ADB News Release
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# LIQUIDITY LAGGING IN ASIAN BOND MARKET EXPANSION, ADB REPORT SAYS

**SINGAPORE (14 November 2006)** – Emerging East Asian bond markets have expanded rapidly since the 1997/1998 Asian financial crisis, spurred by an increased issuance of government debt but the increase in outstanding debt has not led to a corresponding rise in market liquidity, a report issued by ADB says.

Development of legal and regulatory infrastructure, deeper market structures, growth of derivatives market, greater investor diversity and stronger regional cooperation are needed to boost liquidity in emerging East Asian local currency bond markets, according to the November edition of Asia Bond Monitor (ABM).

"Stronger regional cooperation will help to overcome the small and fragmented nature of local currency bond markets, improve liquidity, and deepen capital markets in the region," says Masahiro Kawai, Head of ADB's Office of Regional Economic Integration (OREI) and Special Advisor to the ADB President.

ABM examines local currency bond market developments in Emerging East Asia, defined as the Association of Southeast Asian Nations member countries, plus the People's Republic of China (PRC); Hong Kong, China; and Republic of Korea.

It highlights that the regional bond market expanded in absolute size and, importantly, as a percentage of GDP in 2006, with volume of outstanding local currency bonds reaching $2.4 trillion as of 30 June 2006, up from $2 trillion at the end of 2005.

Aggregate local currency bonds outstanding rose in US dollar terms in PRC (21%), Thailand (19%), Viet Nam (18%), Republic of Korea (13%), Singapore (9%) and Indonesia (10%). Malaysia and Hong Kong, China reported growth rates of above 5%, while in the Philippines, local currency bonds outstanding fell by 5%.

ABM says that the size and growth of bond markets in the region compare favorably worldwide with bond markets in economies with similar per capita income, but liquidity lags behind those of developed economies.

The study used statistical models and a survey of market makers' views to identify the determinants of bond market liquidity. The results show that liquidity in emerging East Asian bond markets as measured by indicators such as turnover ratios, bid-ask spread, and bond yield volatility remains low.

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The study finds that large market size, robust legal and regulatory framework, and access to hedging instruments promote liquidity, while exchange rate volatility impedes it.

The survey of 45 market makers conducted by AsianBondsOnline, an ASEAN+3 initiative supported by ADB and funded by the Government of Japan, shows that market makers are concerned about the narrow investor base in the region. More than 75% of the respondents feel corporate bond markets are particularly illiquid, with buy-to-hold investors dominating the underwriting process, leading to bonds being rapidly absorbed into portfolios without secondary market turnover.

Developing robust derivatives and repurchase markets also ranked high in the survey as a factor in increasing liquidity in both government and corporate bond markets.

The study notes that to encourage private and quasi-public corporations to issue local currency bonds and wean them away from reliance on bank finance, governments need to remove discriminatory taxes and reform regulatory infrastructure.

“Emerging East Asia’s corporate bond market can deepen through further policy actions like the Asian Bond Markets Initiative [ABMI], the Asian Bond Funds [ABFs], and Pan Asian Index Fund," says Mr. Kawai. "These are leading to convergence in market structures and harmonization of regulatory and institutional framework like clearing and settlement.”

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