



# **Linkage of Corporate Bond Market to Government Bond Market**

**1<sup>st</sup> Regional  
Workshop on Developing Government Bond Markets  
in Latin America**

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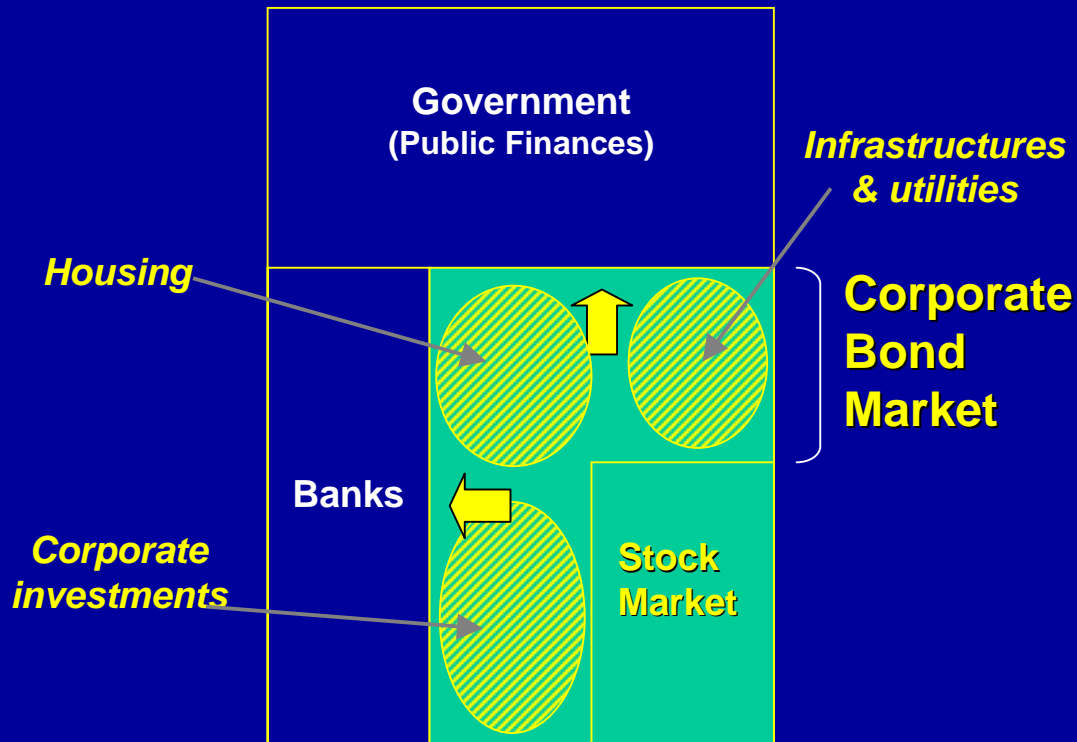
# Objectives of Corporate Bond Market

- Consolidating public finance
- Alleviation of stresses on the banking system ( Sound & strong banks)
  - Not piling up non-performing loans
  - Little maturity mismatch
  - (Little currency mismatch)
- “Long-term” debt capital
- “Long-term” investments
- Efficient capital reallocation

**Private  
Sector  
Development**

# Consolidation of Public Finance

## Increasing Roles of Corporate Bond Markets in Economic Development



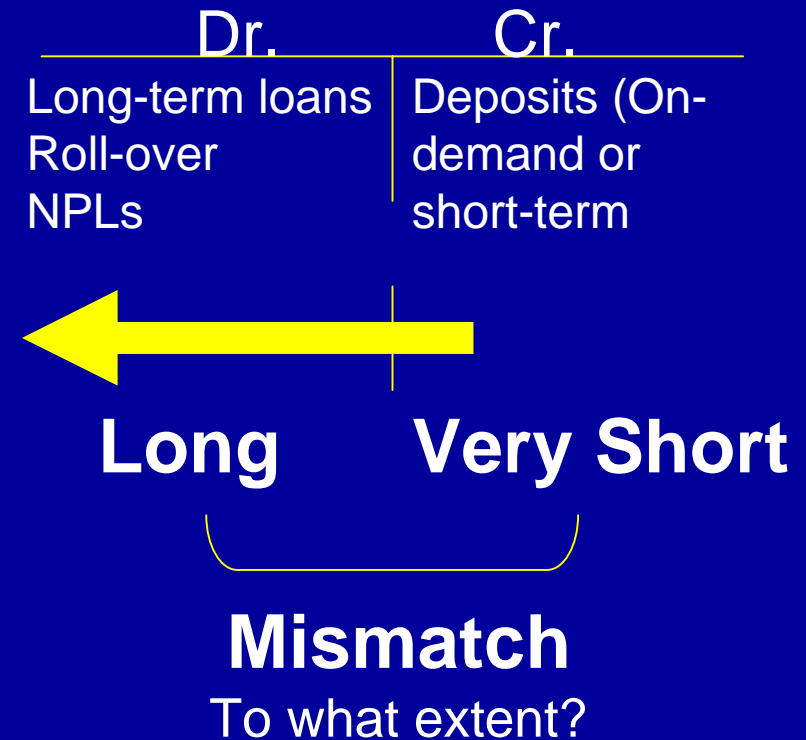
Corporate bond markets increasingly finance:

- infrastructures, utilities,
- housing,
- corporate investments, etc.

Public finances and bank loans increasingly give way to capital markets.

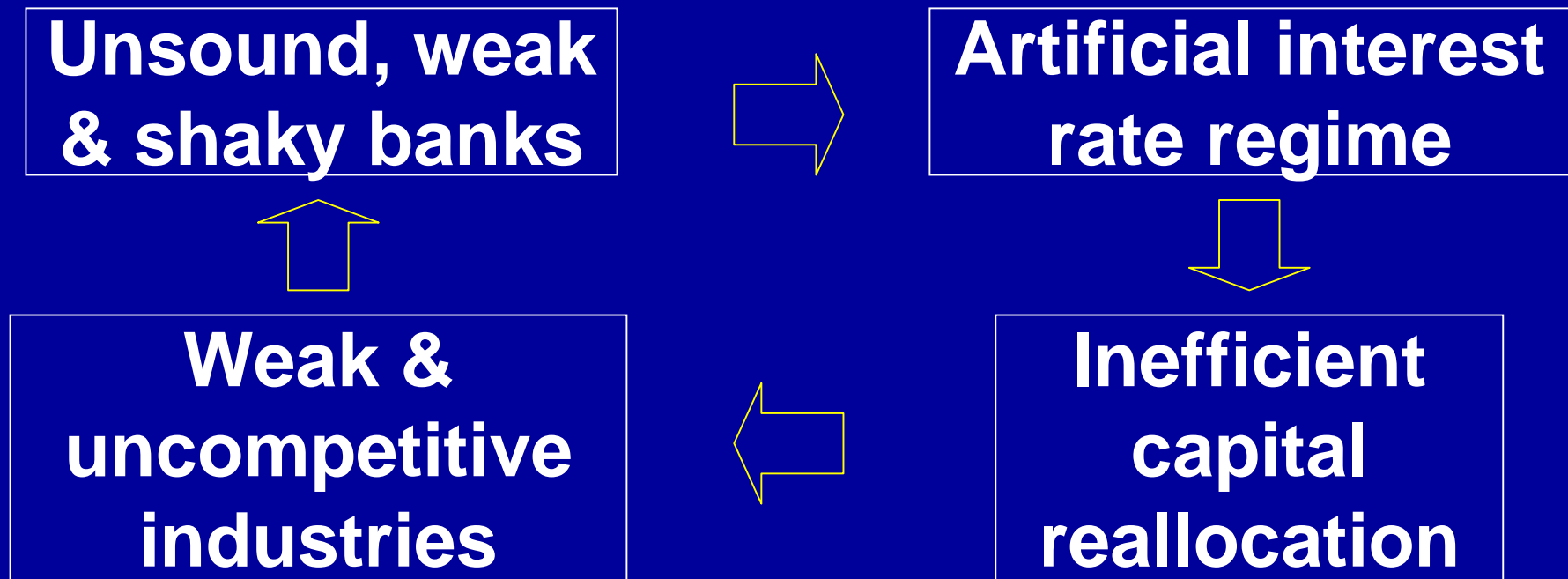
# ■ Alleviation of stresses on the banking system (1)

- Reduce “Maturity Mismatch”
- Increase “transparency”
- Diversify “credit risks” across the economy



# ■ Alleviation of stresses on the banking system (2)

## Vicious Cycle



# Composition of Bond Market

- Liquidity Matters?
- Major & Minor Corporate Issues
- Institutional Investors: Buy & Hold

# ■ Liquidity Matters?

- Should bonds be liquid?
- Should all of them be liquid?
- Can all of them be liquid?
- Which bonds can/should be liquid?
- What is the role of liquid bonds?

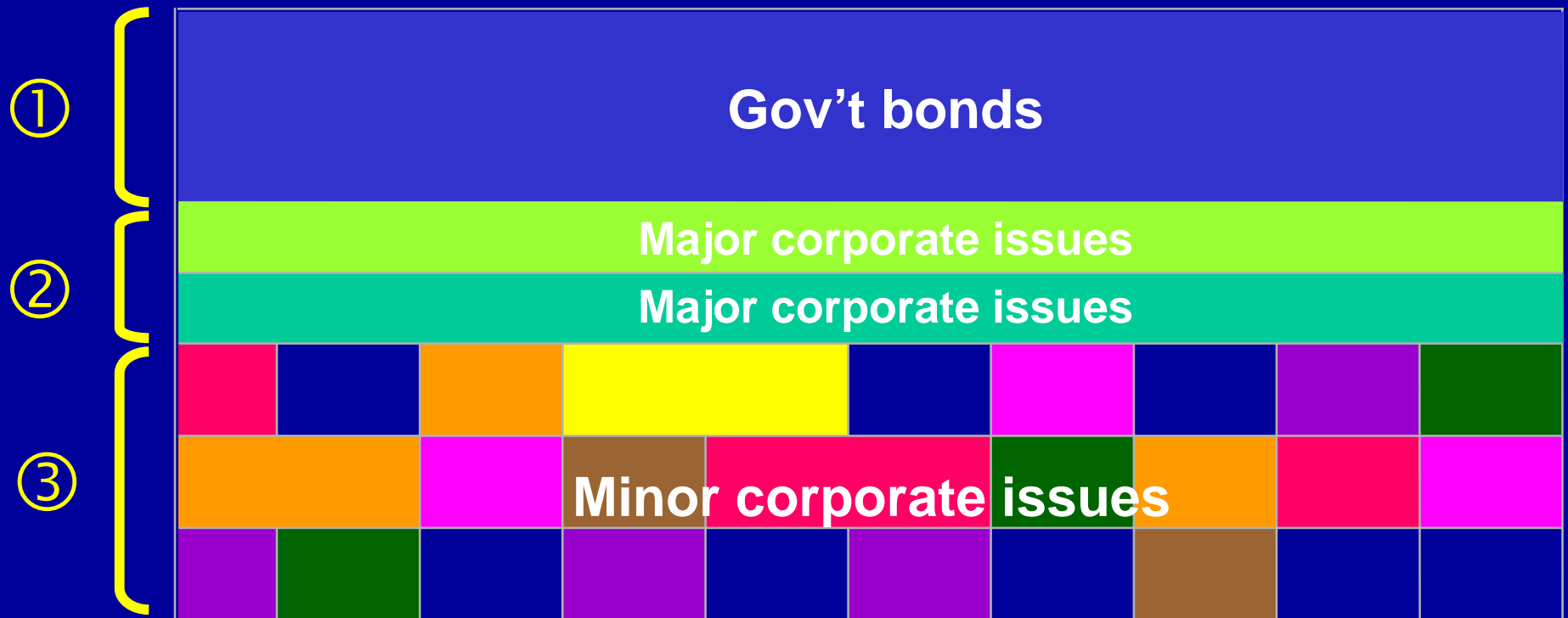
# A Quiz ?

- 400,000 corporate issues outstanding in the US market in 1996.
- What percentage of them did ever trade at least once in that year?

• **Only 4%\*!**

\* The Bond Market Association

# ■ Major & Minor Corporate Issues (1)

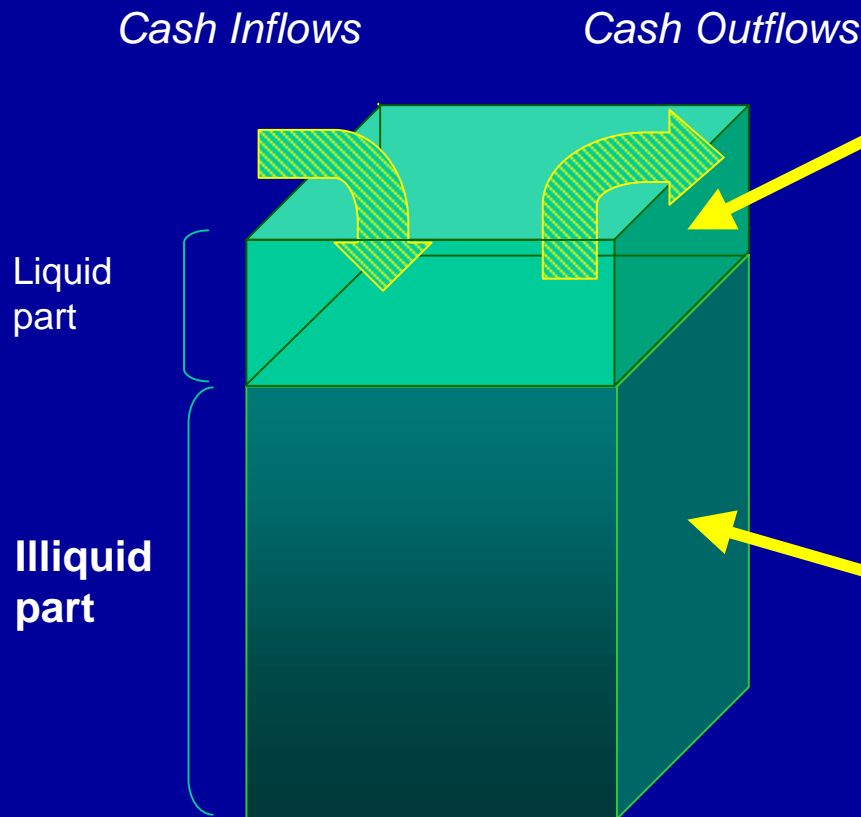


- Gov't bonds
- “Major” corporate issues (if any)
- “Minor” corporate issues

# ■ Major & Minor Corporate Issues (2)

		# of issuers
• <b>Government Bonds</b>	<b>Highly liquid</b>	<b>1</b>
• <b>Major corporate issues (if any)</b>	<b>Liquid</b>	<b>2~3</b> A small number
• <b>Minor corporate issues</b>	<b>Illiquid</b>	<b>Many</b>

# ■ Institutional Investors: Buy & Hold



- Money that frequently inflows and outflows is marginal to the whole investment portfolio.
- The rest does not need to stay liquid at all times.

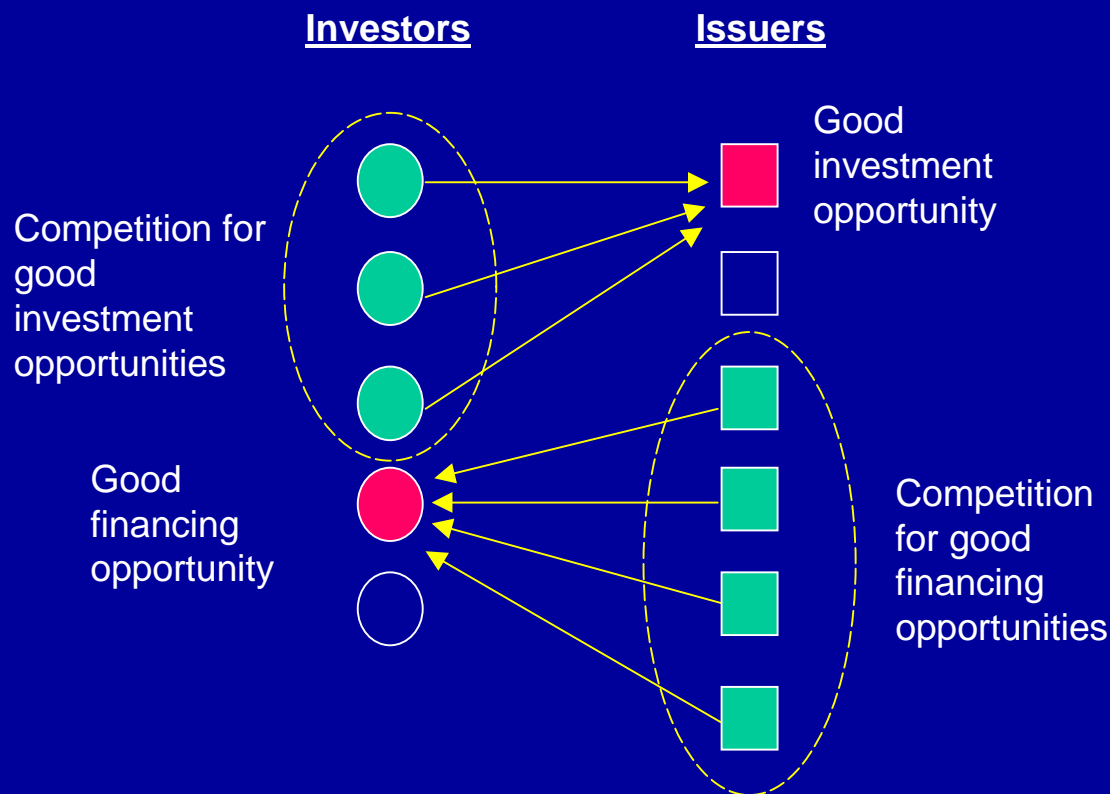
# Policy Implications

- Where does “auction” take place?
- Efficient Primary Market
- Key Policy Measures
- Sequence Model

# ■ Where does “auction” take place?

	Efficient <b>AUCTION</b> should take place in	<b>Conduces to efficient reallocation of capital</b>
<b>Liquid bonds</b>	Primary market	
	Secondary market	
<b>Illiquid bonds</b>	<b>Primary market</b>	

# ■ Efficient Primary Market



In an efficient primary market,

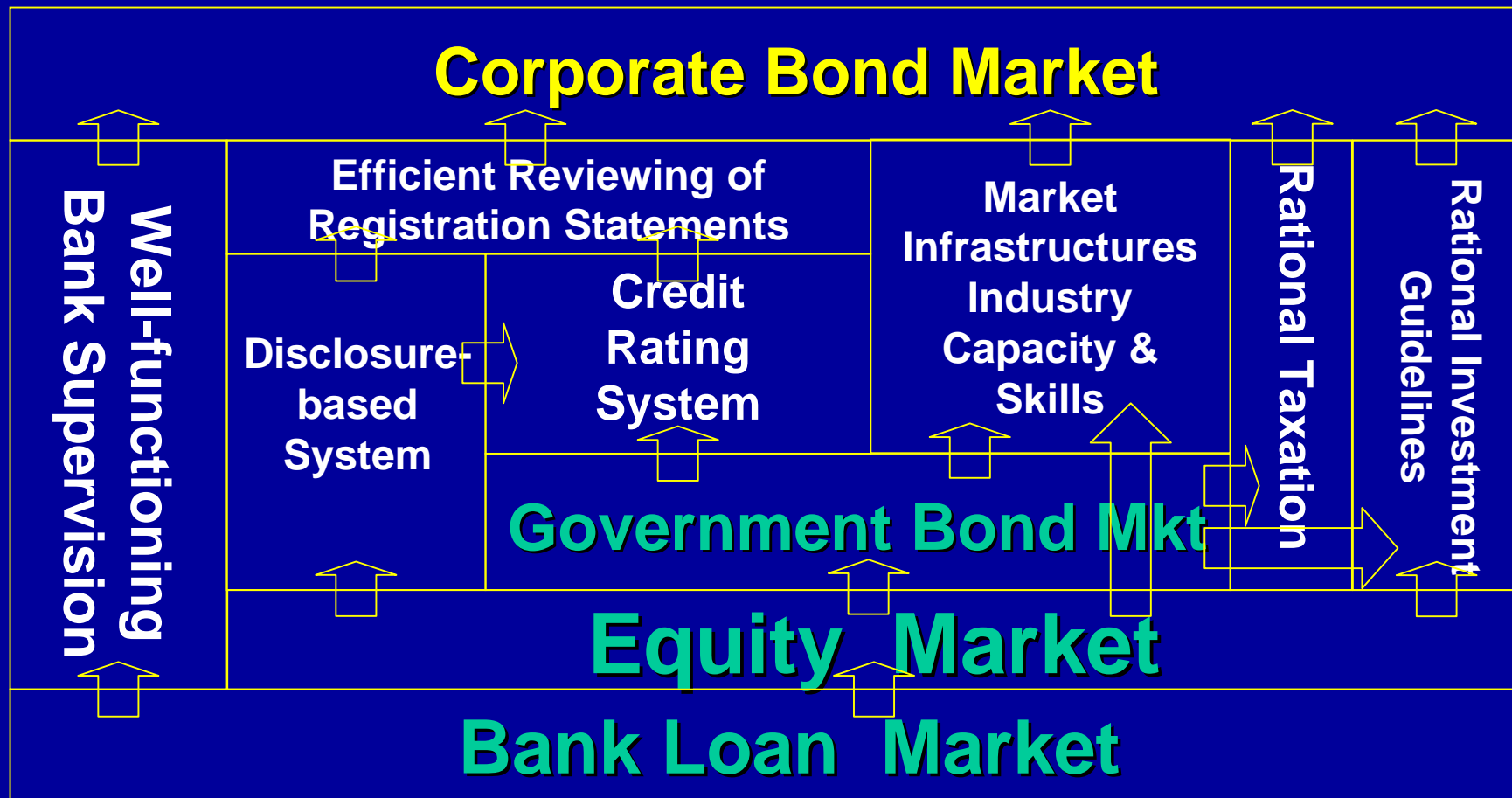
- investors are competing with each other for better investment opportunities provided by issuers, and
- issuers are also competing with each other for better financing opportunities provided by investors.

# ■ Key Policy Measures

- Well-functioning bank loan, equity & government bond markets
- Well-functioning bank supervision
- Simpler corporate authorization
- Disclosure-based system
- Efficient reviewing of registration statements
- Simple & minimal transaction taxes
- Credit rating system
- Rational investment guidelines

Focus on  
**Efficient  
Primary  
Market**

# ■ Sequence Model



***Thank You!***

**Tadashi Endo**