syndicate or consortium, formed by at least two banks[2], using a currency belonging neither to the issuer, or to the country contracting the loan.

Unlike foreign bonds, to which we shall refer later on, the Eurobonds have a different denomination than the country issuing them. The Eurobonds are than traded on the OTC markets via market makers, for a value different to their nominal value, determined by the respective supply and demand. The most relevant Eurobond markets are the London Stock Exchange, Swiss Stock Exchange, Luxembourg Stock Exchange and Euronext and the most relevant purchasers of such bonds are institutional investors. The growth of the Eurobonds issuing is due to the fact that they are an efficient mechanism of attracting financing from foreign markets.

London became the primary market for issuing and trading USD Eurobonds[3]. The expansion of Eurocurrencies and Eurobonds drove the development of the City of London as an important international financial center. In 1957 the foreign liabilities of the British banks were of 157 Bio. USD, in 1972 they had grown 307 times, up to 48,228 Bio USD. While in 1960 there were 77 offices of foreign banks in London, their number grew to 214 in 1972 (Roberts, R., Arnander, C., 2001, p. 14).

The Eurobonds market is not subject to national regulations, but it is overseen by the *Association of International Bond Dealers.*

Many articles estimate the birth date of the Eurobonds market in July 1963, when the Italian national highway company *Autostrade* issued the first such instruments worth 15 Mio. USD. While in 1963 the total amount of Eurobonds was of 148 Mio. USD, by 1972 they had reached already 5.508 Mio. USD (Roberts, R., Arnander, C., 2001, p.10). Throughout the 1960's, several developing countries successfully issued Sovereign Eurobonds: Argentina, Mexico, Philippines, Malaysia etc. Later on, until the 1990s, many of these countries ceased to make use of this instrument of foreign financing (Saini, K. G., 1986, p. 4).

A. Claes *et al* made a thorough and exhaustive analysis of the Eurobonds market throughout 1980-2000, based on 33,000 issuing events (Claes, A., De Ceuster, M.J.K., Polfliet, R., 2002, p. 373–385). The authors demonstrate that while the market had an accelerated dynamics in this period, with occasional slow-downs. While in the 1980s most of the issuing was done by governments of well developed countries, in the year 2000 time most of the Eurobonds were issued by banking institutions. Large industrial, utility, chemical or telecommunications companies were also issuing Eurobonds. Approximately 10% of the Eurobonds that were traded at the end of 1999 were issued by the European Investment Bank and by the International Bank for Reconstruction and Development. Most of the bonds received a very good rating from Standard and Poor's or Moody's. Straight bonds were about 71% of all Eurobonds issued between 1980 and 2000, floating rate notes were about 20%, 5% were zero rate bonds and 4% were equity-linked bonds.[4]

In the early 1960's the Eurobonds had an average pay-back period of 12 months, which later on grew to 10-15 years. In the 1980s, the bonds that matured within 5-10 years were half the total, those who had to be paid back within less than 5 years were 15% of the total, and those who matured in more than 10 years were 35% of all. By the 1990s the proportion of 5-10 years bonds dropped to 40% of the total, and the proportion of bonds which matured in less than 5 year grew to 30%. Over the years, most of the euro-bonds (75%) were issued in USD, but there were also euro-bonds in Deutsch Marks, Japanese Yens, or European Currency Unit (until 1999).

As demonstrated earlier, Eurobonds are different from foreign bonds. An issue of foreign bonds is a debt contracted on the domestic market by a non-resident corporation, state authority or financial institution, according to domestic financial regulations of that country and often using the domestic currency (Cerna, S., 2002, p. 131). Foreign bonds issued on the American market are called *Yankee Bonds*, those issued on the Japanese market are called *Samurai Bonds*, on the English market they are called *Bulldog Bonds*, on the Spanish market they are called *Matador Bonds* etc. Nowadays however, with the lowered restrictions of capital mobilization, eased currency exchange and uniform national regulations, these distinctions have been rendered irrelevant for all practical purposes.

In London and Paris there were foreign bond markets ever since the 1820s, but it was not until end of the Second World War that their development started to become significant. In the last four decades, the unbalance of Balance of Payments, the current account surpluses of some countries and the highly restrictive credit policies of some countries led to the development of these markets.

At the end of the 1950s, most foreign bonds were issued through the New York market, via American investment banks and totaled somewhere between 500 Mio and 1Bio USD. In the early 1960s, most of the foreign bonds were issued in the European countries. The Belgian company Petrofina issued via a syndicate of European banks one of the first successful foreign bonds, by which about 25 Mio USD were mobilized (Roberts, R., Arnander, C., 2001, p. 7).

In the middle of the 1990s an alternative to the Eurobonds appeared, called Euro Medium Term Notes – EMTN. They were meant to fill the gap of financial instruments that was between short terms commercial papers and long term instruments such as bonds. These hybrid financial instruments give a much higher flexibility than Eurobonds, as dealers can place them directly to investors, without going through bank syndicates or costly setups. They can be issued continuously, according to necessity, "on tap", with maturing deadlines that can be extended or realized earlier at any time.

As the classic definitions start to wear out and the modern day financial arrangements grow in complexity, the statistical data of the Bank of International Settlements can no longer distinguish between Eurobonds and foreign bonds, but gather them under the title of "international bonds" (which make up the international medium-long term debt securities along with medium term notes) - Benzie, R., 1992, p. 90-91.

Tab. 1 Annual international medium-long term debt securities issued (Net amounts, Bio. USD), broken down on an yearly basis

	1992	1994	1996	1998	2000	2002	2003	2004	2005	2006
Total. of which:	**151.3**	**285.4**	**512.5**	**678.4**	**1241.1**	**1024.1**	**1439.0**	**1613.5**	**1849.2**	**2782.9**
Developed countries	115.3	208.4	382.4	572.9	1094.7	943	1357.5	1512.8	1681.5	2367.3
% of total	76.2%	73.0%	74.6%	84.4%	88.2%	92.1%	94.3%	93.8%	90.9%	85.1%
Other countries	12.8	28.7	84.7	40.2	41	29.8	28.9	52.9	49.8	84.6
% of total	8.5%	10.1%	16.5%	5.9%	3.3%	2.9%	2.0%	3.3%	2.7%	3.0%
Off-shore centers		38.6	19.3	10.2	82.5	29.4	29.4	24.8	86.5	320.8
% of total	0%	13.5%	3.8%	1.5%	6.6%	2.9%	2.0%	1.5%	4.7%	11.5%
International org.	23.2	9.8	26	55.1	22.8	21.8	23.2	23.1	31.5	10.3
% of total	15.3%	3.4%	5.1%	8.1%	1.8%	2.1%	1.6%	1.4%	1.7%	0.4%
Issuers:										
Companies	24.7	21.4	48.9	126.8	172.6	60	110.6	71.5	52.8	245.2
% of total	16.3%	7.5%	9.5%	18.7%	13.9%	5.9%	7.7%	4.4%	2.9%	8.8%
Governments	83.1	107.9	108.3	126.7	245.3	99.2	124	152.5	131.6	95.4
% of total	54.9%	37.8%	21.1%	18.7%	19.8%	9.7%	8.6%	9.5%	7.1%	3.4%
Financial organizations	43.5	156.1	329.1	369.8	800.4	843.1	1181.2	1366.5	1633.4	2432.1
% of total	28.8%	54.7%	64.2%	54.5%	64.5%	82.3%	82.1%	84.7%	88.3%	87.4%
Maturity:										
Short term	40.40	140	265.1	9.8	152.1	1.6	75.3	61.3	49	167.7
Medium and long term*	110.90	145.4	247.4	668.6	1088.90	1022.50	1363.70	1552.2	1800.3	2615.2
Of which:										
- Floating rate notes			86.3	173.1	356.8	208.5	384.2	637.3	666.2	1290.4
% of total			34.9%	25.9%	32.8%	20.4%	28.2%	41.1%	37.0%	49.3%
- *Straight fixed rate*:			157.4	479.6	715.4	801.7	958.6	921.1	1153.7	1318.7
% of total			63.6%	71.7%	65.7%	78.4%	70.3%	59.3%	64.1%	50.4%
- *Equity related*			3.7	15.9	16.7	12.3	20.9	-6.2	-19.6	6.1
% of total			1.5%	2.4%	1.5%	1.2%	1.5%	-0.4%	-1.1%	0.2%

Source: BIS Quarterly Review 1997-2007, available at www.bis.org, BIS Annual Report 1997, p. 125 and own calculations,

* International medium-long term debt securities (Euro-bonds, foreign bonds medium term notes (Euro Medium Term Notes - EMTN).

Note: The „-„ sign is meant to indicate the fact that the matured bonds have a greater value than the newly issued.

The total amount of international medium-long term debt securities evolved from 52 Bio. USD in 1981 (77% of which benefited the developed countries, 9.43%

were for the benefit of developing countries and 13,58% were issued by international organizations - Saini, K. G., 1986, p. 4) to a value of 2,615.2 Bio. USD registered at the end of 2006 (tab. 1).

From table 1 you can see that as far as developing countries are concerned, the amount of debt securities issued had ups and downs, and so did the amount of Eurobonds, foreign bonds and EMTNs, with a decreasing trend starting from 1998 and which did not reverse until the recent few years. In 2006 the absolute value of debt securities issued is among the greatest of this interval, but only makes up 3% of the total. The countries of Central and Eastern Europe were among the most active on this market in the last decade.

Another visible trend is the decreased participation of the international organizations, which in the year 2006 only had a proportion of 0.4% of the total market, and a proportional increased participation of off-shore centers (corporate issuers located in Bahamas, the Cayman Islands, Bermuda, Aruba, etc.)

The foreign and sovereign bonds have also fluctuated in terms of absolute value and clearly decreased in terms of market share. Based on the data of table 1, one can say that the sheer majority of resources from this market were attracted by financial institutions (banks a.o.) from developed countries (especially the USA, Great Britain, Netherlands, France, Spain and Germany).

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The development of foreign bond markets and Eurobonds markets express the trend to remove intermediaries, but it does not alienate the banks from the process of financing entities via external funds, as they are the ones administering the entire operation. Approximately 200 banks worldwide participate in a syndicate of Eurobonds placement, as either lead manager or member of the syndicate (Claes, A., De Ceuster, M.J.K., Polfliet, R., 2002, p. 373–385).

Conclusions

The euromarkets have been one of the most important stimuli of the financial globalization. Until the 1960s the domestic financial markets were relatively isolated from the international market. After this period the markets began to expand across the borders, a process which was accelerated by the appearance of euro-currencies. After the market of Eurocurrencies was set up, also the markets of Eurobonds, Euroshares and Euroloans were formed. From the data analysis, we noted the continuous increase of activity on the international market of debt securities. Even though the developed countries attract most of the resources, in the last years the developing countries of Latin America have made a come-back, and also the other emerging countries such as China, Russia or India intensified their participation.

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[1] The unofficial story says that the *euro* prefix is derived from the „Banque commerciale pour l'Europe du Nord" – of London, used by the USSR during the Korean war to store the dollars accumulated during the war, which could not be deposited within the US territory due to the risk of nationalization
[2] The syndicate purchases the bond and re-sells it to individual or organizational investors. The syndicate can be made up of up to 25-40 banks and is divided in a management group, a subscription group and a reselling group.
[3] The British authorities encouraged the development of these markets, as London's role as a financial center had diminished as the British pound had lost a lot of its importance as a result of the crisis of 1957;
[4] Hybrid instruments that contain a *warrant* that gives a purchase option for stocks of the company issuing the bonds, for a fixed price or an option to convert the bonds into stock. Often the warrants can also be traded separately.