ADB Asia Bond Monitor 2006

November 2006 asianbondsonline.adb.org

The *Asia Bond Monitor* (ABM) reviews recent developments in East Asian local currency bond markets. In this issue, a theme chapter examines the dimensions and determinants of bond market liquidity, and highlights policy options for improving liquidity. The ABM covers the 10 Association of Southeast Asian Nations member countries plus the People's Republic of China; Hong Kong, China; and the Republic of Korea.

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Emerging East Asian Local Currency Bond Markets: A Regional Update

Highlights

Bond Market Developments in the First Half of 2006

- Emerging East Asian bond markets continued to expand rapidly in the first half of 2006, reaching USD2.4 trillion in bonds outstanding, up from USD2.0 trillion at end-2005.
- Government bond market growth remains strong due to infrastructure spending, although better-than-projected tax revenues in some markets reduced the need for government issuance.
- Fuelled by demand for annuity assets from contractual savings institutions, corporate bond markets also posted strong growth in the first half of 2006.
- On average, turnover ratios in the region's government bond markets fell slightly, while those in corporate bond markets remained stable.
- Bond yield curves—after steepening during the first half of 2006—generally flattened across the region in the third quarter.
- Despite generally higher short term interest rates, currency appreciation and yield curve flattening pushed local currency index returns higher in 2006.

Bond Market Liquidity—Empirical Analysis, Market Survey, and Policy Options

- Bond market liquidity is a multidimensional concept, and is generally measured by indicators such as turnover ratio, bid-ask spread, and bond yield volatility.
- In emerging East Asia, bond market liquidity, although improving, general remains low, with low turnover ratios,wide bid-ask spreads, and high bond yield volatility.
- An empirical analysis using a cross-country regression approach identifies market size, legal and regulatory systems, access to derivatives and hedging instruments, and exchange rate volatility as the key determinants of bond market liquidity.

Continued overleaf

Acronyms and Abbreviations

ABM	Asia Bond Monitor
ADB	Asian Development Bank
ARIC	Asia Regional Integration Center
ASIFMA	Asia Securities Industry & Financial Markets Association
BIBOR	Bangkok Interbank Offered Rate
BIS	Bank for International Settlements
CHIBOR	China Interbank Offered Rate
CGFS	Committee on the Global Financial System
CSI	contractual savings institution
GDP	gross domestic product
HIBOR	Hong Kong Interbank Offered Rate
HKMA	Hong Kong Monetary Authority
HSTC	Ho Chi Minh Securities Trading Centre
IFI	Islamic financial institution
IMF	International Monetary Fund
JIBOR	Jakarta Interbank Offered Rate
KLIBOR	Kuala Lumpur Interbank Offered Rate
KORIBOR	Korea Interbank Offered Rate
LCY	local currency
MAS	Monetary Authority of Singapore
PHIBOR	Philippine Interbank Offered Rate
PRC	People's Republic of China
SGS	Singapore Government Securities
SIBOR	Singapore Interbank Offered Rate
SSX	Surabaya Stock Exchange
TIBOR	Tokyo Interbank Offered Rate
YTD	year-to-date

bps = basis points

Note: To conform with market practice, the *Asia Bond Monitor* uses two-letter official ISO Country Codes and three-letter currency codes rather than ADB's standard symbols.

- Complementing the cross-country evidence, a survey of leading market makers in East Asia rated greater investor diversity, robust derivatives and repurchase markets, and consistent secondary market pricing as important factors for increasing bond market liquidity.
- Policies to improve bond market liquidity should thus focus on enlarging bond market size, strengthening legal and regulatory infrastructure, deepening market microstructures, developing derivatives markets, encouraging investor diversity, and enhancing regional cooperation.

About the Asian Development Bank

ADB, based in Manila, is dedicated to reducing poverty in the Asia and the Pacific region through pro-poor sustainable economic growth, social development, and good governance. Established in 1966, it is owned by 66 members—47 from the region. In 2005, it approved loans and technical assistance totaling $5.8 billion and $198.8 million, respectively.

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6 ADB Avenue, Mandaluyong City
1550 Metro Manila, Philippines
www.adb.org
Publication Stock No. 110306

Printed in the Philippines