DEVELOPING DOMESTIC DEBT MARKETS
TRENDS, CHALLENGES AND PRIORITY ACTIONS

WORLD BANK GROUP
Finance & Markets

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Domestic debt issuance has increased substantially in more developed EM countries since the early 2000s.

EM countries are shifting from issuing hard currency external debt to local currency domestic debt to avoid currency mismatches backed by strong fundamentals and benign international environment.

Local currency bonds consolidate as an asset class and are experiencing increased interest from global investors.

A new generation of EM countries is receiving increased attention from global investors.

J.P. Morgan launches GBI-EM, the first global EM index tracking local currency bonds issued by EM governments.

By end-2006, GBI-EM has the largest market capitalization in the EM category -- $693 billion against $299 billion for the EMBI Global.

J. P. Morgan introduces the Next Generation Markets Index tracking dollar-denominated government bonds issued by frontier markets (NEXGEM).
Domestic marketable debt levels remain low in developing countries compared to more developed EM countries

**Government domestic debt securities to total debt**

Estimated average based on sample of 22 DMF eligible countries

- **Domestic debt securities**: 26%
- **Other**: 74%

**General government domestic debt securities to total gross debt**

Estimated average based on sample of 13 more developed EM countries (non-DMF eligible)

- **Domestic debt securities**: 65%
- **Other**: 34%

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World Bank Group staff estimated based on data collected from Ministries of Finance and Central Banks.

World Bank Group staff estimates based on data from BIS Quarterly Review, December 2014 table 16B (domestic debt securities general government) and IMF WEO April 2015 (general government gross debt to GDP and GDP).
Average across 13 EM countries for end-2014: Brazil, China, Colombia, Hungary, Indonesia, Lebanon, Malaysia, Mexico, Peru, Philippines, South Africa, Thailand, Turkey.
Especially two external factors drive developing economies to enhance their domestic debt markets

- Reduced availability of concessional financing
  - Improved access to domestic financing when access to international concessional financing decreases

- Risks associated with large and volatile capital flows
  - Strengthened financial sector resilience through domestic bond market development
  - Better absorption of capital inflows through the government bond market
  - Improved ability to finance countercyclical fiscal stimulus under downturns
Three key benefits of local currency government bond markets are increasingly relevant for developing countries

**Finance development and growth**
- Improve and enhance impact of fiscal and monetary policies to sustain growth
- Finance critical social and development needs
- Provide savings/investment vehicles to a variety of investors (retail and institutional investors)

**Promote stability**
- Reduce reliance on external debt
- Facilitate counter-cyclical policies
- Enhance resilience to sudden reversals/stops of capital flows
- Improve asset-liability matching (currencies, rates, maturities)

**Financial sector development**
- Provide pricing benchmarks for private sector instruments
- Enable diversification from bank financing
- Provide safer, more liquid savings vehicles for individuals and institutions
Some common challenges to market development in developing countries

**Early stage**

- **Markets**
  - Underdeveloped primary market
  - Inefficient money market

- **Investors**
  - Narrow investor base
  - Untrained investors and low capacity

- **Transparency**
  - Absence of clarity about funding plans and operations
  - Lack of primary market transparency

- **Government capacity**
  - Low capacity and need for training
  - Lack of coordination between entities

- **Infrastructure**
  - Weak market infrastructure

**Deepening stage**

- Illiquid secondary market, poor primary dealer arrangements

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- **Infrastructure**
  - Weak market infrastructure
  - Lack of functionality and capacity
Priority actions to support government bond market development

**Early stage**

- Markets
  - Primary market, short-term market based issuance
  - Active money market
  - Liquidity through buy-backs, exchanges, repos
  - Capacity building

- Investors
  - Increased transparency (e.g. financing plans, auction calendars)
  - Encourage long-time horizon

- Transparency
  - Coordination between MOF, CB, DMO

- Government capacity
  - Consistency/coordination among regulators, policies promoting market development.

- Infrastructure
  - Basic enabling infrastructure

**Deepening stage**

- Gradually lengthen the yield curve
- Promote secondary market liquidity, primary dealer arrangements
- Secondary market trading venue
The WBG supports domestic debt market development - until now predominately in more developed EM countries

- Targeted technical assistance
  - To address specific issues
  - As comprehensive programs to address broader objectives

- Peer Group Dialogues
- South-South collaborations
- Conferences
- Training / webinars
- Handbooks
- Guidelines
- Tools
Support to LICs and LMICs is now being scaled up - amongst others through the DMF II

A sequenced approach to government debt market development

- Diagnostic assessment of market development identifying strength and weaknesses
- Preparation of actionable reform plan based on outcomes from the assessment
- Training and capacity building to prepare implementation of reform program

Assessment and scoping → Actionable reform plan → Capacity building

- Countries may particularly benefit from assistance when:
  - Expect reduction in concessional financing
  - Require a deeper local market to contribute to broader financial sector development
  - Need a local market to support implementation of fiscal and/or monetary policies
  - Subject to risk associated with large and volatile capital flows
- Thank you -

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