

A Good Deal or a Risk? International Bonds in Emerging Markets



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1. Rapidly Rising External Debt of Emerging Market Governments

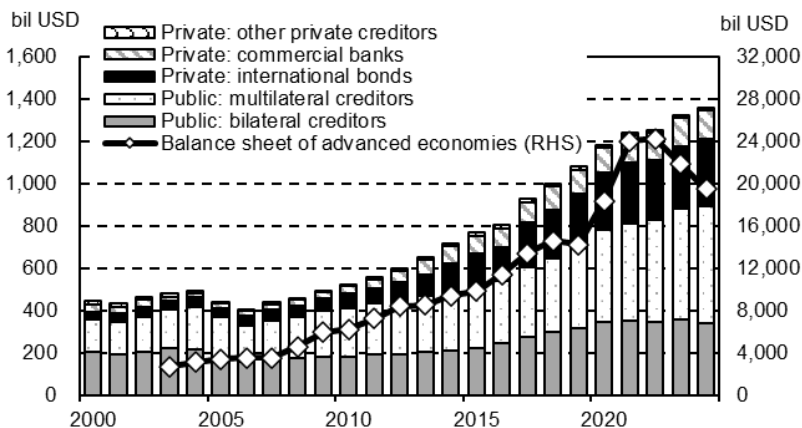
When economic entities such as corporations, governments, or financial institutions borrow funds from outside their country of residence, the resulting liabilities are referred to as external debt. The scale of such debt—particularly external debt owed by emerging market governments^{note1}—has shown a pronounced upward trend over the past decade. Around 2010, the stock of external debt owed by emerging market governments was about USD 500 billion; today, it has now risen to approximately USD 1.4 trillion (Figure 1).

The prolonged global monetary easing before the COVID-19 pandemic was a key factor in this expansion. Under large-scale monetary easing by the central banks of major advanced economies, excess liquidity was created worldwide, resulting in a persistently low-interest-rate environment. As a result, investors increasingly sought higher returns—engaging in a so-called “search for yield”—and allocated more capital to emerging market assets with relatively higher yields.

Another institutional and structural factor supporting this trend has been the rise of index-based investment strategies. The Emerging Markets Bond Index (EMBI) by JPMorgan Chase is a key benchmark for emerging market bond investment. This index primarily tracks emerging market foreign-currency-denominated sovereign bonds (hereafter, “international bonds”). Assets under management benchmarked to the EMBI have roughly doubled over the past five years, totaling approximately USD 600 billion now. The expansion of index-linked investment flows has channeled capital into emerging market bond markets, often lacking detailed country-specific fundamental analysis.

The creditor composition of emerging market governments’ external debt also reflects this trend (Figure 1). In the past, such debt largely included borrowing from official creditors, including international development finance institutions such as the World Bank and the International Monetary Fund (multilateral creditors), as well as public financial institutions from individual countries (bilateral creditors). However, the share of financing from international capital markets through international bond issuance has recently risen rapidly (Table 1).

Figure 1. Emerging Economies’ External Government Debts



Note: The balance sheet of advanced economies is the aggregate of the U.S. Federal Reserve, the European Central Bank, and the Bank of Japan.

Source: World Bank; national central banks.

Emerging market governments often find it challenging to issue bonds in their own currencies in international markets. Instead, sovereign bonds are typically issued in hard currencies, such as the U.S. dollar or euro. These international bonds are often referred to as Eurobonds or global bonds. Emerging market governments have raised funds from markets at low yield levels due to abundant global liquidity and increasing demand for investment assets. Consequently, emerging market governments have quickly increased the issuance of foreign-currency-denominated sovereign bonds in international capital markets.

2. Advantages of Foreign-Currency Sovereign Bonds

Raising funds through the issuance of international bonds offers multiple advantages for emerging market governments.

First, it enables greater diversification of funding sources. By accessing capital markets directly, emerging market governments can build a financing structure that does not rely excessively on specific creditors, thereby enhancing the stability of their funding arrangements. A broader range of financing options also strengthens the government's bargaining position when negotiating borrowing conditions. Moreover, a government's regular issuance of sovereign bonds in international capital markets can signal that the country possesses a certain level of institutional capacity and market readiness. In this sense, maintaining a presence in international bond markets may also function as a form of status for the issuing government.

Second, international bonds provide greater flexibility and speed in financing. International institutions, including the International Monetary Fund or the World Bank, typically require extensive review processes before disbursing loans. Even after approval, policy conditions related to macroeconomic management or structural reforms (known as programs) often accompany loans. Disbursements are usually made in stages, and failure to meet agreed targets within a specified timeframe may lead to the suspension of subsequent tranches. In contrast, market-based financing through international bonds faces relatively fewer institutional constraints and offers greater discretion to the issuer. While the initial issuance requires a certain amount of legal and administrative preparation, once a country establishes a track record and the issuance process becomes routine, funds can be raised rapidly.

In particular, mechanisms such as SEC Shelf Registration^{note2} in the United States and the Euro Medium Term Note program^{note3} in Europe allow issuers to flexibly time their issuances in response to market conditions. Under such frameworks, the time between the decision to issue and the actual bond placement can be brief, and in some cases, issuance may even be completed on the same day. Bonds can typically be issued within a month once preparations are complete, offering a clear speed advantage over bank loans, which may take several months for disbursement.

Third, international bonds allow governments to observe market assessments of their creditworthiness in real time. Once issued, these bonds are traded daily in the market, and their prices and yields immediately reflect how market

participants evaluate the government's credit standing and policy management. Changes in fiscal policy, deterioration or improvement in macroeconomic indicators, political transitions, or shifts in policy stance are often quickly reflected in movements in sovereign bond yields. For governments, this yield serves as one of the clearest barometers of international market perceptions of the country. Recognizing the informational value of such market signals, some emerging market governments continue issuing bonds—even when their immediate financing needs are limited—to roll over maturing bonds and maintain their presence in the market.

Finally, the benefits extend beyond the public sector to domestic corporations. When emerging market firms issue bonds in international markets, the sovereign creditworthiness of their home country serves as a key reference point. If the government already issues international bonds and these securities enjoy a certain degree of market recognition and liquidity, it becomes easier for corporations to establish pricing benchmarks and attract investors. Thus, the external financing environment for the private sector has scope for improvement. In this sense, government issuance of international bonds not only provides a funding instrument for public finances but also expands the country's access to international financial markets.

Table 1. First Year of International Bond Issuance in Emerging Economies

Year	Countries
2001	Egypt
2005	North Macedonia
2007	Gabon, Ghana, Sri Lanka
2008	Georgia
2009	Senegal
2010	Albania, Belarus, Montenegro
2012	Bolivia, Mongolia, Zambia
2013	Armenia, Honduras, Laos, Paraguay, Rwanda
2014	Azerbaijan, Ethiopia, Kenya
2015	Angola, Cameroon
2016	Mozambique, Suriname
2017	Maldives, Tajikistan
2018	Papua New Guinea
2019	Benin, Uzbekistan

3. Risks and Considerations of International Bonds

The issuance of international bonds also entails several important risks that emerging market governments must carefully consider.

The first is exchange rate risk. Beyond international bonds themselves, emerging markets have long faced a structural constraint in international financial markets: the difficulty of borrowing in their own currencies. This limitation has often been described as the “original sin” of emerging markets. Therefore, numerous emerging market governments inevitably rely to some extent on foreign-currency-denominated financing. However, the typical denomination of government revenues in the domestic currency closely links them to tax revenues and domestic economic activity. A sharp depreciation of the domestic currency can significantly increase the burden of principal and interest payments in domestic currency terms. Since exchange rate fluctuations lie largely outside the direct control of governments, the accumulation of external debt, including international bonds, carries the risk of imposing a heavier-than-anticipated fiscal burden during periods of macroeconomic instability.

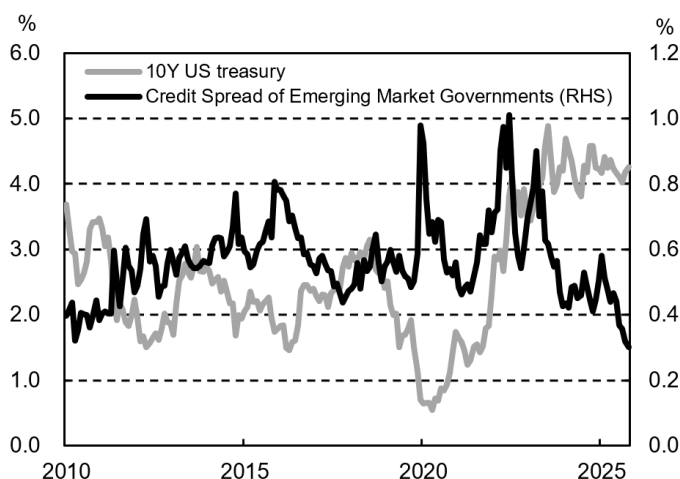
The second concern is dependence on advanced-economy monetary policy through base interest rates. The yield on an international bond is determined by adding a credit spread—reflecting the issuer’s sovereign risk—to the government bond yield of the currency in which the bond is denominated. For example, when issuing a U.S. dollar-

denominated 10-year bond, the yield on the U.S. 10-year Treasury serves as the base rate. Rapid monetary tightening by the Federal Reserve can raise long-term interest rates, leading to increased borrowing costs for the issuing country, regardless of its credit fundamentals.

The third issue is the risk of widening spreads due to shifts in market sentiment. While market-based financing offers flexibility, it also means that funding conditions are directly exposed to changes in the global financial environment. Sovereign spreads do not reflect only country-specific fundamentals. During periods of global risk-off sentiment, investors’ risk aversion tends to rise, and perceptions of emerging markets as a whole may deteriorate. Therefore, borrowing costs can sharply increase or unexpected capital outflows may occur—even if the issuing country itself has experienced little change in its underlying conditions (Figure 2). In particular, international bonds are generally structured with bullet repayment at maturity^{note4}, meaning that the principal is repaid in a lump sum. This structure can make refinancing risks more pronounced when spreads widen.

These risks became evident during the COVID-19 pandemic in 2020 and again following the Russia–Ukraine conflict in 2022. During these periods, yields on emerging market international bonds surged, while bond prices declined. Bond maturities during these episodes forced countries to refinance under extremely unfavorable conditions or abandon market financing altogether. In some cases, these circumstances ultimately resulted in sovereign defaults or debt restructurings.

Figure 2. Funding Costs of International Bonds in Emerging Economies



Note: “Credit spread” is the additional spread associated with a one-notch downgrade, estimated by the author using secondary market prices of outstanding sovereign bonds and credit ratings by rating agencies. The latest data are as of end-January 2026.

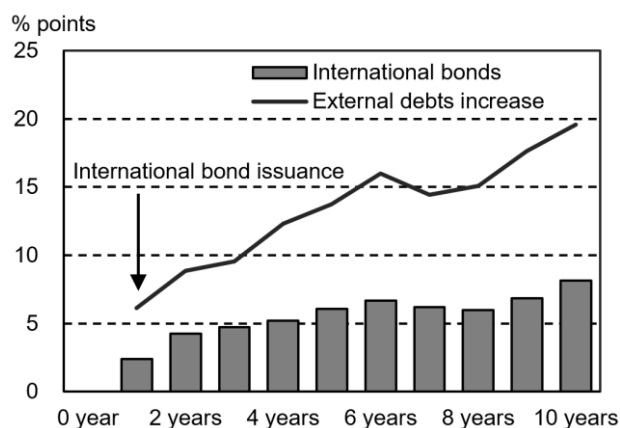
Source: Bloomberg, Moody’s, Fitch, S&P, FRB

4. Dynamics Following the Initiation of International Bond Issuance

Whether issuing international bonds is appropriate must be determined by carefully weighing their advantages against the associated risks. Therefore, the optimal choice varies by country. For this reason, numerous emerging market governments still have not opted to issue foreign-currency sovereign bonds.

Another important perspective concerns how a country’s debt structure and economic trajectory evolve after it begins issuing such bonds. Matsubara (2025) shows that countries issuing international bonds see a significant rise in external debt compared to those that do not (Figure 3). Furthermore, when examining the composition of creditors, little evidence is found of a substitution effect—that is, a decline in other forms of borrowing, such as loans from official creditors or private financial institutions, following the start of international bond issuance.

Figure 3. Illustration of the Increase in External Debt-to-GDP Following the Initiation of International Bond Issuance



Note: For details, please refer to Matsubara (2025).

Instead, the data suggest that total external debt tends to expand by an amount exceeding the volume of the bonds issued.

Notably, the observed increase in external debt following the issuance of international bonds does not imply that such issuance is either desirable or undesirable. Public borrowing is fundamentally intended to support future economic growth and the development of social and economic infrastructure. In cases where a country has strong growth potential but limited access to financing, insufficient investment may constrain that potential. In contrast, if the necessary funds are successfully raised—even at the cost of higher debt levels—such an outcome may in fact be preferable.

The key issue is how international bond issuance affects a country's debt structure, economic growth, and public debt sustainability in the medium to long term. Economic and institutional conditions differ significantly between countries, making it crucial to consider suitable financing strategies.

5. International Bonds from the Perspective of Investors and Creditors

The discussion has focused primarily on the advantages and risks of issuing international bonds from the perspective of emerging market governments as issuers. However, the market for such bonds cannot function without the participation of investors and creditors. Therefore, international bonds present both benefits and challenges.

First, the greatest benefit for investors lies in the investment opportunities these instruments create. For

investors seeking exposure to emerging markets in the form of fixed-income assets, international bonds provide a standardized and accessible investment vehicle. In particular, for real-money investors such as pension funds, insurance companies, and asset management firms, bonds are generally easier to incorporate into portfolios than equities or loans.

Moreover, the expansion of international bond issuance provides significant benefits by enhancing market transparency and increasing the availability of information. A prominent example is the EMBI compiled by JPMorgan Chase. The EMBI reflects market assessments of emerging economies through the yields and spreads of international bonds and has become an important monitoring tool not only for investors but also for financial institutions and policymakers.

In the past, credit default swap spreads—which are traded over the counter—were often used as the primary indicator of sovereign credit risk. However, the rise in countries issuing international bonds and the expansion of market scale and liquidity have increased the relative importance of the EMBI. Because market prices immediately reflect investors' responses to policy changes, political transitions, or external shocks, international bonds have become a valuable source of market-based information. Simultaneously, for emerging market governments as debtors, the immediate feedback provided by market prices can serve as an incentive to maintain sound fiscal management—ultimately benefiting investors and creditors as well.

Nevertheless, there are also important challenges from the perspective of investors and creditors. The most significant among these is the difficulty of coordination in the event of default or debt restructuring. When official creditors are involved, negotiations typically proceed within established frameworks and conventions. In contrast, for international bonds issued in capital markets, creditors are numerous and widely dispersed, thereby complicating coordination. This issue has repeatedly emerged in past sovereign debt restructuring cases.

In response to these challenges, recent years have seen efforts to strengthen Collective Action Clauses and to design bond covenants that facilitate more efficient restructuring processes. The structural problem persists: sovereign debt restructurings with market-based bonds are complex and lengthy, and these challenges remain unresolved.

6. Conclusion

This article has examined the advantages and risks of international bonds from the perspectives of both emerging market governments as issuers and investors and creditors. It is crucial to view international bonds from multiple perspectives and grasp the market's underlying dynamics and interactions. The behavior of issuers influences investors' assessments, while investors' behavior in turn shapes the financing decisions of issuers. The market for international bonds has developed within this framework of mutual interdependence.

Amid a global risk-on environment, issuance spreads for emerging market international bonds have narrowed significantly (Figure 2). This development provides favorable conditions for issuers, and indeed several emerging market governments have resumed or expanded their financing through foreign-currency bond issuance. It is precisely in such favorable market conditions that careful decision-making based on medium- to long-term analysis becomes particularly important.

The evolving global financial environment will determine if international bonds support emerging market growth or create new vulnerabilities, based on the decisions of issuers and investors.

Note1: In this article, “emerging economies” are defined as countries classified by the World Bank as low- and lower-middle-income economies, excluding upper-middle-income economies.

Note2: Mechanism under which securities are registered in advance with the U.S. Securities and Exchange Commission, enabling issuers to access the U.S. market and issue bonds quickly when needed.

Note3: A framework in the European market that allows issuers to flexibly issue bonds within a pre-established maximum issuance limit.

Note4: Some sovereign issuers provide bonds with a sinking-fund structure (sinkable bonds), under which the principal is repaid gradually before maturity. However, these structures are relatively rare and represent exceptions rather than the norm.

References

Matsubara, Ryotaro (2025) “The Impact of International Bond Issuance on Developing Countries’ External Government Debts,” *Japanese Journal of Monetary and Financial Economics*, Vol. 12, pp. 41–61.

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