The Rise of Bond Financing in Europe

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ECB-RFS Discussion:

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Motivation

- Post-GFC period has witnessed a large growth in bond issuance worldwide
- Many of the issuers accessed finance at a very low rate (e.g., Nestle borrowing at 0%)
- The growth also featured high-yield issuers who have not accessed such markets
- The market got distressed during the Covid crisis (sth regulators worried about)
- Understanding the driving forces behind the trends is important for market stability
- **This paper:**

(1) Study the evolution of the market in the European context

(a) Examine distribution of quantities, prices, and ratings across firms and contracts

(b) Link the firm characteristics to the sensitivity to major crisis

Main Results

- Result 1: General patterns for global markets present in the European data. New issuers used bond financing to grow at relatively high rates
- Result 2: Firms' bond issuance extends to slightly longer maturities than loan terms
- Result 3: Bonds of companies with small size and previous absence in the market got most distressed during the Covid crisis

Summary of Comments

- An interesting idea with a set of novel results

- Conceptual framework
- Bonds vs. banks
- LOLR

Comment 1: Conceptual Framework

- Supply vs. demand
  - On the demand side, the rise could be driven by savings glut and reaching-for-yield incentives (-)
  - On the supply side, the rise could manifest the release of financing constraints (+)
  - The paper is explicit not to aim to explain the driving force but each of the two sides may have different implications for policy and financial stability
- Distress of small issuers in times of market stress
  - Fragility of weak companies in times of distress is relevant (externality to financial stability)
  - But the fact that weakest issuers are most distressed does not seem so controversial
  - What is a reasonable counterfactual to this result?
  - Can we learn from the episode something about the ex-ante entry process?

Comment 2: Bonds vs. banks

- Paper focuses mostly on the bond market but is motivated as a tradeoff between bond and bank financing
  - Evidence suggests that both types of debt contracts rise over time (debt capacity grows?)
- Tradeoff between intermediation costs and costs of financing
  - Why would banks not compete for the companies if the reason is purely intermediation cost?
- Why do firms issue bonds?
  - Tradeoff between no financing and financing at higher rates?
  - Why is longer maturity contract important for investments? What does it imply about previous project selection?
  - Is the financing used for positive-NPV projects? What about the increase in payouts?

Comment 3: LOLR

- The paper aims to make important policy implications. Great! (makes it relevant)
- The story about LOLR needs a bit more clarification
- If the mechanism for bond issuance is risk shifting by investors (and issuers?) that is likely manifesting some type of agency problem
- Is LOLR the right mechanism to solve the agency problem?
  - It may be on an ex-post basis, but the market needs a better mechanism to counter such incentives ex ante
  - Better policy prescription would be to avoid such agency costs
  - In fact, removing guarantees is often the better mechanism to limit risk shifting

Conclusion

- A nice paper on an important topic
- An ambitious task to collect difficult-to-get data and document interesting facts
- Need a bit more discussion with respect to conceptual framework
- Discuss in more detail the tradeoff between banks and bond markets
- Think about LOLR