

Assessing Trends and Risks of US Dollar Corporate Bonds in the EMEAP Region

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Summary

The USD non-financial corporate debt in the EMEAP economies has been growing rapidly since the outbreak of Global Financial Crisis (GFC). However, bonds in the region have shown deterioration in overall quality and increasing issuance of short-term bonds. These may expose firms to higher rollover risks, especially during stress periods. Our empirical analysis confirms the importance of rollover risk in driving up the default risk of non-financial corporates after controlling financial characteristics of individual firms and country risk factor. The results also show that the risks during periods of financial distress are mainly found in emerging market economies (EMs) of the region. We also find that within the investment grade (IG) universe, BBB rated bonds, which are subject to greater fallen angel risks and account for a higher share of IG bonds after the GFC, would be exposed to higher default risk due to the elevated rollover risks. Our findings have three financial stability implications.

First, while the low interest rate environment may provide breathing space for corporates, the accumulation of debts may raise concerns about the debt sustainability problem of corporates in the region. Second, the increasing reliance on shorter maturity bonds may expose firms systemically to a sharp rise in funding cost and rollover risks should US monetary policy tighten. Third, EMs, particularly those with weaker economic fundamentals should stay vigilant to the increasing exposures of their corporate sector to USD bonds and the potential currency mismatch problem, as these vulnerabilities could rise sharply if their economies are under stress.