

Highlights

Key Trends

- Financial conditions recovered in emerging East Asian markets from 31 August to 6 November.¹ Investor sentiment improved during the review period amid economic recovery in major advanced economies in the third quarter. However, risks remained tilted to the downside amid a resurgence of the coronavirus disease (COVID-19) in major advanced economies and uncertainty about the trajectory of the global economic recovery.
- Between 31 August and 6 November, 2-year local currency (LCY) government bond yields fell in most emerging East Asian markets as central banks maintained an accommodative monetary stance in response to weak economic outlooks. Meanwhile, 10-year bond yields showed a mixed pattern, tracking market-specific conditions.
- Most regional equity markets rose and regional currencies strengthened during the review period. Credit default swap spreads also narrowed. Regional LCY bond markets experienced net foreign fund inflows in the third quarter of 2020. Net inflows were also observed in equities markets in early November.
- Emerging East Asia's LCY bond market expanded to USD18.7 trillion at the end of September on growth of 4.8% quarter-on-quarter and 17.4% year-on-year in the third quarter of 2020. Growth was largely driven by the increased financing needs of both the public and private sectors due to the pandemic. Government bonds comprised 61.6% of the region's total LCY bonds outstanding at the end of September.

Risks to Financial Stability

- Risks remain tilted to the downside. The overriding risk is the ongoing COVID-19 pandemic, which may last longer than initially forecast.
- Other risks include ongoing tensions between the People's Republic of China and the United States, and heightened social unrest resulting from the economic impact of COVID-19.

Special Section: Financing a Sustainable Recovery

- This issue of the *Asia Bond Monitor* includes a special section with discussion boxes on how green and social finance can contribute to a sustainable economic recovery from the COVID-19 pandemic.
- The first discussion box reviews existing knowledge on how various environmental and social challenges hamper economic growth.
- Another box reviews the development of green and social finance during the COVID-19 pandemic.
- A third box outlines why externalities matter for the financial sector, covering topics such as reduced systematic and idiosyncratic risks, client demands and fund flow concerns, hedging for climate-related risks, and social pressure.
- A fourth box discusses the economic effects of green and social finance.

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.

Theme Chapter: Bank Efficiency and Bond Markets—Evidence from Asia and the Pacific

- The theme chapter investigates the link between bond market development and the profit and cost efficiencies of banks. The bond market is relevant for different aspects of banking sector operations. On the one hand, government bonds offer alternative risk-free assets for depositors and thus compete with bank deposits, while corporate bonds serve as an alternative direct financing instrument to bank loans for high-quality clients. On the other hand, government bonds serve as a liquidity management instrument to shorten the maturity profile of asset portfolios, while corporate bonds serve as a financing instrument that allow banks to tap longer-term funding.
- This study finds that banks consistently become more profit-efficient but less cost-efficient in economies with relatively more developed bond markets. Results also show that the structure of the bond market has an impact on bank efficiency.
- The study highlights the important role of well-functioning and balanced bond markets in financing economic development.