

Executive Summary

Recent Developments in Financial Conditions in Emerging East Asia

Financial conditions in emerging East Asian economies improved modestly but were clouded by heightened uncertainty in the trajectory of United States (US) monetary policy tightening during the review period of 30 November to 10 March.¹ In December 2022 and January 2023, financial conditions in the region recovered strongly as bond yields declined, equity markets gained, risk premiums narrowed, and currencies strengthened across most regional markets. The improvement was largely driven by the easing of recession risk; the moderating pace of monetary tightening by the US Federal Reserve; and downward trending inflation in the US, euro area, and many regional economies. However, from 1 February through 10 March, regional financial conditions weakened over rising uncertainty regarding the pace of the Federal Reserve's monetary tightening and market turmoil due to the collapse of Silicon Valley Bank and Signature Bank, and, subsequently, pressure on Credit Suisse that led to its takeover.

From 30 November to 10 March, emerging East Asian currencies strengthened by a gross domestic product (GDP)-weighted average of 2.1% against the US dollar. Most of this strengthening occurred in December 2022–January 2023 when the region's currencies gained a GDP-weighted average of 5.0%. This was in contrast with a 2.7% depreciation against the US dollar from 1 February to 10 March. Credit default swap spreads, a proxy for risk premiums, posted a GDP-weighted narrowing of 3 basis points (bps) during the overall review period. However, a collective widening of risk premiums was seen from 1 February through 10 March.

Emerging East Asian equity markets gained a market-value-weighted return of 1.6% during the review period, driven by market rallies in the People's Republic of China (PRC) and Hong Kong, China on the PRC's reopening.

Excluding the PRC and Hong Kong, China, the region's markets recorded a value-weighted loss of 3.1% during the review period. Similar to regional currencies, emerging East Asian markets collectively gained during December 2022–January 2023, which saw a value-weighted return of 5.7%, contrasting with a loss of 3.6% from 1 February to 10 March.

Yields on 2-year and 10-year local currency (LCY) government bonds trended down in most emerging East Asian markets during the review period, posting a simple average decline of 12 bps and 18 bps, respectively. The region's 2-year and 10-year yields fell an average of 35 bps and 36 bps, respectively, in December 2022–January 2023, before rising 23 bps and 18 bps, respectively, from 1 February to 10 March.

Portfolio inflows were observed in regional capital markets during the review period. From 30 November to 10 March, the region received net foreign equity inflows of USD31.9 billion. The majority of these inflows were attributed to the PRC on optimism over its economic reopening. In December 2022–January 2023, the region's bond markets recorded net foreign bond inflows amounting to USD1.7 billion.

Risks to regional financial conditions remain tilted to the downside. Key risks include uncertainty in the path of the Federal Reserve's monetary tightening, the persistence of elevated inflation, and uncertainties in the economic outlooks of major advanced and regional economies. High asset prices and rising debt levels generated during the low-interest-rate era may result in vulnerabilities in the balance sheets of some financial institutions and corporates. Liquidity stress has been experienced by real estate companies in the Viet Nam corporate bond market as they find it hard to refinance their debt. The recent turmoil in the US and European banking sectors highlights the importance of liquidity buffers and proper risk management amid tightened financial conditions and the dimmed economic outlook.

¹ Emerging East Asia is defined to include member states of the Association of Southeast Asian Nations (ASEAN) plus the People's Republic of China; Hong Kong, China; and the Republic of Korea.

Recent Developments in Local Currency Bond Markets in Emerging East Asia

LCY bonds outstanding in emerging East Asian markets stood at USD23.2 trillion at the end of December. Growth in the LCY bond market moderated to 1.2% quarter-on-quarter (q-o-q) in the fourth quarter (Q4) of 2022 from 2.3% q-o-q in the previous quarter as regional issuance contracted. Government bonds accounted for 63.9% of the outstanding bond stock in emerging East Asia at the end of December, with a total amount of USD14.8 trillion. Growth in the government bond market eased to 1.9% q-o-q in Q4 2022 from 2.8% q-o-q in the previous quarter. Meanwhile, corporate bonds outstanding contracted 0.1% q-o-q to fall to USD8.4 trillion at the end of December. The aggregate LCY bond stock of Association of Southeast Asian Nations (ASEAN) member economies reached USD2.1 trillion at the end of December, comprising 8.9% of the region's total LCY bond market.

In Q4 2022, regional LCY bond issuance contracted 6.7% compared with the previous quarter to USD2.2 trillion. Both the government and corporate bond segments witnessed contractions in Q4 2022, as most governments had fulfilled the majority of their borrowing requirements in earlier quarters and rising borrowing costs curtailed bond issuance among corporates. LCY bond issuance in ASEAN markets totaled USD456.4 billion, accounting for 20.9% of the regional issuance total during the quarter. On a year-on-year (y-o-y) basis, regional issuance declined 1.9% in Q4 2022, dragged down by a 15.0% contraction in the corporate bond segment. However, full-year issuance volume reached a record-high of USD9.0 trillion in 2022, up 6.8% y-o-y from USD8.4 trillion in 2021.

More than half of emerging East Asia's government bonds outstanding and bond issuance in Q4 2022 comprised medium- to longer-term maturities. At the end of December, 54.4% of the region's outstanding government bonds carried tenors of 5 years or longer, and the size-weighted tenor of outstanding LCY government bonds in emerging East Asia was 9.1 years. The size-weighted

tenor of LCY government bond issuance in Q4 2022 was 5.9 years, with 60.4% of government bond issuances in Q4 2022 having tenors of 5 years or longer. The majority of LCY government bonds outstanding continued to be held by banks, insurance companies, and pension funds at the end of December.

Sustainable bonds outstanding in ASEAN+3 reached USD589.3 billion at the end of December.² Growth in the regional sustainable bond market moderated to 36.7% y-o-y in 2022 from 53.8% y-o-y in 2021, but this was still faster than the global market's growth of 27.2% in 2022. Compared with the overall bond market, ASEAN+3 sustainable bonds accounted for only 1.7% of ASEAN+3's aggregate bonds outstanding at the end of December. The ASEAN+3 sustainable bond market is dominated by LCY financing (64.7%) and private sector financing (77.8%). Around 54% of outstanding sustainable bonds at the end of December carried a remaining maturity of less than 3 years. In terms of issuance, 78.9% of regional sustainable bonds issued in 2022 carried maturities of 5 years or less, 76.8% came from the private sector, and 72.6% were issued in domestic currencies.

AsianBondsOnline 2022 Bond Market Liquidity Survey

Emerging East Asia's LCY bond market saw an overall weakening of liquidity conditions in 2022 compared with 2021. This was largely driven by tightened financial conditions in both global and domestic financial markets. About 61% of respondents to the *AsianBondsOnline* 2022 Bond Market Liquidity Survey noted that overall liquidity declined, bid-ask spreads widened, and transaction sizes narrowed in both government and corporate bond markets across the region. Participants cited domestic and US monetary policy tightening as the top two factors contributing to weakened liquidity conditions in 2022. The survey's findings also indicated that liquidity conditions in conventional bond markets and sustainable bond markets were largely comparable. Among structural issues, the availability of hedging instruments remained the least-developed aspect of the market that requires further policy initiatives for development.

² ASEAN+3 is defined to include member states of the Association of Southeast Asian Nations (ASEAN) plus the People's Republic of China; Hong Kong, China; Japan; and the Republic of Korea.