Executive Summary

Recent Developments in Financial Conditions in Emerging East Asia

During the review period from 1 September to 10 November, financial conditions weakened across emerging East Asia on expectations that the United States (US) Federal Reserve would keep interest rates elevated for an extended period.[1] This prospect drove both US dollar appreciation and capital outflows from emerging markets. To prevent inflationary pressure and safeguard financial stability, some regional central banks recently resumed hiking policy rates, including Bank Indonesia, the Bangko Sentral ng Pilipinas, and the Bank of Thailand. Across emerging East Asian financial markets, widened risk premiums, a retreat in equity markets, and weakened currencies were recorded. Continued high interest rates in both advanced economies and regional markets pushed up bond yields during the review period.

With the Federal Reserve expected to keep interest rates high for a longer period, most regional currencies slightly weakened against the US dollar, posting an average depreciation of 1.0% (simple) and 0.4% (gross-domestic-product-weighted) during the review period. Weak external demand and a moderating growth outlook in the People's Republic of China (PRC), combined with the hawkish monetary stance in the US, drove regional equity markets to fall by 4.9% (simple average) and 4.3% (market-weighted average), and for risk premiums, measured by credit default swaps spreads, to widen by 3.3 basis points (simple average) and 1.4 basis points (gross-domestic-product-weighted average). Capital outflows from the region's equity markets amounted to USD17.1 billion during the review period, while bond markets recorded outflows of USD5.9 billion in September.

The risk outlook for regional financial conditions is generally balanced. On the downside, the Federal Reserve's intention to hold interest rates elevated for a longer period will lead to lasting high borrowing costs in regional markets. This will challenge borrowers with significant leverage and a need for liquidity to refinance debt, including some property companies in the PRC and the Government of the Lao People's Democratic Republic. In addition, higher borrowing costs will exacerbate the fiscal burden for governments using fiscal measures to support economic growth, even in economies with sound fundamentals, which will weaken both their fiscal balance and currency. On the upside, inflation across the region is expected to ease next year and over the medium term despite some transitionary pressure from the recent uptick in food and oil prices. The expected easing of inflation, combined with a weak external environment and heightened financial risks from higher interest rates, may allow central banks to consider easing monetary conditions to support economic growth.

Recent Developments in Local Currency Bond Markets in Emerging East Asia

By the end of September, emerging East Asian local currency (LCY) bonds outstanding reached USD23.5 trillion on modest expansions of 2.5% quarter-on-quarter (q-o-q) and 8.2% year-on-year in the third quarter (Q3) of 2023, compared to 2.0% q-o-q and 7.9% year-on-year in the previous quarter. Growth in government bonds rose to 3.0% q-o-q in Q3 2023 from 2.4% q-o-q in the second quarter (Q2) of 2023, driven by increased issuance. Corporate bond market growth was broadly stable, rising 1.5% q-o-q in Q3 2023 versus 1.4% q-o-q in Q2 2023. Government bonds accounted for 62.4% of total LCY bonds outstanding at the end of September. Aggregate LCY bonds outstanding in member markets of the Association of Southeast Asian Nations (ASEAN) reached USD2.1 trillion at the end of September, equivalent to 9.0% of the emerging East Asian total.

[1] Emerging East Asia is defined to include member states of the Association of Southeast Asian Nations (ASEAN) plus the People's Republic of China; Hong Kong, China; and the Republic of Korea.

During Q3 2023, emerging East Asian LCY bond issuance totaled USD2.5 trillion on q-o-q growth of 8.6%, nearly doubling Q2 2023's growth of 4.6% q-o-q. Growth in government bond issuance surged 13.2% q-o-q to USD1.1 trillion, up from only 2.3% q-o-q in Q2 2023, driven largely by economic stimulus measures in the PRC. Corporate bond issuance recorded USD0.9 trillion on moderated growth of 5.0% q-o-q, compared with 12.5% q-o-q in the previous quarter. ASEAN markets' total issuance reached USD0.5 trillion, comprising 19.7% of the region's total issuance in Q3 2023.

The majority of LCY Treasury bonds outstanding in emerging East Asia at the end of September carried medium- to long-term tenors. In terms of bonds outstanding, Treasury bonds with maturities of over 5 years comprised 53.7% of the total, while the corresponding share was 55.6% in terms of Q3 2023 issuance. The relatively high share of medium- to long-term tenors among all outstanding Treasury bonds mitigated the impact of high interest rates on fiscal burdens. Treasury bonds in the region had a size-weighted average tenor of 8.7 years for outstanding bonds and 6.3 years for Q3 2023 issuance. Meanwhile, domestic investors held 89.4% of the region's outstanding Treasury bonds at the end of September, contributing to Treasury bonds' price resilience to portfolio outflows. Banks were the largest bond holders in the region, holding more than half of all outstanding Treasury bonds at the end of September.

ASEAN+3 sustainable bonds outstanding reached USD734.1 billion at the end of September following robust issuance of USD57.3 billion in Q3 2023.[2] ASEAN+3's sustainable bond market grew 5.2% q-o-q in Q3 2023, posting the fastest q-o-q growth and the largest quarterly issuance total among major regional sustainable bond markets globally. ASEAN+3 is the second-largest regional sustainable bond market in the world, accounting for 18.9% of total global sustainable bonds, after the European Union (EU-20), which accounts for 37.1%. ASEAN+3's sustainable bond issuance during Q3 2023 comprised 36.3% of total global sustainable bond issuance.

ASEAN+3's sustainable bond market remained small, accounting for only 2.0% of its general bond market. This is much smaller than the corresponding share of 6.7% in the EU-20 market. ASEAN+3 sustainable bond issuance is dominated by LCY financing, with 69.5% of Q3 2023 issuance in domestic currencies. However, this also was below the EU-20's LCY issuance share of 85.8% in Q3 2023. ASEAN+3 sustainable bond issuance in Q3 2023 was concentrated in shorter tenors, with 68.1% of issuances carrying maturities of 5 years or less, compared to the corresponding share of 34.9% in the EU-20. Following Singapore's 50-year SGD2.8 billion green bond issuance in August, ASEAN+3's size-weighted average issuance tenor rose to 7.2 years in Q3 2023, from 4.8 years in Q2 2023, which was roughly on par with 7.6 years in the EU-20.

[2] ASEAN+3 is defined to include member states of the Association of Southeast Asian Nations (ASEAN) plus the People's Republic of China; Hong Kong, China; Japan; and the Republic of Korea.