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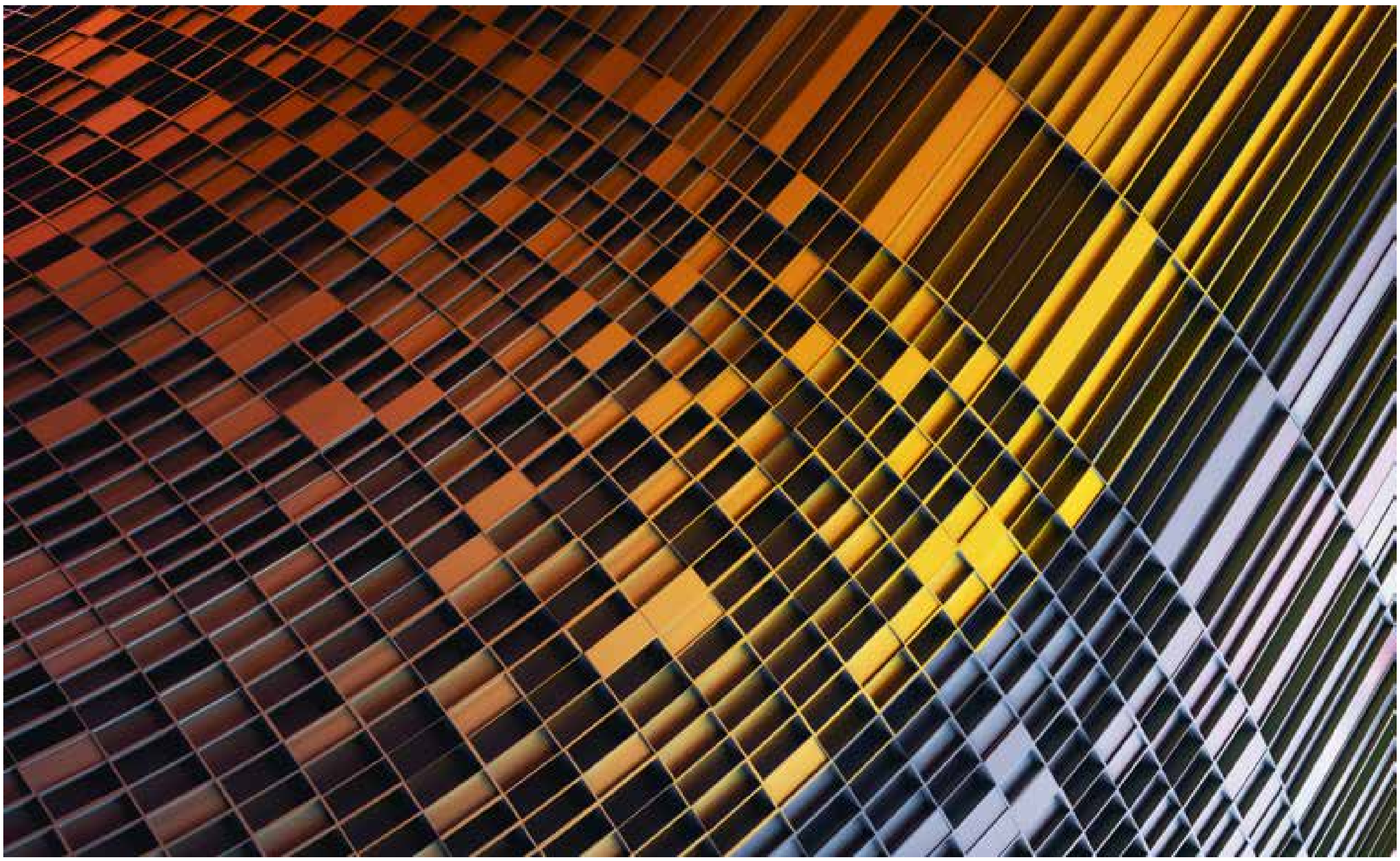
The Growth of Electronic Trading in Latin American Bond Markets



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76% of investors in Latin American bonds expect to trade more electronically

51% of investors in Latin American bonds see all-to-all trading as a primary factor when selecting an e-trading venue

Executive Summary

Global bond markets have experienced a dramatic adoption of electronic trading tools over the past decade, led largely by developed markets in the U.S. and Europe. But in recent years, increased demand for Latin American debt securities by both local and international investors, coupled with new technology solutions, has driven the adoption of e-trading in Brazil, Mexico and other major Latin American markets.

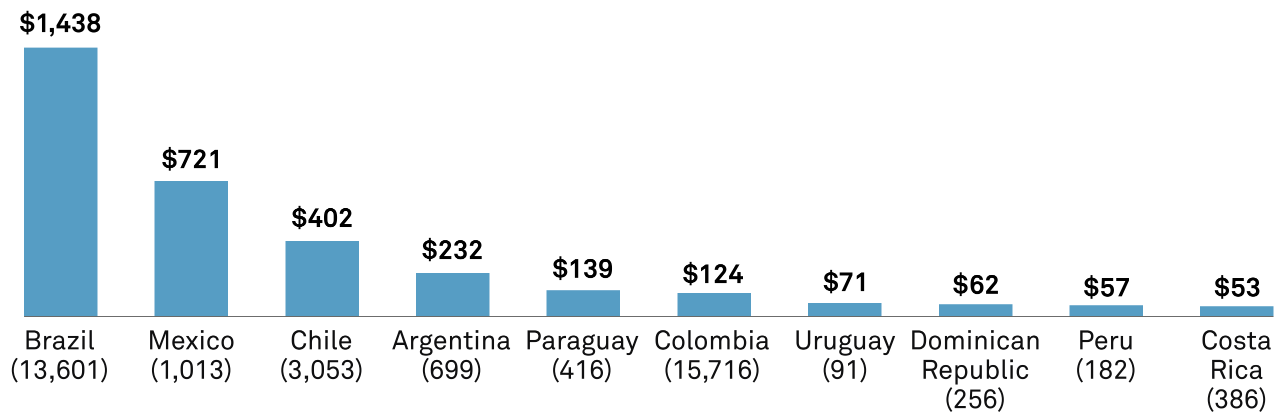
In fact, participants in our recent study traded an average of 46% of their hard currency corporate bonds electronically in the past year, with 76% expecting to trade more electronically going forward. This bodes well not only for the providers of electronic platforms, but for all investors in Latin American bond markets, who will likely see liquidity, transparency and market access improve as their markets continue to modernize.

This research, based on responses from 45 investors and traders of Latin American bonds in Latin America, Europe and the U.S., sheds light on the growth of the market as a whole, where e-trading has grown, where it is likely to grow going forward, and what investors and dealers alike are demanding to further adopt an e-trading approach.

Introduction

The $3.3 trillion bond market in Latin America (LatAm) has grown significantly over the past decade, with both local and global investors demonstrating increased interest in the region's debt securities. Brazil, Mexico, Chile, and Argentina are the largest markets by value of bonds outstanding, with government bonds accounting for 60% of the market (and corporate bonds making up the balance) as of April 2023. While the global run-up in interest rates in 2022–23 continues to hurt new issuance in the region, global and local demand for Latin American debt securities will continue to drive the market forward.

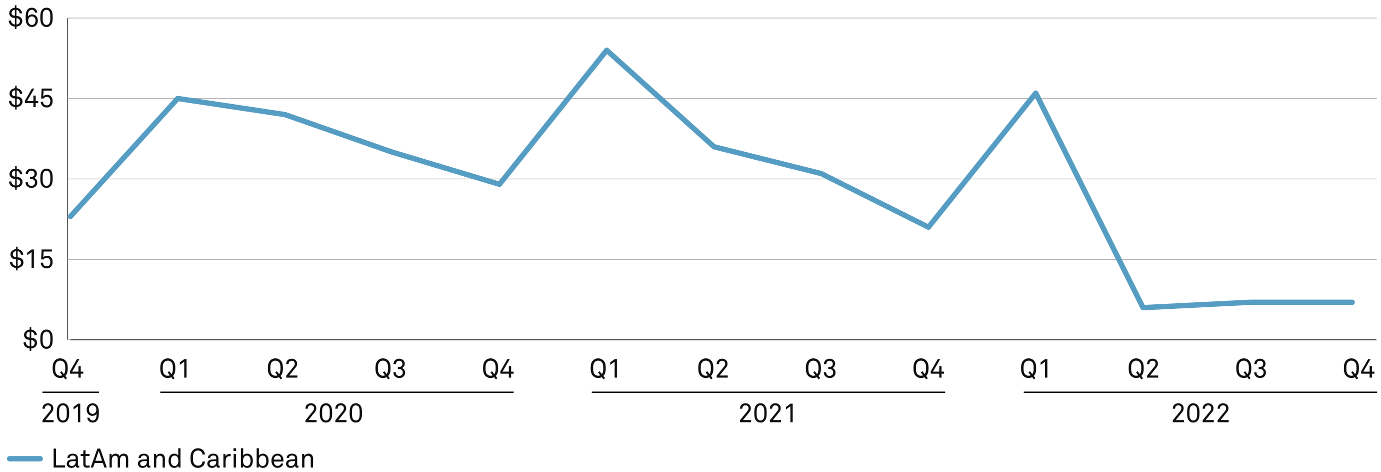
Latin American Debt Outstanding—by Country
(billions)



Note: The J.P. Morgan Emerging Market Bond Index also includes Ecuador, El Salvador, Guatemala, Honduras, Jamaica, Panama, and Venezuela. Numbers in parentheses represent number of respondents.
Source: Refinitiv (an LSEG company)

While, in time, this investor demand will encourage new issuance, new issuance, in turn, will drive additional investor demand. The continued development of a robust secondary market for trading Latin American debt securities—ideally one that is highly electronic—is a key piece of the path forward. For years, closed local markets, regulations that discourage international investments and a lack of standard trading mechanisms left trading largely manual, while major markets in the U.S., Europe and Asia pushed forward with their adoption of electronic trading.

Overall Bond Issuance by Value: Q4 2019–Q4 2022
(billions)



Note: High-yield bonds and non-high-yield bonds
Source: White & Case Debt Explorer

Electronic Trading in LatAm

In an effort to better understand the evolution of trading in the region in general and electronic trading in particular, Coalition Greenwich gathered insights from 45 market participants trading LatAm debt. Unlike bond markets in the U.S. and Europe that offer transparency through standardized trade reporting, understanding bond trading activity across the major markets in LatAm requires input from the largest market participants, including those we spoke with for this study.

"[Electronic trading] will generate a greater scope for investors, causing more marketability in the Latin American bond market."

~Asset Manager, Mexico

Our study participants are active in trading government and corporate bonds, both harder currency (those issued in major global currencies such as the U.S. dollar, Japanese yen and euros) and local currency (those issued in the currencies of the country of issue in LatAm). The issuing currency matters, as it impacts who is mostly likely to trade the bonds and how likely those bonds are to trade electronically.

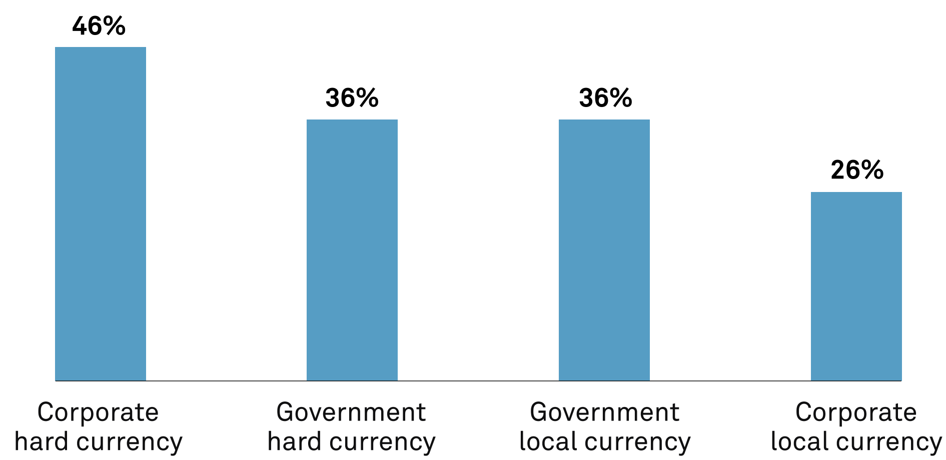
Emerging-Market Fixed Income

Emerging-Market Rates	Emerging-Market Credit
Local-Currency Sovereign Bonds (e.g., Brazilian government bonds issued in Brazilian real)	**Hard-Currency Sovereigns** Emerging-market government bonds issued primarily in USD
Interest-Rate Derivatives (i.e., swaps, futures)	**Hard-Currency Corporates** Emerging-market corporations issuing bonds in USD
Local-Currency Corporates Emerging-market corporations issuing bonds in the local currency	**Emerging-Markets Sovereign CDS** CDS protecting against the default of emerging-market government debt

Source: Coalition Greenwich

For instance, hard currency bonds are more accessible to foreign investors accustomed to trading in U.S. dollars or euros, as only credit and interest-rate risks are in focus, with FX risk largely neutralized. Conversely, local currency bonds are often bought and sold by local investors and brokerage firms who also avoid FX complexities.

Electronic Trading Levels—LatAm Bonds



Note: Based on 45 respondents. Study participants were asked for the percentage of trading they execute electronically in each category on a notional basis. Averages presented here represent the average of those responses. By taking the time to participate in our research about electronic trading, market participants are signaling to us that they are more active or interested in the topic than many of their peers. As such, while our research sample includes many notable market participants and is the largest of its kind on this topic, total market e-trading rates should be taken as representative rather than all encompassing.
Source: Coalition Greenwich 2023 Latin American Bond Market Electronic Trading Study

The broader pool of traders involved in the trading of hard currency bonds is in large part why there is more e-trading in that market today. Our study participants executed 46% of their hard currency corporate bond volume electronically on average, compared to only 26% of their local currency corporate bonds. The gap for government bond e-trading among participants was much smaller, with the averaged percentage traded electronically only slightly higher for hard currency bonds. Further, hard currency bonds are also more likely to be executed via "true" e-trading mechanisms such as multidealer request for quote (RFQ) platforms, as opposed to trades agreed and executed via chat and other less-structured online channels.

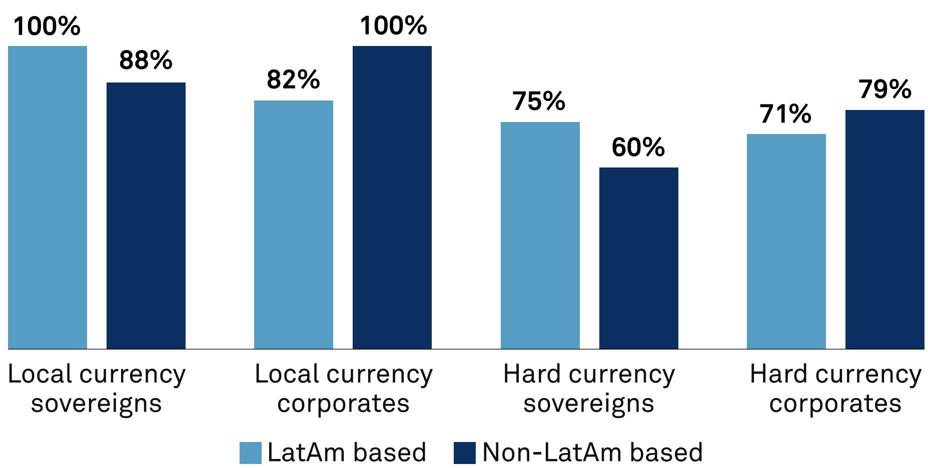
Despite the progress, some dealers remain concerned they will lose touch with their customers if trading moves on screen, and so do what they can to incentivize bilateral communication. The additional cost to dealers of trading via a trading venue can also hold them back. However, the last decade has shown that relationships still very much matter, even if those relationships become electronic in nature and the distribution provided by trading venues allows those dealers to reach clients with prices they otherwise never would have found by phone.

Regarding the tools needed to trade electronically, only about 1 in 5 study participants told us they either did not have the technology needed or did not know how to trade electronically, given their current setup. But with the resources offered by the major trading platforms in the region and the ability to connect to those platforms via third-party order and execution management systems (OEMSs), this roadblock is easily overcome.

An Expectation of Growth

Seventy-six percent of study participants expect their e-trading adoption to grow in the coming year in at least one market segment, with local currency bonds garnering the most votes for more volume via the screen. Those based in LatAm are most bullish on the growth in e-trading for government bonds, whereas international investors see more growth in trading corporate bonds.

Percent that Expect to Trade More Electronically

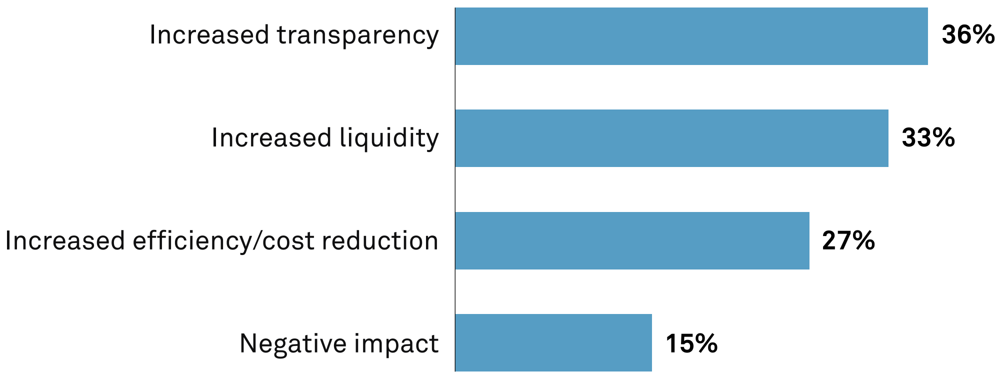


Note: Based on 37 respondents.
Source: Coalition Greenwich 2023 Latin American Bond Market Electronic Trading Study

> **“I hope [electronic trading] develops our landscape to get more efficiency for all users in order to do changes in the portfolio that are not costly for customers.”**
>
> *~Head of Latin American Fixed Income, Asset Manager – U.K.*

While LatAm markets differ in many ways from those in the U.S. and Europe, the expected benefits of e-trading in both hard and local currency bonds were consistent with current and expected outcomes in other parts of the world. Increased transparency and liquidity were the primary benefits cited, with expectations of more market participants, tighter spreads and increased access to data.

Impact of E-Trading Growth



Note: Based on 35 respondents.
Source: Coalition Greenwich 2023 Latin American Bond Market Electronic Trading Study

For the portion of the market still not traded electronically, long-held habits of trading via phone present the largest barrier to e-trading growth. Many market participants feel that they receive better pricing when speaking with a broker directly. This sentiment ties closely with the aforementioned broker concerns about maintaining client relationships and incentives they might offer to trade via the phone.

> **“The [overall] impact is positive. Surely, many more participants will be seen on the electronic execution platform in each of the markets.”**
>
> *~Mexican Asset Manager*

These beliefs create a catch-22, although our interviews suggest this negative cycle is slowly ending. One-third of investors in our study see e-trading improving liquidity—in other words, improving execution quality. Our data[1] also shows that in times of market volatility, e-trading broadly and all-to-all trading in particular increase in the U.S.—a sign that investors look to the screen when liquidity matters the most.

[1] https://www.greenwich.com/market-structure-technology/april-spotlight-all-all-etfs-popular-amid-market-volatility

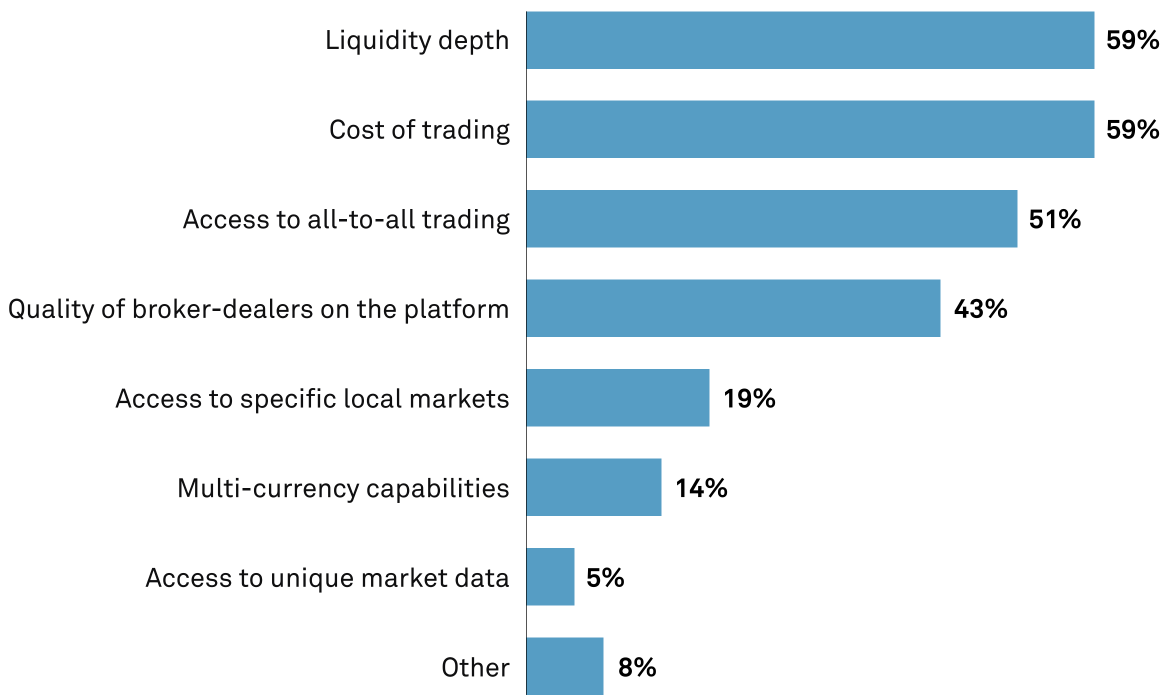
With that in mind, the more investors encourage their brokers to interact on the screen, the more liquid those markets will become. And that liquidity will then bring more market participants (investors and liquidity providers alike) online—a virtuous cycle.

> **"[Electronic trading] … will enhance liquidity with increased participation."**
>
> *~U.S. Asset Manager*

All-to-All in Demand

Thankfully for investors and traders of LatAm bonds, the breadth and depth of e-trading offerings continue to grow. Not surprisingly, liquidity and the cost to trade were the top two criteria when choosing among LatAm bond e-trading platforms. Ultimately, liquidity is what these platforms are designed to provide and improve upon, so offering that service at a fair price is ultimately what will attract the most users. The quality of brokers on the platform ranked highly, which ties in closely with the desire for deep liquidity.

Primary Factors when Choosing E-Trading Platform



Note: Based on 45 respondents.
Source: Coalition Greenwich 2023 Latin American Bond Market Electronic Trading Study

More interestingly, access to all-to-all trading was cited by more than half of study participants as a key factor impacting their platform selection. The positive sentiment toward all-to-all was expressed by investors in Europe, the U.S. and LatAm, and equally by traders and portfolio managers—all a sign of its growing role in global bond markets.

All-to-all trading is a relative newcomer to the institutional bond market. MarketAxess led the way in 2012 when it launched Open Trading, allowing all-to-tall trading of U.S. corporate bonds. Bloomberg, Tradeweb, Trumid, and others have since followed suit with varying degrees of success in the U.S., Europe and Asia. To date, MarketAxess's Open Trading is the only all-to-all offering available for LatAm bonds.

While there are many caveats, including bond type, liquidity profile, order size, and trader needs (e.g., fast execution at the expense of best price, etc.), all-to-all trading has proven to be a successful tool for both the buy and sell sides. Global bond dealers can not commit capital to buy bonds from clients as they once used to, so both clients and the dealers themselves have sought liquidity through all-to-all channels to fill the gap.

Trading Venue Adoption

MarketAxess was the most used platform by our study participants based on those who said they trade on a platform regularly. MarketAxess was also the most used on a notional volume traded basis for trading hard currency bonds and local currency sovereigns. To that point, MarketAxess reported that Latin America local market trading volume on its platform in 2022 was up 24% year over year, hitting a record of $104 billion traded. The interest in all-to-all trading by our study participants suggests Open Trading is well positioned to grow further in LatAm in the coming year.

Bloomberg was the most used platform by our study participants for trading local currency corporate bonds, although the sample was too small for a definitive analysis. Tradeweb's use among our study participants was primarily for trading sovereign bonds, which isn't surprising given their historical strength in the U.S. Treasury market. They saw inquiries on the platform grow by about one-third in the first quarter of 2023. Trumid was also mentioned by some of our study participants who look to their offering to trade hard dollar sovereign LatAm bonds.

Not surprisingly, use of MarketAxess was particularly strong among LatAm investors based in the U.S., where it has a strong market share lead. Among European-based investors, Bloomberg and MarketAxess were equally used by our study participants.

While these usage patterns highlight different habits based on investor location, they also show how truly global the bond market has become. As such, the multi-geography access offered by fixed-income trading venues is a key factor to encouraging the cross-border investing critical to emerging market growth.

Conclusion

The LatAm bond market has grown in size over the past decade, and e-trading adoption has grown along with it. Increased demand from local and international investors has left current market participants clamoring for e-trading access. Those not already invested in LatAm bonds are taking another look as e-trading venues continue to make entrance into the market more palatable (and possible).

While liquidity remains a top requirement for those choosing among e-trading platforms, we found it notable that over half of those in our study were also focused on access to all-to-all trading. This suggests that the hard-won success of all-to-all trading in the U.S. and, increasingly, in Europe might come more quickly to emerging markets like those in LatAm, where thinner liquidity and a more diverse trader/investor base makes the liquidity-seeking benefits of all-to-all markets really stand out.

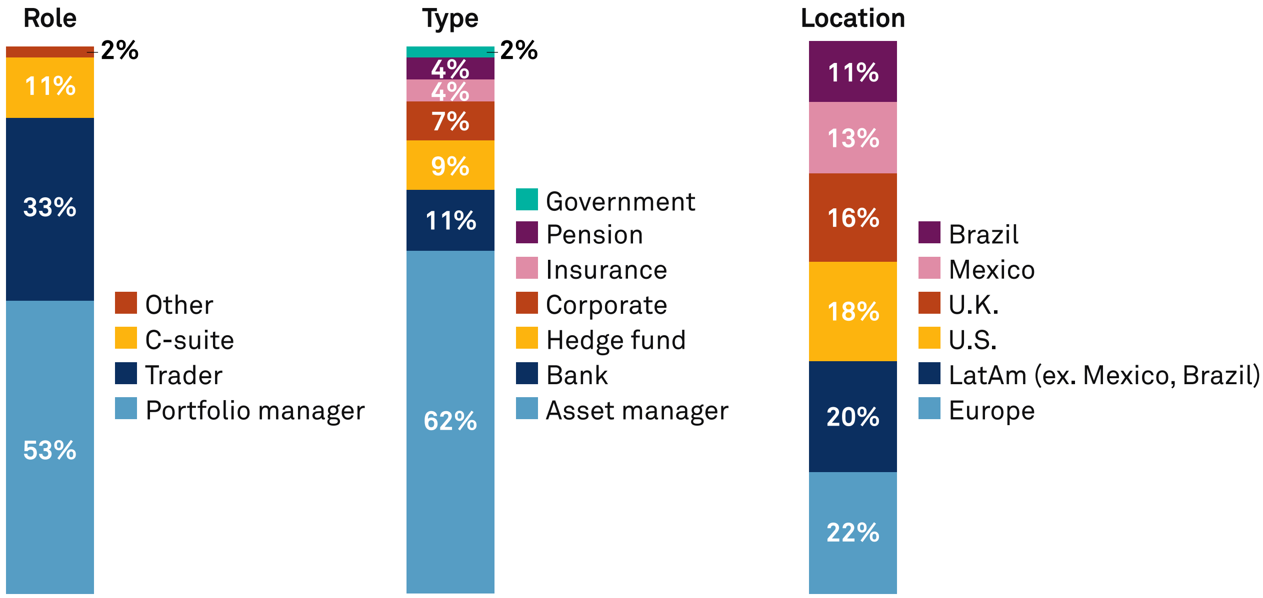
Of course, liquidity providers and the capital they bring to the market remain critical to its functioning and growth. But distributing that liquidity via electronic means rather than through the phone ultimately serves all involved. Liquidity providers find more customers, and customers, in turn, find the high-quality executions they need.

But regardless of the ultimate trading protocol chosen, global markets are on a path toward increased transparency and increased access for investors—both of which electronic trading can provide.

METHODOLOGY

In Q1 2023, Coalition Greenwich gathered responses from 45 participants in the Latin American bond market. Participants were based in Latin America as well as the U.S. and Europe. The majority held roles as either portfolio manager or trader working for asset managers, hedge funds and regional banks.

Respondents



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