The International Government Bond Market

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Abstract: The international financial market is formed by ensembles of markets on which are transacted primary instruments and derivate instruments. In this whole the international government bond market has a central role, assuring the mobilization of some important financial resources, on a long period. Much more complex, the bond issuing on international market is realized by a specific and complex mechanism. The international government bond market isn't a new creation, the bonds issued by governments being transacted on the international market from hundreds of years. The bonds remain the main financing channel, accessible unfortunately mostly to the developed countries, even though more and more emergent markets became attractive to investors. The financing trough bond issuing represents the most complex and efficient way of international financing, assuring the mobilizing and circulation of an important volume of financial resources.

Keywords: international government bond market, financial resources, international market

Jel Classification: P34, P43

1. Introduction

Governments bonds are usually referred to as risk-free bonds, because the government can raise taxes or simply print more money to redeem the bond at maturity. Some counter examples do exist where a government has defaulted on its domestic currency debt.

The international government bond market isn't a new creation, the bonds issued by governments being transacted on the international market from hundreds of years. Kings and emperors were loaning for financing their wars. For example, in the XIXth century, Edward Ist financed his wars by selling bonds in Italy, those being subscribed by the famous families of local bankers. Some centuries after, the big coalition formed against Louis XIV and lead by Wilhelm of Orania was financed by a group of Holland families from Hague. Later, the Rothschild family became famous through the help that they shown in supporting the Englishmen efforts against Napoleon Ist, through the European family lath.

Even though, the public debt financing always had an international feature, there isn't yet a unified international government bond market. The international government bond market can be divided in four different markets:

- Internal government bond markets – the titles are issued by internal issuers and are denominated, usually in national currency;
- External government bond markets – the titles are issued by foreign issuers and are denominated, usually in the internal currency. The issuing and transaction of the external bonds are being done under the settlements and supervision of the market authorities from that country;
- Eurobond markets – the titles are subscribed by a multinational syndicate of banks, and are placed in more countries, generally in jurisdictions outside the currency country in which is denominated the issuing.
- Global bond markets – the titles are registered by the Securities and Exchange Commission in United States and are issued and transaction in North America, Europe and Asia. This market developed as a consequence of the globalization process, in the investor base as well as in the issuing currency, for surpassing the compulsions and the barriers between markets.

The external government bond issues on the national markets have a long history. The most important government bond external markets are represented by centres such as: New York, Tokyo, Zurich or London. The bond transaction on the international financial markets have specific names, like "Yankee" in United States, "Samurai" in Japan, "Rembrandt" in Holland, "Bulldog" in Great Britain or "Matador" in Spain. External bonds can include also external issues in other currencies than the national currency of the internal market. For example, "Shogun" bonds represent external bond issuing launched in Tokyo in other currencies than the Japanese yen. What differences the government bond external markets from the internal ones from the same countries is the lustre imposed by the settlement authorities between the two legislative systems. These differences can include different taxations, restraints regarding the structure of the issued bonds, the title volumes that can be sold, different requirements regarding the kind of information which the issuers must reveal to investors before the issuing, restrains regarding who can buy or subscribe bonds.

2. The difference between foreign bonds, external bonds and Eurobonds

The disappearance of exchange controls and restriction of capital flows made the distinction between Eurobonds and other bonds less relevant. However, the distinction between Eurobonds and foreign bonds is important.

Foreign bond - a foreign bond is a bond issued in a domestic market for a foreign borrower. Foreign bonds tend to be more regulated than Eurobonds and are usually issued by a domestic group of banks.

External bond - it is also important to notice that, strictly speaking, external bonds are neither foreign bonds nor Eurobonds. External bonds include foreign currency denominated domestic bonds, like the Japanese Shogun bonds, for example. They also include Eurodollars bonds, either issued by Japanese corporations (known as "Sushi bonds") or with an embedded currency option (known as "Heaven and Hell" bonds).

3. The international government bond market

Eurobond market is an off-shore market on which the creditors and debtors meet grace to the lower transaction costs, and to the lack of settlement. Eurobond market represent only a segment of what the specialists call "Euromarkets", that is off-shore capital markets, in the sense that the denomination currency of transactions is different by the currency of the country in which take place the transactions. From the beginning of the 80's, the transaction volume realized on the Eurobond markets surpassed the transactions on the government bond external markets, because this market isn't submissive to the settlement restrains from the internal markets. Beside the fact that the restrictive measures make internal markets less competitive than the supranational market, the technology advanced and the globalization process determined the financial centres demand on the world, contributing to strengthen the Euromarkets position.

Eurobonds represent financial titles that certify a debt relationship between the debtor and the creditor, similar to the debt titles used on the government bond internal markets. Among the main characteristics of this instruments are the following ones:

- Eurobonds register the debtor obligation to pay the interest and the capital rates, to the specified dates in the issuing prospect;
- Eurobonds are launched to long and medium due dates;
- Eurobonds are transferable instruments, being issued in un-externalized form as well as on the bearer;
- Eurobonds are created for being transacted on the secondary market;
- Eurobonds are launched, generally through a public offer and are listed to a stock exchange.

Each Eurobond must follow certain terms and conditions, which represent its structure. A typical structure includes about 20 terms and conditions as these. Some conditions are adapted to each mission, for reflecting the situation from the Eurobond market, the issuer characteristics or the particular circumstances of that kind of financing. Other clauses like the issuing form, making interest payments after the tax deduction, remain unchanged from a mission to another and are considered to be “the market practice”. The sovereign states issue this instrument, mainly under three forms:

- Eurobonds
- Euro Medium Term Notes
- Euro Commercial Paper – instruments on the monetary market with a due date smaller than 90 days.

The participants on the Eurobond market are the issuers - the sovereign states and the governmental agencies, intermediaries and the investors. The investors are generally, important institutional investors from the developed countries, but there are a significant number of individual investors. Allowance funds represent the main category of investors, and the demand exercised by these is prefigured to increase at once with the total assets, and specially, the extreme assets of these funds. The second important category of institutional investors is represented by the assurance companies, followed by the investment funds and by the commercial banks departments specialized in managing clients trust funds. Individual investors represent powerful segments on certain markets, as Japan and Belgium.

The function and the settle of the Eurobond market are assured by its intermediaries. Their association, which has a self-regulatory role of the market is called International Securities Market Association (ISMA) and replaced the Association of International Bond Dealers (AIBD). There is an association of the main subscribers on the primary Eurobond market – International Primary Market Association (IPMA), having also a self-regulatory role of the market.

The Eurobond issuing on the primary market, are taking place simultaneously in more international financial centres. Even though, as we already mentioned, the market is relatively free from governmental settlements, in some countries must be asked the authority permission before launching a bond issuing. Eurobond are listed, generally on the London or Luxembourg stock exchange, but their transaction is mainly realized on the decentralized Over the Counter Market, the investors being able to buy or sell titles in any country.

International Securities Market Association (ISMA)

A self-regulatory organization and trade association originally located in Zurich, Switzerland, that encourages systematic and compliant trading in the international securities market. It also promotes the development of the Euromarkets and is acknowledged as a designated investment exchange by the Financial Services Authority, which regulates the financial services industry in the U.K.

ISMA helped to establish standardized trading procedures in the international bond market. It had 430 members in 49 different countries, representing the major securities firms' entire active in the secondary international debt market.

The International Primary Market Association (IPMA) represents the lead managers of equity and debt securities in the global market of capital. Many big European banks and financial institutions have taken the membership of IPMA.

The main objectives of the IPMA are:

- To develop an efficient capital market in Europe.
- To provide protection to the investors of the capital market.

Basically, the International Primary Market Association looks after all the activities happening in the global primary market.

In 2005, the International Primary Market Association merged with the International Securities Market Association and formed the *International Capital Market Association* (ICMA), which develops the regulatory framework for the financial activities in Europe. The ICMA has over 400 members in almost 50 countries across the globe.

ICMA members are not only geographically widespread; they also vary considerably in size and type of activities. They range from the largest global investment banks with a presence in numerous countries, to small regional banks primarily servicing retail bond investors.

There is no central location where trading in the international capital market takes place. Despite the substantial development of electronic trading systems in the recent years, the majority of transactions are still executed 'over the counter' by market participants who are likely to be located in different countries. The market is also characterized by a wide variety of issuers, issuing currencies, credit quality, and the technical specifications of the securities themselves. ICMA maintains standards of good market practice in the primary markets and has developed standard documentation for new issues leading to greater efficiencies and cost savings for issuing banks. Due to its inherent cross border nature, the international capital market is not subject to the same degree of regulation that governs domestic primary and secondary markets. In this marketplace ICMA has, for some 40 years, performed a crucial central role by providing and enforcing a self-regulatory code of industry-driven rules and recommendations which regulate issuance, trading and settlement in the international capital market.

Investment Considerations

Investment decisions involve understanding the potential risks involved, particularly when investing internationally.

Foreign Exchange Risk - When investing in foreign currency Eurobonds, it is important to remember that exchange rates do fluctuate, sometimes dramatically, which will affect the total return on these investments in Canadian dollars. This fluctuation is partly priced into the international bond and currency markets - any excess yield on investments in one currency is normally accompanied by an expected decrease in the relevant forward exchange rate.

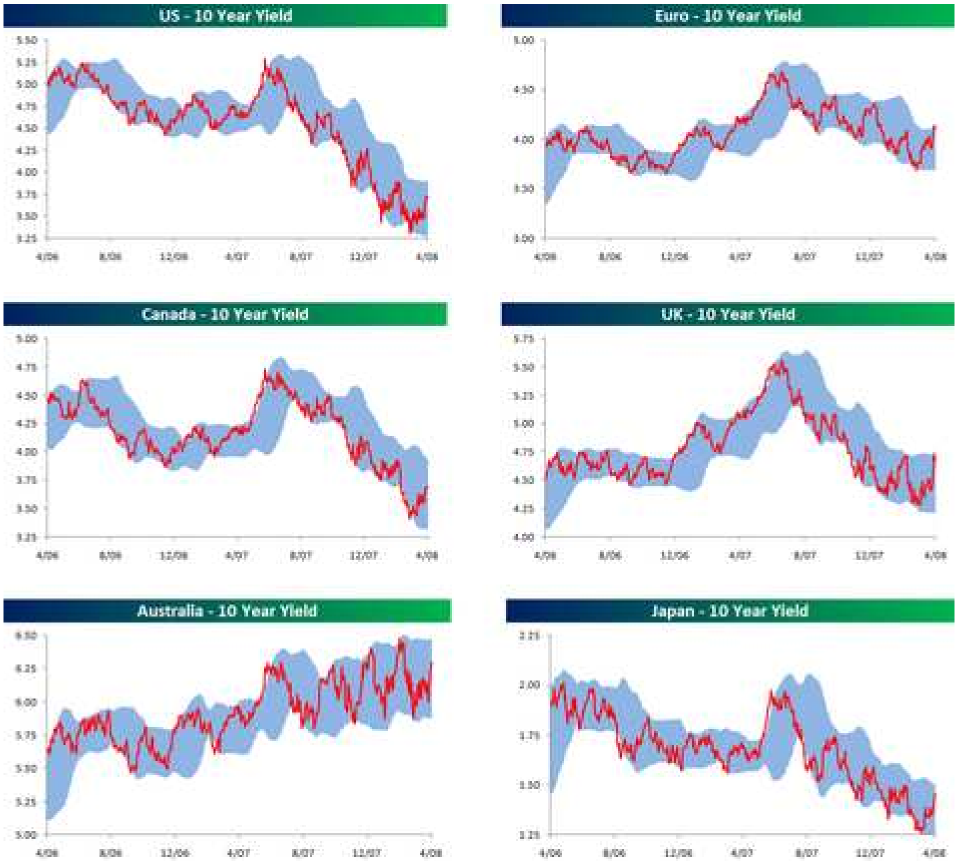
Political and Economic Risks - Political and economic change in foreign markets can have large implications for affected Eurobond issues. Such risks are also partly reflected in the yield on certain Eurobond issues.

Investment Specific Risks - Although most Eurobonds are issued by large, credit worthy companies or responsible, trustworthy governments, there are specific risks involved with any investment. It is important to be aware of any such risks - remember higher yields are usually a compensation for a greater level of risk.

International Long-Term Government Bond Yields

Below we highlight the 10-year yields on government debt for six international markets. With the exception of Australia, interest rates have been in steady downtrends since last spring. However, in many of these markets there are signs that this downtrend may be nearing an end, which could be a signal that investor aversion to risk may be waning.

While Treasury yields in the US, Canada, and Japan still have some room before breaking their downtrends, bond yields in Europe and the UK have already made higher highs.



Source: www.worldbank.org

The Eurobonds global market

The Eurobonds global market tries to resolve one of the major lacks of the Eurobonds issuing, and that is the lower liquidity. During many years, the Eurobonds issuers tried to access the more liquid internal markets like the one of United States and Japan. Obviously, the access on more markets facilitates the launching of some higher issues, which, if it is well placed, it assures a better liquidity, transaction spreads lower than on the secondary market and so, lower financial cost for the issuer.

Beside the settlement problems which were made by the "Yankee" market, there were also the one linked to the bearer form of many Eurobonds series. The World Bank realized a study, which showed that for many international investors the "anonymous statute" isn't so important. Based on this conclusion and on the changes occurred in the "Yankee" market settlement, the World Bank launched in 1989, a series of Eurobonds with a 10 years due date, simultaneously on the denominated Eurobond market in dollars and on the "Yankee" market. Those Eurobonds were the first global bonds. The main distinguish characteristic was the registered form, which respected the United States settlements. The global bonds were, though absolved by respecting the others requirements from the Glass Steagall law. The issue registered a big success, being transacted on the secondary market with low outputs than the World Bank bonds issued in United States or on the Eurobond market. More and mere states and companies copied the success of the World Bank, issuing global bonds.

Bond markets and long-term interest rates in non-euro area member states of the European Union

In the following tables it will be presented the market size in the in some non-euro area member states of the European Union, in January 2008, at the end of period stocks, on nominal value.

ROMANIA

Table 1

Instrument types					
	Total amount outstanding	**Money market Short-term**	**Bond market Long-term**		
Sector of the issuer		**t < 1**	**1 < t < 5**	**5 < t < 10**	**t > 10**
	€ millions				
Central government and other general government	3,451.1	0.0	449.6	1,656.3	1,345.2
Monetary Financial Institutions	1,357.2	515.0	836.4	5.7	0.0

Non-monetary financial corporations	-	-	-	-	-
Non-financial corporations	69.4	0.0	69.4	0.0	0.0
Total	4,877.7	515.0	1,355.4	1,662.0	1,345.2

Sources: National Bank of Romania, Ministry of Economy and Finance

BULGARIA

Table 2

Instrument types					
	Total amount	**Money market**		**Bond market**	
	outstanding	**Short-term**		**Long-term**	
Sector of the issuer		**t < 1**	**1 < t < 5**	**5 < t < 10**	**t > 10**
	€ millions				
Central government and other general					
government	3,578.3	0.0	199.1	961.7	2,417.5
Monetary Financial Institutions	450.6	15.0	292.6	143.0	0.0
Non-monetary financial corporations	428.5	179.0	197.4	50.7	1.5
Non-financial corporations	349.6	0.0	127.6	222.1	0.0
Total	4,807.0	194.0	816.6	1,377.4	2,419.1

Sources: EbJirapCKa HapOflHa 6aHKa (Bulgarian National Bank)

DENMARK

Table 3

Instrument types					
	Total amount outstanding	**Money market Short-term**	**Bond market Long-term**		
Sector of the issuer		**t < 1**	**1 < t < 5**	**5 < t < 10**	**t > 10**
	€ millions				
Central government and other general government	71,873.1	5,721.6	0.0	18,610.9	47,540.6
Monetary Financial Institutions	393,297.2	18,485.8	86,340.2	82,805.2	205,665.9
Non-monetary financial corporations	1,350.8	0.0	41.5	1,107.7	201.7
Non-financial corporations	19,016.1	743.0	1,152.4	5,244.4	11,876.2
Total	485,537.1	24,950.4	87,534.1	107,768.2	265,284.4

Source: Denmark's National bank

HUNGARY

Table 4

Instrument types					
	Total amount outstanding	**Money market Short-term**	**Bond market Long-term**		
Sector of the issuer		**t < 1**	**1 < t < 5**	**5 < t < 10**	**t > 10**
	€ millions				
Central government and other general government	53,846.1	8,517.8	8,858.0	14,199.1	22,271.2
Monetary Financial Institutions	7,733.5	42.6	707.9	4,685.4	2,297.6
Non-monetary financial corporations	247.7	0.0	247.7	0.0	0.0
Non-financial corporations	121.6	0.0	1.0	36.2	84.4
Total	61,948.9	8,560.3	9,814.6	18,920.7	24,653.3

Sources: Magyar Nemzeti Bank, KELER Rt, ÂKK (National Bank of Hungary)

P O L A N D

Table 5

Instrument types					
	Total amount	**Money market**	**Bond market**		
	outstanding	**Short-term**	**Long-term**		
Sector of the issuer		**t < 1**	**1 < t < 5**	**5 < t < 10**	**t > 10**
	€ millions				
Central government and other general					
government	113,281.6	6,622.4	15,070.4	34,375.4	57,213.4
Monetary Financial Institutions	10,993.2	5,962.6	717.6	1,472.6	2,840.4
Non-monetary financial corporations	1,159.2	310.6	790.7	54.3	3.7
Non-financial corporations	3,622.4	966.6	818.7	1,123.7	713.4
Total	129,056.4	13,862.1	17,397.4	37,026.0	60,770.9

Sources: Ministry of Finance, Narodowy Bank Polski, National Depository for Securities

S L O V E N I A

Table 6

Instrument type					
	Total amount outstanding	**Money market Short-term**	**Bond market Long-term**		
Sector of the issuer		**t < 1**	**1 < t < 5**	**5 < t < 10**	**t > 10**
	€ millions				
Central government and other general government	7,470.9	350.5	581.4	1,780.5	4,758.5
Monetary Financial Institutions	3,149.2	1,815.3	382.9	566.3	384.7
Non-monetary financial corporations	50.4	0.0	4.2	46.2	0.0
Non-financial corporations	412.8	0.0	18.0	213.4	181.4
Total	11,083.3	2,165.8	986.5	2,606.4	5,324.6

Sources: Central Securities Clearing Corporation, Bank Slovenije, Ministry of Finance.

SLOVAKIA

Table 7

Instrument types					
	Total amount outstanding	**Money market Short-term**	**Bond market Long-term**		
Sector of the issuer		**t < 1**	**1 < t < 5**	**5 < t < 10**	**t > 10**
	€ millions				
Central government and other general government	11,129.7	0.0	1,760.2	4,947.6	4,421.9
Monetary Financial Institutions	2,314.7	130.0	533.7	1,338.6	312.4
Non-monetary financial corporations	206.5	0.0	81.6	109.5	15.4
Non-financial corporations	638.7	0.0	46.9	465.3	126.5
Total	14,289.6	130.0	2,422.4	6,861.0	4,876.2

Sources: Agentura pre riadenie dlhu a likvidity, Nârodnâ banka Slovenska, (National Bank of Hungary)

UNITED KINGDOM

Table 8

Instrument types					
	Total amount outstanding	**Money market Short-term**	**Bond market Long-term**		
Sector of the issuer		**t < 1**	**1 < t < 5**	**5 < t < 10**	**t > 10**
	€ millions				
Central government and other general					
Government	609,165.9	29,051.7	18,123.8	87,721.7	474,268.6
Monetary Financial Institutions	955,671.2	482,072.8	312,354.5	161,243.9	-

Sources: Debt Management Office, Bank of England.

4. Conclusions

Despite the complexity associated with the bond market, a bond is simple and it might be consider a bit boring when compared with a stock. After all, a stock represents a piece of a company's wealth. An evaluation of a stock requires an evaluation of the entire company's worth. An ordinary bond is an agreement that merely entitles one party to make and another to receive a series of cash flows. While differences among forms of equity are small, there is a wide range of bonds; innovative financial engineers are creating new fixed-income securities almost continuously.

The Eurobond market has had a fantastic growth during the past 30 years. At its inception, in the early 1960s, the Eurobond market was mainly a Eurodollar bond market, that is, a market for USD bonds issued outside the U.S. Today, the Eurobond market comprises bonds denominated in all the major currencies and several minor currencies.

Together the foreign bond and Eurobond markets make up the international bond market.

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