Executive Summary

Recent Trends in Financial Conditions in Emerging East Asia

Monetary stances in emerging East Asia remain largely accommodative.[1] While the improving economic performance and rising inflation in advanced economies has led to adjustments in their monetary policies, most central banks in emerging East Asia maintained accommodative monetary policies, even as some regional markets, such as the Republic of Korea and Singapore, tightened their monetary stances due to inflationary pressure.

Ample liquidity supported regional financial conditions during the review period from 30 November 2021 to 9 March 2022, with some weakening signs related to the United States (US) Federal Reserve's tapering and its signaling of monetary tightening, and the Russian Federation's (Russia) invasion of Ukraine. Between 30 November 2021 and 9 March 2022, bond yields in emerging East Asia rose on inflationary pressure and spillovers from higher bond yields in major advanced markets. The majority of regional currencies depreciated against the US dollar, with most currencies posting relatively small exchange rate movements. Net portfolio inflows were recorded in the region, while equity markets continued to gain, particularly the markets of Association of Southeast Asian Nations (ASEAN) members on improved economic performance in the fourth quarter (Q4) of 2021. At the same time, risk premiums edged up due to increased risk aversion generated by subdued investment sentiment over the Federal Reserve's expected tightening and the Russian invasion of Ukraine.

The risk outlook for regional financial conditions is tilted to the downside. With progress in economic growth and persistent inflationary pressure in the US, the Federal Reserve started another round of rate hikes in 2022, bringing uncertainty to global liquidity conditions. The Russian invasion of Ukraine may further push up inflation via higher oil and food prices. Continued inflationary pressure could induce regional central banks to tighten, which in turn could affect liquidity and financial conditions. Other uncertainties include persistent supply chain disruptions and the future trajectory of the coronavirus disease (COVID-19) pandemic.

Recent Developments in Local Currency Bond Markets in Emerging East Asia

The size of the local currency (LCY) bond market in emerging East Asia climbed to USD22.8 trillion at the end of December 2021, following USD2.4 trillion of issuance in Q4 2021. LCY bond issuance in emerging East Asia for full-year 2021 reached USD9.0 trillion, expanding 7.1% y-o-y from USD8.4 billion in 2020 and marking the region's largest annual issuance total ever. ASEAN member economies recorded aggregate issuance of USD1.5 trillion in 2021, accounting for 17.0% of the region's annual total, up from a share of 14.7% in 2020. ASEAN issuance in 2021 also marked an annual record-high.

Government bonds accounted for 62.7% of LCY bonds outstanding in emerging East Asia at the end of December. The region's LCY government bond market expanded to a size of USD14.3 trillion in Q4 2021 on new issuance of USD1.3 trillion, which accounted for 56.7% of the region's total issuance during the quarter. ASEAN markets accounted for 10.0% of the region's outstanding government bonds at the end of 2021 and 29% of regional LCY government bond issuance in Q4 2021. Outstanding corporate bonds in emerging East Asia totaled USD8.5 trillion at the end of December, expanding at a pace of 2.8% q-o-q and 11.0% y-o-y in Q4 2021 amid economic recovery.

The maturity structure of emerging East Asia's LCY government bond markets continued to be concentrated in medium- to longer-term tenors. At the end of December, 53.8% of outstanding LCY government bonds in the region had a tenor of more than 5 years.

[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.

In terms of investor profile, financial institutions such as banks, pension funds, insurance companies, and mutual funds played an increasingly important role in regional LCY government bond markets in 2021, especially in Indonesia.

ASEAN+3's sustainable bond market saw rapid expansion in 2021.[2] In full-year 2021, ASEAN+3's total issuance of sustainable bonds rose to USD239.5 billion, more than doubling 2020's issuance of USD96.1 billion. Sustainable bonds outstanding reached USD430.7 billion at the end of December, with total issuance in Q4 2021 of USD58.0 billion.

Special Topics on Local Currency Bond Markets in Emerging East Asia

The *Asia Bond Monitor March 2022* issue features four special boxes and the results of the 2021 *AsianBondsOnline* Annual Bond Market Liquidity Survey.

Bond Market Special Boxes

Foreign Participation in Asian Local Currency Bond Markets and Financial Stability Risks
The development of LCY bond markets in emerging Asian economies has helped mitigate the negative impacts of currency and maturity mismatches. However, the expanding presence of foreign investors in these markets can amplify the risk of capital flow reversals during periods of heightened financial tension. A recent paper by Beirne, Renzhi, and Volz (2021) found that less-developed LCY bond markets are more susceptible to capital flow volatility due to foreign investor participation than more developed LCY bond markets. While foreign participation in LCY bond markets provides important risk-sharing and diversification benefits, authorities should be cautious of the potential financial stability risks to domestic markets.

Determinants of Sovereign Local Currency Bond Issuance in Emerging Markets
A recent study by Zheng et al. (2021) analyzed the determinants of sovereign LCY bond issuance in emerging markets and reported the following key findings. First, emerging market sovereign borrowers were more likely to issue LCY bonds amid a period of domestic currency appreciation before, but not after, the global financial crisis (GFC). Second, inflation-targeting governments tended to issue LCY debt before, but not after, the GFC, reflecting fading global concerns about inflation in the post-GFC period. Third, emerging market sovereign issuers that offered higher yields after the GFC were more likely to issue LCY bonds. The results suggest that return-seeking in the aftermath of the GFC allowed sovereign borrowers, including those with less robust fundamentals, to issue LCY bonds, facilitated by low interest rates globally and offshore LCY bond issuances.

Pricing of Frequent Green Bond Issuances
This box compares the yield difference between frequent and infrequent issuers of green bonds. While there are advantages for issuers of and investors in green bonds, information asymmetry remains a key challenge in the green bond market. Funding costs can be reduced by addressing information asymmetry, via a clear taxonomy, information-enhancing mechanisms, and a novel aspect in the market—frequent issuance. The Oaxaca–Blinder decomposition shows an unexplained yield difference of 68 basis points between frequent and infrequent green bond issuers. Thus, frequent green bond issuers can enjoy a cost advantage due to greater information transparency and a stronger environmental commitment.

Progress toward Greater Efficiency and Integrity in Sustainable Financial Markets: Summary of the Asian Development Bank–State Street Global Advisors Webinar Series
This box summarizes key points from discussions among a broad range of sustainable financial market stakeholders—including investors, regulators, and corporates—at a webinar series jointly hosted by the Asian Development Bank and State Street Global Advisors in November 2021. It was recognized that green investing represents a unique opportunity as demand for green investments rise. Investment managers are increasingly following environmental, social, and governance (ESG) principles, while corporates reported that enhanced disclosure improves ESG awareness and positively impacts investor preferences. Challenges remain in the sustainable market that can be addressed via standardized data and reporting, improved disclosure, and the development of ESG databases.

[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.

Annual *AsianBondsOnline* Bond Market Liquidity Survey

Overall liquidity conditions in emerging East Asia's bond market improved slightly in 2021 compared with 2020, with 50% of survey respondents observing increased liquidity and narrowed bid–ask spreads for both government and corporate bonds. Over 70% of survey participants cited market sentiment as the most important factor affecting bond market liquidity in 2021, with a few other factors also cited as important such as domestic monetary policy, the lingering COVID-19 pandemic, and US monetary policy. On structural market development issues, hedging instruments remain the persistently least-developed factor that affects market liquidity, shedding light on the direction of future market developments.