

Executive Summary

Local Currency Government Bond Yields Fall in Emerging East Asia

The yields on 10-year local currency (LCY) government bonds fell in most emerging East Asian markets between 1 March and 15 May as global economic growth moderated and the central banks of advanced economies stopped their monetary policy tightening.¹

Ongoing trade tensions between the People's Republic of China (PRC) and the United States (US) is further constraining global growth momentum. Volatile oil prices are another downside risk. Central banks from advanced economies have become more accommodative in response to slowing growth. Central banks from the euro area, Japan, and the US have all signaled that they will keep their current policy rates unchanged throughout 2019. Some central banks in emerging East Asia are also turning more accommodative, with Malaysia and the Philippines both cutting policy rates in May. This contributed to a decline in yields in most emerging East Asian economies.

The downside risks of the global economic outlook are reflected in other economic and financial indicators. Emerging East Asia's equity markets have declined and their currencies have depreciated against the US dollar, reflecting investors' risk-off sentiment. Similarly, the region's credit default swap spreads and the CBOE Volatility Index have risen.

The June issue of the *Asia Bond Monitor* updates the recent progress made under the Asian Bond Markets Initiative in developing regional bond markets and includes a theme chapter on developing the housing bond market. The issue also contains two discussion boxes. Box 1 reviews efforts to develop green bond markets in emerging East Asia. Box 2 discusses distributed ledger technology and its potential applications in the financial sector.

Emerging East Asia's Local Currency Bond Market Reaches USD15.0 Trillion at the end of March

Emerging East Asia's LCY bonds outstanding reached USD15.0 trillion at the end of March on growth of 2.9% quarter-on-quarter (q-o-q) and 14.0% year-on-year (y-o-y).

The PRC remained the region's leader in terms of bond market size, with its share of the regional bond market total rising to 75.3% at the end of March from 74.6% at the end of December.

At the end of March, government bonds accounted for 61.7% of emerging East Asia's total LCY bond stock. In nominal terms, the outstanding amount of government bonds climbed to USD9.3 trillion, up 2.6% q-o-q and 14.0% y-o-y. Corporate bonds reached USD5.8 trillion, with growth decelerating to 3.5% q-o-q but rising 14.2% y-o-y.

Outstanding LCY bonds among members of the Association of Southeast Asian Nations (ASEAN) grew to USD1.5 trillion at the end of March, expanding 4.0% q-o-q.² Thailand's bond market was ASEAN's largest at USD398.6 billion, while Malaysia's *sukuk* (Islamic bond) market remained the biggest in emerging East Asia.

As a share of gross domestic product (GDP), the region's LCY bond market inched up to the equivalent of 81.4% of GDP at the end of March from 80.4% at the end of December. The Republic of Korea had the largest LCY bonds-to-GDP share at the end of March at 125.6%.

LCY bond issuance in emerging East Asia totaled USD1.4 trillion in the first quarter (Q1) of 2019 on growth of 10.0% q-o-q, largely due to stronger issuance of government bonds amid lower corporate bond issuance.

¹ Emerging East Asia comprises the People's Republic of China; Hong Kong, China; Indonesia; the Republic of Korea; Malaysia; the Philippines; Singapore; Thailand; and Viet Nam.

² LCY bond statistics for ASEAN include the markets of Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Viet Nam.

The region witnessed the fourth bond issuance under the ASEAN+3 Multi-Currency Bond Issuance Framework on 26 March.³ With a guarantee from the Credit Guarantee and Investment Facility, CJ Logistics Asia Pte. Ltd. successfully issued a 5-year bond worth SGD70 million.

Also, in May, microfinance firm LOLC (Cambodia) became the second corporate issuer to list bonds on the Cambodia Securities Exchange. LOLC's bond issuance, worth KHR80 billion, comprised a foreign-exchange-indexed bond with a coupon rate of 8.0% and a 3-year bond with a fixed coupon of 9.0%.

Foreign Investor Outlook for Emerging East Asia Is Mixed

In Q1 2019, foreign holdings and capital flows diverged across the region's bond markets. Foreign investors were upbeat on the PRC on the back of better-than-expected economic indicators in March. The temporary ceasefire in the trade dispute between the PRC and the US also helped. Similarly, Indonesia continued to attract foreign investor flows in Q1 2019 due to its high yields and sound economic fundamentals.

On the other hand, foreign holdings fell in the Philippines and Thailand in Q1 2019. In the Philippines, the foreign holdings share fell to 6.3% at the end of Q1 2019 from 7.5% in the previous quarter as investors cashed out their profits. In Thailand, the decline in the foreign investor share in Q1 2019 was largely due to uncertainty surrounding the Thai general elections held in March.

Trends in foreign investment and capital flows in most of the region's bond markets reversed in the early part of the second quarter as the PRC-US trade conflict reignited.

Theme Chapter: Developing the Housing Bond Market

The theme chapter reviews the development of housing finance in the US and in emerging East Asian economies. Housing matters for personal well-being, yet housing demand is growing faster than supply in Asia. Housing finance typically looks only at the demand side by providing homebuyers with financing. The theme chapter discusses the role of bank financing and capital markets in facilitating the construction of new housing. Our research finds that while banks typically finance housing purchases, developing housing finance via the capital market is a valuable complement that can mitigate the maturity mismatch arising from the short-term nature of bank funding.

Box 1: Singing the Blues but Seeing Green

This box examines the continued development of Asia's green bond market, noting that while the PRC continues to lead the region in the issuance of green bonds, issuances from other markets have increased and become more innovative. The box presents examples of innovative green bond financing across the region, including green bond issuance by Indonesia's Tropical Landscape Finance Facility and the Korea Housing Finance Corporation.

Box 2: Significant Opportunities and Challenges Ahead for Distributed Ledger Technology

This box discusses the benefits of distributed ledger technology such as speeding up cash transfer operations and facilitating improved efficiencies in smart energy. The box also points to its challenges, including the need for a balanced regulatory stance that manages the tradeoff between risk management and innovation. A further challenge to the adoption of distributed ledger technology in emerging markets is the lack of reliable electricity and network connectivity.

³ ASEAN+3 refers to the 10 members of ASEAN plus the People's Republic of China, Japan, and the Republic of Korea.