The Effect of Government Reference Bonds on Corporate Borrowing Costs: Evidence from a Natural Experiment

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Summary

Researchers have recently studied the interactions between corporate and government bond issuances within many countries. Some conclude that government bonds compete with private bond issuances, while others maintain that government bonds provide valuable reference entities that improve the private sector's ability to issue its own bonds. We study the special case of China's 2017 issuance of two sovereign bonds denominated in U.S. dollars (USD). We find that USD-denominated Chinese corporate bonds experienced a decline in yield spreads, bid-ask spreads, and price volatility around the time of this sovereign issues' announcement. The yield spread changes are particularly large for corporate bonds with maturities similar to those of the USD sovereigns. We conclude that these new bonds serve as useful reference instruments, helping investors to price and hedge the risks impounded in Chinese corporate bonds.