Asia Bond Monitor Highlights

Bond Market Outlook

Bond yields in most emerging East Asian markets fell between 1 March and 15 May amid a weak global economy.[1] The exceptions were the People's Republic of China (PRC) and the Philippines, where yields generally picked up.

The United States (US) Federal Reserve continued to exercise caution in keeping interest rates steady at its Federal Open Market Committee meeting on 26–27 April. Global growth forecasts for 2016 have been revised downward amid sluggishness in the world economy. In March, the Asian Development Bank forecasts that developing Asia's growth would decelerate from 5.9% in 2015 to 5.7% in 2016 and 2017.[2] In April, the International Monetary Fund cut its 2016 global growth forecast to 3.2%, down from 3.4% in January. Against this backdrop, bond yields in emerging East Asia generally decreased between 1 March and 15 May, including yields for 10-year local currency (LCY) government bonds.

Emerging East Asian equity markets were up in all economies except Indonesia and Malaysia between 1 March and 15 May. The region's currencies also generally strengthened against the US dollar during the review period, with the Korean won appreciating the most, followed by the Malaysian ringgit. Credit default swap spreads fell in emerging East Asian markets, indicating reduced perceptions of default risk.

The generally benign picture for emerging East Asian LCY bond markets is subject to a number of risks. First, the US Federal Reserve may raise interest rates within the year, which could cause investors to pull back from the region's bond markets. In addition, a broad-based global economic slowdown could amplify global financial instability and further dent global growth. Finally, deflation is emerging as a new risk to financial stability in emerging East Asia.

Local Currency Bond Market Growth in Emerging East Asia

The size of emerging East Asia's LCY bond market expanded to USD9,608 billion at the end of March, up 3.9% quarter-on-quarter and 20.4% year-on-year in the first quarter (Q1) of 2016. The PRC's bond market remained the largest in the region, accounting for a 67.7% share of emerging East Asia's total bond stock at the end of March. The next two largest LCY bond markets were those of the Republic of Korea and Malaysia.

Government bonds continued to dominate the region's LCY bond market. Government bonds outstanding reached USD5,925 billion at the end of March, accounting for a 61.7% share of the region's aggregate bond stock. Corporate bonds outstanding reached a size of USD3,683 billion. All markets in the region except the Republic of Korea's have a larger proportion of government bonds than corporate bonds.

As a share of gross domestic product (GDP), emerging East Asia's LCY bond market climbed to 65.4% in Q1 2016 from 63.7% in the fourth quarter of 2015, with gains coming from both the government and corporate bond segments. The Republic of Korea had the largest share of bonds to GDP in the region at the end of March at 129.8%, which is a reflection of its well-developed bond market. The next two largest bond markets in the region as a share of GDP were those of Malaysia (97.4%) and Singapore (77.9%).

LCY bond issuance in emerging East Asia totaled USD1,052 billion in Q1 2016, down 2.2% quarter-on-quarter but up 51.0% year-on-year. Of this amount, government bonds accounted for 63.8% and corporate bonds for 36.2%.

[1] Emerging East Asia comprises the People's Republic of China; Hong Kong, China; Indonesia; the Republic of Korea; Malaysia; the Philippines; Singapore; Thailand; and Viet Nam.
[2] Developing Asia comprises the 45 member economies of the Asian Development Bank.

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Structural Developments in Local Currency Bond Markets

With the US Federal Reserve leaving its policy rates unchanged thrice in the first 5 months of the year, emerging East Asia's LCY bonds remained attractive to foreign investors, owing to their relatively high interest rates. The share of foreign holdings in LCY government bond markets rose in most emerging East Asian economies for which data are available.

The share of foreign holdings rose in the LCY government bond markets of Indonesia and Malaysia in Q1 2016, buoyed by their recovering currencies. In the Republic of Korea, the share of foreign investors' government bond holdings rose only marginally in the fourth quarter of 2015.

Foreign investor participation in emerging East Asia's LCY corporate bond market remains weak due to the market's illiquid nature. In Indonesia, the share of foreign investor holdings of corporate bonds fell to 7.4% at the end of March from 7.6% at the end of December. The share of foreign investor holdings in the Republic of Korea's corporate bond market accounted for an insignificant 0.2% of the total corporate bond stock at the end of December.

Net foreign capital inflows into emerging East Asian bond markets were strong in the first 4 months of the year. All emerging East Asian markets for which data are available showed net bond inflows every month from January through April, with the exception of the Republic of Korea, which posted net inflows only for the months of March and April.

Local Currency Bond Yields

Amid the backdrop of the US Federal Reserve leaving its key policy rate unchanged at its March and April meetings, yields for most tenors fell between 1 March and 15 May in all of the region's markets except those of the PRC and the Philippines. Weak global growth also contributed to the decline in yields.

The 2-year yield fell during the review period for all emerging East Asia economies with the exception (again) of the PRC and the Philippines. The pattern was similar for the 10-year yield except in the PRC where the 10-year rate was roughly stable.

Credit spreads between AAA-rated corporate bonds and government bonds fell for most tenors in the Republic of Korea and Malaysia during the review period. In Malaysia, sentiment improved over firmer oil prices. In the PRC, on the other hand, credit spreads rose due to a number of corporate debt defaults in the first half of 2016. Lower-rated corporate spreads in the PRC also rose, while they were unchanged in the Republic of Korea and Malaysia.

Theme Chapter: Drivers of Sovereign Bond Yields in Emerging Asia

Yield movements for 5-year LCY bonds varied across emerging Asia during the period 2000–2015, indicating evolving perceptions of the region's individual bond markets.[3]

Inflation has consistently shown to be a significant factor in determining yields. However, the impacts of consumer price inflation and producer price inflation on yields differ across economies, which suggests the need for tailored policy prescriptions depending on the drivers of consumer and producer inflation in a given economy.

Domestic liquidity is also an important yield driver. To the extent that it influences inflation and economic growth, there is a role for monetary authorities in promoting bond market liquidity.

The global economic environment also affects the region's bond yields, emphasizing the importance of domestic macroeconomic stability and bond market resilience in the face of global uncertainty.

[3] Emerging Asia comprises India, Indonesia, the Republic of Korea, Malaysia, the Philippines, Singapore, and Thailand.