Asia Bond Monitor Highlights

ADB

Bond Market Outlook

Yields for emerging East Asian bonds have declined as investor sentiments have improved.[1] Financial markets have been calmer in recent months with the United States (US) Federal Reserve holding back from raising interest rates and the People's Republic of China (PRC) undertaking monetary stimulus. With inflation in the US remaining low and economic growth tepid, the much-anticipated US interest rate hike has been pushed back to December at the earliest. With inflationary pressures remaining muted, bond yields in advanced economies have eased. Subdued growth and weaker oil prices have put further downward pressure on inflation.

Yields for 10-year local currency (LCY) government bonds in emerging East Asia were mostly down between 1 September and 31 October. Investor confidence was buoyed as financial markets in the region stabilized and stock markets staged a recovery. The Philippines had the largest drop in 10-year bond yields in the region with a decline of 64 basis points (bps). The PRC; Hong Kong, China; and Singapore all saw 10-year bond yields decline by more than 30 bps. Only Indonesia experienced an increase of a marginal 7 bps.

Over the same period, most emerging East Asian currencies gained against the US dollar, reflecting improved investor sentiments. The Indonesian rupiah and Korean won appreciated the most against the US dollar among the region's currencies, rising by 2.9% and 2.7%, respectively. Meanwhile, the Malaysian ringgit retreated against the US dollar, depreciating by 3.3%.

The risks to emerging East Asian bond markets are easing. The Federal Reserve looks likely to raise interest rates in December, which could result in outflows from the region's bond markets. That said, the region is better prepared to deal with the effects of a rate rise this time around, even if low levels of liquidity in the bond market could exacerbate the impact of an outflow of funds. There are concerns that liquidity is tightening because banks are cutting back on their bond inventories. Limited liquidity in the region's bond markets could mean there are few buyers at a time when investors are looking to sell their bonds, resulting in large price swings that could make the bond market look riskier and induce greater outflows. Slowing economic growth in emerging East Asia could lead to weaker fiscal conditions for governments, while corporates would likely see their profits reduced. These factors could lead to ratings downgrades for some of the region's bonds. Increased risk perception could also push up yields and make it harder for corporates to raise funds through the bond market.

LCY Bond Market Growth in Emerging East Asia

Emerging East Asia's LCY bond market grew 5.8% quarter-on-quarter (q-o-q) and 14.7% year-on-year (y-o-y) in 3Q15 to level off at US$8,782 billion at the end of September. Both q-o-q and y-o-y growth rates were higher than in 2Q15. Six out of nine emerging East Asian markets experienced positive growth in 3Q15—the PRC; Hong Kong, China; Indonesia; the Republic of Korea; the Philippines; and Thailand—while three markets recorded negative growth—Malaysia, Singapore, and Viet Nam.

The PRC remained the largest LCY bond market in the region with an outstanding bond stock of US$5,891 billion at the end of September. It was also the fastest growing market in the region in 3Q15. The Republic of Korea and Thailand were the second and third largest markets in the region, respectively.

As a share of gross domestic product (GDP), emerging East Asia's LCY bond market stood at 60.9% at the end of September, up from its end-June level of 59.4%. The Republic of Korea posted the highest ratio of LCY bonds outstanding to GDP among all emerging East Asian markets at 125.1%.

Emerging East Asian LCY bond issuance expanded to US$1,589 billion in 3Q15 from US$1,423 billion in 2Q15 and US$1,129 billion in 3Q14, led by relatively strong issuance growth in the PRC and Hong Kong, China.

[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.

Structural Developments in Emerging East Asia's LCY Bond Markets

Foreign investors' shares of the LCY government bond markets in Indonesia and Malaysia fell in 3Q15 from the previous quarter amid mounting concerns over a possible rate hike by the Federal Reserve in the run-up to its Federal Open Market Committee meeting in September, and the unexpected Chinese renminbi devaluation in August. Foreign investors' shares of government bond markets were also down in the Republic of Korea and Thailand in 2Q15, the latest quarter for which data for these markets are available. Foreign investor participation in LCY corporate bond markets in Indonesia and the Republic of Korea remained weak.

All four emerging East Asian bond markets for which capital flows data are available—Indonesia, the Republic of Korea, Malaysia, and Thailand—showed net capital outflows in August and September.

LCY Bond Yields

LCY government bond yields generally fell in most emerging East Asian markets. Weak economic growth in the region, especially in the PRC, coupled with low oil and commodity prices, has kept inflation contained, driving yields down in all markets except Indonesia and the Philippines. Yield spreads between the 2-year and 10-year tenors narrowed in all emerging East Asian markets except Malaysia and Viet Nam.

Credit spreads between AAA-rated corporate bonds and government bonds generally rose in those emerging East Asian markets for which data are available—the PRC, the Republic of Korea, and Malaysia—with the rise in spreads mostly due to increased credit concerns amid a weak growth outlook. In addition, credit spreads between lower-rated corporate bonds and AAA-rated bonds were roughly unchanged.

Special Section: *AsianBondsOnline* Bond Market Liquidity Survey

AsianBondsOnline undertakes a bond market liquidity survey annually to assess liquidity conditions in emerging East Asian LCY bond markets. Survey participants include, among others, fixed-income traders and dealers, brokers, portfolio and asset managers, bond market researchers and strategists, and bond pricing associations and regulatory agencies. *AsianBondsOnline* conducted the 2015 survey mostly through face-to-face interviews and meetings, and via email correspondence, in September and October.

Overall, liquidity conditions in the region's LCY bond markets appear to have tightened in 2015 compared with 2014. Survey results reveal that average bid–ask spreads for both LCY government and corporate bonds are higher in most emerging East Asian markets in 2015 compared with the previous year. The region's LCY government bond markets continue to be more liquid than LCY corporate bond markets.

Survey results also show that greater investor diversity remained the most important structural issue in boosting the liquidity of the region's LCY government and corporate bond markets. This implies that there are a few dominant investor groups in the region's LCY bond markets.