What Effect Has Bond Market Development in Emerging Asia Had on the Issuance of Corporate Bonds?

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Summary

Asian countries have small bond markets. By comparison with the United States, which had a bond market size of $2,914 billion, the eight Asian economies included in this study (which includes China, Hong Kong, Indonesia, Korea, Malaysia, Philippines, Singapore and Thailand) had $547.5 billion of bonds in it's markets in 2008. Even compared to other countries with emerging financial markets in Latin America the scale of bond markets in Asia in relation to broad money or domestic credit is small. This reflects the fact that firms in Asian countries have greater dependence on bank finance than firms in Latin America. Should this matter? Potentially it makes Asian countries more prone to the adverse effects of a credit crunch if there is an exchange rate depreciation, which limits the ability of economies to recover after a crisis. It has been estimated that for emerging markets in general credit supply falls by over 30 percent after a depreciation of 10 percent. Therefore it does matter, and Asian governments have started policy initiatives to allow financial markets to develop to avoid this amplification of shocks. They have done so by co-ordinating the issue and trading of sovereign and quasi-sovereign bonds since 2003 by allowing an Asian Bond Fund to purchase dollar and local currency government bond issues via the Pan Asian Bond Index Fund (PAIF) and the Fund of Bond Funds (FoBF). They have also improved the infrastructure as part of a wider Asian Bond Market Initiative (ABMI) to create a more integrated regional market. As a result the sovereign bond market has grown since 2003 by almost 50%.

Our paper asks whether this initiative has actually enhanced the issue of bonds by non-governments, in other words by firms issuing corporate bonds, and if so how. We begin by asking the question `what influences the probability of bond issuance by firms?' We recognize there are two influential drivers of this decision: firm-specific factors that enhance perceived creditworthiness of firms in bond markets such as firm growth, profitability, leverage etc, and market-specific drivers such as greater market size and liquidity that make bond markets operate more efficiently. These factors have direct effects on bond issuance. But policy initiatives such as the Asian Bond Fund (ABF) and the Asian Bond Market Initiative (ABMI) may also influence the market environment and since we have precise knowledge of the timing of these initiatives, we can explore their influence.

Our results show that firm-level effects have a significant effect on the probability that a firm will issue a bond; additionally, there is evidence of market variables - size and liquidity - have a small direct effect on this probability. The dominating influence on the decision to issue a bond, however, is whether the firm has previously issued a bond, which has fifteen times more influence than the next most important factor influencing the decision to issue. When we split the sample into pre-ABMI and ABMI periods, we find that there is surprisingly little evidence of any effect of the ABMI on firm's decisions to issue bonds compared to these other influences. Our conclusion is that bond market initiatives have had a limited indirect effect through firm-specific characteristics on the probability of a firm issuing a bond in the Asian markets.