Financial Globalization: Implications for Data Needs

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Topics of Discussion

- Changing Global Financial Landscape
- Implications for EM Local Bond Markets
- Capitalizing on the Positive Dynamics – Enhancing Information Flow in EM Countries
I. Changing Global Financial Landscape
Structural Changes in Global Financial Markets Impacting EM Countries

- Financial globalization and financial deepening

- Reduction of home bias and global investor focus on EM countries is a secular trend

- Foreign institutional investors taking exposure to local emerging market beyond cash markets via offshore and derivatives transactions

- Recent financial market turmoil highlights how information gap hobbles effective decision making and risk assessment
Financial Globalization

Total Global Capital Inflows

In billions of U.S. dollars (left scale)

In percent of world GDP (right scale)

Source: IMF staff calculations based on IFS and WEO.
Global Financial Deepening

Global Financial Assets
(In trillions of U.S. Dollars)

- Equity Market Capitalization
- Bond Market Capitalization
- Bank Lending

Sources: IMF staff estimates based on EMDB; WFE; Datastream, Bloomberg and BIS.
Global Investors In Emerging Markets

• Underlying exposure is even larger because of the use of derivatives

Foreign Investor Participation in Local Bond Markets
(end-2006 1/)

Source: BIS, AsianBondsOnline and IMF estimates.
1/ Except for Indonesia (Jun-2007).
Recent Sub-Prime Mortgage Crisis Offers Some Perspective

- Globalization also increases the potential for markets and business cycles to be more correlated in times of stress.

- Slicing and dicing of risk amplify concerns over the location and magnitude of losses.

- Dispersal of risk and lack of information increases uncertainty, that can be manifested in high risk premium in even the most liquid segments of markets.

- Linkages to emerging markets may come from 1) higher price of risk generally; and 2) selling ‘other’ assets to meet collateral (margin) calls.

- Accurate and timely information about the underlying risk are critical in the market’s ability to price risk.
II. Implications for EM Local Bond Markets
Rapid Local Bond Market Growth

Outstanding Domestic Bonds
(in billions of U.S. dollars)

Source: BIS
Rapid Derivative Market Growth in Some EM

Global Trading Volume of Exchange- and Over-the-counter Traded (OTC) Derivative Contracts
(Daily averages, notional amount in millions of US dollars)

Sources: BIS, country exchanges, ISDA, WFE, staff estimates.  
1/ OTC data was obtained for the years 2001 and 2004, while data on exchange-based trading stems from annual trading activity in 2002 and 2005.
EM Local Bond Markets Are Still Evolving As An Asset Class

**Supply**
- Domestic debt growth in EM outpacing External Debt
- EM sovereign external debt markets seeing a decline in supply
- Local government bond markets have developed rapidly
- “Crowding in” of the private sector bond markets

**Demand**
- Growing EM institutional investor base
- Cross-border investments from MM institutional investors
- Liberalization of investment regulations in the EM universe

Key challenge is to have the capacity to generate asset in EM countries
Domestic Institutional Investor Base Is Growing

- Higher institutional savings within EM countries
  - Pension fund reforms in EM Latin America and provident funds in Asia growing.

Pension Fund Assets in Selected Countries, 2005

(In percent of GDP)

Source: Investment Company Institute, European Fund and Asset Management Association, National Mutual Fund Association, OECD, Local insurance regulation institutions, IFS and WEO.
Key Policy Issues

- Financial stability implications of the changing composition from foreign to local currency issuance.

- New risks and exposures both for borrowers and investors (resident and non-resident) have emerged.

- Spread of new instruments make risk monitoring more challenging.

- Data shortcomings are a major policy issue.
III. Capitalizing on the Positive Dynamics –

Enhancing Information Flow in EM Countries
What can be done?

- Strengthening Local Bond Market Data
- Broadening Coverage to the Derivatives Markets
- Tracking the Investor Base
- Discerning Investor Asset Allocation Behavior
- Addressing Information Gaps In Cross-Border Capital Flows
Strengthening Local Bond Market Data

- Data foundations: size, maturity structure, depth and liquidity; information on primary issuance and secondary market trading.

- Generally, it is easier to obtain stock market data, as trading is largely concentrated at exchanges. Bond markets are more fragmented and data are less centralized.

- EM international bond market data is more comprehensive than domestic bond market data.

- But EM local bond market data coverage is limited in terms of existing data on instruments and individual securities.
Strengthening Local Bond Market Data

- **Market Size**: BIS, ECB
- **Maturity/Currency**: Limited, Private Debt Managers
- **Issuance**: Bloomberg and Dealogic
- **Second Market Activity**: EMTA
- **Market Indicators**: Limited, GBI-EM
- **ABS**: Limited, Dealogic
Break downs by country of issuance, sector and remaining maturity for domestic securities (government, corporate, and financial institutions).

Only aggregated information on amounts outstanding and net new issuances.
- Information on individual securities and their characteristics not available (e.g. average maturity, terms). They can be made available to BOP compilers.

The coverage of the corporate bond market is often weak.
Liquidity indicators like trading volume, turnover and bid-ask spreads are not comprehensively covered.

The Emerging Markets Trade Association (EMTA) monitors and publishes data on trading volume. But these data are based on the survey of market participants mainly of foreign investors and dealers.

EMTA database is weak on the Asian region, which partly stems from restrictions of foreign participation in the local bond markets. However, AsianBondsOnline is good source of such data.
Broadening Coverage to the Derivative Markets

- The derivative market is an integral part of capital market development.
- Data availability on EM derivative markets is weak.
  - Both OTC and exchange traded data are available on outstanding amounts of foreign exchange, interest rate, and credit derivatives.
  - No unified source of information.
  - Improve documentation and accounting for OTC
- Key Sources: BIS, BBA, ISDA, WFE
Tracking the Investor Base

- Local debt market statistics are primarily covered from the borrower/issuer side.

- Need for a centralized and consistent database on domestic institutional investor assets (by investor type and by the allocation into asset classes).

- Weak Coverage of AUM of EM institutional investors.

- Data shortcomings in cross-border institutional flows.
Discerning Investor Asset Allocation Behavior

- Asset allocation is critical to understanding the investor decision-making process, its implications on asset prices and volatility of capital flows.

- More disaggregated data on both the investor base and the asset class they are investing in needed.

- EM institutional investors are restricted in their investment allocations. But with liberalization gathering momentum, there will be a need to track them.

- Asset allocation of foreign institutional investors will also need to be monitored more carefully.
Addressing Information Gaps in Cross-Border Capital Flows

- A general difficulty in obtaining accurate and timely information on the cross-border activity of the non-bank private sector, although BOP coverage of such data in many countries is available on a quarterly basis.

- The data problem is prevalent across MM and EM countries.

- In a world of increasing capital flows, the need to cover non-bank private sector activities has become more important.

- The CPIS database developed by the IMF is helpful. However, it is survey-based and it still needs to expand coverage to provide desired comprehensiveness.
Ongoing Initiatives By IMF and other IFIs

- Reporting on external positions (IIP in SDDS).
- Enhancing CPIS data coverage.
- WB / IFC databases (EM database on financial sector indicators).
- Coordinated Direct Investment Survey at end-2009.
Summing up…

- Place high priority on collection of timely data needed to enhance surveillance capabilities and ensure financial stability.

- It is in the interest of the EM countries to enhance the information flow (investor relations, disclosure, transparency).

- Ensuring data consistency across sources and countries will help the compilation of higher quality and comparable data.

- Integration of aggregate data across different sources into a centralized system (IFI initiatives).

- It would be beneficial to encourage non-bank private institutions to disclose data for market use (surveys etc).