GLOSSARY

Balance sheet mismatch	A balance sheet is a financial statement showing a company's assets, liabilities, and equity on a given date. Typically, a mismatch in a balance sheet implies that the maturities of the liabilities differ (are typically shorter) from those of the assets and/or that some liabilities are denominated in a foreign currency while the assets are not.
Banking soundness	The financial health of a single bank or of a country's banking system.
Benchmark issues	High-quality debt securities, typically bonds. Investors use their yield for comparison purposes and to price other bond issues.
Capital account liberalization	Removal of statutory restrictions on cross-border private capital flows, an important part of financial liberalization. In particular, the relaxation of controls or prohibitions on transactions in the capital and financial accounts of the balance of payments, including the removal of foreign exchange convertibility restrictions.
Carry trade	A leveraged transaction in which borrowed funds are used to buy a security whose yield is expected to exceed the cost of the borrowed funds.
Collective action clause	A clause in bond contracts that includes provisions allowing a qualified majority of lenders to amend key financial terms of the debt contract and bind a minority to accept these new terms.
Contagion	The transmission or spillover of financial shocks or crises across countries and/or across asset classes, characterized by an apparent increase in the comovement of asset prices.
Convergence fund	A fund that invests in Eastern European countries' debt securities on the assumption that interest rates in these countries will converge to those in the European Union.
Convexity	A measure of the sensitivity of bond prices to interest rate changes. When interest rates are rising (falling), the price of a bond with negative convexity will decline (rise) by more (less) than one with positive convexity, all other things equal.
Corporate governance	The governing relationships between all the stakeholders in a company—including the shareholders, directors, and management—as defined by the corporate charter, bylaws, formal policy, and rule of law.
Credit default swap	A financial contract under which an agent buys protection against credit risk for a periodic fee in return for a payment by the protection seller contingent on the occurrence of a credit/default event.
Credit spreads	The spread between sovereign benchmark securities and other debt securities that are comparable in all respects except for credit qual-

	ity, (e.g., the difference between yields on U.S. treasuries and those on single-A-rated corporate bonds of a certain term to maturity).
Credit tiering	Differentiation of borrowers by their credit quality (typically resulting in high cost and/or lower flows to borrowers with low credit quality).
Crossover investors	Investors who typically invest in mature markets and may cross over to emerging markets on an opportunistic or long-term basis.
Defined benefit pensions	A retirement pension plan where the benefits that retirees receive are determined by such factors as salary history and the duration of employment. The company is typically responsible for the investment risk and portfolio management.
Derivatives	Financial contracts whose value derives from underlying securities prices, interest rates, foreign exchange rates, market indexes, or commodity prices.
Dollarization	The widespread domestic use of another country's currency (typically the U.S. dollar) to perform the standard functions of money—that of a unit of account, medium of exchange, and store of value.
Double gearing	Situations where multiple companies use shared capital to protect against risk occurring in separate entities. For example, an insurance company may purchase shares in a bank as a reciprocal arrangement for loans. In these cases, both institutions are leveraging their exposure to risk.
Emerging markets	Developing countries' financial markets that are less than fully developed, but are nonetheless broadly accessible to foreign investors.
(Equity) put option	A financial contract that gives the buyer the right, but not the obligation, to sell an asset (equity) at a set price on or before a given date.
Foreign direct investment	The acquisition abroad (i.e., outside the home country) of physical assets, such as plant and equipment, or of a controlling stake (usually greater than 10 percent of shareholdings).
Forward price-earnings ratio	The multiple of future expected earnings at which a stock sells. It is calculated by dividing the current stock price (adjusted for stock splits) by the estimated earnings per share for a future period (typically the next 12 months).
Hedge funds	Investment pools, typically organized as private partnerships and often resident offshore for tax and regulatory purposes. These funds face few restrictions on their portfolios and transactions. Consequently, they are free to use a variety of investment techniques—including short positions, transactions in derivatives, and leverage—to raise returns and cushion risk.
Hedging	Offsetting an existing risk exposure by taking an opposite position in the same or a similar risk, for example, by buying derivatives contracts.

Interest rate swaps	An agreement between counterparties to exchange periodic interest payments on some predetermined dollar principal, which is called the notional principal amount. For example, one party will make fixed-rate and receive variable-rate interest payments.
Intermediation	The process of transferring funds from the ultimate source to the ultimate user. A financial institution, such as a bank, intermediates credit when it obtains money from depositors and relends it to borrowers.
Investment-grade issues (Sub-investment-grade issues)	A bond that is assigned a rating in the top four categories by commercial credit rating agencies. S&P classifies investment-grade bonds as BBB or higher, and Moody's classifies investment-grade bonds as Baa or higher. (Sub-investment-grade bond issues are rated bonds that are below investment grade.)
Leverage	The magnification of the rate of return (positive and negative) on a position or investment beyond the rate obtained by direct investment of own funds in the cash market. It is often measured as the ratio of on- and off-balance-sheet exposures to capital. Leverage can be built up by borrowing (on-balance-sheet leverage, commonly measured by debt-to-equity ratios) or by using off-balance-sheet transactions.
Nonperforming loans	Loans that are in default or close to being in default (i.e., typically past due for 90 days or more).
Offshore instruments	Securities issued outside of national boundaries.
(Pair-wise) correlations	A statistical measure of the degree to which the movements of two variables (e.g., asset returns) are related.
Pension funding gaps	The difference between the discounted value of accumulating future pension obligations and the present value of investment assets.
Primary market	The market where a newly issued security is first offered/sold to the public.
Risk aversion	Describes an investor's preference to avoid uncertain outcomes or payoffs. A risk averse investor will demand a risk premium when considering holding a risky asset or portfolio.
Risk capital	Money allocated to investments in risky securities or speculative investment activities.
Samurai market	The market for yen-denominated debt securities that are issued in Tokyo by issuers that are not Japanese.
Secondary markets	Markets in which securities are traded after they are initially offered/sold in the primary market.
Spread	See "credit spread" above (the word "credit" is sometimes omitted). Other definitions include: (1) the gap between bid and ask prices of a financial instrument; (2) the difference between the price at which an underwriter buys an issue from the issuer and the price at which the underwriter sells it to the public.

Swaptions	Options on interest rate swaps.
Syndicated loans	Large loans made jointly by a group of banks to one borrower. Usually, one lead bank takes a small percentage of the loan and partitions (syndicates) the rest to other banks.
Total return swaps	A swap in which the non-floating-rate side is based on the total return of an equity or fixed-income instrument with a life longer than the swap.
Yield curve	A chart that plots the yield to maturity at a specific point in time for debt securities having equal credit risk but different maturity dates.