Bond Market Outlook

Local currency (LCY) bond markets in emerging East Asia started the year well despite uncertainties over the Greek debt crisis and the end of quantitative easing in the United States (US). Bond yields in most emerging East Asian economies were pushed down by a reduction in inflationary expectations amid a fall in oil prices.

Most of the region’s currencies weakened against the US dollar between end-December 2014 and mid-February 2015. The decline was led by the Indonesian rupiah and Malaysian ringgit as the oil and gas sectors in these economies were adversely affected by lower global oil prices. Credit default swaps (CDSs) in the region have remained relatively stable, reflecting continued investor confidence, while CDSs in the eurozone are rising amid concerns over the possibility of Greece leaving the monetary union.

Bond yield trends in advanced economies were mixed, due to divergent monetary policies between the US on one hand and the eurozone and Japan on the other, between end-December 2014 and mid-February 2015. At the same time, risk premiums decreased in all emerging East Asian economies except Malaysia.

Tighter US monetary policy could signal increasing risks to emerging East Asia’s LCY bond markets: (i) credit spreads might widen ahead of the US Federal Reserve raising interest rates, (ii) the stronger US dollar is making it more costly to service foreign currency (FCY) debts, and (iii) falling oil prices might hurt highly-leveraged oil and gas companies in the region.

LCY Bond Market Growth in Emerging East Asia

The amount of LCY bonds outstanding in emerging East Asia continued to grow in 4Q14 to reach US$8.2 trillion at end-December. Government bonds outstanding totaled US$4.9 trillion, growing 2.4% quarter-on-quarter (q-o-q) and 10.9% year-on-year (y-o-y). Corporate bonds reached US$3.3 trillion, increasing 1.5% q-o-q and 10.0% y-o-y.

The People’s Republic of China’s (PRC) bond market dominated the region in terms of size, accounting for 63.4% of the region’s total bonds at end-December. The next largest bond markets were those of the Republic of Korea and Malaysia.

As a share of gross domestic product (GDP) the size of emerging East Asia’s LCY bond market slipped to 57.8% in 4Q14 from 58.1% in 3Q14. The Republic of Korea and Malaysia have the largest bond markets relative to GDP with shares of over 100%. Indonesia has the smallest market in terms of share of GDP at 15.2%.

LCY bond issuance totaled US$1.0 trillion in 4Q14, less than the US$1.1 trillion issued in 3Q14 but more than the issuance in 4Q13. A total of US$709 billion was issued by governments, central banks, and monetary authorities in 4Q14; corporate entities sold US$323 billion worth of bonds in 4Q14.

Structural Developments in LCY Bond Markets

The maturity structures of government bonds were mostly concentrated at the short-end of the yield curve at end-December. Five out of the nine markets had the largest share of their government bonds at the short-end of the curve. Most government bonds in Malaysia and Singapore carried medium-dated tenors, while bonds in Indonesia and the Philippines were more concentrated at the long-end.

The region’s corporate bonds were also mostly at the short-end of the curve. The fixed-income corporate debt markets of Indonesia and the Republic of Korea had the largest proportion of bonds with short-term maturities. In contrast, Malaysia’s corporate bond market was mostly concentrated in the middle and at the long-end of the curve. Corporate bonds in the Philippines and Viet Nam were mostly medium-dated maturities.

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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.
The share of foreign holdings in the LCY government bond market rose in Indonesia and Thailand in 4Q14, and remained stable in the Republic of Korea. Foreign holdings of LCY-denominated government bonds declined in Malaysia in 4Q14.

Foreign ownership of corporate debt is significantly lower compared with that of government bonds. Foreign holdings’ share in the Indonesian LCY corporate bond market climbed to 9.6% at end-December, while the share of foreign holdings of the Republic of Korea’s corporate bonds remained negligible at less than 0.5%.

Most LCY bond markets in emerging East Asia recorded foreign capital outflows in December as investors took profits amid the weakening of most local currencies against the US dollar. However, this trend reversed in January in Indonesia and the Republic of Korea as foreign capital flows turned positive.

### LCY Bond Yields

Between end-December 2014 and mid-February 2015, LCY government bond yields fell for most tenors in emerging East Asia on falling inflation. Slower global growth and falling oil prices have led to reduced inflationary expectations in the region. Two economies, Singapore and Thailand, are flirting with deflation as both posted negative inflation rates in January. A number of central banks in the region either reduced policy rates or held back from raising rates. For example, the PRC, the Republic of Korea, and Viet Nam have reduced their policy rates within the past few months. Indonesia and the Philippines have held their policy rates steady due to weaker inflationary pressures.

The 2-year versus 10-year spread declined in all markets, except Indonesia and Thailand, in line with declining inflation in the region.

### Special Section: Oil and Gas Corporate Bonds in Asia

Bond issuance from the region’s oil and gas industry has expanded for much of the past decade, peaking at US$118 billion in 2012 before slowing to US$63 billion in 2014. Despite the recent decline in bond issuance volumes, the share of FCY-denominated debt within the industry increased to a record 66% in 2014. The proportion of oil and gas corporate bonds to total bonds outstanding is generally small across Asia, except in Kazakhstan where the ratio stands at 20.2%