GLOBAL FUNDING TRENDS ON THE CAPITAL MARKETS IN 2013

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Introduction

Over the course of 2013 the outlook for economic recovery in the developed countries progressively firmed, especially in the United States and the United Kingdom, while in the emerging economies it turned down. Against this background, and despite expectations of fewer monetary stimuli by the Federal Reserve – which took the form early this year of a reduction in the volume of asset purchases, or tapering – and the subsequent rise in long-term interest rates (even though these are at historical lows), investor risk appetite and yield search have picked up. Only during the summer, owing to communication problems concerning the Federal Reserve's monetary policy strategy, were increases in market volatility and a degree of risk aversion observed.

These developments marked the course of capital markets in 2013, in a setting in which fiscal consolidation and private-sector deleveraging continued apace in the developed countries. Global fixed-income issuance fell owing to the declines in public-sector and bank issues, despite the fact that riskier paper (high-yield corporate and emerging-market issues) reached record volumes.

This article analyses recent developments on international capital markets, for both developed and emerging economies, with a particular emphasis on fixed-income instruments. The analysis focuses on issues by non-financial corporations and by the banking sector, looking at different funding instruments. Apart from fixed-income, issues of equity and hybrid products are discussed, along with structured financial markets. The analysis draws chiefly on data from Dealogic and covers issues of a term greater than or equal to 18 months.

Main characteristics of international debt issues in 2013

Total fixed-income issuance by the developed countries in 2013 fell notably compared with the previous year, down by 9% (see Table 1 and Chart 1). This reduction affected both issuance by the public sector (down 8% y-o-y) and the private sector (-13% y-o-y). In the first case, the decline in issues corresponded to the fiscal consolidation in these economies, while in the case of the private sector the decline in banks' issues was prominent, which was also in line with the ongoing deleveraging by banks, since issues by non-financial corporations held up. In addition to these factors (fiscal consolidation and bank deleveraging), which have been influencing debt issuance in recent years, the chief novelty in 2013 was the impact of the change in the Federal Reserve's monetary policy stance.

In the first two quarters of 2013 the sound pace of issuance apparent since the summer of 2012 continued, despite the fact that the macroeconomic figures tended to be unfavourable, especially in Q1, which led to some decoupling of financial developments and economic activity. During this period, monetary policies retained their expansionary bias and low interest rates, which fuelled investors' risk appetite and search for yield. This setting, combined with a perception of less risk of extreme events materialising, prompted a reduction in uncertainty, which was mirrored by very low volatility and by credit risk spreads at minimum levels, especially in the high-risk segments such as high-yield corporates.

RECENT DEBT MARKET DEVELOPMENTS: ISSUANCE VOLUMES

TABLE 1

$bn

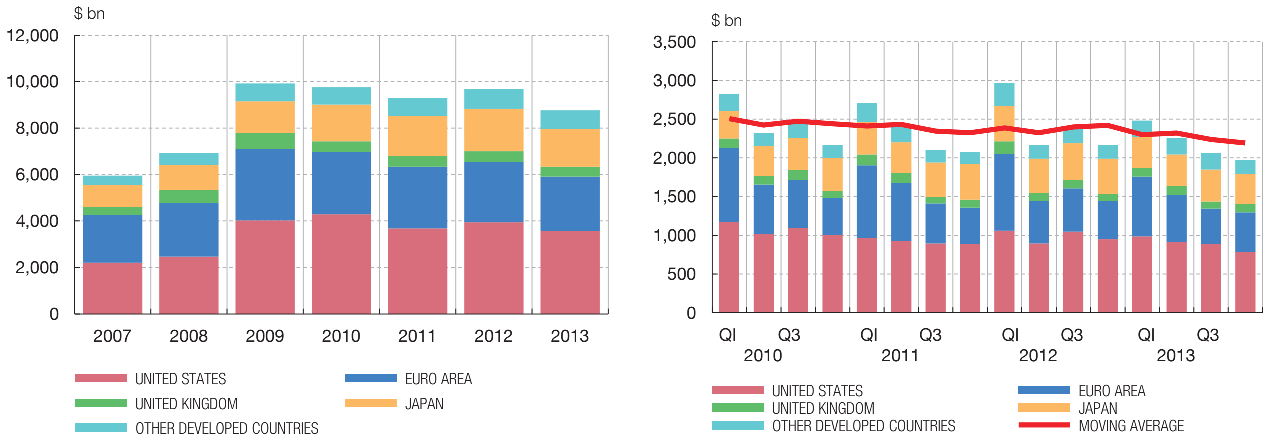
	2011	2012	2013	2013 Q1	2013 Q2	2013 Q3	2013 Q4
TOTAL BONDS (a)	**9,564**	**10,103**	**9,194**	**2,604**	**2,375**	**2,149**	**2,067**
Total bonds by country							
United States	3,677	3,948	3,565	984	911	889	782
Euro Area	2,667	2,593	2,352	772	612	456	512
United Kingdom	460	465	422	108	111	93	110
Japan	1,720	1,827	1,614	408	408	412	387
Emerging economies (b)	275	418	431	125	122	90	94
Other developed countries	764	851	810	208	212	209	181
TOTAL BONDS BY INDUSTRY/SECTOR							
Public sector							
United States	2,772	2,728	2,437	660	624	614	540
Euro Area	1,709	1,675	1,619	529	463	306	322
United Kingdom	258	261	242	59	62	64	57
Japan	1,593	1,675	1,465	367	368	371	359
Emerging economies	84	107	102	27	25	29	21
Other developed countries	323	307	359	92	100	84	83
TOTAL	**6,739**	**6,753**	**6,224**	**1,734**	**1,643**	**1,468**	**1,380**
Non-financial corporations							
United States	508	690	684	181	174	183	145
Euro Area	206	308	314	102	65	72	75
United Kingdom	63	104	84	26	25	12	20
Japan	75	92	102	22	32	25	23
Emerging economies	138	193	254	71	81	50	51
Other developed countries	104	159	126	27	43	33	24
TOTAL	**1,095**	**1,547**	**1,563**	**429**	**420**	**375**	**339**
Banking industry							
United States	313	382	285	100	79	48	58
Euro Area	733	570	383	128	76	76	104
United Kingdom	119	78	53	12	13	6	22
Japan	44	47	37	15	6	13	3
Emerging economies (c)	53	118	76	26	16	11	22
Other developed countries	296	343	284	78	57	83	65
TOTAL	**1,558**	**1,538**	**1,118**	**359**	**248**	**238**	**273**
Other financial institutions							
United States	83	148	159	42	33	44	40
Euro Area	19	39	36	14	8	2	12
United Kingdom	20	23	43	12	10	11	11
Japan	9	13	10	3	2	3	2
Other developed countries	41	42	40	11	11	8	10
TOTAL	**172**	**264**	**288**	**82**	**64**	**68**	**74**
MEMORANDUM ITEM							
Collateralised bonds (d)							
Euro Area	349	236	112	36	31	22	23
Other	165	170	98	28	20	25	25
TOTAL	**514**	**405**	**209**	**64**	**51**	**46**	**48**
High-yield							
United States	180	281	250	78	64	64	45
Euro Area	38	42	84	26	16	14	28
United Kingdom	19	21	38	11	13	6	8
Japan	5	7	10	0	0	7	3
Other developed countries	25	38	29	5	12	6	7
TOTAL	**267**	**388**	**411**	**120**	**105**	**97**	**90**
Syndicated loans							
United States	1,308	1,176	1,549	348	416	355	431
Euro Area	931	629	794	191	169	220	213
United Kingdom	429	343	425	89	106	106	123
Japan	542	557	558	153	127	146	133
Emerging economies	371	402	386	93	120	91	82
Other developed countries	614	517	626	130	180	122	194
TOTAL	**4,194**	**3,624**	**4,337**	**1,004**	**1,118**	**1,039**	**1,176**

SOURCE: Dealogic.

a Estimated totals.
b Only issues on international markets are included under emerging economies.
c Other non-bank financial institutions are included under emerging-economy banks.
d Collateralised bonds issued by all institutions are included, meaning the issuance base is broader than the banking industry.

DEVELOPED COUNTRIES: GROSS BOND ISSUANCE BY COUNTRY OR ISSUING REGION

CHART 1



SOURCE: Dealogic.

The sound performance of issues by non-financial corporations (NFCs) in the first two quarters notably came about despite the uncertainty created by political events, such as the Italian elections and the Cyprus bail-out, which ultimately had less of an impact than expected. In the United States, the political negotiations meant that uncertainty over fiscal policy prevailed throughout the year; on 1 March the sequester (entailing automatic cuts in expenditure) took effect, and tension heightened with the partial closure of Federal government in October. However, as in the euro area, these fiscal policy developments in the United States had a limited effect on the markets.

Brighter economic figures as from Q2, especially in the United States, bolstered optimism and rekindled the debate on the possibility of reducing the Federal Reserve's monetary stimuli. These took specific form in the announcement in May on potential tapering. The discussions gave rise to uncertainty on the market, which translated into a decline in debt issuance during the summer months. The fall was reversed in September, when the Federal Reserve managed to convince the financial markets to separate tapering, which was deferred that month, and the potential rise in interest rates, which is not considered imminent.

Besides the declines in issues by the financial sector and the public sector, which were already coming about, the announcement on tapering in May prompted a reduction in issues by sectors with greater appetite for risk, such as the high-yield corporates sector and that of the emerging markets, which had until then been very dynamic. Uncertainty over monetary policy gave rise to an increase in volatility, especially in fixed-income, which progressively abated as the Federal Reserve's messages were clarified.

Following the episode in the summer, a season in which issuance activity traditionally falls, debt placements rose in September (issues increased by 28% on the previous month in the developed economies) and held at slightly lower levels to those of 2012 in the last quarter. Significantly, the financial markets reacted much more positively to the decision to initiate tapering, adopted at the last meeting of the Federal Open Market Committee (FOMC) in December, building on the communication drive by the Federal Reserve in the previous months. As a result, there was no rise in volatility similar to that observed in May (see Chart 2).

Accordingly, the end of the year saw a favourable market setting, with interest rates more normalised (albeit still at historically low levels), little volatility and expansionary monetary

BOND (MOVE) AND STOCK MARKET (VIX) VOLATILITY INDICES

CHART 2

SOURCE: Datastream.

policies (chiefly in the euro area and in Japan). The scenario thus continues to be one of appetite for risk marked by the virtual disappearance of tail risks, which is favourable for issuance. This trend has continued into the current year, despite questions over the effects that a future rise in interest rates may have and the turbulence in emerging markets.

A key feature of the year, and one marking continuity with previous years, is that bank disintermediation and financial-sector deleveraging continued. This meant that, in the euro area, NFCs replaced bank financing with debt issues, in a setting in which the cost of bank financing has risen, owing partly to regulatory changes. In the United States this process has been less marked in the past year because, on one hand, the starting point is different, since the scale of financing through markets is greater, and, on the other, bank deleveraging began earlier and is at a more advanced stage (see Chart 3).

MODERATION OF ISSUANCE IN DEVELOPED COUNTRIES AND STRONG MOMENTUM IN EMERGING ECONOMIES

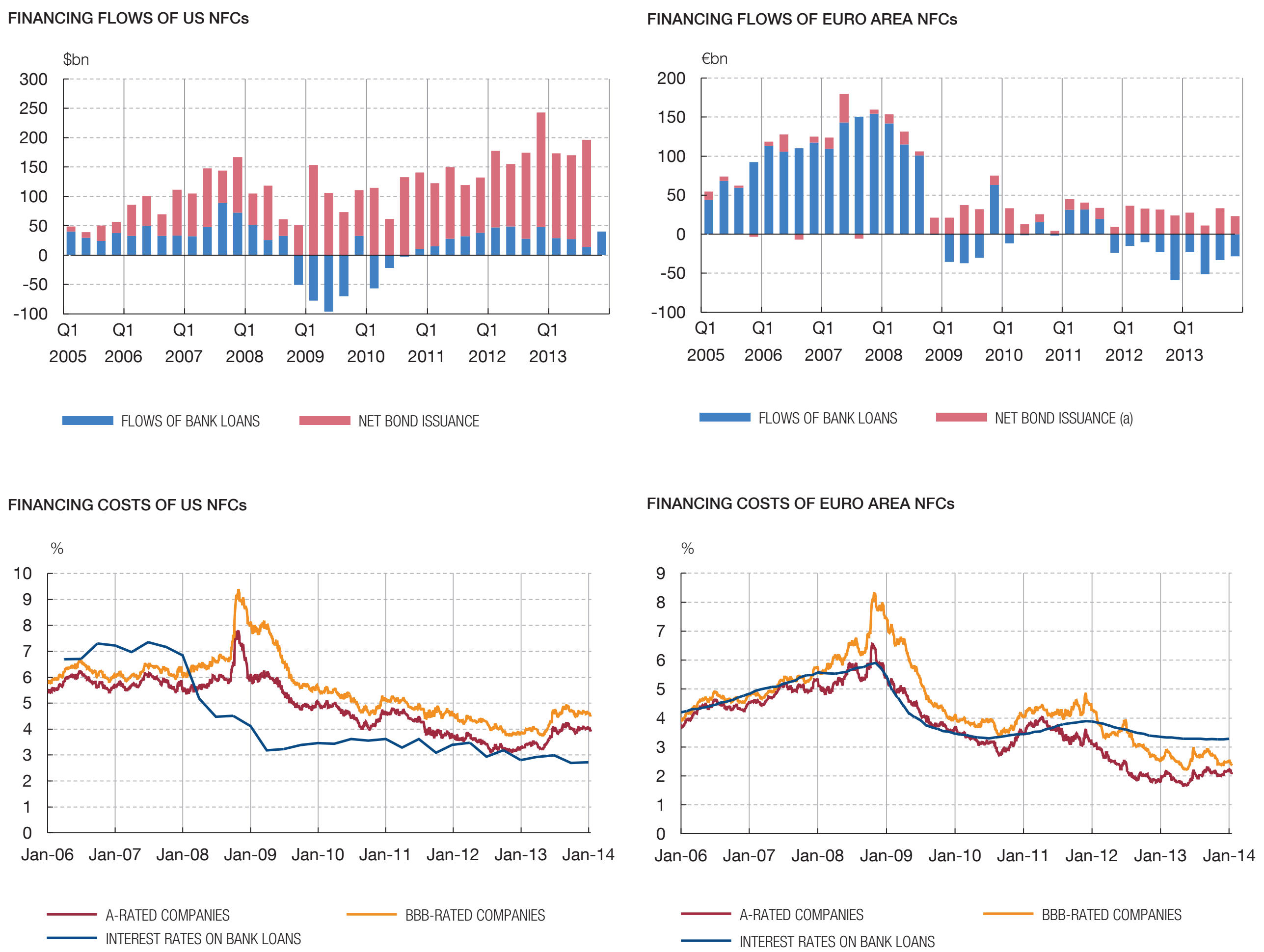
Issues in the developed countries totalled $8,763 billion in 2013, the lowest annual volume recorded since 2008. In terms of countries, the decline was across the board, with a slightly worse performance in Japan. As mentioned, there were differences in terms of timing, with declines on the previous year in all quarters except the second (6% y-o-y) and low issuance activity in the summer months, following the tapering announcement. The highest proportion of issues in 2013 was once again in the United States (41 % of the total), followed by the euro area (27 %), Japan (18 %) and the United Kingdom (5 %), with no changes occurring in the relative weights of each region compared with the previous year. Table 1 shows the total volumes issued, and their breakdown by country and sector.

The public sector continued to be the main debt issuer (70% of the total volume), with issues falling by 8% to $6,123 billion (see Chart 4). By country, the biggest reductions were in the public sector of Japan (-13% y-o-y) and in the United States (-11% y-o-y). Notably, despite the far-reaching fiscal adjustment processes in the public sector of the European countries, the decline in issuance was not very pronounced (-3% y-o-y in the euro area), owing to the fact that most placements were geared to refinancing debt.

The volume issued by the banking sector fell notably (-27% y-o-y), owing to deleveraging and the need to adjust to the new Basel III rules. Issues by non-financial corporations dipped slightly in 2013 (-3% y-o-y) to $1,310 billion, exceeding the banking sector. Finally, “other financial institutions”, a category that includes SPVs (special purpose vehicles) and the rest of the non-bank financial sector, posted the best performance of all the sectors for the year with growth of 9%, although it accounts for only 3% of all issues. Chart 4 shows

FINANCING OF NON-FINANCIAL CORPORATIONS IN THE UNITED STATES AND IN THE EURO AREA

CHART 3



SOURCES: Federal Reserve, ECB and JP Morgan.

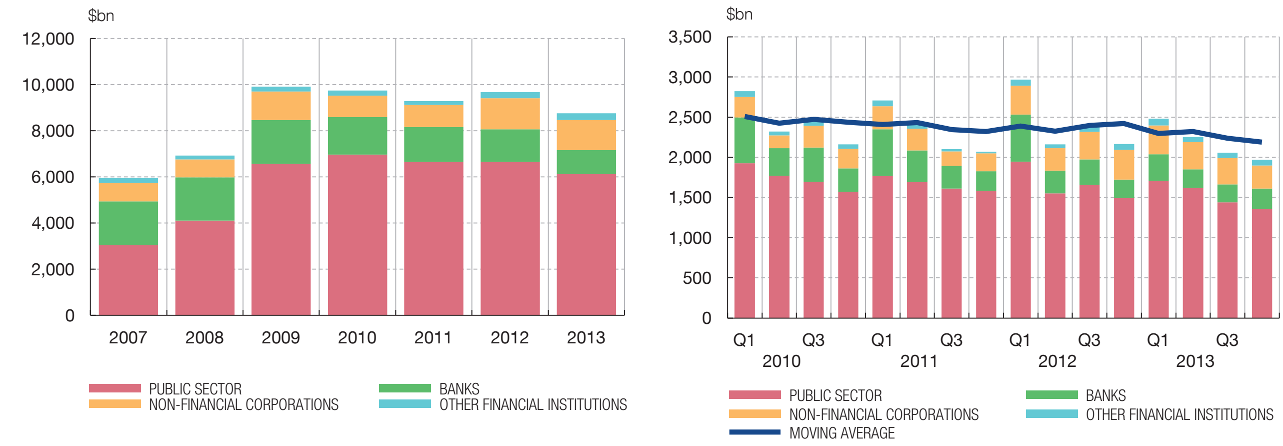
a December data for 2013 Q4 not included.

the annual and quarterly course of issues, by sector, on the markets of the developed countries.

There was much greater momentum in the emerging economies, despite the effect that the announcement of tapering in May had on the capital flows to this group of countries and on the issues of the most vulnerable countries. This sound performance was very similar to that of high-yield corporate bonds, meaning that issues in these two asset classes trended similarly throughout the year. Yield search and risk appetite made the emerging markets very attractive to investors for most of the year, and issuance reached a historical high with a volume of $431 billion, a 3% increase on 2012 (see Chart 5). Across the different regions, the highest growth was in Latin America (9% y-o-y), followed by Africa and the Middle East (7%) and Asia (1%), while there was a decline in eastern Europe (-4%). Most placements were in Asia, making for a total of $143 billion. By sector, issues by NFCs increased notably (31%), to the detriment of those by banks (-35%) and those of the public sector (-5%). The bigger appetite for risk was reflected in the proportion of high-yield issues, which increased to 27% of the total, compared with 17% in 2012, including numerous sovereign and corporate bonds being issued for the first time. By debt denomination, the growth in local currency-denominated issues (7% y-o-y) exceeded those denominated in foreign currency (3%), representing 9% of total issues.

DEVELOPED COUNTRIES: GROSS BOND ISSUANCE BY ISSUING SECTOR

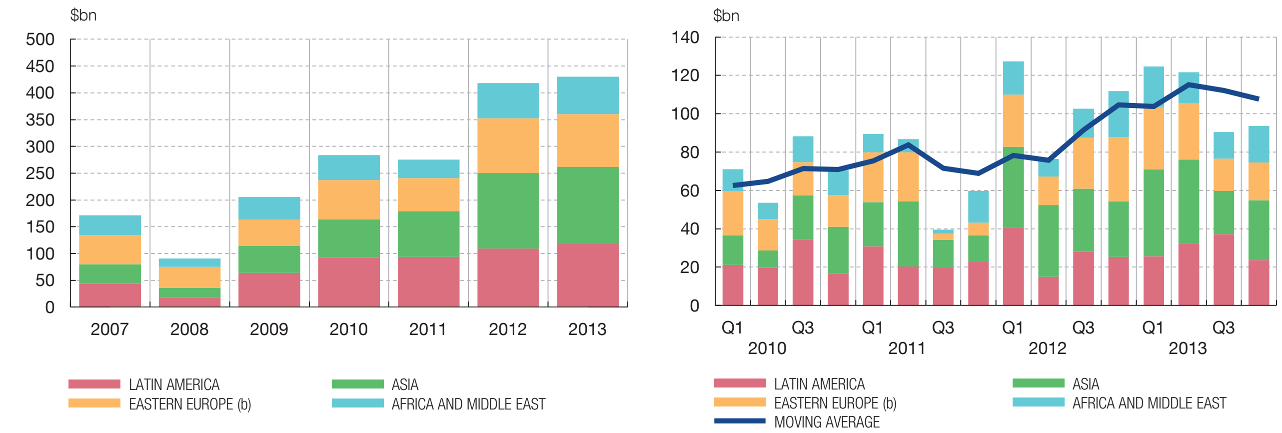
CHART 4



SOURCE: Dealogic.

EMERGING COUNTRIES: GROSS BOND ISSUANCE BY REGION (a)

CHART 5



SOURCE: Dealogic.

a Only issues on international markets are included.
b Including the former USSR.

STRENGTH OF ISSUES BY NON-FINANCIAL CORPORATIONS (NFCS)

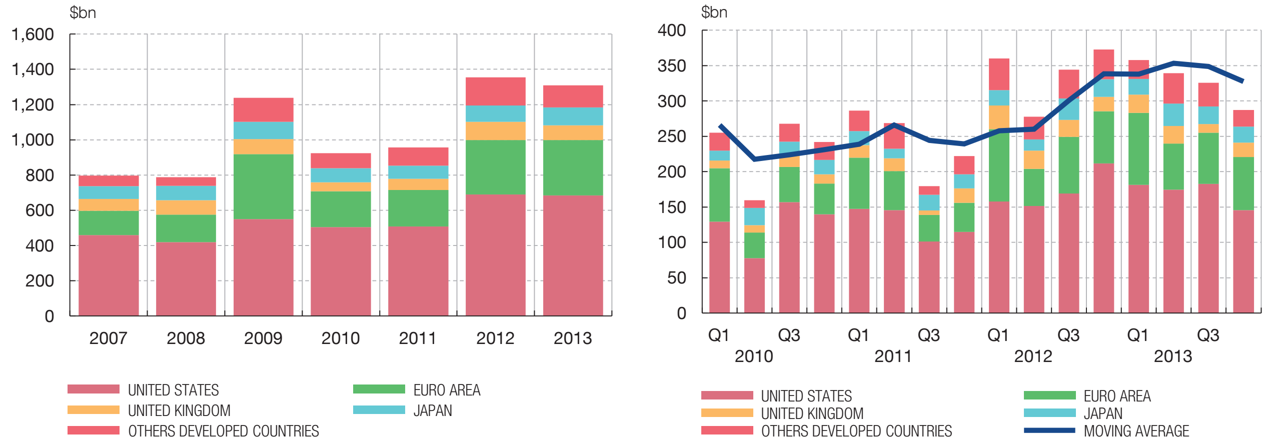
NFCs maintained an issuance volume similar to that observed in 2012, with a slight decline of 3% (see Chart 6). By region, Japan (10% y-o-y) increased strongly and United Kingdom fell notably, while the euro area (2% y-o-y) and the United States (-1% y-o-y) held practically stable. However, the United States saw the biggest placement of corporate debt in history: an investment grade bond of $49 billion issued in September by Verizon Communications Inc. to partially fund the purchase of Verizon Wireless.

These trends respond, on one hand, to favourable financial market conditions and to the above-mentioned appetite for risk, combined with the dearer cost since early 2009 of bank financing in relative terms (principally in the euro area) (see Chart 3), which inclines companies with access to the markets to resort to them to raise funds.

Furthermore, the discussions on the withdrawal of stimuli by the Federal Reserve highlighted the importance of interest rate risk. Issuers have been more aware of risk in a more restrictive credit environment, which may have led them to bring forward their

NFCs IN DEVELOPED COUNTRIES: GROSS BOND ISSUANCE BY ISSUING COUNTRY OR REGION

CHART 6



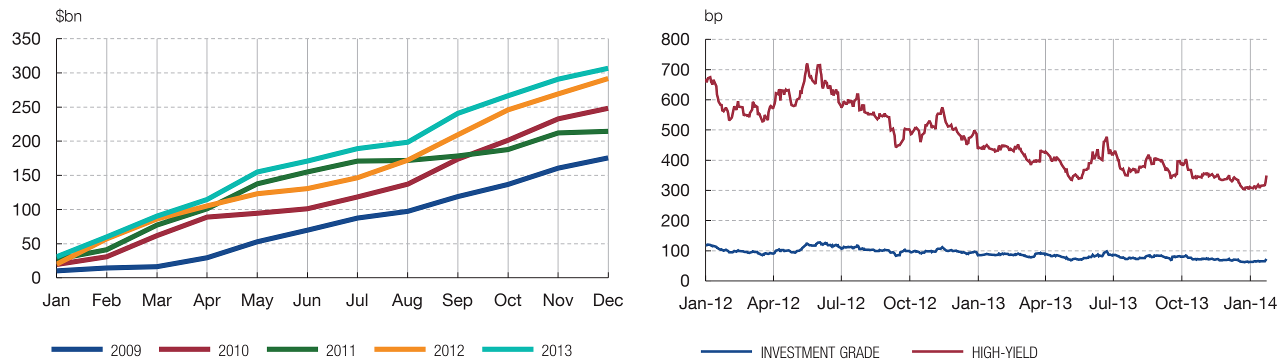
SOURCE: Dealogic.

ISSUANCE AND RISK OF NON-FINANCIAL CORPORATIONS' BONDS IN DEVELOPED COUNTRIES

CHART 7

NFCs: CUMULATIVE ANNUAL ISSUANCE OF HIGH-YIELD BONDS

CREDIT RISK OF NFCs' BONDS IN THE UNITED STATES



SOURCES: Dealogic y JP Morgan.

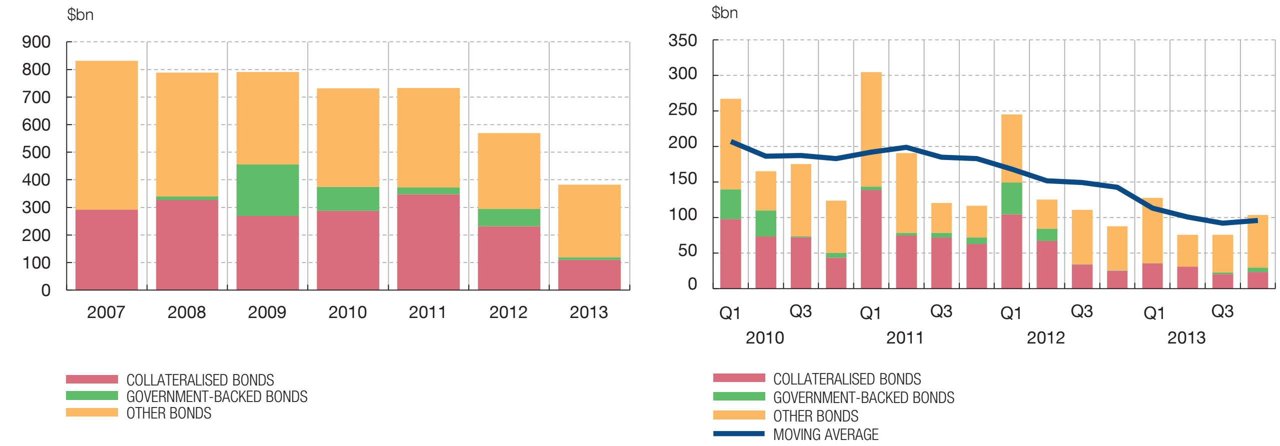
issuance programmes and to make placements at a longer term. Regarding the composition of issues, high-yield corporate debt was the best performer, attaining a record volume of $307 billion in 2013, 5% up on the previous year (see Chart 7). These issues increased in all the developed countries, except in the United States. Their growth was particularly pronounced in the euro area (110% y-o-y), where in the past companies resorted more intensely to bank financing. The better performance by high-yield corporates as opposed to investment grade bonds is attributable not only to the search for yield, but also to the lesser perception of risk involved. This is reflected in the narrowing of credit risk spreads (see Chart 7) and in low default rates (around 2% in the United States, according to Fitch).

As to the purpose of the issues, the volume intended for the recapitalisation of non-financial corporations in the euro area increased substantially to $22.5 billion in 2013, while in 2012 it was only $1.6 billion. Of most relevance in the United States was the increase in issues geared to acquisitions, with a volume of $77.3 billion in 2013 (18% y-o-y[1]), due mainly to the aforementioned Verizon Communications Inc. issue. Another

1 In any event, Dealogic assigns most issues (73% in the United States and 84% in the euro area) to two rather unclearly defined types of uses ("general corporate objectives" and "various").

BOND ISSUANCE BY EURO AREA BANKS

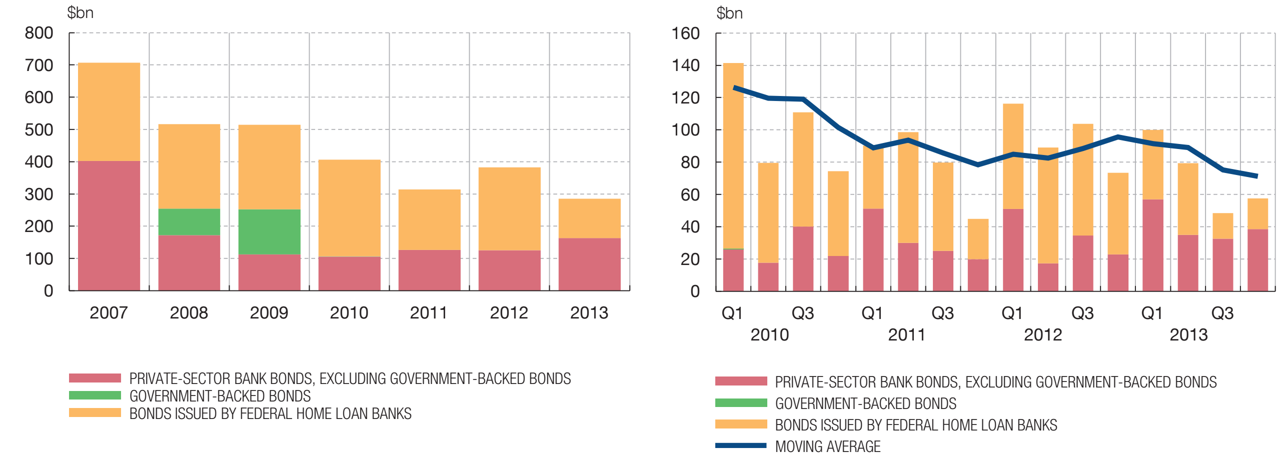
CHART 8



SOURCE: Dealogic.

BOND ISSUANCE BY US BANKS

CHART 9



SOURCE: Dealogic.

favourable event relating to the financing of NFCs was the sound performance of M&A activity, which was up 9% on 2012 at $2,910 billion, the highest volume since 2008.

STRONG REDUCTION IN BANK ISSUANCE

There was a step-up in ongoing bank deleveraging and disintermediation during 2013, with a 27% collapse in banks' issues in the developed countries, totalling $1,043 billion, a decline much greater than that of 6% in 2012. In the developed countries, bank issues have fallen by somewhat less than half (45%) since 2007. By region, declines were seen in all areas, although the most pronounced falls were in the euro area and in the United Kingdom (-33% y-o-y and -32% y-o-y, respectively), unlike the early years of the crisis when deleveraging was more acute in the case of the US banks (see Charts 8 and 9).

Mention should be made of the increase in issues of certain instruments in 2013, such as contingent convertible bonds (CoCos). This was due to the greater capital needs imposed by the new regulatory requirements, since this type of bond can be included as tier 1 or tier 2 capital in balance sheets (see Box 1).

Covered bonds have continued to account for a substantial source of bank funding both in Europe, where they are of long standing, and – increasingly – outside Europe. These

A notable feature of the last few years is the proliferation of bank debt with certain characteristics facilitating loss absorption by bondholders in certain circumstances, known as contingent convertible capital or "CoCos". These instruments, which were common before the crisis, are being revived in a regulatory environment which delimits more clearly their eligibility to form part of bank capital and in which the circumstances requiring their holders to absorb losses seem to be more evident.

Under the new capital requirements introduced by Basel III, CoCos qualify as additional tier 1 capital or as tier 2 capital, depending on their characteristics. CoCos have two basic features: a loss absorption mechanism and the condition which activates that mechanism. Losses can be absorbed in two ways: converting the debt into shares or writing down fully or partially the principal amount. The event triggering this conversion or write-down may be automatic (level of capital with respect to risk-weighted assets) or discretionary, at the regulator's judgement.

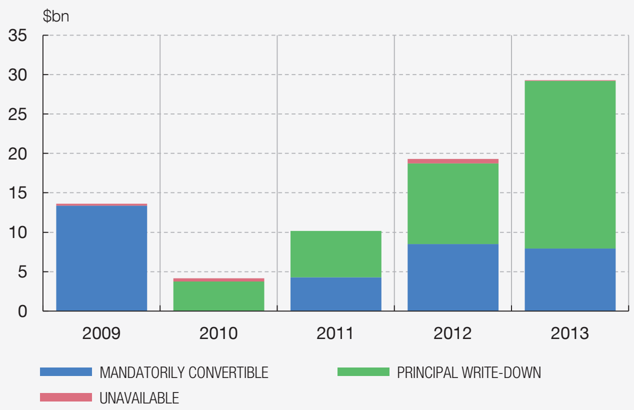
Basel III stipulates that for CoCos to qualify as common equity tier 1 capital, they must be perpetual and their conversion to capital or the write-down of their principal amount must be linked (automatically or discretionally) to the core tier 1 capital ratio falling below 5.125%. These rules are not being implemented completely uniformly across jurisdictions, so the growth rate and characteristics of these products differ depending on the residence of the issuer. Similarly, the differing tax treatment also influences the design of issues. It is thus not surprising that, despite the buoyancy of the primary market, there is not yet a deep and liquid secondary market for trading these instruments. Notable in this respect is the initiative of some private-sector banks to develop a benchmark index for this market. The situation of products of this type was very different in the years preceding the financial crisis, when there was a wider variety of instruments and less regulatory uniformity across jurisdictions.[1]

Turning to more recent developments, 2013 saw marked growth, with the issuance of $29.3 billion[2] and growth of 51% with respect to the previous year. Despite this, the figures are still modest compared with other types of debt issued by banks. Thus, since 2009 banks have issued around $76 billion of CoCos, while in the same period they issued subordinated debt (excluding CoCos) of $550 billion and unsecured senior debt of $4.1 trillion.

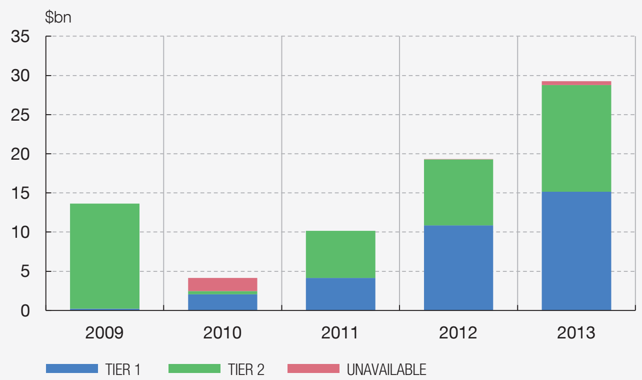
These developments are set against a background highly favourable to the demand for hybrid instruments of all types[3] (not only CoCos). Indeed, in the case of non-financial corporations (not subject to regulatory constraints), there has also been a notable upswing in the issuance of these products, which generally offer higher yields than traditional debt products. Moreover, hybrids may allow the issuer's financial and tax costs to be optimised, and the rating agencies may treat a portion or all of these instruments as capital in the rating process.[4]

1 See "Los instrumentos híbridos en los recursos propios de las entidades financieras: naturaleza y cambios tras la crisis financiera", by José Manuel Marqués Sevillano and Alicia Sanchis Arellano, Financial Stability Journal, November 2009, Banco de España.
2 The sample consists of CoCos issued by banks. Data taken from Bloomberg.
3 Hybrid instruments are defined as securities which, while are neither common shares nor straight bonds, but have some characteristics of both.
4 This is so irrespective of what the accounting treatment of these instruments may be.

BREAKDOWN OF ISSUANCE BY LOSS ABSORPTION MECHANISM



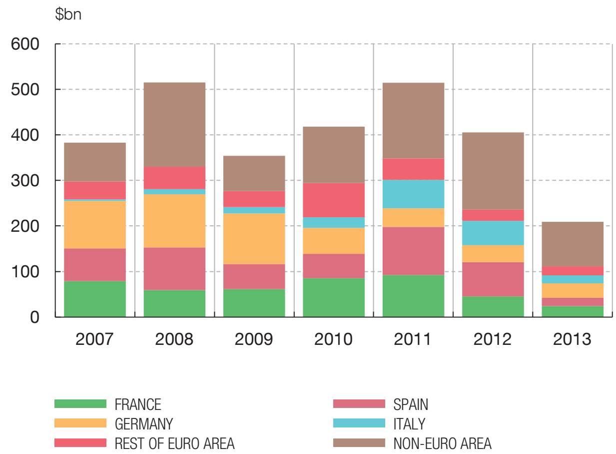
BREAKDOWN OF ISSUANCE BY TYPE OF CAPITAL

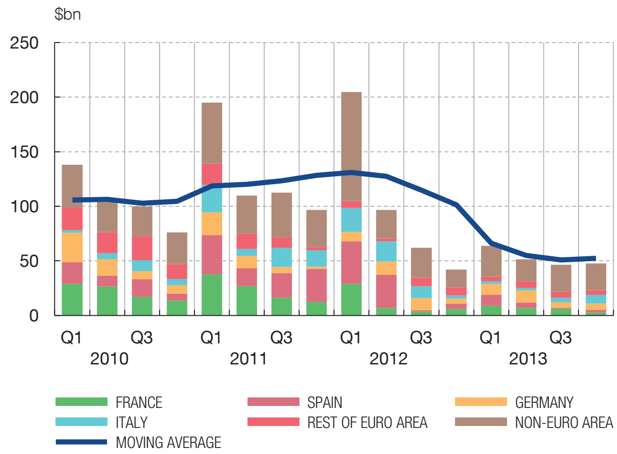


SOURCE: Bloomberg, issue prospectuses.

GROSS INTERNATIONAL ISSUANCE OF COLLATERALISED BONDS BY ISSUING COUNTRY OR REGION

CHART 10





SOURCE: Dealogic.

types of bonds are a vital instrument for the banking sector of those countries where they have been used for the financing of mortgage activity, as in Germany and Spain. A total of $209 billion of covered bonds were issued in 2013, in what was the weakest year since 2001. This weakness was more marked in the euro area (where the lowest level of activity since 1996 was recorded) than in the rest of the world (see Chart 10).

Focusing on Europe[2], lower issuance in 2013 was firstly due to a series of structural supply-side factors, such as the lower European funding requirements further to bank deleveraging and the weak generation of mortgage loans in certain countries, along with factors linked to regulatory changes, such as the greater concern over asset encumbrance[3]. Adding to this is the fact that, so far, alternative underlying assets to those traditionally used (loans to SMEs) continue to be under-utilised. Secondly, it is believed favourable market conditions in 2013 enabled more institutions to diversify their funding sources by means of the issuance of a greater proportion of senior non-collateralised debt, although this type of debt also fell in absolute terms. Hence, the volumes of collateralised debt observed in previous years were defensive in nature, since, in a highly volatile environment, some issuers had no other sources of financing available. Lastly, the presence of alternative programmes such as LTROs or the British *Funding for Lending Scheme* should also be highlighted, as they contributed to easing funding tensions.

In any event, it should be stressed that the demand for debt backed by European collateral remained robust and was greatly over-subscribed throughout the year. The search for yield and greater stability also ensured investors' interests in the countries most affected by the euro crisis, whose weight in the primary market for issuance not retained in the euro area increased in 2013, especially in the fourth quarter, when there were few instances of retained issuance of collateralised debt[4]. Issues in 2013 tended, moreover, to be for a

2 When we refer to Europe it is essentially to the euro area and to the United Kingdom.

3 Moreover, some uncertainty remains over the treatment of collateralised debt in respect of certain aspects of the new European regulations, such as the upcoming LCR or the future European resolution directive. In a Fitch survey, investors identified the regulatory treatment of covered bonds as one of the main future challenges for these instruments.

4 Such issues may have occurred, but may not have been recorded in Dealogic. Of note in this respect was the ECB's announcement in July on further haircuts to ABSs and covered bonds used as collateral by the ECB, with the aim of affording them more uniform treatment, and it distinguished for the first time between retained and public covered bonds, penalising the former, although that penalisation was diluted by the generous definition applied to retained covered bonds. Furthermore, according to Bank of America - Merrill Lynch, there have been cases of collateralised bonds that had initially been retained being placed once more on the market.

longer term. In the secondary markets spreads narrowed across the board, and this was only interrupted during the bout of volatility in the June-September period, which especially affected, as on other occasions, the peripheral countries. The year 2013 also saw specific innovations in this market, such as the issuance of covered bonds with the possibility of extending maturities in the event of the default of the issuer, or issues with an underlying asset other than mortgage loans, such as loans to SMEs[5].

Outside Europe there was also a decline in issues of covered bonds, due essentially to the reduction in the activity of the main issuers: Canada and Australia. That said, non-European institutions accounted in 2013 for 16% of collateralised debt obligations (compared with 21% in 2012), thereby consolidating their importance as issuers of this type of instrument. Canadian banks faced the task of establishing programmes adapted to the new end-2012 requirements and they did not issue again until July. Australian issues normalised after peaking in 2012 (the attendant legislation was approved at end-2011) and in 2013 the proportion in the bank financing of other instruments, such as uncollateralised senior debt and RMBSs, increased once again. Both Canada and Australia were major issuers in the market for dollar-denominated collateralised debt obligations in 2012; however, during 2013 the Canadians issued a greater proportion of euro-denominated debt. In this connection, the harsher regulatory treatment for this type of instrument in the United States compared with Europe adversely affects demand by US investors. It should be added here that, from the supply standpoint, the lack of specific legislation in the United States explains why the market remains dominated by foreign issuers, in particular Canada. By contrast, headway did continue to be made in creating legislation in other countries: South Korea became the first Asian country to have specific legislation for collateralised debt and New Zealand continued to make headway in this respect. The Singapore monetary authority laid down the final rules for issues of this type of debt, although it continued without specific regulations for the moment. In the case of Latin America, the issue by Santander Chile notably saw the inauguration of the Chilean legislation on mortgage-backed bonds approved in 2012.

Activity in other markets

SOUND PERFORMANCE BY EQUITY ISSUES

Equity issues[6] in 2013 ($924 billion) were the highest since 2010 (see Chart 11). Although the level of issuance remains below that for 2006-2007, the year 2013 may be considered to be one of recovery for these markets, especially in the case of the developed countries. The recovery extended to practically all categories of shares, with the sizable issues of convertible securities proving notable. Issues over the course of the year did not behave in a uniform manner and varied in terms of the macroeconomic outlook at each point in time or of the stock market corrections that arose in summer. As a result, the sluggishness of 2013 Q3 was followed by the fourth quarter evidencing considerably more momentum.

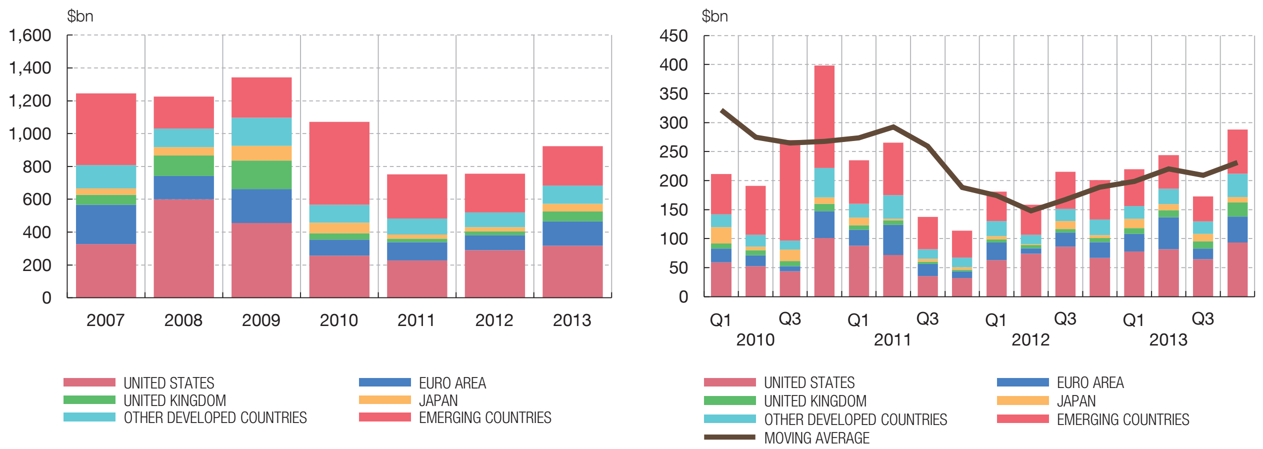
One of the factors most conducive to this sound performance was the stock market pick-up in the main developed countries. This improvement was based, first, on the prospect of better economic growth for 2014, especially in the United States, and on greater market stability; and, further, on the dynamics of the search for yield beyond fixed-income: in 2013 worldwide flows to equity funds exceeded those for bonds for the first time since 2007[7], given the bigger return on shares. As regards the effect that expansionary monetary

5 Following the Commerzbank covered bond backed by loans to SMEs, issued in February, NIBC (The Netherlands) placed the first pass-through covered bond in October. What is involved is a structure that allows higher and more stable ratings to be attained than is the case for bullet bonds by means of the reduction in refinancing risk and greater decoupling from the issuer's rating.

6 These include primary issues (made by the institution itself) and secondary issues (sale of shares by current shareholders of the institution).

7 Data to 11 December.

INTERNATIONAL EQUITY ISSUANCE AND PLACEMENT BY ISSUING COUNTRY OR REGION (a) CHART 11



SOURCE: Dealogic.

a Equities include preference shares and exclude closed-end funds.

policies may be exerting on equity markets, the ratio of prices to business profits increased once again both in the United States and in the euro area, against a background in which profit expectations remained moderate. Precisely because of this, some investors are concerned about the equities market being overvalued.[8] The stock market highs posted were conducive to the increase in financial sponsor[9]-related issues, especially in the United States. In the case of the emerging markets, the scaling down of growth expectations and the doubts arising over their long-term vulnerability, which were reflected in less favourable stock index prices than those in the developed countries, account for the lesser momentum of equity issues and explain why investment fund flows towards these countries' shares were negative for the year as a whole.

The gradual withdrawal of monetary stimuli could be prompting a “rotation” by investors towards equities. However, the scale on which this is taking place is still uncertain. According to some analysts, the rotation is for the moment essentially a retail phenomenon, centred above all on the United States. The influence of this rotation depends on the behaviour of institutional investors, who are in the majority in bond markets. In this respect, the regulatory changes under way and other structural factors, such as demographic trends, mean it is complex to anticipate changes in their strategy.

As to placement and issuance of shares, last year witnessed the biggest volume of IPOs in developed countries since 2007 ($117 billion), with an across-the-board improvement. The year 2013 was one of transition, in which the search for yield in an environment of low rates (reflected in the interest for high-yield defensive shares) combined with expectations of higher economic growth (from which cyclical industries would benefit). These two trends were reflected in the composition of US stock market launches, led by high-dividend, high-yield stocks such as Master-Limited Partnerships[10] and real estate investment trusts

8 *IIF Weekly Insight,* 16 January 2014.

9 A financial sponsor company is defined in Dealogic as a private equity investment company which acquires other existing companies through a leveraged buy-out (LBO) or a management buy-out, takes charge of its restructuring and subsequently monetises its position through the sale of its shares. These transactions do not necessarily indicate that the seller of the shares on the market is the actual financial sponsor.

10 Shares in Master-Limited Partnerships (MLPs), the owners of energy-related assets. These enjoy substantial tax breaks. MLPs are often linked to the oil and gas industry, in which very high issues were recorded in 2013.

(REITs), and others linked to the improvement in the business cycle, such as those in the construction, hotel and technology industries[11].

In the specific case of Europe, issues in the euro area ($148 billion) and the United Kingdom ($60 billion) were the highest since 2009. Of note was the increase in IPOs in the transport and real estate industries. If follow-ons[12] to the initial launch are also taken into account, the banking industry was foremost, recording its highest volumes since 2009. The main issue on a global scale was that by Barclays, carried out so it could adapt to the new regulatory requirements. Other major recapitalisations involved German and Greek banks. It is also noteworthy that the proportion of secondary issues in the European banking industry in 2013 was the highest since 2005 (e.g. the Lloyds privatisation in September).

Share issues in the emerging countries improved slightly on 2012 ($241 billion), although their recovery was not on the scale enjoyed in the developed markets. The situation was similar for IPOs, which were partly affected by the decline in Chinese IPOs further to the suspension of the issuance of A-shares[13] as from October 2012. The withdrawal of this suspension was announced in late 2013, while further headway was made towards an IPO system similar to that in the United States; accordingly, a rise in these shares is expected in 2014.

PICK-UP IN THE INTERNATIONAL ISSUANCE OF SYNDICATED LOANS

Activity on the market for syndicated loans, those granted by a group of banks to a single borrower[14], picked up considerably in 2013, increasing by 23% and attaining a volume of $3,951 billion in the developed countries (see Chart 12). The increase was across the board in terms of the lender regions, although mention should be made of the United States (32% y-o-y) and Europe (26% y-o-y), while in Japan the increase was less than 1%. The emerging markets alone saw declines on the syndicated loans market (–4% y-o-y). In terms of borrower creditworthiness, there was a bigger increase in leveraged loans[15], which group high-risk loans and provide higher yields, in line with the prevailing environment of yield search and risk appetite. Leveraged loans as a proportion of total loans thus increased in 2013 to 44%, up from 40% in 2012.

Despite the rise in the syndicated loans market, the latest BIS Quarterly Review[16] points to a change in the composition of the financing of NFCs, especially in the case of large corporations. Thus, if the volume of corporate bond issues is compared with that of syndicated loans in Europe, the former can be seen to have exceeded the latter in significance. In the case of the United States, the proportion of the volume of syndicated loans relative to funding on the capital markets has held up, the latter accounting for 33% of the total.

SLIGHT IMPROVEMENT ON STRUCTURED FINANCIAL MARKETS

International securitisation issues recovered in 2013, although their level is still far below that attained in 2007 (see Chart 13). Total issues increased by 11% to $478 billion, still far off the 2007 figure of $2,003 billion.

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11 There was a reduction in volume in the technology industry owing to the Facebook effect in 2012, but the number of issues was as high as in 2012. The main issuing industry was health care, considered defensive, and, hereunder, the pharmaceutical industry.

12 Follow-on shares can be primary market shares (the company itself decides to increase its capital, which dilutes earnings per share) or secondary market shares (the company shareholders sell a portion of their shares, which neither increases the number of shares nor dilutes earnings per share).

13 A-shares are renminbi-denominated shares belonging to Shanghai or Schenzen stock market-listed companies which originally could only be acquired by domestic investors. See http://lexicon.ft.com/Term?term=A_share/B_share-markets.

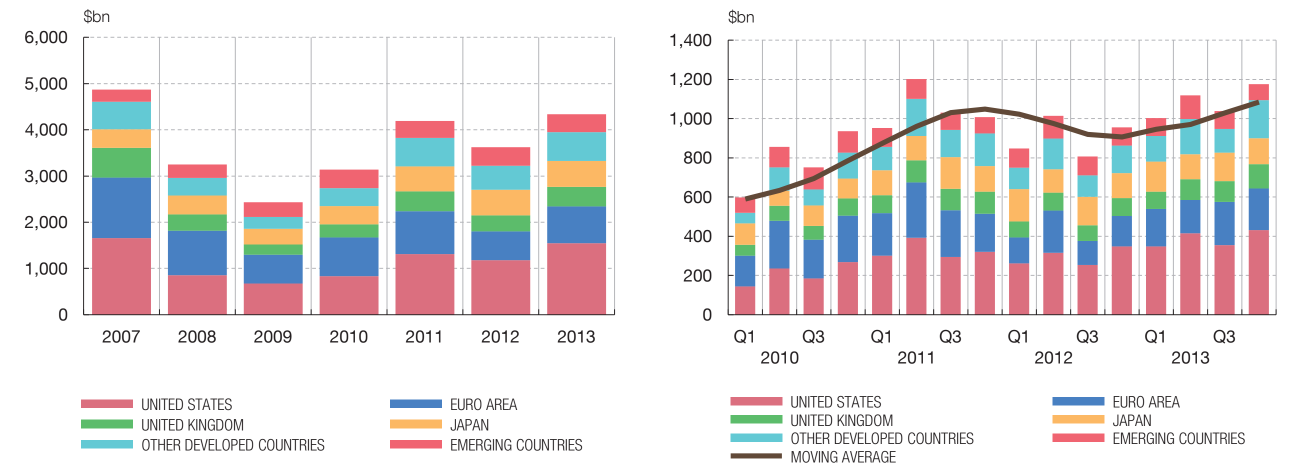
14 Also included are certain bilateral loans that account on average for 5% of the sample total.

15 Included in this category are companies with a credit rating of BB+ or less.

16 December 2013.

INTERNATIONAL ISSUANCE OF SYNDICATED LOANS BY LENDER COUNTRY OR REGION

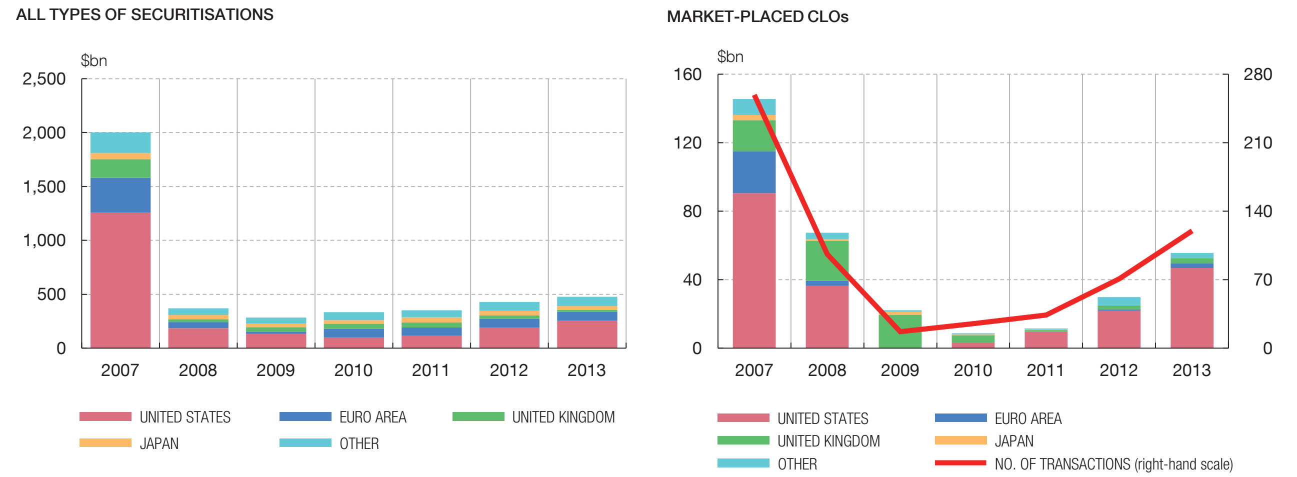
CHART 12



SOURCE: Dealogic.

MARKET-PLACED SECURITISATIONS BY ISSUING COUNTRY OR REGION (a)

CHART 13



SOURCE: Dealogic.

a US agency issues are excluded.

By region, there was a notable increase (35%) in placements in the United States, while elsewhere there more moderate rises or sizable declines, as in Japan (-19 %) and the United Kingdom (-46 %). By type of collateral, the recovery is chiefly discernible in certain classes of instruments, such as CLOs (collateralised loan obligations), which are backed by high-risk loans to NFCs. Issues of CLOs in 2013 were practically twice those in 2012, rising to $56 billion and being placed in the main in the United States (84% of the total) (see Chart 13).

Finally, there was a noteworthy revival of certain instruments, such as payment-in-kind notes, which allow borrowers to pay their creditors with more debt and which grew to a volume of $16.5 billion in 2013, against $6.5 billion in 2012.[17] This growth should be viewed with caution in light of the high default rates of these products during the initial years of the financial crisis.

17 http://www.bloomberg.com/news/2013-12-09/bis-sounds-alarm-over-record-sales-of-payment-in-kind-junkbonds.html.

Conclusions

Issuance activity on the capital markets in 2013 reflects a trend in keeping with favourable monetary conditions and less concern over extreme risks. In this respect, companies (particularly those with a higher level of risk) have found favourable conditions for placing their fixed-income issues. Along these same lines, there has been a clear recovery in equity issues and historically high issuance volumes in the emerging countries.

At the same time, certain trends observed in previous years continued to deepen. The public sector, for instance, continued to see its net borrowing decline, which translated into less dynamic issuance. In the banking sector, for its part, issues fell, especially in the case of European banks, as a result of the efforts to lessen leverage in the industry. At the same time, issues of hybrid products increased significantly as a response to the new Basel III regulations. This trend is part of the setting of bank disintermediation, which is more relevant in those areas which depended to a greater extent on deposit institutions' intermediation role. The market for complex securitisations also picked up to some degree, albeit with issuance standing far below pre-crisis levels.

The outlook for the current year suggests the same underlying trends will continue: disintermediation – with a strengthening of the (non-bank) fixed-income markets – and deleveraging (which would be in the opposite direction). However, the progressive withdrawal of the monetary stimuli may affect these trends in countries such as the United States and the United Kingdom. The biggest doubts concern the impact of these developments on the most dynamic segments in recent years, such as high-yield corporates or the emerging markets.

17.2.2014.