

# Executive Summary

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## Global and Regional Market Developments

Government bond yields rose in major advanced economies between 31 August and 15 October as investment sentiment improved on the 11 October announcement of a limited truce in the trade dispute between the People's Republic of China (PRC) and the United States (US).

Between 31 August and 15 October, 10-year local currency (LCY) government bond yield trends were mixed in emerging East Asia, mainly driven by domestic factors.<sup>1</sup> The 10-year yield rose in most markets, including the PRC; Hong Kong, China; the Republic of Korea; Malaysia; the Philippines; and Thailand; while yields in bond markets in Indonesia, Singapore, and Viet Nam declined, largely driven by monetary policy easing.

Improved investor sentiment was reflected in the recovery in most regional equity markets; the appreciation of almost all regional currencies; as well as narrowed credit default swap spreads, a decline in the Chicago Board Options Exchange Volatility Index, and narrowing in the Emerging Markets Bond Index Global spread.

Foreign investor holdings in the region's LCY bond markets for which data are available remained mostly stable as the region benefited from monetary policy easing in most advanced economies. The PRC experienced a sustained increase in foreign holdings with the removal of quotas on foreign investment in the LCY bond market and the inclusion of government bonds in global bond indexes.

Risks to the regional outlook still tilt toward the downside. The protracted trade conflict between the PRC and the US remains the primary downside risk. While there has been some progress toward a resolution, a comprehensive and long-term settlement is needed. A sharper-than-expected economic slowdown in advanced economies, as well as in the PRC, also poses a risk to emerging East Asia.

On a positive note, the monetary policy easing of central banks in advanced economies is benefiting the region's financial environment.

## Bond Market Developments in Emerging East Asia

Total bonds outstanding in emerging East Asia's LCY bond market reached USD15.2 trillion at the end of September on growth of 3.1% quarter-on-quarter (q-o-q) and 13.0% year-on-year (y-o-y).

The PRC remained the region's leader in terms of bond market size with its share of the regional total rising to 75.4%. The bond market of the Republic of Korea accounted for a 13.1% share of the regional total. Collectively, the outstanding bonds of member markets of the Association of Southeast Asian Nations accounted for a 9.9% share.<sup>2</sup>

At the end of September, government bonds continued to dominate the region's LCY bond market, accounting for a 61.8% share of the total. Total government bonds outstanding stood at USD9.4 trillion, posting growth of 3.1% q-o-q and 11.6% y-o-y. Corporate bonds took a 38.2% share of the total at a size of USD5.8 trillion. Growth in the corporate bond segment hit 3.2% q-o-q and 15.3% y-o-y.

As a share of the region's gross domestic product (GDP), the size of emerging East Asia's LCY bond market inched up to 83.7% at the end of September from 82.7% at the end of June. The largest bond markets as a share of domestic GDP were in the Republic of Korea and Malaysia.

Total LCY bond issuance in emerging East Asia reached USD1.5 trillion in Q3 2019, posting growth of 0.9% q-o-q and 5.2% y-o-y.

The November issue of the *Asia Bond Monitor* includes a chapter discussing the results and analysis of the

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<sup>1</sup> 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.

<sup>2</sup> LCY bond statistics for the Association of Southeast Asian Nations include the markets of Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Viet Nam.

*AsianBondsOnline* Annual Bond Market Liquidity Survey, presents a theme chapter on Bond Market Development and Bank Risk-Taking: Evidence from Developing Markets, and features two special discussion boxes (LIBOR reform and the ongoing PRC–US trade conflict).

## AsianBondsOnline Annual Bond Market Liquidity Survey

*AsianBondsOnline* conducts an annual survey to assess liquidity conditions in the region's LCY bond markets. This year's survey was conducted between the last week of September through the middle of October.

Survey results showed increased liquidity and trading volumes in most LCY bond markets in 2019 compared with 2018, largely boosted by the accommodative monetary policies of central banks in advanced economies and emerging East Asia.

Among qualitative indicators, the lack of well-functioning hedging mechanisms and a diversified investor base for both government and corporate bonds were identified as the most important common structural issues that require attention from regional authorities.

## Theme Chapter on Bond Market Development and Bank Risk-Taking: Evidence from Developing Markets

This study investigates how bond market development shapes banks' risk-taking in terms of portfolio risk, liquidity risk, and overall bank risk. Exploiting a bank-level sample for 26 developing markets, the study finds that bond market development lowers banks' portfolio risk and overall risk, and strengthens their liquidity position. Government bonds serve as liquid assets that allow banks to expand assets without impairing risk positions. Corporate bonds work as a stable funding source and an alternative risky asset class that contributes to bank stability while facilitating risky asset holdings. Large and well-capitalized banks benefit the most from bond market development through an increased ability to take risks while maintaining resilience. This study presents

new evidence on the complementary role of a well-functioning bond market in terms of bank soundness, offering policy implications on the importance of capital market development and a well-balanced bond market structure.

## Box 1: So Long, LIBOR!

This box discusses developments relating to the global transition from the London Interbank Offered Rate (LIBOR) to alternative risk-free rates (RFRs). It highlights progress made in the United Kingdom and the US, the two markets most likely to go through a complete transition to their respective alternative RFRs: the Sterling Overnight Index Average and the Secured Overnight Financing Rate. While market infrastructures have established trading and clearing services for the two RFRs, challenges remain in facilitating a smooth and timely transition before the scheduled LIBOR phaseout after 2021. The discussion of the challenges in adopting the Sterling Overnight Index Average and the Secured Overnight Financing Rate finds that developing liquidity in cash and derivatives markets for the new RFR-linked instruments is essential for a timely transition. For financial firms, building capacity to trade new RFR-linked instruments will become a strategic priority as the deadline for a full transition approaches.

## Box 2: Update on the PRC–US Trade Conflict

The PRC and the US agreed to a temporary trade truce on 11 October. The US will hold off on further tariff increases in exchange for limited concessions from the PRC to purchase more US agricultural products. The easing of tensions is expected to be a boon for both economies, the PRC in particular. The *Asian Development Outlook 2019 Update* shows that without a deal, the trade conflict would reduce the PRC's GDP by 0.65% over the medium term; the corresponding figure for the US is much smaller at 0.13% of GDP. Although the limited trade deal gives some cause for optimism, it falls far short of a comprehensive and long-term settlement. Ongoing trade tensions between the PRC and the US remain a primary downside risk for the global economy and financial markets.