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Private bonds market starts to recover

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Issuances return with shorter maturities and higher spreads than before the crisis

With the escalating international financial crisis, after the bankruptcy of the Lehman Brothers bank in September 2008, the perspective of the world economy sparked a wave of panic. The global credit crunch triggered a sudden slowdown of trade, and the world witnessed the most serious and synchronized reduction in economic activity since the Second World War.

Brazil was severely impacted by the financial crisis. The reduction in exports and, as a consequence, in industrial output led to a drop in economic activity in 4Q08 and in 1Q09. But the effects of the crisis were not limited to production. The financial market was also deeply impacted.

Financing for companies was restricted not only by banks, but also by the capitals market. The stock exchange posted stark losses as foreign investors headed for the hills. The private bonds market, despite much lower liquidity, saw a sudden fall in its fundraising capacity in the

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1 The authors acknowledge ANDIMA for providing the data on rates that show the private bonds traded in the secondary market.

Table 1 – Private bonds: Primary issuances by non-leasing companies		
Period	**Amount of issuances ***	**Number of issuances**
2004	11.6	37
2005	17.0	11
2006	28.0	37
2007	14.5	35
2008	6.2	19
Jan./08 to Aug./08	5.8	17
Sept./08 to Mar./09	1.2	3
April/09 to July/09	6.6	11

* in R$ billion, at July-2009 prices, with deflation by the IGP-M (General Market Price Index)

Source: produced by the authors based on CVM data

months following the crisis. Primary debenture issuances, however, have begun to recover in the last few months.

This issue of Brazilian Economic Insights analyzes the latest evolution of the Brazilian private bonds market. For the sake of this analysis, data regarding leasing companies were not considered, as they had been used for a long time by banks as an indirect way of fundraising. A measure of the real cost of fundraising via private bonds was developed for the analysis to help explain what has recently taken place in the market.

The private bonds market's latest developments

From 2004 to 2007, the primary issuances of private bonds were a significant source of financing for large Brazilian companies, to the tune of R$ 17.8 billion per year, at July-2009 prices. In 2006, the issuances reached the peak, R$ 28 billion. In 2008, however, the international crisis triggered a sudden fall in capital market.

As can be seen in Table 1, fundraising via private bonds was interrupted. In 2008, there were 17 issuances totaling R$ 5.8 billion from January to August. In the six months following the worsening of the crisis, i.e., between September 2008 and March 2009, there were only three new issuances, totaling R$ 1.2 billion.

The stark drop in the private bonds market seems, however, to be a thing of the past. The CVM registered 11 operations between April and July 2009, totaling R$ 6.6 billion. This amount surpasses the total issued during 2008.

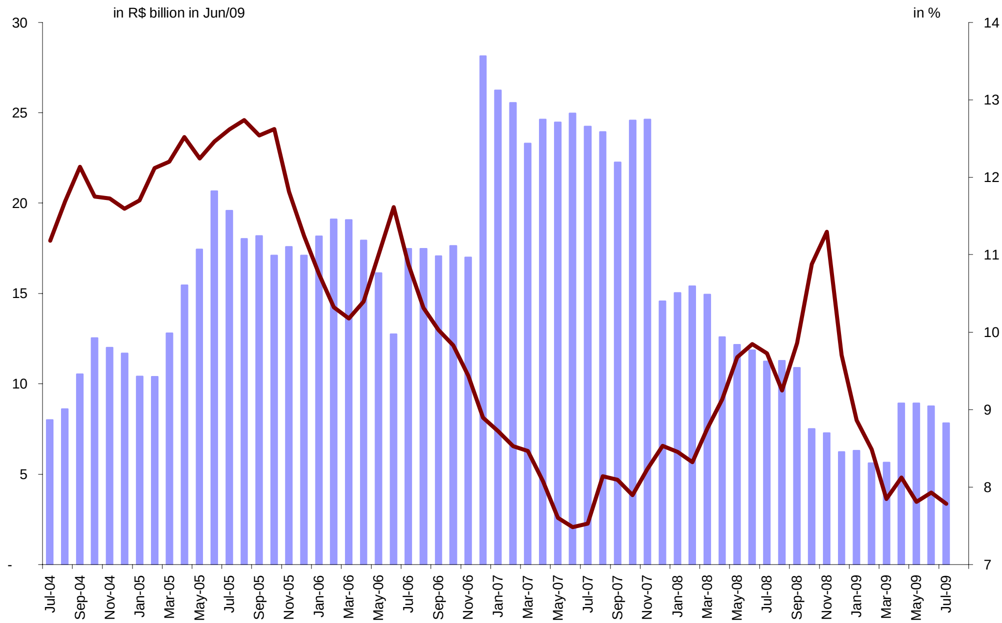
This recent recovery is due to the interest rate paid by bond issuers, which was slightly reduced over the last few months. Chart 1 features the development of the real cost of fundraising, whose calculation is presented in Box 1, as well as the development of the primary issuances of the non-leasing private bonds, accrued over 12 months.

There is a negative relation between the interest rate and the volume of issuances. Despite the time difference between the decision to issue private bonds and the actual fundraising, it is clear that the market reacts to variations in the interest rate. From early 2006 to late 2007, the real interest rate dropped about 4 percentage points – from 11.5% to 7.5% per year.

Fundraising broke a record in this period, exceeding R$ 25 billion, at July-2009 prices. As the international crisis worsened, as of September 2008, the real cost of fundraising quickly went back to 11.5% and the whole market took a nose dive.

The cost of fundraising only recovered after March, renewing the incentive for new issuances. In fact, the market has been making a comeback since April 2009.

Chart 1 - Primary issuances of private bonds accrued over 12 months and the real cost of fundraising



Source: produced by the authors based on data from ANDIMA and the CVM

Environment not fully recovered: maturities and spreads

Although companies are returning to issue private bonds, market conditions have not been fully reestablished yet. In general, new issuances have been characterized by their shorter maturities and higher spreads. According to Chart 2, the average maturity of new issuances ranged from 6 years in 2008, to less than 4 years in 2009 issuances.

In addition to the maturity, the spread paid for private bonds compared to that for public ones also failed to return to the former level. The spread is based on the difference between the average rate of fundraising and the rate of Swap DI x Pre for 720 days, measuring the

Calculating the cost of fundraising

Calculation of the cost of fundraising of private bonds was based on transactions in the secondary market. These transactions indicate the interest rate that would be required by the market for new bonds with the same characteristics of the bonds actually in the market.

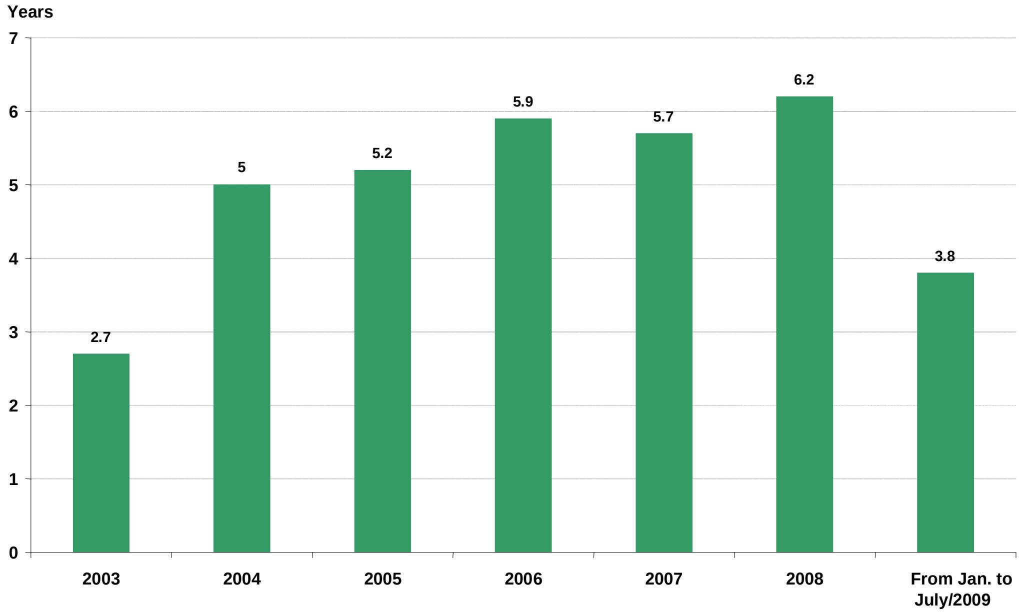
Although liquidity in the private bonds market is low, ANDIMA asks a group of dealers, even when no bond is traded on that day, the rate at which rate they would buy/sell each debenture to a hypothetical seller/ buyer. After evaluating the answers, ANDIMA discloses the rate indicating the market rate for each bond traded.

Based on such data, this study put together a real cost of fundraising index for the private bonds market. The cost of fundraising calculated is close to the cost of a bond that represents the average in the private bonds market.

The calculation considered the several maturities of the bonds traded and their respective indexers. Furthermore, the representative rates of all private bonds traded on the secondary market took into account the total volume issued of each bond. However, the individual rates could not be adjusted by the rating of each bond due to the lack of data.

Considering that some bonds are indexed to the DI rate, and others to the IGP-M (General Market Price Index) or IPCA (Broad Consumer Price Index), the estimates of the Central Bank bulletin Focus for the following 12 months were used to reach an average nominal rate for the inflation indicators. Regarding the DI rate, the Swap DI x PRE for 720 days was applied. After defining the average nominal rate, the inflation rate expected over the next 12 months was deducted to reach the average real cost of fundraising for the companies.

Chart 2 – Private bonds: average maturity



Source: ANBID

general difference in the risk between private and public bonds.

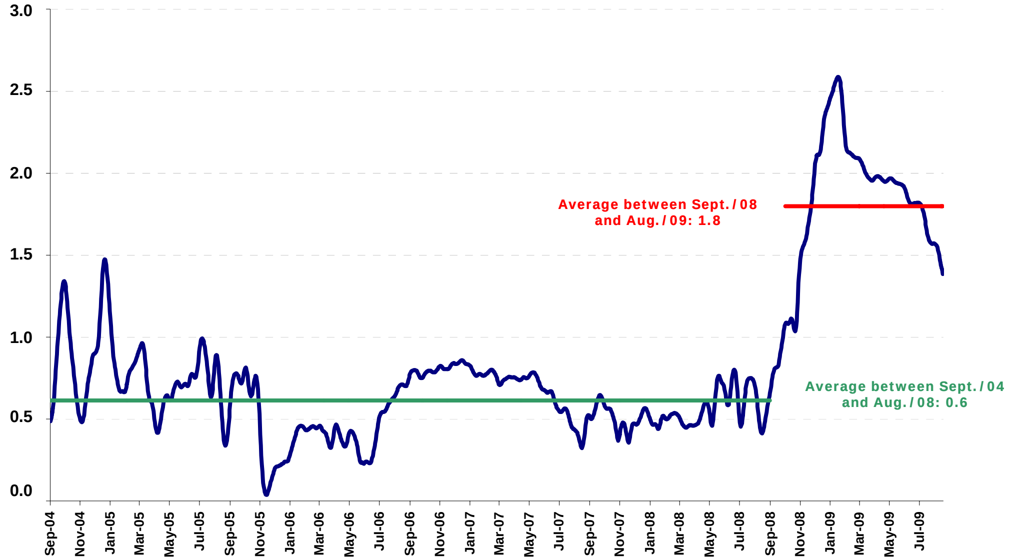
The average spread of private fundraising did not recover its prior status despite the fall in the final cost of fundraising compared to that in late 2008. From September 2004 and August 2008, its average value was 60 basis points. After September 2008, the spread value had a significant increase, reaching over 250 basis points in January 2009.

The news that some Brazilian companies had been deeply impacted by the exchange depreciation in late 2008 is one explanation for the spread increase. Now that the panic over the companies' status has subsided, the spread is starting to advance towards its historical threshold.

The data on maturities and spreads show that, although the private bonds market has overcome the worst after the crisis, those seeking this kind of bond are still very reluctant to assume the risk. This is evident in the shorter maturities of the new issuances and the higher spreads charged when buying these bonds.

The sharp fall in the cost of fundraising, shown in chart 1, occurred in spite of the acute aversion to risk shown by private

Chart 3: Spread between the average cost of fundraising and the Swap DI x Pre for 720 days



Source: produced by the authors based on ANDIMA data.

bonds purchasers, made evident by the increase in the average spread. Such a drop in the cost of fundraising was, therefore, due to the monetary policy enforced by Brazil's Central Bank, reducing the interest rates. In this sense, it is to be expected that the average cost of fundraising for companies will fall in the months to come, since there is no apparent reason for the spread to remain above its historical level.

Conclusions

The international crisis affected Brazil in many ways. As far as the capitals market is concerned, the immediate impacts were rather expressive. The stock exchange went through an intense decline, as foreign investors sought higher ground. The private bonds market, with low liquidity, fell in the months following the crisis. Only two primary issuances were made between September and December 2008. The interest rates in the secondary market shot up, returning to the levels of early 2006.

Recovering investors trust, as well as bringing down the short-term interest rate, which had the support of the Central Bank, allowed companies to reconsider the issuance of private bonds as a feasible alternative for fundraising.

However, according to data on maturities and spreads, the environment is nowhere near that of 2006 and 2007, when the issuance of private bonds broke several records. The worsening of the international crisis brought apprehension as to the status of some Brazilian companies. As the risk related to companies stabilizes, the circumstances for issuing bonds are expected to improve, thus, contributing to a reduction in the cost of capital for Brazilian companies.

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