AsianBondsOnline 2020 Bond Market Liquidity Survey

Introduction

Liquidity is an integral aspect of bond markets. Good market liquidity is a key advantage for investors, as it keeps funds from being locked up and allows investors to quickly liquidate bonds when needed. For issuers, good liquidity allows them to issue bonds with longer maturities to mitigate prepayment risk. Hence, a key aspect in the development of a well-functioning bond market is to ensure both breadth and depth in bond market transactions, as well as doing so at a low transaction cost. If there is a lack of liquidity in bond markets, issuance from corporates and governments, and readiness to invest from investors, will be curtailed.

As part of *AsianBondsOnline*'s efforts to provide information on local currency (LCY) bond markets, a bond market liquidity survey is conducted on an annual basis. The goal of the survey is to provide a snapshot of the state of liquidity in emerging East Asian bond markets.[14] The survey helps identify areas of weakness in each of the region's bond markets that could aid key bond market stakeholders, particularly policy makers and financial market regulators, to undertake reforms and/or address areas for development. For the 2020 survey, a shortened version compared to past surveys was conducted. The survey was undertaken solely via email as the coronavirus disease (COVID-19) outbreak restricted us from conducting market visits and face-to-face interviews.

As in past years, the survey was targeted for various bond market participants such as bond traders from financial institutions, financial market brokers, research houses, fund managers, and bond pricing agencies. The survey period commenced from late November through the middle of December 2020, with the aim of capturing the impact of the COVID-19 outbreak on the region's bond markets.

The survey comprises two parts: a quantitative section and a qualitive section, each covering LCY government and corporate bonds. The quantitative section analyzes market data on bid–ask spreads and transaction sizes, which are used as measures for assessing the liquidity conditions in each of the region's LCY bond markets. The qualitative section presents the overall perception of market participants on the degree of development of their respective bond market based on identified structural issues.

Both advanced and emerging economies were roiled by the COVID-19 pandemic. Government efforts to mitigate the spread of the disease, such as lockdowns and quarantines, as well as reduced consumer demand, led to a contraction in economic output in 2020. Financial markets were also affected, with some markets experiencing a decline in liquidity and heightened bankruptcy risks. This led to central governments and central banks in the region engaging in measures to help support the economy and boost liquidity in financial markets. Central banks also implemented accommodative monetary policy measures.

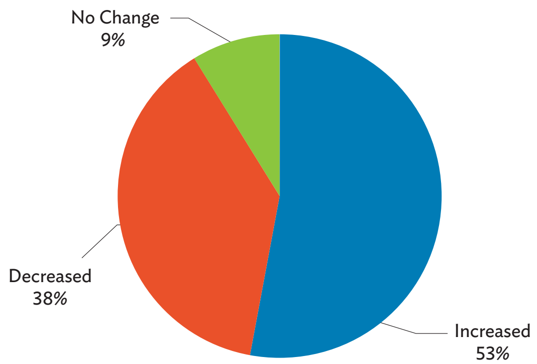
In some markets, liquidity and overall trading activity declined as a result of the negative sentiment and impact of COVID-19. An increase in government bonds as a result of fiscal stimulus measures also helped drain liquidity. But in other cases, positive investor sentiment for that particular economy and/or the accommodative measures of central banks helped boost liquidity.

The majority of survey participants noted that overall bond market liquidity in emerging East Asia increased during 2020. Some 53% of participants said that overall bond market liquidity improved versus 2019, while 38% said that liquidity had worsened (**Figure 24**). Only 9% said that liquidity remained the same.

However, on a per market basis, liquidity conditions were deemed mixed in 2020. Most survey participants from the People's Republic of China (PRC), Indonesia, Malaysia, and Viet Nam observed improved conditions over the previous year. On the other hand, participants from

[14] 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.

Figure 24: Liquidity Conditions in 2020 vs. 2019

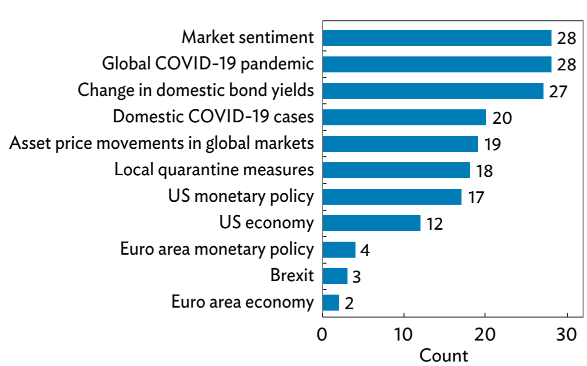


Note: Figures refer to percentage of survey respondents.
Source: *AsianBondsOnline* 2020 Local Currency Bond Market Liquidity Survey.

the Republic of Korea, the Philippines, Singapore, and Thailand noted decreased liquidity. Survey respondents from Hong Kong, China perceived that there was no change in liquidity conditions in 2020 versus 2019.

Market participants were also asked about various factors that affected liquidity conditions in the bond market in 2020. The three biggest drivers of liquidity were market sentiment, the COVID-19 pandemic, and movements in bond yields (**Figure 25**). It was also observed that among various factors, developments relating to the euro area had the least impact on emerging East Asia's bond markets. Factors relating to Brexit and the euro area's economy and monetary policy were only mentioned by a handful of participants.

Figure 25: Factors Affecting Bond Market Liquidity in 2020

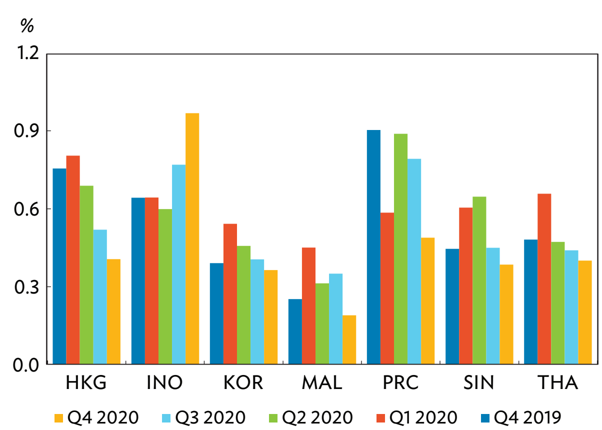


COVID-19 = coronavirus disease, US = United States.
Note: Figures refer to the count of responses for each identified factor.
Source: *AsianBondsOnline* 2020 Local Currency Bond Market Liquidity Survey.

Quantitative Indicators for Government Bond Markets

Figure 26 presents the quarterly turnover ratios for emerging East Asian markets where data are available. A similar pattern in nearly all markets were noted where the quarterly turnover ratio was the highest in the first quarter (Q1) of 2020 before exhibiting a decline. Turnover ratios in the region's government bond markets were mostly down in the second quarter (Q2) of 2020 as markets experienced the full impact of quarantine measures, affecting both investor sentiment and drying up liquidity due to the curtailment of economic activities. The exceptions were the PRC and Singapore, which both saw increases in their respective government bond turnover ratios in Q2 2020. The PRC was one of the few markets that showed an economic recovery in 2020, which had a positive impact on investor sentiment. Also, notable is that nearly all markets posted steady declines in government turnover ratios from Q2 2020 to the fourth quarter (Q4) of 2020, except for Indonesia and Malaysia. In Indonesia, declining interest rates and renewed foreign investor interest helped boost liquidity. In Malaysia, the

Figure 26: Local Currency Government Bond Turnover Ratios



HKG = Hong Kong, China; INO = Indonesia; KOR = Republic of Korea; MAL = Malaysia; PRC = People's Republic of China; Q1 = first quarter, Q2 = second quarter; Q3 = third quarter; Q4 = fourth quarter; SIN = Singapore; THA = Thailand.

Notes:

1. Turnover ratios are calculated as local currency trading volume (sales amount only) divided by average local currency value of outstanding bonds during each 3-month period.
2. For the People's Republic of China, only treasury bonds were included in the computation of turnover ratio.

Sources: People's Republic of China (*ChinaBond*); Hong Kong, China (Hong Kong Monetary Authority); Indonesia (Indonesia Stock Exchange); the Republic of Korea (The Bank of Korea and KG Zeroin Corporation); Malaysia (Bank Negara Malaysia); Singapore (Monetary Authority of Singapore and Singapore Government Securities); and Thailand (Bank of Thailand and Thai Bond Market Association).

government turnover ratio rose in the third quarter of 2020 as market sentiment improved with the easing of lockdown measures before plummeting in Q4 2020 as a resurgence of virus cases drove down investor confidence.

Survey respondents were also asked to provide their quotes for bid–ask spreads, which measure the difference between the buying and the selling price of a particular bond. A lower bid–ask spread indicates a more liquid market. The regional average bid–ask spread for on-the-run government bonds for the 2020 survey stood at 2.8 basis points (bps), which was unchanged from the 2019 survey (**Figure 27**).

The lowest government bond bid–ask spreads were found in the PRC and the Republic of Korea with bid–ask spreads of less than 1 bp each. The PRC has benefitted from continued development of its bond market as well as strong inflows from foreign investors. The Republic of Korea, on the other hand, is considered a safe haven among its emerging East Asian peers.

Bid–ask spreads narrowed in 2020 in four emerging East Asian markets: the PRC, Indonesia, Thailand, and Viet Nam. Bid–ask spreads in Viet Nam improved the most, falling to 4.5 bps in the 2020 survey from 5.5 bps in 2019, owing to strong domestic demand. The PRC's bid–ask spread also fell from 1.1 bps to 0.6 bps in the same period. The PRC and Viet Nam were the two markets in the region that successfully contained their COVID-19 outbreak early on, boosting investor sentiment in their respective markets. In contrast, Malaysia's bid–ask spreads worsened the most, rising to 4.0 bps in 2020 from 2.7 bps in 2019. The bid–ask spreads for all other emerging East Asian markets were marginally changed with either an increase or decrease of 0.3 bps or less.

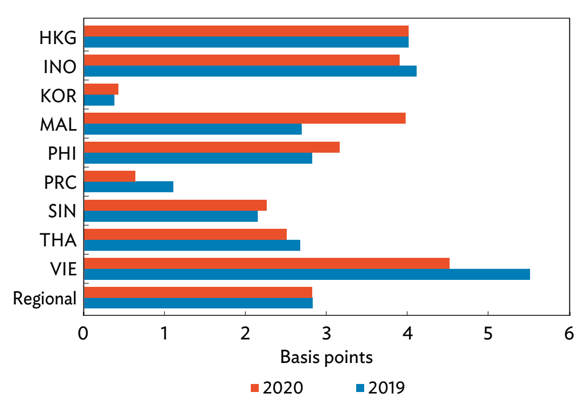
Bid–ask spreads for off-the-run government bonds declined for the region as a whole, averaging 5.0 bps in the 2020 survey versus 5.5 bps in the 2019 survey (**Figure 28**).

Figure 29 presents the average transaction size for on-the-run government bonds in emerging East Asia. Changes in transaction sizes were mixed in the region. Large declines were noted in the PRC; Hong Kong, China; and Singapore; and to a lesser extent in the Philippines, while increases were seen in Malaysia and Indonesia. Based on the 2020 survey results, the Republic of Korea had the largest average transaction size at USD9.2 million per trade. The smaller markets of the Philippines and Indonesia had the smallest average transaction sizes at USD1.7 million each per trade.

Qualitative Indicators for Government Bond Markets

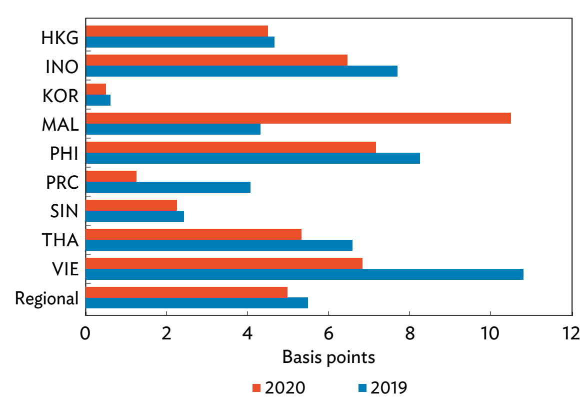
The second part of the liquidity survey delves into identified structural factors to assess the development

Figure 27: Bid–Ask Spread for On-the-Run Government Bonds



HKG = Hong Kong, China; INO = Indonesia; KOR = Republic of Korea; MAL = Malaysia; PHI = Philippines; PRC = People's Republic of China; SIN = Singapore; THA = Thailand; VIE = Viet Nam.
Note: Regional bid-ask spreads refer to the average spreads for the nine markets of emerging East Asia.
Source: *AsianBondsOnline* 2020 Local Currency Bond Market Liquidity Survey.

Figure 28: Bid–Ask Spread for Off-the-Run Government Bonds



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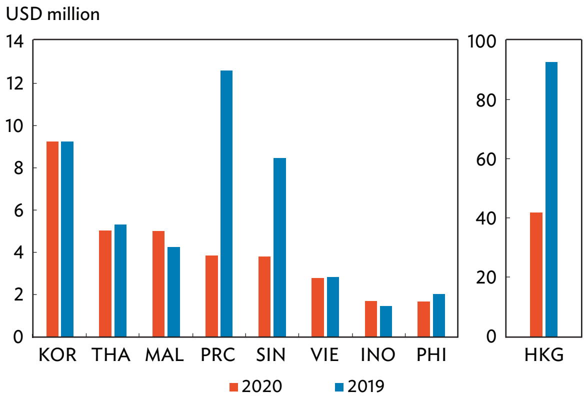
Source: *AsianBondsOnline* 2020 Local Currency Bond Market Liquidity Survey.

Figure 29: Typical Transaction Size for On-the-Run Government Bonds



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Source: *AsianBondsOnline* 2020 Local Currency Bond Market Liquidity Survey.

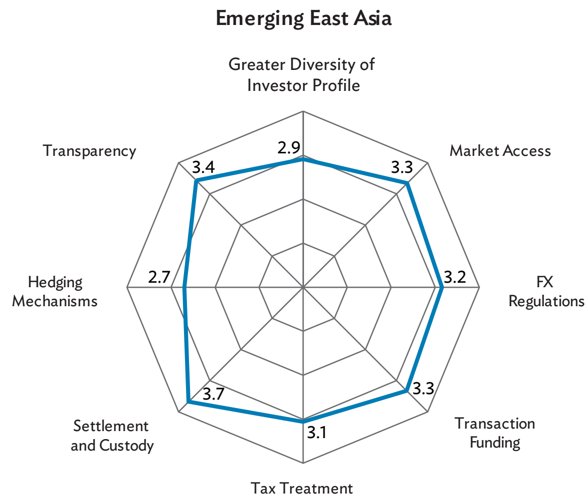
of each of the region's bond markets. Participants were asked to rate their respective markets based on a set of factors. A score of 3.0 or above for any structural factor is indicative of good development of the bond market in that particular area.

The qualitative survey results for 2020 were broadly similar with the 2019 results on average. Hedging instruments continued to score the lowest at 2.7, marginally higher than the previous period's score of 2.6 (**Figure 30**). Some participants cited limited ways of hedging government bond risk. For example, in Viet Nam, government bond futures were only launched in 2019, while in Indonesia, they were first offered in 2017. The Philippines currently lacks a bond futures market. Existing regulations also sometimes hamper the ability of financial institutions in the region to properly hedge.

Diversity of investors also scored a 2.9. In more developed emerging East Asian markets such as the Republic of Korea, a diverse array of investors is present, but in the Philippines and Viet Nam, active investors are mostly limited to a few financial institutions such as banks.

Market access, FX regulations, transaction funding, tax treatment, settlement and custody, and transparency all scored above 3.0, suggesting a high degree of development across the region. The highest score was for settlement and custody at 3.7, owing to modern developments in technology, thereby allowing for

Figure 30: Regional Averages—Local Currency Government Bond Market Structural Issues



FX = foreign exchange.
Note: 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.
Source: *AsianBondsOnline* 2020 Local Currency Bond Market Survey.

more efficient settlement processes in most emerging East Asian markets.

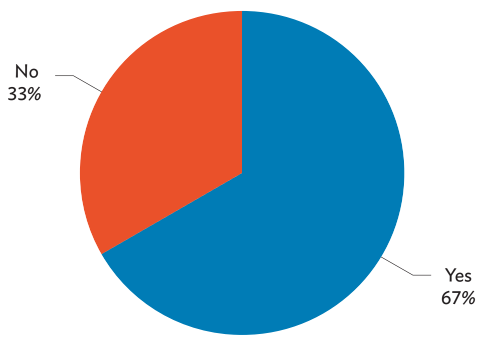
Transaction funding scored 3.3 for the regional average. The availability of funding sources for investors such as repo transactions are available in a number of emerging East Asian markets, but development is still lagging in markets such as the Philippines.

Tax treatment received a score of 3.1. In Hong Kong, China; Malaysia; and Singapore; tax exemptions or incentives are available for government bonds, resulting in higher scores for these markets for this structural factor. There are, however, some markets that still impose withholding taxes on government bond investments, including the Republic of Korea and the Philippines, translating into low tax treatment scores for each of them.

Quantitative Indicators for Corporate Bond Markets

Corporate bond markets in emerging East Asia tend to be less liquid compared to their government counterparts. In some economies, corporate bond markets are considered illiquid with very limited trading activities. In the 2020 survey, more participants noted an active secondary bond

Figure 31: Is There an Active Secondary Bond Market?



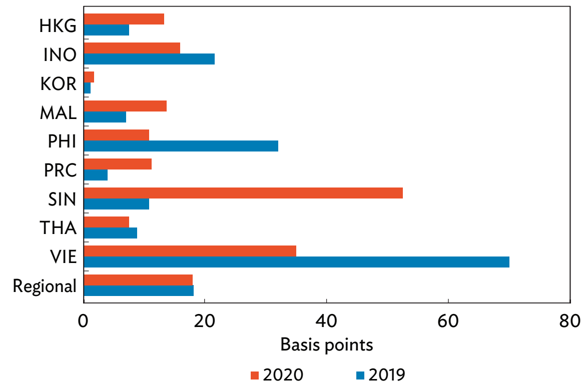
Note: Figures refer to percentage share of survey respondents.
Source: *AsianBondsOnline* 2020 Local Currency Bond Market Liquidity Survey.

market in emerging East Asia compared to participants who said otherwise (**Figure 31**).

In terms of bid–ask spread for corporate bonds, the regional average was mostly unchanged at 18.0 bps in the 2020 survey from the 2019 average of 18.1 bps. Five out of nine emerging East Asian corporate bond markets saw a widening of bid-ask spreads as the pandemic outbreak highlighted bankruptcy concerns amid declines in economic output. Singapore had the largest widening of its corporate bid–ask spread, which rose to 52.5 bps from 10.8 bps (**Figure 32**). The PRC's bid–ask spread rose to 11.3 bps from 4.0 bps. Viet Nam registered the largest drop in its bid–ask spread, posting a spread of 35.0 bps in 2020 versus 70.0 bps in 2019, while the bid–ask spread in the Philippines fell to 10.8 bps in 2020 from 32.0 bps in 2019. For both Viet Nam and the Philippines, bid-ask spreads were based on the spread at the time of issuance as most market participants noted the absence of an active secondary market for corporate bonds. Compared with other markets in the region, Viet Nam and Singapore had the highest bid–ask spreads at 35.0 bps and 52.5 bps, respectively.

The typical transaction size for corporate bonds also significantly declined, with the regional average falling to USD3.2 million in the 2020 survey from USD10.7 million in the 2019 survey, due to a decline in corporate bond liquidity. Most markets had declines in their typical transaction sizes, but the largest declines were in Viet Nam (USD7.0 million in 2020 versus USD64.9 million in 2019), the PRC (USD3.1 million in 2020 versus USD9.4 million in 2019), and the

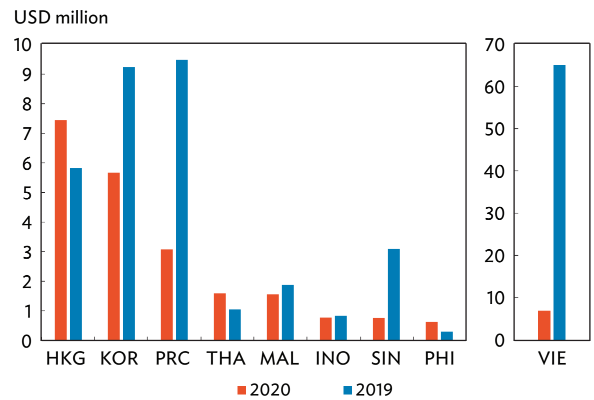
Figure 32: Bid–Ask Spread for Corporate Bonds



HKG = Hong Kong, China; INO = Indonesia; KOR = Republic of Korea; MAL = Malaysia; PHI = Philippines; PRC = People's Republic of China; SIN = Singapore; THA = Thailand; VIE = Viet Nam.
Notes:
1. For 2020, the Philippines and Viet Nam bid-ask spread for corporate bonds refer to spread when bonds are newly issued due to limited liquidity.
2. Regional bid-ask spreads refer to the average spreads for the nine markets of emerging East Asia.

Source: *AsianBondsOnline* 2020 Local Currency Bond Market Liquidity Survey.

Figure 33: Typical Transaction Sizes for Corporate Bonds



HKG = Hong Kong, China; INO = Indonesia; KOR = Republic of Korea; MAL = Malaysia; PHI = Philippines; PRC = People's Republic of China; SIN = Singapore; THA = Thailand; VIE = Viet Nam.
Note: For 2020, the Philippines and Viet Nam typical transaction size for corporate bonds refer to transaction size at the time of issuance.
Source: *AsianBondsOnline* 2020 Local Currency Bond Market Liquidity Survey.

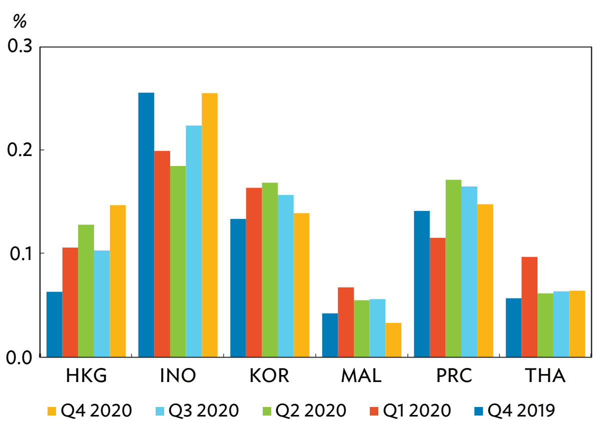
Republic of Korea (USD5.6 million in 2020 versus USD9.2 million in 2019).

Indonesia, Singapore, and the Philippines had the smallest average transaction sizes, each with a typical transaction size of less than USD1.0 million (**Figure 33**). The largest average transaction sizes were in Hong Kong, China (USD7.4 million) and Viet Nam (USD7.0 million).

Corporate bond turnover ratios were mixed for the region. Only the Republic of Korea had fairly stable turnover ratios for each of the four quarters of 2020, ranging from 0.14 to 0.17 (**Figure 34**). In Thailand, corporate bond turnover ratios declined from Q1 2020 to Q2 2020, before posting a steady, albeit marginal, recovery in subsequent quarters.

In contrast, Malaysia's corporate bond turnover ratios were fairly consistent until the last quarter of 2020, where the turnover ratio fell to 0.03 from 0.06 in the third quarter of 2020. In the same period, Indonesia and Hong Kong, China saw improvements in their respective turnover ratios, reflecting increasing investor optimism in the last quarter of the year.

Figure 34: Local Currency Corporate Bond Turnover Ratios



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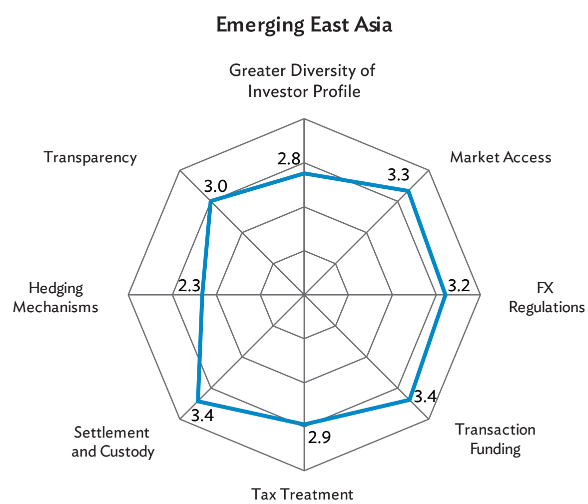
In the PRC, turnover ratios improved after Q1 2020, as an economic recovery was anticipated. Overall, corporate bond turnover ratios in the region were much lower compared to government bond turnover ratios.

Qualitative Indicators for Corporate Bond Markets

For emerging East Asia's corporate bond market, the region can be described as fairly well developed in terms of settlement and custody, FX regulations, transaction funding, and market access, with a regional average score above 3.0 in each of these categories (**Figure 35**). Settlement and custody is not a problem for most markets in the region, with a regional average of 3.4. Transaction funding also received an average score of 3.4. Market access had a score of 3.3, while FX regulations had a score of 3.2.

Figure 35: Regional Averages—Local Currency Corporate Bond Market Structural Issues



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