

Global and Regional Market Developments

Improved financial conditions in emerging East Asia are clouded by uncertainty over the path of monetary tightening in the United States.

Financial conditions in most emerging East Asian economies modestly improved during the review period from 30 November 2022 to 10 March 2023.¹ In December 2022 and January 2023, regional financial conditions collectively improved largely on the expected moderation of monetary tightening in major advanced economies as well as the peaking of domestic inflation in many regional economies. Risk premiums narrowed, equity markets gained, currencies strengthened against the United States (US) dollar, and bond yields fell between 30 November 2022 and 31 January 2023. However, heightened uncertainties regarding the Federal Reserve's monetary path and market turmoil associated with the collapse of Silicon Valley Bank cast a cloud over regional financial conditions in February

and early March, especially in equity markets. Market concerns were then exacerbated by concerns over Credit Suisse in Europe that eventually led to its being taken over by UBS. Most long-term bond yields fell in the region during the review period, while net portfolio investment inflows were observed in many regional capital markets (**Table A**).

In major advanced economies, bond yields continued to rise as their central banks sustained monetary tightening and inflation remained elevated (**Table B**). In the US and Germany, short-term bond yields, which track policy rates closely, rose more than long-term bond yields, which tend to price in inflationary factors. In Japan, where policy rates remained unchanged during the review period, the 2-year government bond yield barely moved, and the 10-year bond yield rose on rising inflation and speculation that the Bank of Japan (BOJ) would pivot from its current monetary policy stance.

Table A: Changes in Financial Conditions in Major Advanced Economies and Select Emerging East Asian Markets (Between 30 November 2022 and 10 March 2023)

	2-Year Government Bond (bps)	10-Year Government Bond (bps)	5-Year Credit Default Swap Spread (bps)	Equity Index (%)	FX Rate (%)
Major Advanced Economies					
United States	28	9	-	(5.4)	-
United Kingdom	35	48	(4)	2.3	(0.2)
Japan	(0.1)	16	0.8	1.6	2.3
Germany	97	58	(5)	7.2	2.3
Select Emerging East Asian Markets					
China, People's Rep. of	7	(4)	(3)	2.5	2.5
Hong Kong, China	(53)	18	-	3.9	(0.5)
Indonesia	24	2	9	(4.5)	1.8
Korea, Rep. of	(9)	(10)	(7)	(3.2)	(0.5)
Malaysia	(24)	(16)	0.1	(3.7)	(1.7)
Philippines	(11)	(86)	7	(2.8)	2.6
Singapore	41	16	-	(3.4)	0.8
Thailand	6	(21)	(11)	(2.2)	0.6
Viet Nam	(94)	(60)	(11)	0.4	4.3

() = negative, - = not available, bps = basis points, FX = foreign exchange.

Note: A positive (negative) value for the FX rate indicates the appreciation (depreciation) of the local currency against the United States dollar.

Source: *AsianBondsOnline* computations based on Bloomberg LP data.

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.

Table B: Changes in Monetary Stances in Major Advanced Economies and Select Emerging East Asian Markets

Economy	Policy Rate	Rate Change (%)												Policy Rate	Change in	
	1-Mar-2022 (%)	Mar-2022	Apr-2022	May-2022	Jun-2022	Jul-2022	Aug-2022	Sep-2022	Oct-2022	Nov-2022	Dec-2022	Jan-2023	Feb-2023	Mar-2023	10-Mar-2023 (%)	Policy Rates (basis points)
United States	0.25	↑0.25		↑0.50	↑0.75	↑0.75		↑0.75		↑0.75	↑0.50		↑0.25		4.75	↑450
Euro Area	(0.50)					↑0.50		↑0.75		↑0.75	↑0.50		↑0.50		2.50	↑300
United Kingdom	0.50	↑0.25		↑0.25	↑0.25		↑0.50	↑0.50		↑0.75	↑0.50		↑0.50		4.00	↑350
Japan	(0.10)														(0.10)	
China, People's Rep. of	2.85						↓0.10								2.75	↓10
Indonesia	3.50						↑0.25	↑0.50	↑0.50	↑0.50	↑0.25	↑0.25			5.75	↑225
Korea, Rep. of	1.25		↑0.25	↑0.25		↑0.50	↑0.25		↑0.50	↑0.25		↑0.25			3.50	↑225
Malaysia	1.75			↑0.25		↑0.25		↑0.25		↑0.25					2.75	↑100
Philippines	2.00			↑0.25	↑0.25	↑0.75	↑0.50	↑0.50		↑0.75	↑0.50		↑0.50		6.00	↑400
Singapore	-	↑				↑			↑						-	-
Thailand	0.50						↑0.25	↑0.25		↑0.25		↑0.25			1.50	↑100
Viet Nam	4.00							↑1.00	↑1.00						6.00	↑200

(-) = negative.

Notes:

1. Data coverage is from 1 March 2022 to 10 March 2023.

2. For the People's Republic of China, data used in the chart are for the 1-year medium-term lending facility rate. While the 1-year benchmark lending rate is the official policy rate of the People's Bank of China, market players use the 1-year medium-term lending facility rate as a guide for the monetary policy direction of the People's Bank of China.

3. The up (down) arrow for Singapore signifies monetary policy tightening (loosening) by its central bank. The Monetary Authority of Singapore utilizes the Singapore dollar nominal effective exchange rate (S\$NEER) to guide its monetary policy.

Sources: Various central bank websites.

The expected pace of US monetary tightening shifted during the review period. In December 2022 and January 2023, a moderation in monetary tightening was expected on softening inflation in the US, where year-on-year (y-o-y) consumer price inflation continued trending downward from June's 9.1% peak to 7.7%, 7.1%, and 6.5% in October, November, and December, respectively. Personal Consumption Expenditures (PCE) inflation also declined from 6.3% y-o-y in September to y-o-y readings of 6.1%, 5.6%, and 5.3% for October, November, and December, respectively. During the 13–14 December Federal Open Market Committee (FOMC) meeting, the Federal Reserve narrowed the policy rate hike to 50 basis points (bps) after hikes of 75 bps each in its past four meetings.

Uncertainties regarding the future direction of the Federal Reserve's monetary policy heightened in February and early March. Although the Federal Reserve hiked the policy rate by 25 bps, as expected, during the 31 January–1 February FOMC meeting, chances of a 50 bps rate hike at the March FOMC meeting increased from zero on 3 February to 24% on 28 February. In February, the Federal Reserve stated that inflation remained elevated with no sign of quickly

falling.² Although consumer price inflation in the US further declined to 6.4% y-o-y in January and 6.0% y-o-y in February—from 6.5% y-o-y in December—core inflation remained persistent. PCE inflation also rose slightly in January to 5.4% y-o-y from 5.3% y-o-y in December. The 22 February release of minutes from the 31 January–1 February FOMC meeting indicated that members still found inflation “unacceptably high” and they continued to worry about inflation. The minutes also indicated that some participants were in favor of a 50 bps rate hike as opposed to the eventual 25 bps rate hike. The collapse of Silicon Valley Bank further clouded the market with uncertainty over the Federal Reserve's monetary policy path. Per the CME FedWatch, the likelihood of a 50 bps rate hike abated as investors believed the Federal Reserve may become cautious to minimize volatility that could lead to bank failures similar to that of Silicon Valley Bank. The probability of a 50 bps rate hike fell to zero on 13 March from 40.2% the previous day.

Market expectations were borne out when the Federal Reserve raised the federal funds target range by 25 bps during its 22–23 March meeting. While the Federal Reserve noted that inflation remains high,

² Schneider, Howard. 2023. Fed's Waller Sees No Signs of 'Quick' Decline in Inflation. *Reuters*. 9 February.

it softened its hawkish language. The Federal Reserve said that it had considered keeping rates steady in light of the recent banking turmoil and removed the phrase “ongoing rate increases” from its policy statement. In addition, the Federal Reserve updated forecasts in March from those made in December with a slight downgrade to GDP forecasts for 2023 (to 0.4% from 0.5%) and 2024 (to 1.2% from 1.6%). The PCE inflation projection for 2023 was slightly increased (to 3.3% from 3.1%). The expected terminal federal funds rate was unchanged for 2023 and 2025, but increased for 2024 (to 4.3% from 4.1%). Based on the Federal Reserve’s forecasts, one more interest rate hike of 25 bps is expected in 2023 before a pause.

Meanwhile, the US economic outlook remained dim. Annualized gross domestic product (GDP) growth weakened to 2.7% in the fourth quarter (Q4) of 2022 from 3.2% in the third quarter (Q3). While unemployment remained low in Q4 2022, nonfarm payroll additions posted continuous declines from 350,000 in September to 324,000 in October, 290,000 in November, and 260,000 in December. The risk of recession abated somewhat following the strong nonfarm payroll report of 504,000 new additions in January 2023 and a higher-than-expected 311,000 additions in February 2023.

Similarly, the European Central Bank (ECB) continued to tighten its monetary stance to ease inflation, albeit at a moderated pace. Inflation in the euro area has trended downward yet remains elevated. Inflation peaked in October at 10.6% y-o-y, then gradually eased to 10.1% y-o-y, 9.2% y-o-y, 8.6% y-o-y, and 8.5% y-o-y in November, December, January, and February, respectively. GDP growth also softened to 1.9% y-o-y in Q4 2022 from 2.5% y-o-y in Q3 2022. On 15 December, the ECB raised its key policy rates by 50 bps, which was less than the 75 bps rate hike announced on 27 October. Meanwhile, the ECB announced a reduction in its Asset Purchase Programme holdings by EUR15 billion each month from March 2023 to June 2023, before it plans to reassess its balance sheet reduction program. On 2 February and 16 March, the ECB raised policy rates by 50 bps each, as expected. The ECB also released updated economic forecasts in March. However, the ECB noted that these were made prior to the recent banking sector turmoil, adding uncertainty to these forecasts.

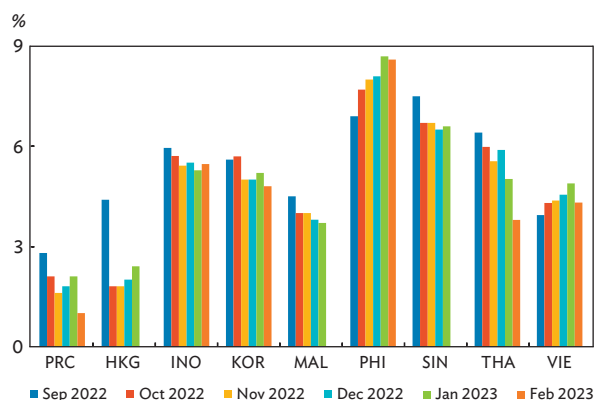
The ECB raised its forecast for 2023 GDP growth in the euro area to 1.0% in March from 0.5% in December,

but lowered its growth forecasts for 2024 to 1.6% from 1.9%, and for 2025 to 1.6% from 1.8%. It also reduced its inflation projections in March for 2023, 2024, and 2025 to 5.3%, 2.9%, and 2.1%, respectively, from 6.3%, 3.4%, and 2.3%.

In Japan, inflation has been steadily increasing and the BOJ has largely maintained the monetary stance. Japan’s consumer price inflation rose from 3.0% y-o-y in September to 3.7% y-o-y in October, 3.8% y-o-y in November, 4.0% y-o-y in December, and 4.3% y-o-y in January. GDP growth accelerated to an annualized 0.1% in Q4 2022, reversing Q3 2022’s 1.1% decline. During its 20 December meeting, the BOJ kept its key policy rates unchanged but widened the trading band of Japanese Government Bonds from $\pm 0.25\%$ to $\pm 0.50\%$. Although the BOJ indicated this does not suggest monetary tightening, the market largely interpreted it as a pivot in the BOJ’s monetary policy. This decision raised expectations that the BOJ would eventually shift its accommodative monetary stance. On 18 January, the BOJ left its monetary policy unchanged and revised downward its GDP growth forecasts to 1.9%, 1.7%, and 1.1% for fiscal years 2022, 2023, and 2024, respectively, from October forecasts of 2.0%, 1.9%, and 1.5%. The BOJ also revised its inflation forecasts for fiscal years 2022, 2023, and 2024 to 3.0%, 1.6%, and 1.8%, respectively, from corresponding October projections of 2.9%, 1.6%, and 1.6%. The BOJ noted that short-term inflation is being driven by the pass-through effect of high commodity prices, which is expected to wane. During its 9–10 March monetary policy meeting, the BOJ maintained its existing monetary policy, keeping policy rates unchanged and the trading band of Japanese Government Bonds at $\pm 0.5\%$. The move reduced market expectations that the BOJ would be pivoting to a tighter monetary policy.

In a majority of emerging East Asia markets, 10-year government bond yields fell during the review period. This trend was largely supported by moderating monetary tightening in major advanced economies, as well as declining inflation in many regional economies (**Figure A**). The 10-year bond yield in the Philippines witnessed the largest decline of 86 bps, with a 109 bps decline recorded in December–January on expectations that the central bank would ease its monetary tightening in 2023 through moderating rate hikes and a reduction in reserve requirement ratios.³ The decline was partly reversed by increases in bond yields from 1 February

³ Morales, Neil Jerome. 2023. Philippines C.bank Flags 25 or 50 bps Rate Hike Next Month. Reuters. 10 January.

Figure A: Inflation in Select Emerging East Asian Markets

HKG = Hong Kong, China; INO = Indonesia; KOR = Korea, Rep. of; MAL = Malaysia; PHI = Philippines; PRC = China, People's Rep. of; SIN = Singapore; THA = Thailand; VIE = Viet Nam.

Note: Data coverage is from September 2022 to February 2023 except for Hong Kong, China; Malaysia; and Singapore (January 2023).

Sources: Various local sources.

through 10 March, as inflation continued to rise and the Bangko Sentral ng Pilipinas surprised markets with a 50 bps rate hike on 16 February. It followed this up with a smaller 25 bps rate hike on 23 March as inflation remained high with slight decline in February. Viet Nam witnessed the second-largest decline in its 10-year bond yield during the review period, which was partly driven by risk aversion in corporate bond markets. Investors flocked to government bonds for safety amid stress in the corporate bond market, where many real estate companies face liquidity constraints in meeting debt obligations. On 14 March, the State Bank of Vietnam left unchanged its refinancing rate but reduced its discount rate and overnight rate by 100 bps each to support economic growth and ease liquidity stress in financial markets.

Regional financial conditions generally improved during the review period. Most improvements happened in December 2022 and January 2023 on moderating monetary tightening in advanced economies, easing inflationary pressures in the region, and boosted investor sentiment over the economic benefits of the reopening of the People's Republic of China (PRC) economy.

Box 1 suggests a sound economic outlook for emerging East Asia in 2023.

During the review period, a majority of emerging East Asian currencies strengthened against the US dollar.

Regional currencies appreciated by an average of 1.3% (simple) and 2.1% (GDP-weighted). The strengthening largely happened in December and January, when average appreciations of 3.9% (simple) and 5.0% (GDP-weighted) were posted. From 1 February to 10 March, most regional currencies weakened against the US dollar, with an average depreciation of 2.5% (simple) and 2.7% (GDP-weighted) (**Figure B**). Risk premiums, gauged by credit default swap spreads, also trended downward during the review period, posting a GDP-weighted average narrowing of 3 bps (**Figure C**). The reduction of risk premiums was more pronounced in December–January, followed by widening risk premiums from 1 February to 10 March in several economies.

The souring of investment sentiment in February and early March was more pronounced in equity markets. During the review period, regional equity markets posted a market-weighted average return of 1.6%, driven by strong gains in the PRC and Hong Kong, China. Excluding the PRC and Hong Kong, China, regional equity markets posted a market-weighted loss of 3.1% (**Figure D**). Regional equity markets rallied 5.7% (market-weighted) in December–January, but retreated 3.6% from 1 February to 10 March over uncertainties in the direction of the Federal Reserve's monetary stance (**Figure E**). The biggest gain was seen in the Lao People's Democratic Republic (Lao PDR), which rose 31.9% during the review period as the reopening of the PRC is expected to boost economic activities through the Lao PDR–PRC railway. The equity markets of both Hong Kong, China and the PRC posted gains during the review period, rising 2.5% and 3.9%, respectively, following the reopening of the PRC's economy.

The region's equity markets experienced strong net portfolio inflows of USD31.9 billion from 30 November 2022 to 10 March 2023 (**Figure F**). Of this total, USD27.9 billion went to the PRC following the economy's reopening. The Republic of Korea received USD5.3 billion of inflows on expectations of possible inclusion in Morgan Stanley Capital International's developed market index this year. In addition, financial regulators in the Republic of Korea are planning to relax regulations to make investing in the stock market easier for offshore investors. In contrast, ASEAN economies posted aggregate net foreign equity outflows of USD1.2 billion during the review period. This was largely driven by Indonesia's net outflows of USD1.1 billion following the decision of the government to curb palm oil exports to

Box 1: Economic Outlook in Developing Asia

Growth in developing Asia remained strong in 2022.^a Robust domestic activity underpinned by reopening offset the negative impact from a worsening global economy; the slowdown in the People's Republic of China (PRC); and policy rate hikes across the region, triggered by rising inflation and aggressive monetary tightening in the United States (US).

External headwinds will continue to be significant this year. Oil prices are forecast to remain elevated. Growth in advanced economies will slow, as above-target inflation leads to tighter financial conditions. Recent indicators, however, suggest that economic activity in the PRC is picking up and may prove more resilient than expected in the US and euro area. In addition, the global economy is set to receive a boost from a growth rebound in the PRC once the current coronavirus disease (COVID-19) wave is over.

Against this backdrop, recovery in developing Asia is projected to lose some steam as the effects of reopening wane—but it will remain solid. In December, the Asian Development Bank trimmed the region's growth forecast for 2023 by 0.3 percentage points to 4.6% (**Table B1**). A challenging global outlook is expected to slow expansion in every subregion but the Caucasus and Central Asia, which has fared better than

expected on positive spillovers from the Russian invasion of Ukraine. The forecast for regional inflation this year is 4.2%, with higher inflation expected for South Asia, Southeast Asia, and the Pacific. Despite the downgraded growth forecast, developing Asia is still projected to grow more than most other regions—and suffer lower inflation.

Developing Asia faces several risks but also opportunities. In the short term, an escalation of the Russian invasion of Ukraine could renew surges in commodity prices, stoking global inflation and inducing further monetary tightening. Inflationary pressures in the US and other advanced economies could prove more persistent than expected, prolonging the current monetary tightening cycle. On the other hand, more rapid disinflation could lead to a quicker pivot toward policy rate cuts, supporting a rebound in economic activity and financial markets.

The main upside risks and opportunities, however, are associated with reopening in the PRC, which may be a turning point for developing Asia. A smooth exit from pandemic-related policies and resolution of property market issues in the PRC could brighten regional economic prospects—boosting exports, consumption, and investment.

Table B1: Gross Domestic Product Growth and Inflation Forecasts (% per year)

	GDP Growth					Inflation				
	2021	2022		2023		2021	2022		2023	
		September Update	December ADOS	September Update	December ADOS		September Update	December ADOS		
Developing Asia	7.0	4.3	4.2	4.9	4.6	2.5	4.5	4.4	4.0	4.2
Caucasus and Central Asia	5.7	3.9	4.8	4.2	4.2	8.9	11.5	12.5	8.5	8.5
East Asia	7.7	3.2	2.9	4.2	4.0	1.1	2.5	2.4	2.5	2.4
South Asia	8.1	6.5	6.5	6.5	6.3	5.8	8.1	8.2	7.4	7.9
Southeast Asia	3.3	5.1	5.5	5.0	4.7	2.0	5.2	5.1	4.1	4.5
The Pacific	(1.7)	4.7	5.3	5.5	4.8	3.1	6.2	5.8	4.8	5.0

() = negative, ADOS = *Asian Development Outlook Supplement*, GDP = gross domestic product.

Source: *Asian Development Outlook* database (accessed 7 March 2023).

^a This box was written by Irfan Qureshi (economist) and David de Padua (economics officer) in the Economic Research and Regional Cooperation Department of the Asian Development Bank.

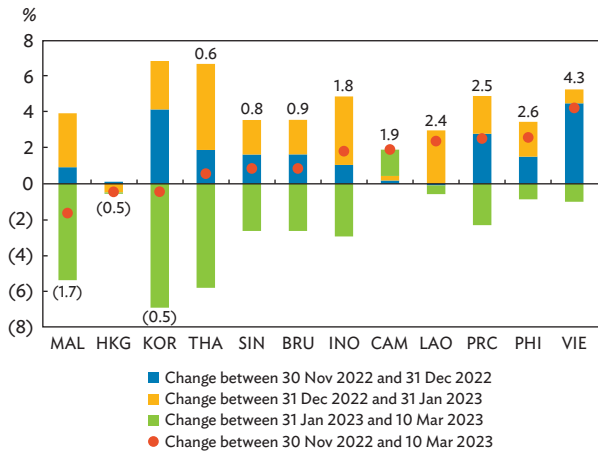
focus on domestic supply, which may impact Indonesia's trade surplus.⁴

The region's bond markets recorded aggregate net foreign portfolio inflows of USD1.7 billion in December

2022 and January 2023 (**Figure G**). Most regional bond markets posted inflows, with the exceptions being the Republic of Korea and Malaysia. The Republic of Korea posted net outflows of USD8.6 billion from its bond market as a sizable volume of bonds matured and

⁴ Thukral, Naveen, and Bernadette Christina. 2023. Indonesia Palm Oil Export Curbs, Biodiesel Plans to Hit World Vegoil Supplies. *Reuters*. 16 January.

Figure B: Changes in Select Emerging East Asian Currencies



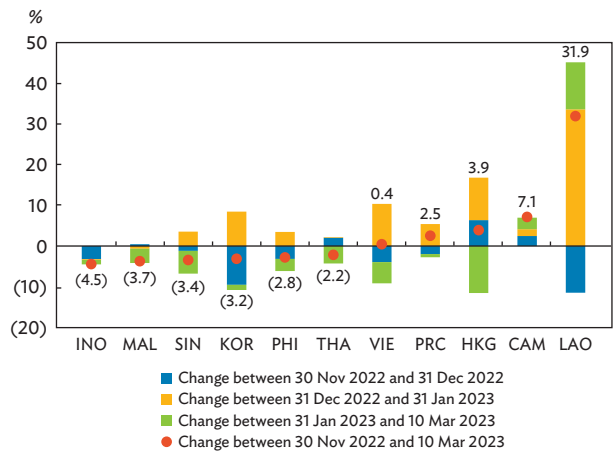
() = negative; BRU = Brunei Darussalam; CAM = Cambodia; HKG = Hong Kong, China; INO = Indonesia; KOR = Korea, Rep. of; LAO = Lao People's Democratic Republic; MAL = Malaysia; PHI = Philippines; PRC = China, People's Rep. of; SIN = Singapore; THA = Thailand; VIE = Viet Nam.

Notes:

1. A positive (negative) value for the foreign exchange rate indicates the appreciation (depreciation) of the local currency against the United States dollar.
2. Figures refer to change between 30 November 2022 and 10 March 2023.

Source: *AsianBondsOnline* computations based on Bloomberg LP data.

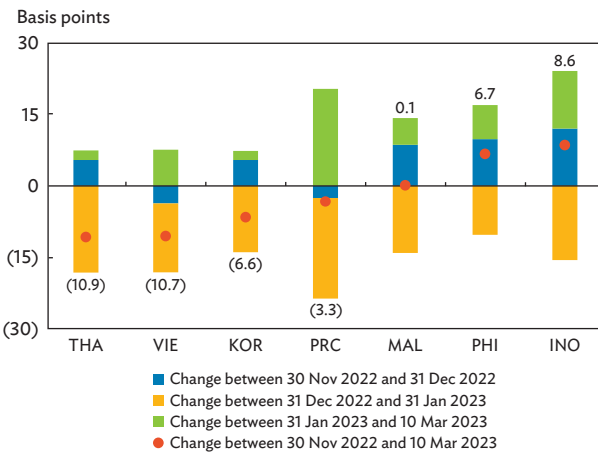
Figure D: Changes in Select Emerging East Asian Equity Indices



() = negative; CAM = Cambodia; PRC = China, People's Rep. of; HKG = Hong Kong, China; INO = Indonesia; KOR = Korea, Rep. of; LAO = Lao People's Democratic Republic; MAL = Malaysia; PHI = Philippines; SIN = Singapore; THA = Thailand; VIE = Viet Nam.

Note: Figures refer to change between 30 November 2022 and 10 March 2023. Source: *AsianBondsOnline* computations based on Bloomberg LP data.

Figure C: Changes in Credit Default Swap Spreads in Select Emerging East Asian Markets (senior 5-year)

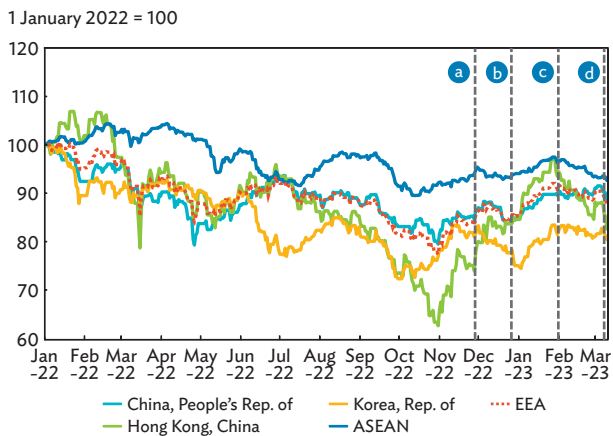


() = negative; INO = Indonesia; KOR = Korea, Rep. of; MAL = Malaysia; PHI = Philippines; PRC = China, People's Rep. of; THA = Thailand; VIE = Viet Nam.

Note: Figures refer to change between 30 November 2022 and 10 March 2023. Source: *AsianBondsOnline* computations based on Bloomberg LP data.

investors anticipated that the Bank of Korea was nearing the end of its tightening cycle. In Malaysia, there were small net capital outflows of USD0.1 billion during the 2-month review period. Among the remaining regional bond markets, Indonesia recorded the largest net inflows at USD5.0 billion due to its attractive yields. The PRC recorded the region's second-largest net foreign capital inflows of USD2.6 billion. Meanwhile, the Thai bond market received USD2.5 billion of foreign capital inflows over optimism that the PRC's reopening would boost tourism receipts. **Box 2** discusses investment opportunities in ASEAN bond markets.

Overall, the outlook for emerging East Asia's financial conditions remains benign as recession fears and inflation have eased and some regional central banks are expected to end their tightening cycles. Investors see many opportunities in global bond markets in 2023. **Box 3** discusses the return of investor demand for bonds. However, the outlook is far from certain and remains largely driven by a few key risk factors.

Figure E: Movements in Equity Indexes in Select Emerging East Asian Markets

ASEAN = Association of Southeast Asian Nations, EEA = emerging East Asia, FOMC = Federal Open Market Committee, PRC = People's Republic of China, US = United States.

- a** Market expectations of slowing Federal Reserve rate hikes in anticipation of Chairman Powell's speech at Brookings Institution
- b** The PRC announced the lifting of quarantine requirements for international arrivals
- c** January FOMC meeting
- d** Chairman Powell's semi-annual report to Congress noted that interest rates will likely rise more than expected

Notes:

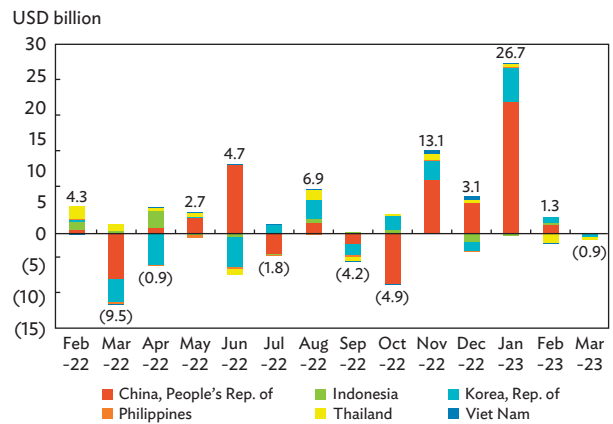
1. Equity market indexes included in ASEAN are the Jakarta Stock Exchange Composite Index, Kuala Lumpur Composite Index, Philippine Stock Exchange Index, Straits Times Index, Stock Exchange of Thailand Index, and Vietnam Ho Chi Minh Stock Index.
2. Data as of 10 March 2023.
3. Emerging East Asia is defined 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.

Sources: *AsianBondsOnline* computations based on Bloomberg LP data; Marte, Jonnelle. 2022. Powell to Set Stage for Slowing Fed Rate Hikes Amid Hawkish Tone. *Bloomberg*. 28 November; and Schneider, Howard, and Ann Saphir. 2022. Fed's Powell: Rate Hikes to Slow, but Adjustment Just Beginning. *Reuters*. 1 December.

First is the uncertain pace of monetary tightening in advanced economies. The Federal Reserve in its March projections indicated that it will take a pause after one more rate hike in 2023.⁵ However, uncertainty in inflation and development of current banking sector turmoil would affect the path of monetary policy, casting uncertainty over financial conditions in the region.

Second, a US dollar strengthened by the Federal Reserve's monetary tightening can challenge financial stability and debt sustainability in emerging markets economies.

Box 4 discusses these debt sustainability risks in emerging markets amid dollar fluctuations.

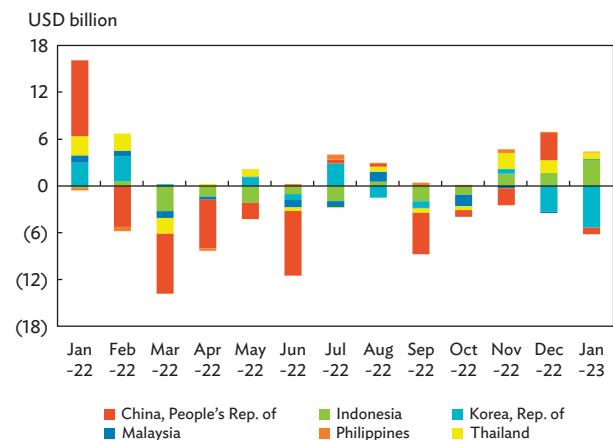
Figure F: Foreign Capital Flows in Equity Markets in Select Emerging East Asian Markets

() = outflows, USD = United States dollar.

Notes:

1. Data coverage is from 1 February 2022 to 10 March 2023.
2. Figures refer to net inflows (net outflows) for each month.
3. 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.

Source: Institute of International Finance.

Figure G: Foreign Capital Flows in Local Currency Bond Markets in Select Emerging East Asian Markets

() = negative, USD = United States dollar.

Notes:

1. The Republic of Korea and Thailand provided data on bond flows. For the People's Republic of China, Indonesia, Malaysia, and the Philippines, month-on-month changes in foreign holdings of local currency government bonds were used as a proxy for bond flows.
2. Data are as of 31 January 2023.
3. Figures were computed based on 31 January 2023 exchange rates and do not include currency effects.
4. 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.

Sources: People's Republic of China (Bloomberg LP); Indonesia (Directorate General of Budget Financing and Risk Management, Ministry of Finance); Republic of Korea (Financial Supervisory Service); Malaysia (Bank Negara Malaysia); Philippines (Bureau of the Treasury); and Thailand (Thai Bond Market Association).

⁵ Federal Reserve. 2023. Summary of Economic Projections. *FOMC Projection Materials*. 21–22 March.

Box 2: Investors' View—Opportunities and Risks for Private Investors in ASEAN Local Currency Bond Markets

Central banks overseeing the 10 most heavily traded currencies delivered a combined 2,700 basis points of tightening through 54 rate hikes in 2022.^a While the World Bank and International Monetary Fund predicted that we saw the peak of inflation in 2022 in their January 2023 *Global Economic Prospects* and *World Economic Outlook* reports, respectively, the future path of major benchmark interest rates is far from certain.

Against this global backdrop, this box discusses what global investors should keep in mind when investing in emerging East Asian local currency (LCY) government bond markets in 2023. The Indonesian market offers relative stability and decent returns. Investments in Thailand have the highest exposure to currency fluctuations and policy rate adjustments. Investors' confidence in Malaysia depends on political actions to rein in rising national debt.

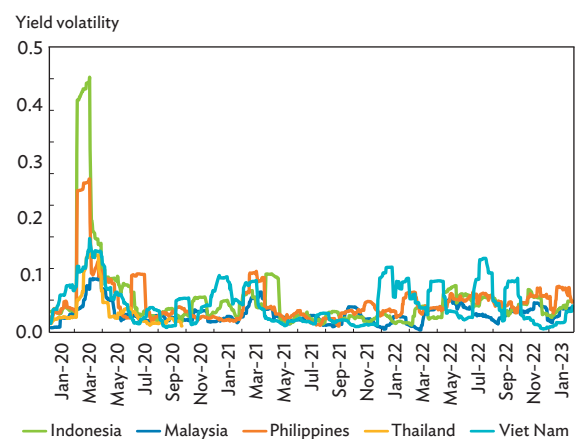
Globally, emerging economies with higher exposure to foreign currency financing are the most impacted by higher interest rates in the United States (US) and a stronger US dollar, as they need to pay more just to service their debt.

Neither of the two Association of Southeast Asian Nations (ASEAN) economies in the frontier market category, Cambodia and the Lao People's Democratic Republic (Lao PDR), have a properly functioning LCY bond market. Further, most of their debts are held by external lenders such as multilateral development banks and the People's Republic of China. The big difference from international investors' point of view between the two economies is that, while Cambodia has experienced relatively low single-digit inflation and a stable exchange rate over the last 2 years, the Lao PDR's inflation started rising significantly in the middle of 2022 and hit 39.3% in December, with the Lao kip losing over 50% in value against the US dollar last year. A recently released case study from the Asian Development Bank highlights how the development of the LCY government bond market in the Lao PDR could help facilitate economic recovery and build resilience against future shocks.^b

All five emerging markets in ASEAN have seen relative stability in their respective LCY government bond markets

over the last 2 years, with the 10-year benchmark yield's volatility in each economy comfortably below the market turmoil levels experienced during the second quarter of 2020 (Figure B2.1). Souring sentiment in global emerging markets in the third quarter of 2022 had bigger impacts on credit default swaps spreads, currency exchange rates, and equity markets than on LCY government bonds.

Figure B2.1: Local Currency Bond Yield Volatility in Emerging ASEAN Economies



ASEAN = Association of Southeast Asian Nations.

Source: AsianBondsOnline calculations based on Bloomberg LP data (accessed 16 February 2023).

Indonesia continued its efforts to promote domestic investment and stabilize capital flows in 2022, which resulted in the most significant reduction of the foreign holdings share in the LCY government bond market among the five economies included in Figure B2.2. In the last 3 years, Indonesia has managed to increase the overall size of its LCY government bond market—now the biggest among emerging markets in ASEAN by a wide margin—while keeping the 10-year benchmark yield in an attractive and stable range of 6%–8%. Increased participation from domestic financial institutions provides a cushion against capital outflows in times of heightened financial tensions, as examined in Box 1: Foreign Participation in Asian Local Currency Bond Markets and Financial Stability Risks in the March 2022 edition of the *Asia Bond Monitor*.^c

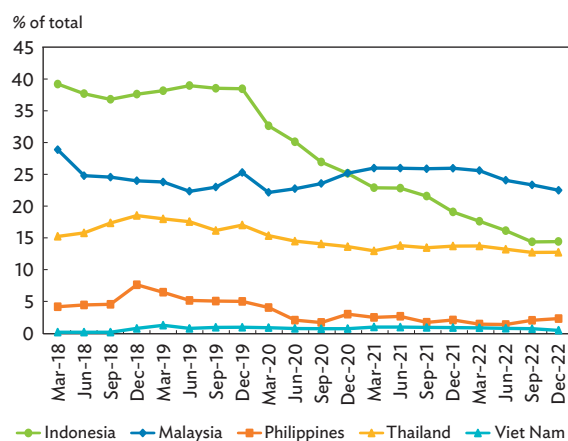
^a This box was written by Krzysztof Rojek (senior director) of Global Solutions Consulting, Finastra. The views expressed in this box are those of the author and do not necessarily reflect the views of Finastra. Data have been sourced from the *AsianBondsOnline* Data Portal.

^b Yamadera, Satoru, and Kengo Mizuno. 2022. *Developing a Local Currency Government Bond Market in an Emerging Economy after COVID-19: Case for the Lao People's Democratic Republic*. <https://www.adb.org/sites/default/files/publication/845376/local-currency-government-bond-market-lao-pdr.pdf>.

^c Beirne, John, and Ulrich Volz. 2022. Box 1: Foreign Participation in Asian Local Currency Bond Markets and Financial Stability Risks. *Asia Bond Monitor* March 2022. pp. 16–18. https://asianbondsonline.adb.org/documents/abm/abm_mar_2022_global_regional_market_developments.pdf.

Box 2 continued

Figure B2.2: Foreign Holdings in Local Currency Government Bond Markets in Emerging ASEAN Economies



ASEAN = Association of Southeast Asian Nations.

Source: *AsianBondsOnline* calculations based on various local sources (accessed 16 February 2023).

Thailand has the lowest policy rate and bond yields among the five ASEAN economies included in Figure B2.2. As the economy with the highest level of dependency on tourism, Thailand looks forward to increased tourist arrivals in 2023, partly driven by the reopening of the People's Republic of China. Thailand has increased its 2023 growth forecast from 2.8% to 3.6%. The risk–return profile is not ideal for the Thai LCY bond market though, with low returns to begin with and two major risks to the downside: (i) the volatility of the Thai baht due to rate differentials, and (ii) another potential spike in energy prices that could upset the policy rate and impact domestic bond yields.

Malaysia faces rapidly rising national debt that needs to be addressed. Newly elected Prime Minister Anwar Ibrahim has promised to take action that will restore investors' confidence in Malaysia. The new budget, which had yet to be proposed at the time of writing, and how new policies are implemented are the most important factors for global investors to watch.

The Philippines and Viet Nam have the region's two smallest LCY government bond markets along with negligible foreign holding shares of 2.3% and 0.5%, respectively. The Philippines has a significant foreign currency government bond market, while Viet Nam's LCY bonds outstanding are owned primarily by domestic banks and insurance and pension funds. Viet Nam's corporate bond market is exhibiting signs of stress, and there are concerns that professional investors are unlikely to return to the market this year due to Decree 65's restrictions and high new issuance costs.^d

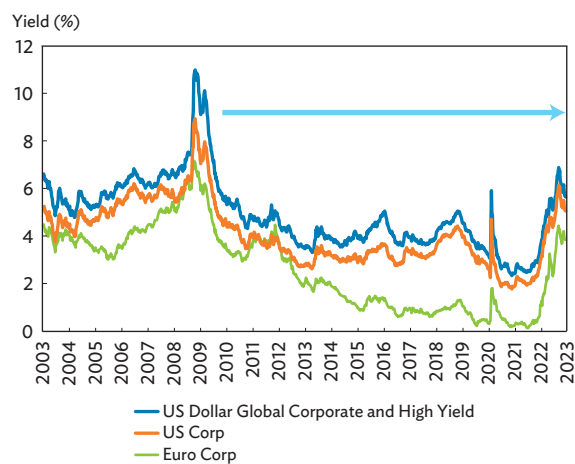
In conclusion, ASEAN bond markets have fared the recent global market turmoil better than either foreign exchange or equity markets. ASEAN LCY government bonds offer relatively more stability than those in other emerging economies in Asia and the world. There are good investment opportunities in the region, both for those who are conservative (Indonesia) and brave (Thailand, if currency exposure is unhedged). Last, but not least, it is very important to closely follow political and regulatory changes, especially in Malaysia and Viet Nam, as new opportunities may emerge very quickly and those who capture them first will benefit the most.

^d Decree 65 stipulates that issuers may no longer use bonds to increase capital or restructure capital sources except for the restructuring of their own debt. Issuers may only issue bonds for the implementation of investment plans and investment projects, or for restructuring their own debt.

Box 3: 2023—A Tale of Two Halves for Credit Markets

Sharp repricing and extreme volatility shook bond markets in 2022 after central banks' abrupt monetary policy tightening.^a Today, markets are navigating a high degree of uncertainty, and bonds are back in focus. More attractive yields and less rate volatility restored demand for the asset class at the turn of the year (**Figure B3.1**). Amundi expects this trend to continue throughout 2023, which we see as a two-speed year for credit markets.

Figure B3.1: Appealing Yields in Credit Markets



Euro = European, US = United States.

Note: Data as of 26 January 2023.

Source: Amundi Institute and Bloomberg LP.

Global Backdrop

Our baseline scenario for 2023 is one of sluggish global economic growth (2.4%) and protracted high inflation (5.8%). Despite recent signs of moderation in headline inflation, the United States (US) Federal Reserve and the European Central Bank (ECB) are keen to fight inflation and avoid excessive easing of financing conditions. In the US, we think the Federal Reserve would tolerate a recession in order to bring down inflation. In the euro area, we will carefully monitor how the ECB will balance inflation expectations and financial stability risk should energy prices remain persistently high. We forecast the Federal Reserve's terminal rate at 5.25% and the ECB's at 3.50%.

Investor concerns will gradually shift from inflation and rates to the economic slowdown. Volatility in equity markets should therefore become the main driver of credit markets, with increasing focus on differentiating across sectors and individual companies to capture the rebound that will follow.

Credit Quality has Probably Peaked, Despite Healthier Corporate Balance Sheets

Corporate balance sheet positions have generally improved since 2020. Low refinancing needs and high use of cash holdings limited the negative impact of monetary tightening on corporate balance sheets in both the US and Europe. Issuers also took advantage of exceptional financing conditions, with primary market activity hitting record levels. Today, despite falling cash levels, net leverage is overall below pre-coronavirus disease (COVID-19) levels, and corporates have also improved their debt duration and credit metrics.

However, the peak in credit quality is probably behind us. Corporates are now facing a more challenging environment. In 2023, sluggish growth, rising energy prices, and higher funding and business costs should result in increased high-yield (HY) default rates. A benign redemption schedule will mitigate these factors, in particular during the first half of the year when relatively few issues are due.

We do not expect higher debt costs to overwhelm investment grade (IG) issuers, but refinancing concerns may pressure financially weaker issuers in the second half of the year. HY default rates may rise close to their historic average by the end of 2023, nearing 5% in the US and 4% in the euro area (**Figure B3.2**).

Attractive Investment-Grade Valuations and High-Yield Opportunities in 2023

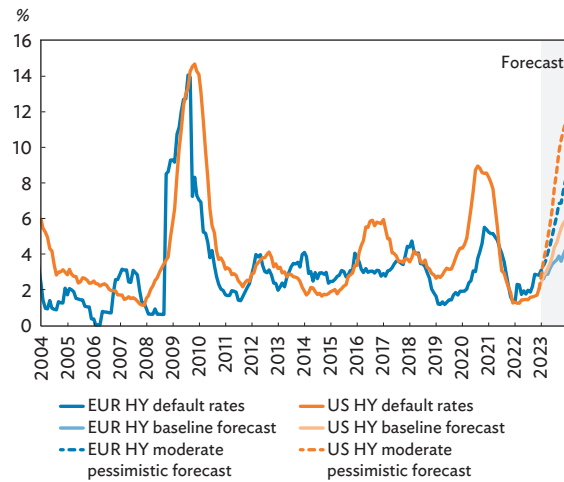
Despite the recent rally in corporate bonds markets, the general backdrop still provides opportunities for global credit investors actively monitoring specific bottom-up risks.

Overall, we favor IG over HY, as we believe the HY-IG spread will widen in 2023. In our view, the HY spread compression in 2022 was technically driven since the segment experienced one of its lowest cumulated issuance in several years (**Figure B3.3**).

^a This box was written by Monica Defend (head) of Amundi Institute. The write up is based on Defend, Monica, and Amaury D'Orsay. 2023. "Bonds are Back: Credit Markets in Focus During 2023." *Amundi Institute*. 26 January.

Box 3 continued

Figure B3.2: Default Outlook, United States and European High-Yield



EUR = euro, HY = high-yield, US = United States.

Note: Data as of 25 January 2023. Forecasts start from January 2023.

Source: Amundi Institute and Moody's.

In the IG segment, our preference goes to EUR- and GBP-denominated debt over US credit. The former are very cheap by historical standards and current spread levels reflect a far bleaker backdrop than what we expect. We also see value in EUR-subordinated debt, where absolute yields currently compensate for potential volatility and should create opportunities.

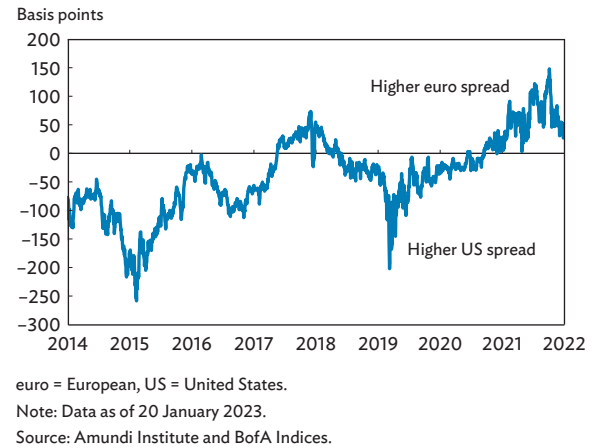
On a sectoral basis, we favor financials, especially banks, over nonfinancials. For nonfinancials, we hold positive views on the auto, technology, media, and telecom sectors, but we are cautious on consumer goods, capital goods, and transportation.

The HY segment is attractive on a mid-term investment horizon as spreads should be volatile throughout the year. We currently maintain a cautious stance but believe opportunities will materialize in the second half of 2023 when uncertainty over monetary policy fades.

Mixed Picture for Technicals

To conclude, more attractive yields and lower risks have improved the technical backdrop for credit markets. Fresh inflows materialized after many months of outflows,

Figure B3.3: European–United States High-Yield Spread Differential



euro = European, US = United States.

Note: Data as of 20 January 2023.

Source: Amundi Institute and BofA Indices.

with less defensive investors across the board seeing fixed income, including IG credit, as a diversifier.

On the supply side, we expect net supply to increase in 2023, with higher issuance than in 2022 when the HY primary market was almost closed. However, 2023 net supply should remain modest by historical standards.

In the euro area, we expect the ECB to start its quantitative tightening in March. We also expect this to have a limited impact on markets. Corporate debt volumes are on the rise, but the volumes announced for the ECB's Asset Purchase Programme and Corporate Sector Purchase Programme redemptions are overall modest.

Finally, investors should look at opportunities in green bonds and other sustainable debt instruments. The market for labeled bonds has continuously grown, reaching EUR700 billion in 2022. It is expected to rise further and offer attractive opportunities as central banks take actions to decarbonize their balance sheets. Green bonds also tend to exhibit lower volatility than conventional bonds, while sustainability-linked bonds are typically forward-looking, performance-based instruments that can bring diversification to the issuer base without compromising yield.

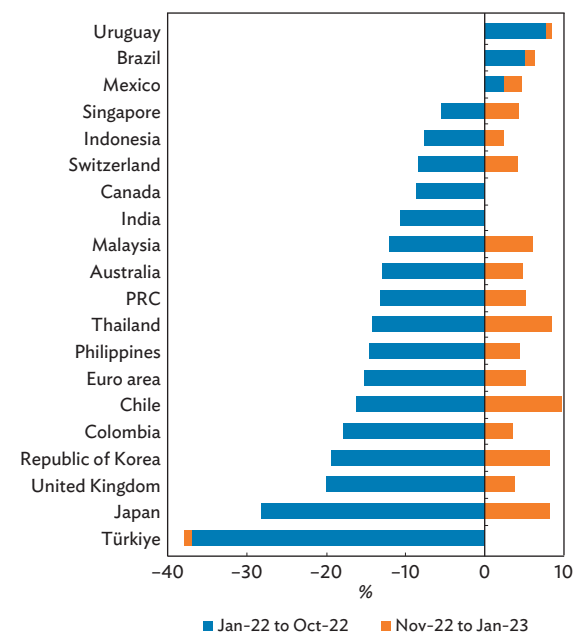
Box 4: United States Dollar Fluctuations and Debt Sustainability Risks in Emerging Market Economies

A tightening United States (US) monetary policy cycle in 2022 in the face of severe inflationary pressures led to a broad-based appreciation of the US dollar for most of the year.^a This raised concerns about debt sustainability in emerging market economies (EMEs) as borrowing costs rose and external debt servicing obligations amplified. Sharp fluctuations in US dollar exchange rates also have well-documented negative implications for the EME growth outlook (e.g., Hofmann and Park 2020). While the US dollar depreciated somewhat at the end of 2022 and the start of 2023, it remained at a relatively high level over the 12-month period from January 2022 to January 2023.

From January through October 2022, EME currencies depreciated relative to the US dollar by around 10% on average, including in Association of Southeast Asian Nations economies. As global commodity prices rose during the year, net commodity exporters largely experienced less severe depreciations, benefiting from dollar-invoiced export revenue, while the currencies of some commodity-exporting Latin American countries actually strengthened. Advanced economies were also affected, including depreciations for the euro and the Japanese yen, among others. Toward the end of 2022, market expectations of less aggressive US monetary policy tightening due to easing domestic inflation, as well as smaller US Federal Reserve rate hikes, led to a depreciation of the US dollar, particularly from November 2022 to January 2023 (Figure B4.1).

To set some context for recent developments, in the latter part of 2022 the US dollar reached its highest level since the aftermath of the 9/11 terrorist attacks in 2001 (Figure B4.2). The appreciation of the dollar since the Russian invasion of Ukraine in February 2022 reflected higher yields in the US as it combatted inflation, which was in part driven by rising food and energy commodity prices as well as the post-pandemic US recovery in demand. In November 2022, dollar depreciation took hold as US inflation eased, and the currency fell 5% month-on-month relative to a global basket of currencies. While downward pressure on the dollar continued through January 2023, the dollar overall remained strong relative to its level in January 2022. Therefore, while there is some respite for EME debt exposures given recent downward shifts in the dollar, debt sustainability risks remain elevated.

Figure B4.1: Global Exchange Rate Changes Relative to the United States Dollar



PRC = People's Republic of China.
 Note: Reported are the nominal bilateral United States (US) dollar exchange rate changes (monthly averages). Negative values imply a depreciation relative to the US dollar.
 Source: Bank for International Settlements database (accessed 7 February 2023).

Macroeconomic Challenges and Debt Sustainability Risks

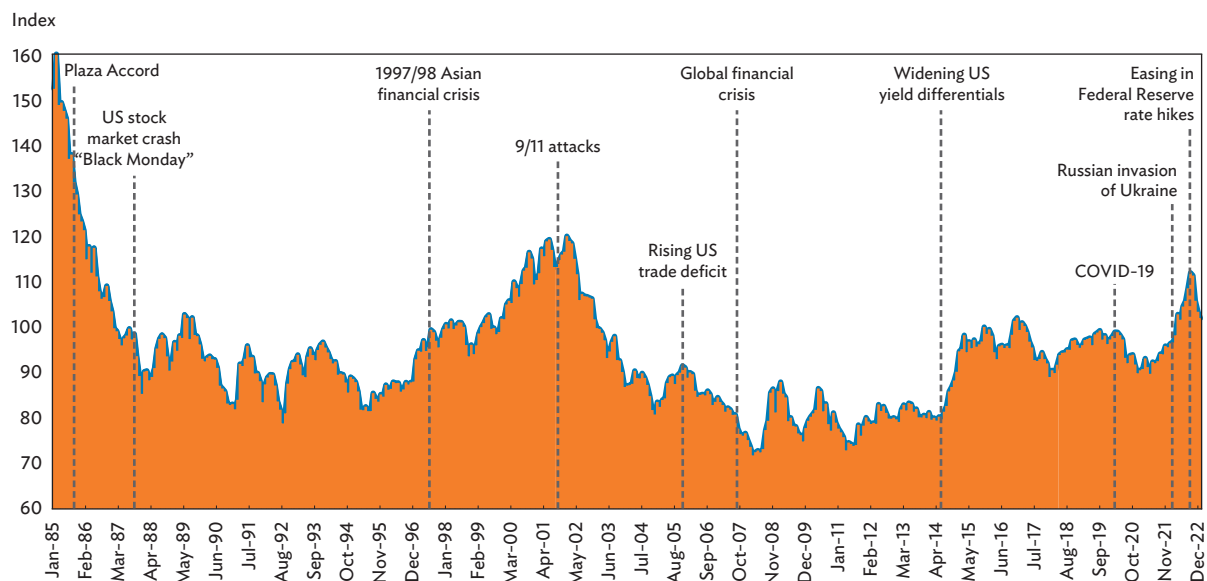
Higher yields in the US during 2022, in conjunction with amplified global risk aversion and uncertainty, led to a flow of capital into US dollar-denominated assets (International Monetary Fund 2022). While many EMEs, particularly in Asia, are more resilient to external shocks than in the past given stronger macroeconomic fundamentals and more favorable current account positions, recent developments pose challenges in managing capital flows, with record levels of emerging market bond fund outflows taking place during 2022.

Rising commodity prices during 2022 weighed further on the currencies of net commodity importers given that commodities are priced in US dollars, thereby negatively

^a This box was written by John Beirne (vice-chair of research and senior research fellow) and Pradeep Panthi (research associate) of the Asian Development Bank Institute.

Box 4 continued

Figure B4.2: United States Dollar Fluctuations, 1985–2023



COVID-19 = coronavirus disease, US = United States.

Note: Reported is the United States (US) Dollar Index Chart from January 1985 to January 2023 (monthly), which measures the value of the US dollar relative to a basket of other currencies.

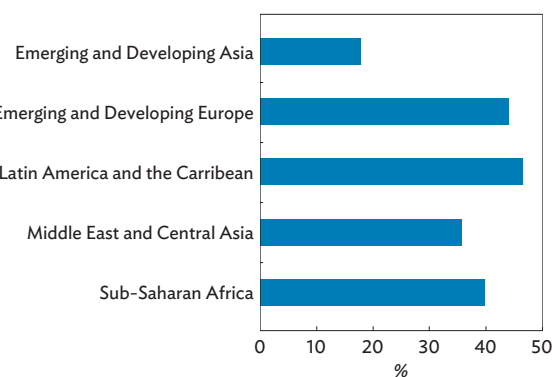
Source: Bloomberg LP data.

affecting trade balances. Economies that have high levels of external debt denominated in US dollars were particularly exposed, with debt sustainability threatened by surges in the local currency value of the debt and rising debt servicing costs. For EMEs globally, with the exception of emerging European economies, over 80% of external debt is denominated in US dollars. In this context, compared to other regions, emerging and developing Asia has a lower share of external debt to gross domestic product (**Figure B4.3**). Therefore, while emerging and developing Asia remains exposed to US dollar appreciation in terms of external debt risks, it is less exposed than other regions.

Policy Options for Emerging Market Economies

While EMEs face inflationary pressures related to supply chain disruptions resulting from the Russian invasion of Ukraine that have amplified energy and food commodity prices, tightening domestic monetary policies in EMEs during 2022 prevented higher imported inflation via currency depreciation relative to the US dollar and also mitigated against sharp net capital outflows. This came at the risk of weakening the growth outlook, however, especially through rising costs of

Figure B4.3: Total External Debt as a Share of Gross Domestic Product, 2022



Note: The economies included in each region are per the International Monetary Fund's regional classification system.

Source: International Monetary Fund. 2022. *World Economic Outlook*. October. Washington, DC.

continued on next page

Box 4 *continued*

borrowing and threats to debt sustainability, which could also hamper investment. While Asian EMEs overall have a more robust growth outlook for 2023 than other EME regions, there remains significant intra-regional heterogeneity.

To defend their currencies against excessive depreciation, as well as raising rates, many EMEs intervened in foreign exchange markets during 2022, selling US dollars from foreign reserves and buying domestic currency. Asian EMEs—including India, Indonesia, the Philippines, and Thailand—reinforced the impact of raising interest rates in their economies with such interventions, also helping to stem capital outflows. While an important tool for addressing financial market functioning and inflation expectations risks, the adequacy of reserve holdings needs to be considered in the context of ensuring that external debt servicing obligations are not compromised. Further, an abrupt and substantial depletion of foreign exchange reserves, while supporting the domestic currency, could have negative implications for sovereign credit rating assessments (e.g., Mohanty and Berger 2013, Disyatat and Galati 2007).

In the short term, EMEs should continue to manage inflationary pressures through well-coordinated domestic monetary and fiscal policies, in particular by ensuring that fiscal policies aimed at mitigating the effects of cost-push inflation do not aggravate inflation expectations. Further easing of inflation in the US during 2023 would also trigger less aggressive US monetary policy tightening and dollar weakening, implying less amplified risks to debt sustainability in EMEs. Over the longer term, while borrowing in US dollar-denominated debt will continue to be necessary for many EMEs, policies should aim to reduce exposure to abrupt US dollar fluctuations. This can include debt restructuring and debt servicing schemes that feature currency hedging

components, as well as further progress on local currency bond market development. In addition, capital flow volatility may call for an assessment of the macroprudential policy toolkit to help smoothen exposure to foreign currency debt and maturity mismatches.

Finally, structural policies should be aimed at further enhancing the diversification of EMEs in global trade and finance, boosting productivity and long-run growth potential and insulating economies from terms-of-trade shocks and spillovers from abroad. In this regard, improving efficiency in the management of public finances, as well as fostering more effective regulation and supervision in the financial sector, will help to bolster EME resilience during episodes of financial distress, including those driven by tightening global financial conditions.

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The third risk is the longer-than-expected persistence of elevated inflation. Although inflation in major advanced economies and many regional economies has eased, it remains at an elevated level. There is uncertainty over how long elevated inflation will last; if longer than expected, it would reduce purchasing power and weaken asset values.

The fourth risk is uncertainty in the economic outlook in the region. Although fears of recession in major advanced economies have abated, external demand in many regional economies remains weak. There is also

uncertainty over how much the PRC’s reopening will benefit other economies in the region.

Last but not least, higher interest rate levels may cause liquidity stress as the balance sheets of financial institutions and corporations weaken. Higher interest rate will lead to value losses in financial and real assets, while tightened financial conditions make refinancing difficult, putting pressure on high-leverage firms such as small banks and real estate companies. For example, during the review period, stress was observed in Viet Nam’s

corporate bond market, as many real estate firms found it hard to refinance their debt. This led to concerns over other firms' ability to repay debt obligations as liquidity in the market dries up. Similarly, the liquidity positions of banks with less diversified portfolios and large maturity

mismatches on their balance sheets must also be closely monitored to avoid the liquidity stress that led to bank failures such as Silicon Valley Bank. **Box 5** discusses the failure of Silicon Valley Bank and its implication for emerging East Asia.

Box 5: Implications of the Failure of Silicon Valley Bank for Emerging East Asia

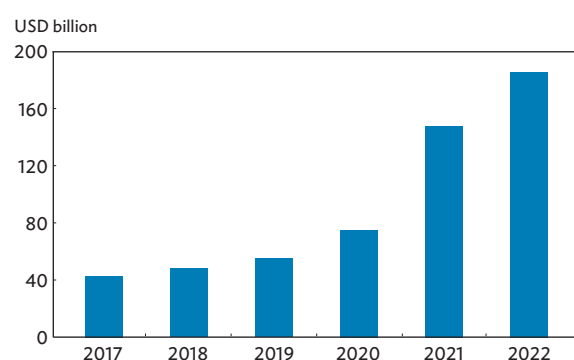
Silicon Valley Bank (SVB) is a commercial bank specializing in providing lending and other services to technology companies in the startup phase.^a At the end of 2022, SVB was the 16th largest bank in the United States (US) and the largest (in terms of deposits) in Silicon Valley. On 10 March, however, SVB's charter was revoked by the California Department of Financial Protection and Innovation, and the bank was placed under the receivership of the Federal Deposit Insurance Corporation.

Two key factors contributed to SVB's collapse. The first factor was a significant maturity mismatch in SVB's balance sheet. On the liability side, SVB's average total deposits saw rapid growth from 2019 to 2022, rising over three-fold from USD55.1 billion to USD185.8 billion (**Figure B5.1**).^{b,c} By the end of 2022, average non-interest-bearing demand deposits had reached USD109.7 billion, accounting for 59% of average total deposits (footnote c). Meanwhile, during the pandemic, SVB was unable to expand its loan portfolio at a rate comparable to its deposit increases. Instead, SVB invested

most of its deposits in fixed-income securities such as mortgage-backed securities and US Treasuries. By the end of 2022, SVB held USD124.2 billion worth of available-for-sale and hold-to-maturity fixed-income securities, accounting for around 60% of its total interest-earning assets (**Figure B5.2**) (footnote c). These fixed-income securities bear a much longer maturity than demand deposits. Moreover, their market value declines as interest rates rise. This maturity mismatch can lead to liquidity risk when liquidity conditions tighten in the market.

The second factor was the lack of diversification that weakened SVB's liquidity position. SVB's client base is concentrated among startups and the technology sector. Amid a negative economic outlook, the bust in technology stocks, and slowing revenue growth, SVB's clients faced increased liquidity demands that led to large withdrawals.^d In the fourth quarter of 2022, SVB reported a USD10.8 billion

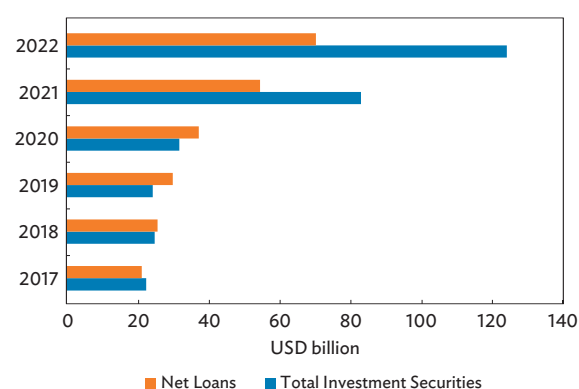
Figure B5.1: Average Total Deposits of Silicon Valley Bank



USD = United States dollar.

Source: SVB Financial Group annual reports.

Figure B5.2: Average Total Investment Securities versus Average Net Loans of Silicon Valley Bank



USD = United States dollar.

Source: SVB Financial Group annual reports.

^a This box was written by Shu Tian (senior economist), Roselyn Regalado (financial analyst), and Russ Jason Lo (CFA, financial analyst) in the Economic Research and Regional Cooperation Department of the Asian Development Bank.

^b United States Securities and Exchange Commission. 2021. *Annual Report for Silicon Valley Bank*. Washington, DC.

^c United States Securities and Exchange Commission. 2022. *Annual Report for Silicon Valley Bank*. Washington, DC.

^d The technology sector's subdued operational outlook is evidenced by the fact that several prominent IT companies were forced to conduct massive layoffs in late 2022 and early 2023. For example, in November 2022, Meta Platforms, the parent company of Facebook and Instagram, announced layoffs for 11,000 employees, equal to 13% of its workforce. In January 2023, Alphabet, the parent company of Google, laid off 12,000 employees, while Microsoft laid off 10,000 workers.

Box 5 *continued*

(5.8%) decrease in average on-balance sheet deposits compared to the previous quarter, as well as a USD10.0 billion decrease in off-balance sheet client investment funds.^e

These two factors jointly exposed SVB to heightened interest rate and liquidity risks when the dimmed economic outlook combined with monetary policy tightening. As the US Federal Reserve aggressively raised interest rates to contain inflation, the debt securities held by SVB generated an unrealized mark-to-market loss of over USD15 billion at the end of 2022 for those held-to-maturity securities (footnote c). Facing rising liquidity pressure, SVB was forced to sell USD21 billion worth of security holdings on 8 March. This ill-timed securities sale realized a mark-to-market loss of USD1.8 billion and signaled the bank's liquidity stress. This triggered more liquidity demand among depositors, which quickly dried out the bank's liquidity. On 10 March, SVB was placed under receivership as regulators deemed the bank to be both insolvent and illiquid.

US regulators stepped in quickly to protect depositors and contain the impacts of this incident. To maintain confidence in the banking system and calm depositors' fears, US financial regulators announced emergency measures on 12 March. The Federal Reserve, jointly with the US Treasury and Federal Deposit Insurance Commission, announced that both insured and uninsured deposits would be safeguarded and depositors would be able to withdraw all of their funds starting on 13 March. In addition, the Federal Reserve said that it would launch a new facility, the Bank Term Funding Program, through which banks and other depository institutions would be able to secure loans of up to 1 year in maturity in exchange for eligible collateral such as US Treasuries, agency debt, and mortgage-backed securities.

The SVB incident will have financial stability implications for regulators in emerging East Asia. First, the liquidity positions of small banks with less diversified portfolios should be revisited to avoid similar incidents. In 2022, many regional central banks also raised interest rates aggressively to contain inflationary pressure. This led to value losses (either realized or unrealized) for both financial and real assets. Meanwhile, although emerging East Asia's economic outlook remains positive, growth in the region will moderate in 2023 amid weakened external demand. The region's small banks with less of a liquidity buffer could face similar liquidity stress when liquidity demand rises.

Second, the uncertainty that soured market sentiment could lead to contagion within US financial markets and around the world. Between 8 March and 13 March, the S&P 500 Index declined 3.4%; equity indexes in Germany and the United Kingdom fell 4.3% and 4.8%, respectively; and emerging East Asian equity markets fell 1.4%. Soured investment sentiment may further tighten liquidity conditions as investors become risk averse. This could translate into capital outflows from the region.

Meanwhile, another possible implication is that the SVB incident might slow the pace of monetary tightening in the US. According to the CME FedWatch, the probability of a 50 basis points rate hike at the Federal Open Market Committee's March meeting fell from 40.2% on 10 March to zero on 13 March, while the probability of there being no rate hike rose from zero to 24.7%. Last, but not least, some regional startups may be negatively affected by SVB's collapse if they have to seek alternative financial service providers. Given the dimmed economic outlook and soured investment sentiment, it might now be more difficult for startups to get funding.

^e Silicon Valley Bank. 2023. SVB Financial Group Announces Fourth Quarter 2022 Financial Results. *News Release*. 19 January.