Priorities in broadening the database in emerging market economies and developing countries and organisation of the further work programme

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Bond Markets in Emerging Market Economies
and Developing Countries
Financial Globalisation, Vulnerabilities and Data Needs

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Background of the initiative

Transparency is a key prerequisite for well-functioning markets. It is also a significant requirement for financial stability analysis.

However, emerging market economies and developing countries have significant gaps in their local bond market data. Against this backdrop, G8 finance ministers recommended in their action plan adopted in May 2007 – inter alia - a broadening of the database and collective international efforts "to identify any gaps".

The conference on "Bond Markets in Emerging Market Economies and Developing Countries – Financial Globalisation, Vulnerabilities and Data Needs", which was organised by the Bundesbank in cooperation with the Federal Ministry of Finance, is making a contribution towards implementing this recommendation, as is also stated in the implementation report.

The main focus of this conference was on the following aspects:

(1) What main financial stability questions - at present and in the near future - cannot be answered owing to a lack of data?
(2) What data sources are currently available for this purpose?

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Significant trends in the international financial markets

To answer these questions, it is important to include the lessons learned from past and present financial developments and to assess their relevance for new data requirements. In this context, particular attention should be paid to four significant trends in the international financial system.

First, *financial globalisation* is a process which is leading to changes in market structures. Adequately recording these changes in the market structures – new investor groups, new instruments, changes in the maturities etc – and its implications for financial stability is a key task, especially with regard to emerging market economies and developing countries.

The *second* important trend is the *institutionalisation of saving*. In the quest for yields and risk diversification, large internationally operating investors are taking growing account of emerging market economies and developing countries in their portfolio decisions.

The *third* trend which is closely related to this is the *marketisation of finance*. This entails not only a greater exploitation of international financial markets through the extended reach of institutional investors and hedge funds. The marketisation of finance also involves a greater transfer of risks from bank balance sheets and their bundling in new marketable instruments (securitisation).

The *fourth* trend is that, in some countries, risks are being increasingly shifted to the household and corporate sectors.

Against this backdrop, the philosophy of the conference in Frankfurt was to promote a wide-ranging discussion between the users and producers of statistics, starting by focusing on the requirements from a financial stability perspective.

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Identification of data requirements - dimensions of the problem

The discussion regarding data requirements can probably be best summarised by focusing on the following aspects, which could also be conducive to achieving the envisaged objectives of the next stages with regard to identifying and closing data gaps.

From a more *static* perspective, it should *first* be ascertained how, for instance, the statistical coverage of the bond markets in the EMEs and the developing countries compares to that of industrial countries. There is a need to enhance the transparency of available data and data quality.

The *second* dimension of the identification of data problems must be considered from a more *dynamic* perspective. In particular, the process of financial globalisation can quickly lead to a rapid change in market players and instruments and, in turn, to significant changes in the risk exposures of these countries. A preventive stability policy which aims to avert financial market crises must focus to a greater extent than in the past on analysing possible new vulnerabilities while simultaneously conducting a critical review of the new data requirements arising as a result.

Experience has taught us that a crisis seldom has the same causes as previous tensions in the financial markets. Furthermore, such a forward-looking debate would also help to shorten the time lag between the emergence of new data gaps and the plugging of these gaps.

The *third* dimension of the data problem is the increasing significance of *international or internationally comparable statistics*. The related requirements and need for statistical data

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which are quickly available are growing. In view of the burgeoning importance of emerging market economies, this also applies, in particular, to their financial markets.

The *fourth* dimension in terms of identifying data requirements is the increasing importance of *microstructural data*. While it is possible to assess the development of currency and maturity mismatches using raw macroeconomic data, it is necessary to analyse and observe the currency and maturity mismatches below the macroeconomic averages across individual sectors or households and enterprises. Balance sheet approaches and micro-level data becoming increasingly important.

Key objectives

The main trends and dimensions of the problem can provide assistance when prioritising further steps to fill data gaps. Discussions on this matter during the conference have highlighted the following key areas of action.

Implementation of the CGFS working group's findings

The CGFS working group on financial stability and local currency bond markets and a related subgroup have made significant contributions to identifying data needs, particularly in terms of better coverage of data with regard to the market structure. These recommendations comprise improvements of BIS securities statistics by better breakdown of currency issue, sector of issue, maturity, instrument, measures of issuance at residual etc. The incorporation of this agenda is part of the work programme of the working group on securities databases.

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Compiling internationally comparable statistics

The creation of a harmonised international framework for collecting and compiling data is central to the objective of filling gaps in data on local bond markets in emerging market economies and developing countries. In her presentation entitled “Securities Markets and External Debt: US Perspectives on Data Availability”, Carol Bertaut (FED) emphasised the fact that this particularly concerns the comparability of data on debt securities, cross-border securities and external debt measures. Data stemming from different sources show distinct differences, in particular for emerging market economies. From this, she rightly identifies a “clear need for comparable definitions and comprehensive measurements of debt securities and external debt”.

Here, the IMF and, in particular, BIS are called upon to create a uniform methodological framework. Paul van den Bergh’s work seeking to lay the foundations for such a framework for creating an internationally comparable database appears to be particularly suitable for shedding light on the different ways in which data have been collected to date. The BIS initiative to draft a compilation guide via the working group on securities databases is among those tasks relating to the broadening of the database which should be given high priority.

Intensifying the dialogue between users and producers of statistics about future data requirements

In his presentation on “Statistics for the Balance Sheet Approach”, Alfredo Leone (IMF) outlined the main future challenges. The most important appear to be “innovative and complex financial instruments, including an increased securitisation of banks’ balance sheets and the use of instruments of credit risk transfer”, the “significant expansion of cross-border financial linkages; extension of financial intermediaries’ international operations

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through cross-border provision of services" and the "rapid growth of cross-border portfolio investments and the stock of international assets and liabilities". These requirements apply not just to bond markets in industrialised countries, but increasingly to emerging market economies, too.

In her presentation on "Financial Globalisation and Emerging Bond Markets", Ceyla Pazarbasioglu drew attention to the speed at which structural changes are currently taking place on bond markets in emerging market economies and also in some developing countries. We would like to emphasize Alfredo Leone's conclusion that "further improvements in financial statistics are needed for them to remain relevant for critical policy and analytical work in understanding the phenomenon and its impacts, and potential risks and vulnerabilities that might arise" in particular with a view to the increasing internationalisation of financial markets, the arrival of new investors and the rapid spread of financial innovations. There is a need for ongoing and institutionalised discussion about changing risk exposures as a result of changing bond market structures and financial innovations and resulting data needs.

With this in mind, the proposal to set up a future financial crises working group within the IMF to analyse countries' susceptibility to potential financial crises in greater detail is to be welcomed. We believe that there is a need for intensified international collaboration in this area, focusing on the data requirements arising from crises and financial innovations. The BIS and the central banks should specifically be involved in this project. Central banks, in particular, should participate in these discussions because, if a liquidity crisis were to arise, then they would form the main "line of defence" and play a key role in data collection.

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Giving greater consideration to central financial stability issues when identifying data gaps

An array of core issues which are left unanswered owing to a lack of data come to light in stability reviews and other reports of international institutions. It is therefore likely that studies which, for example, focus in many different ways on the implications of a greater integration of emerging market economies in the financial globalisation process will become more important. Consequently, important aspects :

- The international integration of markets is leading to changes not only in the transmission channels through which contagion effects are routed but also in the width of these transmission channels. The consequences of the subprime crisis in particular have demonstrated the extent to which tension in one international financial market segment can spill over to financial markets in other global regions.

- Financial markets are exerting a growing influence on a country's fundamentals even though their development is itself not always geared to these fundamentals. The associated implications are becoming more critical for the assessment of financial stability. This means, for example, that the portfolio strategies of internationally active funds are having an increasing impact on financial globalisation.

Data for analysing the investment behaviour of international investors becoming more significant

Potential contagions resulting from the investment behaviour of global players are becoming an increasingly significant issue. The first empirical studies conducted on the basis of microdata available to, for example, major custodians underline the importance of analyses of the investment behaviour of various groups of institutional investors for the development

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of share and bond markets in emerging market economies. The studies also show that the reactions of major institutional investors to exogenous shocks are a key determinant of the development and spread of financial crises. In contrast to the growing importance of these studies for analysing financial stability, many data can only be obtained through surveys, as with the information on institutional investors obtained through the CGFS study. Deepening the database and improving the quality of existing data are two top priorities in this field.

Frank Warnock et al. underlined that we know very little about foreign investor participation in local bond markets. The data quality of the Coordinated Portfolio Investment Survey of the IMF has to be improved. “CPIS data provides no information on currency denomination, which is vital for bonds.” Despite the increasing importance of portfolio flows to local bond markets, “other than anecdotes, we know little about portfolio behaviour” (Warnock). This is all the more important since institutional investors are key drivers for a more efficient allocation of credit and capital. They also contribute to creating new channels for financial spillovers. “These are unavoidable, but we need to understand them better.” (Marianne Schulze-Ghattas) Therefore, collecting data on bond holders and enhancing the quality of cross-border positions and related flows to emerging market economies and developing countries are two top priorities.

Creation of a harmonised international data platform – is the Globalised Securities Database (GSDB) a realistic option?

Some of the above-mentioned challenges can be met by setting up securities databases. Whether the Centralised Securities Database (CSDB), currently being developed by the European Central Bank in close cooperation with the national central banks, can form a nucleus for a Globalised Securities Database remains to be seen. As Werner Bier and

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Stefan Brunken illustrated, the CSDB will offer participating countries a broad pool of data, which can be flexibly used for different analytical purposes.

The principal advantages of the CSDB, as highlighted by Werner Bier and Stefan Brunken, include the fact that the CSDB “allows the compilation of very detailed statistics for a high number of security and issuer features, user needs can be met on a flexible basis …, there is a short 'time-to-market'; and security and issuer classifications are now under the control of statistical experts”.

The database can be flexibly adapted to suit developments on the financial markets. Comparatively little outlay is therefore required to perform various statistical analyses based on the database. Further discussions will show the extent to which this also applies to financial stability issues arising in this connection.

Whether or not a Globalised Securities Database is a realistic option for covering data needs also depends on the amount of time and costs required to develop such a system and get it up and running.

Further extension of balance sheet approaches

Extensive databases have been set up by various bodies as part of their current research activities on local bond markets in emerging market economies. Many of these are devoted to balance sheet approaches.

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Economies' susceptibility to exogenous disruptions emanating from the financial markets can only be estimated using aggregated macroeconomic indicators. This problem is compounded by the fact that new crises in recent years have originated more and more in individual sectors. Balance sheet approaches are especially helpful in revealing intersectoral linkages and thus the transmission channels of disruptions. In particular, they facilitate a better assessment of risks and the extent to which financial market crises will impact on the real economy.

In the context of balance sheet analysis, Alfredo Leone's research highlighted two points. First, the available data are distributed very unevenly across the individual sectors on an international average. Data in the financial sector are far more reliable. Second, a much greater degree of coverage is required regarding balance sheet data of enterprises and households to be able to analyse the balance sheet effects and data needs mentioned. However, such data are in short supply in the industrialised countries and as good as non-existent in emerging market economies.

Developing local currency bond markets are beneficial for reducing currency mismatches. "But we need better data to analyze which vulnerabilities remain, or are perhaps increasing – especially for the private sector." (Marianne Schulze-Ghattas)

Some multilateral development banks have worked closely with economic research institutions and invested a great deal of time and effort in setting up databases to analyse vulnerabilities in precisely this area. In doing so, they have concentrated on evaluating a large number of corporate balance sheets. In many cases, however, these were only prepared for the purpose of specific evaluations and have not been updated. This therefore raises the question of the extent to which these data can be integrated in the work of the International Monetary Fund and whether internationally comparable databases can be set up in this field.

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The discussion has shown that there is still a substantial need for comparable data in this area. These data are especially important given that currency and maturity mismatches seem to be developing in the corporate sector in particular, yet data on this are considerably harder to come by there. There would therefore appear to be scope to coordinate the initiatives of the International Monetary Fund, World Bank and multilateral development banks in this field.

In conclusion, as well as weaker data coverage of local bond markets in emerging market economies and developing countries, there are also data gaps in those fields in which deeper analysis of financial stability issues is necessary.

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