Executive Summary

Recent Developments in Financial Conditions in Emerging East Asia

Persistent inflationary pressure has led to the tightening of monetary stances in major advanced economies and several emerging East Asian economies.[1] Financial conditions in emerging East Asia weakened between 28 February and 9 June amid ongoing monetary tightening and headwinds facing the global and regional economies that are being driven by continued inflation, rising commodity prices, a slowdown in economic growth in the People's Republic of China due to coronavirus disease (COVID-19) containment measures, supply chain disruptions, and the Russian invasion of Ukraine.

Weakened financial conditions in emerging East Asia were evidenced by currency depreciations, a retreat in equity markets, portfolio outflows, and widened risk premiums in most regional markets. During the review period, emerging East Asian currencies posted a simple average depreciation versus the United States (US) dollar of 3.2% and a gross domestic product (GDP)-weighted average depreciation of 5.1%. Most regional equity markets reported declines, recording a weighted average loss of 4.6%. Risk premiums, proxied by credit default swap spreads, posted a GDP-weighted average increase of 4.7 basis points. From 28 February to 9 June, aggregate portfolio outflows of USD4.3 billion were recorded in regional equity markets, mainly concentrated in the Republic of Korea. From March to May, aggregate portfolio outflows of USD21.9 billion were observed in regional bond markets. Local currency (LCY) government bond yields in emerging East Asia rose, tracking higher yields in major advanced economies and escalating domestic inflationary pressure.

The risks to regional financial conditions remain tilted to the downside. Faster-than-expected monetary tightening in the US and the region is a key risk. Meanwhile, heightened downside risks to the global and regional economic outlooks—including persistent inflation, a further increase in commodity prices, a slower-than-expected recovery in the People's Republic of China, prolonged supply chain disruptions, and the protracted end to the Russian invasion of Ukraine—could further weaken financial conditions.

Recent Developments in Local Currency Bond Markets in Emerging East Asia

Emerging East Asia's LCY bond market reached a size of USD23.5 trillion at the end of March, with bond issuance in the first quarter (Q1) of 2022 falling 6.5% quarter-on quarter (q-o-q) to USD2.2 trillion. Association of Southeast Asian Nations (ASEAN) member economies' aggregate LCY bond stock reached USD2.0 trillion at the end of March, accounting for 8.6% of emerging East Asia's LCY bond market. Bond issuance in ASEAN markets stood at USD393.5 billion in Q1 2022, decreasing 6.7% q-o-q from the fourth quarter of 2021 and representing 17.8% of total issuance in emerging East Asia. The drop in bond issuance in Q1 2022 was partly driven by weakened financial conditions, heightened downside risks to the economic outlook, and fiscal consolidation in some regional economies.

At the end of March, 62.6% of the outstanding LCY bonds in the region were government bonds, totaling USD14.7 trillion. LCY government bond issuance recorded USD1.3 trillion in Q1 2022, contracting 2.2% q-o-q on fiscal consolidation in several regional economies, monetary tightening, as well as heightened uncertainty in the global growth outlook. Meanwhile, outstanding corporate bonds in emerging East Asia reached USD8.8 trillion at the end of March and issuance totaled USD902.8 billion in Q1 2021, contracting 12.1% q-o-q amid weakening financial conditions and increasing uncertainties in the economic outlook.

Medium- to longer-term maturity LCY government bonds account for around half of emerging East Asia's bond market. At the end of March, 55.0% of the region's LCY government bonds carried maturities of over 5 years or longer, while 48.6% of the region's LCY government

[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.

bond issuance in Q1 2022 had a maturity of more than 5 years. Domestic financial institutions—particularly banks, pension funds, and insurance companies—continued to hold a majority share of emerging East Asia's LCY bonds.

The sustainable bond market in ASEAN+3 saw solid expansion in Q1 2022 to reach a size of USD478.7 billion at the end of March.[2] Unlike conventional bond markets, the majority of the region's sustainable bond markets carried a maturity of less than 5 years, both in terms of outstanding stock at the end of Q1 2022 and issuance during the quarter. The private sector dominates the regional sustainable bond market, with the financial sector playing a key role.

Special Topics on Local Currency Bond Markets in Emerging East Asia

The June 2022 issue of the *Asia Bond Monitor* presents two special boxes.

United States Monetary Policy News and Financial Market Reactions in Developing Asia

The Federal Reserve's monetary policy decisions have been found to have a significant influence on global financial conditions and emerging financial markets. This box comprehensively examines the impacts of both conventional and unconventional Federal Reserve monetary policy tools on exchange rates, equity market performances, bond yields, and portfolio flows in developing Asia. It finds that developing Asia's currency, equity, and bond markets consistently, persistently, and significantly respond to conventional US monetary instruments such as changes in the federal funds rate, but they respond to a much lower extent to unconventional monetary tools such as changes in securities holdings. Moreover, both conventional and unconventional monetary tightening by the Federal Reserve weaken financial conditions in developing Asia. As the Federal Reserve is expected to further hike the policy rate and start unwinding its asset holdings, developing Asian central banks must closely monitor financial conditions and make the necessary policy adjustments to safeguard financial stability in the region.

Sovereign Bond Yield Spreads and Pandemic-Related Asset Purchase Programs in Four ASEAN Economies

During the pandemic, some emerging market economies conducted asset purchase programs (APPs) to facilitate market liquidity and stabilize bond prices. This box examines the impact of APPs on government bond yield spreads in four ASEAN economies: Indonesia, Malaysia, the Philippines, and Thailand. Using central banks' APP claims as shocks, the evidence shows that APPs effectively compressed bond yield spreads in these markets, with the impacts being statistically significant in all markets except the Philippines. This evidence highlights the effectiveness of APPs in relieving pressure in ASEAN bond markets, with improved institutional and financial development and enhanced central bank credibility since the global financial crisis.

[2] For the discussion on sustainable bonds, ASEAN+3 includes ASEAN members Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Viet Nam plus the People's Republic of China; Hong Kong, China; Japan; and the Republic of Korea.