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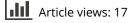
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## Market Development Determinants for Corporate Bonds in National Currencies: Emerging Markets Review

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#### ABSTRACT

Our paper offers analysis of tendencies and determinants of development of local currency corporate bond markets in the period from 2006 to 2015. We consider a wide range of macroeconomic and institutional factors for 15 bond markets. The sample consists of 600 country-quarter observations. Multifactor linear regression models and the generalized method of moments are applied for the balanced panel data. Our analyses reveals that inflation and its stability, exchange rate, and market capitalization have a significant influence on the share of local currency bonds. Financial and macroeconomic instability stimulates the growth of local currency bond markets.

#### ARTICLE HISTORY

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#### **KEYWORDS**

Bond markets in national currencies; corporate bond markets; determinants of bond market development; developing countries

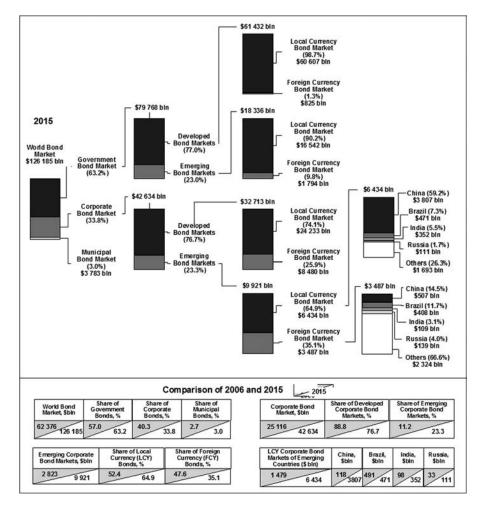
### Introduction

Operating on borrowed capital remains one of the key economic ideas that, in the course of over 50 years, provided growth and satisfied the interests of beneficiaries, companies and countries. Rapidly growing local (i.e., national) corporate bond markets are an important source of funding for issuers from developing countries. Although the total size of the world bond market increased only by two times from 2006 to 2015, the size of the local currency corporate bond market of emerging countries increased by 4.4 times for the same period and reached 6434 billion USD by the end of 2015<sup>1</sup> (Figure 1; Source: Bloomberg Database). Some of the big issues to be tackled are whether the different size of the bond market is influenced particularly by the economy size, the rate of economic growth, the level of institutional development, inflation stability, and movement of the currency.

The aim of our paper is to reveal tendencies and determinants of growth of local currency corporate bond markets in the period from 2006 to 2015. This period is characterized by macroeconomic and financial shocks: the 2008–2009 global financial crisis, the European crisis of 2010 and the difficult financial situation in oil-exporting countries after the drop in oil-prices since

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**Figure 1.** World Structure of Bond's Markets Statistics (Outstanding Bonds, December 2015) *Source*: Bloomberg Database, authors' calculations. *Notes*: The scheme above is based on Bloomberg's data about volumes of government, corporate and municipal bonds of issuers from 175 countries worldwide. For each country the amount of all the bonds outstanding at 31 December 2015 is calculated (separately for bonds denominated in local and foreign currency), than the aggregate volumes of developed and emerging bond markets are found.

mid-2014 (Russia, Brazil, Indonesia). Cross-country econometric research reveals the influence of such factors as macroeconomic and financial stability (inflation and currency exchange rate stability), a country's financial sector development level (market capitalization), and changes in sovereign credit ratings (Moody's, Fitch, Standard and Poor's) on the relative size of corporate markets in national currencies.

Recent years have shown examples of positive steps on the part of emerging markets towards bond market development in spite of previous instability and high inflation rate (e.g., Mexico and Brazil). But even under relatively high inflation (Russia, India, Argentina, Pakistan), bond markets of some countries demonstrate high growth rate.

For a long time developing countries' debt with fairly long maturity (5–7 years) which was available for global investors has been denominated in foreign (USD) rather than national currencies. Bonds issued in developing countries and denominated in USD were especially attractive for global investors since such bonds demonstrated higher yield compared to those issued by US issuers. As a result, some issuers from developing countries attracted excessive amounts of loans in foreign currency, thus disturbing the currency mismatch between their assets and their liabilities. These imbalances are minor in periods of fixed or stable exchange rates, in times of rapid economic growth, but under devaluation of national currencies the debt of borrowers from developing countries grows substantially, which leads to defaults and bankruptcies.

Our analysis of bond markets demonstrates that the main reason for imbalance in proportions between assets and cash flows, as well as in debt obligations in foreign currency connected with these disproportions of currency risks, has been the weakness of national bond markets and the abundance of foreign investors on these markets. Actually, in the 1990s, bond markets in national currencies were so weak that many analysts doubted their growth potential. By the mid-2000s, the situation began to change and by 2015 emerging bond markets became quite important in the financial market sphere (Figure 1). Corporate local-currency bond markets strengthened substantially, reaching 59.3% of total volume of corporate bonds outstanding. In our research we both make cross-country comparison of corporate bond markets in national currencies and reveal the significance of factors supporting the growth of such markets.

This paper makes an empirical contribution to the analysis and clarification of determinants of the development of the local currency bond markets. Unlike previous studies (Claessens, Klingebiel, and Schmukler 2007; Fidora, Fratzscher, and Thimann 2007; Bhattacharyay 2013), we consider a wide range of macroeconomic and institutional factors, as also as indicators of financial sector development. Most previous studies are based only on the multi-factor linear regression analysis, and do not take into consideration that the bond data may be endogenous to the macroeconomic data. We apply not only the multi-factor linear regressions, but also the generalized method of moments (GMM) allowing us to overcome this problem.

Our research consists of two parts. In the first part we analyze the role of corporate bond markets (both primary and secondary) of developing countries (including Brazil, Russia, India, China and the S. Africa (BRICS) and oil exporters) on the global bond market in 2006–2015 and the proportion of bonds in local and foreign currencies. In the second part we