

Asia Bond Monitor Highlights



Bond Market Outlook

Bond markets in emerging East Asia have regained some of their recent losses as global financial markets have stabilized.¹ The United States (US) Federal Reserve's announcement on 18 September that economic conditions did not yet warrant the start of tapering buoyed financial markets and helped drive down bond yields in the US.

The delay in tapering can help ensure that the US economy is on stronger footing, which can provide a helpful boost to the region's growth prospects. This also offers more time for the region to prepare for the eventual normalization of US monetary policy.

Governments in emerging East Asia should use this window of opportunity to strengthen their economies and focus on further structural reforms. The resilience of the region's financial systems also needs to be improved to better handle the possible turmoil ahead.

The risks to the region's local currency (LCY) bond markets have receded slightly as the prospects of the Federal Reserve tapering its quantitative easing operations this year becomes increasingly unlikely. Specifically, risks include the following: (i) the region's bond markets remain susceptible to sudden shifts in global investor sentiment, (ii) tighter liquidity conditions could impact financial stability in the region's economies, and (iii) volatile capital flows make policymakers' efforts to stabilize the economy more difficult.

LCY Bond Market Growth in Emerging East Asia

Emerging East Asia's LCY bonds outstanding grew 2.4% quarter-on-quarter (q-o-q) and 12.5% year-on-year (y-o-y) to reach US\$7.1 trillion in 3Q13,

propelled by growth in both the government and corporate bond sectors. As a share of gross domestic product (GDP), the size of the region's bond market climbed to 55.6% in 3Q13 from 55.1% in 2Q13.

The most rapidly growing bond markets on a quarterly basis in 3Q13 were Indonesia (3.9%), the Philippines (3.6%), the People's Republic of China (PRC) (3.0%), the Republic of Korea (1.8%), and Malaysia (1.8%). On an annual basis, the fastest growing markets were Viet Nam (18.8%), Indonesia (16.3%), the PRC (14.4%), the Philippines (12.5%), and the Republic of Korea (10.4%).

The region's LCY government bond market expanded 2.1% q-o-q in 3Q13, up from 1.1% quarterly growth in 2Q13, to level off at US\$4.4 trillion. The most rapidly growing government bond markets on a quarterly basis were the Philippines (4.0%), Indonesia (3.7%), the PRC (2.7%), and the Republic of Korea (1.3%).

Growth of the region's LCY corporate bond market reached 2.9% q-o-q in 3Q13, significantly less than the previous quarter's 8.0% growth. The market's size amounted to US\$2.7 trillion at end-September. The most rapidly growing corporate bond markets on a quarterly basis were Indonesia (4.6%), the PRC (3.9%), Malaysia (3.8%), and the Republic of Korea (2.2%).

LCY bond issuance in emerging East Asia grew 0.9% q-o-q to US\$843 billion in 3Q13. The slight quarterly increase stemmed from a 6.6% rise in treasury and other government bond issuance that offset decreases in issuances by central banks and monetary authorities (-2.1%) and the corporate sector (-0.6%).

LCY Bond Market Structural Developments

The ratio of bills to bonds issued by governments, central banks, and monetary authorities climbed

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.

on a quarterly basis in Singapore and Viet Nam, remained unchanged in Indonesia and Thailand, and fell in the PRC; Hong Kong, China; the Republic of Korea; Malaysia; and the Philippines. The largest ratios of total LCY bonds outstanding to GDP at the end of 3Q13 were in the Republic of Korea (130.2%) and Malaysia (103.9%).

The share of foreign holdings of LCY government bonds increased in the Republic of Korea, Malaysia, and Thailand, and fell in Indonesia between 4Q12 and 3Q13. Since the end of 2012, the share of foreign holdings of Indonesian government bonds fell to 31.2% at end-September. However, in nominal terms, foreign holdings of Indonesian government bonds have continued to rise, reaching an all-time high of IDR294.1 trillion (US\$25.8 billion) at the end of 3Q13.

Yield Curve Movements

Most government bond yield curves in emerging East Asia have shifted downward since the Federal Reserve decided in mid-September not to taper its asset purchase program in the near-term.

Yield curves dramatically steepened in Hong Kong, China; the Republic of Korea; Malaysia; Singapore; and Thailand; and shifted upward in Indonesia between end-May and end-July following the 19 June statement of the Federal Reserve that it may begin to taper its bond purchase program toward the latter part of this year.

The PRC yield curve shifted dramatically upward between end-May and end-July, reflecting the SHIBOR shock event that occurred in the first week of June, when liquidity demands pushed the SHIBOR rate to 7.49% and the 7-day repo rate to 7.80%.

Market sentiment became more relaxed after the 18 September announcement of the Federal Reserve that there would be no immediate tapering of its quantitative easing program, and after the US Congress approved an increase in the US government's borrowing limit in mid-October. This has resulted in an overall decline of interest rates except for the PRC and the Philippines, between the end of July and 18 October.

Special Section: 2013 *AsianBondsOnline* Bond Market Liquidity Survey

The 2013 *AsianBondsOnline* Bond Market Liquidity Survey received 106 responses for the government bond market and 72 responses for the corporate bond market in Emerging Asia.²

The survey results show that average bid-ask spreads for the region as a whole remained the same between this year and 2012 for government bonds, but narrowed for corporate bonds. The results this year also indicate that transaction sizes are lower for government bonds but higher for corporate bonds.

Turnover ratios for LCY government bonds have decreased in most emerging East Asian markets in 3Q13.

This year's survey identified investor diversity to be the most important structural issue for market participants in the region. This was followed by hedging mechanisms, transaction funding, foreign exchange regulations and transparency, market access and settlement and custody, and tax treatment.

² Emerging Asia comprises the People's Republic of China; Hong Kong, China; India; Indonesia; the Republic of Korea; Malaysia; the Philippines; Singapore; Thailand; and Viet Nam.