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REVIEW ARTICLE

Corporate bonds vis-a-vis bond market: Global economy

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Abstract

Corporations issue corporate bonds, which are then sold to investors as debt to raise capital. Both the firm and the investor gain from this arrangement since the company gets the capital it needs, and the investor receives interest payments at a set or variable rate. Even in the early aftermath of the financial crisis, it is conceivable to consider corporate bond markets as a vital component of economic development, financial stability, and economic recovery, especially in the short term. A vital source of capital financing, they give companies the funds they need to expand and develop, create jobs, and offer the products and services that society requires to prosper. Following the global financial crisis, structural changes in the financial industry have boosted the demand for liquidity among corporate bond investors to levels well over the market's capacity to provide it during stressful periods, as this research found. To get a whole picture of the corporate bond market, this research looked at all phases of growth as well as the connection between the corporate bond market and the rest of the global economy.

Keywords: Corporate, bond, market, economy, finance

Introduction

After the financial crisis, the emergence of the corporate bond market was credited with economic expansion, stability, and recovery. They are a vital source of money for businesses, enabling them to grow, develop, create jobs, and supply the products and services people need. The G20 and other supranational organizations have increasingly emphasized the need for long-term financing via securities markets, especially corporate bond markets. Local currency bond markets throughout the globe are being encouraged and guided by a 'diagnostic framework' devised by the IMF, the EBRD, and the OECD in July 2013 (Asquith *et al.*, 2013; Khondker, 2014; Ge & Liu, 2015). Corporate bond markets were the focus of two IOSCO reports, one in 2004 and the other in 2011 (Bao *et al.*, 2011; Bhole *et al.*, 2004; Manganelli, 2012). This collection of results provides an up-to-date and worldwide assessment of changes in corporate bond markets from 2004 (2000, where data permits), along with topics that may require additional study from the viewpoints of market efficacy, risk, and shareholder rights (De Bondt, 2004). Well-developed corporate bond markets may be necessary for long-term financial stability and economic prosperity. Over the last decade, the size and importance of the corporate bond market have increased dramatically. This growth is occurring in more locations than just developed markets. As worldwide access to and participation in corporate bond markets has grown, certain developing nations have created well-developed corporate bond markets. Examples of these issuances would be high-yielding investment grade, local or nonlocal currency (Eurobonds), refinancing, and those issued by both emerging and developed countries' financial or non-financial issuers. Because of the varying demand and supply characteristics, the markets for these bonds have expanded differently since the financial crisis began.

Bonds now account for 19% of worldwide non-financial corporate debt, up from 10% in 2000 and 2007, respectively (Braun *et al.*, 2008). All areas have seen a transition to bond financing. From a proportion of 19% of total corporate debt financing in 2000, bonds now account for 34% of US corporate debt financing. Western Europe and emerging nations are increasingly adopting the US model of providing corporate financing via a combination of banks and debt markets. Companies' use of bond financing in Western

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Europe almost quadrupled from 9 to 17% over the same period, although it remained less than half as prevalent as in the United States. From 1% in 2000 to 11% in 2016, bond financing accounted for over a quarter of China's total corporate debt. In Brazil, it increased from 5 to 25%. Globally, non-financial corporations have increased their issuance of bonds and the total quantity of outstanding bonds. From $800 billion in 2007 to $2.4 trillion in 2017, annual issuance has surged 2.5 times. A total of $860 billion in U.S.-based bonds were issued in 2017, compared to $421 billion in Western European bonds. Between 2007 and 2017, issuance in China more than doubled, from a modest $33 billion to approximately $357 billion. A rise from $85 billion in 2007 brought the issuance in other developing nations to $164 billion in 2017. Corporate bonds have grown 2.7 times since 2007 to $11.7 trillion in worldwide value, tripling compared to global GDP.

Literature Review

Numerous studies have examined corporate bond markets, but most are in capital structure (Guha *et al.*, 2010). They look at how well optimal capital structure theories explain things. Acharya (2011) discovered that long-term debt and equity market shifts are key variables in corporate security concerns. Corporate borrowing is adversely related to actual option market value (Pinches & Singleton, 1978). It also rationalizes corporate borrowing practices, such as matching asset and loan maturity dates. MacKie-Mason (1990) discovered companies care about who finances them, not only the debt/equity split. Equity is more than just that. Gabbi & Sironi (2005) studied the spreads on Eurobonds issued by major G-10 businesses from 1991 to 2001 to find pricing variables. Bond ratings are the best predictor of yield spreads, with investors relying more on rating agencies' evaluations. Neither primary market efficiency nor predicted secondary market liquidity can explain spreads and cross-sectional variability. Rating agencies and bond investors evaluate the risk of default in different ways. These factors have improved spot curve forecasts and bond pricing (Elton *et al.*, 2001; Elton *et al.*, 2011). Titman (2002) has studied financial market fragmentation and examined the impact on corporate financing techniques (Guha *et al.*, 2002). According to Titman, capital providers' choices may affect how organizations raise money and how much hedging they use. Companies that use financial intermediaries outperform those that borrow straight from investors at arm's length. These markets are most active during low riskless rates or financial intermediary profits. They cater to enterprises that are safe and lucrative. One research focused on India and other emerging markets (Chakraborty, 2010). Anand (2002) looked at the capital budgeting, capital structure, and dividend policy practices of Indian corporations. Based on financial expert evaluations, Sengupta (1998) concluded that enterprises with high disclosure quality had reduced effective interest costs. Aside from academic research, various policy papers and committee reports have examined enterprises' aversion to generating debt capital via the issuance of bonds. The Reserve Bank of India (RBI) has established several committees to improve India's corporate bond markets. A Hundred Small Steps, the R. H. Patil Committee Report on Corporate Bonds and Securitization (R. H. Patil Committee, 2005), the Percy Mistry Committee Report on Making Mumbai an International Financial Centre (Percy Mistry Committee, 2007), and the R. H. Patil Committee Report on Corporate Bonds and Securitization (R. H. Patil Committee, [Report of the Financial Sector Reform Committee], chaired by Raghuram Rajan (2009). The Khan Committee Report (2016) is the newest policy report. The multiple structural faults in the Indian corporate bond market, according to these committees, obstruct the establishment of a deep market. A lack of study and knowledge of variables influencing businesses' choices to obtain cash through bank loans or bond markets has been noted. In recent years, the bond markets in developing nations have been plagued by a lack of demand and a buy-and-hold mentality among those who participate. Regulators feel frustrated that the corporate bond market has not matured despite several attempts. The most pressing concern is whether considerable progress has been accomplished and if basic business considerations influence decision-making. www.ijbed.org (accessed on July 2, 2018) According to the 53rd issue of the ABRM Journal, where to earn funds. As a result, an empirical study based on publicly available data and engaging various stakeholders may be beneficial. The ownership of corporate bonds has changed dramatically in recent years. On the other hand, mutual funds increased their assets quicker than insurance firms, reaching $2.2 trillion in the first quarter of 2020. From $738 billion in 2008, investment-grade corporate bond mutual funds' net assets grew to $2.159 billion in 2019; similarly, the net assets of high-yield corporate bond mutual funds increased to $337 billion in 2019 from $116 billion in 2008. Incorporated as the Investment Company Institute. There is inadequate liquidity when comparing trading volumes for corporate bonds to daily bond fund liquidity. O'Hara and Zhou (2020) forecast that average daily trading volumes for investment-grade bonds will be $22.1 billion in 2019 and $7.8 billion for high-yield bonds. On the other hand, Treasury securities have daily trading volumes of around $530 billion (TPMG, 2018). The top fifth percentile of bonds trades for the full 100 days, according to Boyarchenko *et al.* (2020), but the average bond trades for just 49 days. A study on capital structure and firm profitability from an Indian perspective found that good corporate governance can yield better economic performance (Selva, 2019). The allocation of corporate bonds can be done by specific decision-making processes (Ramalakshmi *et al.*, 2020).

Objectives of Research

- To examine the current situation of the corporate bond market with the global corporate bond market.
- To investigate the global economy's demand for a strong corporate debt/bond market.

Research Methodology

Secondary data sources were used in the study's analysis—re-analyzed data from the Organization for Economic Cooperation and Development (OECD). Thomson Reuters Eikon offers worldwide deal-level data on new corporate bond offerings supported by an investment bank, as evaluated by the Organization for Economic Cooperation and Development. Primary corporate bond market statistics are produced from the information included in this data collection. Also included are details such as the issuer's name and nationality, the quantity of money obtained and the purpose for which it was used, and the issuer's name and industry. The database is accessible via the Internet.

Result and Discussion

Companies may issue bonds and then sell them to the public as an investment opportunity. The firm gets the money it needs, and the investor receives a set or variable interest rate. When the bond reaches its "maturity," the initial investment is refunded, and the payments stop.

Forecasts of future income and profitability often determine the company's ability to repay the bond. Collateral might include the firm's tangible assets. A corporate bond is a debt that a corporation issues to obtain funds. Investment in corporate bonds is like lending money to the firm, except that the money is returned to the investor over time through interest payments. Because of their perceived risk, corporate bonds have higher interest rates than government bonds. Bonds rated "triple-A" are the safest and lowest yielding, while those rated "junk" are the least creditworthy.

High-quality corporate bonds are considered a conservative and safe investment option at the top of the investing food chain. Bonds are typically included in balanced portfolios as a hedge against more volatile assets like growth stocks. These investors buy more bonds and make fewer hazardous bets to protect their earned wealth. Bonds are a popular choice for retirees since they provide a steady source of income.

Corporate bonds are considered riskier than government bonds in the United States. The effect is that corporate bonds are virtually always more expensive, even if the company has a high degree of creditworthiness. It's known as the credit spread when the rates on high-rated corporate bonds are lower than the yields on US Treasuries.

One or more of the three US rating agencies—Standard & Poor's Global Ratings, Moody's Investor Services, and Fitch Ratings—perform financial checks to sell bonds. Bonds with the highest ratings, frequently called "Triple-A" rated bonds, have their grading system. To compensate for the increased risk associated with these bonds, they are referred to be "high-yield" bonds. Junk bonds are another name for them. A bond's rating is crucial for investors to know about its quality and stability. As a result, these ratings influence interest rates, investor demand, and bond prices.

A corporate bond's face value, or par value, is one thousand dollars. Almost most of them use a coupon-based payment system. An investment bank typically handles the underwriting and marketing of a company's bond issuance to investors.

The issuer pays the investor interest regularly until the bond expires. The face value of the bond is returned to the investor currently. Based on the performance of a certain economic indicator, bonds may have fixed or variable interest rates. Call clauses in corporate bonds allow for early prepayment if the firm believes it can get a better deal by issuing a new bond at a lower interest rate. Bonds may be sold early if the investor so desires. The bondholder receives less than the bond's actual value whenever a bond is sold. A bond's value is determined by the number of payments remaining before it matures. Investors may utilize several bond-focused mutual funds and ETFs to obtain access to corporate bonds. A kind of debt financing, corporate bonds are used to raise money for a company. Aside from bank loans and other unsecured financing like equity, they're a vital source of cash for many firms. Often, they are issued to provide immediate funding for a particular project that the firm has in mind. Generally, the borrowing firm prefers to issue debt rather than stock (equity financing) since it is less expensive and does not force it to relinquish ownership or control of the corporation.

When it comes to debt instruments, a company must be able to provide them to the market at an acceptable coupon rate to be desirable to investors. If a company's credit rating is assessed to be higher than average, debt may be granted at a reduced interest rate. A company needing a quick injection of money may sell commercial paper, which has a maturity of 270 days or fewer, akin to bonding.

In other words, when you purchase a corporate bond, you give the corporation some money. In other words, when investors buy stock, they effectively purchase a piece of the firm: a stock's value and the investor's ownership increase and decrease. If the stock price rises, the investor may resell it and profit, or they can keep the dividends the firm pays out.

Investing in bonds results in interest payments rather than profits for the investor. Only in the event of a business failure is the initial investment in danger. This is a critical distinction because even insolvent companies must fully pay their bondholders and other creditors. A shareholder's losses may only be recouped if all the company's obligations have been satisfied. A convertible bond is a debt instrument

that may be converted into the corporation's common stock if specific criteria are satisfied.

Global non-financial firms borrowed USD 2.1 trillion more in corporate bonds after returning to a more expansive monetary policy in early 2019. Despite 2018's decline in corporate bond issuance, this represents a significant turnaround and is like the record year of 2016 (Sensarma & Bhattacharyya, 2016). There was a record amount of non-financial corporate bond debt at the end of 2019. Since 2008, corporate bond debt has grown at an astronomical pace, resulting in record borrowing in 2019. Along with its expanding size, the outstanding stock of corporate bonds has changed in terms of quality and dynamics, which policymakers must consider. The current corporate bond stock has poorer overall credit quality, larger repayment needs, longer maturities, and inferior covenant protection compared to past financial cycles, as seen in the chart below. Non-financial corporations and the economy might suffer significantly if the economy slumps. Thus, today's corporate bond markets have grown in importance as a driver of monetary policy because of their size, quality, and dynamic nature. With low interest rates, firms have expanded their leverage ratios while retaining a BBB credit rating, the industry norm for investment-grade firms in the United States and Europe. BBB-rated bonds have accounted for 52% of all new investment-grade bond issuance in the recent three years. The distinction between investment-grade and non-investment-grade bonds is becoming increasingly essential since BBB has the lowest investment-grade rating. Companies' borrowing costs will rise, and their investment potential will be limited if the exact rating mechanisms that allowed for higher leverage are no longer in place, such as low interest rates or an economic slump. Non-investment-grade bond market liquidity will be tested if significant investors are forced to sell bonds upgraded from investment-grade to non-investment-grade status. Due to the increase in investment grade corporate bond offers' initial term lengths, downgrades will have a higher impact on portfolio value.

Since 2008, the overall amount of corporate bond issuance worldwide has averaged USD 1.8 trillion yearly. The annual average from 2000 to 2007 was more than twice as high. Due to the rise in interest rates, the statement that the central bank would be less accommodating, and concerns about the weakening economy in the second half of 2018, bond issuance decreased significantly. A boom in corporate bond issuance occurred in the first quarter of 2019 as major central banks signalled that they were preparing to reintroduce or adjust their accommodating policies. As a result, the total number of bonds issued in 2019 exceeded the previous record year, 2016.

Since 2010, the proportion of non-investment grade bonds issued has increased yearly, reaching 25% in 2019. Since non-investment grade issuance is already at a record high level (the highest since 1980), future credit cycles will likely see higher-than-average default rates. Only 51% of investment grade bonds in 2019 were BBB-rated, the lowest quality investment grade bonds. In 2000-2007, barely 39 per cent of the population had access. More than $13.5 trillion in non-financial corporate bonds will be outstanding by 2019. This is more than twice as much as was owed as recently as December 2008. There's been an increase in BBB-rated, non-investment-grade, and emerging market bonds since 2008. This has resulted in poorer credit quality bonds dominating the worldwide stock. Non-financial corporate bonds issued by corporations in advanced economies accounted for just 30% of the worldwide outstanding stock in 2019. Emerging and non-investment grade bonds issued by enterprises from advanced markets have a total repayment or refinancing obligation of USD 2.5 trillion, which is 41% of the total outstanding amount.

In the first five years of this decade, investment-grade bond maturities grew from 9.4 years to 12.4 years on average, according to Barclays Capital. In 2019, the average maturity for investment-grade bonds was 13 years. With longer maturities and worse credit quality, the bond market has become more susceptible to monetary policy shifts. Both factors are associated with increased price sensitivity to interest rate variations in the bond market. Pension funds, insurance companies, and investment funds are among the vital bondholders whose allocations are influenced by external credit rating agencies (ECRAs). Both regulations and self-imposed rating-based investing procedures have a substantial influence on the financial markets, and both are reflected in the investment mandates and policies of the financial institutions that use them. In 2008, ETFs based on the passive rating technique had assets under management of USD 32 billion; in 2018, they had assets under management of USD 420 billion. Bondholders from non-financial enterprises have also gained prominence. Large non-financial American corporations' aggregate bonds rose from USD 119 billion in 2009 to USD 356 billion in 2018. The most prominent company's corporate debt portfolio is 124 billion dollars worth of corporate loan instruments. The combined holdings of the six most significant exchange-traded funds (ETFs) equal this amount.

Investors have been able to seek higher yields due to an increase in the supply of BBB-rated bonds, but laws and investing requirements that are based on ratings often impact portfolio allocation. The significant concentration of BBB-rated bonds on the market might lead to big selloffs, which could generally stress corporate bond markets, leading to concerns about financial stability. Downgrades to non-investment grade status could lead to similar limitations.

Between $1.6 trillion and $2.1 trillion in bonds will mature annually between 2018 and 2022, setting a record (Koijen

& Yogo, 2022; Zhang *et al*., 2022). A total of $7.9 trillion in bonds worldwide will be due in the next five years, based on bonds already issued worldwide. However, certain short-term bonds may still be issued and come due throughout the five years. As much as $10 trillion in bonds are expected to mature over the next five years if present patterns in issuance are maintained (Exhibit 7). Of this amount, US firms will contribute $3 trillion, Chinese corporations will contribute $1.7 trillion, and Western European corporations will contribute $1.7 trillion, at the very least. A rise in interest rates may make refinancing more difficult for many people. Interest rate increases might significantly increase corporate default rates, already over the 30-year norm. We examine the capacity of corporate issuers to repay their debt in this section. We found that certain firms are currently barely able to afford their debt service obligations and that the percentage of these companies will increase as interest rates climb. Following the global financial crisis in 2008, global debt soared, exceeding three times the global GDP in 2018. An essential factor in this growth was non-financial corporate debt.

A similar financial disaster like the Great Recession has been predicted by practitioners and academics alike due to growing business indebtedness. Concerns about the COVID-19 epidemic have only grown. Considering the global economic slowdown brought on by border closures and lockdowns, companies' debt management has risen to the top of the agenda. This might be the Achilles heel of the global economy, increasing the slump and delaying economic recovery. Corporations borrow heavily from the market for corporate bonds. Non-financial companies borrowed $6,5 billion in corporate bonds from banks, while banks borrowed $1,4 billion from non-financial enterprises. Companies may be obliged to decrease investment and lay off people if the corporate bond markets are seriously affected.

Investment-grade corporate bond prices fell more than high-yield bond prices due to the COVID-19 crisis, which was expected given that high-yield bonds are riskier, less liquid, and more vulnerable to a worsening economy. Since market liquidity indicators like bid-ask spreads and price impact had deteriorated, trading an investment-grade bond cost the same as trading a high-yield bond.

Conclusion

Several experts believe developing a strong corporate bond market is essential for long-term financial stability and economic growth. Corporate bond markets have increased considerably in size and importance over the last decade regarding volume and value to the economy. This growth isn't limited to developed economies; it's also happening in emerging markets. Due to the development of global access to and activity in corporate bond markets, certain developing nations have benefitted from increasing access to and activity in corporate bond markets. Even though it still has several advantages, more significant business financing in developing nations, particularly in bond markets, has also brought a potential cause of financial instability, particularly in the bond market. A new set of techniques, distinct from those used to address more conventional causes of financial instability in developing markets, such as banks and government debt, will be required to cope with it. To design successful policies that minimize risk in the non-financial corporate sector while also taking advantage of the increased funding options that deeper debt markets may provide, it is essential first to measure and understand the risks companies face. Due to the increased danger of business financial difficulty resulting from the COVID-19 economic crisis, this problem may be significant. Several research areas may be helpful and should be explored further. First and foremost, more complete, and comprehensive assessments of the levels and mix of non-financial corporate debt across nations are required. As a result of its tendency to concentrate on specific markets and borrowers, current research on corporate debt tends to provide only a limited picture of the situation. For example, several empirical publications demonstrate the rapid expansion in bond financing during the Great Recession. Still, they tend to concentrate on the international bond markets rather than illustrating how other (much bigger) components of debt corporate financing grew over this period.

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