GDBS - Secondary Market Developments

Turkish Experience

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Turkey has observed a deterioration in the government bonds’ secondary market liquidity following global financial crisis...

...however, dramatic change occurred especially following Fed’s tapering signal in May 2013

- Average monthly transaction volume decreased from 32.1 billion TRY in 2013 to 26.7 billion TRY and then to 20.8 billion TRY in 2014 and 2015, respectively
- Therefore Treasury took several steps to support the secondary market liquidity in 2016
  - Average monthly transaction volume increased to 29.3 billion TRY in 2016 and 35.6 billion TRY in 2017 Jan-March period
Outflow of foreign investors from Turkish domestic borrowing securities resulted a sharp decrease in the liquidity of the secondary market...

...since there is a high correlation between the transaction volumes and the share of non-residents in domestic debt stock in Turkey

→ Foreign investors are the main liquidity providers in the secondary market of Turkish Government bonds
Main Factors Behind the Change In the Secondary Market Liquidity of Turkish Government Bonds

Global Factors

• Uncertainties regarding the pace and timing of policy actions of developed economies’ central banks
• Concerns on the health of global economy
• Declining energy prices and deflationary expectations
• Slowdown in the emerging economies
• Tightening of international financial conditions
• Change of the distribution of bond stockholders in favor of buy&hold investors
• International regulations
Main Factors Behind the Change In the Secondary Market Liquidity of Turkish Government Bonds

Idiosyncratic Factors

- **Borrowing requirement has decreased → Decreased supply of government bonds**
  - Fiscal discipline
  - Smoother redemption profile between 2015-2020 due to 10Y securities issued in 2010
- **Developments in the investor base**
  - Higher share of public institutions, pension funds, mutual funds → buy & hold investors
  - Decline in the share of foreign investors in total domestic debt stock
- **Changes in the structure of the banking sector balance sheet**
  - Total Securities / Total Assets ratio declined
  - Larger amounts of GDBS are used as collateral for borrowing in money market
- **Impacts of different structures of securities → FRNs, CPI-Linkeds, Lease Certificates**
  - Demanded by asset liability management purposes
  - Lower trading volumes than the fixed rate bonds
Measures Taken to Increase the Liquidity in Turkish Government Domestic Bond Market

1. Re-openings
   - Obtain a more liquid debt stock structure by having a smaller number of bonds with higher nominal amounts, instead of having too many bonds with lower nominal amounts
   - Re-opening of the same bond are intended to provide sufficient amount of securities for the investors who purchase these securities for trading purpose, as well as buy&hold investors.

2. Increased Outstanding Amounts of 5 & 10-Year Benchmark Bonds
   - In general, liquidity of a bond depends on its total issuance amount and its investor distribution

3. Started Weekly Regular Buy-Back Program
   - To increase the secondary market liquidity of bonds
   - To reduce roll-over risk that may occur at the redemption date due to the increased nominal amount of the bonds

4. Revision of Primary Dealership Contract
   - PD contract revised to narrow and differentiate the maximum spread between bid and offer quotations according to maturities of benchmark securities in 2016
   - Increased the required time period for quotation obligation in the secondary market

5. Amendment of the General Communiqué for Public Treasurership
   - Secondary market trading volume and market liquidity are affected by the the public institutions’ choice of holding government securities until the maturity in their portfolio (buy&hold investors)
Measures Taken to Increase the Liquidity in Turkish Government Domestic Bond Market

Regular Weekly Buy-Back Auctions

- In March 2016, Treasury has started to implement regular weekly buyback auctions in the domestic market
  - 4 and 9 year off-the-run fixed coupon bonds are being bought back
  - Weekly maximum buyback amount is TL 100 million for each security

- Different than the previous implementation in 2010

- While buying back these off-the-run 4 and 9 year benchmark securities, the Treasury is increasing the supply of on-the-run 5 and 10 year benchmark securities in the primary market

- Through 2016, Treasury has conducted 78 buy-back auctions and successfully bought back net TL 6.8 billion worth of bonds

- In January-March 2017, Treasury has conducted 26 buy-back auctions and successfully bought back net TL 880 million worth of bonds in domestic markets
Measures Taken to Increase the Liquidity in Turkish Government Domestic Bond Market

Revision of Primary Dealership Contract

• Primary Dealership (PD) System is being implemented in Turkish domestic bond market without any interruption since 2002
• Primary Dealers have to quote bid and offer prices continuously
• Treasury has revised the PD contract to narrow and differentiate the maximum spread between bid and offer quotations

<table>
<thead>
<tr>
<th>Maturity Intervals (For Bid and Offer Quotations)</th>
<th>Maximum Spread Between Bid and Offer Quotations (Kurus)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-2 Years (2 years included)</td>
<td>20</td>
</tr>
<tr>
<td>2-5 Years (5 years included)</td>
<td>30</td>
</tr>
<tr>
<td>5-10 Years (10 years included)</td>
<td>40</td>
</tr>
<tr>
<td>+10 years</td>
<td>50</td>
</tr>
</tbody>
</table>

• Moreover, Treasury has increased the time period that PDs are obliged to provide quotations in the secondary market

- PD Code and Other Government Domestic Borrowing Securities Volume of Benchmark Securities

- PD Code and Non PD Code Volume of Benchmark Securities Within PD System
Measures Taken to Increase the Liquidity in Turkish Government Domestic Bond Market

Amendments on General Communiqué for Public Treasurership

Following the FED’s statements in May 2013

- Decline in the share of foreign investors in GDBS stock
- A sharp increase in the share of public funds in total debt stock

By the new regulations in General Communiqué for Public Treasurership, some new instruments are also acknowledged as instruments that public funds can invest in

- The facility of diversification of investment instruments of public funds could have led to increase in GDBS supply for investors excluding public funds
Main Challenges and Next Steps

Main Challenges
Pace and Timing of FED, ECB and Other Major Central Banks’ Decisions on Normalization Policies
  • Effects on share of non-resident investors in Domestic Debt Stock

Institutional Investors’ Behaviours
  • Share of Public institutions, pension funds, mutual funds (buy&hold investors) in total domestic debt stock

Decreasing Supply of Government Bonds
  • Smoother redemption profile between 2015-2020 due to 10Y securities issued in 2010

Next Steps
Continuation of Good Practices
  • Efficient Primary Dealership System should be sustained and continued
  • Increasing the nominal amounts of government debt securities without causing unbearable additional risks → Re-openings → Buyback auctions

Increasing the Liquidity in the Sukuk Secondary Market
  • Increasing the nominal issuance amount of Sukuks
    • 5Y TRY denominated fixed coupon Sukuk & 5Y TRY denominated CPI Linked Sukuk
  • Establishing a PD System for the Sukuk Market
Thanks for your attention and interest...

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