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Emerging East Asian Local Currency Bond Markets: A Regional Update

Highlights

Bond Market Outlook

Emerging East Asian local currency (LCY) bond markets continued to perform well as global financial conditions have remained relatively benign thus far in 2014.[1] The region, however, should prepare for possibly tighter liquidity as United States (US) quantitative easing is expected to end in October. More expansionary monetary actions from the eurozone and Japan could offset some of the impact on liquidity conditions caused by the end of US quantitative easing.

While the region's LCY bond markets have been calm in 2014, the risks are rising, including (i) earlier-than-expected interest rate hikes by the US Federal Reserve (ii) geopolitical tensions that push up oil prices; and (iii) a slowdown in the People's Republic of China's (PRC) property market.

LCY Bond Market Growth in Emerging East Asia

LCY bonds outstanding in emerging East Asia climbed 2.5% quarter-on-quarter (q-o-q) and 9.3% year-on-year (y-o-y) in 2Q14 to reach US$7.9 trillion at end-June. The PRC bond market continued to dominate the region's bond market with outstanding bonds totaling US$4.9 trillion. Viet Nam remained the fastest-growing emerging East Asian bond market in 2Q14, recording growth of 5.9% q-o-q and 36.4% y-o-y.

At end-June, the size of the emerging East Asian LCY government bond market was US$4.8 trillion, or 60% of the size of the region's overall bond market. In 2Q14, the government bond market expanded 3.0% q-o-q—eclipsing the region's LCY corporate bond market's growth rate of 1.9% q-o-q, while the government bond market's y-o-y growth rate of 9.2% was almost at par with the corporate bond market at 9.4% y-o-y.

LCY bonds outstanding as a share of the region's gross domestic product (GDP) stood at 59.3% at the end of 2Q14, up 1.2 percentage points from the end of 1Q14 and 2.1 percentage points from the end of 2Q13. The Republic of Korea and Malaysia had the largest shares of bonds to GDP in the region.

Emerging East Asian LCY bond issuance stood at US$1.1 trillion in 2Q14, compared with US$852 billion in 1Q14 and US$974 billion in 2Q13. The region's LCY government bond issuance accounted for 72.7% of total issuance in 2Q14, led by central banks and monetary authorities' LCY bond sales of US$475 billion, and central governments and other government units' combined LCY bond issuance of US$315 billion.

Structural Developments in LCY Bond Markets

Foreign investor holdings of LCY government bonds in emerging East Asia were generally stable. The only exceptions were in Indonesia, where the share of foreign holdings rose to 35.7% at end-June, and in Thailand, where the share of foreign holdings declined to 15.8% at end-June.

The share of foreign investor holdings in LCY corporate bonds in Indonesia climbed to 7.6% at end-June from 6.6% at end-March, while it remained steady from the previous quarter in the Republic of Korea at 0.4% at end-March.

Emerging East Asia's LCY bond market continued to attract foreign interest, buoyed by improving investor sentiments, as foreign bond inflows recovered strongly in Indonesia, the Republic of Korea, and Thailand in July.

The maturity structures of emerging East Asian LCY government and corporate bond markets were mostly concentrated toward the shorter-end of yield curves (tenors of more than 1 year to 3 years).

LCY Bond Yields

LCY government bond yields generally fell for most emerging East Asian markets between end-March and end-August, supported by ample global liquidity.

[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.

Government bond yield curves shifted downward in the Republic of Korea amid moderating growth, while in Hong Kong, China interest rates fell, tracking US interest rate movements. In contrast, Indonesian government bond yields rose during this period over concerns of a widening current account deficit.

The yield spread between 2- and 10-year government bonds narrowed in all emerging East Asian markets between end-March and end-August amid lower growth expectations.

Special Section: Renminbi Internationalization: Progress and Challenges Ahead

The PRC's economy has grown rapidly to become the second-largest economy in the world. However, the international role of the renminbi is still relatively limited, even though there have been efforts, particularly since the 2008/09 global financial crisis, to promote the internationalization of the renminbi.

On the other hand, the international use of the renminbi is growing. The implementation of a cross-border settlement program has resulted in renminbi trade settlement rising from CNY534.8 billion in 2010 to CNY3.3 trillion in the first half of 2014. Cross-border settlement in other markets is expected to grow with the establishment of clearing banks in Singapore, the United Kingdom, Germany, and the Republic of Korea.

The market share of the renminbi in world payment values has increased substantially from 0.3% in January 2012 to 1.6% in June 2014, ranking the renminbi as the seventh-most used currency in the world.

The offshore renminbi bond market has grown significantly from CNY10 billion worth of bonds issued in 2007 to CNY369 billion in 2013. Majority of offshore renminbi bonds were issued by PRC companies.

The push toward internationalizing the renminbi has made progress so far, but the pace of liberalization is still very much under the control of the authorities. The careful and measured pace of liberalization reflects an understanding that full liberalization could lead to large and destabilizing capital flows.

Meanwhile, there are challenges that hamper the further development of the offshore renminbi bond market that will have to be addressed, including expanding the diversity of issuers, increasing the issuance of higher-rated renminbi bonds, and strengthening the domestic capital market prior to additional liberalization.

The internationalization of the renminbi also has implications for the region's economy. Closer trade and financial ties will likely lead to a greater push for regional cooperation in the region.

Global and Regional Market Developments

Emerging East Asian local currency (LCY) bond markets continued to perform well as global financial conditions have remained relatively benign thus far in 2014.[2] The United States (US) economy bounced back strongly in 2Q14 after contracting in 1Q14. The robustness of the US economy should give confidence to the US Federal Reserve to continue on its current path of gradually normalizing monetary policy. Therefore, the region should prepare for tighter liquidity as quantitative easing is expected to end in October. The US Federal Reserve has also indicated it may wait a "considerable time" after the end of quantitative easing to hike interest rates. This should allow the region to adjust gradually to higher interest rates. So far, the region's LCY bond markets have remained calm in the lead-up to the end of tapering, suggesting that investors have likely incorporated it into their expectations.

While economic conditions in the US continue to improve, growth in the eurozone and Japan has been more disappointing. With the eurozone flirting with deflation, there have been increasing calls for the European Central Bank to take more aggressive monetary actions. In Japan, following the increase in the sales tax, growth dropped sharply in 2Q14. Slowing growth could put pressure on the Bank of Japan to introduce further measures. More expansionary monetary actions from the eurozone and Japan could offset some of the impact on liquidity conditions caused by the end of US quantitative easing.

Despite the tapering of US Federal Reserve quantitative easing operations, 10-year bond yields in the US were on a downward trend in April–August. One reason could be increased demand for US Treasuries as safe-haven assets in the face of growing geopolitical tensions. There also may have been larger purchases of US bonds by emerging market governments in order to build up foreign exchange reserves after the market volatility of last year. Nevertheless, if the US economy continues to perform strongly, bond yields there are likely to start rising again.

Supported by ample global liquidity, emerging East Asian 10-year bond yields continued to fall in April–August **(Table A)**. Among the region's economies, Viet Nam's 10-year bond yield experienced the largest decline, dropping 92 basis points (bps). The fall was mostly due to lower inflation and the economy's upgrade by Moody's in July. This next largest dips in yields were 50 bps and 46 bps declines in the Republic of Korea and Hong Kong, China, respectively. Only in Indonesia did 10-year bond yields rise in April–August. This was likely due to concerns about the widening current account deficit in 2Q14, which was driven primarily by increased imports ahead of Eid celebrations.

Most of the region's currencies appreciated against the US dollar between April and August. The strongest gains were recorded in the Republic of Korea and Malaysia, where domestic currencies appreciated 4.2% and 3.4%, respectively. Both economies likely benefited from increased inflows of funds, while Malaysia's improved growth performance likely supported its exchange rate as well. In the People's Republic of China (PRC), the renminbi halted its decline against the dollar and appreciated 1.0% in April–August. In contrast, the Indonesian rupiah lost 3.3% of its value over the same period after giving up gains made during the first 3 months of the year

Funds flowed back into emerging East Asia as global financial conditions stabilized in 2Q14. The region's stable macroeconomic conditions and improved investor sentiment also helped in attracting foreign investors. Credit default swaps (CDSs) in the region were mostly stable in 2Q14, reflecting the generally higher level of geopolitical tensions rather than economy-specific factors **(Figure A)**. The eurozone has also benefitted from improved market sentiments, with CDSs falling in a number of European economies that had previously experienced soaring rates **(Figure B)**. The exception was Portugal, which saw its CDS rise after it had to rescue one of its largest banks, Banco Espirito Santo. Emerging market spreads have broadly been stable, but the so-called volatility index spiked recently, likely due to heightened geopolitical tensions **(Figure C)**

Bond yields in advanced economies continued their downward trend between January and July. US bond yields were down slightly despite the US Federal Reserve's tapering actions **(Figure D)**. Inflation in the eurozone fell

[2] 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.

Table A: Changes in Global Financial Conditions

	2-Year Government Bond (bps)	10-Year Government Bond (bps)	5-Year Credit Default Swap Spread (bps)	Equity Index (%)	FX Rate (%)
Major Advanced Economies					
United States	6	(41)	–	6.3	–
United Kingdom	15	(36)	(4)	2.5	0.2
Japan	(1)	(12)	(14)	5.6	(0.4)
Germany	(20)	(68)	(2)	(1.4)	4.8
Emerging East Asia					
China, People's Rep. of	31	(25)	(18)	8.3	1.0
Hong Kong, China	(7)	(46)	–	10.2	0.1
Indonesia	27	29	(37)	5.4	(3.3)
Korea, Rep. of	(35)	(50)	(9)	3.8	4.2
Malaysia	8	(20)	(22)	1.0	3.4
Philippines	(13)	(1)	(20)	8.2	2.6
Singapore	(8)	(22)	–	4.0	0.8
Thailand	30	(1)	(37)	12.6	1.3
Viet Nam	(64)	(92)	–	9.0	(0.5)
Select European Markets					
Greece	(226)	(56)	–	(13.5)	4.8
Ireland	(45)	(111)	(24)	(5.8)	4.8
Italy	(32)	(87)	(32)	(6.7)	4.8
Portugal	(49)	(59)	(22)	(23.2)	4.8
Spain	(38)	(112)	(37)	2.5	4.8

( ) = negative, – = not available, bps = basis points, FX = foreign exchange.
Notes:
1. Data reflect changes between 1 April 2014 and 31 August 2014.
2. For emerging East Asian markets, a positive (negative) value for the FX rate indicates the appreciation (depreciation) of the local currency against the US dollar.
3. For European markets, a positive (negative) value for the FX rate indicates the depreciation (appreciation) of the local currency against the US dollar.
Sources: Bloomberg LP and Institute of International Finance.

to just 0.3% year-on-year (y-o-y) in August, bringing the region close to deflation. Expectations are rising that the European Central Bank will initiate more aggressive measures to bring inflation to its target level of 2.0%. Unemployment in the eurozone has also remained stubbornly high. Japanese bond yields have been relatively stable despite signs of rising inflationary expectations. Interest rates in emerging East Asia have been broadly stable or falling, reflecting ample liquidity in the region **(Figure E)**.

Foreign holdings of Indonesian LCY government bonds continued to rise in 2Q14 as relatively high interest rates attracted investors chasing yields **(Figure F)**. At end-June, foreign investors' share of the total market was 35.7%, up from 33.6% at end-March. In Thailand, foreign holdings of LCY government bonds dipped slightly to 15.8% at end-June from 16.1% at end-March. The share of foreign holdings of government bonds in Indonesia remained the highest in the region, followed by Malaysia at 30.8% at end-March, the latest date for which data are available. Foreign holdings in Japan and the Republic of Korea remained relatively stable in 1Q14.

While financial conditions in the region have been calm in 2014, the risks to the region's LCY bond markets are rising:

The US Federal Reserve could hike interest rates earlier than expected, prompting fund outflows from the region. With US economic growth back on track, the US Federal Reserve looks set to end quantitative easing by October as planned. The US Federal Reserve also appears committed to keeping interest rates low for a considerable time after the end of tapering. However, if economic indicators were to show a stronger-than-expected recovery, the US Federal Reserve might accelerate its timetable for interest rate hikes. Financial markets in the region would experience volatility if this resulted in capital outflows. That said, the region's economies look to be better prepared to handle the end of tapering now compared with 2013; current account deficits have narrowed and fiscal deficits have been trimmed. In addition, greater Japanese investment in the region may help offset some of the outflows.

Geopolitical tensions could disrupt fuel supplies, resulting in higher inflation. As conflicts in the

Figure A: Credit Default Swap Spreads[a, b] (senior 5-year)

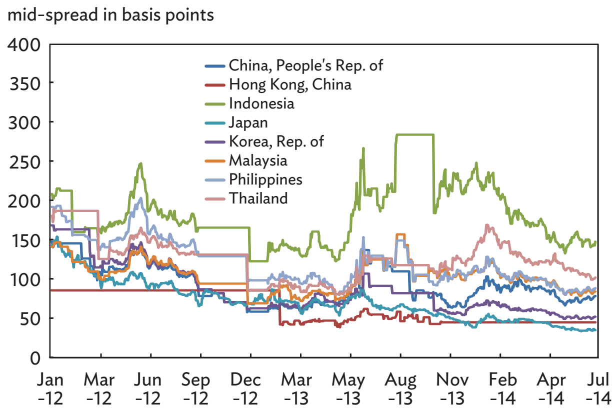


Figure B: Credit Default Swap Spreads for Select European Markets[a, b] (senior 5-year)

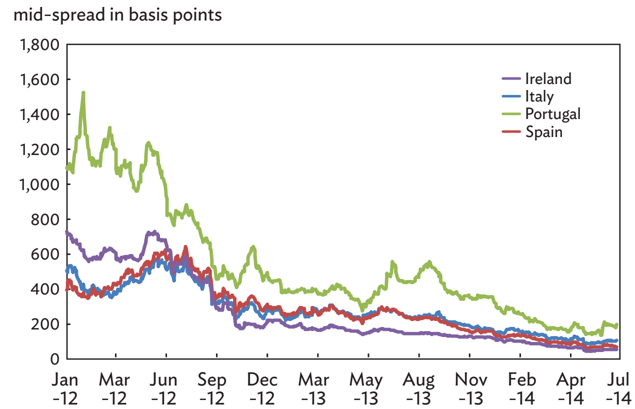


Figure C: US Equity Volatility and Emerging Market Sovereign Bond Spreads[b] (% per annum)

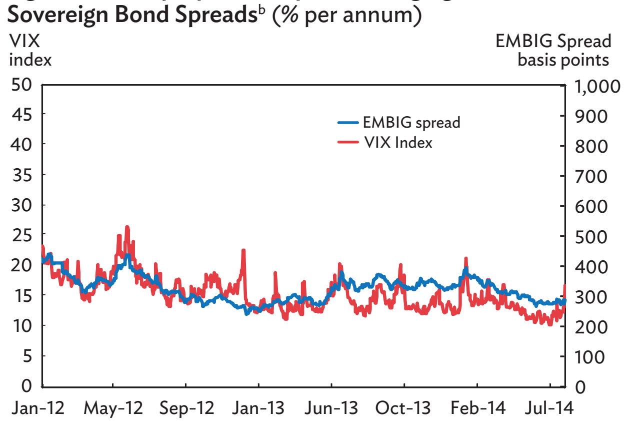


Figure D: 10-Year Government Bond Yields[b] (% per annum)

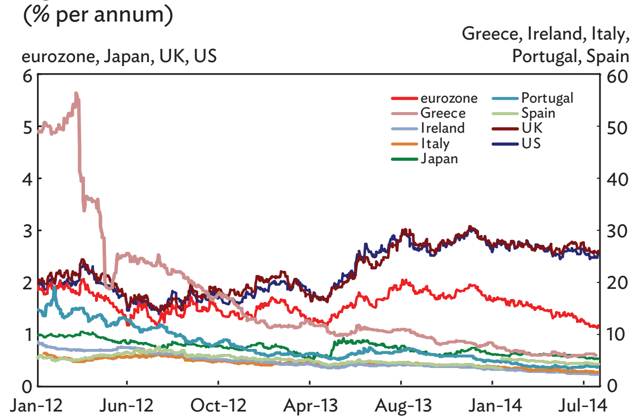


Figure E: JPMorgan EMBI Sovereign Stripped Spreads[a, b]

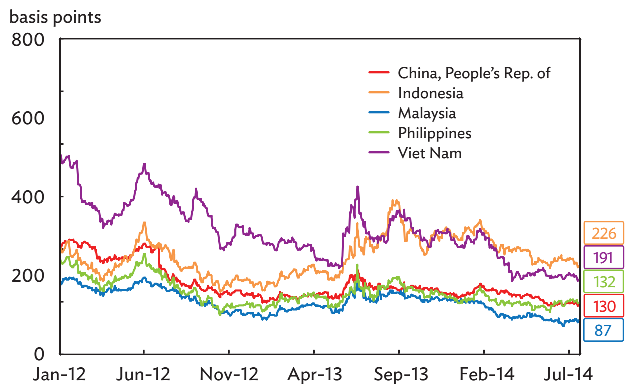
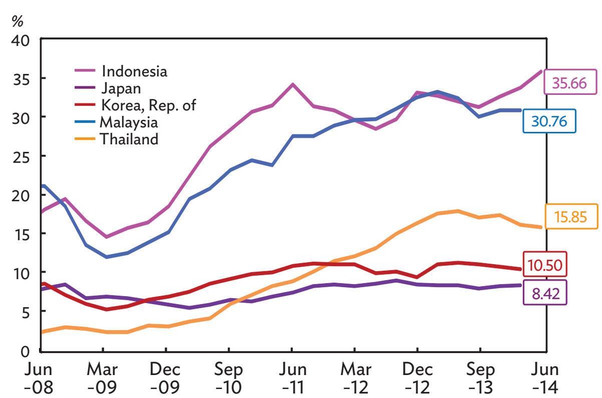


Figure F: Foreign Holdings of LCY Government Bonds in Select Asian Economies[c] (% of total)



EMBI = Emerging Markets Bond Index, EMBIG = Emerging Markets Bond Index Global, LCY = local currency, UK = United Kingdom, US = United States, VIX = Chicago Board Options Exchange Volatility Index.

Notes:

[a] In US$ and based on sovereign bonds.

[b] Data as of end-July 2014.

[c] Data as of end-March 2014, except for Indonesia and Thailand as of end-June 2014.

Sources: *AsianBondsOnline* and Bloomberg LP.

Middle East continue, there is a risk that oil supplies could be threatened by the violence. A worsening of the conflict in Ukraine could put further upward pressure on oil prices. While oil prices have remained low despite rising violence in major oil-producing countries such as Iraq and Libya, prices could start rising if demand picks up in the months ahead. This could cause inflation to rise in the region and prompt monetary authorities to raise policy rates. In countries where fuel subsidies are a major portion of the budget, higher oil prices could result in widening fiscal deficits. Above all, heightened geopolitical tensions may cause a broad pullback from all emerging markets if investors' risk aversion were to rise.

Bond markets could be affected by a slowdown in the PRC's property market. While macroeconomic conditions remain favorable in the PRC, there are increasing signs of weakness in the property market. Data released in August show that residential property prices declined on a monthly basis in 64 out of 70 medium- and large-sized cities in July. Declining prices are problematic as most collateralized borrowings are secured against property. Furthermore, many local governments are dependent on property-related transactions for a large part of their revenue. Hence, a slowdown in the property market will affect their ability to service the large amount of bonds that have been issued by local government financing vehicles. While regional investors are generally restricted from participating in the PRC's onshore bond market, investors' exposure to PRC bonds has increased due to the rising number of issuances made by property companies in the offshore market.

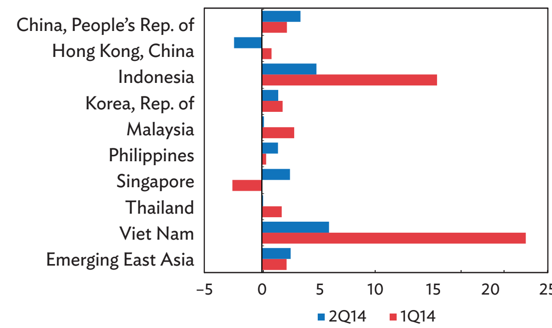
Bond Market Developments in the Second Quarter of 2014

Size and Composition

Emerging East Asian LCY bonds outstanding climbed to US$7.9 trillion at end-June, up 2.5% q-o-q and 9.3% y-o-y.[3]

The outstanding size of the emerging East Asian local currency (LCY) bond market rose 2.5% quarter-on-quarter (q-o-q) to US$7.9 trillion at end-June, compared with 2.2% q-o-q growth in the previous quarter. The People's Republic of China (PRC) continued to dominate the LCY bond market in emerging East Asia, with its stocks of government bonds (US$3.2 trillion) and corporate bonds (US$1.7 trillion) the largest in the region. The PRC bond market saw 3.4% q-o-q growth in 2Q14, with outstanding bonds climbing to US$4.9 trillion at end-June **(Figure 1a)**. Growth was driven mostly by the rapid rise in its stock of policy bank bonds and local corporate bonds.

Figure 1a: Growth of LCY Bond Markets in 1Q14 and 2Q14 (q-o-q, %)



LCY = local currency, q-o-q = quarter-on-quarter.
Notes:
1. Calculated using data from national sources.
2. Growth rates are calculated from LCY base and do not include currency effects.
3. Emerging East Asia growth figures are based on end-June 2014 currency exchange rates and do not include currency effects.
4. For the People's Republic of China, 2Q14 corporate bonds outstanding data based on *AsianBondsOnline* estimates. For Singapore, corporate bonds outstanding data based on *AsianBondsOnline* estimates.

Sources: People's Republic of China (*ChinaBond*, Shanghai Clearing, Shanghai Stock Exchange, Shenzhen Stock Exchange, and *Wind*); Hong Kong, China (Hong Kong Monetary Authority); Indonesia (Bank Indonesia, Indonesia Debt Management Office, and Indonesia Stock Exchange); Republic of Korea (EDAILY *BondWeb* and The Bank of Korea); Malaysia (Bank Negara Malaysia); Philippines (Bureau of the Treasury and Bloomberg LP); Singapore (Monetary Authority of Singapore, Singapore Government Securities, and Bloomberg LP); Thailand (Bank of Thailand); and Viet Nam (Bloomberg LP).

On a q-o-q basis, the Republic of Korea's bond market expanded 1.4%, driven in large part by the growth of its government bond sector, particularly Korea Treasury Bonds and industrial finance debentures, as well as a modest increase in its stock of central bank bonds. The outstanding size of LCY bonds in the Republic of Korea reached US$1.8 trillion at the end of 2Q14.

Malaysia has the third largest market in the region, with outstanding bonds of US$328 billion at end-June, followed by Thailand, with outstanding bonds of US$283 billion. The LCY bond markets in both Malaysia and Thailand recorded negligible growth in 2Q14—0.2% and 0.1% q-o-q, respectively.

Singapore's bond market climbed 2.5% q-o-q to reach US$247 billion at end-June, with growth mainly resulting from increases in the stock of Monetary Authority of Singapore (MAS) bills. MAS bills were first issued in April 2011 as a tool for money market operations. Singapore, which has no need for budget financing, has a debt cap to maintain. Hence, it prefers to issue MAS bills, as opposed to Singapore Government Securities, to avoid reaching its debt ceiling limit.

The LCY bond market of Hong Kong, China contracted during the review period. Hong Kong, China's LCY bonds outstanding fell 2.4% q-o-q to US$192 billion at end-June as government and corporate bonds both declined.

The smaller markets of Indonesia, the Philippines, and Viet Nam recorded growth of 4.8%, 1.4%, and 5.9% q-o-q, respectively. The Indonesian LCY bond market reached a size of US$123 billion at end-June, with increases coming mostly in the stocks of government bonds and central bank bills, which are known as *Sertifikat* Bank Indonesia, or SBI. The government continued with its frontloading issuance policy in 2Q14. In addition, a revised 2014 state budget was passed by the House of Representatives raising the budget deficit to an equivalent of 2.4% of gross domestic product (GDP) from 1.7% in the original budget. The revised 2014 state budget

[3] 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.

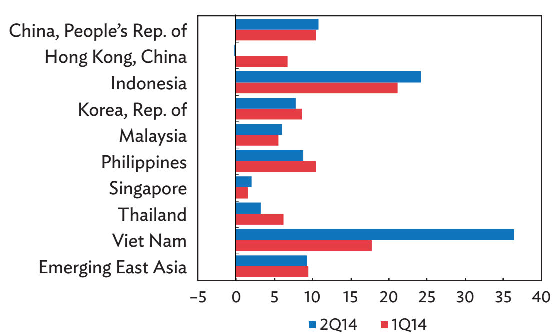
also raised the net government securities financing requirement to IDR265.0 trillion, up 29.2% from the original budget.

In 2Q14, the Philippine bond market grew 1.4% q-o-q, rising to US$103 billion on the back of modest growth in the government bond sector as the Bureau of the Treasury issued more bonds in 2Q14 than in the previous quarter.

Viet Nam was the fastest growing bond market in emerging East Asia—albeit from a small base—registering a 5.9% q-o-q growth rate in 2Q14. Viet Nam's rapid growth was driven mainly by its government bond sector, particularly Treasury bonds and central bank bonds

On a y-o-y basis, the region's LCY bond market expanded 9.3% in 2Q14, slightly lower than expansion of 9.5% in the previous quarter **(Figure 1b)**. The fastest growing bond markets on a y-o-y basis were Viet Nam (36.4%), Indonesia (24.2%), and the PRC (10.8%). The only market that recorded negative y-o-y growth in 2Q14 was Hong Kong, China.

Figure 1b: Growth of LCY Bond Markets in 1Q14 and 2Q14 (y-o-y, %)



LCY = local currency, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Growth rates are calculated from LCY base and do not include currency effects.
3. Emerging East Asia growth figures are based on end-June 2014 currency exchange rates and do not include currency effects.
4. For the People's Republic of China, 2Q14 corporate bonds outstanding data based on *AsianBondsOnline* estimates. For Singapore, corporate bonds outstanding data based on *AsianBondsOnline* estimates.

Sources: People's Republic of China (*ChinaBond*, Shanghai Clearing, Shanghai Stock Exchange, Shenzhen Stock Exchange, and *Wind*); Hong Kong, China (Hong Kong Monetary Authority); Indonesia (Bank Indonesia, Indonesia Debt Management Office, and Indonesia Stock Exchange); Republic of Korea (EDAILY *BondWeb* and The Bank of Korea); Malaysia (Bank Negara Malaysia); Philippines (Bureau of the Treasury and Bloomberg LP); Singapore (Monetary Authority of Singapore, Singapore Government Securities, and Bloomberg LP); Thailand (Bank of Thailand); and Viet Nam (Bloomberg LP).

At end-June, government bonds accounted for nearly 60% of emerging East Asian total LCY bonds outstanding **(Table 1)**. The government bond sector grew 3.0% q-o-q and 9.2% y-o-y to reach US$4.8 trillion. On a q-o-q basis, growth in the government sector was driven by increases in the stock of central bank bills and bonds, and Treasury bonds.

On an aggregate basis, Treasury bills and bonds accounted for the bulk of the total government bond stock in emerging East Asia in 2Q14. At end-June, the stock of Treasury bills stood at US$43 billion and Treasury bonds at US$2.3 trillion. The PRC has the largest stock of Treasury bonds (US$1.3 trillion) and the Republic of Korea has the largest stock of Treasury bills (US$12 billion).

At end-June, the stock of central bank securities in emerging East Asia stood at US$558 billion **(Figure 2)**. The Republic of Korea had the region's largest market, accounting for 32.1% of total central bank securities outstanding in 2Q14. This was followed by Hong Kong, China (US$97 billion) and Thailand (US$87 billion). In the PRC, the amount of central bank securities outstanding continued to fall, settling at US$79 billion at end-June, as the People's Bank of China (PBOC) has been relying less on central bank issuances and more on other monetary policy tools.

Emerging East Asian LCY corporate bonds rose 1.9% q-o-q and 9.4% y-o-y to reach US$3.2 trillion at end-June. Corporate bonds now account for 40.2% of total outstanding bonds in the region. On a q-o-q basis, only the PRC recorded significant growth in its stock of corporate bonds in 2Q14 at 3.6%. All other markets registered growth of 1.6% q-o-q or less, while the corporate bond markets of Hong Kong, China; the Philippines; and Viet Nam contracted on a q-o-q basis.

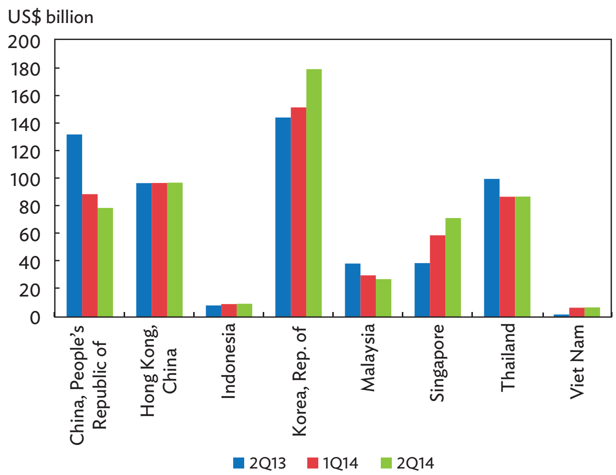
Hong Kong, China's corporate bond stock declined 4.8% as most companies preferred to borrow funds through loans. In the Philippines, corporate bonds outstanding fell due to less issuance in 2Q14, as most corporates shied away from issuing bonds amid expectations of higher interest rates. In Viet Nam, corporate bonds outstanding have been on a downtrend, with no new corporate issuance since November 2012. As of end-June, only 13 corporate entities comprised the entire corporate bond market in Viet Nam.

Table 1: Size and Composition of LCY Bond Markets

	2Q13		1Q14		2Q14		Growth Rate (LCY-base %)				Growth Rate (US$-base %)			
							2Q13		2Q14		2Q13		2Q14	
	Amount (US$ billion)	% share	Amount (US$ billion)	% share	Amount (US$ billion)	% share	q-o-q	y-o-y	q-o-q	y-o-y	q-o-q	y-o-y	q-o-q	y-o-y
China, People's Rep. of														
Total	4,445	100.0	4,702	100.0	4,872	100.0	3.1	18.1	3.4	10.8	4.3	22.3	3.6	9.6
Government	2,905	65.4	3,056	65.0	3,164	64.9	1.5	8.7	3.3	10.1	2.7	12.5	3.5	8.9
Corporate	1,540	34.6	1,646	35.0	1,708	35.1	6.3	41.1	3.6	12.1	7.5	46.1	3.8	10.9
Hong Kong, China														
Total	192	100.0	196	100.0	192	100.0	4.4	10.7	(2.4)	(0.2)	4.5	10.7	(2.3)	(0.1)
Government	107	56.0	109	55.5	109	56.6	7.0	15.7	(0.5)	0.9	7.1	15.7	(0.4)	1.0
Corporate	84	44.0	87	44.5	83	43.4	1.3	4.9	(4.8)	(1.6)	1.4	4.9	(4.7)	(1.5)
Indonesia														
Total	118	100.0	123	100.0	123	100.0	2.2	12.4	4.8	24.2	(0.5)	6.0	0.2	4.6
Government	97	82.6	104	84.5	105	85.2	1.7	10.3	5.6	28.0	(1.0)	4.0	1.1	7.9
Corporate	21	17.4	19	15.5	18	14.8	4.5	23.6	0.02	5.9	1.7	16.5	(4.3)	(10.8)
Korea, Rep. of														
Total	1,445	100.0	1,648	100.0	1,759	100.0	2.2	10.6	1.4	7.8	(0.5)	11.0	6.7	21.7
Government	558	38.6	635	38.6	692	39.4	2.3	6.0	3.5	9.9	(0.4)	6.3	9.0	24.1
Corporate	887	61.4	1,012	61.4	1,066	60.6	2.1	13.8	0.1	6.5	(0.6)	14.1	5.4	20.2
Malaysia														
Total	314	100.0	322	100.0	328	100.0	(0.2)	6.4	0.2	6.0	(2.3)	6.9	1.9	4.3
Government	186	59.1	188	58.4	191	58.1	(0.2)	5.1	(0.3)	4.1	(2.3)	5.7	1.4	2.5
Corporate	128	40.9	134	41.6	138	41.9	(0.3)	8.2	0.9	8.7	(2.4)	8.8	2.6	7.0
Philippines														
Total	96	100.0	99	100.0	103	100.0	3.0	13.2	1.4	8.8	(2.6)	10.6	4.1	7.5
Government	83	86.9	84	84.6	87	85.0	3.2	13.8	1.9	6.5	(2.4)	11.2	4.6	5.2
Corporate	13	13.1	15	15.4	15	15.0	1.7	9.3	(1.1)	24.4	(3.8)	6.7	1.6	23.0
Singapore														
Total	238	100.0	239	100.0	247	100.0	2.0	14.0	2.5	2.0	(0.2)	13.8	3.4	3.8
Government	148	62.2	146	61.1	152	61.6	1.9	14.9	3.3	1.1	(0.3)	14.6	4.2	2.8
Corporate	90	37.8	93	38.9	95	38.4	2.2	12.6	1.1	3.6	(0.1)	12.4	2.0	5.4
Thailand														
Total	286	100.0	282	100.0	283	100.0	3.0	10.6	0.1	3.2	(2.9)	12.5	0.1	(1.2)
Government	226	78.9	217	76.8	216	76.4	3.4	8.7	(0.3)	0.01	(2.6)	10.5	(0.4)	(4.3)
Corporate	60	21.1	66	23.2	67	23.6	1.8	18.5	1.6	15.3	(4.1)	20.4	1.6	10.3
Viet Nam														
Total	27	100.0	35	100.0	37	100.0	(8.6)	26.8	5.9	36.4	(9.8)	25.0	4.7	35.6
Government	26	97.0	35	98.3	36	98.4	(8.1)	34.3	6.0	38.3	(9.3)	32.4	4.8	37.5
Corporate	1	3.0	0.6	1.7	0.6	1.6	(22.5)	(55.5)	(1.2)	(27.5)	(23.5)	(56.2)	(2.3)	(27.9)
Emerging East Asia														
Total	7,161	100.0	7,646	100.0	7,943	100.0	2.7	15.1	2.5	9.3	2.3	17.6	3.9	10.9
Government	4,337	60.6	4,574	59.8	4,752	59.8	1.8	8.8	3.0	9.2	1.5	11.3	3.9	9.6
Corporate	2,824	39.4	3,072	40.2	3,191	40.2	4.1	26.0	1.9	9.4	3.6	28.9	3.9	13.0
Japan														
Total	10,408	100.0	10,239	100.0	10,496	100.0	1.2	3.8	0.6	3.1	(3.8)	(16.5)	2.5	0.9
Government	9,567	91.9	9,443	92.2	9,689	92.3	1.4	4.6	0.7	3.5	(3.6)	(15.8)	2.6	1.3
Corporate	840	8.1	796	7.8	807	7.7	(0.8)	(4.4)	(0.5)	(1.9)	(5.7)	(23.0)	1.4	(4.0)

( ) = negative, LCY = local currency, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. For the People's Republic of China, 2Q14 corporate bonds outstanding data based on *AsianBondsOnline* estimates. For Singapore, corporate bonds outstanding data based on *AsianBondsOnline* estimates.
2. Corporate bonds include issues from financial institutions.
3. Bloomberg LP end-of-period LCY—US$ rates are used.
4. For LCY base, emerging East Asia growth figures based on end-June 2014 currency exchange rates and do not include currency effects.
5. 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.
Sources: People's Republic of China (*ChinaBond*, Shanghai Clearing, Shanghai Stock Exchange, Shenzhen Stock Exchange, and *Wind*); Hong Kong, China (Hong Kong Monetary Authority); Indonesia (Bank Indonesia, Indonesia Debt Management Office, and Indonesia Stock Exchange); Republic of Korea (EDAILY *BondWeb* and The Bank of Korea); Malaysia (Bank Negara Malaysia); Philippines (Bureau of the Treasury and Bloomberg LP); Singapore (Monetary Authority of Singapore, Singapore Government Securities, and Bloomberg LP); Thailand (Bank of Thailand); Viet Nam (Bloomberg LP); and Japan (Japan Securities Dealers Association).

Figure 2: Central Bank Bills and Bonds Outstanding



Note: The Philippines has no central bank bills and bonds outstanding.
Source: *AsianBondsOnline*.

The size of the LCY bond market in emerging East Asia expressed as a percentage of GDP climbed to 59.3% in 2Q14 from 58.1% in the previous quarter and 57.2% a year earlier **(Table 2)**. The Republic of Korea (129.6%) and Malaysia (101.8%) had the largest shares of bonds to GDP among all markets in the region.

The maturity structures of LCY bond markets in the region were mostly concentrated at the shorter-end of the curve.

At end-June, the maturity structures of emerging East Asia's LCY government bond markets were mostly concentrated at the shorter-end of the curve (maturities of more than 1 year to 3 years), with the exceptions being the PRC, Indonesia, Malaysia, and the Philippines **(Figure 3)**. The PRC and Malaysia had a larger share of their bonds with medium-dated tenors (maturities of more than 5 years to 10 years), while the Indonesian and Philippine markets were more concentrated at the longer-end (maturities of more than 10 years).

About 46% of government bonds in Indonesia had remaining maturities of more than 10 years **(Figure 4)**. Three out of four benchmark government bond series carried maturities of more than 10 years, resulting in a bond curve heavily concentrated at the longer-end. The Indonesian government has been undertaking debt buybacks and debt switches on a regular basis as part of

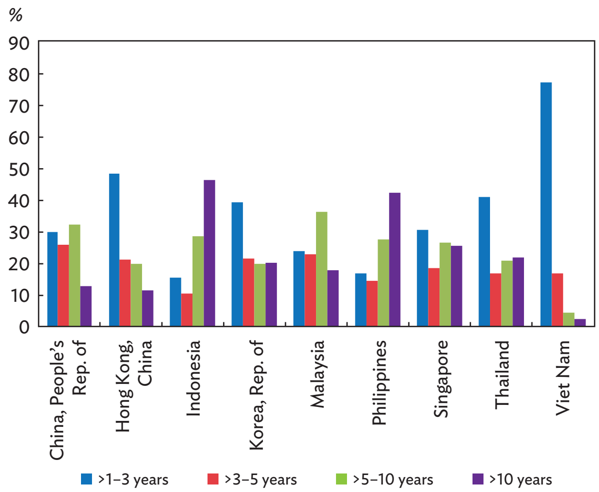
Table 2: Size and Composition of LCY Bond Markets
(% of GDP)

	2Q13	1Q14	2Q14
China, People's Rep. of			
Total	50.6	50.6	51.2
Government	33.1	32.9	33.3
Corporate	17.5	17.7	18.0
Hong Kong, China			
Total	71.7	70.8	68.3
Government	40.1	39.3	38.7
Corporate	31.5	31.5	29.6
Indonesia			
Total	13.8	15.0	15.2
Government	11.4	12.6	13.0
Corporate	2.4	2.3	2.3
Korea, Rep. of			
Total	118.0	121.4	129.6
Government	45.6	46.8	51.0
Corporate	72.4	74.6	78.6
Malaysia			
Total	104.3	104.1	101.8
Government	61.6	60.8	59.1
Corporate	42.6	43.3	42.7
Philippines			
Total	37.5	37.6	37.3
Government	32.5	31.8	31.7
Corporate	4.9	5.8	5.6
Singapore			
Total	82.8	79.5	81.1
Government	51.5	48.6	50.0
Corporate	31.3	30.9	31.1
Thailand			
Total	75.8	76.7	76.3
Government	59.8	58.9	58.3
Corporate	16.0	17.8	18.0
Viet Nam			
Total	16.5	20.4	21.1
Government	16.0	20.0	20.8
Corporate	0.5	0.3	0.3
Emerging East Asia			
Total	57.2	58.1	59.3
Government	34.6	34.7	35.5
Corporate	22.5	23.3	23.8
Japan			
Total	174.6	219.3	219.7
Government	160.5	202.3	202.8
Corporate	14.1	17.1	16.9

GDP = gross domestic product, LCY = local currency.
Notes:
1. Data for GDP is from CEIC. 2Q14 GDP figure carried over from 1Q14 for the Republic of Korea.
2. For the People's Republic of China, 2Q14 corporate bonds outstanding data based on *AsianBondsOnline* estimates. For Singapore, corporate bonds outstanding data based on *AsianBondsOnline* estimates.

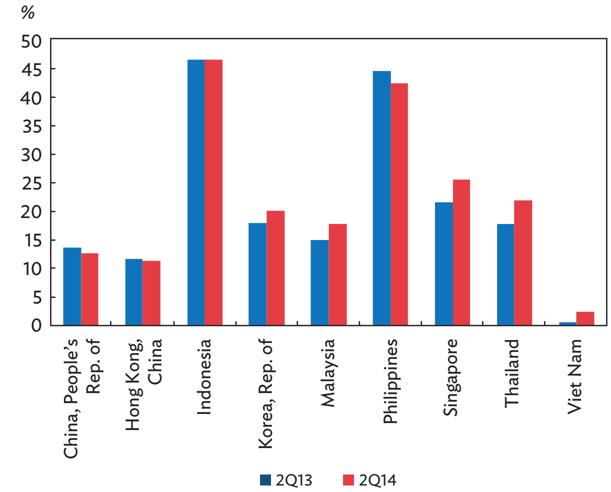
Sources: People's Republic of China (*ChinaBond*, Shanghai Clearing, Shanghai Stock Exchange, Shenzhen Stock Exchange, and *Wind*); Hong Kong, China (Hong Kong Monetary Authority); Indonesia (Bank Indonesia, Indonesia Debt Management Office, and Indonesia Stock Exchange); Republic of Korea (EDAILY *BondWeb* and The Bank of Korea); Malaysia (Bank Negara Malaysia); Philippines (Bureau of the Treasury and Bloomberg LP); Singapore (Monetary Authority of Singapore, Singapore Government Securities, and Bloomberg LP); Thailand (Bank of Thailand); Viet Nam (Bloomberg LP); and Japan (Japan Securities Dealers Association).

Figure 3: Government Bond Maturity Profiles (individual maturities as % of total)



Source: *AsianBondsOnline*.

Figure 4: Government Bonds—Maturities of More Than 10 Years (% of total)



Source: *AsianBondsOnline*.

the portfolio management of its government securities. More recently, the government has structured its debt switches as "many-to-many," in which destination bonds can be any one of its four benchmark series instead of only one series. This measure has helped to attract higher bids during debt switch offerings.

The government bond market of the Philippines is also more weighted toward the longer-end, with about 42% of bonds carrying a remaining maturity of more than 10 years. The maturity profile of Philippine LCY government bonds has changed significantly from the time the government introduced its debt liability management program in February 2006. Since then, the Bureau of the Treasury has held various bond swaps and reissuances, leading to the lengthening of the maturity profile of the securities issued. This has also deepened liquidity in the LCY bond market, where banks have been able to convert their illiquid holdings to liquid benchmark securities, thus increasing trading volume in the LCY bond market.

In the corporate sector, the maturity structures were also mostly concentrated at the shorter-end **(Figure 5)**. Majority of corporate bonds in the PRC; Hong Kong, China; Indonesia; the Republic of Korea; and Thailand carried maturities of more than 1 year to 3 years. Meanwhile, in the Philippines and Viet Nam, more than 50% of corporate bonds had maturities of 5 years to 10 years. In Malaysia, about 37% of corporate bonds had maturities of 5 years to 10 years. In Indonesia and Viet Nam, there were no corporate bonds with maturities of more than 10 years.

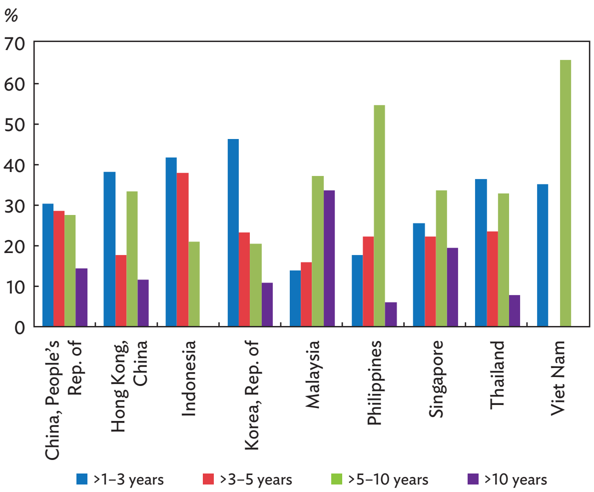
Foreign holdings as a share of total LCY government bonds were mostly unchanged in the region's markets.

Foreign investor holdings in the region's LCY government bond markets were broadly stable for most markets in 1Q14 **(Figure 6)**. The only exceptions were in Indonesia, where the share of foreign holdings hit new highs in recent months, and Thailand, where the share of foreign holdings declined in 2Q14.

The share of foreign holdings in Indonesia rose to 35.7% at end-June, and climbed further to 36.3% at end-July. In addition to attractive yields, continued strong inflows from foreign participants can be partly attributed to rising market confidence amid the conclusion of the presidential election.

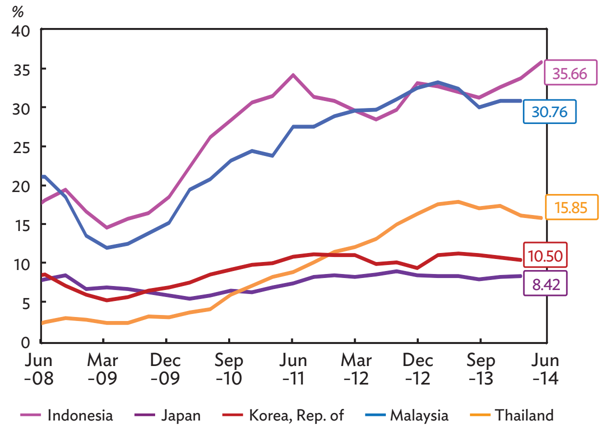
In Thailand, foreign holdings' share of the government bond market declined to 15.8% in 2Q14 amid negative sentiments arising from political uncertainty in the first half of the year. Meanwhile, negligible declines were noted in shares of foreign holdings of government bonds in Malaysia and the Republic of Korea in 1Q14, the latest quarter for which data are available.

Figure 5: Corporate Bond Maturity Profiles (individual maturities as % of total)



Source: *AsianBondsOnline*.

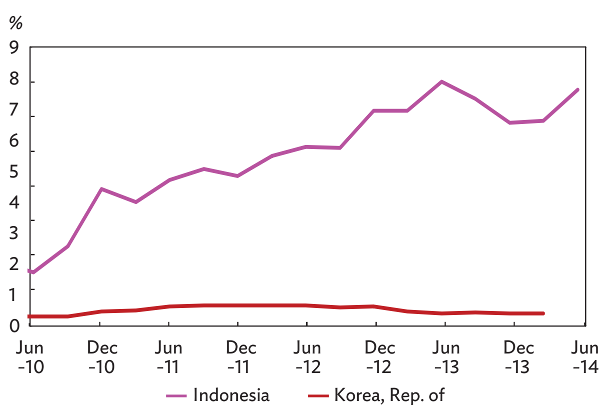
Figure 6: Foreign Holdings of LCY Government Bonds in Select Asian Markets (% of total)



LCY = local currency.
Note: Data as of end-March 2014, except for Indonesia and Thailand as of end-June 2014.
Source: *AsianBondsOnline*.

The shares of foreign holdings in LCY corporate bond markets in Indonesia and the Republic of Korea remained significantly lower compared with their respective government bond markets **(Figure 7)**. In both economies, most corporate bonds are illiquid, and investors tend to buy and hold until maturity. The share of foreign holdings of LCY corporate bonds in Indonesia gained 1 percentage point in 2Q14 to reach 7.6% at end-June. Meanwhile, foreign holdings' share of LCY corporate bonds in the Republic of Korea in 1Q14 was negligible at 0.4%.

Figure 7: Foreign Holdings of LCY Corporate Bonds in Indonesia and the Republic of Korea (% of total)



LCY = local currency.
Note: For Indonesia, data as of 27 June 2014. For the Republic of Korea, data as of end-March 2014.
Sources: Based on data from Otoritas Jasa Keuangan and The Bank of Korea.

Foreign capital inflows into Emerging East Asian LCY bond markets surged in July.

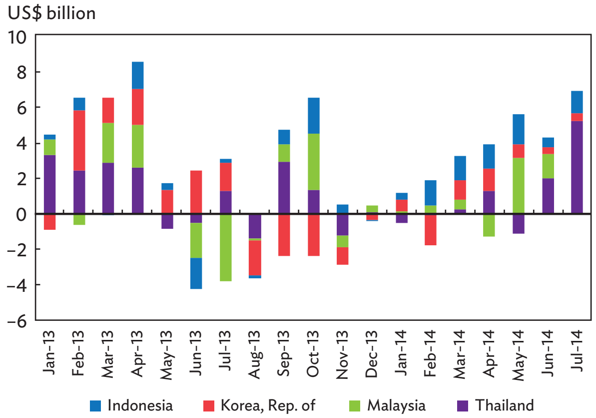
Emerging East Asian LCY bond markets continued to attract foreign interest, buoyed by improving sentiments toward emerging market assets. Foreign bond inflows recovered strongly in July for all markets except Malaysia **(Figure 8)**. The biggest increase was noted in Thailand, where foreign bond inflows jumped to US$5.3 billion in July on renewed interest among foreign investors resulting from the stabilizing political situation and the approval of an infrastructure investment plan.

Emerging East Asian LCY bond issuance rose in 2Q14.

Emerging East Asian LCY bond issuance stood at US$1.1 trillion in 2Q14, up from US$852 billion in 1Q14 and US$974 billion in 2Q13 **(Table 3)**. The region's LCY government bond issuance in 2Q14 accounted for 72.7% of the total issuance for the period, led by central banks and monetary authorities' sales of US$475 billion, and central governments and other government units' combined issuance of US$315 billion.

In 2Q14, issuance in the region's LCY government bond sector reached US$789 billion, reflecting double-digit growth on both a q-o-q and y-o-y basis. The region's corporate sector issued US$296 billion worth of new

Figure 8: Foreign Bond Flows in Select Emerging East Asian Markets



LCY = local currency.
Notes:
1. The Republic of Korea and Thailand provide data on bond flows. For Indonesia and Malaysia, month-on-month changes in foreign holdings of LCY government bonds were used as a proxy for bond flows.
2. Data provided as of end-July 2014, except for Malaysia as of end-June 2014.
3. Figures were computed based on end-July 2014 exchange rates to avoid currency effects.

Sources: Indonesia Debt Management Office, Financial Supervisory Service, Bank Negara Malaysia, and Thai Bond Market Association.

LCY bonds in 2Q14, reflecting q-o-q growth and a y-o-y decline.

Hong Kong, China and the PRC led the region in terms of LCY government bond issuance in 2Q14, contributing US$285 billion and US$239 billion, respectively. The Hong Kong Monetary Authority (HKMA) again led the region in terms of central bank and monetary authority LCY bond issuance, generating bond sales worth US$284 billion, or about 60% of total LCY bonds sold by central banks and monetary authorities in the region. The large issuances of HKMA were the result of the refinancing of matured short-term Exchange Fund Bills.

In the PRC, Treasury bonds, savings bonds, and local government bonds were all sold during the quarter, with issuance of Treasury bonds and savings bonds rising on a q-o-q basis and falling on a y-o-y basis, while issuance of local government bonds was up on both a q-o-q and y-o-y basis.

LCY government bond issuance was up on both a q-o-q and y-o-y basis in the Republic of Korea and the Philippines. Growth in government issuance in the Republic of Korea was driven by the issuance of Korea Treasury Bonds and Monetary Stabilization Bonds, while in the Philippines it was due mainly to the successful auction of Treasury bonds in 2Q14.

LCY government bond issuance in Malaysia, Singapore, and Thailand was up from the previous quarter due to increases in bonds sold by their respective central banks and central governments; however, government bond issuance fell on a y-o-y basis in these three markets due to decreases in issuances of Bank Negara Malaysia bills, Bank of Thailand bills and bonds, and Singapore Government Securities.

Meanwhile, 2Q14 LCY government bond issuance in both Indonesia and Viet Nam was down on a q-o-q basis and up on a y-o-y basis. The quarterly decreases stemmed from lower bond issuance by central banks and central governments. In Indonesia, the y-o-y upswing emanated from higher bond sales by its central bank and central government; in the case of Viet Nam, growth in bond sales was driven by central bank issuance.

LCY corporate bond issuance in emerging East Asia in 2Q14 was dominated by the PRC, which accounted for 67% of the regional total. The PRC's LCY corporate bond issuance was up on both a q-o-q and y-o-y basis, with the quarterly uptick bolstered by greater issuance in commercial bank bonds and local corporate bonds in 2Q14, while the annual increase stemmed from y-o-y increases in the issuance of asset-backed and local corporate bonds. The second largest amount of corporate bond issuance in the region came from the Republic of Korea, which comprised 21% of the regional total.

In contrast to the PRC, LCY corporate bond issuance in the Republic of Korea was down on both a q-o-q and y-o-y basis, due to lower sales of special public bonds, financial debentures, and private corporate bonds. For the rest of emerging East Asia, corporate bond issuance fell on a q-o-q basis in all markets except Indonesia, Singapore, and Thailand. However, on a y-o-y basis, all markets recorded lower levels of corporate bond issuance in 2Q14 except Malaysia, the Philippines, and Singapore.

Intraregional bond issues continued in 2Q14, including the PRC's Yanlord Land Group's SGD400 million 3-year bond offering a 6.2% coupon issued in May; the PRC's Industrial and Commercial Bank of China's dual-tranche

Table 3: LCY-Denominated Bond Issuance (gross)

	2Q13		1Q14		2Q14		Growth Rate (LCY-base %)		Growth Rate (US$-base %)	
							2Q14		2Q14	
	Amount (US$ billion)	% share	Amount (US$ billion)	% share	Amount (US$ billion)	% share	q-o-q	y-o-y	q-o-q	y-o-y
China, People's Rep. of										
Total	387	100.0	298	100.0	437	100.0	46.4	14.2	46.8	13.0
Government	194	50.3	137	46.0	239	54.7	73.9	24.3	74.3	23.0
Central Bank	19	4.8	0	0.0	0	0.0	–	–	–	–
Treasury and Other Govt.	176	45.5	137	46.0	239	54.7	73.9	37.4	74.3	35.9
Corporate	192	49.7	161	54.0	198	45.3	23.0	4.1	23.3	3.0
Hong Kong, China										
Total	220	100.0	195	100.0	292	100.0	49.5	32.3	49.6	32.4
Government	212	96.1	186	95.5	285	97.6	52.7	34.4	52.9	34.5
Central Bank	210	95.3	185	95.0	284	97.4	53.3	35.3	53.4	35.4
Treasury and Other Govt.	2	0.8	1	0.5	0.5	0.2	(49.3)	(70.8)	(49.3)	(70.7)
Corporate	9	3.9	9	4.5	7	2.4	(19.8)	(19.1)	(19.7)	(19.1)
Indonesia										
Total	9	100.0	11	100.0	10	100.0	(4.6)	32.9	(8.7)	11.9
Government	7	77.2	10	95.6	8	85.3	(14.9)	46.8	(18.6)	23.7
Central Bank	2	22.2	3	26.6	2	24.6	(11.9)	46.9	(15.7)	23.7
Treasury and Other Govt.	5	55.0	7	69.0	6	60.7	(16.0)	46.7	(19.7)	23.6
Corporate	2	22.8	0.5	4.4	1	14.7	221.1	(14.4)	207.2	(27.9)
Korea, Rep. of										
Total	146	100.0	158	100.0	144	100.0	(13.7)	(13.0)	(9.2)	(1.8)
Government	67	45.6	75	47.1	82	57.1	4.6	9.0	10.1	23.0
Central Bank	39	26.7	45	28.1	47	32.6	0.0	6.1	5.3	19.8
Treasury and Other Govt.	28	18.8	30	19.0	35	24.5	11.4	13.0	17.2	27.5
Corporate	80	54.4	84	52.9	62	42.9	(30.0)	(31.3)	(26.3)	(22.5)
Malaysia										
Total	39	100.0	36	100.0	37	100.0	1.3	(2.3)	3.0	(3.8)
Government	32	83.0	27	73.9	29	77.7	6.5	(8.6)	8.2	(10.0)
Central Bank	24	61.7	18	48.9	19	52.2	8.0	(17.3)	9.8	(18.6)
Treasury and Other Govt.	8	21.4	9	24.9	9	25.5	3.5	16.5	5.2	14.7
Corporate	7	17.0	9	26.1	8	22.3	(13.4)	28.6	(12.0)	26.6
Philippines										
Total	3	100.0	6	100.0	5	100.0	(5.7)	74.1	(3.2)	72.1
Government	3	89.6	3	60.1	4	75.3	18.2	46.3	21.3	44.6
Central Bank	0	0.0	0	0.0	0	0.0	–	–	–	–
Treasury and Other Govt.	3	89.6	3	60.1	4	75.3	18.2	46.3	21.3	44.6
Corporate	0.3	10.4	2	39.9	1	24.7	(41.6)	314.2	(40.0)	309.3
Singapore										
Total	91	100.0	77	100.0	86	100.0	11.2	(7.0)	12.2	(5.4)
Government	88	96.7	74	95.7	83	96.0	11.6	(7.7)	12.5	(6.1)
Central Bank	56	61.9	71	91.8	75	87.4	5.9	31.3	6.8	33.5
Treasury and Other Govt.	32	34.8	3	3.9	7	8.6	144.7	(76.9)	146.9	(76.5)
Corporate	3	3.3	3	4.3	3	4.0	3.1	13.5	4.1	15.4
Thailand										
Total	76	100.0	60	100.0	65	100.0	7.6	(10.9)	7.6	(14.7)
Government	57	75.8	46	77.2	50	77.5	8.1	(8.8)	8.0	(12.7)
Central Bank	51	67.4	35	58.9	39	60.5	10.6	(20.0)	10.5	(23.4)
Treasury and Other Govt.	6	8.4	11	18.3	11	17.0	0.1	80.2	0.0	72.5
Corporate	18	24.2	14	22.8	15	22.5	6.2	(17.2)	6.1	(20.8)

continued on next page

Table 3 *continued*

	2Q13		1Q14		2Q14		Growth Rate (LCY-base %)		Growth Rate (US$-base %)	
							2Q14		2Q14	
	Amount (US$ billion)	% share	Amount (US$ billion)	% share	Amount (US$ billion)	% share	q-o-q	y-o-y	q-o-q	y-o-y
Viet Nam										
Total	3	100.0	12	100.0	9	100.0	(23.0)	259.2	(23.9)	257.1
Government	3	100.0	12	100.0	9	100.0	(23.0)	259.2	(23.9)	257.1
Central Bank	0	0.0	8	69.1	7	79.4	(11.5)	–	(12.5)	–
Treasury and Other Govt.	3	100.0	4	30.9	2	20.6	(48.8)	(26.1)	(49.4)	(26.5)
Corporate	0	0.0	0	0.0	0	0.0	–	–	–	–
Emerging East Asia										
Total	974	100.0	852	100.0	1,085	100.0	25.8	10.2	27.3	11.5
Government	663	68.1	570	66.9	789	72.7	37.2	18.4	38.4	19.1
Central Bank	401	41.2	365	42.8	475	43.7	29.1	17.5	30.2	18.4
Treasury and Other Govt.	262	26.9	206	24.1	315	29.0	51.7	19.7	53.0	20.2
Corporate	311	31.9	282	33.1	296	27.3	3.0	(7.0)	4.8	(4.8)
Japan										
Total	546	100.0	485	100.0	522	100.0	5.5	(2.4)	7.5	(4.5)
Government	503	92.1	459	94.5	480	91.9	2.6	(2.5)	4.5	(4.6)
Central Bank	0	0.0	0	0.0	0	0.0	–	–	–	–
Treasury and Other Govt.	503	92.1	459	94.5	480	91.9	2.6	(2.5)	4.5	(4.6)
Corporate	43	7.9	26	5.5	42	8.1	55.7	(1.1)	58.7	(3.2)

( ) = negative, – = not applicable, LCY = local currency, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. For the People's Republic of China, 2Q14 corporate bond issuance based on *AsianBondsOnline* estimates.
2. Corporate bonds include issues from financial institutions.
3. Bloomberg LP end-of-period LCY—US$ rates are used.
4. For LCY base, emerging East Asia growth figures are based on end-June 2014 currency exchange rates and do not include currency effects.
Sources: People's Republic of China (ChinaBond); Hong Kong, China (Hong Kong Monetary Authority); Indonesia (Bank Indonesia, Indonesia Debt Management Office, and Indonesia Stock Exchange); Republic of Korea (EDAILY Bondweb and The Bank of Korea); Malaysia (Bank Negara Malaysia); Philippines (Bloomberg LP); Singapore (Singapore Government Securities and Bloomberg LP); Thailand (Bank of Thailand and ThaiBMA); Viet Nam (Bloomberg LP); and Japan (Japan Securities Dealers Association).

sale of IDR-denominated bonds, also issued in May, comprising a IDR265 billion 1-year bond at a 9.7% coupon and a IDR235 billion 3-year bond at a 10.6% coupon; Hong Kong, China's Sun Hung Kai Properties' SGD320 million 7-year bond sold in May at 3.25%; Indonesia's Trikomsel's SGD100 million 3-year bond carrying a 7.875% coupon sold in June; and Singapore's OCBC Bank's CNY200 million 3-year bond with a 2.7% coupon issued in June.

Emerging East Asian companies issued a number of HKD-denominated bonds in 2Q14. These included Malaysia's CIMB Bank, which sold a HKD300 million 5-year bond offering a 2.7% coupon; the Korea Development Bank, which issued a HKD1.0 billion 7-year bond at a 3.2% coupon; and Singapore's Wilmar International, which sold a HKD300 million 7-year bond at a 4.7% coupon. In more recent months, CIMB Thai sold a MYR400 million 10-year bond at a 5.6% coupon in July.

Emerging East Asian G3 currency bond issuance remained on pace to exceed last year's record level.

Emerging East Asian G3 currency bond issuance remained vibrant, reaching US$121.4 billion in January–July, which was on pace to exceed the US$141.5 billion of issuance in full-year 2013 **(Table 4)**. G3 bond issuers continued to lock in low interest rates in anticipation of a rate hike by the Federal Reserve amid signs of economic recovery in the US.

The PRC was the largest source of G3 currency bond issuance in emerging East Asia at US$56.8 billion, already surpassing the previous year's total and accounting for 47% of the region's total. Energy companies and financial institutions were the dominant issuer groups in the PRC, including Sinopec, which raised US$7 billion from selling five US$-denominated bonds in April and three in June;

Table 4: G3 Currency Bond Issuance

2013			1 January–31 July 2014		
Issuer	US$ (million)	Issue Date	Issuer	US$ (million)	Issue Date
China, People's Rep. of	**56,709**		**China, People's Rep. of**	**56,802**	
CNOOC Finance 3.0% 2023	2,000	9-May-13	CNOOC Finance 4.25% 2024	2,250	30-Apr-14
Evergrande Real Estate 8.75% 2018	1,500	30-Oct-13	Tencent 3.375% 2019	2,000	29-Apr-14
Sinopec Group 4.375% 2023	1,500	17-Oct-13	Sinopec 1.0136% 2017	1,800	10-Apr-14
CNOOC Curtis Funding 4.5% 2023	1,300	3-Oct-13	State Grid Overseas Investment 4.125% 2024	1,600	7-May-14
Sinopec Capital 3.125% 2023	1,250	24-Apr-13	Sinopec 1.75% 2017	1,550	10-Apr-14
Others	49,159		Others	47,602	
Hong Kong, China	**24,011**		**Hong Kong, China**	**16,291**	
Hutchison Whampoa 3.75% Perpetual	2,367	10-May-13	CLP Power 4.25% Perpetual	750	7-May-14
Shimao Property 6.625% 2020	800	14-Jan-13	New World Development 5.25% 2021	750	26-Feb-14
Others	20,844		Others	14,791	
Indonesia	**12,270**		**Indonesia**	**8,971**	
Pertamina 4.3% 2023	1,625	20-May-13	Indonesia (Sovereign) 5.875% 2024	2,000	15-Jan-14
Pertamina 5.625% 2043	1,625	20-May-13	Indonesia (Sovereign) 6.75% 2044	2,000	15-Jan-14
Indonesia (Sovereign) 3.375% 2023	1,500	15-Apr-13	Pertamina 6.45% 2044	1,500	30-May-14
Indonesia (Sovereign) 4.625% 2043	1,500	15-Apr-13	Perusahaan Gas Negara (PGN) 5.125% 2024	1,350	16-May-14
Perusahaan Penerbit SBSN 6.125% 2019	1,500	17-Sep-13	Indonesia (Sovereign) 2.875% 2021	1,339	8-Jul-14
Others	4,520		Others	782	
Korea, Rep. of	**30,400**		**Korea, Rep. of**	**23,038**	
Korea Eximbank 2.0% 2020	1,369	30-Apr-13	Republic of Korea (Sovereign) 2.125% 2024	1,004	10-Jun-14
The Republic of Korea (Sovereign) 3.875% 2023	1,000	11-Sep-13	Republic of Korea (Sovereign) 4.125% 2044	1,000	10-Jun-14
Korea Development Bank 3.0% 2019	750	17-Sep-13	Woori Bank 4.75% 2024	1,000	30-Apr-14
Others	27,281		Others	20,034	
Malaysia	**4,065**		**Malaysia**	**1,689**	
1MDB Global Investments 4.40% 2023	3,000	19-Mar-13	AmBank 3.125% 2019	400	3-Jul-14
Sime Darby 2.053% 2018	400	29-Jan-13	Malayan Banking 0.669% 2019	303	6-Feb-14
Sime Darby 3.29% 2023	400	29-Jan-13	EXIM Sukuk Malaysia 2.874% 2019	300	19-Feb-14
Others	265		Others	686	
Philippines	**3,858**		**Philippines**	**2,675**	
San Miguel Corporation 4.875% 2023	800	26-Apr-13	Philippines (Sovereign) 4.2% 2024	1,500	21-Jan-14
JG Summit 4.375% 2023	750	23-Jan-13	SM Investments 4.875% 2024	350	10-Jun-14
Petron Corporation 7.50% Perpetual	750	6-Feb-13	SMC Global Power 7.5% Perpetual	350	7-May-14
Others	1,558		Others	475	
Singapore	**5,925**		**Singapore**	**8,548**	
Olam International 6.75% 2018	750	29-Jan-13	OCBC Bank 4% 2024	1,000	15-Apr-14
Global A&T Electronics 10.00% 2019	625	7-Feb-13	OCBC Bank 4.25% 2024	1,000	19-Jun-14
Stats Chippac 4.5% 2018	611	20-Mar-13	Avago Technologies 2% 2021	1,000	6-May-14
Flextronics International 5.0% 2023	500	20-Feb-13	United Overseas Bank 3.75% 2024	800	19-Mar-14
Others	3,439		Others	4,748	
Thailand	**3,445**		**Thailand**	**3,390**	
PTT Exploration & Production 3.707% 2018	500	16-Sep-13	PTT Exploration & Production 4.875% Perpetual	1,000	18-Jun-14
Others	2,945		Others	2,390	
Viet Nam	**827**		**Viet Nam**	**0**	
Emerging East Asia Total	**141,510**		**Emerging East Asia Total**	**121,405**	
Memo Items:			**Memo Items:**		
India	**14,053**		**India**	**13,409**	
Bharti Airtel International 5.125% 2023	1,500	11-Mar-13	Bharti Airtel 3.375% 2021	1,004	20-May-14
Vedanta Resources 6.0% 2019	1,200	3-Jun-13	Abja Investment 5.95% 2024	1,000	31-Jul-14
Others	11,353		Others	11,405	
Sri Lanka	**2,441**		**Sri Lanka**	**1,915**	

Sources: Bloomberg LP, newspaper and wire reports.

CNOOC Finance, which sold three US$-denominated bonds totaling US$4 billion in April; and China EximBank, which raised US$3 billion from a dual-tranche bond sale in July.

The Republic of Korea was the second largest source of emerging East Asian G3 currency bond issuance in January–July at US$23.0 billion, or 19% of the region's total. Korean banks sustained their active participation in the G3 currency bond market, including Korea Development Bank and Korea Eximbank with G3 currency bond issues of US$3.4 billion and US$3.5 billion, respectively. In addition, the government of the Republic of Korea was a major sovereign issuer of G3 currency bonds in the region, selling a 30-year US$-denominated bond worth US$1 billion and carrying a coupon rate of 4.125%, and a 10-year EUR750 million bond with a 2.125% coupon in June. Meanwhile, G3 currency bonds sold by firms domiciled in Hong Kong, China were valued at US$16.3 billion, with half of total issuance coming from financial institutions.

G3 currency bond issuance from Association of Southeast Asian Nations (ASEAN) member in the first 7 months of the year totaled US$25.3 billion—of which 35% was from Indonesia, 34% from Singapore, 13% from Thailand, 11% from the Philippines, and 7% from Malaysia. The largest Indonesian G3 currency bond issuer was the central government, raising US$4 billion from a dual-tranche bond sale in January and EUR1 billion from the sale of 7-year bonds in July.

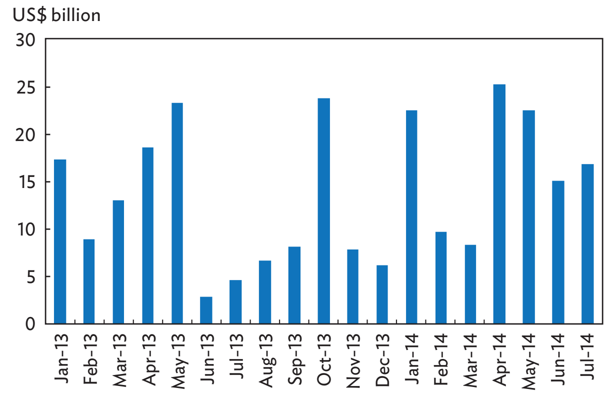
Most G3 currency bond issuers in Singapore in January–July were banks, including OCBC Bank, DBS, and United Overseas Bank. The largest issuer was OCBC Bank, which raised a total of US$2.4 billion from selling six US$-denominated bonds, two of which were 10-year bonds at US$1 billion each, with one sold in April carrying a 4.0% coupon and the other issued in June offering a 4.25% coupon.

In Thailand, the domestic banking sector raised US$1.8 billion from the G3 currency bond market in January–July. The total comprised Siam Commercial Bank's US$750 million 5-year bond sold in April at a 3.5% coupon, Krung Thai Bank's US$700 million 10-year bond issued in June offering a 5.2% coupon, and Kasikorn Bank's US$350 million 5.5-year bond issued in April at a 3.5% coupon. In addition, PTT Exploration and Production issued a US$1 billion perpetual bond carrying a 4.875% coupon in June.

In the Philippines, there were only five G3 currency bond issuers during the first 7 months of the year. The biggest seller was the Government of the Philippines, which issued a 10-year bond in January worth US$1.5 billion and with a coupon of 4.2%. In Malaysia, there were only four issuers of G3 currency bonds, three of which were banks—AmBank, Export–Import Bank of Malaysia, and Maybank.

Through the first 7 months of the year, April saw the most G3 currency bond issuance, with a total of US$25.3 billion, followed by May's US$22.7 billion and

Figure 9: G3 Currency Bond Issuance in Emerging East Asia



Source: *AsianBondsOnline* calculations based on Bloomberg LP data.

January's US$22.5 billion **(Figure 9)**. The majority of the issuance of G3 currency bonds in April and May came from PRC-based companies, specifically CNOOC and Sinopec in April, and State Grid Corporation of China in May. The Government of the Republic of Korea was the largest G3 currency bond issuer in June, while China Eximbank was the largest issuer in July.

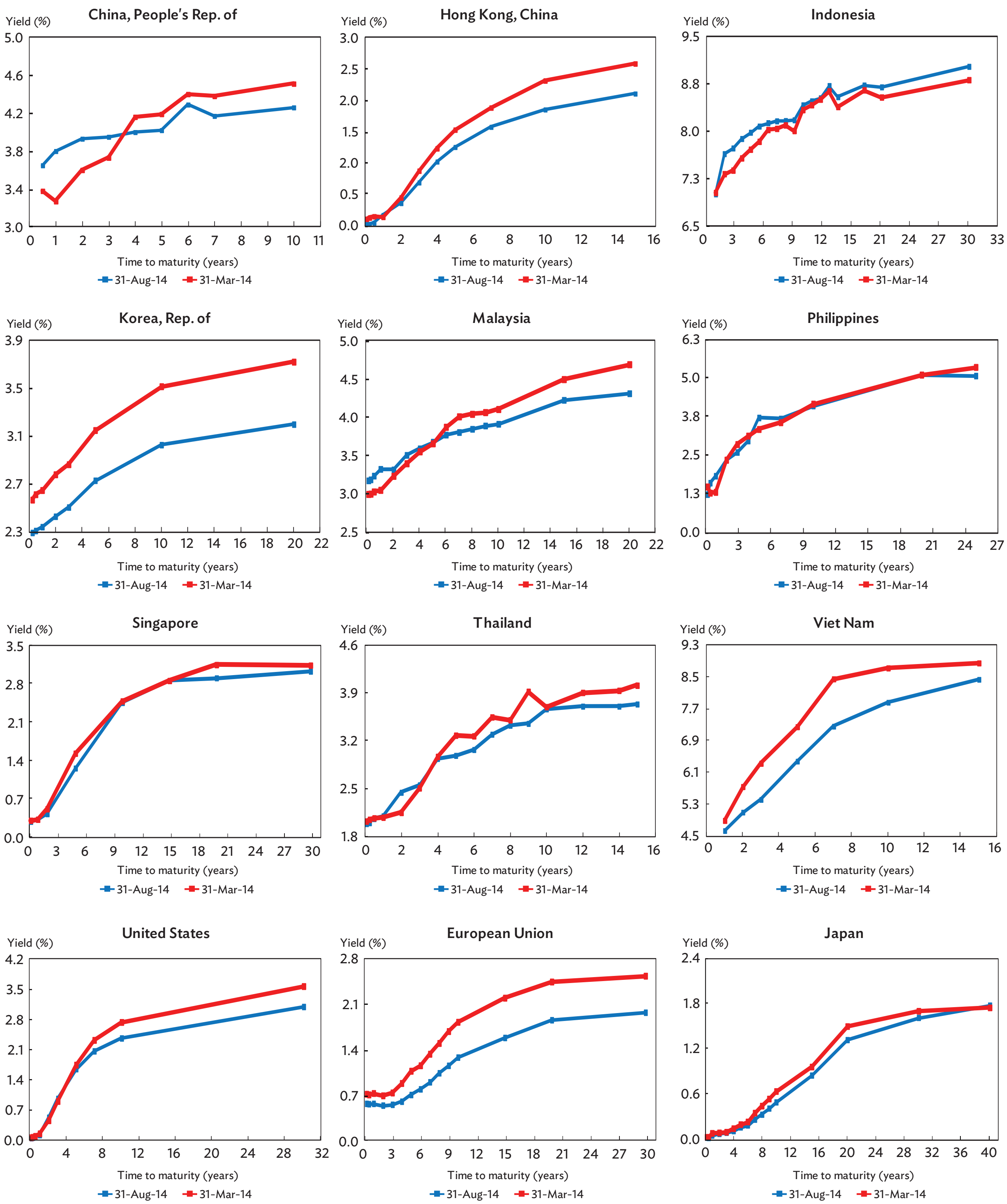
Government bond yields in emerging East Asia fell in all markets except Indonesia.

Despite the better-than-expected economic growth in the US in 2Q14, slowing growth and moderate inflation in the majority of economies in emerging East Asia led to a decline in yields, mostly at the longer-end of the curve, with the exception of Indonesia.

From end-March to end-August, the yield curve shifted downward in most economies. Yields fell at the longer-end in the PRC and Malaysia, while yield changes in the Philippines were mixed. Indonesia was the only economy whose yield curve rose during the period **(Figure 10).**

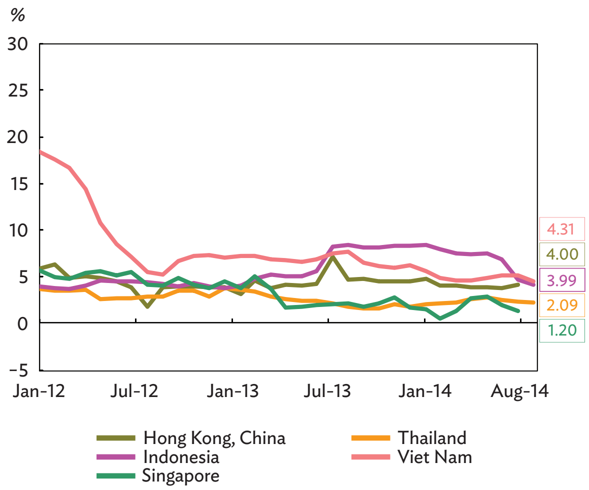
The markets whose yield curves shifted downward the most were Viet Nam and the Republic of Korea's. The 10-year yield in Viet Nam fell 86 basis points (bps) and the Republic of Korea's fell 49 bps. Despite accelerating y-o-y GDP growth in Viet Nam in 2Q14 (5.3% versus 5.1% in the previous quarter), the inflation outlook remains benign **(Figures 11a and 11b)**. Viet Nam reported inflation of 4.3% in August, lower than July's 4.5% and well below the country's full year target of 7.0%. Viet Nam's credit rating was upgraded by Moody's in July

Figure 10: Benchmark Yield Curves—LCY Government Bonds



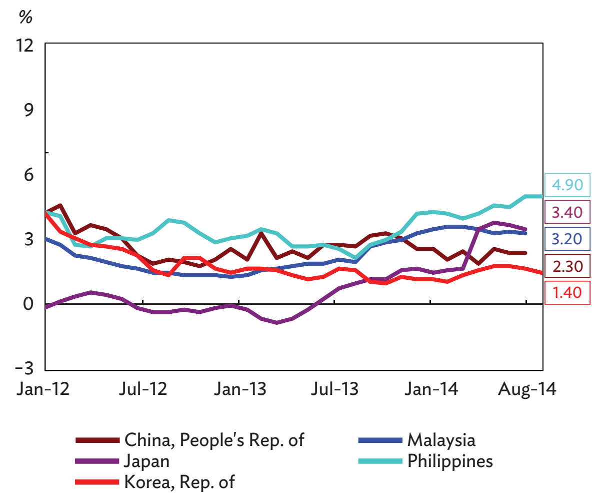
LCY = local currency.
Source: Based on data from Bloomberg LP.

Figure 11a: Headline Inflation Rates



Note: Data as of end-August 2014, except for Hong Kong, China and Singapore as of end-July 2014.
Source: Bloomberg LP.

Figure 11b: Headline Inflation Rates



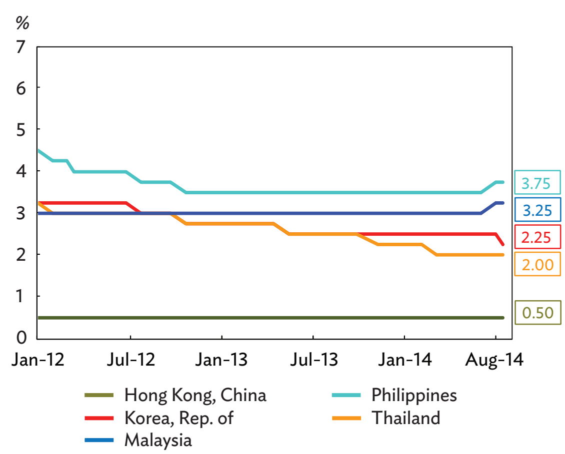
Note: Data as of end-July 2014, except for the Republic of Korea and the Philippines as of end-August 2014.
Source: Bloomberg LP.

to B1. The Republic of Korea experienced lower growth on a q-o-q basis, with 2Q14's GDP expanding only 0.6%, down from 0.9% in 1Q14. The slower growth prompted the Republic of Korea to cut its policy rates by 25 bps in August **(Figures 12a and 12b)**.

Tracking US interest rate movements, Hong Kong, China's yields moved downward, with the 10-year bond yield falling 46 bps. The US 10-year yield fell 37 bps in the same period. The economy's GDP growth slowed to 1.8% in 2Q14 from 2.6% in the prior quarter. Hong Kong, China's 10-year bond yield fell 46 bps.

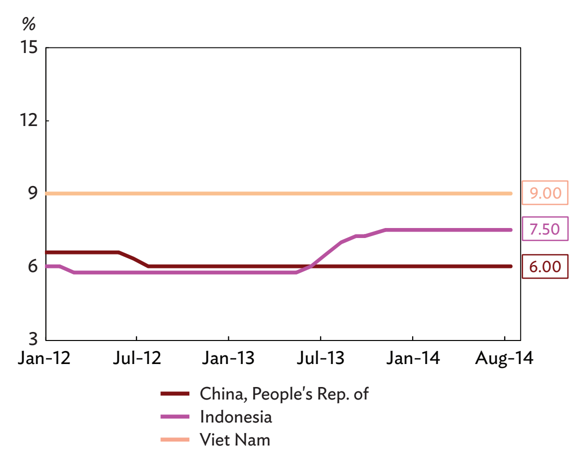
While growth slowed in the PRC and accelerated in Malaysia in 2Q14, yields in both economies decreased at the longer-end and increased at the shorter-end of the curve. In the PRC, the 10-year yield fell 25 bps and the 1-year rate rose 53 bps. In Malaysia, the 10-year yield fell 19 bps and the 1-year yield rose 27 bps. The fall in the PRC's longer-term yields was driven by concerns over slowing growth, while shorter-term yields rose due to seasonal factors in money markets. In the case of Malaysia, higher GDP growth has led to the central bank hiking policy rates in July, which has put upward pressure on yields with shorter tenors.

Figure 12a: Policy Rates



Note: Data as of end-August 2014.
Source: Bloomberg LP.

Figure 12b: Policy Rates



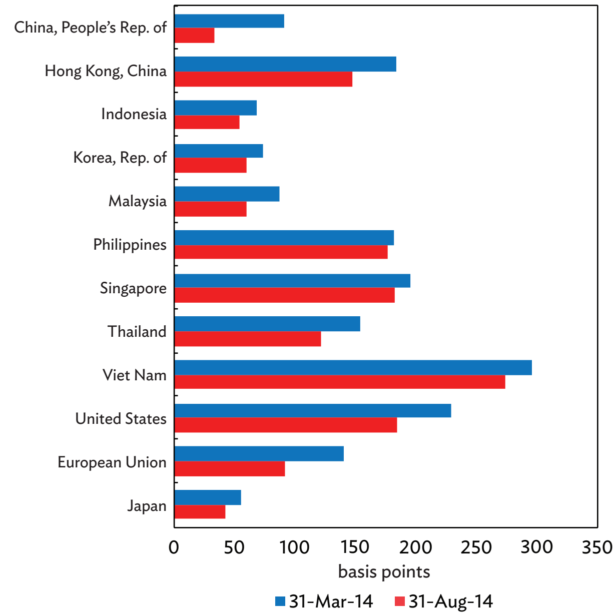
Notes:
1. Data as of end-August 2014.
2. For Viet Nam, base interest rate was used.
Source: Bloomberg LP.

In the Philippines, changes in the yield curve were mixed due to a combination of positive and negative news. Yields fell in May after a rating upgrade from Moody's to BBB, but fell in later months due to rising inflation and inflationary expectations amid elevated food prices, prompting the central bank to raise policy rates 25 bps in July.

Indonesia is the sole market whose bond market saw a rise in yields between end-March and end-August. Indonesian bond yields were under pressure as the rupiah remained weak on concerns over a widening current account deficit and the initial uncertainty over the result of the presidential election. In 2Q14, the current account deficit widened to US$9.1 billion (equivalent to 4.3% of GDP), compared with US$4.2 billion in 1Q14 (equivalent to 2.1% of GDP). Further upward pressure on yields is expected as the government is being pushed to raise subsidized fuel prices. Indonesia's 10-year rate rose 17 bps during the period under review.

The 2- versus 10-year spread fell in all markets from end-March to end-August, mostly due to lower growth expectations **(Figure 13)**. In the case of Malaysia, the fall in the yield spread was mostly due to larger increases at the shorter-end of the curve as the result of policy rate changes. In Indonesia, yields at the shorter-end rose at a faster pace on rising inflationary expectations.

Figure 13: Yield Spreads Between 2- and 10-Year Government Bonds



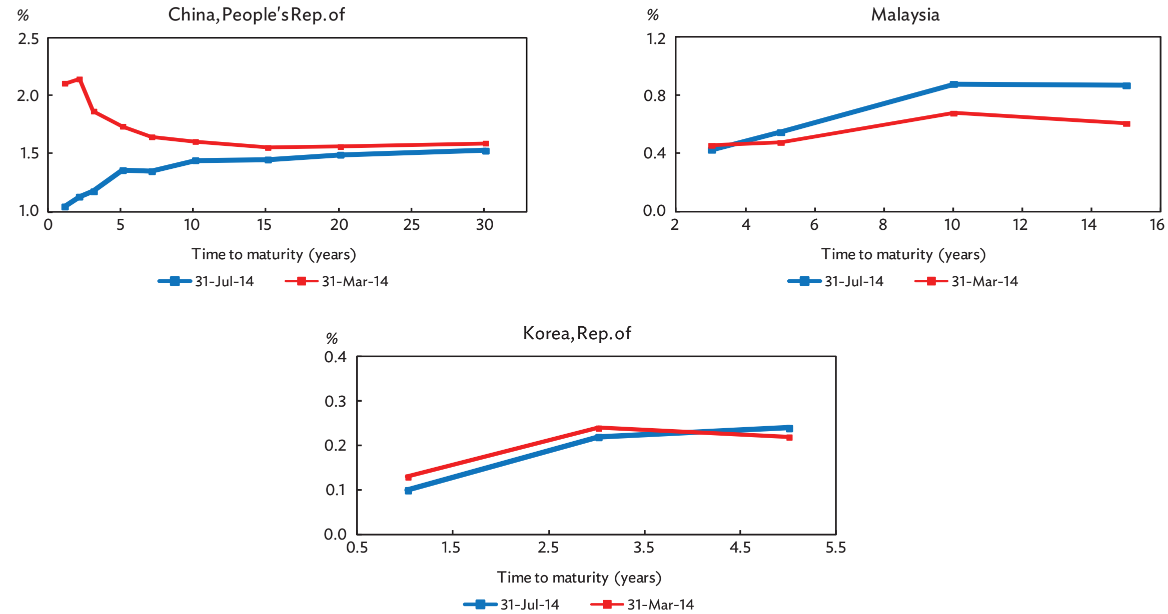
Source: Based on data from Bloomberg LP.

Corporate yield spreads were stable in the Republic of Korea, and mixed in the PRC and Malaysia.

Credit spreads between AAA-rated corporate bonds and government bonds tightened in the PRC, particularly at the shorter-end of the curve, mostly due to lower demand for government bonds with shorter tenors, thereby raising yields. In contrast, the spread widened for Malaysia, particularly for longer-dated tenors, owing to higher demand for government bonds. The spread in the Republic of Korea was mostly unchanged **(Figure 14a)**.

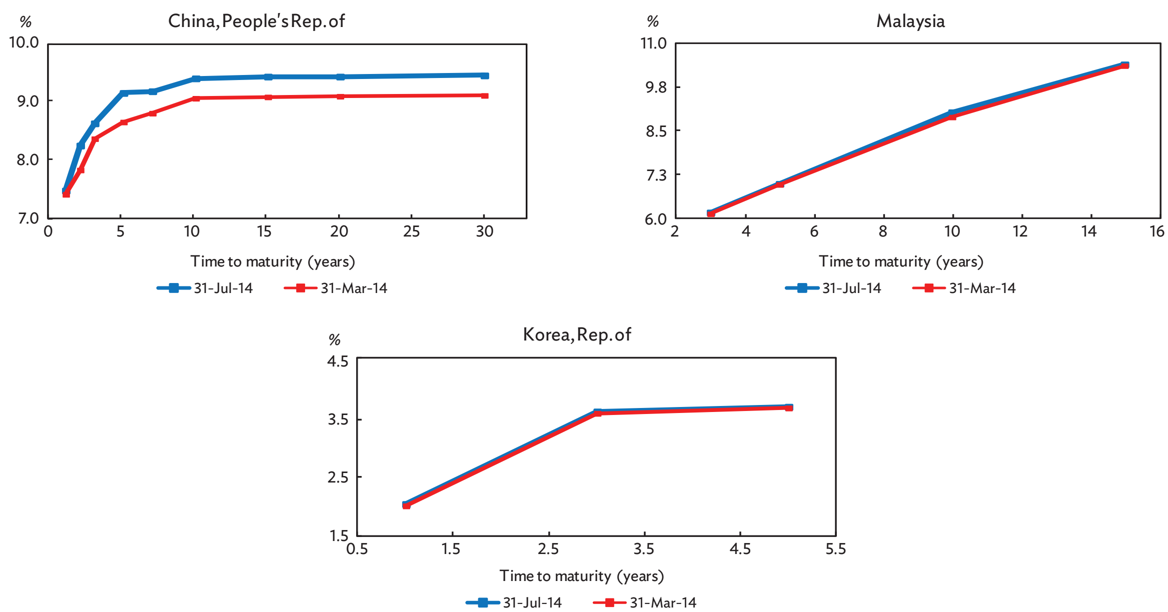
Credit spreads between AAA-rated and lower-rated corporate bonds were mostly unchanged in all markets, with the exception of the PRC, possibly due to heightened risk aversion on concerns of a downturn in the PRC's property market **(Figure 14b)**.

Figure 14a: Credit Spreads—LCY Corporates Rated AAA vs. Government Bonds



LCY = local currency.
Note: Credit spreads are obtained by subtracting government yields from corporate indicative yields.
Sources: People's Republic of China (*ChinaBond*), Republic of Korea (EDAILY *BondWeb*), and Malaysia (Bank Negara Malaysia).

Figure 14b: Credit Spreads—Lower-Rated LCY Corporates vs. AAA



LCY = local currency.
Notes:
1. For the People's Republic of China and the Republic of Korea, credit spreads are obtained by subtracting corporate indicative yields rated AAA from corporate indicative yields rated BBB+.
2. For Malaysia, credit spreads are obtained by subtracting corporate indicative yields rated AAA from corporate indicative yields rated BBB.
Sources: People's Republic of China (*ChinaBond*), Republic of Korea (EDAILY *BondWeb*), and Malaysia (Bank Negara Malaysia).

Policy and Regulatory Developments

People's Republic of China

Local Government Issuance Program Launched

On 29 May, the People's Republc of China (PRC) launched a pilot program allowing 10 local government units to issue bonds directly. A similar pilot program was to have been launched before, but was scrapped over concerns about mounting local government debt. On 23 June, Guangdong issued the first local government bonds under the pilot program, auctioning 5- and 10-year bonds.

The PRC Expands Coverage of Targeted Ratio Cuts

On 31 May, the People's Bank of China (PBOC) announced that it would extend a reserve requirement ratio cut, originally targeted to state-level rural banks and rural cooperatives, to include other types of banks with a certain level of loans to the agricultural industry and small- and medium-sized enterprises.

The PRC Pursues Measures to Promote Agricultural Sector

On 28 August, the PBOC announced an increase in its re-lending quota by CNY20 billion to help support the agricultural industry and rural financial institutions. The relending facility allows financial institutions to provide loans to various sectors from funds provided by the PBOC. In addition, the PBOC said that qualified rural financial institutions availing of the facility will be charged 100 basis points less than the preferential rate for agricultural loans.

Hong Kong, China

Hong Kong, China Announces Planned *Sukuk* Issuance

On 4 July, Hong Kong, China announced that it had selected HSBC, Standard Chartered Bank, CIMB, and National Bank of Abu Dhabi as underwriters for its debut *sukuk* (Islamic bond) issuance. The issuance is expected to be priced in September with a target size of between US$500 million and US$1.0 billion, and a tenor of 5 years. The structure to be used is expected to follow the *ijarah* (leasing) principle.

Indonesia

Parliament Approves Revised 2014 State Budget

In June, the House of Representatives approved the 2014 revised state budget, which projects a deficit equivalent to 2.4% of GDP, compared with 1.7% in the original budget. The revised 2014 state budget raised the net government securities financing requirement to 2.6% of GDP. In absolute terms, the net government securities financing requirement is up 29.2% from the original budget to IDR265.0 trillion. The underlying macroeconomic assumptions for the revised state budget include (i) GDP growth of 5.5%, (ii) annual inflation of 5.3%, (iii) an exchange rate of IDR11,600 to US$1, and (iv) a 3-month treasury bill rate of 6.0%.

Bank Indonesia Issues *Shari'a* FCY Term Deposits

On 25 July, Bank Indonesia announced plans to issue *shari'a* FCY term deposits as part of efforts to develop *shari'a* banking and deepen the *shari'a* financial market. The term deposits are FCY-denominated Islamic monetary instruments that will complement FCY liquidity management in the *shari'a* financial market. They will be based on a *ju'alah* contract, which is backed by a commitment to provide a specific return after completion of a job, and carry a tenor of between 1 day and 12 months. The first auction was subsequently held on 20 August.

Republic of Korea

Financial Regulatory Reforms Announced

The Republic of Korea's Financial Services Commission (FSC) announced in July plans for financial regulatory reform, including (i) building a financial regulatory system with "better regulation," (ii) mitigating inconveniences facing financial consumers and enhancing support for the real economy, (iii) creating growth opportunities and new markets for the financial sector, (iv) abolishing implicit regulations, (v) establishing a permanent system for financial regulatory reform, and (vi) tightening internal controls and market discipline for financial institutions.

Road Map for Derivatives Market Unveiled

The FSC introduced in June a road map for the development of the country's derivatives market. The road map seeks to develop the exchange-traded derivatives market into a "risk-managed market" by promoting greater autonomy in market operations and introducing new derivatives products. The road map also calls for the over-the-counter derivatives market to utilize a central counterparty for a wider range of derivatives contracts and to introduce a trade repository system. In the derivatives-linked securities market, the road map calls for the listing of exchange-traded notes, enhancing public disclosure and sales of equity-linked securities and derivatives-linked securities, and standardizing issuance of equity-linked warrants.

Public Institutions' Debt Reduction Plans Approved

The Republic of Korea's Ministry of Strategy and Finance announced in June the acceptance of the revised debt reduction plans—totaling KRW6.2 trillion—submitted by 10 highly-indebted public institutions to frontload debt reduction in 2014.

Malaysia

Prime Minister Announces Liberalization Measures

In June, Prime Minister Najib Razak announced several measures aimed at liberalizing Malaysia's financial sector. Effective immediately, the barriers for new foreign unit trust management companies entering Malaysia were lifted. Effective 1 January 2015, credit rating agencies will be given more flexibility in the trading of unrated bonds and *sukuk*. Effective 1 January 2017, mandatory credit ratings for new corporate issues will be removed and full foreign ownership of international credit rating agencies will be allowed. The liberalization program seeks to strengthen the country's capital market in support of sustainable, long-term growth.

Philippines

BSP to Monitor Banks' Real Estate Exposure

On 11 June, the Monetary Board of the Bangko Sentral ng Pilipinas (BSP) approved preemptive macroprudential policy measures to monitor the exposure of the banking system to real estate development. This policy, which includes stress tests, reinforces the requirement for banks to have sufficient capital to withstand shocks that could affect their credit risk exposure to real estate. The stress tests are in accordance with international standards under the Basel Accords. Universal, commercial, and thrift banks are required to meet a Capital Adequacy Ratio of 10% of qualifying capital (QC) after adjusting for the stress test results. Universal and commercial banks, and their thrift bank subsidiaries are also required to maintain a level of Common Equity Tier 1 equivalent to at least 6% of QC after adjusting for the stress test. For stand-alone thrift banks, a Tier 1 ratio of 6% of QC is required.

Singapore

MAS to Promote Renminbi Use in Singapore

On 13 June, the Monetary Authority of Singapore (MAS) announced an initiative to promote renminbi transactions, including the provision of an overnight renminbi liquidity facility for financial institutions in Singapore beginning 1 July. The liquidity facility will provide up to CNY5 billion in overnight funds for borrowing by eligible counterparties. Singapore dollars, Singapore Government Securities bills and bonds, and MAS bills may be used as collateral for the overnight liquidity facility.

PBOC Allows Limited Cross-Border Transactions with Singapore

On 13 June, the Nanjing branch of the PBOC announced it would allow eligible corporations, equity investment funds, and individuals in Suzhou Industrial Park (SIP) to conduct renminbi cross-border transactions with eligible participants in Singapore. The new regulation allows for the following transactions: (i) banks in Singapore can provide renminbi lending to corporates in SIP, (ii) corporates in SIP can issue renminbi bonds in Singapore, (iii) equity investment funds in SIP can directly invest in corporates in Singapore, and (iv) individuals in

SIP can provide renminbi remittances to Singapore for the settlement of current account and direct investment transactions.

On 9 July, the Tianjin branch of the PBOC made a similar announcement allowing eligible corporations, equity investment funds, and individuals in Sino–Singapore Tianjin Eco-City to conduct renminbi cross-border transactions with eligible participants in Singapore.

Thailand

Structured Notes Regulations Streamlined

The Securities and Exchange Commission (SEC) announced in August that the Capital Market Supervisory Board had approved the streamlining of regulations on structured notes. The new rules will allow the issuance of LCY- and FCY-denominated structured notes; harmonization of the types and classifications of issuers, both in initial public offerings and private placements; removal of the minimum face value of THB10 million in both cases; and removal of the minimum redemption value, which is 80% of the principal, for private placements only. These regulatory revisions will take effect in 4Q14.

New Regulations for Municipal Bond Issuance

The SEC reported in July that the Capital Market Supervisory Board approved regulations governing municipal bond issuances from municipalities, provincial administration organizations, public organizations, Bangkok Metropolitan Administration, Pattaya City, and any juristic person as defined by specific law. These regulations, which cover LCY- and FCY-denominated municipal bonds offered in onshore and offshore markets, will take effect on 1 January 2015.

Viet Nam

Decree on State Foreign Exchange Reserves Issued

On 20 May, Decree No. 50/2014/ND-CP was issued to manage foreign exchange reserves, which are defined as foreign currencies in cash and deposits abroad, securities and other valuable papers issued by the government and foreign and international institutions, Special Drawing Rights reserved at the International Monetary Fund (IMF), gold managed by SBV, and other foreign currencies of the government. The decree identifies five sources of foreign reserves: (i) the state budget and foreign exchange market, (ii) loans from banks and international financial institutions, (iii) the State Treasury and credit institutions, (iv) profits from official foreign exchange reserve investments, and (v) other sources. The decree further states that SBV will manage the state foreign exchange reserves and stipulate the structure, criteria, and limits of investments, which will be approved by the SBV Governor and reported to the Prime Minister on a semi-annual basis. SBV will determine the investment structure of the Foreign Exchange Reserve Fund based on global trends in exchange rate fluctuations, interest rates, and gold prices; and the status of the international reserves (foreign currency and gold) of other countries, as compiled by the IMF. SBV will also stipulate the investment structure of the Exchange Rate Stabilization and Gold Market Management Fund.

The decree supersedes Decree No.86/1999/ND-CP, dated 30 August 1999, and takes effect on 15 July.

Viet Nam Dong Devalued

On 19 June, State Bank of Viet Nam (SBV) devalued the Vietnamese dong by 1% against the United States (US) dollar for the first time in 12 months in a move to boost exports. SBV re-set its exchange rate for the US currency to VND21,246 per dollar from VND21,036. The change also allows the Vietnamese dong to fluctuate by 1% above or below the central bank's rate.

Renminbi Internationalization: Progress and Challenges Ahead

Introduction

Currently, the United States (US) dollar is the dominant international currency. It has reigned over the financial market since the middle of the 20th century after taking over the role from the pound sterling. In a sense, the ascent of the US dollar came rather late. The US economy had been the largest in the world since the late 19th century. The slow ascent of the US dollar was probably due to the underdeveloped capital market of the US at that time. It also lacked a central bank until the creation of the US Federal Reserve in 1913, meaning the financial system had to rely on private institutions to play the role of lender of last resort.

In recent decades, the People's Republic of China's (PRC) economy has grown rapidly to become the second-largest in the world. However, the international role of the renminbi is still relatively small. At the same time, there have been many efforts, particularly since the 2008/09 global financial crisis, to promote the internationalization of the PRC's currency.

For the PRC, there are potential benefits from making the renminbi an international currency. The main one being that it would reduce the exchange rate risk faced by Chinese companies. At the moment, the bulk of trade transactions for Chinese firms are denominated in US dollars. This means that fluctuations in the exchange rates affect the revenue of trading firms. Internationalization would be particularly beneficial for industries in which there is a long time lag between the order and payment for goods.

If the renminbi were to gain wider acceptance as an international currency, it would give Chinese financial institutions access to a large pool of renminbi funding within their home market. It could also make Chinese financial institutions more globally competitive. Another advantage of making the renminbi an international currency would be that it could reduce the need for the PRC to hold large amounts of international reserves. As of end-March, the PRC held nearly US$4 trillion in foreign exchange reserves. The bulk of reserves were in US$-denominated assets, meaning the PRC faces the risk of capital losses in the event of a depreciation of the US dollar.

There are also risks to internationalizing the renminbi. Having an international currency would likely mean the PRC would have to allow for greater movement of capital in and out of its economy. The PRC has yet to fully liberalize its capital account and allow the renminbi to float freely. The financial system in the PRC, while large, is still not well developed, leading to concerns that opening up the capital account could result in destabilizing flows that could impact the financial system. Allowing the exchange rate to freely float could also lead to large fluctuations in the exchange rate that would be detrimental to exporters. An international currency could also open the economy to speculative attacks.

Could the renminbi, over time, take on a greater role as an international currency? This special section will examine the progress made toward internationalization of the renminbi and examine the challenges ahead.

What Is an International Currency?

An international currency is one that is used outside the home economy, by both residents and non-residents. This implies a currency that has gained acceptance outside its own borders. There are several key functions for an international currency. Similar to a domestic currency, it has to function as a store of value, a medium of exchange, and a unit of account. The main difference with an international currency is that it has to perform these functions for both residents and non-residents in cross-border transactions. Another important distinction between a domestic currency and an international one is that a domestic currency usually derives its legitimacy by fiat. A government can decree its currency to be legal tender within its national borders. However, for international transactions, the choice of currency is determined mostly by market factors rather than any legal requirements.

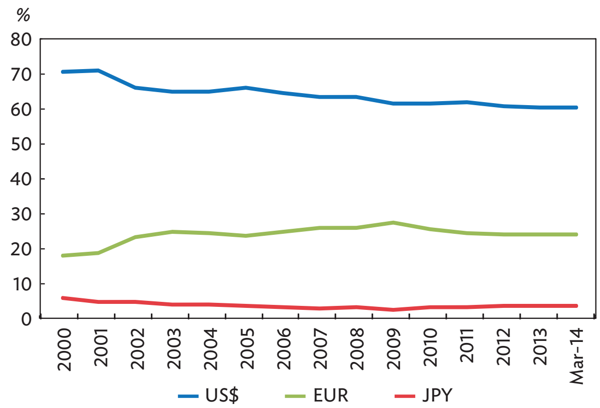
As a medium of exchange, an international currency is expected to figure prominently in the payment and settlement of international trade transactions. At the moment, the US dollar has a dominant role. Since its introduction in 1999, the role of the euro in international trade settlement has grown. However, the euro tends to be used mostly among economies in Europe that trade heavily with other eurozone members. Only the US dollar is used extensively in broad geographic areas, even when the US is not a partner in the trade transaction. The Japanese yen has been used for trade settlement in some Asian economies, but its role is relatively small. In addition to trade transactions, the US dollar is also the vehicle currency for interbank foreign exchange transactions. This means that when a government decides to intervene in the foreign exchange market to influence the exchange rate, it tends to find it more effective to use the US dollar as the intervention currency.

An international currency should also function as an international store of value. In this regard, the dollar also dominates. In several economies, the US dollar circulates freely together with the domestic currency. The preference for the US dollar exists because it is seen as a more stable store of value. Within the Asia-Pacific region, Cambodia is a highly dollarized economy. The importance of the US dollar as a store of value can be gauged from the amount of international banking deposits. Data shows that US dollar deposits have the largest share at 63% followed by the euro at 19% **(Figure 15)**.

Governments around the globe have also favored using the US dollar as a store of value. Most international foreign reserves are held mainly in dollars. The introduction of the euro has led to some degree of diversification away from the US dollar, but the crisis in the eurozone has slowed the process. Data from the International Monetary Fund shows that the US dollar comprises 61% of foreign exchange reserves **(Figure 16)**. The second most common currency is the euro at 24%. The Japanese yen only has a 4% share.

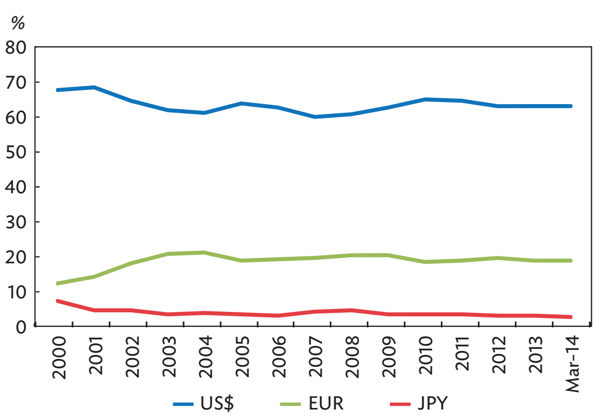
The US dollar plays an important role as the unit of account for international finance and trade. About 87% of global foreign exchange trading is in US dollars, compared with 33% for the euro and 23% for the Japanese yen, with the remainder being in other currencies **(Figure 17)**.[4] A

Figure 16: Foreign Reserves Holdings
(share of the total)



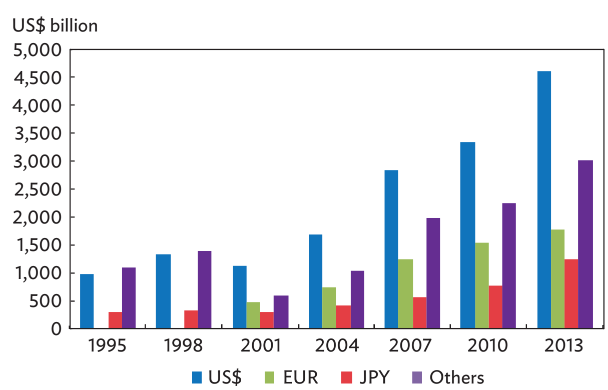
Source: International Monetary Fund.

Figure 15: Cross-Border Banking Deposits
(share of the total)



Source: Bank for International Settlements.

Figure 17: Global Foreign Exchange Market Turnover



Note: Data reflects average daily turnover for the month of April.
Source: Bank for International Settlements.

[4] The total sums to 200% as there are two sides in a currency transaction.

significant advantage of the US dollar in terms of trade is that invoicing for most transactions is in US dollars and prices in commodity markets are also in US dollars.

For many commodities such as oil, the US dollar is commonly used as the main currency for invoicing trade. However, the choice of invoice currency for trade in manufactured goods is more complex. The choice of currency to be used is usually determined by the industry in which the trade occurs. Generally, goods that are produced competitively by many different firms tend to be traded in a single currency. This is because exporters prefer to keep prices stable relative to their competitors, leading to the use of the same currency.

Another factor that could affect currency choice is the transaction cost of using a currency. Hence, currencies that are very liquid in the foreign exchange market will be favored. Also, there is the influence of history. Once a currency has established itself as a popular currency, it is difficult for a new currency to supplant it. Further, if a currency has been used for a long time it will have a large market share, which contributes to its greater liquidity, thereby lowering transactions costs.

Decisions on which currency to use will also be affected by the bargaining power between the exporter and the importer. Both parties would like to minimize currency risk and so prefer to invoice in their own currency. In this case, the advantage would likely be on the side of the larger party. Traditionally, Chinese manufacturers have tended to sell similar products to one another and were smaller than the large retail chains in developed economies to whom they were selling. This meant they had less sway in negotiations. But more recently, with the rapid growth in the PRC's economy, Chinese firms have become much larger. They are now major importers in their own right, which has given them additional leverage in the bargaining process.

Within Asia, trade is still mostly invoiced in US dollars. This may have been convenient when the US was the major destination for the region's exports. Expanding intra-Asian trade, with more exports being consumed within the region, is likely to lead to greater use of a regional currency within Asia.

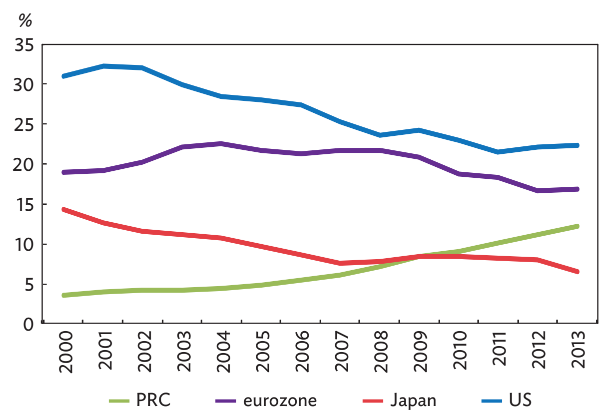
What Drives the Adoption of an International Currency?

How does a currency become internationally accepted? There are several factors that influence which economy's currency is used internationally. The first is the size of the economy and its presence in global trade. A large global economy will have a more familiar currency that can more easily serve as a unit of account or medium of exchange. As the US is the largest global economy, it is natural that the US dollar is widely used as an international currency. However, the PRC's economy is catching up fast, and in 2013 it was equivalent to 55% of the US economy when measured in current exchange rates **(Figure 18)**.

An economy's economic influence can also be measured by its share of international trade. Here, the rise of the PRC has been stunning: between 2000 and 2012, its share of global trade rose from 3.7% to 11.0% **(Figure 19)**. Yet, the use of the renminbi has so far lagged behind the PRC's global economic influence.

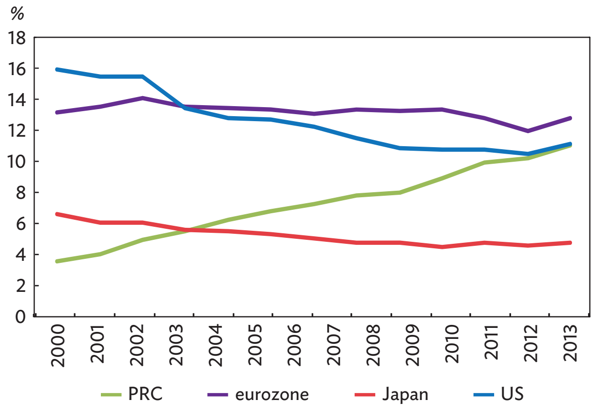
Second, an international currency must command confidence in its value. This usually implies that the economy has a strong track record of economic stability and low inflation. That way, the currency can be expected

Figure 18: Share of Global GDP



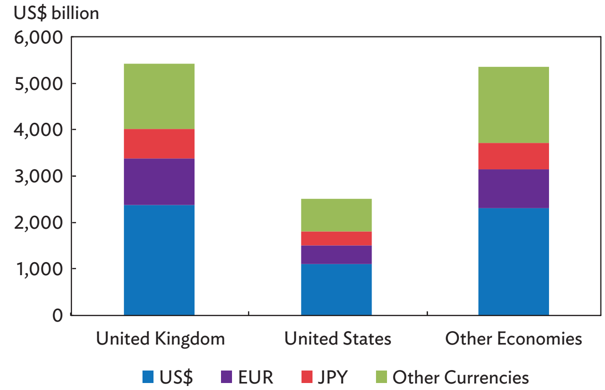
PRC = People's Republic of China, GDP = gross domestic product, US = United States.
Sources: Bloomberg LP and World Bank.

Figure 19: Share of Global Trade



PRC = People's Republic of China, US = United States.
Source: World Bank.

Figure 21: Share of Foreign Exchange Turnover by Currency and Economy



Note: Data reflects average daily turnover for April 2013.
Source: Bank for International Settlements.

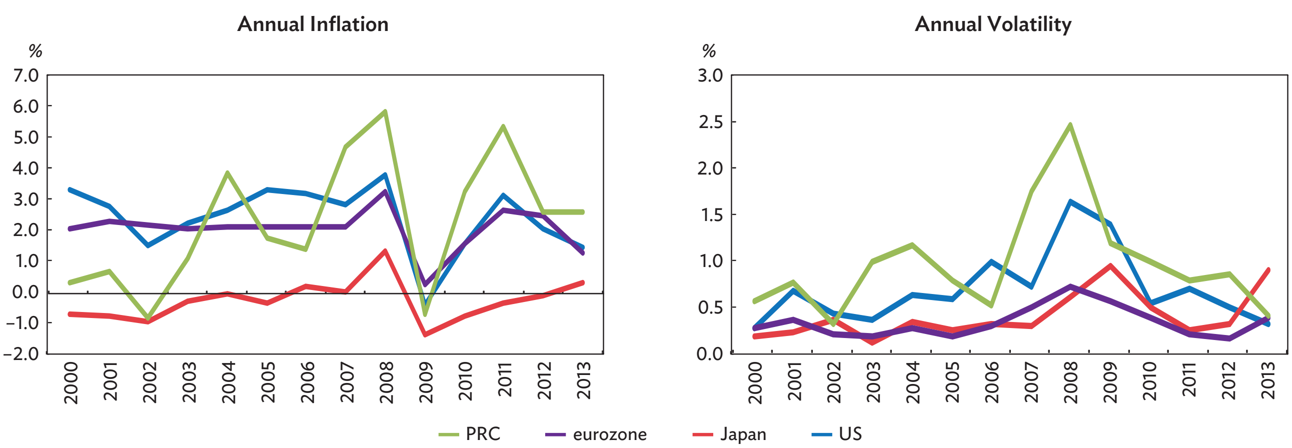
to maintain its value and facilitate its function as a unit of account and medium of exchange. The PRC's inflation record since 2000 has been comparable to that of the US, eurozone, and Japan **(Figure 20)**.

Third, the economy should have well-developed financial and capital markets that can support demand for the currency's assets. It is important that the financial and capital markets are open so that investors can freely participate. The US has the largest and most liquid capital market, and the amount of investable assets in the US is much larger than that of any other economy. Importantly, US financial markets are highly sophisticated, with a large variety of financial instruments catering to all needs.

Looking at the share of foreign exchange turnover, the US dollar has the largest share among all currencies **(Figure 21)**. Interestingly, while the US dollar is the most popular currency, the majority of foreign exchange trading takes place outside the US, mainly in London.

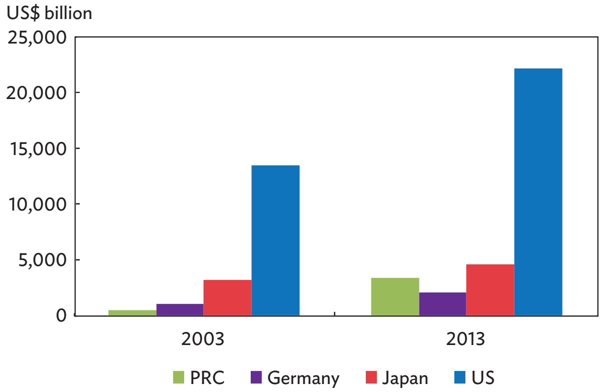
The size of an economy's capital market can also be measured by the capitalization of its stock market and the amount of bonds outstanding. The US stock market is the largest in the world, followed by Japan **(Figure 22a)**.

Figure 20: Annual Inflation and Volatility



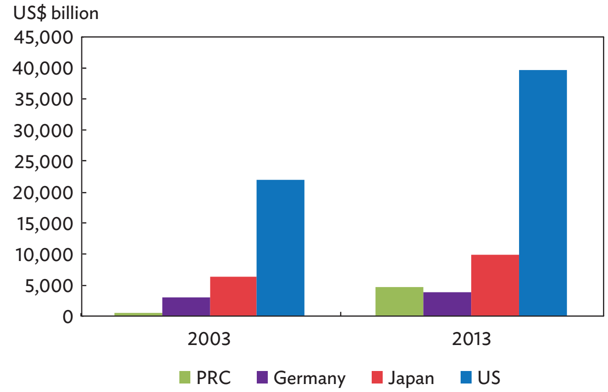
PRC = People's Republic of China, US = United States.
Sources: Bloomberg LP and *AsianBondsOnline*.

Figure 22a: Stock Market Capitalization



PRC = People's Republic of China, US = United States.
Source: Bloomberg LP.

Figure 22b: Bonds Outstanding in Selected Markets



PRC = People's Republic of China, US = United States.
Sources: *AsianBondsOnline*, European Central Bank (ECB), and Securities Industry and Financial Markets Association (SIFMA).

The PRC's stock market is the fifth-largest in the world in 2013. In terms of bonds outstanding, the US market is also the largest, while the PRC's bond market is about 12% the size of the US market **(Figure 22b)**. When measuring the depth of bond markets, the US market is much more developed than that of the PRC. This reflects the more dominant role that banks still play in the PRC.

Progress of Renminbi Internationalization

The PRC has shown tremendous growth over the past 2 decades and is now the largest exporter in the world. The dynamism of the Chinese economy has also attracted significant foreign investment into the economy. At the same time, the presence of Chinese firms abroad has been growing as they seek out new markets. While a huge amount of international transactions originate in the PRC, most of the payment and settlement for trade and investment transactions are in US dollars. There is a tremendous opportunity for these transactions to instead be conducted in renminbi. As a result, the PRC has stepped up its efforts to promote the internationalization of the renminbi and make it more attractive for foreigners to transact in and hold renminbi.

In addition to trade, liberalization of the renminbi has also occurred along another front, investment. Liberalization in the bond market began when the first offshore renminbi bond, popularly known as a dim sum bond, was issued in 2007.

The Use of the Renminbi in Trade Settlement

The first step in the internationalization of the renminbi has been in the area of trade. This is not surprising as the current account in the PRC is more liberalized than the capital account. Trade is also an area where the PRC plays a major role in the global economy, accounting for 11% of all global trade flows. A significant step in promoting trade settlement in renminbi was taken in July 2009 when the PRC started a pilot program in 5 cities: Shanghai, Guangzhou, Shenzhen, Dongguan, and Zhuhai. Firms in these cities were allowed to settle renminbi-denominated cross-border trade transactions with firms in Hong Kong, China; Macau, China; and the members of the Association of South East Asian Nations (ASEAN). This was soon expanded to 20 provinces and cities, and the geographic limitations outside of the PRC were eliminated. Over time, the program has gradually expanded to the point that all trade with the PRC can now be settled in renminbi. **Table 5** below shows a timeline of the progression of the cross-border trade settlement scheme.

In 2010, the total amount of renminbi used for trade settlement stood at CNY534.8 billion, compared with the first half of 2014, when the amount of renminbi trade settlement grew to CNY3.3 trillion. Similarly, the share of the PRC's trade in renminbi has basically grown from zero to about 25% of the total in 2Q14. The share is expected to continue growing in the years ahead **(Figure 23)**.

Table 5: Timeline of Renminbi Trade Settlement

Date	Event
July 2009	Pilot renminbi trade settlement scheme is announced; mainland-designated entities (MDEs) in five cities can settle trades directly in renminbi, allowable trade partners were limited to Hong Kong, China; Macau, China; and ASEAN countries
November 2010	The PRC and the Russian Federation sign bilateral trade settlement agreement.
June 2010	Participating provinces in renminbi trade settlement scheme expanded to 20 provinces and cities; imports for all companies in the designated provinces can be settled in renminbi; settlement of exports are still limited to certain MDEs. List of allowable trade partners expanded to entire world.
August 2010	The PRC and Malaysia begin direct trading of MYR–CNY.
November 2010	The PRC and the Russian Federation begin direct trading of RUB–CNY.
August 2011	Renminbi trade settlement scheme expanded to the whole of PRC
March 2012	Companies no longer need to secure MDE permit to settle export transaction in renminbi directly
June 2012	The PRC and Japan begin direct trading of JPY–CNY.
September 2012	The PRC and Taipei,China sign memorandum of understanding on currency clearing.
April 2013	PBOC and ICBC (Singapore) sign Currency Clearing Agreement
April 2013	The PRC and Australia begin direct trading of AUD–CNY.
November 2013	The PRC and Singapore begin direct trading of SGD–CNY.
March 2014	The PRC and New Zealand begin direct trading of NZD–CNY.
June 2014	The PRC and the United Kingdom begin direct trading of GBP-CNY.
July 2014	The PRC and the Republic of Korea begin direct trading of KRW-CNY.

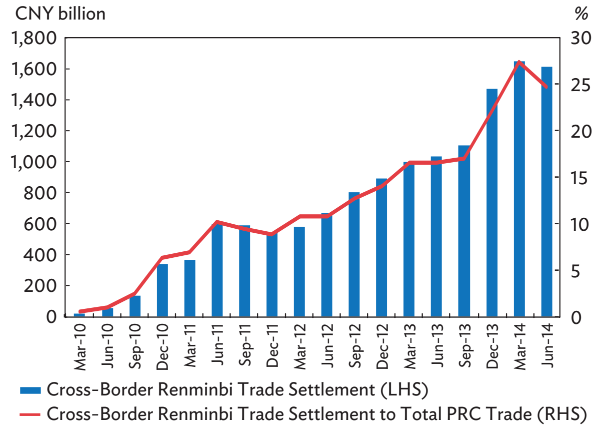
ICBC = Industrial and Commercial Bank of China, PBOC = People's Bank of China, PRC = People's Republic of China.
Source: Various news articles.

Global payment statistics also reflect the increasing popularity of the renminbi. Data from Society for Worldwide Interbank Financial Telecommunication (SWIFT) show that the market share of the renminbi in world payment values has increased substantially from 0.3% in January 2012 to 1.6% in June 2014 **(Figure 24)**. However, while growth has been significant, with the renminbi now ranking as the seventh-most used currency, its share is still significantly lower than those of the US and Europe, which have market shares of 41.9% and 31.3%, respectively.

SWIFT indicated that, as of October 2013, the renminbi was the second-most used currency for trade finance, based on data for letters of credit, with a market share of 8.7%. However, this remained far behind the share of the US dollar, which was 81.1%.

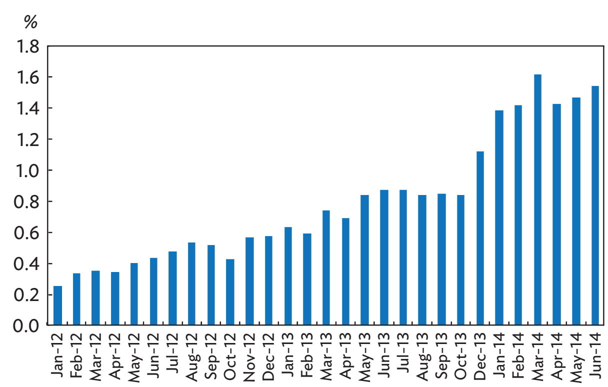
The increasing popularity of the renminbi for trade settlement is the result of a number of benefits it provides. Without renminbi direct trading, traders have to resort to converting to a third currency, such as the US dollar, before converting to renminbi. The availability of

Figure 23: Renminbi Trade Settlement



LHS = left-hand side, RHS = right-hand side.
Source: CEIC.

Figure 24: Renminbi Share of World Payments



Source: SWIFT.

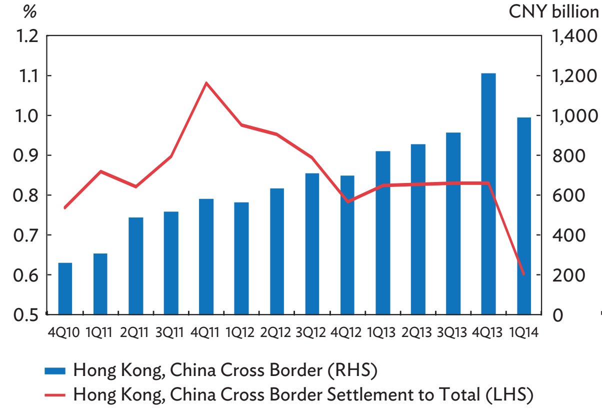
direct trading will, therefore, allow for fewer trades and lower transaction costs. Against this benefit is the need to ensure there are sufficient market participants to trade renminbi. Otherwise, a lack of liquidity in renminbi trading could result in wide spreads, thereby negating the benefit of direct trading. The start of direct trading against various currencies has seen quite a lot of interest. Given the large amount of trade activity between the PRC and other economies, there is natural demand for such trades.

Settlement in renminbi can also benefit Chinese companies by potentially reducing their hedging costs. Some of the benefits from lower hedging costs can be passed on to counterparties through lower prices. Foreign counterparties may also receive a market advantage if Chinese companies are more willing to do business with those that settle in renminbi.

The bulk of cross-border renminbi settlement flows course through Hong Kong, China. Since the start of the trade settlement program, cross-border renminbi settlement with Hong Kong, China has grown rapidly and accounts for a significant portion of all renminbi trade settlement, although this share has declined from its peak **(Figure 25)**.

Another factor promoting the use of cross-border trade settlement is the expansion of currency swap agreements. To ensure that there is a sufficient supply of renminbi available for economies to trade in, the PRC has set up a network of bilateral swaps. Since 2008, it has inked swap agreements with 24 economies, of which six have expired. As of end-August, the size of outstanding swaps totaled CNY2.6 trillion **(Table 6)**. The PRC now has bilateral swap arrangements with economies that account for 40%

Figure 25: Hong Kong, China Cross-Border Renminbi Trade Settlement



LHS = left-hand side, RHS = right-hand side.
Sources: CEIC and Hong Kong Monetary Authority.

Table 6: Currency Swap Arrangements

No.	Date	Counterparty	RMB Amount (billion)	Swap Term	Remarks
1	December 2008	Republic of Korea	180.0	3 Years	Replaced by No. 13 below
2	January 2009	Hong Kong, China	200.0	3 Years	Replaced by No. 14 below
3	February 2009	Malaysia	80.0	3 Years	Replaced by No. 18 below
4	March 2009	Belarus	20.0	3 Years	
5	March 2009	Indonesia	100.0	3 Years	Replaced by No. 27 below
6	March 2009	Argentina	70.0	3 Years	
7	June 2010	Iceland	3.5	3 Years	Replaced by No. 26 below
8	July 2010	Singapore	150.0	3 Years	Replaced by No. 22 below
9	April 2011	New Zealand	25.0	3 Years	
10	April 2011	Uzbekistan	0.7	3 Years	
11	May 2011	Mongolia	5.0	3 Years	
12	June 2011	Kazakhstan	7.0	3 Years	
13	October 2011	Republic of Korea	360.0	3 Years	Revised the swap amount from No. 1 above
14	November 2011	Hong Kong, China	400.0	3 Years	Revised the swap amount from No. 2 above
15	December 2011	Pakistan	10.0	3 Years	
16	December 2011	Thailand	70.0	3 Years	
17	January 2012	United Arab Emirates	35.0	3 Years	
18	February 2012	Malaysia	180.0	3 Years	Revised the swap amount from No. 3 above
19	February 2012	Turkey	10.0	3 Years	
20	March 2012	Australia	200.0	3 Years	
21	June 2012	Ukraine	15.0	3 Years	
22	March 2013	Singapore	300.0	3 Years	Revised the swap amount from No. 8 above
23	April 2013	Brazil	190.0	3 Years	
24	June 2013	United Kingdom	200.0	3 Years	
25	September 2013	Albania	2.0	3 Years	
26	September 2013	Iceland	3.5	3 Years	Renewed from No. 7
27	October 2013	Indonesia	100.0	3 Years	Renewed from No. 5
28	October 2013	Hungary	10.0	3 Years	
29	October 2013	European Union	350.0	3 Years	
30	July 2014	Switzerland	150.0	3 Years	
	Total		**2,585.5**		

Note: Total is sum of outstanding swaps as of end-August 2014.
Source: People's Bank of China.

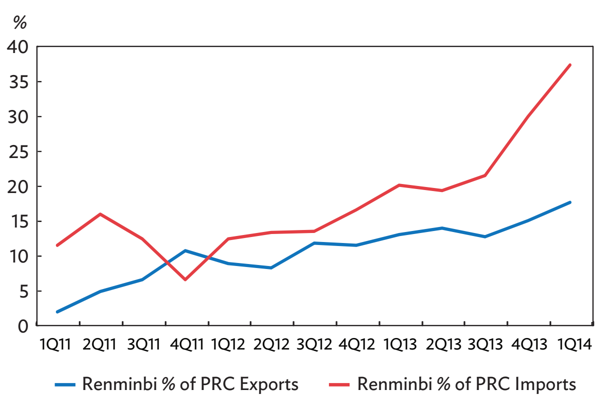
of its total trade. The swaps can promote greater use of different currencies by assuring participants that they will be able to conduct large trade settlement transactions. The swap arrangements also ensure a continuous supply of renminbi liquidity during periods of financial turmoil.

While the increased use of renminbi in trade settlement can be seen as a success, there is a mismatch between the use of the currency by importers and exporters. In the early days of its introduction, Chinese importers were the overwhelming users of the renminbi as exporters to the PRC were happy to accept renminbi for their products. However, there is limited use among Chinese exporters of the renminbi as payment for their products. Foreign customers typically still pay in US dollars, partially because of the limited availability of offshore renminbi. This tends to be a problem for companies not located in one of the offshore centers for renminbi trading. As the number of offshore centers for renminbi trading increases, this will become less of a constraint.

A more important reason for the limited use of the renminbi in payment for Chinese exports is the same reason that renminbi deposits have risen in Hong Kong, China, which is that foreigners want to hold renminbi since it is expected to appreciate; that is, foreign purchasers of Chinese goods prefer to pay in a depreciating currency such as the US dollar.

AsianBondsOnline estimates confirm that a larger share of imports than exports are settled in renminbi **(Figure 26)**. This shows that Chinese companies increasingly use the renminbi for offshore payments,

Figure 26: Renminbi-Settled Exports and Imports as Percentage of Total PRC Exports and Imports



PRC = People's Republic of China.
Sources: CEIC, People's Bank of China, and *AsianBondsOnline* estimates.

while less renminbi are used for receipts. The disparity shows that companies abroad are increasingly willing to receive renminbi and more reluctant to pay in renminbi.

The greater use of the renminbi in the settlement of payments is also a major factor contributing to the rise in the supply of offshore renminbi. More receipts of renminbi payments could potentially reduce the supply of offshore renminbi.

As inter-market trade expands, there is a need to develop a settlement system. Most trade in US dollars is settled through the US Federal Reserve System. There is no centralized system for cross-border renminbi settlement. Instead, foreign banks need to deal with local Chinese banks with access to the onshore renminbi payment system known as China National Advanced Payment Systems (CNAPS). To further promote the development of offshore renminbi centers, the PRC has begun designating clearing banks. The establishment of an official clearing bank for renminbi is significant as it not only enables participants to settle cross-border renminbi payments, but also provides banks a way to transfer offshore renminbi to other banks. Hence, a clearing bank lowers the cost of renminbi payments, makes transactions more efficient, and reduces foreign exchange risk. In Hong Kong, China, the clearing bank allows financial institutions to square their renminbi positions arising from an open position due to a trade-related transaction. This means that the clearing bank allows offshore banks to tap onshore renminbi for trade-related activities, but not for investment.

There are, however, drawbacks to this system. As the participants are commercial banks, they are usually subject to the single-party exposure limit of financial institutions. This limits the amount of transactions that can be conducted with the clearing banks. The clearing bank in Hong Kong, China offers a fiduciary service through which it can make placements in the People's Bank of China (PBOC) on behalf of a client, thereby reducing counterparty risk.

The first official renminbi clearing bank was established when the Hong Kong, China branch of the Bank of China was named a designated enterprise. As interest in offshore renminbi has grown, more official clearing banks have been established. Bank of China's Macau, China branch was established as a clearing bank in December 2009, and its Taipei,China branch was assigned as a clearing bank in December 2012.

On 8 April 2013, the PBOC signed an agreement with the Singapore branch of Industrial and Commercial Bank of China for the branch to act as the renminbi clearing bank in Singapore. In addition, a memorandum of understanding on renminbi business cooperation was signed.

In March 2014, the Bank of England and Germany's Bundesbank signed currency clearing agreements with the PBOC, allowing banks in the United Kingdom and Germany to provide renminbi clearing and settlement services. In July, it was announced that China Construction Bank would be the clearing bank for London and Bank of China would be the clearing bank for Germany. Also in July, Bank of Communications was assigned as the clearing bank for the Republic of Korea.

The Use of Renminbi for Financing and Investment

In addition to increasing cross-border renminbi flows from trade in goods and services, there has also been a gradual easing of restrictions on capital flows to facilitate the growth of the dim sum bond market. The PRC has taken a gradual approach to the liberalization of its capital account. The liberalization process has generally been initiated through the introduction of pilot programs. If a pilot program functions smoothly, then it will be expanded.

There has been considerable development in the use of the renminbi for investment purposes, which is closely linked to the development of the dim sum bond market and growing interest in the renminbi for diversification and speculative purposes.

The creation of the dim sum bond market has its roots in Hong Kong, China where, on 8 June 2007, the PBOC and the National Development and Reform Commission unveiled provisional rules governing issuance of renminbi bonds in Hong Kong, China. The two institutions announced that local PRC financial institutions—policy banks and commercial banks—could issue renminbi bonds in Hong Kong, China, subject to regulatory approval. Would-be issuers also needed to meet various criteria of financial soundness such as sufficiency of loan loss reserves, positive cashflow, and sustained operating profits for the past 3 years.

One month following the announcement, China Development Bank issued CNY5 billion worth of bonds in Hong Kong, China, the first company to do so. The PRC has gradually expanded the range of companies that it allows to issue CNY bonds in Hong Kong, China every year since 2007 **(Table 7)**.

In May 2009, the PRC gave permission to HSBC (China) and Bank of East Asia (China) to issue renminbi bonds in Hong Kong, China, the first time that locally incorporated foreign banks were allowed to do so. The PRC's Ministry of Finance also issued the first renminbi sovereign bond in Hong Kong, China in 2009.

The list of allowable issuers in Hong Kong, China rapidly expanded in 2010. The Hong Kong Monetary Authority announced that issuance of renminbi bonds in Hong Kong, China would be governed by regular rules and regulations for bond issues, thus allowing foreign issuers. However, issuance of renminbi bonds in Hong Kong, China by mainland companies would continue to be governed by existing PRC regulations. McDonald's would later become the first foreign corporate issuer of renminbi bonds in Hong Kong, China.

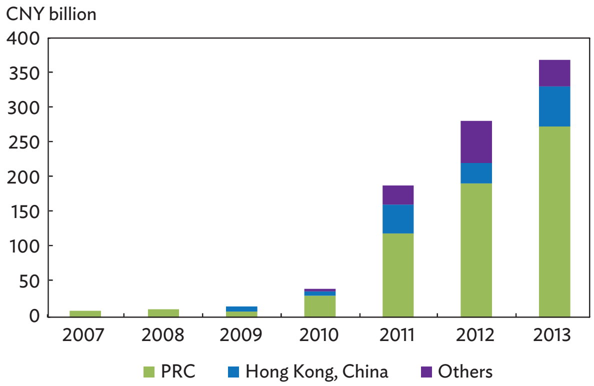
The dim sum bond market has since developed in other economies such as Singapore, albeit at a slower pace than in Hong Kong, China. Overall, the dim sum bond market has grown rapidly from issuance of CNY10 billion in 2010

Table 7: Milestones in the Dim Sum Bond Market

Year	Event
June 2007	PRC financial institutions allowed to issue dim sum bonds in Hong Kong, China
December 2008	Hong Kong, China-registered companies with operations in the mainland allowed to issue dim sum bonds
May 2009	First time foreign-banks' subsidiaries in PRC issue dim sum bonds in Hong Kong, China
September 2009	Ministry of Finance issues dim sum bonds
February 2010	Foreign companies allowed to issue dim sum bonds in Hong Kong, China
August 2010	McDonald's issues first dim sum bond by a foreign company
December 2011	Bao Steel issues first dim sum bond by an onshore PRC nonfinancial company
April 2012	HSBC issues first dim sum bond in London
March 2014	China Trust Commercial Bank issues first dim sum bond in Taipei,China
May 2014	HSBC and Standard Chartered issue first dim sum bond in Singapore
May 2014	Hainan Airlines Issues first corporate dim sum bond in Singapore

PRC = People's Republic of China.
Sources: Bloomberg LP, Hang Seng Bank Research, Hong Kong Monetary Authority, and various news reports.

Figure 27: Yearly Issuance of Bonds and Certificates of Deposit by Market of Risk



PRC = People's Republic of China.
Note: Market of risk is based on Bloomberg's definition of market of risk and is based on a number of criteria such as the issuer's domicile (unless key management such as the CEO is located elsewhere), primary listing, major source of revenues or reporting currency.
Source: Bloomberg LP.

to CNY369 billion in 2013 **(Figure 27)**. A large number of dim sum bond issuances have been through bank certificates of deposit (CDs).

While the bulk of dim sum bond issuance still comes from companies based in the PRC, issuance from other economies has grown significantly. Cumulative issuances from companies based outside of the PRC and Hong Kong, China totaled CNY129 billion in 2013, compared with CNY141 billion from companies based in Hong Kong, China.

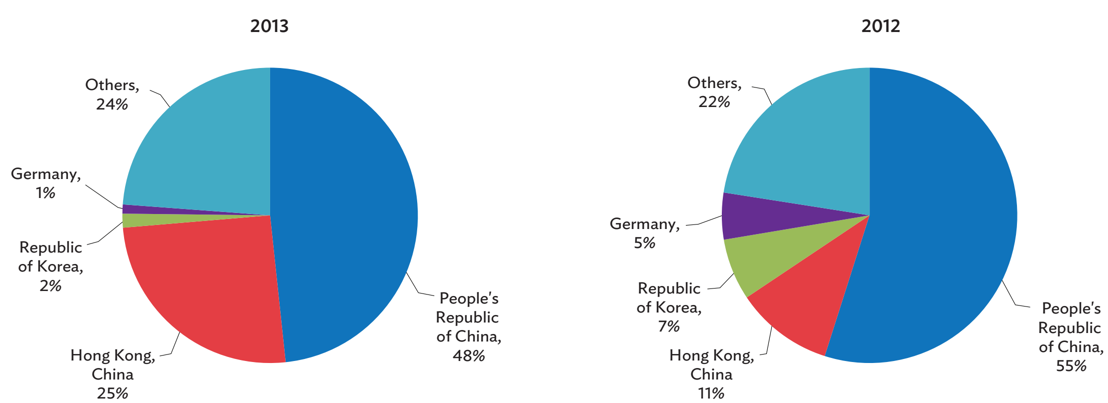
Figure 28 shows the breakdown of bond issuances in 2012 and 2013. The largest issuances—excluding those from the PRC and Hong Kong, China—came from the Republic of Korea and Germany. In 2013, the shares of those economies fell as issuance from Hong Kong, China grew rapidly. The World Bank is an active participant in the dim sum bond market, issuing a total of CNY4 billion in 2013. The Asian Development Bank (ADB) also issued a dim sum bond in 2010 worth CNY1.2 billion.

In terms of cumulative CD issuance, Hong Kong, China is the leader while Singapore is second, followed by Macau, China **(Figure 29)**.

There were a total of 1,150 bonds and CDs issued in 2013 versus 890 in 2012, bringing the cumulative number of bonds and CDs issued to roughly 2,500 at the end of 2013. This is a significant jump from only five issuances for the year as a whole when the dim sum bond market first started in Hong Kong, China in 2007.

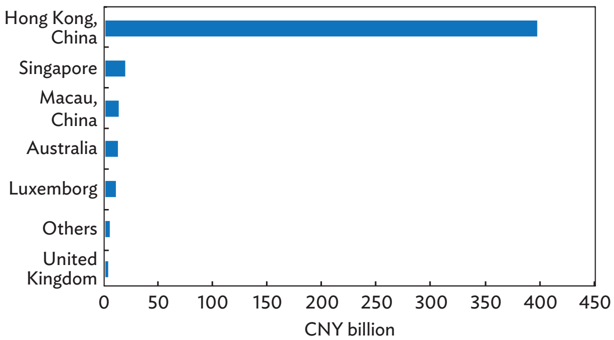
The number of issuers has also grown. In 2007, there were three issuers of dim sum bonds; by the end of 3Q13, the cumulative number of issuers had grown to 222. In addition to the increase in issuers from different economies, the diversity of issuers in terms of industry has also increased. Prior to 2009, issuers were from the PRC, and from either commercial banks or the government. However, starting in 2010, the corporate sector began

Figure 28: Dim Sum Bond Issuance (excluding CDs) **by Market of Risk**



CDs = certificates of deposit.
Note: Market of risk is based on Bloomberg's definition of market of risk and is based on a number of criteria such as the issuer's domicile (unless key management such as the CEO is located elsewhere), primary listing, major source of revenues or reporting currency.
Source: Bloomberg LP.

Figure 29: Certificates of Deposit Issuance by Domicile



Notes:
1. Others includes United Arab Emirates, Australia, the People's Republic of China, and Spain.
2. Domicile is based on Bloomberg's Economy of Domicile which is defined as the location of the company's senior management.

Source: Bloomberg LP.

issuing renminbi bonds. Issuance from corporates in 2013 was slightly higher than in 2012 **(Figure 30)**.

Banks remain the largest issuers of dim sum securities, mostly due to the number of CDs they have issued. The dim sum bond market has also been a significant source of financing for Chinese real estate companies. This is in part due to restrictions limiting their access to the onshore bond market. Other companies have issued renminbi bonds in order to attract the growing pool of offshore renminbi funds. In fact, two Malaysian companies, Axiata and Khazanah, issued renminbi-denominated *sukuk* (Islamic bonds).

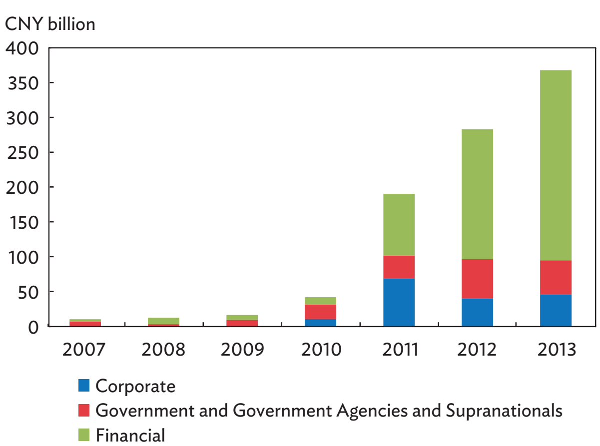
If commercial banks, supranationals, and special purpose banks are excluded, the real estate industry is the largest issuer of dim sum bonds. Most of these issuances are from Chinese real estate companies, which are restricted from issuing bonds in the onshore market and therefore resort to tapping external bond markets.

In terms of maturity, most early dim sum bond issuances were concentrated in the 1- to 3-year segment **(Figure 31)**. Foreign companies that issued dim sum bonds were cautious about the risk of issuing longer-term bonds given the relative infancy of the market and the possibility of being unable to source the renminbi needed to repay the bond. Early investors in dim sum bonds were also mostly looking for high-yield alternatives to renminbi deposits. However, this has changed and the maturity profile has gradually lengthened, reflecting the development of the dim sum bond market and growing interest from institutional investors and fund managers.

The growing interest in the dim sum bond market is also seen in the trading activity for the bonds. There is already more liquidity in the dim sum bond market in Hong Kong, China than in the local currency corporate bond market **(Figure 32).**

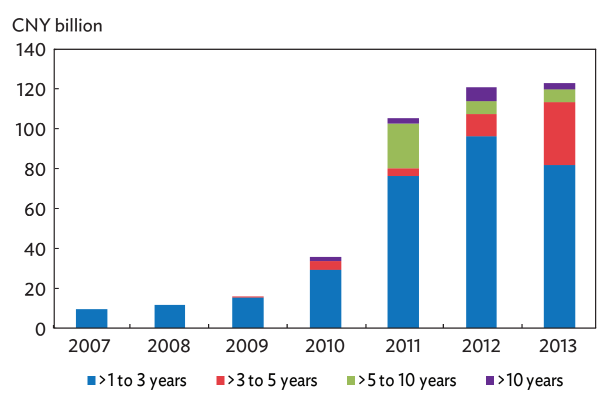
The path taken by the PRC to promote internationalization of the renminbi is unique in that while the PRC has promoted internationalization, it has done so while restricting capital account flows. This has led to the

Figure 30: Issuance by Sector



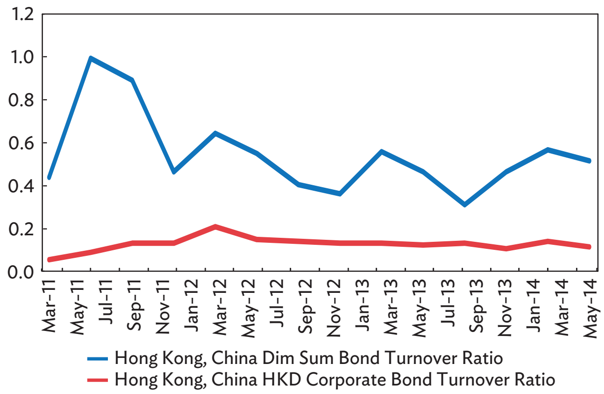
Source: Bloomberg LP.

Figure 31: Maturity Profile of Dim Sum Bond Issuance



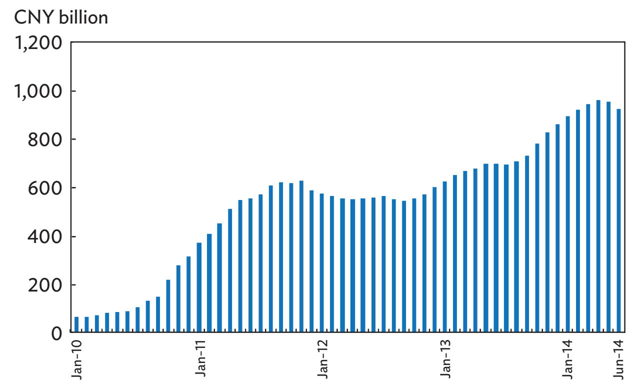
Source: Bloomberg LP and *AsianBondsOnline*.

Figure 32: Dim Sum Bond versus HKD Corporate Bond Turnover Ratio



Source: Hong Kong Monetary Authority.

Figure 33: Renminbi Deposits in Hong Kong, China



Source: Hong Kong Monetary Authority.

creation of distinct offshore and onshore markets. While the offshore market is a freely convertible currency and easily accessible to investors, there are still considerable restrictions to accessing the onshore market. Due to the closed nature of the PRC's capital markets, differences between the two cannot easily be arbitraged away.

This is reflected in the difference in the yields between onshore and dim sum bonds. Yields on dim sum bonds tend to be lower than comparable onshore renminbi bonds. This has been the result of the increasing pool of offshore renminbi liquidity chasing a relatively limited supply of offshore renminbi investments. In Hong Kong, China, a large pool of renminbi deposits has built up **(Figure 33)**. As of June 2014, total renminbi deposits amounted to CNY926 billion in Hong Kong, China, while there was CNY437 billion of outstanding dim sum bonds. The imbalance in supply and demand is due to the phenomenon in which imports are increasingly settled in renminbi and exports are still settled mostly in US dollars. Demand for renminbi investments is also high due to speculative bets on the expected appreciation of the renminbi.

The large pent-up demand for renminbi-denominated assets has allowed issuers to obtain lower funding costs offshore versus onshore. In December 2009, ADB issued onshore CNY bonds with a spread of 57 basis points (bps) over comparable PRC onshore government bonds. However, in October 2010, ADB's dim sum bonds were issued 81 bps below comparable PRC onshore government bonds. The International Finance Corporation has issued a CNY bond with a spread of 45 bps over comparable PRC government bonds, while its dim sum bond was issued at a spread of 182 bps below comparable PRC government bonds.

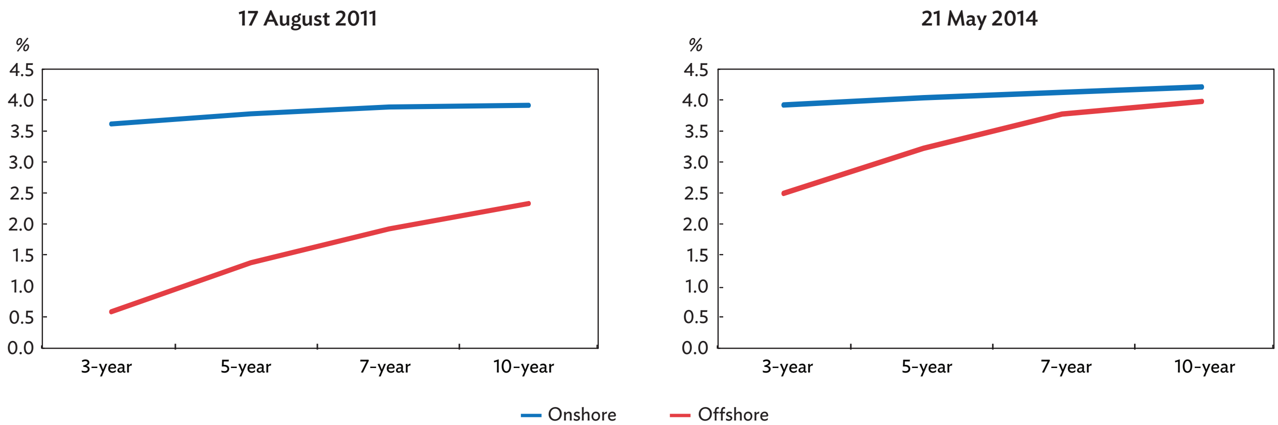
In August 2011, the PRC government conducted a multi-tranche dim sum bond auction. The 3-year bonds were issued at a coupon of 0.6%, while the prevailing yield offshore was 3.65%. The 5-year bonds were issued at a rate of 1.40%, while the prevailing offshore yield was 3.80%. The 7- and 10-year bonds were issued at a coupon rate of 1.94% and 2.36%, respectively, while the comparable offshore yields were 3.90% and 3.94%. On average, the PRC issued the bonds at a spread of 225 bps lower than onshore borrowing costs.

The difference between onshore and offshore yields has narrowed in 2014. Part of the reason stems from concerns during the prior year that the renminbi had changed direction and would depreciate against the US dollar. The dim sum bond market has also developed to the point it is viewed less-and-less by market participants simply as a way to bet on the currency. **Figure 34** shows the onshore and offshore yield comparison for PRC government bonds auctioned in the PRC.

As the yield difference in the onshore and offshore has narrowed, the premium between the CNH and CNY spot currency prices has also largely disappeared **(Figure 35)**.[5] When CNH was first introduced, it traded at a premium

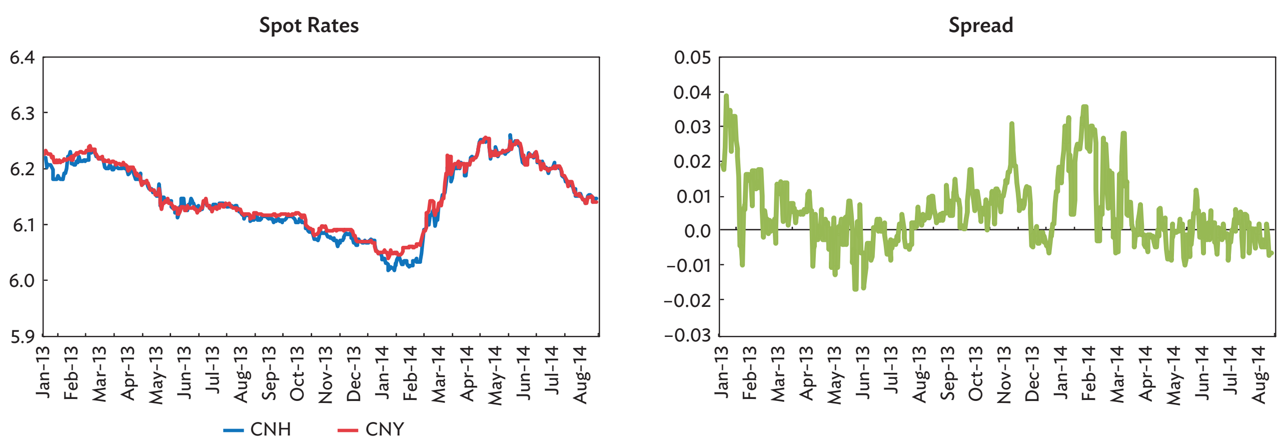
[5] CNH refers to offshore renminbi traded in Hong Kong, China.

Figure 34: PRC Government Onshore versus Offshore Yields



PRC = People's Republic of China.
Note: Yields were based on auction results.
Sources: Bloomberg LP and Hong Kong Monetary Authority.

Figure 35: Spread between CNH versus CNY Spot Exchange Rates



Note: Spread is the difference between CNY and CNH spot exchange rates.
Sources: Bloomberg LP and *AsianBondsOnline*.

to the onshore CNY rate as demand was high and investors were eager to participate in the market with the expectations of renminbi appreciation. However, the recent weakening of the renminbi and the realization that it is no longer a one-way bet has reduced the premium. This is a good development in the long-run and a sign of a maturing market as the exchange rate for the CNH will increasingly be determined by market conditions.

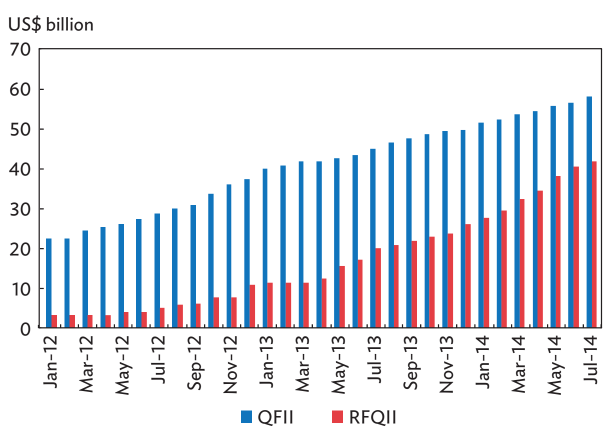
When the renminbi began depreciating at the start of the year, it raised concerns that the currency may no longer be a one-way bet. However, market interest in the dim sum bond market has also gradually shifted away from a simple currency bet and toward its potential diversification benefits.

The maturing of the offshore renminbi market can also be seen in the transition from the CNY non-deliverable forward (NDF) market to the CNH deliverable forward (DF) market. In 2013, DBS Bank estimated the volume of CNY NDFs at CNY3.2 billion and the volume of CNH DFs at CNY6.0 billion. The popularity of the CNH DF is due to increased demand from end-users such as corporates hedging their foreign currency payments. In contrast, the CNY NDF market is cash-settled and is more useful to speculators seeking to profit from expected currency changes.

Recognizing the build-up in offshore renminbi deposits in Hong Kong, China, the PRC has liberalized its rules to allow for the funds to be used for investment in the onshore financial market. The Renminbi Qualified Foreign Institutional Investor (RQFII) scheme permits Hong Kong, China-based financial institutions to invest directly in onshore financial assets using renminbi obtained from the offshore market. This is a key channel for rapidly accumulating renminbi funds abroad to be invested back into the PRC. The range of financial institutions that are allowed to take part have been broadened and the RQFII quotas have been increased. Initially, the quota for RQFII was CNY10 billion, but it has grown to CNY257 billion. There is a similar set of quotas called the Qualified Foreign Institutional Investor (QFII) to allow institutions globally to invest in the Chinese onshore market. The quotas for QFII have traditionally been much larger than those for RQFII, but the difference has been narrowing. As of July, the QFII quota is US$58 billion, compared with US$42 billion for RQFII **(Figure 36)**.

More recently, the PRC announced the introduction of a direct trading link between Hong Kong, China and the PRC. The Hong Kong, China–Shanghai Stock Connect will allow international investors to purchase Shanghai A shares via Hong Kong, China, and allow mainland Chinese investors to access H shares listed in Hong Kong, China. The direct connection between the two stock markets is expected to be operational by October 2014.

Figure 36: Cumulative QFII and RQFII



QFII = Qualified Foreign Institutional Investors, RQFII = Renminbi Qualified Foreign Institutional Investors.
Source: CEIC.

The direct trading link is seen as an improvement over the existing QFII and RQFII systems because there is no longer a need for investors to go through a potentially lengthy approval process. Also, while there will be an overall maximum limit of the trading allowed on the system, the limit is on the overall volume of transactions and not on an individual investor basis.

Currently, investors in Hong Kong, China can invest up to a net CNY13 billion in the PRC on a daily basis, subject to an overall aggregate limit of CNY300 billion. Meanwhile, investors from the PRC can invest up to CNY10.5 billion a day with a CNY250 billion aggregate limit. While these quotas are still relatively small, when combined with the QFII and RQFII quotas, they are a substantial share of the market.

Capital account liberalization does not refer to just inward investment of foreign capital, but also to outward investment of domestic capital. Outward direct investment by Chinese institutions has been greatly liberalized. In 2006, a quota on purchases of foreign exchange for outward direct investment was removed. For outward direct investment made by institutions, approval from the authorities is currently needed. Investment quotas have also been gradually increasing for outward portfolio investment as well. The Qualified Domestic Institutional Investors (QDII) quota has increased from US$65 billion in end-2010 to US$81 billion by end-July 2014.

Challenges for Renminbi Internationalization

The PRC is close to meeting many of the conditions required for having an international currency. Its economy is large and stable, and it has an enviable record of low inflation. Use of the renminbi outside of the PRC has greatly expanded. Initially, much of the interest in holding renminbi was due to speculation that the renminbi would appreciate against the US dollar. However, increased volatility following its depreciation in early 2014 has modified this view. Nevertheless, demand for the renminbi persists. This is a positive sign indicating that there is natural demand for the renminbi, rather than just speculation over possible future appreciation.

The PRC's financial markets have grown in size and sophistication. In 1Q14, the outstanding amount of government and policy bank bonds total US$3.1 trillion. This is still smaller than the US market size of US$29.0 trillion and Japan's US$9.7 trillion. Despite its rapid growth, the PRC's bond market is still relatively undeveloped, and its onshore bond market remains close to foreigners.

There has been progress in opening up a portion of the market to foreigners. For example, the PRC has launched the QFII and RQFII programs to allow foreigners to invest in the PRC's domestic markets, and introduced a direct trading link between Shanghai and Hong Kong, China, demonstrating that access to the PRC's financial markets is gradually being liberalized. But the pace of liberalization is still very much under the control of the authorities. The careful and measured pace of liberalization reflect an understanding that complete liberalization could lead to a risk of large and destabilizing capital flows. It could also potentially lead to large swings in the exchange rate, which would hurt exporters.

Meanwhile, there are also constraints that hamper the further development of the dim sum bond market that will have to be addressed. While there has been tremendous growth in the market, the issuers remain predominantly Chinese companies: 74% of the value of dim sum bond issuances (including CDs) in 2013 came from PRC-based firms. While there has been a trend toward greater variety among issuers, market conditions still favor issuance from the PRC as onshore yields are higher than offshore yields. Some of the increase in issuances in dim sum bonds also reflects tightening regulatory conditions for issuing bonds in the PRC. Further development of the offshore market would likely require increased participation from non-Chinese entities.

There is also a greater need for AAA-rated, risk-free offshore renminbi investment assets. As the offshore renminbi market grows, demand for risk-free assets will increase. Currently, the closest risk-free asset available is the dim sum PRC government bond issued in Hong Kong, China, although issuance is limited on an annual basis. This is in contrast to most domestic markets in which Treasury bill and bond auctions are conducted on a weekly basis.

There also has been a decline in the credit quality of the dim sum corporate bond issuances. The proportion of investment grade bond issuances has declined from roughly 40% in 2012 to 26% for Moody's and to less than 15% for Standard & Poor's **(Table 8)**. The proportion of unrated issuances has also increased over time and now accounts for the vast majority of issuance. Encouraging greater issuance of higher quality dim sum bonds will help in creating an offshore renminbi risk-free curve that will aid in the pricing of risk assets.

The renminbi is expected to continue on its path toward greater acceptance. However, the road that it takes may be different from that charted by other currencies. Most of the assessment of the potential rise of the renminbi is based on the historical experience of the internationalization of the US dollar. In this sense, there is a strong belief that an open capital market is necessary for renminbi internationalization.

It is possible that the PRC will establish a new model of currency internationalization in which capital market development is not as important as it has been in the past. Authorities in the PRC have two main concerns about further liberalizing the capital account. Allowing capital to flow in freely could destabilize monetary conditions, and complicate the process of managing the financial system. With deposit rates currently capped in the PRC, opening up the capital account could also cause an outflow of funds that could destabilize the financial system. Under the current system, the PRC is able to control and limit capital inflows. The authorities favor foreign direct investment, which is seen as contributing more to the development of the economy. With large

Table 8: Ratings Breakdown for Dim Sum Bonds (%)

	Moody's			Standard & Poor's		
	2012	2013	2014	2012	2013	2014
Investment Grade	40.79	19.85	26.40	39.12	22.81	14.29
Non-Investment Grade	3.77	11.62	3.69	4.06	18.63	3.72
No Ratings	55.44	68.53	69.91	56.82	58.55	81.99

Sources: Bloomberg LP and *AsianBondsOnline*.

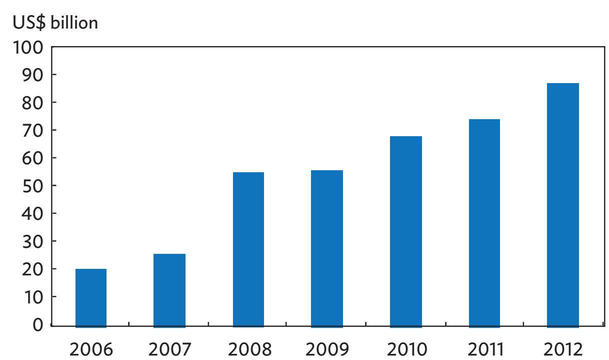
current account surpluses, the PRC does not have much need for portfolio inflows.

A closed capital account does not necessarily prevent the renminbi from becoming a leading international currency. As a capital surplus economy, it may be more important for the PRC to loosen restrictions on capital outflows. This will allow individuals and firms to invest in higher yielding opportunities abroad, and can also contribute to the rebalancing of the PRC economy from being investment-driven to one that is more consumption-driven. Progress has already been made on this front with the increase in overseas direct investment by Chinese companies to US$88 billion in 2012 from US$21 billion in 2002 **(Figure 37)**.

The shift toward renminbi and emerging assets in general has been the result of the deteriorating quality and returns of advanced markets sovereign bonds. Following the 2008/09 global financial crisis, fiscal conditions in advanced economies worsened as increased deficit spending and anemic growth led to ballooning public debt. The standoff during the 2011 debt ceiling debate in the US highlighted that even the US might not be completely safe from default. There are also concerns about the sustainability of US debt if yields were to start rising from their current levels. Hence, the capacity of advanced economies to supply safe assets may be constrained in the future.

As a result, central banks have shown increased interest in holding sovereign renminbi bonds, which offer many of the characteristics of a safe asset. The PRC has a strong economic track record, a history of low inflation, stable fiscal conditions, and a rising share of global trade. These conditions have led to increased interest among central banks in the region in adding renminbi bonds as reserve assets. However, the existence of capital controls and the lack of liquidity in the dim sum bond market is tempering some of the enthusiasm. To meet this demand, while still maintaining capital controls, will require more issuance in the dim sum bond market. This way, the PRC could pursue the internationalization of its currency without losing control of its monetary policy.

Figure 37: The PRC's Outward Direct Investment



PRC = People's Republic of China.
Source: CEIC.

Conclusion

The PRC is making a strong push for the internationalization of its currency. Considerable progress has been achieved toward this goal, with the renminbi gaining popularity as a trade and settlement currency. There has been tremendous growth in the offshore renminbi market as well. The historical experience of the US dollar suggests that promoting further use of the renminbi will require greater openness in the capital account. However, it is possible that the path of renminbi internationalization will be different.

While the pace of internationalization of the currency may be slower without opening up the capital market, it may be a process that is more stable. History is littered with examples of economies that suffered financial crisis from a premature liberalization of their capital account. This suggests that the PRC should focus on strengthening its domestic financial system first. The gradual approach to opening up the capital account will allow the PRC to learn from the outside world, while at the same time limiting the risk to its financial system.

The banking system is still the major source of financing in the PRC. The volume of lending by banks to the private sector far exceeds that of corporate bonds issuance. However, there are restrictions within the banking system. While lending rates have been partially liberalized, there is a ceiling on deposit rates. This complicates opening up the capital account, as it could lead to large outflows of funds.

The onshore bond market in the PRC is large. However, it remains relatively fragmented and underdeveloped. Bond futures, which could be used for hedging, cannot be traded by banks, thereby limiting liquidity and usefulness. The bond market is also split into an interbank bond market and an exchange bond market, with interbank bond market liquidity being much greater than that of the exchange bond market. The bulk of Treasury bonds are also held by banks rather than institutional investors.

Hence, there is considerable scope to improve and open up the domestic capital market. The banking system and bond markets should be further strengthened to better handle the associated challenges. As mentioned above, bank lending to the corporate sector in the PRC far outstrips corporate bond issuance. At the same time, onerous restrictions on bank lending persist, suggesting that reforming the banking system should be a priority.

While the onshore bond market is less constrained than the banking system, there are still significant challenges. One issue is that investors generally assume that onshore bonds carry an implicit guarantee. The first onshore bond default only occurred this year. The authorities may have decided to allow this default to encourage investors to price risk more carefully, rather than relying on implicit government guarantees. Investors need to understand that the higher returns offered by bonds with lower credit quality come with a higher risk. This may encourage Chinese companies to be more adventurous and issue more offshore bonds as the benefit of an implicit government guarantee for domestic issuances is removed. The dim sum bond market may benefit from this as Chinese companies seek more funding from overseas.

The internationalization of the renminbi will also have implications for emerging East Asia's economy.[6] As the PRC grows, it becomes more important as a final destination for the region's exports. This may lead to greater use of the renminbi for intraregional trade settlement. As the region's economies accumulate renminbi, they will look to invest more in the PRC's financial markets, bringing the region's markets closer together. Closer trading and financial ties will likely lead to a greater push for regional cooperation.

The PRC continues to be pragmatic rather than dogmatic in its pursuit of renminbi internationalization. It will likely continue weighing carefully the benefits and costs of promoting further international use of the renminbi. The opening up of the capital account will likely come only after the authorities are confident the domestic financial system is resilient enough to deal with the volatile capital flows that will likely follow. Given that the export sector is a large part of the PRC's economy, it will be wary of allowing the renminbi to float freely. But if the economy rebalances toward consumption versus investment, this may be less of a concern. Finally, as the PRC's trade is increasingly denominated in renminbi, the risk of exchange rate fluctuations, particularly in the export sector, will become less of a factor.

[6] 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.

Market Summaries

People's Republic of China

Yield Movements

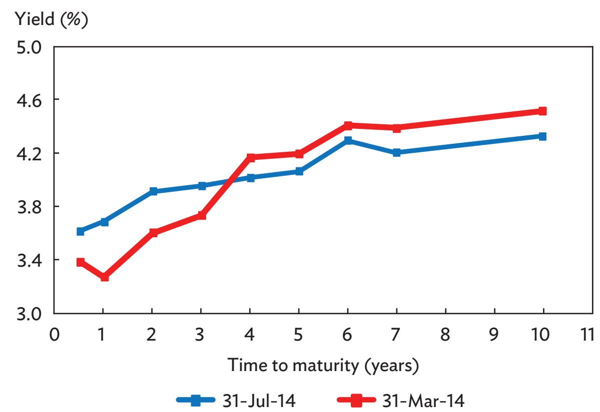
The government bond yield curve for the People's Republic of China (PRC) showed a mixed pattern between end-March and end-July **(Figure 1)**. Yields at the shorter-end of the curve rose. Yields for tenors of 3-years or less rose between 22 basis points (bps) and 41 bps. Yields for longer tenors fell 11 bps–19 bps.

The rise in yields at the shorter-end was driven mostly by volatility in the PRC's money market. In 2Q14, the 7-day repo rate peaked on 30 April at 4.18% as a result of seasonal liquidity driven by the payment of taxes. Rates then fell and were relatively stable until rising again from end-June to end-July. The 7-day repo rates rose to 3.85% at end-June and further to 4.02% at end-July. The rate rise was due to a combination of increased demand for liquidity toward the middle of 2014 as well as market concerns over a repeat of the June 2013 SHIBOR shock event. In July, a number of initial public offerings also increased demand for liquidity.

At the longer-end of the curve, the decline in yields was driven by data indicating that the PRC's economic growth might be slowing. Gross domestic product (GDP) growth in 2Q14 was up marginally at 7.5% year-on-year (y-o-y) from 7.4% in 1Q14. In contrast, the PRC's GDP growth for full-year 2013 was 7.7%. Inflation in the PRC has also been modest. In July, the PRC reported consumer price inflation of 2.3%, the same rate as in June, but down from May's 2.5%.

While concerns over the PRC's economic growth exist, the government seems focused on rebalancing the economy and is concerned with potential asset bubbles in the real estate market and rising credit risk. Thus, the PRC has not yet engaged in any full-blown stimulus measures, but has preferred to use targeted stimulus measures to promote development of the agricultural sector and small- and medium-sized enterprises (SMEs). On 31 May, the PRC expanded reserve requirement cuts, which were originally targeted to rural banks and rural cooperatives, to include

Figure 1: The People's Republic of China's Benchmark Yield Curve—LCY Government Bonds



LCY = local currency.
Source: Bloomberg LP.

other types of banks whose lending to the agricultural sector and SMEs reaches a certain level. Previously, on 22 April, the People's Bank of China (PBOC) cut the reserve requirement rate of rural banks and rural cooperatives by 200 bps and 50 bps, respectively. On 27 August, the PBOC increased relending quotas to the agricultural sector by CNY20 billion and decreased the relending rate by 100 bps.

There are also concerns regarding a slowdown in the country's property markets. In July, 64 out of 70 medium- and large-sized cities reported declines in the prices of newly constructed residential buildings. Also, 65 cities reported declines in prices of second-hand residential buildings.

Size and Composition

The amount of outstanding local currency (LCY) bonds in the PRC reached CNY30.2 trillion (US$4.9 trillion) at end-June, an increase of 3.4% quarter-on-quarter (q-o-q) and 10.8% y-o-y, largely driven by growth in policy bank and local corporate bonds **(Table 1)**.

Table 1: Size and Composition of the LCY Bond Market in the People's Republic of China

	Outstanding Amount (billion)						Growth Rates (%)			
	2Q13		1Q14		2Q14		2Q13		2Q14	
	CNY	US$	CNY	US$	CNY	US$	q-o-q	y-o-y	q-o-q	y-o-y
Total	**27,283**	**4,445**	**29,233**	**4,702**	**30,223**	**4,872**	**3.1**	**18.1**	**3.4**	**10.8**
Government	17,830	2,905	19,002	3,056	19,625	3,164	1.5	8.7	3.3	10.1
Treasury Bonds	8,438	1,375	9,136	1,470	9,461	1,525	4.5	12.5	3.56	12.1
Central Bank Bonds	995	162	552	89	489	79	(26.0)	(39.7)	(11.4)	(50.8)
Policy Bank Bonds	8,397	1,368	9,313	1,498	9,675	1,560	3.1	15.8	3.9	15.2
Corporate	9,453	1,540	10,231	1,646	10,598	1,708	6.3	41.1	3.6	12.1
Policy Bank Bonds										
China Development Bank	5,525	900	5,988	963	6,217	1,002	1.9	12.3	3.8	12.5
Export–Import Bank of China	1,268	207	1,458	235	1,480	239	7.2	36.4	1.5	16.7
Agricultural Devt. Bank of China	1,604	261	1,867	300	1,978	319	4.1	14.5	5.9	23.3

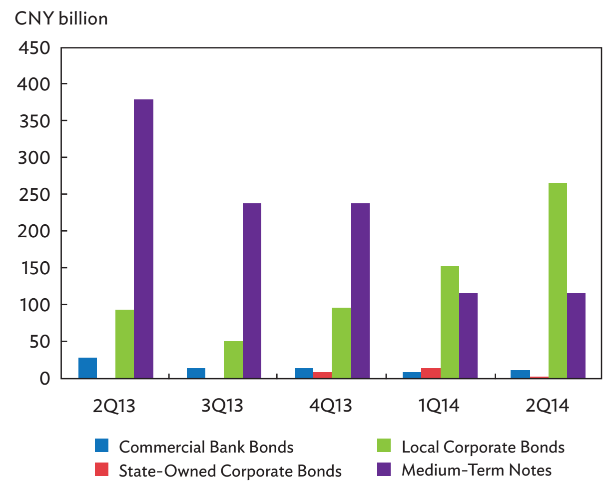
( ) = negative, LCY = local currency, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources. 2Q14 corporate bonds outstanding data based on *AsianBondsOnline* estimates.
2. Treasury bonds include savings bonds and local government bonds.
3. Bloomberg LP end-of-period LCY–US$ rate is used.
4. Growth rates are calculated from LCY base and do not include currency effects.
Sources: *ChinaBond*, Shanghai Clearing, Shanghai Stock Exchange, Shenzen Stock Exchange, and *AsianBondsOnline* estimates.

Government Bonds. LCY government bonds outstanding grew 3.3% q-o-q and 10.1% y-o-y in 2Q14, driven by growth in policy bank bonds. Central bank bonds continued to decline as the PBOC opted to use other tools, such as reverse repos, to manage liquidity.

Corporate Bonds. Corporate bonds outstanding grew 3.6% q-o-q and 12.1% y-o-y in 2Q14 to reach CNY10.6 trillion **(Table 2)**. The bonds with positive growth rates were medium-term notes and local corporate bonds at 9.8% and 32.0% y-o-y, respectively. Outstanding commercial bank bonds were slightly lower in 2Q14 than in 1Q14, despite slightly higher issuance, due to more commercial bank bonds maturing.

LCY corporate bond issuance was the highest among the major corporate bond types in 2Q14 **(Figure 2)**. However, overall issuance levels were lower compared to 2013 owing to the uncertainty in money markets.

Figure 2: Corporate Bond Issuance in Key Sectors



LCY = local currency.
Sources: *ChinaBond*, Shanghai Clearing, Shanghai Stock Exchange, Shenzen Stock Exchange, and *AsianBondsOnline* estimates.

Table 2: Corporate Bonds Outstanding in Key Categories

	Amount (CNY billion)				Growth Rate (%)				
					q-o-q				y-o-y
	3Q13	4Q13	1Q14	2Q14	3Q13	4Q13	1Q14	2Q14	2Q14
Commercial Bank Bonds	1,299	1,294	1,287	1,264	(2.2)	(0.4)	(0.5)	(1.8)	(4.9)
SOE Bonds	647	630	635	618	(0.9)	(2.6)	0.8	(2.7)	(5.3)
Local Corporate Bonds	1,626	1,702	1,833	2,085	2.9	4.7	7.7	13.7	32.0
Medium Term Notes	3,721	3,848	3,841	3,867	5.7	3.4	(0.2)	0.7	9.8

( ) = negative, – = not applicable, q-o-q = quarter-on-quarter, SOE = state-owned enterprise, y-o-y = year-on-year.
Sources: *ChinaBond*, Shanghai Clearing, Shanghai Stock Exchange, Shenzen Stock Exchange, and *AsianBondsOnline* estimates.

At the end of 2Q14, the top 30 corporate bond issuers accounted for CNY4.1 trillion worth of corporate bonds outstanding, or about 39% of the market **(Table 3)**. Among the top 30 corporate issuers, the 10 largest accounted for CNY2.8 trillion worth of bonds outstanding.

State-owned companies—defined as majority-owned by the government—continued to dominate the corporate bond market in 2Q14. Among the top 30 corporate issuers at end-June, 21 were state-owned.

Table 3: Top 30 Issuers of LCY Corporate Bonds in the People's Republic of China

	Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
		LCY Bonds (CNY billion)	LCY Bonds (US$ billion)			
1.	China Railway	896.0	144.44	Yes	No	Transportation
2.	State Grid Corporation of China	354.5	57.15	Yes	No	Public Utilities
3.	China National Petroleum	340.0	54.81	Yes	No	Energy
4.	Industrial and Commercial Bank of China	233.0	37.56	Yes	Yes	Banking
5.	Bank of China	224.9	36.26	Yes	Yes	Banking
6.	China Construction Bank	205.0	33.05	Yes	Yes	Banking
7.	Agricultural Bank of China	153.0	24.67	Yes	Yes	Banking
8.	China Minsheng Bank	134.7	21.71	No	Yes	Banking
9.	Central Huijin Investment	112.3	18.10	Yes	No	Diversified Financial
10.	Industrial Bank	109.0	17.57	No	Yes	Banking
11.	Senhua Group	106.0	17.09	Yes	No	Energy
12.	China Power Investment	102.3	16.49	Yes	No	Public Utilities
13.	Petrochina	97.0	15.64	Yes	Yes	Energy
14.	China Petroleum & Chemical	89.6	14.44	Yes	Yes	Energy
15.	Shanghai Pudong Development Bank	89.0	14.35	No	Yes	Banking
16.	China Guodian	82.2	13.25	Yes	No	Public Utilities
17.	China Southern Power Grid	77.5	12.49	Yes	No	Public Utilities
18.	China Life	71.0	11.45	Yes	Yes	Insurance
19.	China Merchants Bank	68.5	11.04	No	Yes	Banking
20.	China Three Gorges Project	68.0	10.96	Yes	No	Public Utilities
21.	Bank of Communications	64.7	10.43	No	Yes	Banking
22.	China Citic Bank	60.5	9.75	No	Yes	Banking
23.	Tianjin Infrastructure Investment Group	60.0	9.67	Yes	No	Capital Goods
24.	China Everbright Bank	55.0	8.87	No	Yes	Banking
25.	Shananxi Coal and Chemical Industry Group	52.7	8.50	No	Yes	Energy
26.	Beijing State-owned Assets Operation & Management Center	49.5	7.98	Yes	No	Diversified Financial
27.	Tianjin Binhai New Area Construction & Investment Group	47.8	7.71	Yes	No	Engineering and Construction
28.	China Huaneng Group	44.7	7.21	Yes	No	Public Utilities
29.	Citic Group	43.5	7.01	Yes	No	Diversified Financial
30.	Bank of Beijing	43.0	6.93	No	Yes	Banking
Total Top 30 LCY Corporate Issuers		**4,134.94**	**666.59**			
Total LCY Corporate Bonds		**10,597.50**	**1,708.42**			
Top 30 as % of Total LCY Corporate Bonds		**39.0%**	**39%**			

LCY = local currency.
Notes:
1. Data as of end-June 2014.
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on Bloomberg LP data.

Table 4 presents the most significant issuances of 2Q14.

Table 4: Notable LCY Corporate Bond Issuance in 2Q14

Corporate Issuers	Coupon Rate (%)	Issued Amount (CNY billion)
China Railway		
20-year bond	7.58	20
20-year bond	5.70	20
15-year bond	5.26	15
15-year bond	5.42	15
15-year bond	5.26	15
Shenhua Group		
5-year bond	5.15	20

LCY = local currency.
Source: Bloomberg LP.

Investor Profile

Treasury Bonds. Banks remained the largest category of investors in the PRC's treasury bond market, which includes policy bank bonds, holding a slightly smaller share of treasury bonds at end-June (76.7%) than in the same period last year (77.7%) **(Figure 3)**.

Corporate Bonds. Banks were also the largest holders of corporate bonds at the end of 2Q14, albeit with a comparatively smaller share than their holdings of treasury bonds and policy bank bonds. Banks' share of corporate bonds fell to 28.9% at the end of 2Q14 from 31.3% in 2Q13 **(Figure 4)**. The second largest holders of corporate bonds were insurance companies, with a 13.1% share at the end of 2Q14, down from a 16.1% share in the prior year.

Figure 5 presents investor profiles across corporate bond categories for the latest period for which data are available (2Q14). Banks were the largest holders of medium-term notes at end-June 2014 with more than 50% of the total. Meanwhile, insurance companies were the largest holders of commercial bank bonds.

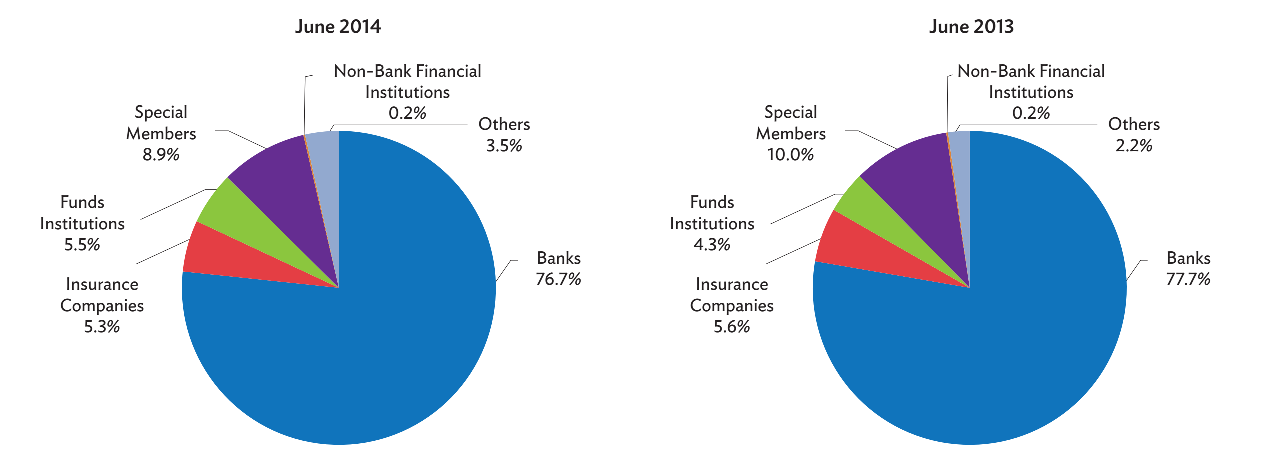
Liquidity

Figure 6 presents the turnover ratios for different categories of government bonds, which have seen a significant decline since 2013 owing to the tight liquidity conditions driven by the June 2013 SHIBOR shock and a crackdown on illegal bond trades. However, 2Q14 saw an increase in turnover ratios from 1Q14 due to increased trading as yields fell, particularly for longer-tenored bonds.

Interest Rate Swaps

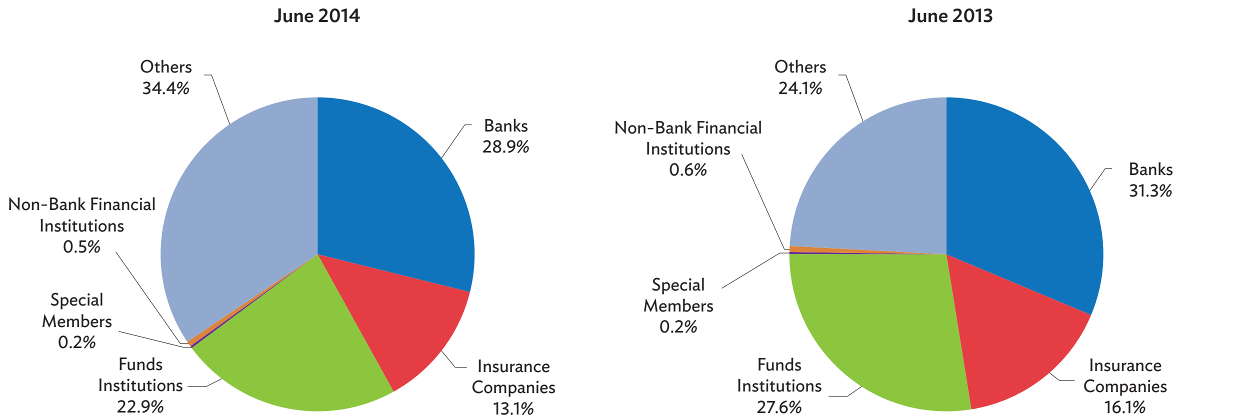
In 2Q14, the total notional amount of signed interest rate swap agreements in the PRC reached CNY894.2 billion on 9,292 transactions **(Table 5)**. The most popular benchmark is the 7-day repo, which accounts for 73% of all transactions.

Figure 3: LCY Treasury Bonds Investor Profile



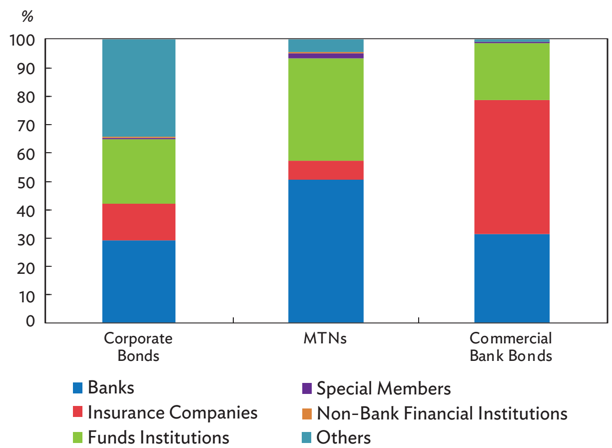
LCY = local currency.
Source: *ChinaBond*.

Figure 4: LCY Corporate Bonds Investor Profile



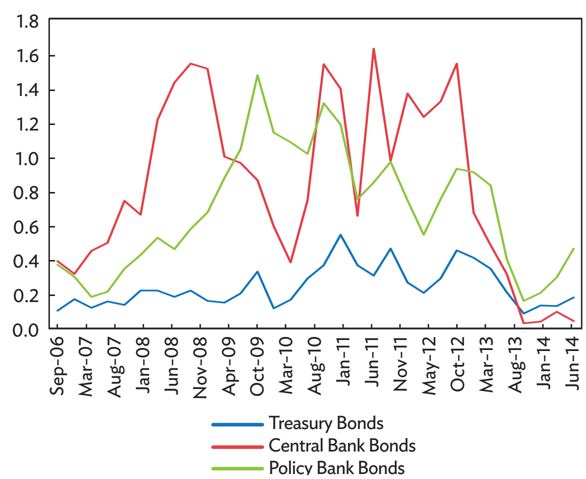
LCY = local currency.
Source: *ChinaBond*.

Figure 5: Investor Profile across Bond Categories



MTNs = medium-term notes.
Note: Data as of end-June 2014.
Source: *ChinaBond*.

Figure 6: Turnover Ratios for Government Bonds



Source: *ChinaBond*.

Policy, Institutional, and Regulatory Developments

Local Government Issuance Program Launched

On 29 May, the PRC launched a pilot program allowing 10 local government units to issue bonds directly. A similar pilot program was to have been launched before, but was scrapped over concerns about mounting local government debt. On 23 June, Guangdong issued the first local government bonds under the pilot program, auctioning 5-, 7-, and 10-year bonds for an aggregate amount of CNY14.8 billion.

The PRC Expands Coverage of Targeted Ratio Cuts

On 31 May, the PBOC announced that it would extend a reserve requirement ratio cut, originally targeted to state-level rural banks and rural cooperatives, to include other types of banks with a certain level of loans to the agricultural industry and SMEs.

Table 5: Notional Values of the PRC's Interest Rate Swap Market in 2Q14

Interest Rate Swap Benchmarks	Notional Amount (CNY billion)	% of Total Notional Amount	Number of Transactions	Growth Rate (%)
				q-o-q
7-Day Repo Rate	656.3	73.4	8,040	(2.7)
Overnight SHIBOR	140.6	15.7	231	243.4
3-Month SHIBOR	87.5	9.8	939	11.2
1-Year Term Deposit Rate	5.1	0.6	74	(22.8)
LIBOR	0.5	0.1	2	(80.6)
1-Year Lending Rate	3.7	0.4	2	96.8
LPR1Y	0.1	0.0	2	(50.0)
3-Year Lending Rate	0.2	0.0	1	–
5-Year Lending Rate	0.2	0.0	1	–
Total	**894.2**	**100.0**	**9,292**	**6.4**

( ) = negative, – = not available, PRC = People's Republic of China, q-o-q = quarter-on-quarter, Repo = repurchase, SHIBOR = Shanghai Interbank Offered Rate.
Note: Growth rate computed based on national amounts.
Sources: *AsianBondsOnline* and *ChinaMoney*.

The PRC Pursues Measures to Promote Agricultural Sector

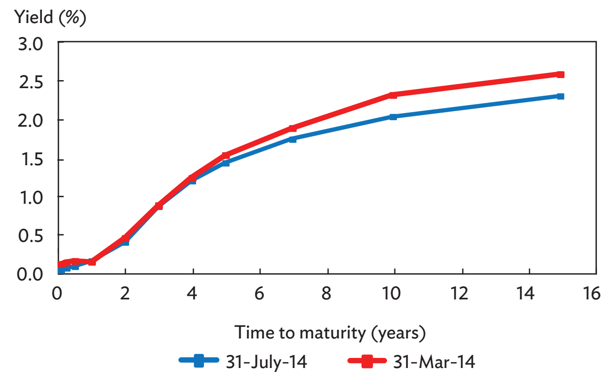
On 28 August, the PBOC announced an increase in its re-lending quota by CNY20 billion to help support the agricultural industry and rural financial institutions. The relending facility allows financial institutions to provide loans to various sectors from funds provided by the PBOC. In addition, the PBOC said that qualified rural financial institutions availing of the facility will be charged 100 bps less than the preferential rate for agricultural loans.

Hong Kong, China

Yield Movements

Between end-March and end-July, yields for Hong Kong, China's Exchange Fund Bills and Notes fell for most maturities. The drop in yields was most significant for the 5- through 15-year tenors, resulting in the downward shift from the belly through the end of the curve **(Figure 1)**. Yields fell the most for the 15-year Exchange Fund Note (EFN), decreasing 28 basis points (bps), while yields at the short-end of the curve declined between 7 bps and 8 bps. The yield spread between 2- and 10-year EFNs narrowed to 162 bps at end-July from 185 bps at end-March.

Figure 1: Hong Kong, China's Benchmark Yield Curve—EFBNs



EFBN = Exchange Fund Bills and Notes.
Source: Bloomberg LP.

The drop in yields at the longer-end of the curve followed the drop in United States (US) yields, as Hong Kong, China yields are highly correlated with US yields. This reflects Hong Kong, China's lack of independent monetary policy with its exchange rate pegged to the US$.

Hong Kong, China's economic expansion slowed to 1.8% year-on-year (y-o-y) in 2Q14, after rising 2.6% in 1Q14, on account of weaker growth in consumption due to lower tourism receipts and reduced domestic demand. Growth in private consumption eased to 1.2% y-o-y in 2Q14, after gaining 1.5% in the previous quarter. Investments also contracted 5.6% y-o-y, compared with 3.0% annual growth in 1Q14. As a result, the government has revised downward its economic growth forecast for 2014 to a range of 2.0%–3.0% from 3.0%–4.0%. Also, the government noted that risks to growth have increased, including uncertainly in developed economies and reduced domestic demand.

Consumer price inflation climbed to 4.0% y-o-y in July from 3.6% in June and 3.7% in May and April. However, the government expects consumer price inflation to remain subdued for the rest of the year.

Size and Composition

The size of Hong Kong, China's local currency (LCY) bond market declined 2.4% quarter-on-quarter (q-o-q) and 0.2% year-on-year (y-o-y) to reach HKD1,486 billion (US$192 billion) at end-June **(Table 1)**.

Table 1: Size and Composition of the LCY Bond Market in Hong Kong, China

	Outstanding Amount (billion)						Growth Rate (%)			
	2Q13		1Q14		2Q14		2Q13		2Q14	
	HKD	US$	HKD	US$	HKD	US$	q-o-q	y-o-y	q-o-q	y-o-y
Total	**1,488**	**192**	**1,522**	**196**	**1,486**	**192**	**4.4**	**10.7**	**(2.4)**	**(0.2)**
Government	834	107	846	109	841	109	7.0	15.7	(0.5)	0.9
Exchange Fund Bills	682	88	683	88	684	88	6.5	16.0	0.1	0.4
Exchange Fund Notes	68	9	68	9	68	9	(0.4)	(0.9)	(0.4)	(0.9)
HKSAR Bonds	84	11	94	12	89	11	18.4	30.5	(5.3)	6.6
Corporate	655	84	677	87	645	83	1.3	4.9	(4.8)	(1.6)

( ) = negative, HKSAR = Hong Kong Special Administrative Region, LCY = local currency, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Bloomberg LP end-of-period LCY–US$ rates are used.
3. Growth rates are calculated from LCY base and do not include currency effects.
Sources: Hong Kong Monetary Authority and Bloomberg LP.

At end-June, the stock of government bonds comprising Exchange Fund Bills, EFNs, and Hong Kong Special Administrative Region (HKSAR) bonds fell 0.5% q-o-q to reach HKD841 billion. This was largely driven by the decline in the size of outstanding HKSAR bonds as a result of less issuance by the Hong Kong Monetary Authority compared with 1Q14. However, on a y-o-y basis, government bonds slightly increased by 0.9%.

LCY corporate bonds outstanding fell 4.8% q-o-q and 1.6% y-o-y to reach HKD645 billion at end-June as companies preferred to raise funds via bank loans. In 2Q14, the three largest non-bank issuances came from Rexlot Holdings (HKD1.9 billion), China Ocean (HKD1.0 billion), and Wharf Finance (HKD0.57 billion) **(Table 2)**.

Corporate bonds outstanding from the top 30 non-bank issuers in Hong Kong, China amounted to HKD110.8 billion at end-June, representing about 17% of total outstanding corporate bonds at end-June. The top 30 list of issuers was dominated by real estate firms **(Table 3)**. HKMC remained the top issuer in Hong Kong, China with outstanding bonds of HKD13.1 billion. Next was CLP Power Hong Kong Financing with HKD10.4 billion of bonds outstanding, followed closely by Sun Hung Kai Properties with HKD10.3 billion. Among the list, there are 5 five state-owned companies and 11 Hong Kong Exchange-listed firms. Only one state-owned company, the MTR Corporation, is listed.

Table 2: Notable LCY Corporate Bond Issuance in 2Q14

Corporate Issuers	Coupon Rate (%)	Issued Amount (HKD billion)
Rexlot Holdings		
5-year bond	4.50	1.90
China Ocean		
3-year bond	7.50	1.00
Wharf Finance		
10-year bond	4.25	0.20
10-year bond	4.10	0.18
10-year bond	3.90	0.20

LCY = local currency.
Source: Central Moneymarkets Unit (CMU) HKMA.

Policy, Institutional, and Regulatory Developments

Hong Kong, China Announces Planned *Sukuk* Issuance

On 4 July, Hong Kong, China announced that it had selected HSBC, Standard Chartered Bank, CIMB, and National Bank of Abu Dhabi as underwriters for its debut *sukuk* (Islamic bond) issuance. The issuance is expected to be priced in September with a target size of between US$500 million and US$1.0 billion, and a tenor of 5 years. The structure to be used is expected to follow the *ijarah* (leasing) principle.

Table 3: Top 30 Nonbank Corporate Issuers in Hong Kong, China

	Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
		LCY Bonds (HKD billion)	LCY Bonds (US$ billion)			
1.	The Hong Kong Mortgage Corporate	13.12	1.69	Yes	No	Finance
2.	CLP Power Hong Kong Financing	10.35	1.33	No	No	Electric
3.	Sun Hung Kai Properties (Capital Market)	10.31	1.33	No	No	Real Estate
4.	Wharf Finance	7.29	0.94	No	No	Diversified
5.	The Link Finance (Cayman) 2009	6.14	0.79	No	No	Finance
6.	MTR Corporation (C.I.)	5.75	0.74	Yes	Yes	Transportation
7.	HKCG (Finance)	5.60	0.72	No	No	Gas
8.	Swire Pacific	5.53	0.71	No	Yes	Diversified
9.	Hongkong Electric Finance	5.51	0.71	No	No	Electric
10.	NWD (MTN)	5.05	0.65	No	Yes	Real Estate
11.	Cheung Kong Bond Finance	4.62	0.60	No	Yes	Real Estate
12.	Urban Renewal Authority	4.60	0.59	Yes	No	Real Estate
13.	Kowloon-Canton Railway	4.40	0.57	Yes	No	Transportation
14.	Wheelock Finance	4.04	0.52	No	No	Diversified
15.	Yue Xiu Enterprises (Holdings)	3.00	0.39	No	No	Diversified
16.	Airport Authority Hong Kong	2.80	0.36	Yes	No	Transportation
17.	Hysan (MTN)	2.43	0.31	No	No	Finance
18.	Cathay Pacific MTN Financing	1.70	0.22	No	Yes	Airlines
19.	Nan Fung Treasury	1.31	0.17	No	No	Real Estate
20.	Henderson Land MTN	1.19	0.15	No	Yes	Finance
21.	AIA Group	1.16	0.15	No	Yes	Insurance
22.	Dragon Drays	1.00	0.13	No	No	Diversified
23.	Swire Properties MTN Financing	0.80	0.10	No	No	Real Estate
24.	R-Reit International Finance	0.78	0.10	No	No	Real Estate
25.	Wing Tai Properties (Finance)	0.58	0.07	No	No	Real Estate
26.	HLP Finance	0.56	0.07	No	Yes	Real Estate
27.	CITIC Pacific	0.50	0.06	No	Yes	Diversified
28.	K. Wah International	0.45	0.06	No	Yes	Real Estate
29.	The Hongkong Land Notes Company	0.20	0.03	No	No	Finance
30.	Far East Horizon	0.09	0.01	No	Yes	Finance
Total Top 30 Nonbank LCY Corporate Issuers		**110.82**	**14.30**			
Total LCY Corporate Bonds		**644.73**	**83.19**			
Top 30 as % of Total LCY Corporate Bonds		**17.2%**	**17.2%**			

LCY = local currency.
Notes:
1. Data as of end-June 2014.
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on Hong Kong Monetary Authority data.

Indonesia

Yield Movements

Indonesian local currency (LCY) government bond yields rose for most tenors in the belly and longer-end of the curve between end-March and end-July, while falling at the shorter-end, resulting in the steepening of the yield curve **(Figure 1)**. Yields shed 8 basis points (bps) at the very short-end of the curve. Meanwhile, the 3-year maturity's yield increased 25 bps, the biggest increase among any tenor. The drop in yields at the short-end can be attributed to a sustained downward trend in inflation in recent months. In July, inflation eased to 4.5% year-on-year (y-o-y), marking the first time since June 2013 that inflation came within Bank Indonesia's 2013 and 2014 target range of 3.5%–5.5%.

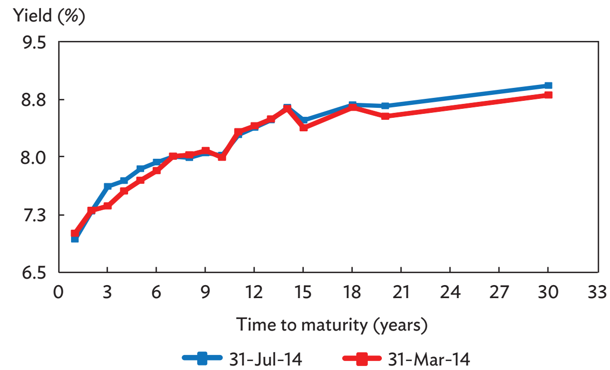
Bond yields, however, remained under pressure on concerns over a widening current account deficit. The current account deficit reached US$9.1 billion in 2Q14, equivalent to 4.3% of gross domestic product (GDP), up from US$4.2 billion in 1Q14, equivalent to 2.1% of GDP. Bank Indonesia however expects the current account deficit to be lower in the second half of the year as the spike in 2Q14 was due mainly to Eid celebrations when imports normally rise ahead of the expected surge in domestic demand.

Other domestic factors also weighed on the bond market, dragging down sentiments as the rupiah remained weak, higher borrowing requirements due to revisions in the state budget, and uncertainty surrounding the presidential election results.

Economic growth in Indonesia slowed to 5.1% y-o-y in 2Q14, from revised 5.2% growth in 1Q14. The slower growth was due mainly to weak exports as regulations prohibiting raw mineral ore exports acting as a drag on GDP. Imports and government spending also slowed on a y-o-y basis in 2Q14. Meanwhile, domestic consumption and investment remained strong, expanding 5.6% and 4.5%, respectively. On a quarter-on-quarter (q-o-q) basis, the economy grew 2.5% in 2Q14.

Given these developments, Bank Indonesia continued to maintain a tightening bias toward its monetary policy and kept its benchmark rate steady at 7.5% in its meeting held on 14 August. The benchmark rate has stayed at this level since November 2013. Bank Indonesia noted that at its current level, the policy rate remains consistent with efforts to steer inflation toward its 2014 target range of 3.5%–5.5% and to lower the current account deficit to a more sustainable level.

Figure 1: Indonesia's Benchmark Yield Curve—LCY Government Bonds



LCY = local currency.
Source: Bloomberg LP.

Size and Composition

The outstanding size of LCY bonds in Indonesia reached IDR1,465.8 trillion (US$123 billion) at end-June on growth of 4.8% q-o-q **(Table 1)**. On a y-o-y basis, the bond market grew at a pace of 24.2%.

The outstanding stock of LCY government bonds stood at IDR1,248.4 trillion, up 5.6% over the previous quarter and 28.0% over the previous year. Growth in the government sector was driven by increases in central government bonds, comprising treasury instruments issued by the Ministry of Finance, and central bank bills, known as *Sertifikat* Bank Indonesia (SBI), issued by Bank Indonesia.

Central Government Bonds. The stock of central government bonds rose 5.5% q-o-q and 27.4% y-o-y to reach IDR1,131.6 trillion at end-June. Growth was largely driven by increases in the stock of conventional fixed-rate bonds and project-based *sukuk* (Islamic bonds).

Table 1: Size and Composition of the LCY Bond Market in Indonesia

	Outstanding Amount (billion)						Growth Rate (%)			
	2Q13		1Q14		2Q14		2Q13		2Q14	
	IDR	US$	IDR	US$	IDR	US$	q-o-q	y-o-y	q-o-q	y-o-y
Total	**1,180,422**	**118**	**1,398,996**	**123**	**1,465,790**	**123**	**2.2**	**12.4**	**4.8**	**24.2**
Government	975,057	97	1,181,628	104	1,248,379	105	1.7	10.3	5.6	28.0
Central Govt. Bonds	888,514	89	1,072,741	94	1,131,630	95.3	3.1	12.3	5.5	27.4
of which: *Sukuk*	79,750	8	96,764	9	101,329	9	7.5	32.5	4.7	27.1
Central Bank Bills	86,543	9	108,887	10	116,749	10	(10.6)	(6.8)	7.2	34.9
of which: *Sukuk*	4,623	0.5	5,377	0.5	6,792	0.6	(4.8)	48.4	26.3	46.9
Corporate	205,365	21	217,369	19	217,412	18	4.5	23.6	0.02	5.9
of which: *Sukuk*	7,538	0.8	7,194	0.6	6,658	0.6	(10.1)	13.0	(7.5)	(11.7)

( ) = negative, LCY = local currency, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Bloomberg LP end-of-period LCY–US$ rates are used.
3. Growth rates are calculated from LCY base and do not include currency effects.
4. The total stock of nontradable bonds as of end-June stood at IDR270.0 trillion.
Sources: Bank Indonesia, Indonesia Debt Management Office, Indonesia Stock Exchange, Otoritas Jasa Keuangan, and Bloomberg LP.

In 2Q14, the government raised a total of IDR69.6 trillion worth of Treasury bills and bonds in line with its quarterly target. There were seven auctions of conventional bonds, where the government issued benchmark series, and six auctions of Islamic instruments. As in the past, auctions of conventional bonds were either fully awarded or upsized from the targeted amount, while Islamic bond auctions fell below target except for one auction during the review period.

Central government issuance in 2Q14 was 16.0% lower than in 1Q14, but was 46.7% higher than in the previous year. The government continued with its frontloading policy into the second quarter, in which it issued a huge amount of bonds early in the year to take advantage of lower rates. Interest rates are expected to rise later this year with the anticipated end of the United States Federal Reserve's asset purchase program in October.

Based on the revised 2014 state budget, the government raised nearly 60% of its net government securities issuance target for the year, including foreign-currency denominated bonds, through end-June.

Central Bank Bills. The stock of SBI rose to IDR116.7 trillion at end-June, gaining 7.2% q-o-q and 34.9% y-o-y. Bank Indonesia issues SBI as one of its monetary tools for liquidity management. In 2Q14, new issuance of SBI and *shari'a*-compliant SBI with 9-month tenors totaled IDR28.1 trillion.

Corporate Bonds. LCY corporate bonds outstanding in Indonesia reached IDR217.4 trillion at end-June, rising by 0.02% q-o-q and 5.9% y-o-y. *Sukuk* comprised about 3% of the total corporate bond stock at the end of 2Q14.

The top 30 LCY corporate bond issuers in Indonesia in 2Q14 had aggregate outstanding bonds worth IDR161.9 trillion, accounting for 74.5% of total corporate bonds **(Table 2)**. By industry type, banks and financial institutions accounted for two-thirds of the firms on the list. State power firm PLN maintained the top spot with outstanding LCY bonds valued at IDR15.6 trillion, followed by state-owned Indonesia Eximbank (IDR12.6 trillion). Completing the top three was Astra Sedaya Finance, which rose up one spot from 1Q14, with outstanding bonds amounting to IDR12.3 trillion at the end of 2Q14.

New issuance of corporate bonds totaled IDR16.8 trillion in 2Q14, more than a three-fold increase from IDR5.2 trillion in 1Q14. On a y-o-y basis, however, corporate bond issuance declined 14.4% at end-June. A total of 15 corporate entities raised funds from the bond market in 2Q14; all of the issues were conventional bonds, including one issue of subordinated debt. New corporate names issuing bonds in 2Q14 included Bank UOB Indonesia, Express Transindo Utama, Sarana Multi Infrastruktur, and Sumber Alfaria Trijaya.

Eleven bond series carried 3-year maturities, with coupon rates ranging from 9.25% to 11.40%. There were seven

Table 2: Top 30 Issuers of LCY Corporate Bonds in Indonesia

	Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
		LCY Bonds (IDR billion)	LCY Bonds (US$ billion)			
1.	PLN	15,573	1.31	Yes	No	Energy
2.	Indonesia Eximbank	12,608	1.06	Yes	No	Banking
3.	Astra Sedaya Finance	12,341	1.04	No	No	Finance
4.	Adira Dinamika Multi Finance	11,612	0.98	No	Yes	Finance
5.	Bank Tabungan Negara	7,950	0.67	Yes	Yes	Banking
6.	Bank CIMB Niaga	7,930	0.67	No	Yes	Banking
7.	Bank Internasional Indonesia	7,000	0.59	No	Yes	Banking
8.	Bank Pan Indonesia	6,800	0.57	No	Yes	Banking
9.	Bank Permata	6,478	0.55	No	Yes	Banking
10.	Indosat	6,190	0.52	No	Yes	Telecommunications
11.	Perum Pegadaian	5,739	0.48	Yes	No	Finance
12.	Jasa Marga	5,600	0.47	Yes	Yes	Toll Roads, Airports, and Harbors
13.	Federal International Finance	4,875	0.41	No	No	Finance
14.	Bank Tabungan Pensiunan Nasional	4,820	0.41	No	Yes	Banking
15.	Agung Podomoro Land	4,350	0.37	No	Yes	Property, Real Estate, and Building Construction
16.	Indofood Sukses Makmur	4,000	0.34	No	Yes	Food and Beverages
17.	Sarana Multigriya Finansial	3,511	0.30	Yes	No	Finance
18.	Bank Mandiri	3,500	0.29	Yes	Yes	Banking
19.	Medco-Energi International	3,500	0.29	No	Yes	Petroleum and Natural Gas
20.	Indomobil Finance Indonesia	3,059	0.26	No	No	Finance
21.	Antam	3,000	0.25	Yes	Yes	Petroleum and Natural Gas
22.	Telekomunikasi Indonesia	3,000	0.25	Yes	Yes	Telecommunications
23.	Bank OCBC NISP	2,907	0.24	No	Yes	Banking
24.	Toyota Astra Financial Services	2,795	0.24	No	No	Finance
25.	Bumi Serpong Damai	2,750	0.23	No	Yes	Property, Real Estate, and Building Construction
26.	Bank Jabar Banten	2,124	0.18	No	Yes	Banking
27.	BCA Finance	2,100	0.18	No	No	Finance
28.	Bank Rakyat Indonesia	2,000	0.17	Yes	Yes	Banking
29.	Garuda Indonesia	2,000	0.17	Yes	Yes	Infrastructure, Utilities, and Transportation
30.	BII Finance	1,824	0.15	No	No	Finance
Total Top 30 LCY Corporate Issuers		**161,935**	**13.64**			
Total LCY Corporate Bonds		**217,412**	**18.31**			
Top 30 as % of Total LCY Corporate Bonds		**74.5%**	**74.5%**			

LCY = local currency.
Notes:
1. Data as of end-June 2014.
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on Indonesia Stock Exchange data.

bond series with maturities of 370 days and coupon rates ranging from 8.25% to 11.00%, and seven bond series with 5-year tenors and coupon rates ranging from 9.75% to 12.40%. Two bond series had 7-year tenors, with coupons of 11.35% and 13.0% each. Some of the notable corporate bonds issued in 2Q14 are presented in **Table 3**.

Foreign Currency Bonds. As of end-June, foreign currency (FCY) government bonds outstanding reached US$34.2 billion. In January, the government raised a total of US$4 billion from the sale of US$-denominated bonds. Subsequently, in July, the Indonesian government sold its first EUR-denominated bonds amounting to EUR1 billion.

Table 3: Notable LCY Corporate Bond Issuance in 2Q14

Corporate Issuers	Coupon Rate (%)	Issued Amount (IDR billion)
Indonesia Eximbank		
370-day bond	8.25	803
2-year bond	8.50	134
3-year bond	9.25	1,594
5-year bond	9.75	1,469
Indofood Sukses Makmur		
5-year bond	10.13	2,000
Astra Sedaya Finance		
370-day bond	9.60	1,135
3-year bond	10.50	740
4-year bond	10.60	75
Adira Dinamika Multi Finance		
370-day bond	9.60	687
3-year bond	10.50	363
5-year bond	10.75	450
Bank UOB Indonesia		
7-year bond	11.35	1,000
Express Transindo Utama		
5-year bond	12.25	1,000
Sarana Multi Infrastruktur		
3-year bond	9.60	100
5-year bond	10.00	900
Sumber Alfaria Trijaya		
3-year bond	10.50	1,000

LCY = local currency.
Source: Indonesia Stock Exchange.

The bonds carried a maturity of 7 years and a coupon of 2.875%. The bond sale was oversubscribed with the orderbook reaching EUR6.7 billion.

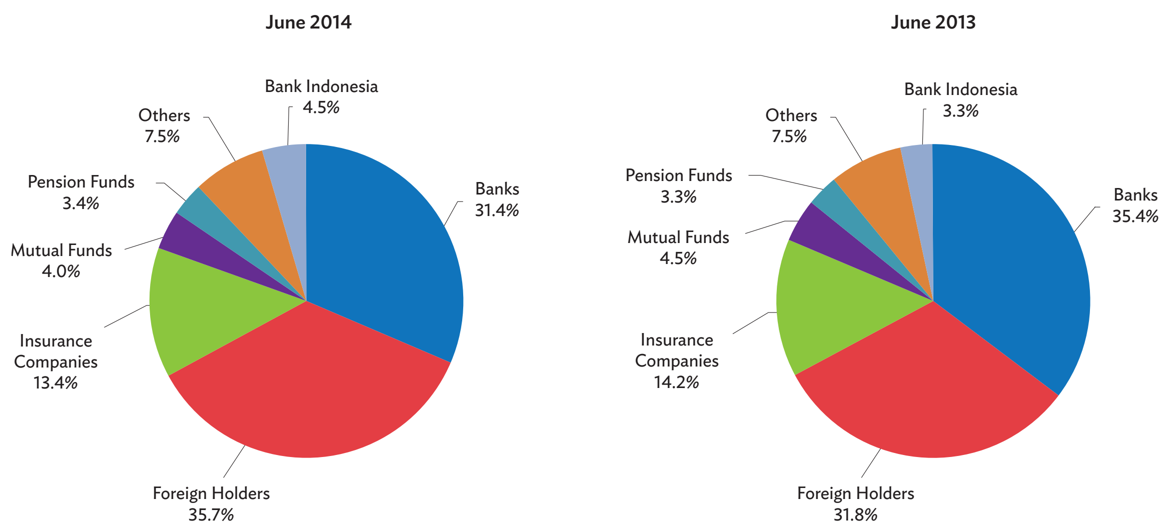
Investor Profiles

Central Government Bonds. Foreign investors now hold more than a third of Indonesia's LCY central government bonds, making them one of the biggest players in Indonesia's bond market. At end-June, the share of LCY central government bonds held by foreign investors climbed to 35.7% from 31.8% a year earlier **(Figure 2)**. In absolute terms, outstanding bonds held by foreign investors climbed to IDR403.6 trillion at end-June. Indonesian bonds continued to attract interest from foreign players due to attractive yields that are the highest (at the longer-end of the curve) among all emerging East Asian markets except Viet Nam.

At end-June, about 42% of government bonds held by foreign investors had maturities of more than 10 years, slightly lower compared with end-December's level **(Figure 3)**. However, the share of medium-term bonds (maturities of more than 5 years to 10 years) held by these investors increased slightly over the same period from about 32% to about 33%. The biggest change in terms of foreign ownership of bonds occurred for bonds with maturities of 2 years–5 years, with the share of foreign holdings climbing from about 13% at end-December to about 16% at end-June.

The second largest investor group comprised banking institutions, with a share of 31.4% of central government bonds at end-June, down from 35.4% a year earlier.

Figure 2: LCY Central Government Bonds Investor Profile



LCY = local currency.
Source: Indonesia Debt Management Office.

Banking institutions comprise state recap banks, private recap banks, non-recap banks, regional banks, and *shari'a* banks.

Meanwhile, central government bond holdings of other domestic investors were broadly unchanged in 2Q14, except for insurance companies, whose share of central government bond holdings dropped to 13.4% from 14.2% in 2Q13. Mutual funds' holdings of government bonds also declined to a share of 4.0% from 4.5% a year earlier. The only other significant increase in holdings was noted for Bank Indonesia, whose share of government bonds climbed to 4.5% at end-June from 3.3% a year earlier.

Central Bank Bills. At end-June, central bank bills, or SBI, were primarily held by banking institutions, which accounted for a share of 86.9% of the total **(Figure 4)**. Foreign non-bank investors accounted for the remaining 13.1% of SBI holdings. The share of SBI held by non-residents has markedly increased since June 2013 when Bank Indonesia lowered the minimum holding period for SBI from 6 months to 1 month.

Rating Changes

On 28 April, Standard & Poor's affirmed its BB+ sovereign credit rating for Indonesia. The outlook on the rating was stable. In making its decision, Standard & Poor's cited as key factors Indonesia's favorable fiscal and debt metrics, and moderately strong growth outlook.

Policy, Institutional, and Regulatory Developments

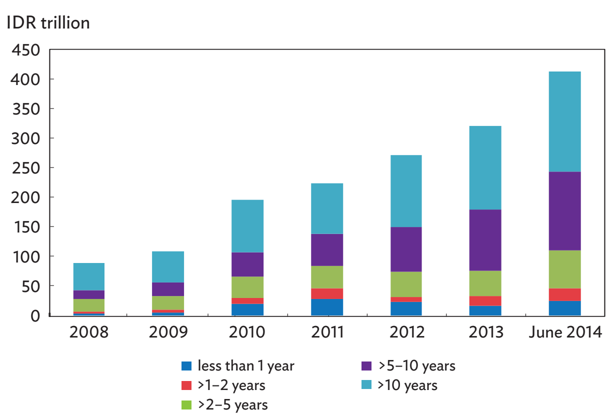
Parliament Approves Revised 2014 State Budget

In June, the House of Representatives approved the 2014 revised state budget, which projects a deficit equivalent to 2.4% of GDP, compared with 1.7% in the original budget. The revised 2014 state budget raised the net government securities financing requirement to 2.6% of GDP. In absolute terms, the net government securities financing requirement is up 29.2% from the original budget to IDR265.0 trillion. The underlying macroeconomic assumptions for the revised state budget include (i) GDP growth of 5.5%, (ii) annual inflation of 5.3%, (iii) an exchange rate of IDR11,600 to US$1, and (iv) a 3-month treasury bill rate of 6.0%.

Bank Indonesia Issues *Shari'a* FCY Term Deposits

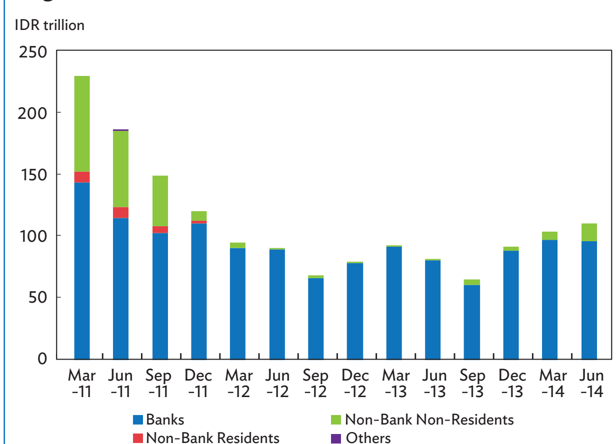
On 25 July, Bank Indonesia announced plans to issue *shari'a* FCY term deposits as part of efforts to develop *shari'a* banking and deepen the *shari'a* financial market. The term deposits are FCY-denominated Islamic monetary instruments that will complement FCY liquidity management in the *shari'a* financial market. They will be based on a *ju'alah* contract, which is backed by a commitment to provide a specific return after completion of a job, and carry a tenor of between 1 day and 12 months. The first auction was subsequently held on 20 August.

Figure 3: Foreign Holdings of LCY Central Government Bonds by Maturity



LCY = local currency.
Source: Indonesia Debt Management Office.

Figure 4: LCY Central Bank Bills Investor Profile



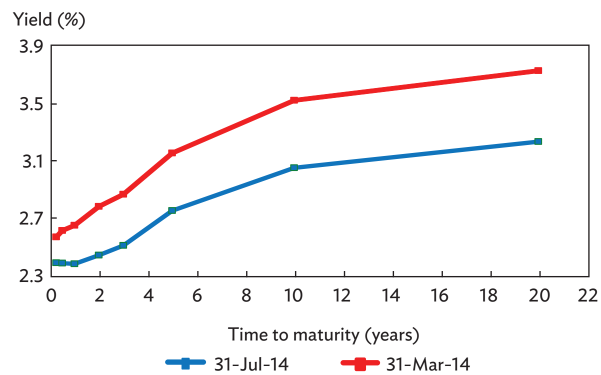
LCY = local currency.
Source: Bank Indonesia.

Republic of Korea

Yield Movements

The Republic of Korea's local currency (LCY) government bond yield curve shifted downward between end-March and end-July as yields fell for all tenors, with the sharpest drop at the longer-end of the curve, amid market expectations of a policy rate cut **(Figure 1)**. Meanwhile, the yield spread between 2- and 10-year tenors narrowed 13 basis points (bps) between end-March and end-July, resulting in a flattening of the yield curve.

Figure 1: The Republic of Korea's Benchmark Yield Curve—LCY Government Bonds



LCY = local currency.
Source: Bloomberg LP.

Real gross domestic product (GDP) growth in the Republic of Korea moderated to 0.5% quarter-on-quarter (q-o-q) in 2Q14 from 0.9% q-o-q in 1Q14, and to 3.5% year-on-year (y-o-y) from 3.9% y-o-y, based on preliminary estimates released by The Bank of Korea. On a q-o-q basis, the decline in real GDP growth stemmed from a contraction in household consumption and domestic investment on the demand side. On the production side, weaker output growth in manufacturing and construction was accompanied by contractions in agriculture, fishery, and forestry, and utilities.

Consumer price inflation leveled off at 1.4% y-o-y in August, led by relatively high price hikes in housing and utilities. In the first half of 2014, the monthly y-o-y inflation rate ranged from 1.0% in February to 1.7% in May and June. Following 14 consecutive months of leaving the base rate unchanged, The Bank of Korea's Monetary Policy Committee decided on 14 August to reduce the base rate by 25 bps from 2.50% to 2.25%.

Size and Composition

The outstanding size of the LCY bond market in the Republic of Korea expanded on both a quarterly and annual basis in 2Q14, bolstered by relatively strong growth in the stock of LCY government bonds **(Table 1)**. Central government bonds continued to dominate the LCY government bond market, accounting for 69% of outstanding government bonds. Growth in central government bonds in 2Q14 was led by Korea Treasury

Table 1: Size and Composition of the LCY Bond Market in the Republic of Korea

	Outstanding Amount (billion)						Growth Rate (%)			
	2Q13		1Q14		2Q14		2Q13		2Q14	
	KRW	US$	KRW	US$	KRW	US$	q-o-q	y-o-y	q-o-q	y-o-y
Total	**1,650,267**	**1,445**	**1,754,188**	**1,648**	**1,779,533**	**1,759**	**2.2**	**10.6**	**1.4**	**7.8**
Government	637,277	558	676,491	635	700,464	692	2.3	6.0	3.5	9.9
Central Bank Bonds	165,420	145	170,800	160	174,000	172	(1.4)	0.5	1.9	5.2
Central Government Bonds	439,059	384	466,463	438	485,792	480	2.9	7.5	4.1	10.6
Industrial Finance Debentures	32,798	29	39,227	37	40,671	40	16.6	16.2	3.7	24.0
Corporate	1,012,990	887	1,077,697	1,012	1,079,069	1,066	2.1	13.8	0.1	6.5

( ) = negative, LCY = local currency, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Bloomberg LP end-of-period LCY–US$ rates are used.
3. Growth rates are calculated from LCY base and do not include currency effects.
4. Central government bonds include Korea Treasury bonds, National Housing bonds, and Seoul Metro bonds.
Sources: EDAILY *BondWeb* and The Bank of Korea.

Bonds (KTBs), which climbed 4.6% q-o-q and 11.7% y-o-y. Meanwhile, central bank bonds, or Monetary Stabilization Bonds (MSBs), expanded on both a q-o-q and y-o-y basis in 2Q14, albeit at relatively modest paces, while industrial finance debentures also registered positive growth. Issuance of LCY government bonds rose 4.6% q-o-q in 2Q14, led by a 10.3% increase in central government bond issuance. On a y-o-y basis, LCY government bond issuance climbed 9.0% in 2Q14, induced by 25.1% growth in central government bond issuance and a 6.1% rise in MSB issuance.

LCY corporate bonds outstanding also rose in 2Q14, only marginally on a q-o-q basis and moderately on a y-o-y basis. On a q-o-q basis, the 0.1% growth resulted from an expansion in private corporate bonds that was almost negated by declines in special public bonds and financial debentures—excluding Korea Development Bank bonds. On a y-o-y basis, the 6.5% expansion was driven by 10.6% growth in the stock of private corporate bonds. Meanwhile, LCY corporate bond issuance was down 30.0% q-o-q and 31.3% y-o-y in 2Q14, amid lower issues of special public bonds, financial debentures, and private corporate bonds.

As of end-June, the top 30 LCY corporate issuers' share of total LCY corporate bonds outstanding stood at 61.9% **(Table 2)**, up 0.5 percentage points from 3 months earlier. Korea Land & Housing Corporation overtook Korea Housing Finance Corporation in 2Q14 as the largest issuer of LCY corporate bonds. Of the five largest LCY corporate bond issues in 2Q14, three were from banks, one from a housing finance entity, and one from a shipbuilding company **(Table 3)**.

Liquidity

Liquidity tightened in the LCY government bond market in 2Q14, with the turnover ratio falling to 0.80 from 0.85 in 1Q14. The quarterly drop stemmed from lower trading volumes for central government and central bank bonds. Between 1Q14 and 2Q14, the turnover ratio for central government bonds declined from 0.88 to 0.84, and for central bank bonds from 0.99 to 0.88 **(Figure 2)**.

Liquidity in the KTB futures market improved marginally in 2Q14, as the total number of traded 3- and 10-year KTB futures contracts inched up to 6.6 million from 6.4 million in 1Q14 **(Figure 3)**. Between 1Q14 and 2Q14, the share of 3-year KTB futures contracts traded declined from 73% to 61% of the total, while the share of 10-year KTB futures contracts rose from 27% to 39%.

Liquidity tightened in the LCY corporate bond market in 2Q14, with the turnover ratio for LCY corporate bonds slipping, marginally to 0.13 from 0.14 in 1Q14. The fall is attributed to q-o-q declines in the trading volumes of special public bonds, financial debentures, and private corporate bonds. Between 1Q14 and 2Q14, the turnover ratio for special public bonds fell from 0.13 to 0.10, financial debentures remained unchanged at 0.35, while private corporate bonds slipped from 0.06 to 0.05 **(Figure 4)**.

Investor Profile

Insurance companies and pension funds remained the largest investor group in the LCY government bond market in the Republic of Korea in 1Q14 **(Figure 5)**. They were followed by other financial institutions (financial institutions other than banks, insurance companies, and pension funds), the general government, banks, and foreign investors. Between end-March 2013 and end-March 2014, the share of total LCY government bond holdings of insurance companies and pension funds rose 3 percentage points, while other financial institutions' share inched up 1 percentage point. In contrast, the shares of the general government and foreign investors fell 4 percentage points and 1 percentage point, respectively.

Insurance companies and pension funds and other financial institutions each held 33% of total LCY corporate bonds outstanding at the end of 1Q14, with their shares up 3 percentage points and 2 percentage points, respectively, compared to a year earlier **(Figure 6)**. In contrast, the shares of banks, households and non-profit institutions, and non-financial corporations dropped 1 percentage point, 3 percentage points, and 1 percentage point, respectively.

Net foreign investment in the Republic of Korea's LCY bond market was positive for the fifth consecutive month in July, according to Financial Supervisory Service data **(Figure 7)**. Relatively large bond purchases by foreign investors, compared with bond redemptions, contributed to the net foreign bond inflow position for the month. In the first 7 months of the year, the cumulative amount of foreign investors' net bond investment was KRW3.1 trillion, down from KRW11.9 trillion in January–July 2013.

Table 2: Top 30 Issuers of LCY Corporate Bonds in the Republic of Korea

	Issuers	Outstanding Amount		State-Owned	Listed on		Type of Industry
		LCY Bonds (KRW billion)	LCY Bonds (US$ billion)		KOSPI	KOSDAQ	
1.	Korea Land & Housing	57,646	57.0	Yes	No	No	Real Estate
2.	Korea Housing Finance	54,823	54.2	Yes	No	No	Financial
3.	Korea Finance	47,151	46.6	Yes	No	No	Financial
4.	Korea Deposit Insurance	42,200	41.7	Yes	No	No	Insurance
5.	KDB Daewoo Securities	38,281	37.8	Yes	Yes	No	Securities
6.	Korea Investment and Securities	35,319	34.9	No	No	No	Securities
7.	Woori Investment and Securities	34,783	34.4	Yes	Yes	No	Securities
8.	Korea Electric Power	30,910	30.5	Yes	Yes	No	Utilities
9.	Industrial Bank of Korea	29,561	29.2	Yes	Yes	No	Bank
10.	Hana Daetoo Securities	25,858	25.6	No	No	No	Securities
11.	Mirae Asset Securities	25,385	25.1	No	Yes	No	Securities
12.	Korea Expressway	21,280	21.0	Yes	No	No	Infrastructure
13.	Kookmin Bank	17,211	17.0	No	No	No	Bank
14.	Korea Rail Network Authority	17,010	16.8	Yes	No	No	Infrastructure
15.	Small & Medium Business Corp.	15,405	15.2	Yes	No	No	Financial
16.	Korea Gas	14,995	14.8	Yes	Yes	No	Utilities
17.	Hyundai Securities	14,623	14.5	No	Yes	No	Securities
18.	Shinhan Bank	14,614	14.4	No	No	No	Bank
19.	Woori Bank	14,412	14.2	Yes	No	No	Bank
20.	Shinhan Investment	13,847	13.7	No	No	No	Securities
21.	Tong Yang Securities	11,472	11.3	No	Yes	No	Securities
22.	Korea Railroad	11,150	11.0	Yes	No	No	Infrastructure
23.	Standard Chartered First Bank Korea	11,130	11.0	No	No	No	Bank
24.	Hana Bank	10,762	10.6	No	No	No	Bank
25.	Samsung Securities	10,613	10.5	No	Yes	No	Securities
26.	Korea Water Resources	10,304	10.2	Yes	Yes	No	Utilities
27.	Korea Eximbank	9,900	9.8	Yes	No	No	Bank
28.	Korea Student Aid Foundation	9,630	9.5	Yes	No	No	Financial
29.	Shinhan Card	9,156	9.0	No	No	No	Financial
30.	Hyundai Capital Services	8,805	8.7	No	No	No	Financial
Total Top 30 LCY Corporate Issuers		**668,235.8**	**660.4**				
Total LCY Corporate Bonds		**1,079,069.0**	**1,066.4**				
Top 30 as % of Total LCY Corporate Bonds		**61.9%**	**61.9%**				

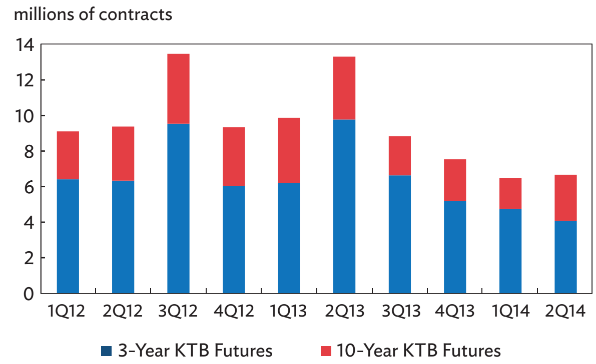
KOSDAQ = Korean Securities Dealers Automated Quotations, KOSPI = Korea Composite Stock Price Index, LCY = local currency.
Notes:
1. Data as of end-June 2014.
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Sources: *AsianBondsOnline* calculations based on Bloomberg and EDAILY *BondWeb* data.

Table 3: Notable LCY Corporate Bond Issuance in 2Q14

Corporate Issuers	Coupon Rate (%)	Issued Amount (KRW billion)
Industrial Bank of Korea		
1-year bond	2.63	580
Korea Finance Corporation		
2-year bond	2.85	600
Daewoo Shipbuilding & Marine Engineering		
3-year bond	3.37	440
Woori Bank		
1-year bond	2.65	410
1.5-year bond	2.80	380

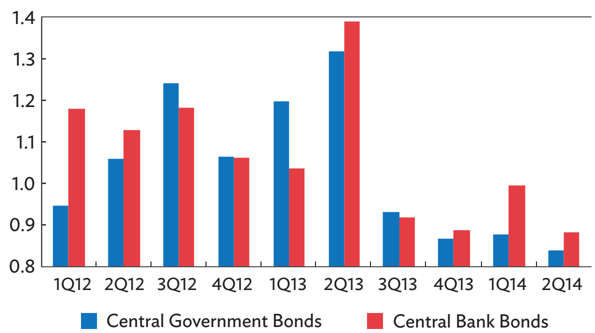
LCY = local currency.
Note: Coupon rates for 1-year bond of Industrial Bank of Korea and Woori Bank are indicative yields as of end-June 2014.
Source: Bloomberg LP.

Figure 3: Trading Volume of KTB Futures Contracts



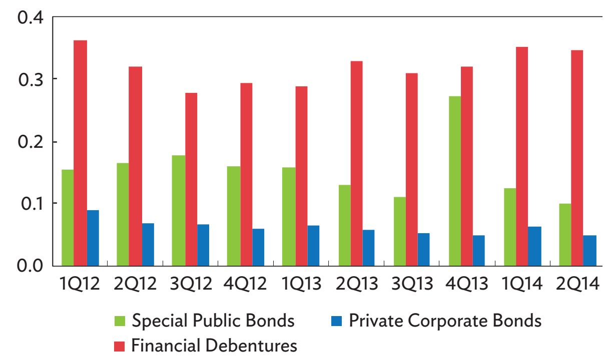
KTB = Korea Treasury Bond.
Source: Korea Exchange.

Figure 2: Turnover Ratios for Central Government and Central Bank Bonds



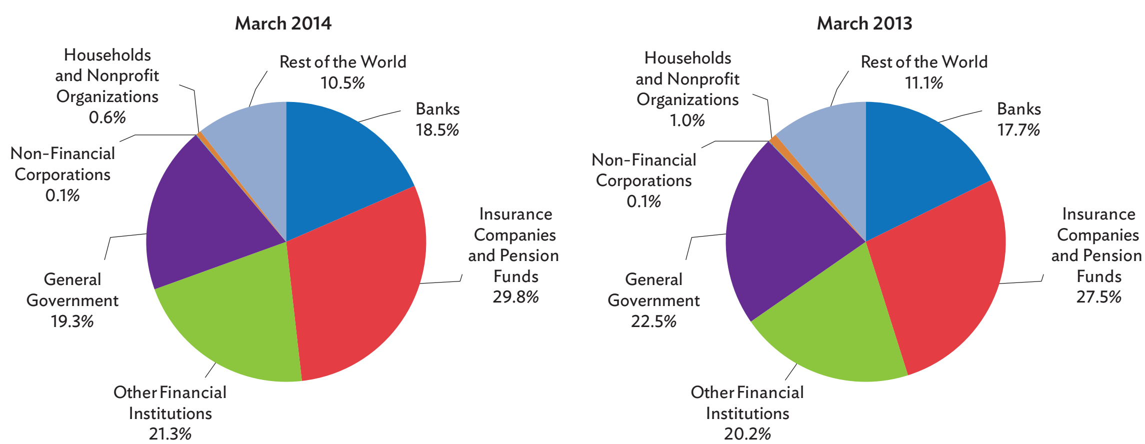
Note: Central government bonds include Korea Treasury Bonds and National Housing Bonds.
Sources: The Bank of Korea and EDAILY *BondWeb*.

Figure 4: Turnover Ratios for Special Public Bonds, Financial Debentures, and Private Corporate Bonds



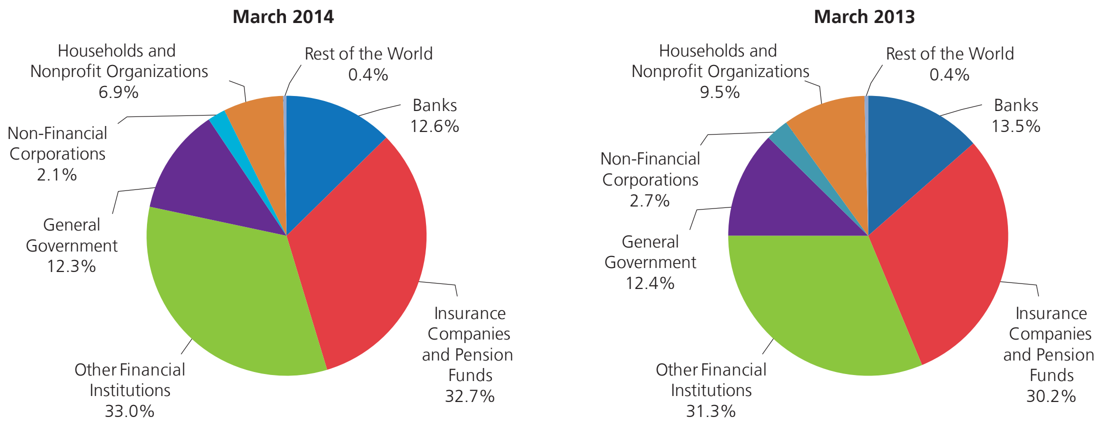
Source: EDAILY *BondWeb*.

Figure 5: LCY Government Bonds Investor Profile



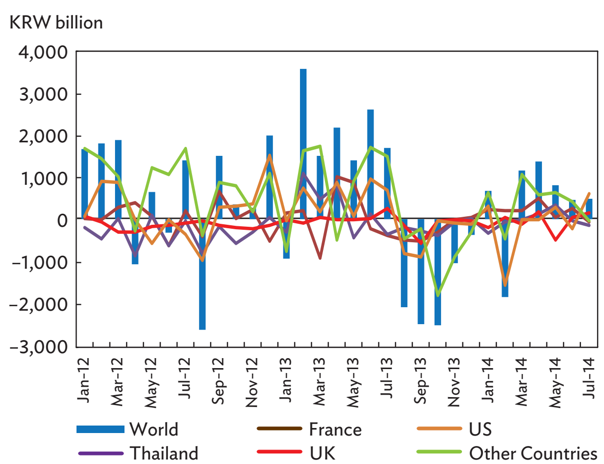
LCY = local currency.
Sources: *AsianBondsOnline* and The Bank of Korea.

Figure 6: LCY Corporate Bonds Investor Profile



LCY = local currency.
Sources: *AsianBondsOnline* and The Bank of Korea.

Figure 7: Net Foreign Investment by Country in LCY Bonds in the Republic of Korea



LCY = local currency, UK = United Kingdom, US = United States.
Source: Financial Supervisory Service.

Policy, Institutional, and Regulatory Developments

Financial Regulatory Reforms Announced

The Republic of Korea's Financial Services Commission announced in July plans for financial regulatory reform, including (i) building a financial regulatory system with "better regulation," (ii) mitigating inconveniences facing financial consumers and enhancing support for the real economy, (iii) creating growth opportunities and new markets for the financial sector, (iv) abolishing implicit regulations, (v) establishing a permanent system for financial regulatory reform, and (vi) tightening internal controls and market discipline for financial institutions.

Road Map for Derivatives Market Unveiled

The Financial Services Commission introduced in June a road map for the development of the country's derivatives market. The road map seeks to develop the exchange-traded derivatives market into a "risk-managed market" by promoting greater autonomy in market operations and introducing new derivatives products. The road map also calls for the over-the-counter derivatives market to utilize a central counterparty for a wider range of derivatives contracts and to introduce a trade repository system. In the derivatives-linked securities market, the road map calls for the listing of exchange-traded notes, enhancing public disclosure and sales of equity-linked securities and derivatives-linked securities, and standardizing issuance of equity-linked warrants.

Public Institutions' Debt Reduction Plans Approved

The Republic of Korea's Ministry of Strategy and Finance announced in June the acceptance of the revised debt reduction plans—totaling KRW6.2 trillion—submitted by 10 highly-indebted public institutions to frontload debt reduction in 2014.

Malaysia

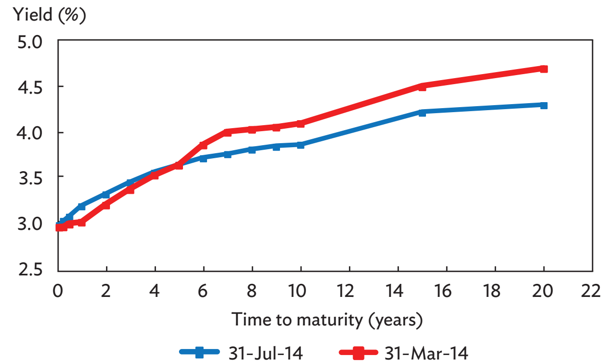
Yield Movements

Between end-March and end-July, Malaysia's local currency (LCY) government bond yields rose for short-term instruments with maturities of 5 years and less, while yields declined for longer-dated tenors (maturities of more than 6 years), resulting in a slight flattening of the curve **(Figure 1)**. Yields rallied the most for the 1-year tenor, which rose 17 basis points (bps), followed by the 2-year maturity, which gained 11 bps. Yields slumped at the longer-end of the curve, falling between 14 bps and 39 bps. The yield spread between 2- and 10-year tenors tightened to 53 bps at end-July from 87 bps at end-March.

Rising inflationary pressures, which were triggered in January by sugar and fuel subsidy rationalization, may have prompted bonds yields at the shorter-end to move higher. Consumer price inflation reached 3.5% year-on-year (y-o-y) in February—the fastest pace in 2.5 years—before easing to 3.3% in June. To guard against inflation and potential economic and financial imbalances, the Monetary Policy Committee of Bank Negara Malaysia (BNM) decided on 10 July to raise its overnight policy rate by 25 bps to 3.25%. This was the first rate hike since May 2011. BNM expects inflation to remain elevated and exceed its long-run average on higher domestic cost factors. The rate hike seeks to mitigate the risk of broader economic and financial imbalances that could undermine the growth prospects of the Malaysian economy.

These developments come as the economy re-gained positive momentum in 2014 and appeared poised to gather additional pace. Robust exports and private consumption drove economic growth higher in 2014. Real gross domestic product (GDP) growth accelerated to 6.4% y-o-y in 2Q14, the fastest pace in 6 quarters, from 6.2% in 1Q14. Exports advanced 8.8%—a significant reversal from the negative growth of 4.4% in 2Q13 and higher than the 7.8% growth recorded in 1Q14—contributing the bulk of GDP growth during the quarter. The expansion in exports was underpinned by both recovery in the advanced economies and regional demand. Private consumption grew 6.5% in 2Q14, down from a 7.1% gain in 1Q14. Buoyant private spending could be linked in part to a low unemployment rate of 3.1% and average real wages that rose an estimated 1.0% in 2Q14.

Figure 1: Malaysia's Benchmark Yield Curve—LCY Government Bonds



LCY = local currency.
Source: Bloomberg LP.

On the supply side, growth was fueled by increases in the manufacturing sector, which expanded 7.3% y-o-y in 2Q14, compared with 6.8% in 1Q14, led by electrical and electronics products, and transport equipment. Services climbed 6.0% in 2Q14, following a 6.6% rise in the previous quarter. On a seasonally adjusted and quarter-on-quarter (q-o-q) basis, the economy expanded 1.8%.

Size and Composition

Total LCY bonds outstanding in Malaysia rose 6.0% y-o-y to MYR1,053 billion (US$328.0 billion) at end-June, slightly lower than the pace of 6.4% in 2Q13, but higher than the 5.5% rise in 1Q14 **(Table 1)**. The corporate bond sector expanded faster than the government bond market on both a q-o-q and y-o-y basis. *Sukuk* (Islamic bonds) dominated the market, after surpassing conventional securities in terms of share of the total market in 1Q14, with 51.5% of bonds outstanding.

Government Bonds. LCY government bonds outstanding stood at MYR611.8 billion at end-June, up 4.1% y-o-y but down 0.3% q-o-q. Central government bonds, which accounted for 82.3% of total government bonds, led the increase with 10.7% y-o-y growth to MYR507.9 billion. In absolute terms, the increase in the outstanding amount of central government bonds was driven by Malaysian Government Securities (MGSs), up MYR156.0 billion, or 7.0% y-o-y, to MYR315.5 billion. Government Investment

Table 1: Size and Composition of the LCY Bond Market in Malaysia

	Outstanding Amount (billion)						Growth Rate (%)			
	2Q13		1Q14		2Q14		2Q13		2Q14	
	MYR	US$	MYR	US$	MYR	US$	q-o-q	y-o-y	q-o-q	y-o-y
Total	**994**	**314**	**1,051**	**322**	**1,053**	**328**	**(0.2)**	**6.4**	**0.2**	**6.0**
Government	588	186	614	188	612	191	(0.2)	5.1	(0.3)	4.1
Central Government Bonds	459	145	502	154	508	158	2.8	10.0	1.2	10.7
of which: *sukuk*	162	51	180	55	190	59	8.0	24.2	5.6	17.6
Central Bank Bills	123	39	99	30	88	28	(10.1)	(13.7)	(10.5)	(27.9)
of which: *sukuk*	51	16	41	12	35	11	(12.5)	(1.3)	(12.7)	(30.1)
Sukuk Perumahan Kerajaan	6	2.0	13	4	16	5	0.0	–	20.2	150.0
Corporate	406	128	438	134	442	138	(0.3)	8.2	0.9	8.7
of which: *sukuk*	272	86	298	91	302	94	(0.3)	13.0	1.4	11.1

( ) = negative, – = not applicable, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Bloomberg LP end-of-period LCY–US$ rate is used.
3. Growth rates are calculated from LCY base and do not include currency effects.
Sources: Bank Negara Malaysia Fully Automated System for Issuing/Tendering (FAST) and Bloomberg LP.

Issues (GIIs) also made rapid gains, albeit from a low base, rising MYR28.5 billion, or 17.9% y-o-y, to MYR188.0 billion. Total central bank bills outstanding, on the other hand, plunged 27.9% y-o-y and 10.5% q-o-q, due to a decline in monetary note issuance by BNM.

The government issued more bonds in 2Q14 than in the previous quarter, with issuance rising 6.5% q-o-q to MYR92.4 billion, led by central government bills and central bank bills. On a y-o-y basis, however, the issuance of government bonds saw negative growth of 8.6% due to a drop in central bank bill issuance.

Corporate Bonds. LCY corporate bonds rose 8.7% y-o-y, bringing total outstanding bonds to MYR441.5 billion at end-June. The split between corporate *sukuk* and conventional bonds stood at 68.3% to 31.7%.

Islamic medium-term notes (IMTNs) were the most common instrument at 52.4% of total corporate bonds and 76.7% of total *sukuk* outstanding at end-June. IMTNs are sold in smaller amounts compared with corporate bonds and provide semi-annual dividends depending on the structure used.

Corporate issuance contracted 13.4% q-o-q to MYR26.6 billion in 2Q14. A total of 88 new issues were completed during the quarter. *Sukuk* remained the preferred structure of corporate debt financing and accounted for over 60%, or MYR16.3 billion, of new corporate issuance in 2Q14. **Table 2** lists some notable corporate bonds issued in 2Q14.

Table 2: Notable LCY Corporate Bond Issuance in 2Q14

Corporate Issuers	Coupon Rate (%)	Issued Amount (MYR million)
Danainfra Nasional		
7-year Islamic MTN	4.40	500
10-year Islamic MTN	4.55	500
15-year Islamic MTN	5.03	200
20-year Islamic MTN	5.25	300
25-year Islamic MTN	5.38	700
30-year Islamic MTN	5.51	400
Aman *Sukuk*		
3-year Islamic MTN	4.00	260
5-year Islamic MTN	4.30	305
7-year Islamic MTN	4.53	310
10-year Islamic MTN	4.78	355
12-year Islamic MTN	4.93	245
15- year Islamic MTN	5.13	105
Midciti *Sukuk*		
3-year Islamic MTN	3.90	300
5-year Islamic MTN	4.20	400
7-year Islamic MTN	4.55	400
10-year Islamic MTN	4.80	455

LCY = local currency, MTN = medium-term note.
Source: Bank Negara Malaysia Bond Info Hub.

The largest corporate issuer in 2Q14 was DanaInfra Nasional, a company wholly owned by the Ministry of Finance to raise funds for infrastructure projects assigned by the government. DanaInfra raised MYR2.6 billion from six tranches of government-guaranteed IMTNs with maturities ranging from 7 years to 30 years. Profit rates ranged from 4.40% to 5.51%, which were 40 bps–56 bps more than sovereign non-Islamic notes with similar maturities, and about 35bps–45bps higher than existing *sukuk* with similar tenors issued in October 2013. Proceeds of the sale will be spent on expanding Mass Rapid Transit rail network coverage in the Klang Valley and Kuala Lumpur.

Other notable issuers in 2Q14 included government-owned special purpose vehicles. Aman Sukuk issued six tranches of IMTNs amounting to MYR1.58 billion and with profit rates ranging from 4.00% to 5.13% for tenures of between 3 years and 15 years. The IMTNs were assigned an AAAIS rating by MARC and given a stable outlook. Aman Sukuk is the funding vehicle for Pembinaan BLT, a unit wholly owned by the Government of Malaysia and established to build facilities for the Royal Malaysia Police. Meanwhile, Midciti Sukuk issued a total of MYR1.55 billion of IMTNs with profit rates ranging from 3.9% to 4.8%. The IMTNs were rated AAA by RAM Ratings and given a stable outlook. Midciti Sukuk is a wholly owned funding vehicle of KLCC Real Estate Investment Trust, which owns PETRONAS Twin Towers, Menara 3 Petronas, and Menara ExxonMobil.

Table 3 provides a breakdown of the top 30 LCY corporate bond issuers in Malaysia, whose total LCY bonds outstanding stood at MYR240.5 billion at end-June, representing 54.5% of the LCY corporate bond market. Financial firms comprised 10 of the 30 largest corporate bond issuers, with bonds outstanding worth MYR83.8 billion.

Highway operator Project Lebuhraya Usahasama remained the largest issuer with outstanding bonds valued at MYR30.6 billion.

Investor Profile

Financial institutions—including banking institutions, development financial institutions, and non-bank financial institutions—saw the largest increase in their holdings of government bonds, which rose MYR43.7 billion, or 39.2% y-o-y, in 1Q14. Financial institutions accounted for a 32.7% share of total outstanding government bonds at end-March **(Figure 2)**. Social security institutions saw the largest decrease in their holdings by 3 percentage points, followed by foreign investors and insurance companies, which reduced their holdings by 2.4 percentage points and 0.9 points, respectively.

Domestic banks (commercial and Islamic) decreased their holdings of LCY corporate bonds but still remained the largest investor group at end-June with a share of 46.8% of corporate bonds outstanding **(Figure 3)**. Life insurance companies are the only investor group that have consistently increased their investments in LCY corporate bonds since 2006, increasing holdings by MYR11.1 billion on an annual basis in 2Q14 to reach MYR130.3 billion, or 31.5% of the LCY corporate bond market.

Rating Changes

On 23 July, Fitch Ratings affirmed a negative credit outlook for Malaysia, while also affirming the long-term foreign currency and LCY issuer default ratings at A– and A, respectively. Fitch Ratings maintains that the country's key sovereign weakness stems from its public finances, the same reason it provided for its downgrade last year. The credit rating agency is also concerned that (i) the path to achieving the government's budget deficit targets remains unclear as the impact of the new goods and services tax has yet to be determined, (ii) the current account might shift into a deficit amid heavy public sector deficits, and (iii) rising household debt could magnify the impact of any future macroeconomic volatility on the credit profile.

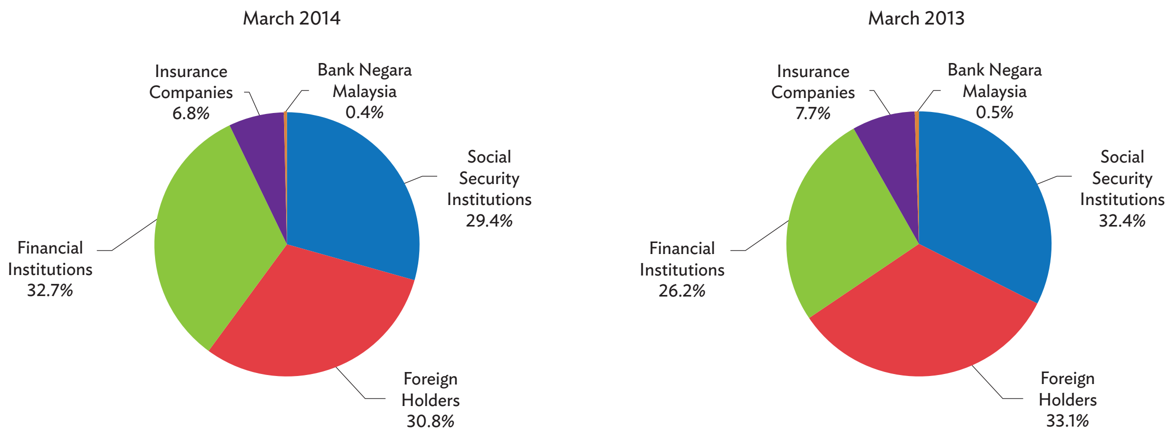
On 24 July, Standard & Poor's likewise affirmed Malaysia's A– and A long-term foreign currency and LCY ratings, respectively, with a stable outlook for both. Standard & Poor's asserts that Malaysia's strong external asset position, which is expected to see stronger trade surpluses in the next 2–3 years, and its high degree of monetary flexibility, demonstrated by a track record of controlling inflation, balances its moderate fiscal deficits and government debt burden.

Table 3: Top 30 Issuers of LCY Corporate Bonds in Malaysia

	Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
		LCY Bonds (MYR billion)	LCY Bonds (US$ billion)			
1.	Project Lebuhraya Usahasama	30.60	9.53	No	Yes	Transport, Storage, and Communications
2.	Cagamas	24.00	7.47	Yes	No	Finance
3.	Khazanah	20.00	6.23	Yes	No	Quasi-Government
4.	Prasarana	13.91	4.33	Yes	No	Transport, Storage, and Communications
5.	Pengurusan Air	11.73	3.65	Yes	No	Energy, Gas, and Water
6.	Maybank	11.30	3.52	No	Yes	Finance
7.	Danainfra Nasional	9.10	2.83	Yes	No	Finance
8.	Perbadanan Tabung Pendidikan Tinggi Nasional	8.50	2.65	Yes	No	Quasi-Government
9.	CIMB Bank	8.05	2.51	No	No	Finance
10.	Public Bank	8.02	2.50	No	Yes	Finance
11.	BGSM Management	7.20	2.24	No	No	Transport, Storage, and Communications
12.	Aman *Sukuk*	6.44	2.01	Yes	No	Construction
13.	Cagamas MBS	5.76	1.79	Yes	No	Finance
14.	Sarawak Energy	5.50	1.71	Yes	No	Energy, Gas, and Water
15.	Malakoff Power	5.38	1.68	No	No	Energy, Gas, and Water
16.	Turus Pesawat	5.31	1.65	Yes	No	Quasi-Government
17.	Celcom Transmission	5.00	1.56	No	No	Transport, Storage, and Communications
18.	1Malaysia Development	5.00	1.56	Yes	No	Quasi-Government
19.	Hong Leong Bank	4.95	1.54	No	Yes	Finance
20.	Manjung Island Energy	4.85	1.51	No	No	Energy, Gas, and Water
21.	RHB Bank	4.60	1.43	No	No	Finance
22.	AM Bank	4.54	1.41	No	No	Finance
23.	Putrajaya Holdings	4.43	1.38	No	No	Property and Real Estate
24.	KL International Airport	4.36	1.36	Yes	No	Transport, Storage, and Communications
25.	Tanjung Bin Power	4.05	1.26	No	Yes	Energy, Gas, and Water
26.	YTL Power International	3.77	1.17	No	Yes	Energy, Gas, and Water
27.	Jimah Energy Ventures	3.71	1.16	No	No	Energy, Gas, and Water
28.	TNB Western Energy	3.66	1.14	No	No	Construction
29.	Cekap Mentari	3.50	1.09	Yes	No	Finance
30.	Rantau Abang	3.30	1.03	Yes	No	Quasi-Government
Total Top 30 LCY Corporate Issuers		**240.51**	**74.90**			
Total LCY Corporate Bonds		**441.54**	**137.51**			
Top 30 as % of Total LCY Corporate Bonds		**54.5%**	**54.5%**			

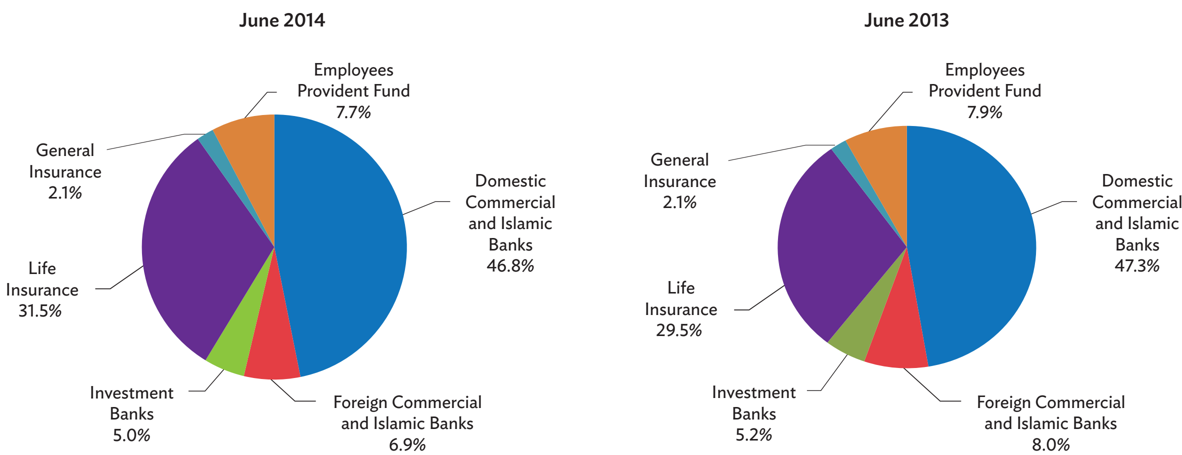
LCY = local currency.
Notes:
1. Data as of end-June 2014.
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on Bank Negara Malaysia Fully Automated System for Issuing/Tendering (FAST) data.

Figure 2: LCY Government Bonds Investor Profile



LCY = local currency.
Source: Bank Negara Malaysia.

Figure 3: LCY Corporate Bonds Investor Profile



LCY = local currency.
Note: Employees Provident Fund as of end-2012.
Source: Bank Negara Malaysia.

Policy, Institutional, and Regulatory Developments

Prime Minister Announces Liberalization Measures

In June, Prime Minister Najib Razak announced several measures aimed at liberalizing Malaysia's financial sector. Effective immediately, the barriers for new foreign unit trust management companies entering Malaysia were lifted. Effective 1 January 2015, credit rating agencies will be given more flexibility in the trading of unrated bonds and *sukuk*. Effective 1 January 2017, mandatory credit ratings for new corporate issues will be removed and full foreign ownership of international credit rating agencies will be allowed. The liberalization program seeks to strengthen the country's capital market in support of sustainable, long-term growth.

Philippines

Yield Movements

Between end-March and end-July, yield movements were volatile for Philippine local currency (LCY) bonds **(Figure 1)**. The yield for the 3-month tenor fell 13 basis points (bps), while yields for the 6-month and 1-year tenors rose 33 bps and 55 bps, respectively. Yields for medium-term tenors of 3- and 4-years fell 18 bps and 22 bps, respectively, while yields for 5- and 7-year tenors increased 13 bps and 11 bps, respectively. Yields on the longer-end of the curve fell between 5 bps and 29 bps.

Between end-March and end-April, yields rose for most tenors due to speculation over possible monetary tightening by the Bangko Sentral ng Pilipinas (BSP) generated by inflation concerns. Yields for tenors between 6 months and 7 years increased 3 bps–90 bps. In contrast, the yield for the 3-month tenor fell 20 bps as the market favored the shorter-end of the curve.

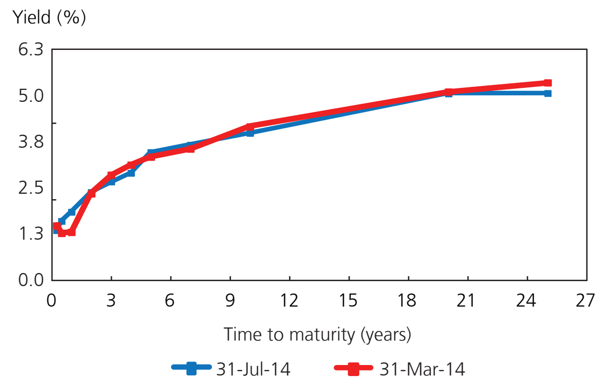
Yields fell 23 bps–54 bps across the length of the curve between end-April and end-May due to Standard & Poor's (S&P) upgrade of the Philippines to BBB from BBB–. Lower-than-expected gross domestic product (GDP) growth in 1Q14 suggests that the BSP may keep policy rates unchanged.

Yields rose again between end-May and end-July as inflation accelerated to 4.5% year-on-year (y-o-y) in May from 4.1% in April. On 19 June, the BSP raised the special deposit account rate by 25 bps to dampen inflation risks arising from increased liquidity in the market. As a result, the yield for the 3-month tenor rose 31 bps, yields for tenors of 5 years and above rose 13bps–32bps.

On 31 July, the BSP raised its key policy rates by 25 bps—bringing the overnight reverse repurchase rate to 3.75% and the overnight repurchase rate to 5.75%—in response to rising inflation expectations.

Inflation fell slightly in June to 4.4% before accelerating again to 4.9% in July. Average inflation for the first 7 months of the year was 4.3%, which is at the upper end of the BSP's 2014 target range of 3%–5%. Current inflationary pressures are coming from elevated food prices, volatile oil prices, and pending rate adjustments in energy and transport prices.

Figure 1: Philippines' Benchmark Yield Curve—LCY Government Bonds



LCY = local currency.
Source: Bloomberg LP.

The Philippines' real GDP growth accelerated to 6.4% y-o-y in 2Q14, following 5.6% growth in 1Q14. However, this was down from the 7.9% growth posted in the same period last year. Growth in 2Q14 was mainly driven by the industrial and services sectors, which expanded 7.8% and 6.0% y-o-y, respectively.

Size and Composition

The Philippine LCY bond market grew 8.8% y-o-y at end-June, led by Treasury and corporate bonds **(Table 1)**. Total LCY bonds reached PHP4,492 billion (US$103 billion), up 1.4% from end-March's level of PHP4,429 billion. Government securities accounted for the majority of bonds outstanding, totaling PHP3,819 billion, while corporate bonds summed to PHP673 billion.

Government Bonds. Outstanding fixed-income instruments issued by the Philippine government and government-controlled companies rose 1.9% quarter-on-quarter (q-o-q) and 6.5% y-o-y to close at PHP3,819 billion at end-June. Treasury bills decreased 1.6% q-o-q and 6.4% y-o-y to stand at PHP288 billion at end-June. The Bureau of the Treasury (BTr) rejected some of its Treasury bill auctions as investors

Table 1: Size and Composition of the LCY Bond Market in the Philippines

	Outstanding Amount (billion)						Growth Rate (%)			
	2Q13		1Q14		2Q14		2Q13		2Q14	
	PHP	US$	PHP	US$	PHP	US$	q-o-q	y-o-y	q-o-q	y-o-y
Total	**4,128**	**96**	**4,429**	**99**	**4,492**	**103**	**3.0**	**13.2**	**1.4**	**8.8**
Government	3,587	83	3,749	84	3,819	87	3.2	13.8	1.9	6.5
Treasury Bills	308	7	293	7	288	7	6.4	20.9	(1.6)	(6.4)
Treasury Bonds	3,165	73	3,340	75	3,415	78	3.0	14.2	2.2	7.9
Others	113	3	116	3	116	3	0.0	(8.5)	0.0	2.1
Corporate	541	13	680	15	673	15	1.7	9.3	(1.1)	24.4

( ) = negative, LCY = local currency, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Bloomberg end-of-period LCY–US$ rates are used.
3. Growth rates are calculated from an LCY base and do not include currency effects.
4. "Others" comprise bonds issued by government agencies, entities, and corporations for which repayment is guaranteed by the Government of the Philippines. This includes bonds issued by Power Sector Assets and Liabilities Management (PSALM) and the National Food Authority, among others.
5. Peso Global Bonds (PHP-denominated bonds payable in US dollars) and multi-currency Retail Treasury Bonds (RTBs) are not included. As of end-June 2014, the Government of the Philippines and Petron Corporation had PHP129.7 billion and PHP20.0 billion of outstanding Peso Global Bonds, respectively. There was a total of PHP9.0 billion of outstanding multi-currency Treasury Bonds as of end-June 2014.
Sources: Bloomberg LP and Bureau of the Treasury.

sought higher yields given rising inflationary concerns. Treasury bonds increased 2.2% q-o-q and 7.9% y-o-y to PHP3,415 billion. Fixed-income instruments issued by government-controlled companies remained unchanged at PHP116 billion.

In terms of issuance, 2Q14 saw higher volume at PHP177 billion compared to PHP150 billion in 1Q14, due to more successful government bond auctions by BTr. The government has programmed LCY borrowing of PHP135 billion through its regular auction schedule in 3Q14: PHP60 billion of Treasury bills with 91-, 182-, and 364-day tenors; and PHP75 billion of Treasury bonds with 7-, 10-, and 20-year tenors.

Corporate Bonds. Total outstanding LCY corporate bonds increased 24.4% y-o-y to reach PHP673 billion at end-June, but declined 1.1% on a quarterly basis.

Table 2: Notable LCY Corporate Bond Issuance in 2Q14

Corporate Issuers	Coupon Rate (%)	Issued Amount (PHP billion)
San Miguel Brewery		
7-year bond	5.50	12.46
10-year bond	6.00	2.54
SM Investments		
7-year bond	5.30	11.67
10-year bond	5.61	3.33
Ayala Land		
11-year bond	5.63	8.00
RCBC		
10-year Tier 2 note	5.38	7.00
Cebu Holdings		
7-year bond	5.32	5.00
Vista Land		
5.5-year bond	5.65	4.32
7-year bond	5.94	0.67
Philippine Savings Bank		
10-year Tier 2 note	5.50	3.00

LCY = local currency.
Source: Bloomberg LP.

Total corporate bond issuance in 2Q14 stood at PHP58 billion. Seven companies issued bonds and Tier 2 notes. San Miguel Brewery and SM Investments were the largest issuers in 2Q14, raising PHP15 billion worth of bonds each, Ayala Land was third with PHP8 billion, and RCBC was fourth with PHP7 billion **(Table 2)**.

Only 54 companies are actively tapping the bond market in the Philippines. The top 30 issuers accounted for 88.5% of total LCY corporate bonds outstanding at end-June **(Table 3)**. Out of this group, only seven companies were privately-held corporations and the rest were publicly listed with the Philippine Stock Exchange. Ayala Land was the largest corporate issuer in the country as of end-June with PHP57.9 billion of outstanding debt, SM Investments was the next largest borrower (PHP41.9 billion) and Ayala Corporation was third (PHP40.0 billion).

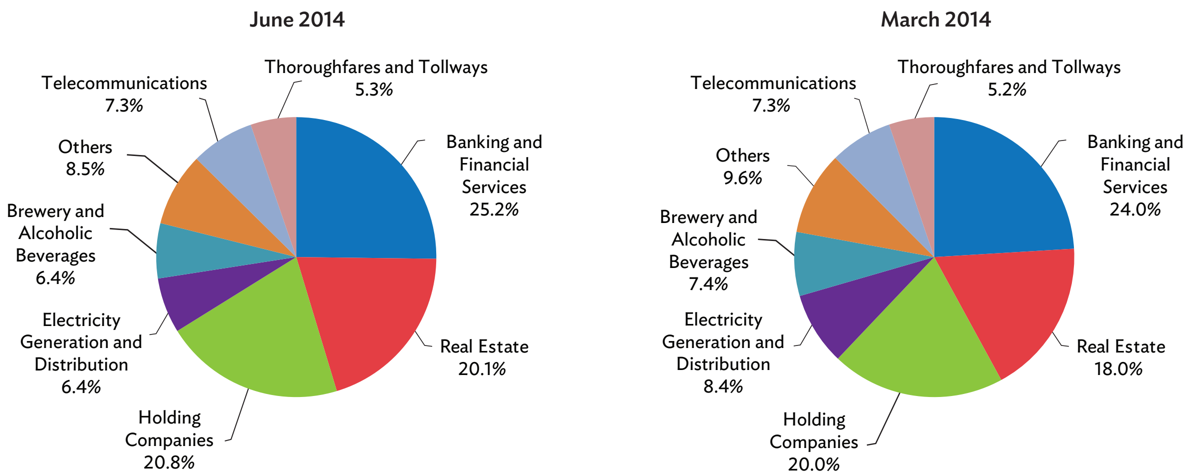
The diversity of LCY corporate bond issuers in 2Q14 was comparable with that in 1Q14 **(Figure 2)**. Banks and financial services, including investment houses, remained the leading issuers of debt in 2Q14 with 25.2% of the total as the BSP moved toward more stringent liquidity and capital requirements. The market share of most industries remained unchanged, except for real estate, which increased to 20.1% from 18.0%. Firms from industries as diverse as electricity generation and distribution, telecommunications, and thoroughfares and tollways

Table 3: Top 30 Issuers of LCY Corporate Bonds in the Philippines

	Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
		LCY Bonds (PHP billion)	LCY Bonds (US$ billion)			
1.	Ayala Land	57.9	1.3	No	Yes	Real Estate
2.	SM Investments	41.9	1.0	No	Yes	Diversified Operations
3.	Ayala Corporation	40.0	0.9	No	Yes	Diversified Operations
4.	JG Summit Holdings	39.0	0.9	No	Yes	Diversified Operations
5.	San Miguel Brewery	37.8	0.9	No	Yes	Brewery
6.	Philippine Long Distance Telephone	29.8	0.7	No	Yes	Telecommunications
7.	Philippine National Bank	27.6	0.6	No	Yes	Banking
8.	Metrobank	26.0	0.6	No	Yes	Banking
9.	Meralco	23.5	0.5	No	Yes	Electricity Distribution
10.	RCBC	22.0	0.5	No	Yes	Banking
11.	Filinvest Land	21.5	0.5	No	Yes	Real Estate
12.	BDO Unibank	20.0	0.5	No	Yes	Banking
13.	Energy Development Corporation	19.0	0.4	No	Yes	Electricity Generation
14.	Globe Telecom	17.0	0.4	No	Yes	Telecommunications
15.	Maynilad Water Services	16.6	0.4	No	No	Water
16.	MCE Leisure	15.0	0.3	No	No	Casino Services
17.	SM Development	14.3	0.3	No	Yes	Real Estate
18.	Manila North Tollways	13.0	0.3	No	No	Transport Services
19.	Security Bank	13.0	0.3	No	Yes	Banking
20.	First Metro Investment	12.0	0.3	No	No	Investment Banking
21.	MTD Manila Expressway	11.5	0.3	No	No	Transport Services
22.	South Luzon Tollway	11.0	0.3	No	No	Transport Services
23.	GT Capital Holdings	10.0	0.2	No	Yes	Investment Companies
24.	United Coconut Planters Bank	9.5	0.2	No	No	Banking
25.	Filinvest Development	8.8	0.2	No	Yes	Real Estate
26.	Petron	8.4	0.2	No	Yes	Oil Refining and Marketing
27.	Aboitiz Equity Ventures	8.0	0.2	No	Yes	Diversified Operations
28.	Allied Bank	8.0	0.2	No	Yes	Banking
29.	Union Bank of the Philippines	6.8	0.2	No	Yes	Banking
30.	Megaworld	6.4	0.1	No	Yes	Real Estate
Total Top 30 LCY Corporate Issuers		**595.3**	**13.6**			
Total LCY Corporate Bonds		**673.0**	**15.4**			
Top 30 as % of Total LCY Corporate Bonds		**88.5%**	**88.5%**			

LCY = local currency.
Notes:
1. Data as of end-June 2014.
2. Petron has PHP20 billion of Global Peso Bonds outstanding that were not included in this table.
3. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on Bloomberg data.

Figure 2: LCY Corporate Bond Issuers by Industry



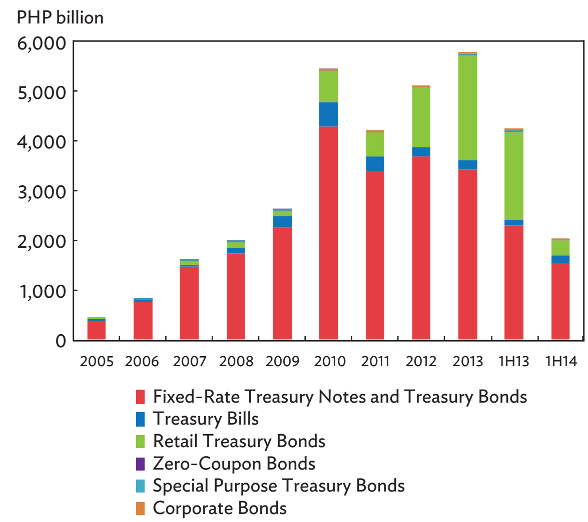
LCY = local currency.
Source: Bloomberg LP.

had shares of total corporate bonds outstanding in the single-digit levels.

As the sole fixed-income exchange in the country, the Philippine Dealing and Exchange Corporation captures the secondary trading of listed fixed-income issues. The volume of secondary trading of government securities surged from PHP438 billion in 2005 to PHP5,732 billion in 2013 **(Figure 3)**.

Total trading volume of bonds for the first half of 2014 dropped 52.0% y-o-y to PHP2,003 billion from PHP4,180 billion in the same period in 2013, as the market remained cautious due to domestic inflation concerns and tapering by the United States Federal Reserve. Between January 2005 and June 2014, Treasury bonds accounted for the largest share of total trading volume at about 76%, followed by Retail Treasury Bonds at about 17%.

Figure 3: PDEx Trade Volume Trends—Government Securities

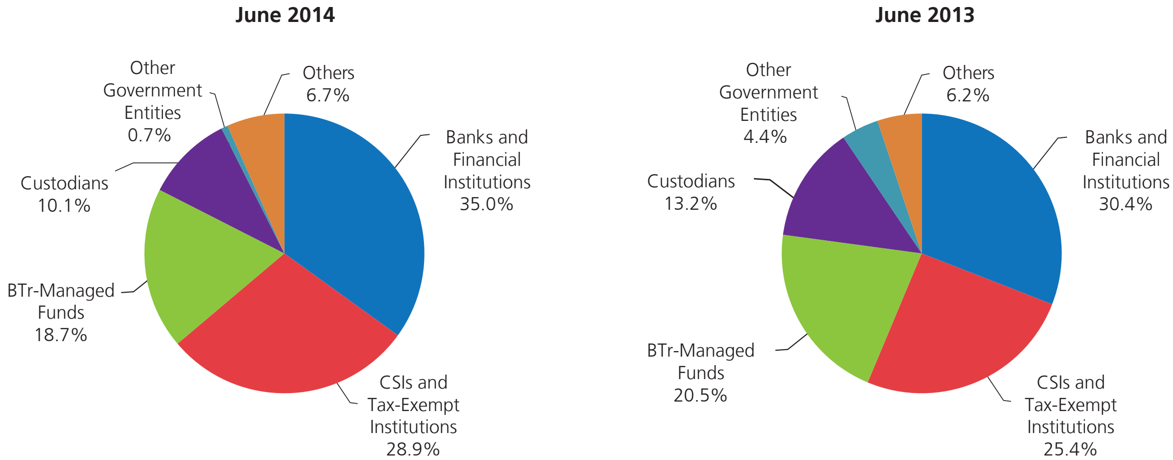


Notes:
1. PDEx reports one side of the trade only.
2. Data on Corporate Bonds started in 2010.
Source: Philippine Dealing and Exchange Corporation (PDEx).

Investor Profile

The largest grouping of investors in government securities in 2Q14 comprised banks and financial institutions, with a 35.0% of the total **(Figure 4)**. This was up slightly from a share of 30.4% in 2Q13. Contractual savings institutions—including the Social Security System, Government Service Insurance System, Pag-ibig, and life insurance companies—and tax-exempt institutions—such as trusts and other tax-exempt entities—accounted for 28.9% of the total in 2Q14, up from 25.4% in 2Q13. The share of funds being managed by BTr, which includes the Bond Sinking Fund, fell to 18.7% in 2Q14 from 20.5% in 2Q13. The participation of custodians slightly decreased to 10.1% from 13.2%. The share of other government entities and other investors, which include individuals and private corporations, also decreased to 7.4% in 2Q14 from 10.6% in 2Q13.

Figure 4: LCY Government Bonds Investor Profile



BTr = Bureau of the Treasury, CSIs = contractual savings institutions, LCY = local currency.
Source: Bloomberg LP.

Rating Changes

On 7 May, S&P upgraded its long-term sovereign credit rating for the Philippines to BBB from BBB–, and its short-term rating to A-2 from A-3, with a stable outlook for both. S&P raised both ratings based on expectations that the government will be able to maintain its structural, administrative, institutional, and governance reforms after the presidential election in 2016. The ratings also reflect the Philippines' sustained low level of inflation and low interest rates, strong external liquidity and international investment positions, and effective monetary policy framework.

Policy, Institutional, and Regulatory Developments

BSP to Monitor Banks' Real Estate Exposure

On 11 June, the Monetary Board of the BSP approved preemptive macroprudential policy measures to monitor the exposure of the banking system to real estate development. This policy, which includes stress tests, reinforces the requirement for banks to have sufficient capital to withstand shocks that could affect their credit risk exposure to real estate. The stress tests are in accordance with international standards under the Basel Accords. Universal, commercial, and thrift banks are required to meet a Capital Adequacy Ratio of 10% of qualifying capital (QC) after adjusting for the stress test results. Universal and commercial banks, and their thrift bank subsidiaries are also required to maintain a level of Common Equity Tier 1 equivalent to at least 6% of QC after adjusting for the stress test. For stand-alone thrift banks, a Tier 1 ratio of 6% of QC is required.

Singapore

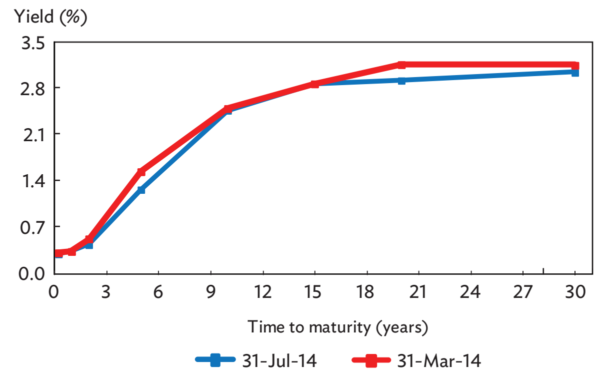
Yield Movements

Between end-March and end-July, local currency (LCY) government bond yields in Singapore fell for most tenors **(Figure 1)**. The largest drops in yields were noted for the 5-year maturity, which shed 27 basis points (bps), and the 20-year tenor, which fell 24 bps. The yield spread between the 2- and 10-year maturities widened to 202 bps at end-July from a spread of 196 bps at end-March.

Slight upticks in prices of goods were noted in 2Q14, although overall inflation has remained benign. Consumer price inflation rose 2.5% year-on-year (y-o-y) in April, and 2.7% in May, before easing to 1.8% in June and 1.2% in July. The Monetary Authority of Singapore (MAS), however, expects inflation to ease further in the rest of the year, and estimates inflation to range between 1.5% and 2.0% in 2014.

Economic growth slowed to 2.4% y-o-y in 2Q14 from 4.8% in 1Q14. Growth in the manufacturing sector eased to 1.5% y-o-y, a significant drop from 9.9% growth in 1Q14, due mainly to a decline in electronics output and a slowdown in transport engineering output. Growth in the construction sector also moderated to 4.4% y-o-y from 6.4% in 1Q14. Services industries recorded slower growth in 2Q14, expanding 2.6% y-o-y compared with 3.9% in 1Q14. On a seasonally adjusted quarter-on-quarter (q-o-q) basis, gross domestic product (GDP) grew a marginal 0.1% in 2Q14.

Figure 1: Singapore's Benchmark Yield Curve–LCY Government Bonds



LCY = local currency.
Source: Bloomberg LP.

The Ministry of Trade and Industry expects the economy to grow modestly in 2014, revising its annual GDP growth forecast downward to a range of 2.5%–3.5%. It also noted that global growth has remained weak and cited that uncertainties remain over the pace of the United States Federal Reserve's exit from its accommodative monetary policy stance.

Size and Composition

The outstanding size of LCY bonds in Singapore climbed to SGD307 billion (US$247 billion) at end-June on modest growth of 2.5% q-o-q and 2.0% y-o-y **(Table 1)**.

Table 1: Size and Composition of the LCY Bond Market in Singapore

	Outstanding Amount (billion)						Growth Rate (%)			
	2Q13		1Q14		2Q14		2Q13		2Q14	
	SGD	US$	SGD	US$	SGD	US$	q-o-q	y-o-y	q-o-q	y-o-y
Total	**301**	**238**	**300**	**239**	**307**	**247**	**2.0**	**14.0**	**2.5**	**2.0**
Government	187	148	183	146	189	152	1.9	14.9	3.3	1.1
SGS Bills and Bonds	138	109	109	87	100	80	(6.1)	(3.4)	(8.0)	(27.3)
MAS Bills	50	39	74	59	89	72	33.3	143.1	19.9	79.8
Corporate	114	90	117	93	118	95	2.2	12.6	1.1	3.6

( ) = negative, LCY = local currency, MAS = Monetary Authority of Singapore, q-o-q = quarter-on-quarter, SGS = Singapore Government Securities, y-o-y = year-on-year.
Notes:
1. Government bonds are calculated using data from national sources. Corporate bonds are based on *AsianBondsOnline* estimates.
2. SGS bills and bonds do not include the special issue of SGS held by the Singapore Central Provident Fund (CPF).
3. Bloomberg LP end-of-period LCY–US$ rates are used.
4. Growth rates are calculated from LCY base and do not include currency effects.
Sources: Bloomberg LP, Monetary Authority of Singapore, and Singapore Government Securities.

Government Bonds. LCY government bonds grew 3.3% q-o-q and 1.1% y-o-y to reach SGD189 billion at end-June. Growth was mainly driven by increases in the stock of MAS bills, which were issued for the first time in April 2011 as a new tool for money market operations. The stock of MAS bills climbed 19.9% q-o-q and 79.8% y-o-y to SGD89 billion. Issuance of MAS bills was up during the quarter, rising 5.9% q-o-q and 31.3% y-o-y.

Table 2: Top 30 Issuers of LCY Corporate Bonds in Singapore

	Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
		LCY Bonds (SGD billion)	LCY Bonds (US$ billion)			
1.	Housing and Development Board	19.3	15.5	Yes	No	Financial
2.	United Overseas Bank	5.1	4.1	No	Yes	Financial
3.	DBS Bank	3.3	2.6	No	Yes	Financial
4.	Temasek Financial I	3.6	2.9	No	No	Financial
5.	SP PowerAssets	2.4	1.9	No	No	Utilities
6.	CapitaLand	2.3	1.9	No	Yes	Financial
7.	Public Utilities Board	2.1	1.7	Yes	No	Utilities
8.	GLL IHT	1.8	1.5	No	No	Real Estate
9.	Land Transport Authority	1.8	1.4	Yes	No	Industrial
10.	City Developments	1.6	1.3	No	Yes	Consumer
11.	Keppel	1.5	1.2	No	Yes	Industrial
12.	Olam International	1.4	1.1	No	Yes	Consumer
13.	Singapore Airlines	1.3	1.0	No	No	Transportation
14.	Neptune Orient Lines	1.3	1.0	No	Yes	Industrial
15.	Hyflux	1.3	1.0	No	Yes	Industrial
16.	Keppel Land	1.1	0.9	No	Yes	Real Estate
17.	CapitaMalls Asia Treasury	1.0	0.8	No	No	Financial
18.	Oversea-Chinese Banking Corp.	1.0	0.8	No	Yes	Financial
19.	PSA	1.0	0.8	No	No	Consumer
20.	Mapletree Treasury Services	1.0	0.8	No	No	Financial
21.	Singtel Group Treasury	0.9	0.7	No	No	Telecommunications
22.	DBS Group Holdings	0.8	0.6	No	Yes	Financial
23.	Temasek Financial III	0.8	0.6	No	No	Financial
24.	CMT MTN	0.8	0.6	No	No	Financial
25.	Global Logistic Properties	0.8	0.6	No	Yes	Industrial
26.	CapitaLand Treasury	0.7	0.6	No	No	Financial
27.	Joynote	0.7	0.6	No	No	Financial
28.	Overseas Union Enterprise	0.7	0.6	No	Yes	Consumer
29.	Sembcorp Financial Services	0.7	0.6	No	No	Industrial
30.	SMRT Capital	0.7	0.6	No	No	Financial
Total Top 30 LCY Corporate Issuers		**62.6**	**50.2**			
Total LCY Corporate Bonds		**118.0**	**94.6**			
Top 30 as % of Total LCY Corporate Bonds		**53.1%**	**53.1%**			

LCY = local currency.
Notes:
1. Data as of end-June 2014.
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on Bloomberg data.

On the other hand, SGS bills and bonds outstanding, which comprised 53% of the total government bond stock, declined 8.0% q-o-q and 27.3% y-o-y in 2Q14 to SGD100 billion. Issuance of SGS bonds and bills surged more than two-fold in 2Q14 from 1Q14. However, new issuance was more than offset by SGS redemptions in 2Q14. On a y-o-y basis, issuance of SGS bills and bonds fell 76.9%.

Corporate Bonds. LCY corporate bonds outstanding reached SGD118 billion at end-June, according to *AsianBondsOnline* estimates. This represented an increase of 1.1% q-o-q and 3.6% y-o-y. At end-June, the outstanding bonds of the top 30 LCY corporate issuers in Singapore totaled SGD62.6 billion, representing 53.1% of the total LCY corporate bond market **(Table 2)**.

Leading the list was the state-owned Housing and Development Board, with outstanding bonds valued at SGD19.3 billion. United Overseas Bank was in the second spot with outstanding bonds amounting to SGD5.1 billion. Completing the top three was DBS Bank with outstanding bonds amounting to SGD3.3 billion. Issuers from the financial sector dominated the list, accounting for about half of the total number of companies on the list.

In 2Q14, new issuance of corporate bonds totaled SGD4.3 billion, up 3.1% q-o-q and 13.5% y-o-y. A total of 29 new bond series were issued by 24 corporate entities. Most of the bonds issued carried medium-term maturities (5–7 years). Three new bond issues had a maturity of 10 years, one issue of 12 years, and one issue was a perpetual bond. **Table 3** lists some of the largest corporate bond issues during the quarter.

Table 3: Notable LCY Corporate Bond Issuance in 2Q14

Corporate Issuers	Coupon Rate (%)	Issued Amount (SGD million)
Housing and Development Board		
5-year bond	2.22	675
Singapore Air		
7-year bond	3.15	200
10-year bond	3.75	300
United Overseas Bank		
12-year Bond	3.50	500
Yanlord Land Group		
3-year bond	6.20	400
Gallant Venture		
2-year bond	5.95	175
3-year bond	5.90	150
Swiber Holdings		
2-year bond	5.13	130
2.5-year bond	5.55	100

LCY = local currency.
Source: Bloomberg LP.

Policy, Institutional, and Regulatory Developments

MAS to Promote Renminbi Use in Singapore

On 13 June, MAS announced an initiative to promote renminbi transactions, including the provision of an overnight renminbi liquidity facility for financial institutions in Singapore beginning 1 July. The liquidity facility will provide up to CNY5 billion in overnight funds for borrowing by eligible counterparties. Singapore dollars, SGS bills and bonds, and MAS bills may be used as collateral for the overnight liquidity facility.

PBOC Allows Limited Cross-Border Transactions with Singapore

On 13 June, the Nanjing branch of the People's Bank of China (PBOC) announced it would allow eligible corporations, equity investment funds, and individuals in Suzhou Industrial Park (SIP) to conduct renminbi cross-border transactions with eligible participants in Singapore. The new regulation allows for the following transactions: (i) banks in Singapore can provide renminbi lending to corporates in SIP, (ii) corporates in SIP can issue renminbi bonds in Singapore, (iii) equity investment funds in SIP can directly invest in corporates in Singapore, and (iv) individuals in SIP can provide renminbi remittances to Singapore for the settlement of current account and direct investment transactions.

On 9 July, the Tianjin branch of the PBOC made a similar announcement allowing eligible corporations, equity investment funds, and individuals in Sino–Singapore Tianjin Eco-City to conduct renminbi cross-border transactions with eligible participants in Singapore.

Thailand

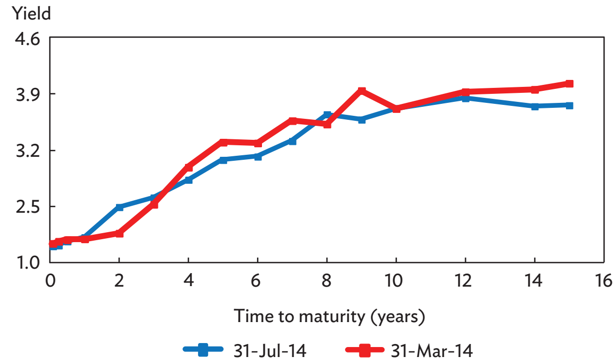
Yield Movements

Thailand's local currency (LCY) government bond yields fell for most tenors between end-March and end-July **(Figure 1)**. Yields fell for tenors of (i) less than 1 year; (ii) 4 years to 7 years; (iii) 9 years; and (iv) 12, 14, and 15 years. Yields rose for tenors of 1, 2, 3, 8, and 10 years. The yield curve flattened between end-March and end-July, as the yield spread between 2- and 10-year maturities narrowed by 32 basis points (bps).

The Bank of Thailand's (BOT) Monetary Policy Committee decided on 6 August to maintain the 1-day repurchase rate at 2.00%, marking the third consecutive time that the committee has kept the policy rate unchanged. The committee last cut the policy rate in April by 25 bps.

Thailand's real gross domestic product (GDP) rebounded in 2Q14, rising 0.4% year-on-year (y-o-y) after contracting 0.5% in 1Q14. On the expenditure side, positive growth in household consumption, government spending, and the trade surplus more than offset negative growth in domestic investment in 2Q14. On the production side, growth in the agricultural sector accelerated and output growth in non-agricultural sectors turned positive in 2Q14. In August, the Office of the National Economic and Social Development Board revised its 2014 real GDP growth forecast for Thailand to 1.5%–2.0% from 1.5%–2.5%.

Figure 1: Thailand's Benchmark Yield Curve—LCY Government Bonds



LCY = local currency.
Source: Bloomberg LP.

Consumer price inflation moderated to 2.1% y-o-y in August from 2.2% in July, led by slower gains in food and non-alcoholic beverage prices. Prices for food and non-alcoholic beverages rose 3.9% y-o-y in August, following a 4.2% hike in July, while nonfood and beverage prices climbed 1.1% in August, the same rate of increase in July.

Size and Composition

The outstanding size of the local currency (LCY) bond market in Thailand grew 0.1% quarter-on-quarter (q-o-q) and 3.2% y-o-y in 2Q14, both of which were down from 2Q13 **(Table 1)**. The slower growth can be attributed to

Table 1: Size and Composition of the LCY Bond Market in Thailand

	Outstanding Amount (billion)						Growth Rate (%)			
	2Q13		1Q14		2Q14		2Q13		2Q14	
	THB	US$	THB	US$	THB	US$	q-o-q	y-o-y	q-o-q	y-o-y
Total	**8,882**	**286**	**9,158**	**282**	**9,169**	**283**	**3.0**	**10.6**	**0.1**	**3.2**
Government	7,007	226	7,031	217	7,007	216	3.4	8.7	(0.3)	0.01
Government Bonds and Treasury Bills	3,231	104	3,461	107	3,425	106	4.3	7.7	(1.0)	6.0
Central Bank Bonds	3,099	100	2,820	87	2,824	87	2.4	4.6	0.1	(8.9)
State-Owned Enterprise and Other Bonds	676	22	750	23	758	23	3.4	40.5	1.1	12.1
Corporate	1,875	60	2,127	66	2,162	67	1.8	18.5	1.6	15.3

( ) = negative, LCY = local currency, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Bloomberg end-of-period LCY–US$ rates are used.
3. Growth rates are calculated from an LCY base and do not include currency effects.
Source: Bank of Thailand.

Table 2: Top 30 Issuers of LCY Corporate Bonds in Thailand

	Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
		LCY Bonds (THB billion)	LCY Bonds (US$ billion)			
1.	PTT	191.9	5.9	Yes	Yes	Energy and Utilities
2.	The Siam Cement	146.5	4.5	Yes	Yes	Construction Materials
3.	CP All	90.0	2.8	No	Yes	Commerce
4.	Charoen Pokphand Foods	69.3	2.1	No	Yes	Food and Beverage
5.	Bank of Ayudhya	60.1	1.9	No	Yes	Banking
6.	Krung Thai Bank	47.2	1.5	Yes	Yes	Banking
7.	Thai Airways International	43.6	1.3	Yes	Yes	Transportation and Logistics
8.	The Siam Commercial Bank	40.0	1.2	No	Yes	Banking
9.	True Corporation	39.0	1.2	No	Yes	Communications
10.	Thanachart Bank	37.9	1.2	No	No	Banking
11.	Ayudhya Capital Auto Lease	33.8	1.0	No	No	Financial
12.	Toyota Leasing Thailand	32.7	1.0	No	No	Finance and Securities
13.	PTT Exploration and Production Company	32.1	1.0	Yes	Yes	Energy and Utilities
14.	Kasikorn Bank	29.5	0.9	No	Yes	Banking
15.	Mitr Phol Sugar	29.3	0.9	No	No	Food and Beverage
16.	Thai Oil	28.0	0.9	Yes	Yes	Energy and Utilities
17.	IRPC	27.6	0.9	Yes	Yes	Energy and Utilities
18.	Indorama Ventures	27.6	0.8	No	Yes	Petrochemicals and Chemicals
19.	Banpu	27.4	0.8	No	Yes	Energy and Utilities
20.	TMB Bank	23.7	0.7	No	Yes	Banking
21.	ICBC Thai Leasing	23.4	0.7	No	No	Finance and Securities
22.	DAD SPV	22.5	0.7	Yes	No	Finance and Securities
23.	Krung Thai Card	22.4	0.7	Yes	Yes	Finance and Securities
24.	Kiatnakin Bank	22.0	0.7	No	Yes	Banking
25.	Bangkok Bank	20.0	0.6	No	Yes	Banking
26.	Bangkok Expressway	19.4	0.6	No	Yes	Transportation and Logistics
27.	Thanachart Capital	19.3	0.6	No	Yes	Finance and Securities
28.	Glow Energy	19.1	0.6	No	Yes	Energy and Utilities
29.	Minor International	18.9	0.6	No	Yes	Food and Beverage
30.	Quality Houses	18.0	0.6	No	Yes	Property Development
Total Top 30 LCY Corporate Issuers		1,262.0	38.9			
Total LCY Corporate Bonds		2,161.6	66.6			
Top 30 as % of Total LCY Corporate Bonds		58.4%	58.4%			

LCY = local currency.
Notes:
1. Data as of end-June 2014.
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on Bloomberg data.

the LCY government bond market, which contracted on a quarterly basis and was unchanged on an annual basis. The stock of government bonds and Treasury bills fell on a q-o-q basis, more than offsetting the positive growth in BOT bonds and state-owned enterprise (SOE) bonds. On a y-o-y basis, central government bonds and Treasury bills, and SOE bonds recorded positive growth, but this was offset by a contraction in the stock of central bank bonds.

Issuance of LCY government bonds was up 8.1% q-o-q in 2Q14, induced by a 7.5% hike in the issuance of central government bonds and Treasury bills, and a 10.6% rise in BOT bonds. However, on a y-o-y basis, LCY government bond issuance was down 8.8%, amid declines in the bond offerings of the central bank and SOEs.

Thailand's LCY corporate bonds outstanding expanded 1.6% q-o-q and 15.3% y-o-y in 2Q14. Issuance was up 6.2% q-o-q, but down 17.2% y-o-y. The top 30 corporate issuers accounted for 58% of total corporate bonds outstanding at end-June, with PTT remaining the largest corporate bond issuer **(Table 2)**. The five largest LCY corporate bond issues in Thailand in 2Q14 were from a cement company, two banks, and an energy company **(Table 3)**.

Liquidity

Liquidity in Thailand's LCY bond market improved in the first half of 2014. The turnover ratio for LCY government bonds climbed to 0.71 in 2Q14 from 0.64 in 1Q14 and 0.60 in 4Q13. The turnover ratio for LCY corporate bonds stood at 0.07 in both 2Q14 and 1Q14, up from 0.05 in 4Q13 **(Figure 2)**. The quarterly hike in the turnover ratio for LCY government bonds is attributed to an increase in the trading values of central bank bonds and Treasury bills.

Investor Profile

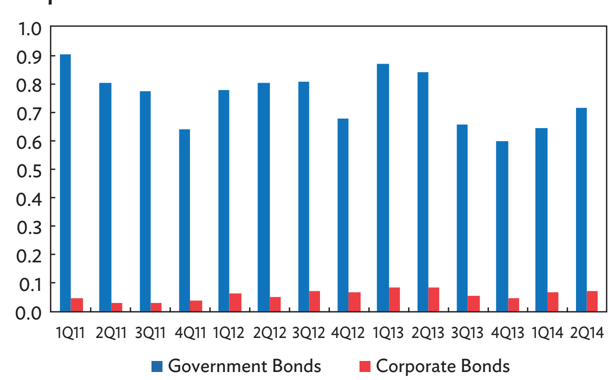
Contractual savings funds and insurance companies were the two largest investor groups in Thailand's LCY government bond market at end-June, with shares of 29% and 25% of the total, respectively **(Figure 3)**. Compared with end-June 2013, the government bond holdings of contractual savings funds, insurance companies, non-financial market mutual funds, and financial companies not classified elsewhere all climbed as a share of the total, while the shares of the central bank, commercial banks, and foreign investors declined.

Table 3: Notable LCY Corporate Bond Issuance in 2Q14

Corporate Issuers	Coupon Rate (%)	Issued Amount (THB billion)
PTT Exploration & Production		
5-year bond	3.91	8.20
10-year bond	4.82	11.40
Siam Cement		
4-year bond	4.00	15.00
Thanachart Bank		
10.5-year bond	6.00	13.00
Bank of Ayudhya		
2-year bond	3.00	6.50

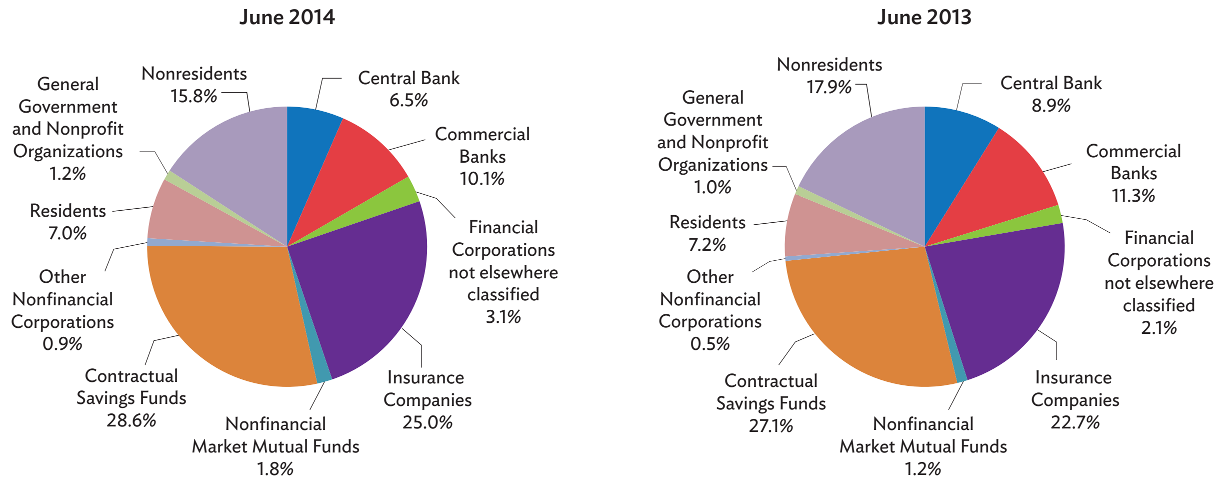
LCY = local currency.
Source: Bloomberg LP.

Figure 2: Turnover Ratios of Government and Corporate Bonds in Thailand



Sources: Bank of Thailand and ThaiBMA.

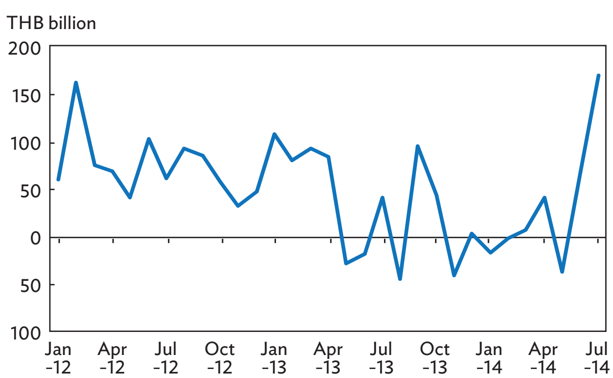
Figure 3: LCY Government Bonds Investor Profile



LCY = local currency.
Note: Government bonds exclude central bank bonds and state-owned enterprise bonds.
Sources: *AsianBondsOnline* and Bank of Thailand.

Foreign net purchases of Thai LCY bonds soared in June and July, reaching a record high in the latter month, amid sentiments of an improved economic outlook among foreign investors **(Figure 4)**. The net bond purchases in June and July were a reversal from net sales in 3 of the first 5 months of the year (January, February, and May).

Figure 4: Foreign Investors' Net Trading Value of LCY Bonds in Thailand



LCY = local currency.
Source: ThaiBMA.

Policy, Institutional, and Regulatory Developments

Structured Notes Regulations Streamlined

The Securities and Exchange Commission announced in August that the Capital Market Supervisory Board had approved the streamlining of regulations on structured notes. The new rules will allow the issuance of LCY- and foreign currency-denominated structured notes; harmonization of the types and classifications of issuers, both in initial public offerings and private placements; removal of the minimum face value of THB10 million in both cases; and removal of the minimum redemption value, which is 80% of the principal, for private placements only. These regulatory revisions will take effect in 4Q14.

New Regulations for Municipal Bond Issuance

The Securities and Exchange Commission reported in July that the Capital Market Supervisory Board approved regulations governing municipal bond issuances from municipalities, provincial administration organizations, public organizations, Bangkok Metropolitan Administration, Pattaya City, and any juristic person as defined by specific law. These regulations, which cover LCY- and foreign currency-denominated municipal bonds offered in onshore and offshore markets, will take effect on 1 January 2015.

Viet Nam

Yield Movements

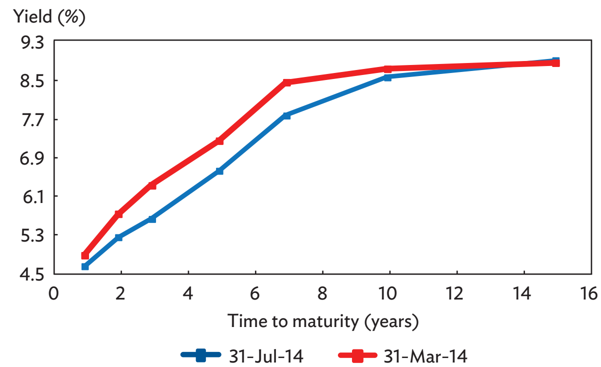
Viet Nam's local currency (LCY) government bond yields plunged for all tenors, except the 15-year, between end-March and end-July **(Figure 1)**. Yields for securities with 3- to 7-year tenors fell the most, dropping 69 basis points (bps) for 3-year bonds and 68 bps for 7-year bonds. Meanwhile, the yield for the 2-year tenor slid more than that of the 10-year tenor, widening the spread between the two to 328 bps at end-July from 298 bps at end-March.

The drop in yields could be attributed to two major drivers: record low interest rates and strong demand from banks. Yields of instruments with maturities of 2, 3, and 5 years reached an all-time low at end-July as a result of moderating inflation. On 18 March, the State Bank of Vietnam (SBV) reduced its key policy rates by 50 bps. The refinance rate, discount rate, and overnight inter-bank lending rate were cut 50 bps each to 6.50%, 4.50%, and 7.50%, respectively.

Rising demand for bonds among banks is underpinned by (i) weak credit growth, (ii) low inflation, and (iii) stable exchange rate expectations. Lending growth has been weak due to bad debts, which continue to weigh on banks' willingness to lend. As of end-June, SBV reported modest credit growth of 3.5% for the first half of the year, which is well outside the annual target range of 12%–14%. Meanwhile, inflation remained benign in the first 7 months of the year, with July's figure coming in at 4.9% year-on-year (y-o-y), compared with SBV's full-year target of about 7.0%. The exchange rate is also expected to stabilize following the downward adjustment of the average inter-bank VND–US$ exchange rate by 1% in June.

Viet Nam's real gross domestic product (GDP) expanded 5.3% y-o-y in 2Q14, following revised growth of 5.1% in 1Q14. For the first half of 2014, the country's GDP growth stood at 5.2% on an annualized basis. The services sector remained the growth driver in 2Q14, with a 6.0% y-o-y gain and a contribution of 43% of total GDP.

Figure 1: Viet Nam's Benchmark Yield Curve—LCY Government Bonds



LCY = local currency.
Source: Bloomberg LP.

Size and Composition

Total LCY bonds outstanding in Viet Nam surged on both a quarterly and annual basis in 2Q14 to reach VND788.3 trillion (US$37.0 billion), led by a rapid rise in the government sector **(Table 1)**.

Government Bonds. LCY government bonds outstanding amounted to VND775.9 trillion (US$36.4 billion) at end-June, up 38.3% y-o-y and 6.0% quarter-on-quarter (q-o-q), primarily on increased issuance of central bank bills and Treasury bonds.

Government issuance amounted to VND193.7 trillion in 2Q14, with SBV issuance comprising almost 80% of the total. The most common issue in 2Q14 was the 91-day zero-coupon SBV bill, which represented 91% of SBV issuance and over 70% of all government issuance.

In 3Q14, the State Treasury plans to issue VND50 trillion worth of government bonds: VND7 trillion of bonds with tenors of less than 1 year, VND6 trillion of 2-year bonds, VND16 trillion of 3-year bonds, VND16 trillion of 5-year bonds, and VND5 trillion of bonds with tenors of 10–15 years.

Table 1: Size and Composition of the LCY Bond Market in Viet Nam

	Outstanding Amount (billion)						Growth Rate (%)			
	2Q13		1Q14		2Q14		2Q13		2Q14	
	VND	US$	VND	US$	VND	US$	q-o-q	y-o-y	q-o-q	y-o-y
Total	**577,997**	**27**	**744,589**	**35**	**788,313**	**37**	**(8.6)**	**26.8**	**5.9**	**36.4**
Government	560,938	26	732,069	35	775,943	36	(8.1)	34.3	6.0	38.3
Treasury Bonds	324,054	15	373,960	18	412,263	19	4.4	74.8	10.2	27.2
Central Bank Bills	43,586	2	147,004	7	153,926	7	(61.4)	(25.0)	4.7	253.2
State-Owned Enterprise Bonds	193,298	9	211,104	10	209,754	10	3.4	11.1	(0.6)	8.5
Corporate	17,059	1	12,520	0.6	12,370	0.6	(22.5)	(55.5)	(1.2)	(27.5)

( ) = negative, LCY = local currency, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Bloomberg LP end-of-period LCY–US$ rates are used.
2. Growth rates are calculated from LCY base and do not include currency effects.
Source: Bloomberg LP.

Corporate Bonds. LCY corporate bonds outstanding fell to VND12.4 trillion (US$0.6 billion) at end-June, down 27.5% y-o-y and 1.2% q-o-q. A total of 13 issuers comprised the entire corporate bond sector, with cumulative bonds outstanding amounting to VND12.4 trillion **(Table 2)**.

Rating Changes

In July, Moody's raised Viet Nam's credit rating, citing an improving balance of payments and rising foreign reserves. The rating agency upgraded Viet Nam's (i) sovereign bond rating to B1 from B2, giving it a stable outlook; (ii) long-term foreign currency bond ceiling to Ba2 from B1; and (iii) long-term foreign currency deposit ceiling to B2 from B3. Viet Nam's LCY country risk ceiling was also upgraded to Ba1 from Ba2. The upgrade hinged on Viet Nam's emerging track record of macroeconomic stability demonstrated by 3 consecutive years of price stability, and strengthening balance of payments and external payments positions supported by a diversified export structure.

Table 2: Corporate Issuers of LCY Corporate Bonds in Viet Nam

Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
	LCY Bonds (VND billion)	LCY Bonds (US$ billion)			
1. Asia Commercial Joint Stock	3,000.00	0.14	No	Yes	Finance
2. Techcom Bank	3,000.00	0.14	No	No	Finance
3. HAGL JSC	2,480.00	0.12	No	Yes	Real Estate
4. Vincom	1,000.00	0.05	No	Yes	Real Estate
5. Vinpearl	1,000.00	0.05	No	Yes	Resorts and Theme Parks
6. Kinh Bac City Development	500.00	0.02	No	Yes	Real Estate
7. Development Investment	350.00	0.02	No	No	Building and Construction
8. Saigon Telecommunication	300.00	0.01	No	No	Computer Services
9. Binh Chanh Construction	300.00	0.01	No	Yes	Building and Construction
10. Lam Son Sugar	150.00	0.01	No	No	Diversified
11. Tan Tao Investment	130.00	0.01	No	No	Real Estate
12. Ho Chi Minh City Securities	110.00	0.01	No	No	Finance
13. Phu Hoang Anh	50.00	0.002	No	No	Real Estate
Total LCY Corporate Issuers	**12,370.00**	**0.58**			
Total LCY Corporate Bonds	**12,370.00**	**0.58**			
% of Total LCY Corporate Bonds	**100.0%**	**100.0%**			

LCY = local currency.
Notes:
1. Data as of end-June 2014.
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on Bloomberg data.

Policy, Institutional, and Regulatory Developments

Decree on State Foreign Exchange Reserves Issued

On 20 May, Decree No. 50/2014/ND-CP was issued to manage foreign exchange reserves, which are defined as foreign currencies in cash and deposits abroad, securities and other valuable papers issued by the government and foreign and international institutions, Special Drawing Rights reserved at the International Monetary Fund (IMF), gold managed by SBV, and other foreign currencies of the government. The decree identifies five sources of foreign reserves: (i) the state budget and foreign exchange market, (ii) loans from banks and international financial institutions, (iii) the State Treasury and credit institutions, (iv) profits from official foreign exchange reserve investments, and (v) other sources. The decree further states that SBV will manage the state foreign exchange reserves and stipulate the structure, criteria, and limits of investments, which will be approved by the SBV Governor and reported to the Prime Minister on a semi-annual basis. SBV will determine the investment structure of the Foreign Exchange Reserve Fund based on global trends in exchange rate fluctuations, interest rates, and gold prices; and the status of the international reserves (foreign currency and gold) of other countries, as compiled by the IMF. SBV will also stipulate the investment structure of the Exchange Rate Stabilization and Gold Market Management Fund.

The decree supersedes Decree No.86/1999/ND-CP, dated 30 August 1999, and takes effect on 15 July.

Viet Nam Dong Devalued

On 19 June, SBV devalued the Vietnamese dong by 1% against the United States (US) dollar for the first time in 12 months in a move to boost exports. SBV re-set its exchange rate for the US currency to VND21,246 per dollar from VND21,036. The change also allows the Vietnamese dong to fluctuate by 1% above or below the central bank's rate.

Asia Bond Monitor
September 2014

This publication reviews recent developments in East Asian local currency bond markets along with the outlook, risks, and policy options. It covers the 10 members of the Association of Southeast Asian Nations plus the People's Republic of China; Hong Kong, China; and the Republic of Korea.

About the Asian Development Bank

ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries reduce poverty and improve the quality of life of their people. Despite the region's many successes, it remains home to approximately two-thirds of the world's poor: 1.6 billion people who live on less than $2 a day, with 733 million struggling on less than $1.25 a day. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

Based in Manila, ADB is owned by 67 members, including 48 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance.

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