

Highlights

Key Trends

- Government bond yields rose in major advanced economies between 31 August and 15 October as investment sentiment improved and demand for safe-haven assets declined following the 11 October announcement of a limited trade truce between the People's Republic of China (PRC) and the United States (US).
- In emerging East Asia, bond yield trends were mixed. Bond yields rose in most markets while declining in a few others, driven primarily by domestic factors.¹
- Most emerging East Asian currencies strengthened against the US dollar between 31 August and 15 October. The Korean won gained the most as it benefited from the easing of PRC–US trade tensions in October.
- Equity markets also benefited from the easing of trade tensions, with the largest gains observed in the Republic of Korea; the PRC; and Hong Kong, China.
- Credit default swap spreads narrowed in all markets, reflecting improved investment sentiment.
- Foreign holdings in emerging East Asian local currency (LCY) government bond markets were largely stable during the review period. The share of foreign holdings continued to rise in the PRC, where the bond market is gradually opening up.
- The size of emerging East Asia's LCY bond market reached USD15.2 trillion at the end of September on growth of 3.1% quarter-on-quarter and 13.0% year-on-year.

Risks to Financial Stability

- The trade dispute between the PRC and the US remains the primary downside risk to the region's financial stability. While there has been some encouraging progress in bilateral negotiations in recent weeks, there is still no sign of a comprehensive long-term settlement.
- Another downside risk to emerging East Asia is a sharper-than-expected slowdown in advanced

economies and the PRC given the region's close economic linkages with both.

- One positive factor has been the easing of monetary policies by central banks in advanced economies, which is contributing to more benign global financial conditions.

AsianBondsOnline Annual Bond Market Liquidity Survey

- The *AsianBondsOnline* Annual Bond Market Liquidity Survey showed increased liquidity and trading volumes in most regional LCY bond markets in 2019 compared with last year, largely driven by the accommodative monetary policies of central banks in advanced economies and emerging East Asia.
- 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

- The special theme chapter investigates the effect of bond market development on the risk-taking decisions of banks. Using bank-level data from developing markets around the world, the analysis finds that bond market development reduces banks' risks and supports credit creation.
- Both government bonds, which serve as a liquid asset class, and corporate bonds issued by banks, which provide a stable source of funding, help mitigate maturity mismatches in banks' balance sheets. Evidence indicates that large banks and well-capitalized banks benefit the most from bond market development.
- The key takeaway from the study is that a well-functioning capital market can contribute to the soundness of the banking sector.

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.