Executive Summary

Recent Developments in Financial Conditions in Emerging East Asia

Financial conditions marginally improved in emerging East Asia between 1 December 2023 and 29 February 2024.[1] Improvements in regional financial market conditions were largely supported by (i) expectations that the United States (US) Federal Reserve would ease its monetary policy later this year, (ii) moderating inflation, and (iii) robust economic performance in most regional economies. However, the recovery of financial conditions in the region was tempered by heightened uncertainties about the timing and magnitude of US monetary policy easing, given the continued strength of the US economy and the slowing pace of disinflation there. In addition, the People's Republic of China (PRC) weighed on the region's overall financial conditions during the review period due to heightened concerns over its economic slowdown, persistent deflation, and amplified trade tensions.

During the review period, most regional markets recorded equity gains, lowered risk premiums, and positive net foreign portfolios inflows, despite the marginal depreciation of regional currencies against a strong US dollar. Furthermore, equity markets gained in six out of nine of the region's economies, credit default swap spreads marginally fell by a regional (simple) average of 0.8 basis points if the PRC is excluded, and emerging East Asia's net foreign equity inflows totaled USD17.4 billion. The region's financial conditions were buoyed by robust economic growth, the expected ending of monetary tightening, and continued disinflation trends. At the same time, the increased likelihood of a delay in monetary easing and a strong US economic performance supported the US dollar, leading to a gross-domestic-product-weighted average depreciation of 1.0% for regional currencies versus the dollar. Most regional short-term bond yields also declined during the review period, but long-term bond yields rose slightly, tracking movements in advanced economies.

Risks to regional financial conditions remain tilted to the downside, largely due to uncertainties over the timing of US monetary policy easing. Possible disruptions to disinflationary momentum and spillover effects from the economic slowdown and deflation in the PRC could heighten the risk outlook.

Recent Developments in Local Currency Bond Markets in Emerging East Asia

At the end of December 2023, the local currency (LCY) bond market in emerging East Asia reached a size of USD25.2 trillion, expanding 2.5% quarter-on-quarter (q-o-q) in the fourth quarter (Q4) of 2023. Outstanding government bonds rose 3.9% q-o-q in Q4 2023, despite reduced issuance, due to a low volume of maturities in most regional markets. Government bonds accounted for 61.2% of total LCY bonds outstanding at the end of December. Meanwhile, the region's corporate bonds outstanding expanded marginally by 0.2% q-o-q in Q4 2023 as elevated interest rates and concerns about the property sector suppressed issuance in some markets. Aggregate LCY bonds outstanding among members of the Association of Southeast Asian Nations (ASEAN) totaled USD2.2 trillion, comprising 8.7% of the emerging East Asian market.

In Q4 2023, LCY bond issuance in emerging East Asia contracted 4.8% q-o-q to USD2.5 trillion as both government and corporate bond issuance declined. Government bond issuance fell 6.3% q-o-q to USD1.1 trillion as most regional governments had already fulfilled their borrowing requirements during the first 3 quarters of the year. LCY corporate bond issuance in Q4 2023 declined 7.8% q-o-q to USD0.9 trillion, dragged down by a contraction in corporate bond issuance in the PRC amid a weakened economic outlook and concerns over the property sector. ASEAN markets' combined LCY bond issuance totaled USD0.5 trillion in Q4 2023,

[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.

equivalent to 21.2% of total emerging East Asian LCY bond issuance during the quarter.

Treasury bonds outstanding in emerging East Asia, as well as new issuances in Q4 2023, have generally been concentrated in longer-term maturities. Around 52.0% of Treasury bonds outstanding at the end of December had tenors of over 5 years. The corresponding share for Treasury bonds issued in Q4 2023 was 53.2%. At the end of 2023, the size-weighted average tenor of outstanding Treasury bonds was 8.9 years in emerging East Asia, with ASEAN markets' average being slightly higher at 9.0 years. The size-weighted average tenor of Treasury bond issuance in Q4 2023 was 7.4 years and 9.3 years in the markets of emerging East Asia and ASEAN, respectively.

Emerging East Asian LCY Treasury bonds are held primarily by relatively inactive traders such as domestic banks and insurance and pension funds. At the end of December, banks held an average of 36.7% of outstanding Treasury bonds in emerging East Asian markets, while insurance and pension funds held an average of 28.5%. Indonesia and the Republic of Korea have the most diversified investor profiles among all regional markets.

The ASEAN+3 sustainable bond market posted a robust expansion in 2023.[2] At the end of December, the outstanding amount of sustainable bonds in ASEAN+3 reached USD798.7 billion, buttressed by annual issuance totaling USD242.2 billion. The ASEAN+3 sustainable bond market expanded 29.3% year-on-year in 2023, which was much faster than the growth rates of the global (21.0%) and euro area (21.0%) sustainable bond markets. As a result, ASEAN+3's share of global sustainable bonds outstanding inched up to 20.1% in 2023 from 18.8% in 2022. Despite its rapid expansion, ASEAN+3's regional sustainable bond market only comprised 2.1% of its general bond market, which was much smaller than the euro area's corresponding 6.9% share.

Sustainable bond issuance in ASEAN markets in 2023 comprised a relatively higher share of LCY and long-term financing due to the greater participation of the public sector in the market. In ASEAN, the share of LCY financing in sustainable bond issuance was 80.6%, close to the LCY financing share in ASEAN general bond markets (82.3%). However, for ASEAN+3, the LCY financing share of sustainable bond issuance (73.4%) was lower than the corresponding share of general bond issuance (96.4%). Meanwhile, in ASEAN markets, around 84.5% of sustainable bond issuance in 2023 carried a tenor of over 5 years, which was higher than the corresponding share of 43.1% in ASEAN+3. The size-weighted average tenor for ASEAN sustainable bond issuance in 2023 was 14.7 years, compared with 6.2 years for ASEAN+3, largely driven by a higher share of public sector issuance in ASEAN markets.

AsianBondsOnline 2023 Bond Market Liquidity Survey

An overall improvement in liquidity conditions was noted in most emerging East Asian LCY bond market in 2023 compared with 2022, per the *AsianBondsOnline* annual bond market liquidity survey. Around two-thirds of respondents in the survey noted an improvement in liquidity amid relatively improved financial conditions, especially in the second half of the year, as the Federal Reserve signaled the end of its rate-hiking cycle. Most regional markets recorded a narrowing of bid–ask spreads and an increase in transaction sizes for both government and corporate bonds. Survey participants cited monetary policy and market sentiment as the most important domestic factors affecting liquidity in the market, while US monetary policy was the most important global factor. The 2023 survey also noted strong investor interest in sustainable bonds, with around three-fourths of participants indicating that they or their firms now trade and invest in sustainable bonds. The lack of hedging instruments in the region's bond markets remained a key structural issue in 2023 that needs further policy action.

[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.