

Highlights

- The global outlook facing emerging East Asia has deteriorated significantly in recent months with weaker growth now expected in Europe and an uncertain pace of recovery in the United States (US).¹ This slowdown—exacerbated by ongoing sovereign debt issues in the eurozone—is heightening risk aversion and generating volatility in global financial markets.
- The recent bouts of financial market volatility are a timely reminder of the region’s continued vulnerability to external shocks. Emerging markets have not been spared the impact of dampening market sentiments in developed economies as the end of 3Q11 saw substantial portfolio outflows from the region. However, this trend reversed itself somewhat in October.
- A slowdown in growth and an easing of inflationary pressures in 3Q11 has moved the policy focus in emerging East Asia toward supporting growth. Authorities in many economies had begun tightening liquidity in late 2010, but in most cases they have suspended these efforts.
- The principal impact of the weakening external environment in September–October on benchmark yield curves was either a flattening or simply a downward shifting of the entire government bond yield curve in most markets. The only exceptions to this were in Singapore and Hong Kong, China, where yield curves steepened slightly in October.
- Total bonds outstanding in emerging East Asia’s local currency (LCY) market rose 5.5% on a year-on-year (y-o-y) basis—and 1.0% on a quarter-on-quarter (q-o-q) basis—to reach US\$5.5 trillion at the end of 3Q11, driven mainly by strong growth in corporate bonds. On a y-o-y basis the region’s most rapidly growing LCY bond markets in 3Q11 were Viet Nam, Malaysia, Singapore, and the Republic of Korea.
- Total government bonds outstanding grew only 0.5% q-o-q in 3Q11, reflecting negative or only marginal growth rates in most markets. The People’s Republic of China’s (PRC) government bond market expanded only 0.1% q-o-q. The region’s most rapidly growing government bond markets in 3Q10 on a q-o-q basis were Thailand; Malaysia; Viet Nam; and Hong Kong, China.
- Bonds issued by provinces and other local governments may emerge as a new asset class in the region’s LCY bond market over the coming year. In emerging East Asia, Thailand has taken steps to permit the issuance of bonds by its local governments. Furthermore, recent announcements that the PRC government has approved bond issuance by some of its provincial and municipal governments—in their own name—signal another new source of bond issuance.
- Growth of the region’s LCY corporate bond market in 3Q11 was 2.0% q-o-q, led by the Republic of Korea and Malaysia.
- LCY bond issuance in emerging East Asia totaled US\$829 billion in 3Q11—a 19.9% decline on a y-o-y basis but a 7.6% rise on a q-o-q basis. The principal cause of the y-o-y decline was the curtailment of issuance by central banks and monetary authorities as they either sharply reduced sterilization activities over the last year or shifted to tools other than bills and bonds to reduce liquidity growth.
- The 2011 *AsianBondsOnline* Bond Market Liquidity Survey was conducted from early August through mid-October. During the survey period the central role of liquidity in the health of

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.

the region's LCY bond market was underscored by the emergence of concerns about European sovereign debt and mixed signals of economic recovery in the US. These factors contributed to a widening of bid-ask spreads in most emerging Asian markets since the last *AsianBondsOnline* survey in 2010.

- The 2011 survey revealed that market participants want governments in the region to issue more investable LCY government bonds to improve market liquidity.
- The region's LCY bond market participants were asked for their views on market structure and

policy changes that would help improve bond market liquidity. Greater diversity of investors and traders was once again identified as a key factor in promoting liquidity in emerging East Asia's LCY government and corporate bond markets.

- The risks to the region's outlook are significantly tilted to the downside. These risks include (i) potential spillover from Europe that impairs demand and investment, (ii) growing volatility in global markets and a flight to low-risk investments, (iii) a reduced growth outlook for Asia in 2012, and (iv) moderately high inflation in some markets.