

Thinking of Risk Control in Bond Market

Xiaohan Xi

Hefei No.8 high school, Hefei 230031, Anhui, China

Abstract

Bonds/debenture is a kind of financial contract, which is essentially a certificate of debt and has legal benefits. It is a way for enterprises, governments, banks and other institutions to raise funds from the society in accordance with legal procedures. From the perspectives of policy makers, operators, local officials and ordinary people, this paper explores the impact of bond trading on national economies, the future of enterprises, regional development and people's living standards, as well as the unique contribution of bonds to risk management strategies.

Keywords

The Bond Market; Corporate Bonds; Local Bond.

1. Introduction

"It's important to remember how fortunate we are as a country to have a currency and a bond market that is seen in every way as a source of strength and it's a huge responsibility for us to keep it that way."] A debt instrument owed by the issuer to the holder, almost tradable with a fixed maturity period (no less than one year) as well as paying a specified rate of interest rate (coupon rate) to the holder, which named as bond. The birth of bonds can be dated back to the Mesopotamian ages. Over the years, bond has become one of the most popular ways for various kinds of organizations to raise money. Investing in the right bonds is equally important as investing in stocks, said Massi De Santis, a certified financial planner with DESMO Wealth Advisors. There are many financial instruments in this world, why bond market is significant and can not be displaced by others? According to De Santis, the right bonds help you avoid unnecessary risks to get some extent return and utilize your portfolio, particularly in a low-interest rate environment. The main purpose of this essay is not just to discuss the benefits to readers of buying bonds issued by these three different institutions from the perspective of investors. From the perspective of policy makers, business operators, local officials and ordinary people, the paper discusses the impact of bond trading on national economy, the future of enterprises, regional development and people's living standards, as well as the unique contribution of bonds to risk management strategies.

2. National Debt Risk and Countermeasures

National debt, a type of safe bond in the bond market, satisfying the needs of conservative investors. National debt, which is simply the net accumulation of the federal government's annual budget deficits. It is the total amount of money that the U.S owes to its creditor.

Generally speaking, in a sound financial market, only the interest rate of financial products with high reputation and strong liquidity can be qualified as the benchmark interest rate, and the interest rate of national debt is in line with this, because national debt is generally regarded as the interest rate of risk-free assets, which is the benchmark for the evaluation of other assets and derivative instruments. Towards investors, buying national bonds can help investors to avoid the risk of default to the maximum extent. Default risk refers to the risk that the issuing borrower cannot pay the interest or repay the principal of the bond on time, which will bring

losses to the bond investors. Of all bonds, national bonds are often considered gilt-edged by the market because they are backed by the government, so there is no risk of default but the soundable choice for conservative investors. For a country, a highly liquid and open government bond market can not only provide market benchmark interest rates, but also guard against financial risks. A more complete bond market can effectively reduce the risk of the country's financial system.

As one of the most effective financial tool, bonds, also plays an significant role for a nation that can be used to make adjustments to encounter various kind of economic conditions as a result avoiding the risk of long- term economy crisis. Usually, measures that can be divided into two main parts to deal with recession and inflation are expansionary policy and contractionary policy, respectively. As part of economic stimulus measure to recovery economy during the recession. Using open market operation - buy bonds, which is an expansionary monetary policy used by Central bank (different countries has its own name) aims to expand money and decrease nominal interest rate to stimulate an important component of Gross Domestic Product: investment. Such measures have been proven to be effective by and large in most countries of the world because there is a famous economic conclusion : as the price of bond goes up, a corresponding interest rate will goes down , which boosts the investment and real wealth. For example, at the onset of COVID-19 epidemic in 2020, the Federal Reserve began purchasing bonds to keep interest rate low, stimulus the economy, and maintain market liquidity. The bank of Japan is no exception. The Bank of Japan has defied the global trend towards tighter monetary policy by keeping its ultra-loose stance. Their goal is to lower the Japanese 10-year yields by buying bonds perpetually so that the price of bonds will increase continuously. The low interest rates means that Yen (the currency of Japan) is depreciate, which suitable for export commodity to other countries as well as encourage investment. At the same time, Bank of England also adopted the same approach to bought bonds, which pushes down on long-term interest rates on savings and loans. Doing that stimulates spending in the economy. When the bank of England buy bonds, their price tends to increase compared with the coupon. The diagram of the bond price and yield is convex means that the relationship between them is inversely proportional. If the price of a bond goes up, compared with its coupon, the rate of return on the bond, or 'yield', goes down. As a result, lower interest rate lead to higher spending in the economy and raise the rate of inflation if it is too low. Also, as an important part of the financial market, the bond market has the function of making the funds flow from the surplus to the demander and raising funds for the underfunded. Government issue bonds to help provide operating cash flow, to finance debt, to offset government budget deficit and to offer capital investment in many of the country's key construction projects , such as : energy, transportation, important raw materials and other key construction projects, as well as the construction of urban public facilities.

3. Corporate Bond Risk and Countermeasures

Corporate bonds Corporate bonds refer to the securities issued by an enterprise in accordance with legal procedures and agreed to repay principal and interest within a certain period of time. Based on the issuance of corporate bonds, the legal relationship between creditors and debts is formed between bondholders and issuers. Therefore, a corporate bond is a debt certificate issued by a company to bondholders.

Corporate bonds bring a soundable return for person who is resilient to risk and enhance the anti-uncertainty of an enterprise.

For investors, receiving high returns are accompanied by high risks, such as operational risks. Operation risk refers to that the management and decision-making personnel of the unit issuing bonds make mistakes in the process of their operation and management, which leads to the

reduction of assets and makes bond investors suffer losses. Therefore, in order to prevent business risks, the selection of bonds must be investigated by the company, through the analysis of its statements, to understand its profitability and solvency, reputation and so on. People who have great tolerance on risks are recommended to buy corporate bonds. Towards an enterprise, issue bonds can help a company avoid the risk of encountering capital chain ruptures.

Also, corporate bond plays a decisive role for the development of enterprises. For enterprises, the purpose of issuing bonds is multi-faceted. The main purpose is to expand the source of funding. In addition to the accumulation of capital appreciation, companies also obtain bank loans and issue stocks and bonds. By issuing bonds, enterprises increase financing channels and financing methods to expand their sources of funds with relatively low cost. Usually, when the market is optimistic, the real estate will sell the prospective houses to the buyers and put the money from the sale into the construction of the houses and the development of the next project, such as buying land from the local government, so as to obtain a large amount of objective income in the shortest time and maintain the development of the company. But the cycle works on the basis that the company has access to a steady stream of money. What if the buyers don't provide enough money for the company to develop the next project? What if you can't borrow money because you can't deposit enough money with the bank? In effect, developers can sell corporate bonds to get the money to start their next project and to build the homes they have promised buyers, which is helpful for avoiding bankruptcy due to the break of capital chain. Secondly, companies can pay less tax to the government. In Europe, U.S. and other countries, the interest on corporate bonds is a kind of operating expense of the company, which is paid in the operating costs of the company. Therefore, it can be deducted from the company's taxable items, so that companies can reduce tax expenses by issuing corporate bonds. More significantly, sell corporate bonds to earn money render corporations to improve their productivity through two means: increase physical capital and human capital. To be more specific, in the side of physical capital as a real estate owns too much surplus funds property, they may not only invest them into the next program perpetually but also input them into researches and developments on some plants which manufacture products or materials about how to construct buildings in an effective but high-quality and low-cost way. In the side of human capital, companies can use money to foster relevant talents by job-training. Also, offering welfare and subsidy can also improve the enthusiasm of employees and help stabilize the army, which can save the cost of recruitment, encourage people to focus on working hard or staying up late for their companies, and suitable for enterprise's long-term and stable development, since those are not only the candidates of the future management of the company, who may provide value in various kinds of aspects for an enterprise potentially in the future, but also the guide of the development of the company.

4. Local Bond Risk and Countermeasures

Local bond is a type of debt security issued by local government. They are often used to pay for capital expenditures, including the construction of roads, bridges or schools, which makes great efforts to satisfy the needs of citizens.

Local bonds avoid the risk of long-term significant gaps in local government revenue and expenditure.

Thanks for the local bonds help ordinary people on their daily basis and help cities operate well at the base of local government can generate enough revenue apart from the local tax revenue and the assistance of the central government. Secondly, issuing local bonds aims to provide pensions, subsidy and civil servants' salaries for retired person, impoverished people, and local government staff, respectively. Apart from offering them stable source of

income on time but also stimulate economy. Because most of the people would definitely divide their income into two main parts: consumption and saving. To be more specific, in the part of saving, people especially elder people are willing to allocate them into different finance sector, like buying stocks, bonds, or funds. However, their capacities to taking risks is very weak since they could not make living by themselves to earn money as well as they are not professional people. The main purpose of buying these kinds of products is to lay a foundation for their future lives. As a result, buying bonds especially the low-risk bonds like local bonds probably be their best choice to offer them fixed return. The money will be returned to the local fiscal revenue, which is a virtuous circle for local development and for the people.

5. Conclusion

To sum up, bond has gained popularity all around the world, which can definitely be considered as a useful tool. Its potential returns for every important parts within a nation including the parties that issue bonds and that of buying bonds has been proved by itself with strength. Currently, although there are various types of bonds issued by different organizations with different return, different maturity and even different risks, every bond has its unique benefit. We cannot rank the importance of what they can contribute to society in order to select the best bonds since all things in this world are relative, advantages have disadvantages, different positions to see its benefits are also different. If this essay can intrigue you about bonds. I strongly recommend you to evaluate your anti-risk ability at first. Then, choosing the most suitable bond for yourself.

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