

Euromoney China Global Debt Capital Markets Congress

Beijing, November 16-17, 2010

Remarks of Kenneth G. Lay, Vice President and Treasurer, The World Bank

Mr. Governor, Mr. Secretary-General, Mr. Chairman, ladies and gentlemen.

We're here to celebrate an extraordinary and accelerating transformation in China's bond markets and to reflect on what's next.

Twenty-four years ago, I was privileged to join the first delegation from the World Bank Treasury to visit Beijing. On that occasion, and for four or five years thereafter, we conducted seminars on bond-market operations for finance managers in state-owned enterprises and banks, provincial and national government and government agencies.

The challenge for China then was to raise the level of market-based financial literacy as the country financed the transformation to which it had committed only a few years earlier. The challenge for my colleagues and me was to bring a practitioner's perspective to very bright and engaged counterparts who had thrown themselves into the academic literature but had never had a chance to do a road show or a bond deal, haggle over documentation or arrange for settlement and clearing. The notion that within our professional lifetimes China would become the world's largest official creditor, or that we'd be discussing the renminbi's prospects as a reserve currency, would have astounded us.

Over the next two days this conference will cover the bond-market waterfront, and in substantial detail. It's assembled an extraordinary group of speakers and panelists, which is a testament to the importance of the issues, the timeliness of the

event and, of course, the talent that Padraic and his colleagues at *Euromoney* bring to arranging these gatherings.

In these opening remarks I'd like to offer a few observations from the perspective of a major institutional issuer and investor in the debt markets over the past 63 years. Last year alone, my colleagues in the World Bank Treasury raised the equivalent of more than RMB 225 billion in 360 transactions in 28 currencies for The World Bank and other clients. We invested more than RMB 660 billion in the fixed income markets, generating substantial excess returns for the Bank and the many others for whom we manage money. Over the years, as part of this process, we've worked with governments and market participants in many countries as they've opened, broadened and deepened their debt markets.

This "end-user" perspective on both the buy side and the sell side, and our work with World Bank members as they've opened their markets, have given us strong convictions about what makes for excellent debt-market infrastructure:

- **Scale** to finance the needs of issuers and, more broadly, the economy.
- **Transparency**, supported by efficient **regulation** to prevent against fraud and abuse and facilitated by **well-developed IT**.
- **Price discovery** that ensures that returns to investors and costs to issuers are an accurate and timely reflection of supply and demand.
- **Liquidity** that keeps transactions costs down for both the suppliers and users of capital; liquidity comes naturally as the range of market participants broadens among investors, speculators and market-makers.

- **Risk management tools** – futures, forwards and swaps – to allow market participants to hedge positions and customize instruments (and that, themselves, contribute to liquidity and effective price discovery.

Much of the evolution of international and domestic bond markets over the past forty years has moved in these directions, and it's worthwhile to recall just a few of the notable developments: **Bond futures** in the '70s, **interest rate and currency swaps** in the early '80s, **information technology** such as Bloomberg in the mid-'80s that "democratized" market information, **global issuance to a global investor base** in the late '80s and early '90s. We take these things for granted today, but they were major innovations, and all have helped produce a dramatically more robust market infrastructure. My own institution was involved directly in several of them.

All of this has been driven, of course, by the increasing institutionalization and diversification of savings vehicles and the investor base as interest rates have been liberalized, pension funds, insurance companies and investment trusts grown and professionalized and national reserves accumulated and, increasingly diversified with the emergence of sovereign wealth funds.

This global market infrastructure isn't perfect. It's still too fragmented. It lacks transparency in key areas. It can't protect against distortions in fiscal or monetary policy, or in government regulation. But it is a much more efficient platform for intermediating savings than existed when I began working in the financial markets. And as countries' economies have grown and strengthened, their domestic markets have developed and, ultimately, opened to broader international participation. Here in Asia, Japan provides perhaps the most notable example, but the same is happening in Korea and now, China.

Against this background, what can we say, broadly, about the renminbi debt market? The short answer is that things are moving in the right direction, and quickly. Scale, of course, is taking care of itself: By some estimates, the size of the debt market in RMB could exceed that of the debt market in EUR in the relatively near future. Meanwhile, the authorities have taken a series of measured steps over a period of years, each of which helps move toward the kind of high-performing bond-market infrastructure I outlined a moment ago. You'll be having detailed conversations on these points today and tomorrow, but let me cite a few:

- **Increased use of RMB in trade settlement and overseas direct investment (ODI).** This is leading to large increases in RMB holdings outside China and much larger transaction flows, creating the demand for more investment choices and greater liquidity in markets. At the World Bank, we've been receiving inquiries from some countries the prospect of our lending to them in RMB as Chinese ODI becomes a larger part of their development effort.
- **Encouraging growth of the offshore RMB market centered in Hong Kong.** Much more remains to be done, but this is setting a useful example for the onshore market in terms of regulatory efficiency and the associated much shorter lead times for issuance. As I understand it, it's also dramatically lengthened the working hours of many of the bankers in this room!
- **Opening the domestic market to certain foreign issuers.**
- **Establishing SHIBOR and liberalizing access to currency and interest rate swaps,** thus improving price discovery and risk management.
- **Making available the onshore debt market – notably the 95%traded in the OTC interbank market - for investment by foreign central banks**

and clearers in the RMB trade settlement arrangements. This is a further step that broadens the investor base.

- **Running an orderly and predictable auction system** for central government bonds.
- **Encouraging the development of pension funds to address social safety net concerns and demographic trends** – this promises over time to broaden significantly the breadth of demand in the domestic bond market.

Where are the key challenges? They are well known: The **banking system still intermediates a disproportionate share of the credit in China**, reflecting the early stage of development of other institutions for longer-term savings and investment. **Secondary-market liquidity has improved dramatically, but is less than it should be**, no doubt reflecting both the relative lack of diversification in the investor base and continuing and understandable constraints on full foreign participation in the market. Finally, **regulation remains complex, segmented by category of issuer and license-based** rather than disclosure-based, and sometimes seems to be used as an instrument of industrial policy rather than market regulation, all of which tend to impair efficiency.

The good news is that policy-makers and market participants are very much aware of these issues and thinking about orderly ways to address them, and I look forward to this conference as an important part of the process.

Thank you.