Is bond financing a factor of recovery?

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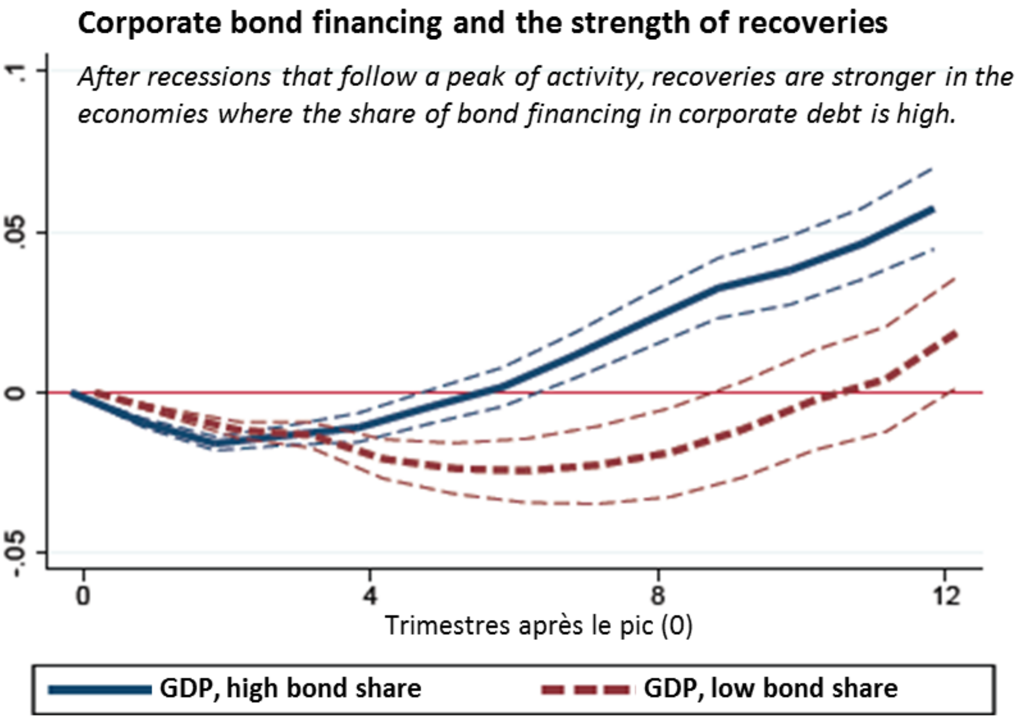
The Capital Markets Union project (CMU) recommends diversifying the financing of companies, in particular through debt securities in addition to bank loans. Is the choice of debt instrument important in economic recoveries? In fact, companies replace bank financing by bond financing in a recovery phase. In addition, recoveries are more robust when the share of bond financing is high.

Chart 1: Recoveries according to the share of bond financing

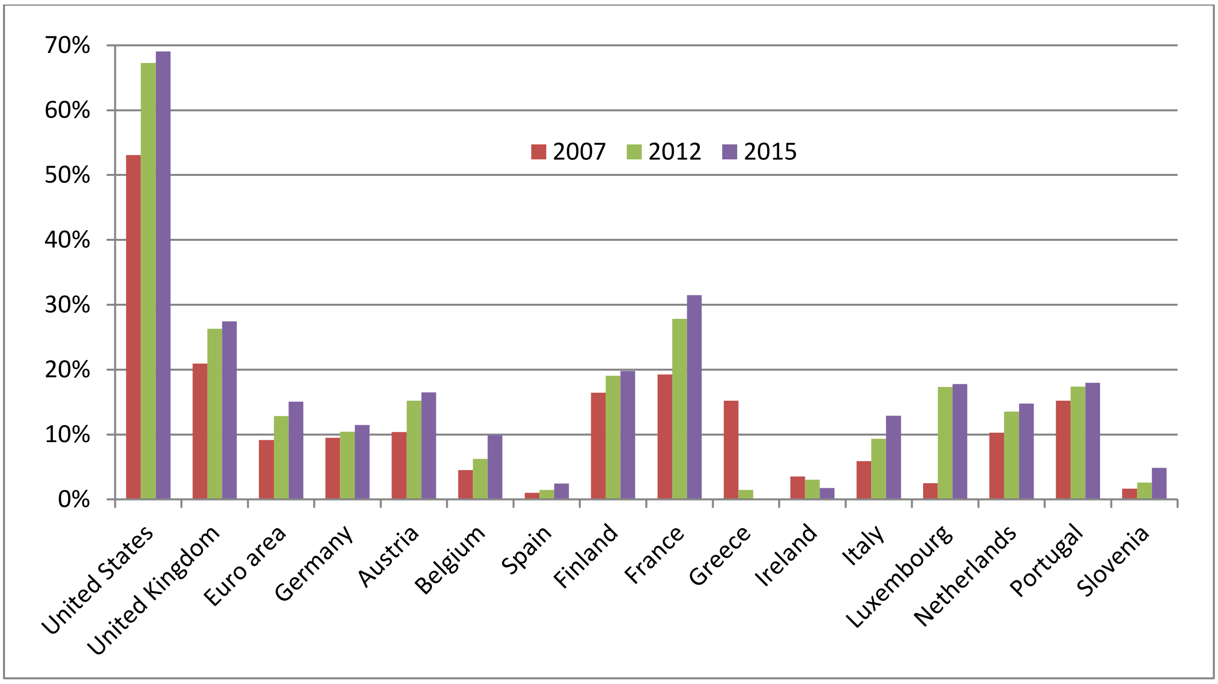


Source: Grjebine, Szczerbowicz & Tripier (2017)

"GDP" is a deviation of real GDP with respect to its level at the peak (in log, average value). The dotted curves represent the 90% confidence intervals.

After the 2008-2009 crisis the recovery in the United States was faster than the recovery in the euro area. Some authors suggest that the US economy returned to growth more rapidly thanks to its financial system that enabled it to replace bank financing by bond financing (see Adrian et al., 2012, Becker and Ivashina, 2014). Bond financing is particularly significant in the United States: the share of bonds already accounted for more than 50% of total corporate debt in the 1950s. After the recent crisis, it rose from 53% in 2007 to 69% in 2015 (Chart 2).

Chart 2: Share of bond financing of non-financial corporations before and after the 2008-2009 crisis (as a % of total debt)



Source: authors' calculations; Flow of Funds, [L.103 Nonfinancial Corporate Business], for the United States; Eurostat for the others ([ESA (2010]): Debt securities (F.3) and Loans (F.4), consolidated data.

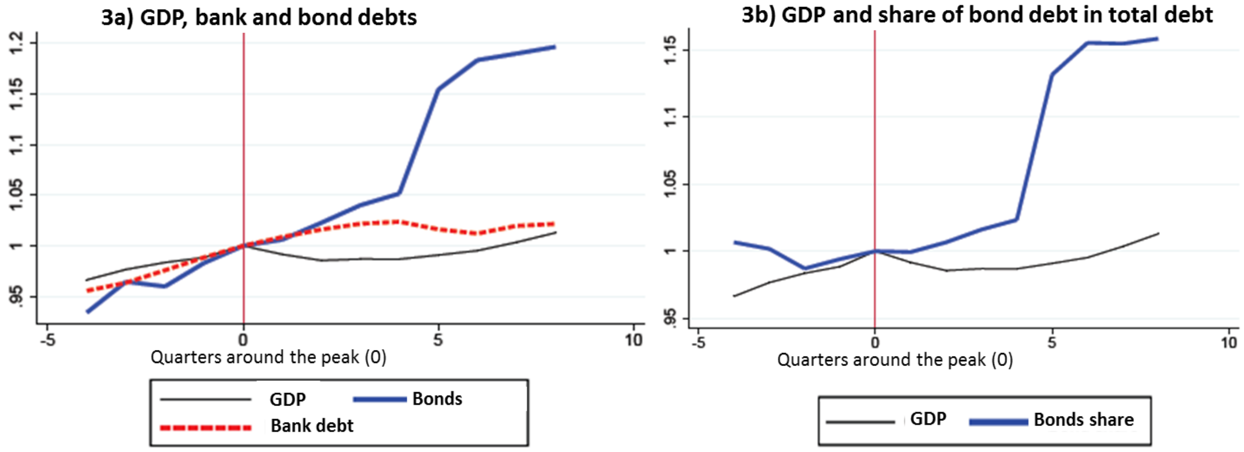
Although lower, bond financing is also significant in the United Kingdom, where it increased during the crisis, climbing from 21% in 2007 to 27% in 2015. In the euro area, the share of bond financing rose by 9% to 15% over the same period. Although almost all member countries posted such growth, there is still considerable heterogeneity. In 2015, bond financing accounted for 31% of corporate debt in France, 13% in Italy, 11% in Germany, compared with only 2% in Spain.

Substitution between loans and bond financing during recoveries

The increase in bond financing in total corporate debt is not specific to the Great Recession but is a regular feature of the business cycle. Our regressions on panel data (see Grjebine et al., 2017) show that during economic recoveries, companies replace bank financing by bond financing.

Chart 3a shows the average changes in GDP, bond financing and bank lending in real terms relative to their value at the height of the cycle for 81 recessions in 23 countries (OECD and non-OECD) between 1989 and 2013. Loans and bonds follow a similar trend during the year before the peak, but diverge strongly during the recovery phase. The cumulative growth of bank loans over the two years following the peak is close to 1%, while the cumulative growth of bond debt amounts to 20%. Chart 3b shows the changes in the share of bond financing before and after the peak. The change in the structure of corporate debt occurs during the recovery phase, and leads to a total increase in the bond share of 15%.

Chart 3: Real GDP and corporate debt during the cycle



Source: Grjebine, Szczerbowicz & Tripier (2017)

NB: Deviations with respect to GDP peak. Average values for the 81 recessions. Series are normalized to 1 at the peak period (0).

Positive correlation between recoveries and bond financing

The substitution of bond debt for bank loans that occurs during a recovery phase appears to reflect banks' difficulty in meeting companies' demand for credit (see Becker and Ivashina, 2014). Access to bond markets as an alternative source of financing would increase investment and thus accelerate the recovery. In Grjebine et al. (2017), we highlight the existence of a link between the structure of corporate debt and the strength of the recovery. Chart 1 shows the change in real GDP after a peak of activity, depending on whether the initial value of the share of bond financing is high (above average, full line) or low (below average, dotted line) . At the beginning of the recession, the trend is similar: in the first three quarters, the two curves are very close. Subsequently, the two curves diverge.

The recovery starts earlier in the countries where the share of bond financing is high - on average three quarters after the peak, compared with six quarters in the economies with a low share of bond financing - then the gap widens. Economies where the share of bond financing is high return to pre-recession GDP levels five quarters after the peak, while economies with a low share of GDP only reach such levels eleven quarters after the peak. At this date, the real GDP of the economies where the share of bond financing is high exceeds its value by 5% at the height of the cycle. The positive relationship between the recovery dynamics and the level of the initial bond share exists irrespective of the nature (financial or non-financial) of the crisis. It is maintained when we exclude the United States and the 2008 recession from the sample. The debt structure also has a specific effect when we take into account the effect of firm size, the development of financial markets and the quality of institutions.

Towards a diversification of sources of financing in the EU?

These analyses contribute to supporting the Capital Markets Union (CMU) project which aims at deepening and further integrating capital markets in the 28 EU Member States. One of the Commission's stated priorities is to reduce the reliance on bank credit to finance growth, for example by reducing the critical size from which companies could access bond financing, a method of financing which is the preserve of the largest companies in Europe. The diversification of debt instruments would contribute to a better capital allocation and more investment, as a complement and support of other CMU initiatives such as strengthening equity financing and supporting venture capital funds.