IFC Experiences: Developing Local Currency Debt Markets

25th - 26th April 2007
It is a good thing ...

Bonds denominated in local currency, predominantly sold to domestic investors and issued by resident companies are a good thing.
Why? ...

We have seen benefits for market participants ...

**Issuers**
- Lower funding costs
- Longer tenors - curve extension
- Mitigation of foreign exchange risk
- Entrance of foreign issuers
- Broaden access of finance to sub investment grade companies

**Institutional Investors**
- New investment assets
- Risk diversification

**Financial Markets**
- Reduce vulnerability to global financial shocks
- Pricing transparency
- Creation of derivative instruments
- Resource mobilization
- Additional source of finance
However ...

Conclusion

Credit quality improvements should continue to drive performance.

Positive credit trends are not universal — differentiation is imperative.

Volatility comparable to broader credit markets.

Local currency markets remain unexploited.

Michael C. Taylor
Wellington Management, LLP
11th October 2006

1 As of December 31, 2006 had client assets under management totaling over US$575 billion.
Emerging Markets Evolution
Total Domestic debt Issuance ...

![Graph showing total domestic debt issuance from 1990 to 2005 in billions of US dollars. The bars represent Emerging Markets and Developed Markets. The annual growth rate is shown as 175% for Emerging Markets and 678% for Developed Markets. The source is BIS Quarterly Review: December 2006, Table 16A: “Domestic Debt Securities”.

Source: BIS Quarterly Review: December 2006, Table 16A: “Domestic Debt Securities”.

Emerging Markets
Developed Markets

Annual Growth Rate
175%
678%
Domestic institutional investor evolution ...

Pension fund assets under management (USD bn)

Mutual fund assets under management (USD bn)

Source: Joyce Chang, Head of Global Emerging Markets, Global Currency and Commodities Research; JP Morgan; “How will Emerging Markets Fare in the Coming Years”; October 16-19, 2006
Improving underlying country credit ...

- Robust GDP growth and sound fiscal policies improved emerging market credit across all regions

- Approximately 40% of the JP Morgan Emerging Bond Index is now rated investment grade, compared to approximately 12% ten years ago
IFC and Local Market Development
IFC’s three-pronged role ...

Issuer

• Achieve attractive funding costs
• Diversify investor base
• Capture arbitrage

Private Sector Development

Advisor

• Create consistent and transparent financial markets legal regimes
• Establish payment and settlement systems
• Develop capital markets

• Expand IFC’s partial guarantee and other structured products
• Reduce credit risk (no foreign exchange impact)
• Provide local currency funding to clients
• New source in addition to banks
Local currency issue track record...

Source: BIS Quarterly Review: December 2006, Table 16A: “Domestic Debt Securities”.
Hurdles we face putting the puzzle together ...

- Local oriented rules / regulations
- Tax Demands
- Lack of competitive tension - Local Gorillas (Issuers) vs Euro (Investors)
- Investor Credit Assessment / Education
- Swap market illiquidity
- Limited market transparency - mispricing potential
- Exposure to payment and clearing system
- Underwriters / -Expertise -Credit Risk

Local vs Euro
Conclusion
Building a fertile environment ...

- SME IFC clients
- Blue-chip corporations
- Increase in institutional investors
- Development of domestic Institutional investors
- Deregulation, an outlet to issue medium- and long-term debt
- Reform of social security systems and financial deregulation
Sound public debt management helps ...

<table>
<thead>
<tr>
<th>Upgrading of trading, clearance and settlement systems</th>
<th>Development of repo and derivative markets, which help market participants better manage interest rate risk</th>
<th>Use of open auctions and similar market tools for placing debt</th>
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<tr>
<td>Pre-announcement of the issuance calendar</td>
<td>Creation of a primary dealer system, to provide more liquidity to domestic issues</td>
<td>Establishing better channels of communication with the market</td>
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Conditions required for bond market development are comparable to those that cultivate the progress of the banking system
How policy advisors / makers can assist …

“Plumbing is Vital”

- Investor regulatory limitations
- Risk Weighting - adoption of Basel II
- Reserve eligibility
- Accounting standards - IFRS / US GAAP
- Taxation - World Bank Group status
- Domestic disclosure - International conformity
- Prospectus language - global standards