



FINANCIAL MARKETS SERIES

# BOND MARKETS

OCTOBER 2012



TheCityUK champions the international competitiveness of the financial and professional services industry. Created in 2010, we support the whole of the sector, promoting UK financial and professional services at home and overseas and playing an active role in the regulatory and trade policy debate.

TheCityUK has a global export focus with a commitment to help UK based firms grow their business in other parts of the world. In 2010, the financial services industry accounted for 9% of UK GDP and 12% of UK tax receipts. The sector currently employs more than 1 million people, more than 66% of whom work outside London, and underpins the businesses that drive jobs and growth. Added together with nearly 1 million employed in professional services, it is easy to see the importance of a sector that employs 7% of the working population.

TheCityUK provides constructive advice and is the practitioner voice on trade policy and all aspects of taxation, regulation, and other legislative matters that affect the competitiveness of the sector. We conduct extensive research and run a national and international events programme to inform the debate. Our senior team regularly engages with regulators and policymakers at home and overseas, ensuring the sector's views are represented at the highest levels. We are tasked with creating a new vision for the financial services sector. We are focused on supporting policymakers and business to deliver the new policy ideas which will help deliver growth.



# BOND MARKETS

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The importance of bond markets as a source of finance has increased during the economic slowdown as companies have diversified away from reliance on banks for funding and many governments also have increased borrowing. This report provides an overview of the global bond market with particular emphasis on the UK's role as one of the largest centres for issuance and trading of international bonds.

## SUMMARY

The amounts outstanding on the global bond market totalled a record \$100 trillion in March 2012, up 2% on twelve months earlier (Chart 1). Domestic bond markets accounted for 70% of the total, and international bonds for the remainder. The considerable growth in the size of the global bond market over the past decade means that in March 2012 it was almost twice the size of the global equity market which had a market capitalisation of around \$53 trillion. As a proportion of global GDP, the world bond market increased to over 140% from around 80% a decade earlier. The US was the largest market in March 2012 accounting for 33% of the value outstanding. It was followed by Japan 14%, the UK and France with around 6% each.

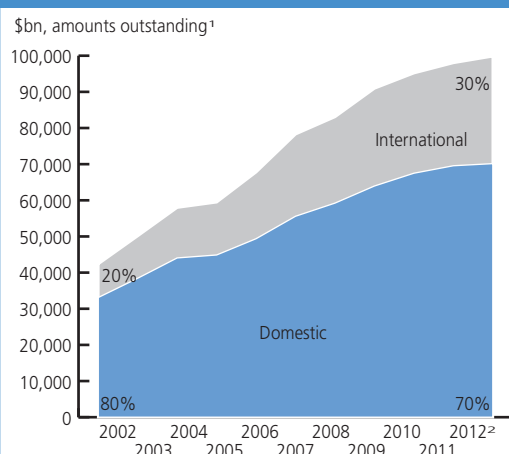
**Domestic bonds** The global outstanding value of domestic bonds increased by 2% in the twelve months to March 2012 to \$70 trillion. This was primarily due to strong government bond issuance during this period (Chart 2).

*Government bonds* accounted for 61% of the outstanding value of domestic bonds in March 2012, up from around a half in 2009. Demand for government bonds in many countries has been strong since the start of the economic downturn as investors avoided more risky investments.

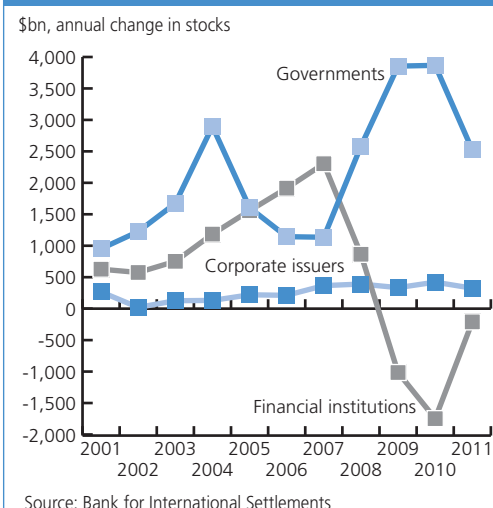
Concerns about the ability of some countries to continue to finance their debt have come to the forefront since 2009. Three countries significantly affected, Greece, Ireland and Portugal, collectively accounted for 6% of the eurozone's gross domestic product. Since June 2012, Spain has also become a matter of concern, as rising interest rates have begun to affect its ability to access capital markets, leading to a bailout of its banks and other measures. While sovereign debt increases have been most pronounced in only a few Euro area countries, they have become a problem for the area as a whole. Increasing concern about the ability of some countries to repay debt, has resulted in a significant widening of their government bond yields. On the other hand, countries perceived as having a low sovereign

Amounts outstanding on the global bond market reach a record  
**\$100 trillion**

**Chart 1**  
*World bond market*



**Chart 2**  
*Domestic bond markets, annual change in stocks*



credit risk have seen their borrowing costs fall.

**Corporate bond market** According to Dealogic, bookrunners' deal volume from global debt capital markets (DCM) totalled \$4.91 trillion in the first nine months of 2012, up 6% on the same period in the previous year. Corporate investment grade volume reached a record \$1.26 trillion, up 49% on the same period in 2011. Asia Pacific (ex Japan) DCM volume reached a record high \$794bn, up 51% on the previous record activity in the first three quarters of 2011.

The US corporate bond markets have long been an important source of capital for issuers. The relative importance of bonds as a source of finance for companies in Europe has increased since the start of the economic downturn. This was partly due to a decline in bank lending during this period. In the first nine months of 2012, European corporate investment grade bond volume totalled over \$360bn, up two-thirds on the same period in 2011 and the highest nine month total since 2009.

**International bonds** The outstanding value of international bonds increased by 2% in the twelve months to March 2012 to \$29.7 trillion. Net issuance of some \$1.2 trillion during 2011 was down a fifth on the previous year's total (Chart 3). The first half of 2012 was off to a relatively strong start with net issuance of over \$800bn. The US is the leading centre for international bonds accounting for around a fifth of global issuance. The US also has the lead in terms of value outstanding with 24% of the total in March 2012. It was followed by the UK, 13%.

**UK bond market** The nominal value of bonds outstanding of UK-based issuers increased by 2% in the twelve months to March 2012 to a record £3,504bn. Government bond issuance was strong for the third year running. TheCityUK estimates that the outstanding value of the UK bond market is likely to increase by 10% in the next 3 years to £3.8 trillion, due to substantial forecast Government issuance in the next few years, and a resumption of the rise in international bond issuance in the UK.

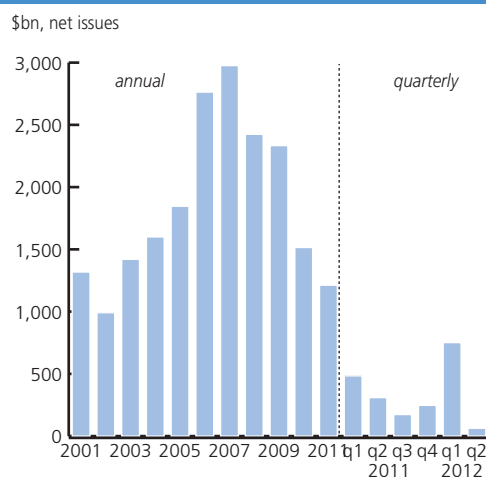
Excluding public sector interventions, UK public sector net debt increased to £1,024bn in the financial year 2011/12 from £905bn at the end of the previous year. Including financial sector interventions, net debt stood at £2.2 trillion. Excluding financial sector interventions, net debt as a percent of GDP increased to 66% from 60% in 2011/12. It is forecast by the Office for Budget Responsibility to peak at 76% in 2014/15, falling thereafter. The UK's fiscal deficit is amongst the highest in Europe, although its debt as a per cent of GDP is lower than in other large European countries. An unexpected rise in the deficit during 2012/13 means that the OBR's predictions of a peak are being called into question.

UK non-financial companies are mirroring a Europe-wide trend, and seeing an emerging shift from loans to bond finance. UK corporate bond issuance totalled \$75bn in the first 8 months of 2012, with a full year total likely to reach a record \$110bn. Financial institutions' issuance on the other hand dropped significantly in the past two years, with the full year total for 2012 likely to be the lowest in nearly a decade. The drop in bond sales by UK banks and other financial institutions and healthy overall demand for UK bonds, opens up an opportunity for non-financial UK companies to fill.

## Value of outstanding UK bonds amounts to **£3.5 trillion**

**Chart 3**

*Issuance on international bond market*



Source: Bank for International Settlements

**Table 1**

*London's share of the international bond market*

% share	----- 2011 -----		----- 2010 -----	
	UK	Rest of world	UK	Rest of world
Issuance	3	97	2	98
Secondary trading	70	30	70	30
Amounts outstanding	13	87	13	87

Source: Bank for International Settlements; TheCityUK estimates

**Table 2**

*Domestic bond market by residence of issuer*

	\$bn outstanding, March 2012			
	Total	----- of which -----		
		Public	Financial	Corporate
US	26,391	13,257	9,704	3,430
Japan	14,051	12,143	1,047	861
France	3,574	1,874	1,399	301
China	3,407	1,485	1,256	666
Italy	2,973	2,056	859	58
Germany	2,621	1,838	438	345
UK	1,823	1,524	279	20
Canada	1,622	1,134	307	181
Spain	1,574	750	804	21
Other	12,112	6,532	4,350	1,230
World	70,148	42,593	20,443	7,113

Source: Bank for International Settlements

**Table 3**

*Bonds by market-place*

Market place	Currency	Issuer	Main market	Syndicate	Primary investors
Domestic	Domestic	Domestic	Domestic	Domestic	Domestic
Foreign	Domestic	Foreign	Domestic	Domestic	Domestic
Euro	Eurocurrency	Any	Internat.	Internat.	Internat.

Source: International Capital Market Association (ICMA)

The UK's substantial domestic market in bonds is complemented by London's continuing role as a major centre for issuance and the trading of international bonds. London accounts for an estimated 70% of secondary market turnover in international bonds. The outstanding value of international bonds issued in the UK has been practically unchanged since 2008, after having doubled in value between 2005 and 2008.

## BOND MARKETS WORLDWIDE

The amounts outstanding on the global bond market totalled a record \$100 trillion in March 2012, up 2% on the value twelve months earlier (Chart 1). Domestic bond markets accounted for 70% of the total, and international bonds for the remainder. The considerable growth in the size of the global bond market over the past decade means that in March 2012 it was nearly twice the size of the global equity market which had a market capitalisation of around \$53 trillion. The US was the largest market in March 2012 accounting for 33% of the global value outstanding. It was followed by Japan 14%, the UK and France with around 6% each.

As a proportion of global GDP, the world bond market increased to over 140% from around 80% a decade earlier. Amongst more developed countries, the ratio between the value of the overall bond market and GDP was highest in Japan and the UK. In Japan this was almost entirely due to the large size of the domestic bond market, whereas in the UK this was due to the high proportion of international bonds (Chart 4).

**Domestic bond markets** The outstanding value of domestic bonds increased by 2% in the twelve months to March 2012 to \$70 trillion. This was primarily due to strong government bond issuance during this period (Chart 2). The large share of the US and Japanese markets (Table 2) primarily stems from the size of their individual economies as well as the high level of government borrowing over time. Emerging market corporate and government bonds have seen a strong increase in recent years, a sign of growing investor interest in opportunities outside the more developed markets.

*Government bonds* accounted for 61% of the outstanding value of domestic bonds in March 2012, up from a half in 2009. This was partly a result of large debt taken on by some governments in order to reverse the economic downturn, finance bank bailouts and sustain public spending in market conditions of lower tax revenues. Demand for government bonds in many countries has been strong during the economic slowdown as investors avoided more risky investments.

In relation to the size of the economy, in Europe, public sector debt is highest in Greece (161% of GDP), Italy (124%), Ireland (116%) and Portugal (114%). Net government debt is likely to increase in the next few years due to the high level of projected government borrowing in many countries. Countries such as Greece, Ireland, Portugal and Spain have seen rising yields since 2009, with some yields on government bonds hitting record levels due to concerns about the ability of these countries to finance and service their debt.

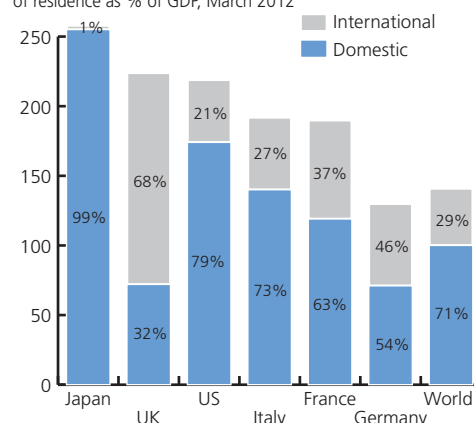
*The corporate bond market* According to Dealogic, bookrunners' deal volume from global debt capital markets (DCM) totalled \$4.91 trillion in the

# International bonds

account for 68% of outstanding UK bonds

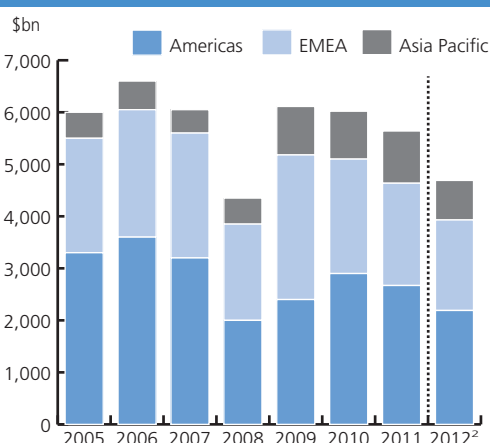
**Chart 4**  
Relative size of bond market

Value of bond market based on issuers country of residence as % of GDP, March 2012



Source: Bank for International Settlements; IMF; TheCityUK estimates

**Chart 5**  
Global debt capital markets volume<sup>1</sup>



<sup>1</sup> Only transactions with bookrunners are included; <sup>2</sup> First 9 months  
Source: Dealogic

**Table 4**  
Global debt capital markets bookrunner ranking

\$bn outstanding	\$bn 9m 2012	% share 9m 2012	% share 9m 2011
JP Morgan	349	7.1	6.8
Barclays	313	6.4	6.5
Deutsche Bank	298	6.1	6.5
Citi	289	5.9	5.5
Bank of America Merrill Lynch	248	5.1	5.6
Morgan Stanley	210	4.3	4.1
Goldman Sachs	203	4.1	4.5
HSBC	194	3.9	3.9
Credit Suisse	193	3.9	4.0
UBS	185	3.8	4.6

Source: Dealogic

first nine months of 2012, up 6% on the \$4.63 trillion raised in the same period in the previous year. Global corporate investment grade volume totalled \$1.26 trillion, the highest volume on record and up 49% on the same period in 2011. Asia Pacific (ex Japan) DCM volume reached a record high \$794bn, up 51% from the previous record activity between January and September 2011. JP Morgan, Barclays and Deutsche Bank were the leading global bookrunners in the first nine months of 2012 (Table 4).

The US bond market is the largest securities market in the world. Its value outstanding has doubled in the decade up to 2011 to \$37 trillion. Mortgage-backed bonds accounted for \$8.4 trillion of this total, Treasury bonds for \$9.9 trillion and corporate debt \$7.9 trillion. Most of the remainder was in Federal Agency securities and municipal bonds. Issuance

## European sovereign debt crisis

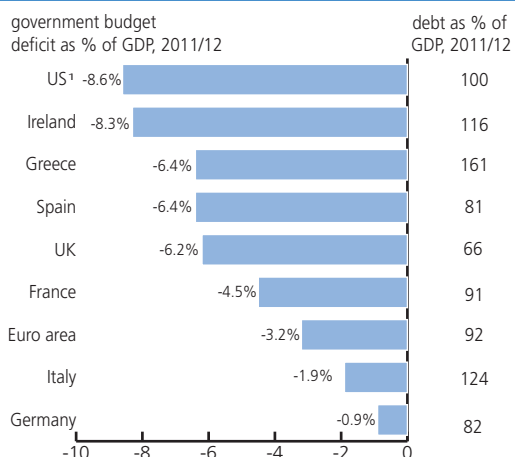
Government deficits and debt levels have increased as a result of the financial crisis and subsequent economic downturn. Large amounts raised by some governments were largely a result of debt taken to finance bank bailouts, reverse the economic slowdown and sustain public spending in market conditions of lower tax revenues.

Concerns about the ability of some countries to continue to finance and service their debt have come to the forefront since late 2009. Three countries significantly affected, Greece, Ireland and Portugal, collectively accounted for 6% of the eurozone's gross domestic product. Since June 2012, Spain has also become a matter of concern, as rising interest rates have begun to affect its ability to access capital markets, leading to a bailout of its banks and other measures. While sovereign debt increases have been most pronounced in only a few Euro area countries, they have become a problem for the area as a whole. In some countries where sovereign debts have increased sharply (Chart 7), increased concerns have emerged about their government's ability to repay debt.

Concerns about the crisis led Europe's finance ministers in May 2010 to approve a rescue package worth €750 billion aimed at ensuring financial stability across Europe by creating the European Financial Stability Facility. In October 2011 and February 2012, eurozone leaders agreed on more measures designed to prevent the collapse of member economies. This included an agreement whereby banks would accept a 53.5% write-off of Greek debt owed to private creditors, increasing the EFSF to about €1 trillion, and requiring European banks to achieve 9% capitalisation. To restore confidence in Europe, EU leaders also agreed to create a European Fiscal Compact including the commitment of each participating country to introduce a balanced budget amendment. European policy makers have also proposed greater integration of the EU banking system with euro-wide deposit insurance, bank oversight and joint means for the recapitalization or resolution of failing banks.

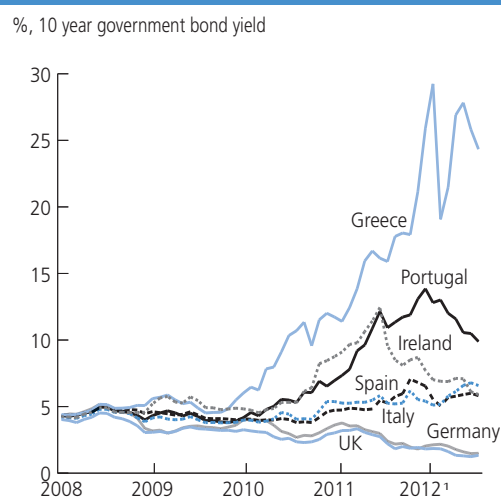
Greece's credit rating has been downgraded a number of times since December 2009. Other countries with high budget deficits such as Portugal, Ireland, Turkey, Italy and Spain have also seen downgrades. This has resulted in the tightening of market conditions for government refinancing in these countries and the widening of bond yield spreads between these countries and other EU members (Chart 7). The subsequent transmission of sovereign risk to local banking systems and the wider economy remains a risk. On the other hand, countries perceived as having a low sovereign credit risk, such as Germany and the US have seen their borrowing costs fall. Even though the US budget deficit and national debt are globally the highest in nominal terms, demand for its Treasury bonds remains strong due to its traditional safe-haven status.

**Chart 6**  
Government budget deficits



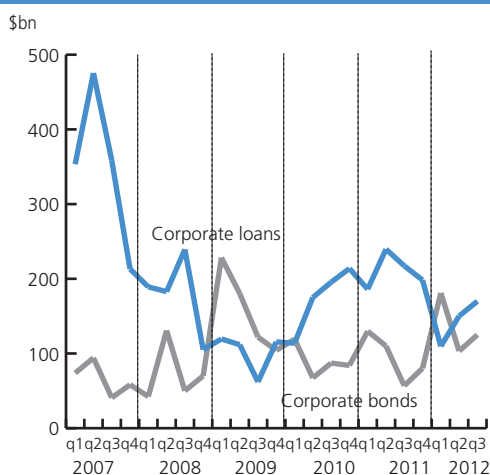
<sup>1</sup> Excluding financial sector interventions  
Source: IMF; Wikipedia; Eurostat

**Chart 7**  
Euro zone bond yields



<sup>1</sup> up to August  
Source: ECB

**Chart 8**  
Europe corporate bonds and corporate loans



Source: Dealogic; TheCityUK estimate

## Debt securities

**Bonds and notes** make up around 80% of the global bond market. Nearly four-fifths of this is in domestic securities. The structure of individual domestic markets differs markedly, mostly averaging 10-year maturities. The liquidity of longer term securities tends to be smaller, although in the US, UK and France bonds with longer term maturities are also issued and traded on the market.

**Money market instruments** The money market is an informal network which has no physical site where wholesale funds are borrowed and lent for short periods. The London Money Market facilitates trading in bills of exchange, certificates of deposit, treasury bills, and commercial paper. Most of trading in such instruments has been generated by the financial markets in New York, Tokyo, Frankfurt and London.

The **international bond market** is a wholesale market where around 90% of bonds are held by institutional investors such as insurance companies, pension funds and mutual funds. Bonds are traded on the secondary market, but are more often purchased and held to maturity. Issuers mostly include large companies, national and local governments and international organisations.

of US domestic bonds totalled \$5.9 trillion in 2011, 10% down on the previous year. Although issuance of Treasury bonds was down by 9% in 2011 to \$2.1 trillion, it had more than tripled in the three previous years. Mortgage related bond issuance declined for the second year running by over 15% while corporate bond issuance fell slightly.

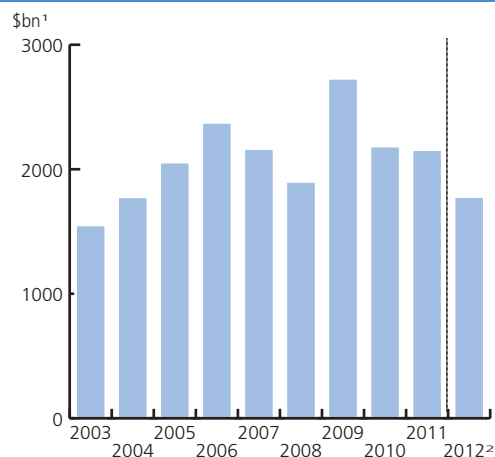
Corporations use the funds they raise from selling bonds for a variety of purposes, from building facilities to purchasing equipment to expanding their business. The US corporate bond markets have long been an important source of capital for issuers, with daily trading volume of \$21bn and more than 400 mutual funds investing in US high-yield bonds.

In contrast to US companies, European SMEs have historically been reliant on bank lending and more vulnerable to its reduced availability. Europe is however gradually moving towards a US style bond market and many companies are diversifying their funding sources to include bond markets. Stock exchanges across Europe are extending services to bond markets to boost their growth. In February 2010, the London Stock Exchange introduced the Order book for Retail Bonds (ORB) in response to growing private investor demand for greater accessibility to fixed income securities.

The relative importance of bonds as a source of finance for companies in Europe has increased since the start of the economic downturn. This was partly due to a decline in bank lending during this period. In the first three quarters of 2012, European corporate investment grade bond volume totalled over \$360bn, up two-thirds on the same period in 2011 and the highest nine month total since 2009. At the outset of the credit crisis, loan volume was five times bond issuance. In the first three quarters of 2012 they were roughly the same. The shift towards bond markets, should it persist, could have important implications for how companies fund themselves in Europe.

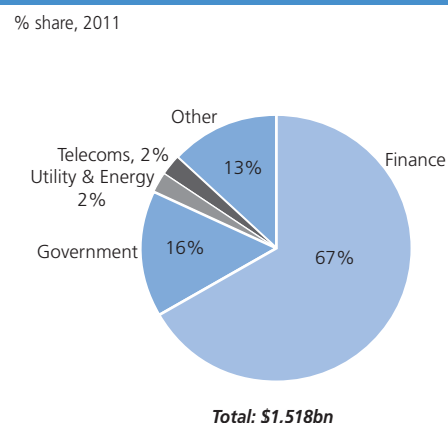
Total European DCM volume totalled around \$1.7 trillion in the first nine

**Chart 9**  
Annual European DCM value



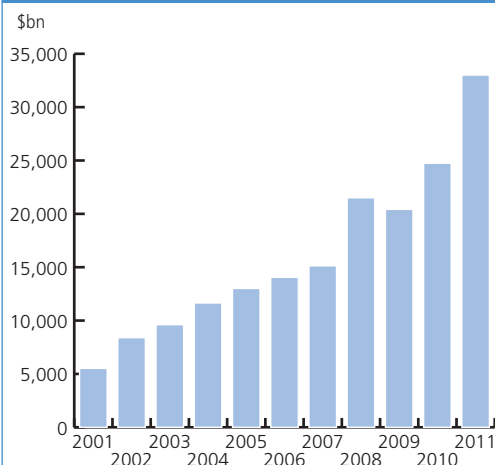
<sup>1</sup> figures are for Europe, Middle East, Africa; <sup>2</sup> to end-September  
Source: Dealogic

**Chart 10**  
European DCM, by industry



Source: Dealogic

**Chart 11**  
Bond trading on exchanges



Source: World Federation of Exchanges



months of 2012, down 8% from the same period in 2011 (Chart 9). European DCM volume in recent years has been more than twice the deal volume a decade earlier. Financial services generated around two-thirds of European DCM issuance in 2011. The Government category was the second most important issuer with 16% of the total in 2011, followed by utility/energy and telecoms with around 2.4% each. Oil & gas, auto/truck, transportation, insurance, construction and food/beverage accounted for most of the remainder (Chart 10).

**Secondary market** The secondary market involves the trading of bonds after the initial offering. This is almost entirely an over-the-counter (OTC) market. Most trades are conducted on closed, proprietary bond-trading systems or via the phone. An average investor can participate through a broker. Most of the \$909bn traded daily on the US domestic bond market in 2011 took place between broker-dealers and large institutions. The US bond market operates without a central exchange with hundreds of market makers on the OTC market. Around a half of trading was in Treasury bonds and a third in mortgage-backed securities.

Some bonds, such as corporate bonds, are listed and can be traded on a number of exchanges. According to the World Federation of Exchanges, trading of bonds on exchanges increased by a third in 2011 to a record \$33 trillion (Chart 11). Bond turnover on the London Stock Exchange of \$5.4 trillion in 2011 was exceeded only by trading on the BME Spanish Exchanges (\$17.3 trillion).

**International bond market** The international bond market includes eurobonds and foreign bonds which are instruments issued or traded outside the country of their domestic currency (Table 3). The outstanding value of international bonds increased by 2% in the twelve months to March 2012 to \$29.7 trillion. Around \$900bn of this was in international money market instruments. Net issuance of \$1.2 trillion in 2011 was down a fifth on the previous year's total. In the first half of 2012, net issuance totalled over \$800bn, although the bulk of this was in the first quarter (Chart 13).

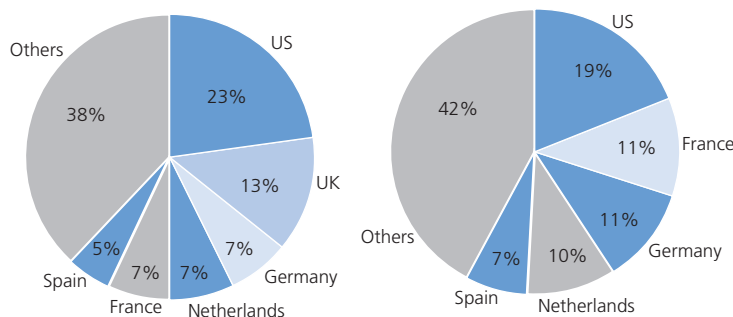
Advanced economies generate the vast majority of business in international bonds. The US was the leading centre for issuance in 2011 with around a fifth of the global total, down from 40% in the previous year. Other leading centres in 2011 included France (11%), Germany (11%) and Netherlands (10%). The US also has the lead in terms of the values outstanding with 23% of the global total, followed by the UK (13%) Germany (7%) and Netherlands (7%) (Chart 12).

Net issuance by non-financial corporations has been higher than issuance by financial institutions since 2010. Prior to this, from the early 1990s, net issuance by financial institutions was larger. The \$851bn issued by non-financial institutions in 2011 was down from \$937bn in the previous year. Net issuance from financial institutions declined more quickly during this

**Chart 12**  
*International bonds, by country of residence*

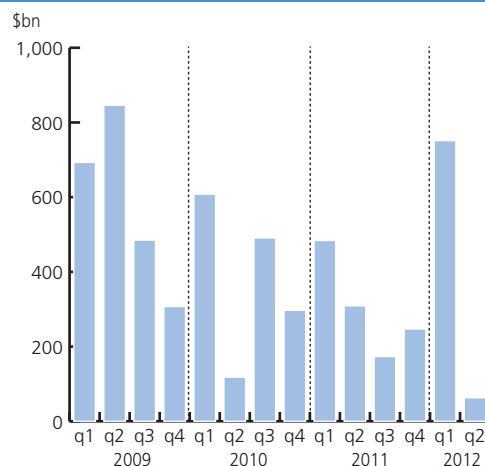
% share of amounts outstanding  
(totalling: \$29,711bn at end-March 2012)

% share of net issues  
(totalling: \$1,221bn in 2011)



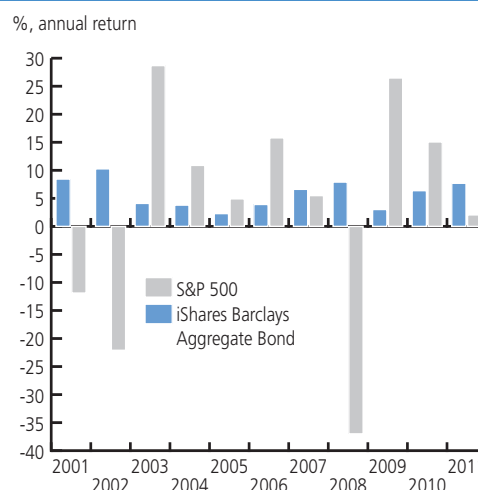
Source: Bank for International Settlements

**Chart 13**  
*International bond market, quarterly issuance*



Source: World Federation of Exchanges

**Chart 14**  
*Bond market returns*



Source: S&P 500, Barclays Capital



period from \$564bn to \$376bn.

The US dollar accounted for two-thirds of international bond issuance in 2011, down from 72% in the previous year. The share of euro denominated issues decreased to 26% from 42% in the previous year. Straight fixed rate bonds accounted for nearly all issues with floating rates bonds seeing an outflow of \$60bn, a result of borrowers adjusting their debt profile to lock in low funding costs. Equity related bonds either in the form of convertibles or equity warrants remain an important niche market.

**Secondary trading** Secondary trading in the international bond market has increased over the past decade in line with the growing volume of issues and increase in electronic trading. TheCityUK estimates that trading in international bonds probably grew ten-fold during the past decade to some \$80 trillion in 2011. London is the leading centre for international bond trading with an estimated 70% of secondary market turnover.

**Bond market returns** Bonds generally display less volatility than equities. The Barclays Capital Aggregate Bond Index, which includes US Government, corporate and mortgage-backed securities with maturities of at least one year returned 7.7% in 2010, up from 6.4% in the previous year. (Chart 14). Since the start of the decade, the index has consistently delivered a positive return, fluctuating between 2.4% and 11.7%. During this period the S&P 500 index moved between an annual gain of 29% and loss of 37%.

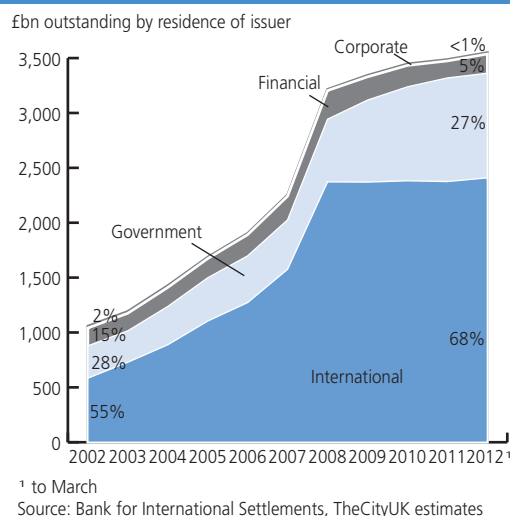
While there is retail investment interest, trading of bonds in value terms is mainly institutional. Factors such as the rate of inflation, the state of government finances and monetary policy all affect returns. Bond returns are however, primarily subject to movements in interest rates. Upward moves in interest rates, for example, erode the value of fixed payments to be received in the future, thereby reducing the value of a bond. Local currency movements also affect bond market returns.

The attraction of bonds as an investment has grown during the economic slowdown as institutional investors looked for less risky assets in volatile market conditions. Risk aversion and flight to quality has particularly increased demand for government bonds, mainly in countries traditionally seen as more financially stable. Corporate bonds on the other hand have offered the potential for high returns. Yields among such bonds can differ substantially based on the perceived credit risk of the individual corporation and the outlook for the profitability and competitiveness of its sector.

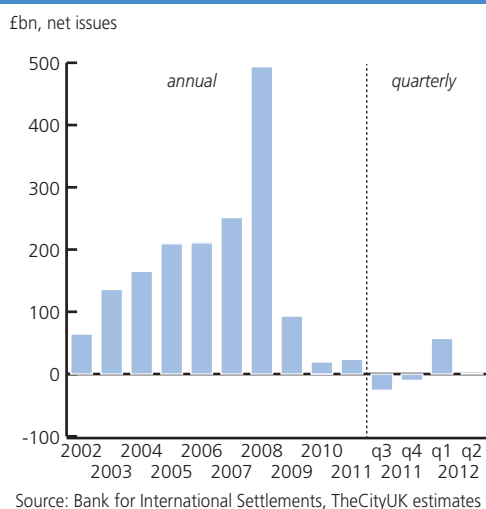
## BOND MARKETS IN THE UK

The value of bonds outstanding of UK-based issuers totalled a record £3,550bn in March 2012, up 2% on twelve months earlier (Chart 15). Government bonds issuance was strong during this period while the outstanding value of international bonds increased only marginally for the third year running, after having doubled in value between 2005 and 2008. TheCityUK estimates that the outstanding value of the UK bond market is likely to increase by 10% in the next 3 years to £3.8 trillion, due to substantial forecast Government issuance in the next few years, and a resumption of the rise in international bond issuance in the UK. The demand for UK bonds has been strong, partly due to the UK's status as a

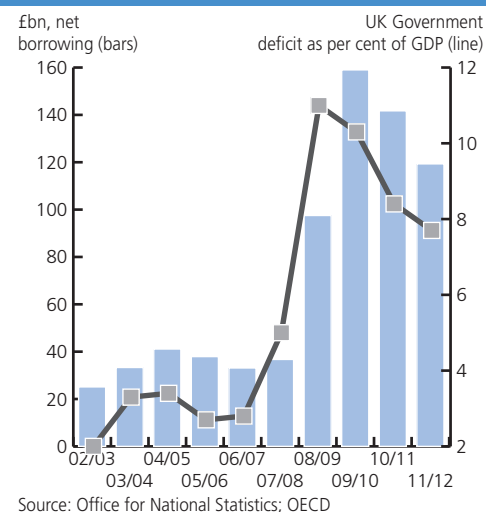
**Chart 15**  
Size of the bond market in the UK



**Chart 16**  
UK international bond issuance



**Chart 17**  
UK Government net borrowing



relative safe-heaven in Europe. Gilts have benefited from the eurozone crisis, with yields falling to record lows. This has had a positive effect on sterling-denominated corporate bond sales.

**Government securities** have captured a growing share of the market in recent years. Figures for UK public sector finances show that the UK Government budget balance has consistently been in deficit over the past decade. Excluding the temporary effects of financial sector interventions, between the financial year 2002/03 and 2010/11 the budget deficit increased from £11.3bn to £110.5bn before falling back to £95.0bn in 2011/12. UK Government net borrowing which was below £50bn in the years prior to the economic crisis, increased to nearly £160bn in 2009/10 before falling back to around £119bn in 2011/12 (Chart 17).

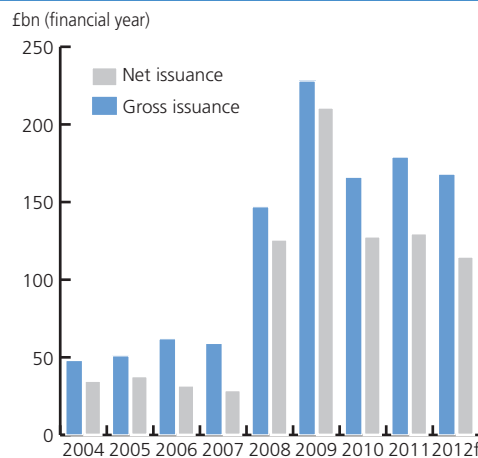
Excluding public sector interventions, UK public sector net debt increased to £1,020bn in the financial year 2011/12 from £903bn at the end of the previous year (Chart 19). The 2010/11 outstanding value was up almost twice on three years earlier. The outstanding value of net borrowing from recent financial sector interventions totalled £1,154bn at the end of 2011/12, down from £1,345bn at the end of the previous year.

In the period up to September 2007, before the classification of Northern Rock to the public sector, the level of public sector net debt largely reflected UK Government's net debt. By the end of December 2008, the classification to the public sector of, first, Northern Rock and subsequently Bradford & Bingley added around £130 billion to the public sector net debt. Including the Lloyds Banking Group, RBS and other interventions in the public sector finances in 2010, added around a further £1,300bn. The debt the UK Government has taken on for financial sector interventions represents an investment, so funds committed could be recouped when the investments are sold. In November 2011 it was announced that Virgin Money were going to buy Northern Rock plc for £747 million up front and other potential payments of up to £280 million over the next few years. The sale was completed on 1 January 2012.

Excluding financial sector interventions, net debt as a percent of GDP increased to 66% from 60% in 2011/12, and 36% in 2007/08. It is forecast by the Office for Budget Responsibility to peak at 76% in 2014/15, falling thereafter. An unexpected rise in the deficit during 2012/13 means that the OBR's predictions of a peak are being called into question. Including financial sector interventions, net debt as a percent of GDP stood at 140% in 2011/12 (Chart 20). In addition to financial sector interventions, the economic recession has resulted in lower tax receipts and higher spending on unemployment benefits which has placed an additional strain on public finances. The UK's fiscal deficit fell to 6.2% of GDP in 2011/12, down from 7% in the previous financial year. The UK's fiscal deficit is amongst the highest in Europe, although the UK's debt as a per cent of GDP is lower than in other large European countries such as Italy, France and Germany.

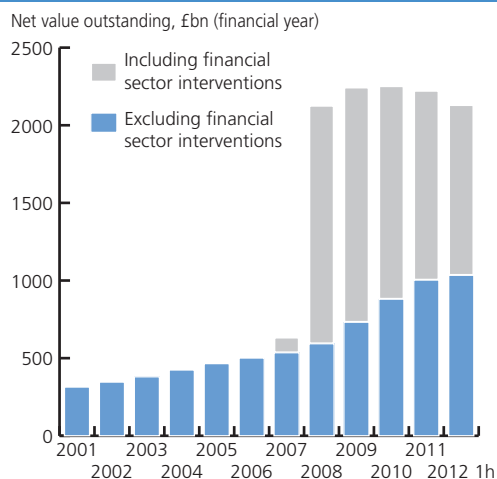
**Corporate bond market** The UK corporate bond market is smaller than some other developed countries because of the tendency of UK corporations historically to raise debt finance through the banking system rather than bond markets. The financial landscape is however starting to change, with an emerging shift away from bank loans towards the bond

**Chart 18**  
UK Government debt issuance



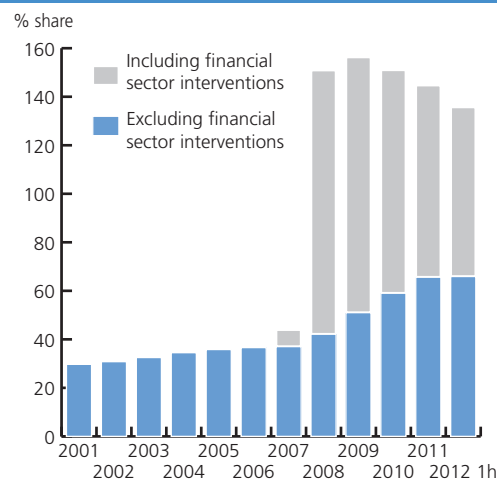
Source: Debt Management Office

**Chart 19**  
UK Government debt



Source: Office for National Statistics

**Chart 20**  
UK public sector net debt as percentage of GDP



Source: Office for National Statistics

market and other forms of finance for non-financial companies.

The outstanding value of domestic UK corporate bonds totalled £13bn in March 2012. The outstanding value of domestic bonds of commercial banks and other financial institutions was much larger at £175bn, but down from £195bn at the end of 2010. The drop in bond sales by banks and other financial institutions and healthy overall demand for UK bonds, opens up an opportunity for non-financial UK companies to fill. Bond markets have become a more important source of finance for UK companies since the start of the economic slowdown (Chart 21). Large deals in 2012 included bond market issues by Saab Miller Holdings, Arkle, Glaxo Smith Kline, Holmes and Fosse (Table 5). As the volume of corporate bond issuance rises, yields on corporate debt are falling. The falling cost of bond issuance contrasts with rising costs for bank loans.

UK DCM issuance totalled \$328bn in 2011, up on \$307bn in 2010 and \$258bn in 2008. The first eight months of 2012 saw issuance of some \$230bn. The financial sector accounted for around a half of the 2012 issuance, followed by Government 17%. Utility/energy and telecoms accounted for around 5% each. UK corporate bond issuance totalled \$75bn in the first 8 months of 2012, with a full year total likely to reach a record \$110bn. Financial institutions' issuance on the other hand dropped significantly in the past two years, with the full year total for 2012 likely to be the lowest in nearly a decade.

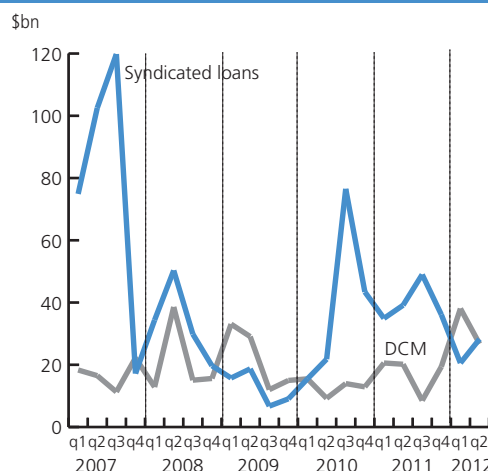
While the institutional bond market provides larger companies with an alternative to the loan market, the smaller funding needs of SMEs have typically made it more difficult to attract traditional fixed-income buyers. To help fill that gap, the London Stock Exchange (LSE) opened an electronic retail bond trading platform in 2010, the Order Book for Retail Bonds (ORB). This has helped to open up the UK corporate bond market to retail investors and increase transparency and liquidity in this market. The ORB has been used by companies like Provident Financial, Tesco Personal Finance PLC, Places for People and National Grid to access capital. The ORB offers continuous, transparent, two-way tradable prices in nearly 150 individual UK gilts, supranational and corporate bonds, all tradable in typical denominations of £1,000 or less.

**International bond** issues in the UK totalled £24bn in 2011, slightly up from the previous year but well down from peak issuance of £494bn in 2008. The first half of 2012 was however off to a stronger start with net

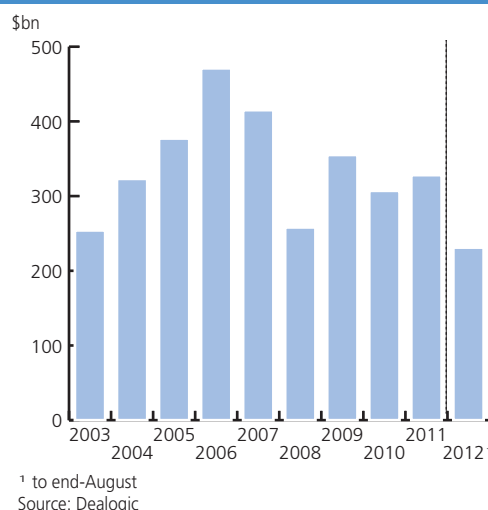
## International bond trading in the UK

The market for international bonds in the UK is distinct from the domestic market. These bonds are typically traded over-the-counter. Since the beginning of the Euromarkets, the International Capital Market Association (ICMA) has facilitated the interaction between issuers, lead managers, dealers and investors. ICMA has been approved by the HM Treasury as an 'international securities self-regulating organization' (ISSRO) in the UK. ICMA is the only body to be accorded ISSRO status. ICMA has been designated by the UK Financial Services Authority as a Designated Investment Exchange (DIE). It issues the rules and recommendations which form a framework for trading in international debt and related securities as well as for the clearing and settlement of trades in such securities.

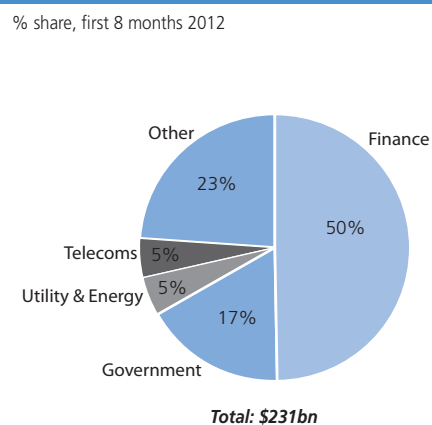
**Chart 21**  
UK corporate bonds and corporate loans



**Chart 22**  
Annual UK DCM value



**Chart 23**  
UK DCM, by industry

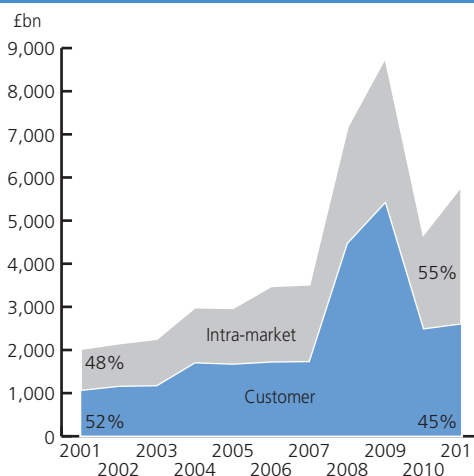


issuance totalling nearly £60bn (Chart 16). The outstanding value of international bonds in the UK totalled around £2.4 trillion at the end of 2011, some 13% of the global total and second only to the US. Eurobonds account for around three-quarters of the UK total. London is the leading centre for international bond trading with an estimated 70% of secondary market turnover.

**Dealing in UK bonds** Turnover of UK Government debt and other fixed interest securities totalled £5.8 trillion in 2011, up from £4.7 trillion in 2010, but still down on peak activity of £8.8 in 2009 (Chart 24). Primary dealing in government securities is handled by Gilt-Edged Market Makers. A Gilt-edged Market Maker is a primary dealer in gilts and actively trades in either conventional gilts, index-linked gilts or both. Inter-dealer brokers act as intermediaries for anonymous trading between market makers.

As well as UK government bonds, there are a variety of other domestic fixed interest securities that can be traded on the London Stock Exchange. These include fixed interest convertible and preference shares and other bonds issued by companies, local authorities and banks. The remaining fixed interest securities include Commonwealth government stocks and some preference and convertible shares.

**Chart 24**  
London Stock Exchange turnover in bonds



**Table 5**  
Largest UK DCM deals

	General industry	\$m value
SAAB Miller Holdings Inc	Food & beverage	6,974
Arkle Master Issuer plc	Finance	6,246
Glaxo Smith Kline Capital plc	Healthcare	4,977
Holmes Master Issuer plc	Finance	4,323
Fosse Master Issuer plc	Finance	4,102

Source: Dealogic



## LINKS TO OTHER SOURCES OF INFORMATION

**Bank for International Settlements**

[www.bis.org](http://www.bis.org)

**Dealogic**

[www.dealogic.com](http://www.dealogic.com)

**Debt Management Office**

[www.dmo.gov.uk](http://www.dmo.gov.uk)

**European Commission**

[www.ec.europa.eu](http://www.ec.europa.eu)

**Financial Services Authority**

[www.fsa.gov.uk](http://www.fsa.gov.uk)

**International Capital Market Association (ICMA)**

[www.icmagroup.org](http://www.icmagroup.org)

**International Monetary Fund**

[www.imf.org](http://www.imf.org)

**London Stock Exchange**

[www.londonstockexchange.com](http://www.londonstockexchange.com)

**National Statistics**

[www.statistics.gov.uk](http://www.statistics.gov.uk)

**Securities Industry and Financial Markets Association**

[www.sifma.org](http://www.sifma.org)

**World Federation of Exchanges**

[www.world-exchanges.org](http://www.world-exchanges.org)





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## **THECITYUK RESEARCH CENTRE:**

Report author: Marko Maslakovic

For further information about our work, or to comment on the programme/reports, please contact:

Duncan McKenzie, Head of Research  
[duncan.mckenzie@thecityuk.com](mailto:duncan.mckenzie@thecityuk.com), +44 (0)20 7776 8976

Marko Maslakovic, Economic Research Senior Manager  
[marko.maslakovic@thecityuk.com](mailto:marko.maslakovic@thecityuk.com), +44 (0)20 7776 8977

TheCityUK, 65a Basinghall Street, EC2V 5DZ [www.thecityuk.com](http://www.thecityuk.com)  
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