

Corporate foreign bond issuance and interfirm loans in China

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Motivation

- **Surge** in foreign borrowing by emerging markets (EMs) after the global financial crisis.
 - ▶ Number of outstanding **international** bonds issued by EMs between 2007 and 2016 almost tripled.
- Importance of **nonfinancial** corporations.
- **China** played pivotal role in international bond issuance increase.

This paper:

- Do Chinese firms use international capital markets like ‘typical emerging market firms’?
 - ▶ **Misallocation**? Reduction in investment and reduced value creation?
- Documents the main **patterns** of international bond issuances by Chinese non-financial firms.
- Analyzes the **use** of the issuance proceeds.

Methodology

- Merging **bond-level** data from Dealogic with **firm-level** data from China Stock Market & Accounting Research (CSMAR).
 - ▶ Bonds issued by Chinese nationals between 2005-2015.
 - ▶ Domestic and international issuances in all currencies by all types of issuers.
- **Linear probability models** to uncover the determinants of dollar bond issuance.
 - ▶ Regress issuer dummy over a set of firm characteristics and year FE.
 - ▶ Regress uses of funds over an issuer dummy, a set of firm characteristics and year FE.

Findings

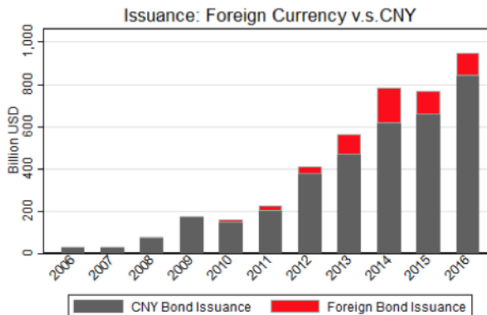
- USD issuance is positively correlated with **interest rate differential**.
- Interest rate differential increases (decreases) the likelihood of dollar bond issuance by **risky** firms (exporters and profitable firms).
- Risky firms do more **inter-firm lending** than non-risky firms.
 - ▶ Lending rose significantly after the **regulatory shock of 2008-09** aiming to restrict the financial activities of risky firms.
- Risky firms try to boost profitability by **speculative activities** that resemble the behavior of financial institutions, escaping prudential regulation.

Contribution I

- **Important** question with implications for risks to the global economy that has caused **controversy** among financial policy makers.
- Relates to the literature on **incomplete financial markets**, the literature on the links between **international bond issuances and capital controls** (Shin and Zhao (2013); Gruić et al. (2014); Caballero et al. (2016); Acharya and Vij (2016)), the literature that looks at the development of **Chinese capital markets** [Bai, Hsieh, and Song (2016); Huang, Pagano, and Panizza (2016)]
- Contributes to the literature of **debt issues of EMs** [Bruno and Shin (2017); Caballero, Panizza, and Powell (2016); Shin and Zhao (2013)].
 - ▶ Complements macro-finance perspective with **corporate finance considerations**.
 - ★ Rich, **micro-data** can shed more light into this question

Main Issues I: Results Interpretation

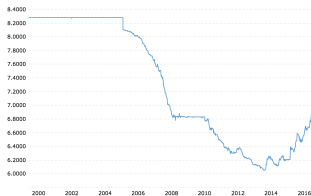
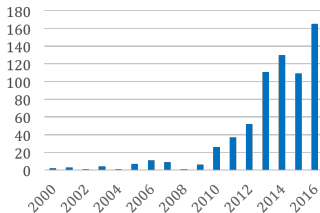
- USD bond issuance generally slower than the growth of yuan bonds. Indication of carry trade activity or **natural financial development**?
- Is the effect of regulation **immediate** or **lagged**?
 - ▶ 2007: regulation guide for corporate bonds by the China Securities Regulatory Commission. Publicly listed companies now allowed to issue corporate bonds which are traded on exchanges.
 - ★ Lagged effect or no effect on the USD debt issuance?



Non Financial/Non Govt Sectors Only

Data Source: Dealogic, 2016

Main Issues II: Number of USD Bond Issuances and the Exchange Rate



★ Spot fx returns erode part of 'carry trade gains' between 2014-2016 when USD bond issuance peaks. Dollar appreciation may generate losses through **negative balance sheet effects** → vulnerability of the yuan.

Main Issues III: Endogeneity issues

- **Endogeneity** of firms' cash holding? Higher **cash holding** goes together with **low credit ratings**.
- **Risky sectors?**
- Are firms being opportunistic or they need to establish an investor base / obtain **access to international financial markets**?
- Did the 2009-2010 policies cause the Chinese **shadow banking system** growth?
 - ▶ **Also**, in 2011 dollar deposits became popular, likely in response to sudden weakening of the **housing market**, the **economy**, and the **yuan**.

Main Issues IV: Firm Heterogeneity

- Are the issuances seasoned or unseasoned?
- Are these state-owned or private-owned firms?
- What happens to Chinese **capital controls** during this period? [Caballero, Panizza, and Powell (2015)].
- **Other uses** of funds? Dividend payments?

Overall

Assets

- **Insightful** and **important** paper
- Very interesting for **policy**
- Rich dataset

Room for improvement

- More emphasis on the **econometrics**: strengthen **identification** and robustify main findings.
- Few interesting **channels** that could be further explored
- Exploit more firm **heterogeneity**.