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The cost of private debt over the credit cycle

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ABSTRACT

We identify global and regional fluctuations in international private debt flows to emerging and developing countries using data on cross-border loans and international bond issuance over 1993–2009. We use micro-level data on syndicated cross-border loans and international bond placements to estimate the effects of individual borrower characteristics as well as macroeconomic conditions on the cost of foreign borrowing and test whether these effects differ across phases of the lending cycle. First, we find that borrower characteristics associated with lower loan spreads are not necessarily associated with lower bond spreads. Second, we find differential effects of borrower characteristics between cycle phases for loans and bonds separately. Third, we find strong reductions in the cost of debt finance during periods when international debt flows are more than one standard deviation above their mean, but not for expansionary periods, when the growth rate of debt flows is increasing. We also find that higher trade ratios in the borrower's home country raise loan spreads more in periods of high credit flows but have no effect on bond spreads. At the same time, borrowers residing in countries with high investment ratios pay lower spreads on bond issuance particularly during periods of high credit flows, but we find no similar effect for loan spreads. Inflation rates, real exchange rates and previous banking crises have small impacts on loan and bond spreads.

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1. Introduction

The last two decades have witnessed remarkable progress in emerging and developing countries' ability to access international capital markets. Net private debt flows to developing countries increased more than sevenfold by 2007 compared to levels in the previous two decades, and accounted for half the international capital inflows to these economies throughout the 2000s (Dailami and Timmer, 2009). Both private- and publicly-owned corporations in these countries have increasingly relied on cross-border debt flows to finance investments and operations. Most of the upsurge has been in cross-border bank lending with bond issuance remaining highly concentrated in a few emerging economies (Fig. 1).

Along with the benefits of improved access to international capital markets have come both global- and region-wide financial crises, as rapid credit increases were followed by sharp credit contractions (Mendoza and Terrones, 2008). Figs. 1 and 2 depict the three cycles of credit we focus on, commonly associated with the Asian crisis, the dot-com bubble, and the housing-financial crisis. Although the origins of these crises are different, they had similar effects on cross-border credit availability.

The market for cross-border syndicated lending and international bonds is characterized by strong cyclical variation in volumes and interest rate spreads generated in part by global credit conditions. In this paper, we focus on the impact of the global credit cycle on the cost of credit to emerging market and developing country borrowers. We first ask what types of firms pay lower spreads in times of relative credit scarcity and are these the same types that pay lower spreads in times of credit abundance? Second, we consider the significance of the borrowers' country of residence for loan and bond spreads paid on debt issued at different phases of the global credit cycle. That is, controlling for borrower and contract characteristics, what role, if any, do the macroeconomic fundamentals of the borrower's country of residence play in the pricing of loans and bonds and does this role vary across the credit cycle?

In order to answer these questions, we identify three cycles in global credit market. The first episode, starting in the early 1990s and coming to an abrupt end with the 1997–1998 East Asian crisis

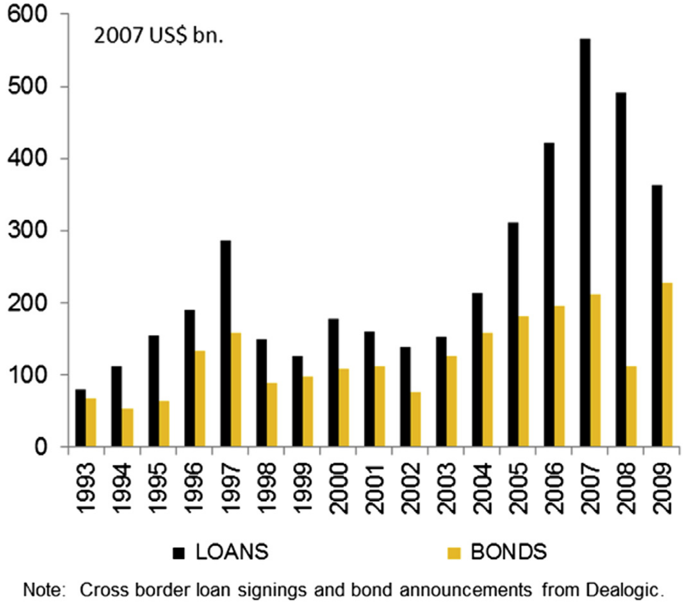

Fig. 1. Private debt flows to emerging and developing countries.