Title:

Factors Affecting Japanese Corporate Bond Spreads and Primary Bond Holder Investment Activities: Flight to Liquidity

Abstract: (Your abstract <u>must</u> use 10pt Arial font and <u>must</u> not be longer than this box)

We empirically examine the market liquidity and funding liquidity of Japanese bond spreads from the perspective of primary bond holder, banks, investment activity during two financial crises, the 1990s and the 2008 global financial crisis.

Through empirical analysis, we identify three key issues. First, Japanese bond spreads are affected by the following factors: credit risk, macroeconomics, market liquidity, primary bond holder funding liquidity, and bond-issuing company funding liquidity. Second, the liquidity impacts of the Japanese financial crisis of the 1990s and the 2008 global financial crisis are quite different. During the financial crisis of the 1990s, bond spreads were affected by two types of liquidity—market liquidity and funding liquidity. During the 2008 global financial crisis, bond spreads were affected only by market liquidity as a result of different investment activities conducted by the primary bond holders. Since, bond holders did not face a funding liquidity problem during the 2008 global financial crisis. Finally, during periods of temporary bond market paralysis in Japan, banks have faced high demand for loans and have preemptively transferred assets from illiquid corporate bonds to highly liquid Japanese government bonds. This bank behaviour affects bond spreads and causes flight to liquidity.

The findings in this study suggest that if banks continue to experience systemic funding stress, the liquidation of a bond at a fair price may be difficult.