Market Summaries

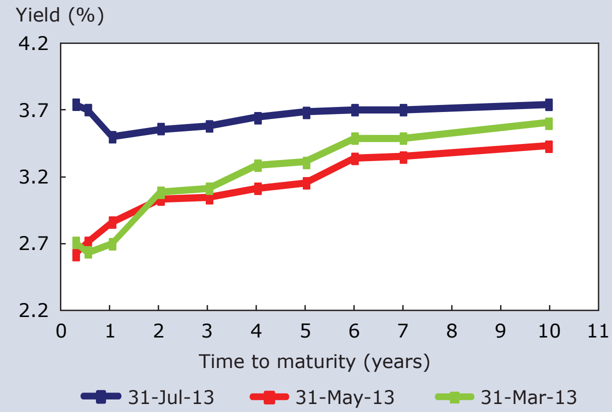
People's Republic of China

Yield Movements

The government bond yield curve of the People's Republic of China (PRC) was relatively unchanged between end-March and end-May (**Table 1**). On the shorter-end, yields rose slightly for the 6-month and 1-year tenors, rising 7 basis points (bps) and 16 bps, respectively. Yields for the 2- and 3-year tenors, however, fell 5 bps and 7 bps, respectively. For tenors of 4 years and longer, yields rose between 14 bps and 17 bps.

A major change in the yield curve occurred between end-May and end-July, particularly at the shorter-end of the curve where yields rose between 63 bps and 111 bps for tenors of 1-year or less. In comparison, yields rose between 31 bps and 53 bps for tenors longer than 1-year. Meanwhile, the spread on 2- versus 10-year yields narrowed to 18 bps at end-July from 39 bps at end-May due to the significant rise in yields at the shorter-end of the curve.

Figure 1: The People's Republic of China's Benchmark Yield Curve—LCY Government Bonds



LCY = local currency.
Source: Bloomberg LP.

The steep rise at the shorter-end of the yield curve was due to the lingering effects of the Shanghai Interbank Offered Rate (SHIBOR) shock event in late June. Bank liquidity requirements rose in June due to withdrawals in advance of the Dragon Boat holiday as well as the maturation of wealth products. At the beginning of June, the overnight SHIBOR rate was 4.6% and the 7-day interbank repo rate was 4.8%. By 8 June, liquidity demands had driven the SHIBOR rate up to 7.5% and the 7-day repo rate to 7.8%. Markets expected the People's Bank of China (PBOC) to step in and provide additional liquidity to the market; instead, the PBOC issued central bank bills on 18 June for the first time since 2011. The issuance sent a signal to markets regarding the PBOC's stance toward liquidity, resulting in a rise in the SHIBOR rate to a high of 13.4% on 20 June, while the 7-day repo rate rose to 11.2%. United States (US) Federal Reserve Chairman's Ben Bernanke's statements regarding the possibility of tapering its quantitative easing program also served to increase market anxiety, which led to an increase in yields at the longer-end of the curve.

The PBOC released a statement on 26 June that sought to clarify its actions by stating that the rise in money market rates was due to temporary seasonal factors and rapid loan growth, but claimed that overall liquidity in the system was sufficient. The PBOC also said that banks needed to be more prudent in their liquidity management.

At the longer-end of the curve, the rise in yields also reflected concerns about somewhat higher levels of inflation and a lack of policy stimulus despite weak economic growth. Even with gross domestic product (GDP) growth falling to 7.5% year-on-year (y-o-y) in 2Q13 from 7.7% in 1Q13, and exports falling 3.1% y-o-y in June, consumer price inflation rose to 2.7% y-o-y in June from 2.1% in May.

Table 1: Size and Composition of the LCY Bond Market in the People's Republic of China

	Outstanding Amount (billion)						Growth Rates (%)			
	2Q12		1Q13		2Q13		2Q12		2Q13	
	CNY	US$	CNY	US$	CNY	US$	q-o-q	y-o-y	q-o-q	y-o-y
Total	22,042	3,469	24,448	3,937	24,825	4,045	1.5	6.9	1.5	12.6
Government	16,396	2,580	17,555	2,827	17,644	2,875	1.1	3.9	0.5	7.6
Treasury Bonds	7,500	1,180	8,071	1,300	8,438	1,375	1.1	8.0	4.5	12.5
Central Bank Bonds	1,644	259	1,338	215	809	132	(14.7)	(41.0)	(39.5)	(50.8)
Policy Bank Bonds	7,251	1,141	8,146	1,312	8,397	1,368	5.6	20.0	3.1	15.8
Corporate	5,646	889	6,893	1,110	7,180	1,170	2.6	16.5	4.2	27.2
Memo Item: Local Government Bonds including Treasury Bonds Issued on Behalf of Local Government	455	72	650	105	664	108	(23.8)	13.7	2.1	45.9
Policy Bank Bonds										
China Development Bank	4,921	775	5,422	873	5,525	900	5.2	14.9	1.9	12.3
Export–Import Bank of China	930	146	1,183	191	1,268	207	3.1	36.0	7.2	36.4
Agricultural Devt. Bank of China	1,400	220	1,541	248	1,604	261	8.4	30.0	4.1	14.5

( ) = negative, LCY = local currency, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Treasury bonds include savings bonds and local government bonds.
3. Bloomberg LP end-of-period LCY–US$ rate is used.
4. Growth rates are calculated from an LCY base and do not include currency effects.
5. The balance of outstanding commercial paper as of 2Q13 was CNY1.5 trillion based on data from *Wind*.
Sources*: ChinaBond* and Bloomberg LP.

More recent data, however, has suggested a slight rebound in the PRC's economy. Exports rose 5.1% y-o-y and imports rose 10.9% in July, while consumer price inflation remained at 2.7%. Also, the Purchasing Managers' Index (PMI) for manufacturing showed improvement in July, rising to 50.3 from 50.1 in June, while the services PMI rose to 54.1 from 53.9 in the previous month.

The government has undertaken a number of policy measures to improve the outlook for continued economic and financial stability. In a recent statement supporting the development of small and medium-sized enterprises (SMEs), the PBOC said that it would continue to ensure a sound monetary policy and keep monetary and aggregate credit at a reasonable level. On 22 June, the PBOC removed the floor on the bank lending rates but maintained the floor on interest rates for mortgages. The PBOC took these steps to curb investment and speculative demand in the real estate market. On 6 May, the State Administration of Foreign Exchange (SAFE) instituted a new rule requiring banks with foreign currency (FCY) loan-to-deposit ratios exceeding a certain level to maintain an FCY net open position greater than zero.

Size and Composition

The amount of outstanding local currency (LCY) bonds in the PRC market reached CNY25 trillion (US$4.0 trillion) at end-June, an increase of 12.6% y-o-y and 1.5% quarter-on-quarter (q-o-q), largely driven by growth in policy bank and corporate bonds.

Government Bonds. LCY government bonds outstanding grew 7.6% y-o-y and 0.5% q-o-q in 2Q13, largely driven by growth in policy bank bonds, which expanded 15.8% y-o-y and 3.1% q-o-q. Central bank bonds continued to act as a drag on government bond growth, falling 50.8% y-o-y and 39.5% q-o-q due to a lack of issuance as the PBOC elected to use other means to affect monetary policy. Meanwhile, treasury bonds increased 12.5% y-o-y and 4.6% q-o-q.

Less than 10% of treasury bonds consist of bonds issued by the central government on behalf of local governments and bonds issued directly by local governments. While many companies owned by local governments issue bonds in the corporate bond market, only a few provinces and municipalities are permitted to issue bonds in

Table 2: Corporate Bonds Outstanding in Key Sectors

	Outstanding Amount (CNY billion)				Growth Rates (%)				
					q-o-q				y-o-y
	3Q12	4Q12	1Q13	2Q13	3Q12	4Q12	1Q13	2Q13	2Q13
Commercial Bank Bonds	1,106.2	1,265.3	1,304.5	1,329.0	0.6	14.4	3.1	1.9	20.8
State-Owned Corporate Bonds	991.4	992.9	1,024.4	652.9	(0.1)	0.2	3.2	(36.3)	(34.2)
Local Corporate Bonds	1,103.2	1,304.9	1,484.3	1,579.6	11.8	18.3	13.7	6.4	60.0
Asset- and Mortgage-Backed Securities	8.2	7.6	5.0	5.0	–	(7.5)	(35.0)	–	(39.8)
Medium-Term Notes	2,340.1	2,492.2	2,661.5	2,749.5	9.9	6.5	6.8	3.3	29.1

( ) = negative, – = not available, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Source: *ChinaBond.*

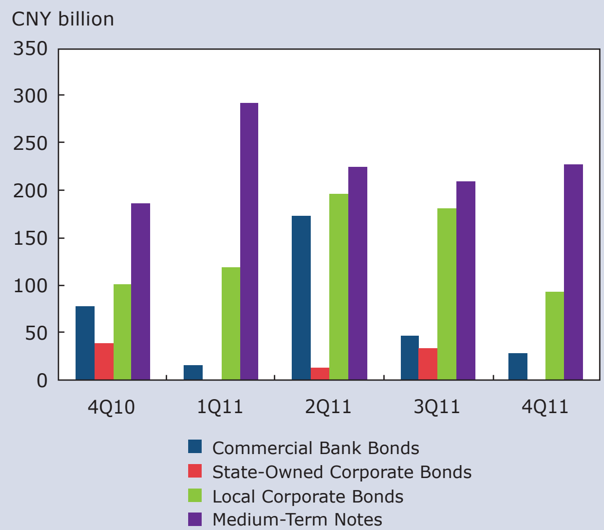
their own name. Those that are permitted include Guangzhou, Zheijiang, Shanghai, and Shangdong. Whether or not local governments should be allowed to issue bonds more freely is currently an important policy question.

Corporate Bonds. Corporate bonds outstanding grew 4.2% q-o-q and 27.2% y-o-y in 2Q13 (**Table 2**). Growth was driven mainly by increases of 6.4% q-o-q and 60.0% y-o-y in outstanding local corporate bonds. Commercial bank bonds grew 20.8% y-o-y, largely due to the issuance of subordinated notes in 2012 as the PRC's banks sought to bolster capital bases amid the implementation of Basel III capital adequacy requirements. State-owned enterprise (SOE) bonds outstanding fell 34.2% y-o-y and 36.3% q-o-q in 2Q13. Medium-term notes (MTNs) expanded 29.1% y-o-y. Outstanding asset-backed securities (ABS) continued to decline, falling 39.8% y-o-y due to a lack of issuance that began in 2008 when ABS issuance was halted by the government. ABS issuance resumed in 4Q12.

The issuance of corporate bonds was down in 2Q13 on a q-o-q basis (**Figure 2**), with the exception of MTNs. Issuance was negatively affected by tighter liquidity conditions and higher interest rates brought about by the June SHIBOR shock.

A relatively small number of issuers dominate the PRC's corporate bond market (**Table 3**). At end-June, the top 30 corporate bond issuers accounted for CNY4 trillion worth of corporate

Figure 2: Corporate Bond Issuance in Key Sectors



Source: *ChinaBond.*

bonds outstanding, or about 58% of the market. Among the top 30 corporate issuers, the 10 largest accounted for CNY3.5 trillion worth of bonds outstanding.

State-owned companies—defined as majority-owned by the government—continued to dominate the corporate bond market in 2Q13. Among the top 30 corporate issuers at end-June, 23 were state-owned, with a total of CNY3.3 trillion worth of bonds outstanding.

Table 4 presents the most significant issuances of 2Q13.

Table 3: Top 30 Issuers of LCY Corporate Bonds in the People's Republic of China

Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
	LCY Bonds (CNY billion)	LCY Bonds (US$ billion)			
1. China Railway	747.00	120.29	Yes	No	Transportation
2. China National Petroleum	380.00	61.19	Yes	No	Energy
3. State Grid Corporation of China	349.50	56.28	Yes	No	Public Utilities
4. Industrial and Commercial Bank of China	230.00	37.04	Yes	Yes	Banking
5. Bank of China	219.93	35.41	Yes	Yes	Banking
6. China Construction Bank	200.00	32.21	Yes	Yes	Banking
7. Agricultural Bank of China	150.00	24.15	Yes	Yes	Banking
8. China Petroleum & Chemical	144.70	23.30	Yes	Yes	Energy
9. Central Huijin Investment	109.00	17.55	Yes	No	Diversified Financial
10. Petrochina	107.50	17.31	Yes	Yes	Energy
11. Shenhua Group	105.00	16.91	Yes	No	Energy
12. China Guodian	103.20	16.62	Yes	No	Public Utilities
13. China Minsheng Bank	102.31	16.47	No	Yes	Banking
14. Shanghai Pudong Development Bank	79.20	12.75	No	Yes	Banking
15. Bank of Communications	76.00	12.24	No	Yes	Banking
16. China Three Gorges Project	75.50	12.16	Yes	No	Public Utilities
17. Industrial Bank	72.08	11.61	No	Yes	Banking
18. China Life	68.00	10.95	Yes	Yes	Insurance
19. China Power Investment	67.30	10.84	Yes	No	Public Utilities
20. China Merchants Bank	61.70	9.94	No	Yes	Banking
21. China Southern Power Grid	60.50	9.74	Yes	No	Public Utilities
22. State-Owned Capital Operation and Management Center of Beijing	58.50	9.42	Yes	No	Diversified Financial
23. Huaneng Power International	54.20	8.73	Yes	Yes	Public Utilities
24. Citic Group	53.50	8.61	Yes	No	Diversified Financial
25. Bank of Beijing	53.50	8.61	No	Yes	Banking
26. China Huaneng Group	53.00	8.53	Yes	No	Public Utilities
27. China Everbright Bank	52.70	8.49	No	Yes	Banking
28. China United Network Communications	50.00	8.05	Yes	Yes	Telecommunications
29. China Citic Bank	42.50	6.84	No	Yes	Banking
30. China Datang	42.20	6.80	Yes	No	Public Utilities
Total Top 30 LCY Corporate Issuers	**3,968.52**	**639.03**			
Total LCY Corporate Bonds	**6,892.54**	**1,109.87**			
Top 30 as % of Total LCY Corporate Bonds	**57.6%**	**57.6%**			

LCY = local currency.
Notes:
1. Data as of end-June 2013.
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on *Wind* data.

Table 4: Notable LCY Corporate Bond Issuance in 2Q13

Corporate Issuers	Coupon Rate (%)	Issued Amount (CNY billion)
China National Petroleum		
6-year bond	4.7	20
China Railway		
5-year bond	4.5	20
China Railway Construction		
7-year bond	5.1	10
Anshan Iron and Steel Group		
3-year bond	4.4	5
China Three Gorges		
5-year bond	4.4	5
Tianjin Bohai State-owned Assets Management		
5-year bond	4.8	5
Datong Coal Mining Group		
15-year bond	5.2	5
Shanxi Lu'an Mining Group		
10-year bond	5.2	3
Changsha Metro Group		
10-year bond	6.2	2.5

LCY = local currency.
Source: *Wind*.

In 2011, the PRC's Audit Office released the results of its audit on the indebtedness of the country's local governments. The report found that local governments had an outstanding debt obligation of CNY10.7 trillion at the end of 2010. Of this amount, CNY6.7 trillion comprised direct obligations of local governments, CNY2.3 trillion came from local government guarantees, and CNY1.7 trillion came from other contingent liabilities.

Local government debt increased at a slower pace of 18.9% y-o-y in 2010 from 61.9% in 2009. The report also shows that the bulk of local government borrowing came from corporations set up for the sole purpose of raising funds: 46.4% of the debt was funded through local-government-owned corporations and 23.3% came from the local government agencies.

By instrument, bank loans were the primary source of the local government funding, comprising 79% of total loans versus 7% for bonds. In June 2013, the audit office released a partial audit report for 36 local government units. The estimated debt of the 36 local governments under review grew 12.9% y-o-y to CNY3.8 trillion at the end of 2012. CNY1.8 trillion comprised direct obligations of the local government and CNY0.9 trillion comprised guarantees.

By vehicle, the bulk of local government funding came from corporations owned by local government, which comprised 45.7% of the total, followed by government agencies at 25.4%.

By instrument, bank loans were still the largest source of debt, comprising 78% of the total, while bonds comprised 12%.

By region, the largest issuances of local corporate bonds come from the Greater Shanghai region, which accounted for 34% of outstanding local corporate bonds in 2Q13. Within the Greater Shanghai region, outstanding bonds from Jiangsu alone comprised 14% of all local corporate bonds **(Table 5)**.

Investor Profile

Treasury Bonds. Banks remained the largest category of investors in the PRC's treasury bond market, which includes policy bank bonds, holding a slightly larger share of these bonds at the end of 2Q13 (77.7%) than at the end of 2Q12 (76.7%) **(Figure 3)**. The share held by special members fell to 10.0% from 11.2% during the same period. Special members comprise the PBOC, Ministry of Finance, policy banks, China Government Securities Depository Trust and Clearing Company, and China Securities Depository and Clearing Corporation.

Corporate Bonds. Banks were also the largest holder of corporate bonds at the end of 2Q13, albeit with a comparatively smaller share than their holdings of treasury bonds and policy bank bonds. Banks' share of corporate bonds fell to 31.3% at the end of 2Q13 from 40.1% a year earlier **(Figure 4)**. The second largest holder of corporate bonds were insurance companies, with a 16.1% share at end-June, which was less than their 26.3% share at end-June 2012.

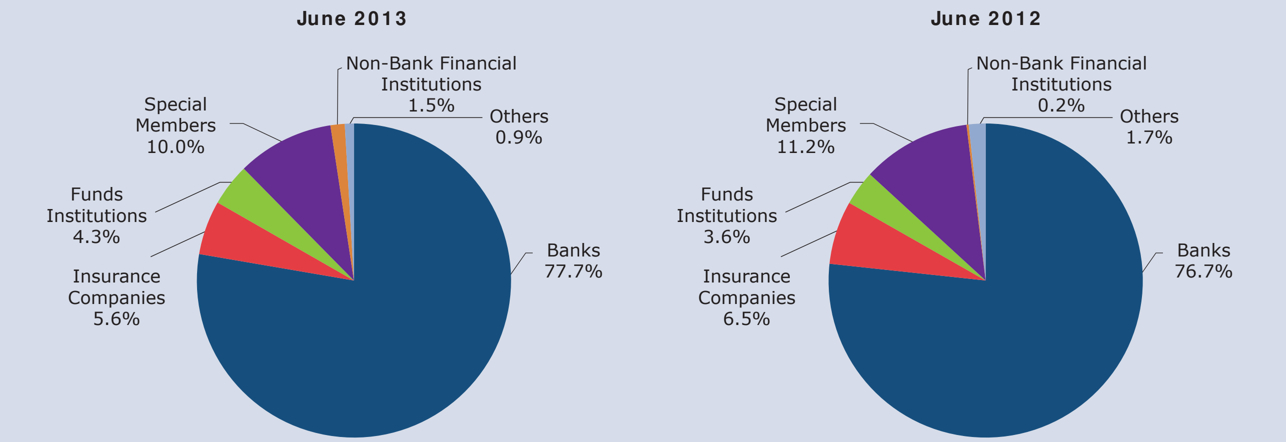
Figure 5 presents the investor profile across different bond categories. Based on the latest data available, banks were the largest holders of

Table 5: Local Corporate Bonds Outstanding by Region

	Number of Issuers	Number of Issuances	Outstanding Amount (CNY billion)		% Change
			4Q12	2Q13	
Greater Shanghai					
Shanghai	26	36	50	51	1.1
Zhejiang	105	126	114	139	21.4
Jiangsu	146	180	192	229	19.3
Anhui	45	68	69	76	10.2
Jiangxi	32	40	36	47	30.2
Subtotal	**354**	**450**	**461**	**541**	**17.3**
Greater Beijing					
Beijing	35	45	78	84	8.2
Tianjin	23	34	42	62	44.9
Hebei	21	29	29	33	15.2
Subtotal	**79**	**108**	**149**	**179**	**20.0**
Greater Guangdong					
Guangdong	36	38	37	52	39.9
Fujian	40	44	27	42	52.8
Hunan	49	65	73	82	13.0
Guangxi	19	26	26	27	3.9
Subtotal	**144**	**173**	**164**	**203**	**24.4**
The Southwest					
Chongqing	42	56	63	76	20.9
Yunnan	33	39	37	43	16.7
Sichuan	36	46	39	49	23.6
Subtotal	**111**	**141**	**140**	**168**	**20.5**
Central					
Henan	39	44	39	47	21.4
Hubei	31	36	26	34	28.8
Shaanxi	25	31	26	33	30.0
Subtotal	**95**	**111**	**91**	**114**	**26.0**
The West					
Inner Mongolia	26	32	31	36	18.6
Gansu	4	5	6	7	12.7
Xinjiang	22	23	20	24	22.9
Qinghai	5	7	5	6	12.0
Ningxia	6	9	9	9	0.0
Subtotal	**63**	**76**	**71**	**82**	**16.5**
The Northeast					
Jilin	11	13	13	15	13.4
Liaoning	35	49	62	72	17.1
Heilongjiang	17	23	26	28	9.8
Subtotal	**63**	**85**	**101**	**115**	**14.7**
Others					
Shangdong	69	89	70	89	26.1
Hainan	8	9	7	12	85.0
Shanxi	25	31	34	50	49.0
Guizhou	26	28	28	33	18.5
Xizang	0	0	0	0	–
Subtotal	**128**	**157**	**139**	**185**	**32.9**

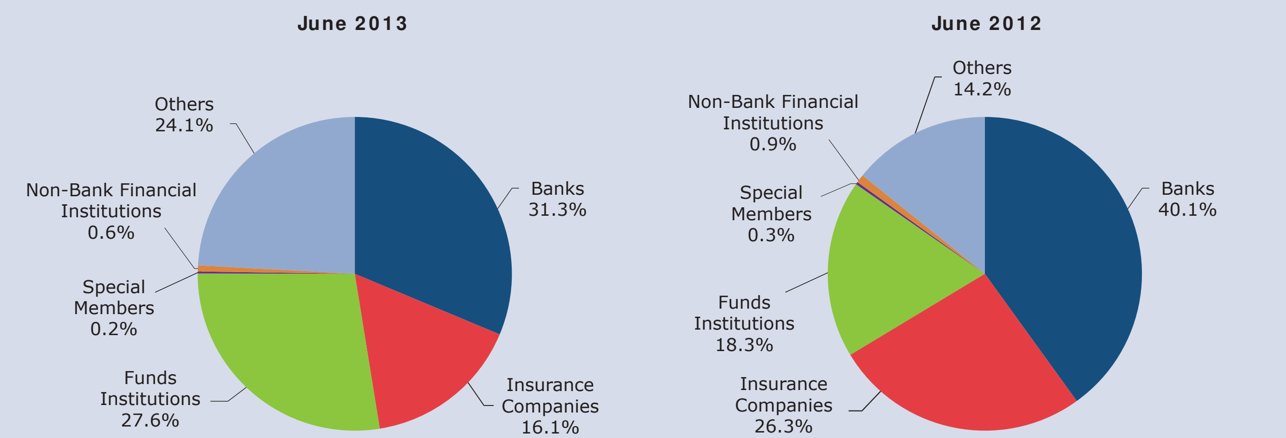
– = not applicable.
Notes:
1. Data as of end-June 2013.
2. Local corporate bonds are bonds approved by the China Securities Regulatory Commission, and are tradable on the exchanges. They exclude bonds issued by state-owned corporations.
Source: *Wind*.

Figure 3: LCY Treasury Bonds Investor Profile



LCY = local currency.
Source: *ChinaBond*.

Figure 4: LCY Corporate Bonds Investor Profile



LCY = local currency.
Source: *ChinaBond*.

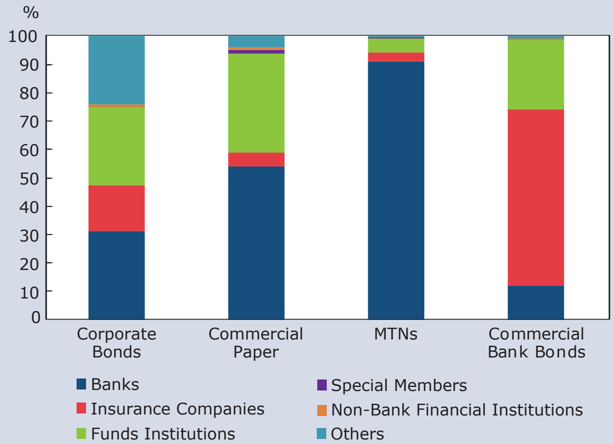
MTNs and policy bank bonds at end-December 2012 with more than 80% of MTNs and policy bank bonds outstanding. Meanwhile, insurance companies were the largest holders of commercial bank bonds.

Liquidity

Figure 6 presents the turnover ratio for government bonds, including both spot trading and repo trading volumes. The volume of repo trading is larger than that of spot trading in the PRC bond market, and the repo market is also the more active of the two. In 2Q13, spot turnover ratios for treasury, central bank, and policy bank bonds all fell due to concerns over potential US monetary policy tightening and local liquidity conditions. Tight liquidity conditions in 2Q13 also prompted a rise in the repo turnover ratio.

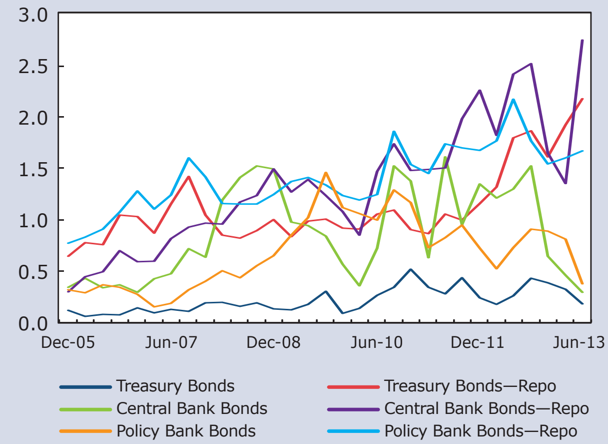
Bid–ask spreads rose in June, reflecting tight liquidity conditions domestically and negative sentiment created by the possibility of US monetary policy tightening (**Figure 7**). Bid–ask

Figure 5: Investor Profile across Bond Categories



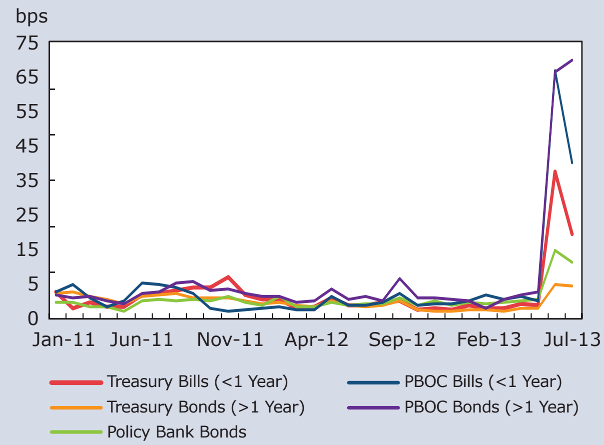
bps = basis points, MTNs = medium-term notes.
Note: Data as of end-June 2013.
Source: *ChinaBond*.

Figure 6: Turnover Ratios for Government Bonds



Repo = repurchase.
Source: *ChinaBond*.

Figure 7: Bid–Ask Spreads among Market Makers



PBOC = People's Bank of China.
Source: *Wind*.

spreads for treasury bills and PBOC bills rose the most, owing to their short-term nature. The SHIBOR shock in June led to higher interest rates at the shorter-end of the yield curve, prompting market participants to become bearish on shorter-dated securities.

Interest Rate Swaps

In 2Q13, the total notional amount of signed interest rate swap (IRS) agreements in the PRC reached CNY795.8 billion on 7,005 transactions **(Table 6)**. The most popular benchmark was the 7-day repo, which accounted for 66% of all transactions.

Rating Changes

On 9 April, Fitch Ratings (Fitch) affirmed the PRC's FCY rating of A+ with a stable outlook. However, Fitch downgraded the LCY rating to A+ from AA–. Fitch said that its affirmation of the country's FCY ratings reflects the central government's strong FCY balance sheet that includes significant foreign reserves. However, the LCY rating was affected by a worsening outlook for the PRC's financial stability due to rapid credit growth in bank balance sheets and local government liabilities. Also, the country's revenues are more volatile than its peers.

Moody's Investors Service (Moody's) downgraded the PRC's FCY rating outlook to stable from positive, but affirmed the rating at AA– on 16 April. Moody's rationale for the downgrade in outlook was similar to that of Fitch for the rating downgrade, including concerns over the level of credit growth and risks associated with the liabilities of local government units.

Table 6: Notional Values of the PRC's Interest Rate Swap Market in 2Q13

Interest Rate Swap Benchmarks	Notional Amount (CNY billion)	% of Total Notional Amount	Number of Transactions	Growth Rate (%)	
	2Q13			q-o-q	y-o-y
7-Day Repo Rate	532.8	66.9	5,524	29.9	53.3
Overnight SHIBOR	179.1	22.5	440	(21.7)	(23.3)
3-Month SHIBOR	73.8	9.3	749	(17.3)	(2.3)
1-Year Term Deposit Rate	3.8	0.5	26	313.5	(82.0)
1-Year Lending Rate	5.3	0.7	259	(27.0)	122.1
3-Year Lending Rate	0.9	0.1	6	32.4	105.0
Above 5-Year Lending Rate	0.2	0.03	1	43.9	(68.3)
Total	**795.8**	**100.0**	**7,005**	**7.9**	**16.7**

( ) = negative, PRC = People's Republic of China, q-o-q = quarter-on-quarter, Repo = repurchase, SHIBOR = Shanghai Interbank Offered Rate, y-o-y = year on year.
Sources: *AsianBondsOnline* and *ChinaMoney*.

Policy, Institutional, and Regulatory Developments

SAFE Issues New Requirements on Net Open Position

On 6 May, SAFE announced that local banks with FCY loan-to-deposit ratios exceeding 75% and foreign banks with FCY loan-to-deposit ratios exceeding 100% would be required to maintain a net open position on FCY holdings of at least zero.

SMEs Allowed to Issue Exchangeable Bonds

On 31 May, the Shenzhen Stock Exchange announced that it would allow SMEs to issue exchangeable bonds. Exchangeable bonds are bonds collateralized with the listed equity securities of other companies. The coupon rate for the bonds cannot be three times higher than the relevant benchmark rate and the tenor must be at least 1 year. The bond conversion price also cannot be less than 90% of the 20-day average trading price of the collateral.

CSRC Increases QFII Quota

On 12 July, the China Securities Regulatory Commission (CSRC) announced that it would increase the Qualified Foreign Institutional Investor (QFII) Program's quota to US$150 billion. It also expanded the Renminbi Qualified Foreign Institutional Investor (RQFII) Program. (For more detail, see the Hong Kong, China Market Summary.)

PBOC Removes Lending Rate Floor

On 20 July, the PBOC announced that it would remove the floor on lending rates. Previously, banks could not set lending rates lower than 30% of the benchmark rate. The PBOC also removed the limits on interest rates for bill discounting. However, the PBOC did not remove the floor on mortgage interest rates. The PBOC said that the moves were part of the PRC's policy of moving toward a market-based interest rate regime.

The PRC to Audit Local Government Debt

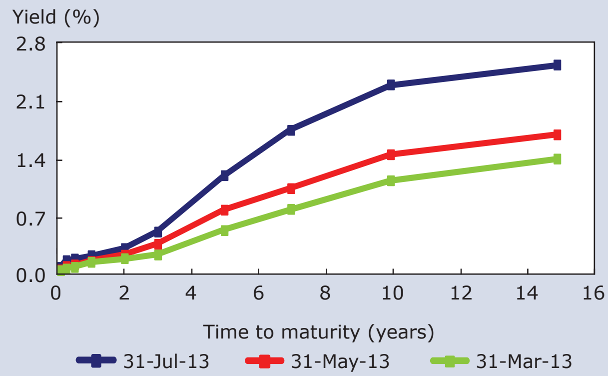
On 26 July, the PRC ordered a nationwide audit of local government debt. The National Audit Office said the last audit found that local governments had a total of CNY10.7 trillion in outstanding debt at the end of 2010.

Hong Kong, China

Yield Movements

The yield curve for Hong Kong, China's Exchange Fund Bills and Notes (EFBNs) has been rising since end-March, particularly at the longer-end (**Figure 1**). Between end-March and end-May, yields rose 4 basis points (bps) or less for tenors of 2-years or less, while yields rose 13 bps–31 bps for longer-dated tenors. The rise in yields was prompted by statements from United States (US) Federal Reserve (Fed) Chairman Ben Bernanke in May that the pace of Fed bond purchases could be tapered later in 2013 and halted in 2014 should economic data support such action.

Figure 1: Hong Kong, China's Benchmark Yield Curve—EFBNs



EFBN = Exchange Fund Bills and Notes.
Source: Bloomberg LP.

Between end-May and end-July, yields rose between 3 bps and 15 bps on tenors of 3-years or less, and between 41 bps and 84 bps on longer-dated tenors. The larger increase in yields at the longer-end of the curve caused the 2- versus 10-year spread to rise to 196 bps at end-July from 120 bps at end-May.

The rise in Hong Kong, China's bond yields tracks closely with yield changes in the US Treasuries market as Hong Kong, China does not have an independent monetary policy and pegs its dollar to the US dollar.

The rise in yields also reflects improvements in Hong Kong, China's economy as well as rising inflation. Hong Kong, China's economic growth rose in 2Q13, to 3.3% year-on-year (y-o-y) from 2.9% in 1Q13. Growth was supported mostly by domestic demand, with private consumption adding 2.9 percentage points to GDP growth. In June, retail sales rose 14.7% y-o-y in June from 12.9% in May.

The government now expects GDP growth for 2013 to be between 2.5%-3.5% compared with its original forecast of 1.5%-3.5%.

Inflation has also risen in Hong Kong, China mostly due to the feed-through effects of higher housing rents in 2012. Consumer price inflation rose to 6.9% y-o-y in July from 4.1% in June. Inflation in May was at 3.9%. The government expects further upside risks to inflation from the feed-through effects of housing rents but noted moderating influences on inflation in the latter half of 2013, such as lower import prices and a slower pace of increases in housing rents in certain areas.

Size and Composition

The size of Hong Kong, China's local currency (LCY) bond market grew 10.7% y-o-y to HKD1.5 trillion (US$192 billion) at end-June (**Table 1**). On a quarter-on-quarter (q-o-q) basis, LCY bonds outstanding rose 4.4% in 2Q13.

Total LCY government bonds outstanding rose 15.7% y-o-y and 7.0% q-o-q as of end-June. Government bonds include Exchange Fund Bills (EFBs), Exchange Fund Notes (EFNs), and bonds issued under the Institutional Bond Issuance Programme (HKSAR Bonds).

The amount of LCY government bonds outstanding at end-June reached HKD834 billion. Most of the growth in government bonds in 2Q13 could be attributed to growth in EFBs, which expanded

Table 1: Size and Composition of the LCY Bond Market in Hong Kong, China

	Outstanding Amount (billion)						Growth Rate (%)			
	2Q12		1Q13		2Q13		2Q12		2Q13	
	HKD	US$	HKD	US$	HKD	US$	q-o-q	y-o-y	q-o-q	y-o-y
Total	1,345	173	1,426	184	1,488	192	1.1	3.8	4.4	10.7
Government	720	93	779	100	834	107	2.1	5.3	7.0	15.7
Exchange Fund Bills	587	76	640	82	682	88	0.1	0.4	6.5	16.0
Exchange Fund Notes	69	9	69	9	68	9	(0.4)	(0.9)	(0.4)	(0.9)
HKSAR Bonds	64	8	71	9	84	11	29.3	113.3	18.4	30.5
Corporate	624	80	646	83	655	84	(0.1)	1.5	1.3	4.9

( ) = negative, HKSAR = Hong Kong Special Administrative Region, LCY = local currency, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Bloomberg LP end-of-period LCY–US$ rates are used.
3. Growth rates are calculated from an LCY base and do not include currency effects.
Sources: Hong Kong Monetary Authority and Bloomberg LP.

16.0% y-o-y to HKD682 billion from HKD587 billion at end-June 2012. On the other hand, the stock of EFNs declined slightly by 0.9% y-o-y to HKD68 billion. HKSAR bonds grew rapidly in 2Q13, rising 30.5% y-o-y, although the absolute amount of HKSAR bonds remains much lower than EFBs.

Under the Institutional Bond Issuance Programme, HKD3 billion of 3-year HKSAR bonds were issued in May and HKD2 billion of 5-year HKSAR bonds were issued in July. Under the Retail Bond Issuance Programme, HKD10 billion of 3-year HKSAR bonds were issued. A total of HKD15 billion worth of HKSAR bonds were issued in 2Q13.

Turnover volumes for EFBs and EFNs declined significantly in 2012 and 2013 compared with 2011 levels. The turnover volumes in 1H12 and 1H13 were equivalent to only 3% and 2%, respectively, of the turnover volume in the first half of 2011. The drop in trading volumes was due to a December 2011 change in the criteria for market makers, which previously included trading volume, as the Hong Kong Monetary Authority (HKMA) had become concerned with "round-tripping" trades used to artificially increase trading volume.

The amount of LCY corporate bonds outstanding rose to HKD655 billion at end-June, reflecting growth of 4.9% y-o-y and 1.3% q-o-q. The top 24 non-bank corporate issuers in Hong Kong, China accounted for about 16% of total corporate bonds outstanding in 2Q13 **(Table 2)**. Hong Kong, China's top corporate issuer of LCY bonds remained the state-owned Hong Kong Mortgage Corporation (HKMC) with outstanding bonds valued at HKD17.4 billion at end-June. CLP Power Hong Kong Financing Ltd. was the next largest issuer with outstanding bonds of HKD10.9 billion. Sun Hung Kai Properties (Capital Market) Ltd. was the third-largest issuer with outstanding bonds of HKD10 billion.

Financial firms were well represented among the top 24 non-bank corporate issuers in 2Q13, accounting for six of the 24 issuers. Five state-owned companies were included on the list, while 19 were privately owned. Among the companies in Table 2, six are listed on the Hong Kong Exchange. **Table 3** presents some notable issuances from non-bank institutions in 2Q13.

Policy, Institutional, and Regulatory Developments

Taxation on *Sukuk* to be Revised

On 19 June, Hong Kong, China's Inland Revenue Department released the Inland Revenue and Stamp Duty Legislation (Alternative Bond Schemes) (Amendment) Ordinance 2013. The amendment seeks to promote the development of the *sukuk* (Islamic bond) market in Hong Kong, China by revising the taxation framework for some types of *sukuk*.

Table 2: Top 24 Non-Bank Corporate Issuers in Hong Kong, China

Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
	LCY Bonds (HKD billion)	LCY Bonds (US$ billion)			
1. The Hong Kong Mortgage Corporate	17.38	2.24	Yes	No	Finance
2. CLP Power Hong Kong Financing	10.93	1.41	No	No	Electric
3. Sun Hung Kai Properties (Capital Market)	10.01	1.29	No	No	Real Estate
4. MTR Corporation (C.I.)	6.50	0.84	Yes	Yes	Transportation
5. Wharf Finance	6.18	0.80	No	No	Diversified
6. The Link Finance (Cayman) 2009	5.79	0.75	No	No	Finance
7. HKCG (Finance)	5.60	0.72	No	No	Gas
8. Hongkong Electric Finance	5.51	0.71	No	No	Electric
9. Swire Pacific	4.88	0.63	No	Yes	Diversified
10. Kowloon-Canton Railway	4.80	0.62	Yes	No	Transportation
11. Cheung Kong Bond Finance	4.62	0.60	No	Yes	Finance
12. Urban Renewal Authority	3.90	0.50	Yes	No	Property Development
13. Wheelock Finance	3.74	0.48	No	No	Diversified
14. Yue Xiu Enterprises (Holdings)	3.00	0.39	No	No	Diversified
15. Airport Authority Hong Kong	2.85	0.37	Yes	No	Transportation
16. Hysan (MTN)	2.43	0.31	No	No	Finance
17. Henderson Land MTN	1.83	0.24	No	Yes	Finance
18. Cathay Pacific MTN Financing	1.70	0.22	No	Yes	Airlines
19. Nan Fung Treasury	1.31	0.17	No	No	Real Estate
20. Dragon Drays	1.00	0.13	No	No	Diversified
21. R-Reit International Finance	0.78	0.10	No	No	Real Estate
22. Wing Tai Properties (Finance)	0.58	0.07	No	No	Real Estate
23. HLP Finance	0.56	0.07	No	Yes	Real Estate
24. The Hongkong Land Notes Company	0.20	0.03	No	No	Finance
Total Top 24 Non-Bank LCY Corporate Issuers	**106.04**	**13.67**			
Total LCY Corporate Bonds	**654.90**	**84.43**			
Top 24 as % of Total LCY Corporate Bonds	**16.19%**	**16.19%**			

LCY = local currency.
Notes:
1. Data as of end-June 2013.
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on Hong Kong Monetary Authority data.

Table 3: Notable LCY Corporate Bond Issuance in 2Q13

Corporate Issuers	Coupon Rate (%)	Issued Amount (HKD billion)
Hong Kong Mortgage Corporation		
2-year bond	0.46	0.78
3-year bond	0.68	0.78
2-year bond	0.38	0.50
Urban Renewal Authority		
7-year bond	1.64	0.30
10-year bond	2.14	0.30
Sun Hung Kai Properties		
10-year bond	2.95	0.30
Hong Kong Electric Finance		
15-year bond	3.00	0.20

LCY = local currency.
Source: Central Moneymarkets Unit (CMU) HKMA.

RQFII Expanded

On 12 July, the People's Republic of China expanded the Renminbi Qualified Institutional Investor (RQFII) program. The RQFII program had been limited to financial institutions in Hong Kong, China but will now be expanded to include firms in London; Singapore; and Taipei,China.

Revision to the Renminbi Liquidity Facility

On 25 July, HKMA expanded the CNH liquidity facility that provides CNH funds to banks in Hong Kong, China. Previously, banks availing of the facility would receive funds the following day, which had to be repaid after 1 week. With the expansion of the facility, HKMA will provide banks two additional funding options: (i) overnight borrowing with funds available on the same day, and (ii) 1-day borrowing with funds available the following day.

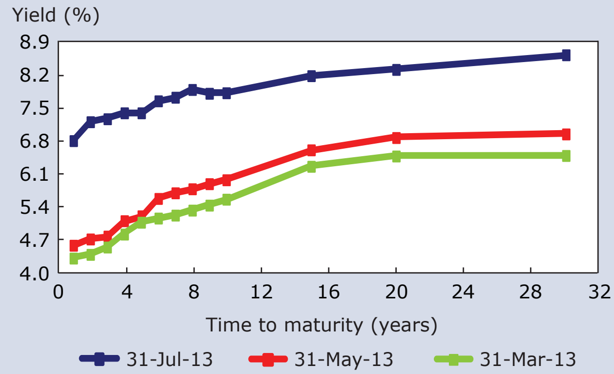
Indonesia

Yield Movements

Between end-March and end-May, Indonesia's local currency (LCY) government bond yields rose across all maturities. Yields rose the most for 7-year maturities, rising 47 basis points (bps), while climbing 46 bps for both 9- and 30-year maturities.

Between end-May and end-July, government bond yields rose dramatically, shifting the curve further upward (**Figure 1**). Yields climbed between 145 bps and 250 bps across the length of the curve, rising more at the shorter-end than at the longer-end, resulting in a flattening of the yield curve. The yield spread between 2- and 10-year maturities narrowed to 62 bps at end-July from 117 bps at end-March and 126 bps at end-May.

Figure 1: Indonesia's Benchmark Yield Curve—LCY Government Bonds



LCY = local currency.
Source: Bloomberg LP.

Bond yields have been on the rise since May over uncertainty related to United States (US) monetary policy. The remarks made by US Federal Reserve (Fed) Chairman Ben Bernanke on 19 June signaling that the Fed may begin to taper its bond purchase program toward the latter part of the year resulted in a significant increase in bond yields and a sell-off in the rupiah bond market.

The Indonesian bond market is still largely influenced by external factors as nearly one-third of government bonds are held by foreign investors, leaving the market vulnerable to the risk of sudden capital outflows. Immediately after the Fed announcement, the Indonesian rupiah breached the psychological IDR10,000–US$1 barrier, and has remained above that level since then. Data from the Indonesia Debt Management Office showed foreign investors as net sellers of bonds in June with a capital outflow of IDR15.76 trillion.

These developments coupled with other domestic factors—including (i) rising inflation expectations as the government was pressured to cut fuel subsidies, (ii) a widening current account deficit and weakening rupiah, (iii) greater budget financing requirements to be funded by increased issuance of bonds, and (iv) warnings from rating agencies of a possible sovereign rating downgrade—dampened bond market sentiments in 2Q13.

The government's decision to raise fuel prices by an average of 33%, effective 22 June, pushed Indonesia's inflation rate to the highest level in emerging East Asia. Inflation jumped to 8.6% year-on-year (y-o-y) in July and 8.8% in August, from relatively stable levels of 5.6%, 5.5%, and 5.9% in April, May, and June, respectively. The celebration of *Ramadan*, which commenced in July, also contributed to pressure on the prices of goods and services. For the January–August period, inflation stood at 7.9%, breaching Bank Indonesia's (BI) annual target of between 3.5% and 5.5%.

Rising inflation expectations led BI's Board of Governors to raise the benchmark interest rate by 25 bps to 6.0% in June, 50 bps to 6.5% in July, and 50 bps to 7.0% in August. The central bank also raised its deposit facility rate twice in June by a combined 75 bps to 4.75%, and another 50 bps to 5.25% in August. The lending facility rate was also raised by 25 bps to 7.0% in August. The rate hikes were initiated to contain inflation, stabilize the rupiah exchange rate, and ease the current account deficit.

Economic growth in Indonesia fell below 6.0% y-o-y in 2Q13 for the first time since September 2010. Real gross domestic product (GDP) growth eased to 5.8% y-o-y in 2Q13 from 6.0% in 1Q13. Domestic consumption and investment moderated to 5.1% and 4.7% y-o-y, respectively, in 2Q13. Growth in government spending, on the other hand, rose to 2.1% y-o-y in 2Q13 from 0.4% in the previous quarter. On a quarter-on-quarter (q-o-q) basis, the economy grew 2.6% in 2Q13 compared with 1.4% in 1Q13. BI expects Indonesia's annual economic growth to fall to between 5.8% and 6.2% in 2013, based on a forecast that has economic growth rising marginally to 5.9% in 3Q13 before further accelerating in 4Q13.

Size and Composition

Total LCY bonds outstanding in Indonesia climbed to IDR1,180.4 trillion (US$118 billion) at end-June, expanding a modest 2.2% q-o-q (**Table 1**). On a y-o-y basis, the bond market grew at a robust pace of 12.4%.

At end-June, growth in LCY government bonds moderated to 1.7% q-o-q and 10.3% y-o-y to reach IDR975.1 trillion. Growth in the government bond sector was mainly driven by central government bonds, comprising treasury bills and treasury bonds issued by the Ministry of Finance. Central bank bills, on the other hand, recorded negative growth on both a q-o-q and y-o-y basis.

Central Government Bonds. The stock of central government bonds rose 3.1% q-o-q to IDR888.5 trillion in 2Q13. On a y-o-y basis, central government bonds rose 12.3%. Fixed-rate bonds, which accounted for 71% of total central government bonds outstanding in 2Q13, were the main drivers of growth, expanding 3.7% q-o-q and 16.7% y-o-y (**Table 2**). Islamic treasury instruments, such as Islamic treasury bills and project-based *sukuk* (Islamic bonds), also contributed to the growth.

New issuance of treasury bills and treasury bonds totaled IDR47.4 trillion in 2Q13, declining 31.3% q-o-q. Since May, most treasury auctions have failed to meet their target as investors seek higher yields. On a y-o-y basis, however, issuance of treasury instruments rose 17.1%.

Based on the revised state budget for 2013, the government needs to issue a total of IDR231.8 trillion (net) this year to fund a deficit equivalent to 2.4% of GDP. To fulfill the additional budgetary requirements, the government plans to issue treasury bills, retail government bonds, fixed-rate bonds, and foreign currency (FCY) bonds. The allotment for FCY bond issuance was increased from 14% to a maximum of 18%–20% of total government debt issuance for the year. The

Table 1: Size and Composition of the LCY Bond Market in Indonesia

	Outstanding Amount (billion)						Growth Rate (%)			
	2Q12		1Q13		2Q13		2Q12		2Q13	
	IDR	US$	IDR	US$	IDR	US$	q-o-q	y-o-y	q-o-q	y-o-y
Total	1,050,246	111	1,154,804	119	1,180,422	118	3.6	3.8	2.2	12.4
Government	884,029	94	958,369	98	975,057	97	3.0	0.5	1.7	10.3
Central Govt. Bonds	791,180	84	861,515	88	888,514	89	4.0	14.5	3.1	12.3
Central Bank Bills	92,849	10	96,854	10	86,543	9	(5.3)	(50.9)	(10.6)	(6.8)
Corporate	166,217	18	196,435	20	205,365	21	7.4	25.9	4.5	23.6

( ) = negative, LCY = local currency, m-o-m = month-on-month, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Bloomberg LP end-of-period LCY–US$ rates are used.
3. Growth rates are calculated from LCY base and do not include currency effects.
4. The total stock of non-tradable bonds as of end-June stood at IDR269.1 trillion.
Sources: Bank Indonesia, Indonesia Debt Management Office, Indonesia Stock Exchange, and Bloomberg LP.

Table 2: Central Government Bonds Outstanding by Type of Bond

Government Bonds	Outstanding Amount (IDR billion)	% Share	Growth Rate (%)	
			q-o-q	y-o-y
Treasury Bills (SPN)	20,790	2.3	(4.3)	(26.2)
Fixed-Rate Bonds	631,067	71.0	3.7	16.7
Variable-Rate Bonds	122,755	13.8	0.0	(5.4)
Zero-Coupon Bonds	0	0.0	–	–
Retail Bonds	34,153	3.8	0.0	14.7
Islamic Treasury Bills	3,020	0.3	87.0	154.9
Sukuk	17,137	1.9	0.0	0.0
Retail *Sukuk*	35,924	4.0	0.0	23.9
Project-Based *Sukuk*	23,669	2.7	21.3	83.5
Total	**888,515**	**100.0**	**3.1**	**12.3**

( ) = negative, – = not applicable, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Note: Data as of end-June 2013.
Source: Indonesia Stock Exchange.

Table 3: Corporate Bonds Outstanding by Type of Bond

Corporate Bonds	Outstanding Amount (IDR billion)	% Share	Growth Rate (%)	
			q-o-q	y-o-y
Conventional Bonds	174,112	84.8	6.2	26.7
Subordinated Bonds	23,486	11.4	(4.9)	3.9
Convertible Bonds	150	0.1	0.0	0.0
Zero-Coupon Bonds	500	0.2	0.0	0.0
Sukuk Ijarah	4,224	2.1	(10.0)	(5.7)
Sukuk Mudharabah	1,079	0.5	(15.6)	39.2
Sukuk Mudharabah Subordinate	1,814	0.9	62.8	477.7
Total	**205,365**	**100.0**	**4.5**	**23.6**

( ) = negative, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Data as of end-June 2013.
2. *Sukuk Ijarah* refers to Islamic bonds backed by a lease agreement.
3. *Sukuk Mudharabah* refers to Islamic bonds backed by a profit-sharing scheme from a business venture or partnership.
Source: Indonesia Stock Exchange.

government still plans to issue US$-denominated bonds in the domestic market as part of its debt strategy for 2013.

Central Bank Bills. The stock of central bank bills known as *Sertifikat* Bank Indonesia (SBI) declined 10.6% q-o-q and 6.8% y-o-y to reach IDR86.5 trillion at end-June. Issuance of SBI and *shari'a* (Islamic law)–compliant SBI fell 34.2% q-o-q. On a y-o-y basis, however, issuance rose 31.1% in 2Q13. SBI are issued by the central bank as one of its monetary tools to help contain inflation.

Corporate Bonds. The LCY corporate bond market in Indonesia reported robust growth in 2Q13, expanding 4.5% q-o-q and 23.6% y-o-y. Total corporate bonds outstanding stood at IDR205.4 trillion. Growth came mainly from an increase in outstanding conventional corporate bonds and *sukuk mudharabah* (profit-sharing) subordinated bonds. **Table 3** presents a breakdown of corporate bonds outstanding by type of bond as of end-June. Conventional corporate bonds, which grew 6.2% q-o-q and 26.7% y-o-y, comprised a large chunk of the total with a share of 84.8% in 2Q13. *Sukuk mudharabah* subordinated bonds grew at a much faster pace of 62.8% q-o-q and 477.7% y-o-y in 2Q13, albeit while coming from a low base.

LCY bonds outstanding among the top 30 corporate bond issuers in Indonesia reached IDR160.5 trillion at the end of 2Q13, representing 78.1% of total corporate bonds outstanding (**Table 4**). Financial and banking institutions dominated the list of the top 30 issuers of corporate bonds in 2Q13. About one-third of the firms are state-owned or those in which the government holds a 50% (or more) ownership stake. State-power firm PLN led the list with LCY corporate bonds outstanding valued at IDR14.2 trillion. It was followed by state-owned Indonesia Eximbank with outstanding stock amounting to IDR13.0 trillion. The third largest corporate bond issuer was automotive leasing company Astra Sedaya Finance with a total bond stock amounting to IDR10.7 trillion.

Corporate bond issuance in 2Q13 remained strong on a q-o-q basis, posting a significant 31.5% hike. On a y-o-y basis, however, corporate bond issuance fell 21.6% in 2Q13. A total of 30 bond series were issued by 16 corporate entities during the quarter. Most of the bonds carried maturities of between 3 years and 5 years. The new corporate bond issues in 2Q13 were all conventional bonds except for one of each of the following: subordinated bond, *sukuk*, and *sukuk mudharabah*. Corporate

Table 4: Top 30 Issuers of LCY Corporate Bonds in Indonesia

Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
	LCY Bonds (IDR billion)	LCY Bonds (US$ billion)			
1. PLN	14,208	1.42	Yes	No	Energy
2. Indonesia Eximbank	12,994	1.30	Yes	No	Banking
3. Astra Sedaya Finance	10,710	1.07	No	No	Finance
4. Adira Dinamika Multifinance	10,277	1.03	No	Yes	Finance
5. Bank Tabungan Negara	8,850	0.88	Yes	Yes	Banking
6. Federal International Finance	7,901	0.79	No	No	Finance
7. Indosat	7,820	0.78	No	Yes	Telecommunications
8. Bank Internasional Indonesia	7,000	0.70	No	Yes	Banking
9. Bank Pan Indonesia	7,000	0.70	No	Yes	Banking
10. Bank CIMB Niaga	6,480	0.65	No	Yes	Banking
11. Jasa Marga	5,000	0.50	Yes	Yes	Toll Roads, Airports, and Harbors
12. Bank Tabungan Pensiunan Nasional	4,585	0.46	No	Yes	Banking
13. Perum Pegadaian	4,514	0.45	Yes	No	Finance
14. Medco-Energi International	4,487	0.45	No	Yes	Petroleum and Natural Gas
15. Bank Permata	4,250	0.42	No	Yes	Banking
16. Sarana Multigriya Finansial	3,936	0.39	Yes	No	Finance
17. Bank OCBC NISP	3,880	0.39	No	Yes	Banking
18. Indofood Sukses Makmur	3,610	0.36	No	Yes	Food and Beverages
19. Agung Podomoro Land	3,600	0.36	No	Yes	Property, Real Estate, and Building Construction
20. Bank Mandiri	3,500	0.35	Yes	Yes	Banking
21. Antam	3,000	0.30	Yes	Yes	Petroleum and Natural Gas
22. Telekomunikasi Indonesia	3,000	0.30	Yes	Yes	Telecommunications
23. BCA Finance	2,850	0.28	No	No	Finance
24. Bank Danamon Indonesia	2,800	0.28	No	No	Banking
25. Bumi Serpong Damai	2,750	0.27	No	Yes	Property, Real Estate, and Building Construction
26. Toyota Astra Financial Services	2,716	0.27	No	No	Finance
27. Indomobil Finance Indonesia	2,518	0.25	No	No	Finance
28. Bank Jabar Banten	2,400	0.24	No	Yes	Banking
29. Bank Rakyat Indonesia	2,000	0.20	Yes	Yes	Banking
30. BII Finance Center	1,824	0.18	No	No	Finance
Total Top 30 LCY Corporate Issuers	**160,458**	**16.04**			
Total LCY Corporate Bonds	**205,365**	**20.53**			
Top 30 as % of Total LCY Corporate Bonds	**78.1%**	**78.1%**			

LCY = local currency.
Notes:
1. Data as of end-June 2013.
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on Indonesia Stock Exchange data.

bonds issued in recent months carried coupons ranging from 6.75% to 9.25%. **Table 5** presents some notable corporate bonds issues in 2Q13.

Investor Profile

Central Government Bonds. Banking institutions remained the biggest holder of central government bonds in Indonesia in 2Q13 (**Figure 2**). The stock of bonds held by banks stood at IDR314.3 trillion in 2Q13, representing a 35.4% share of the total. However, banks' share of government bonds has steadily declined from highs of 70%–80% between 2003 and 2006.

The second largest holder of LCY central government bonds in 2Q13 was foreign investors whose share climbed to 31.8% at end-June from 28.4% a year earlier. In contrast to bank holdings, foreign investors' share in LCY government bonds has steadily increased since 2008 (**Figure 3**). In absolute amounts, outstanding bonds held by foreign investors reached IDR283.0 trillion at end-June.

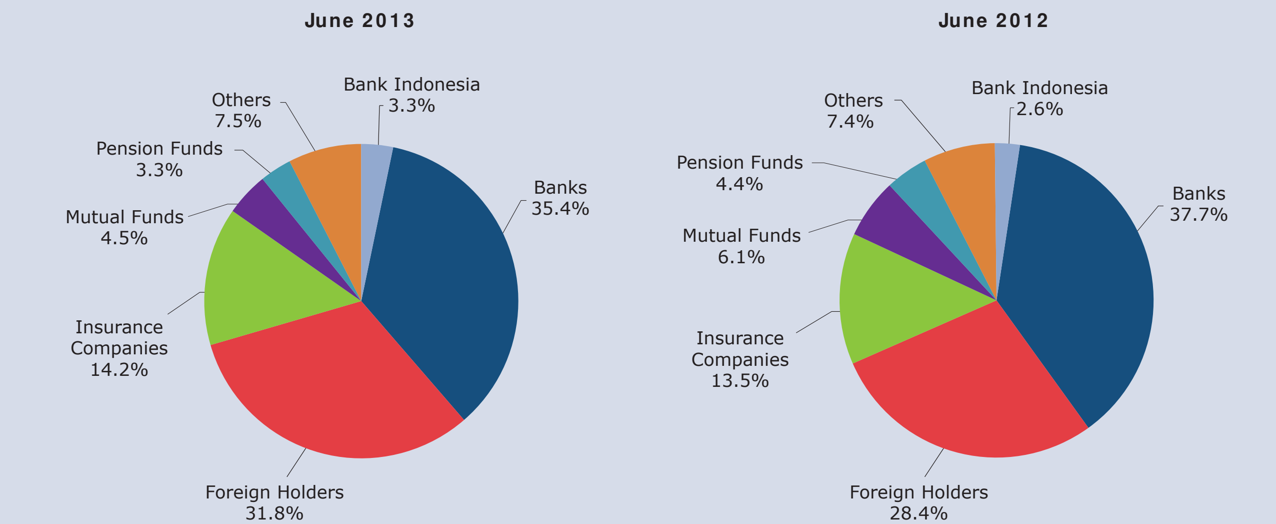
Long-term investors comprise a significant share of foreign investors in Indonesia's LCY central government bond market. At end-June, 44% of

Table 5: Notable LCY Corporate Bond Issuance in 2Q13

Corporate Issuers	Coupon Rate (%)	Issued Amount (IDR billion)
Indonesia Eximbank		
370-day bond	6.15	1,920
3-year bond	6.40	1,940
Federal International Finance		
370-day bond	6.75	710
3-year bond	7.75	1,690
Bumi Serpong Damai		
5-year bond	8.375	1,750
Astra Sedaya Finance		
370-day bond	6.75	650
2-year bond	7.25	100
3-year bond	7.75	950
BCA Finance		
370-day bond	6.50	750
3-year bond	7.50	350
4-year bond	7.60	200
BII Finance		
3-year bond	7.75	775
5-year bond	8.25	525
Agung Podomoro Land		
5-year bond	9.25	1,200
Toyota Astra Financial Services		
370-day bond	6.60	400
3-year bond	7.60	700
4-year bond	7.65	100

LCY = local currency.
Source: Indonesia Stock Exchange.

Figure 2: LCY Central Government Bonds Investor Profile



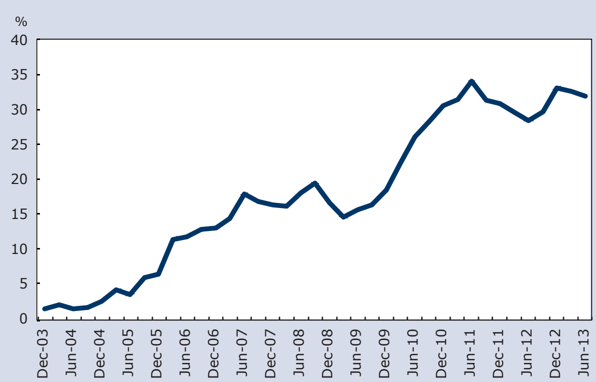
LCY = local currency.
Source: Indonesia Debt Management Office.

bonds held by offshore investors were in maturities of more than 10 years, while foreign investors' holdings of bonds with maturities of more than 5 years and up to 10 years accounted for 30% (**Figure 4**). Offshore holdings of short-dated tenors (bonds with maturities of 1 year or less) only accounted for a 4% share.

Among domestic investors, only insurance companies increased their share of central governments bond holdings in 2Q13, which rose to 14.2% from 13.5% a year earlier. Mutual fund and pension fund holdings of government bonds remained relatively small compared with other investor classes, accounting for shares of only 4.5% and 3.3%, respectively, at the end of 2Q13. Meanwhile, the share of government bonds held by BI rose slightly to 3.3% as central bank actively supported the bond market in recent months.

Central Bank Bills. Central bank bills were held primarily by banking institutions, which had a share of 98.6% at end-June (**Figure 5**). In absolute terms, outstanding SBI held by banks stood at IDR80.8 trillion at end-June, down from IDR91.7 trillion at end-March. Foreign investors accounted for the remaining 1.4% share of SBI holdings. Their share dropped significantly after the central bank implemented a 6-month holding period for SBI in 2011.

Figure 3: Foreign Investor Share of LCY Central Government Bonds

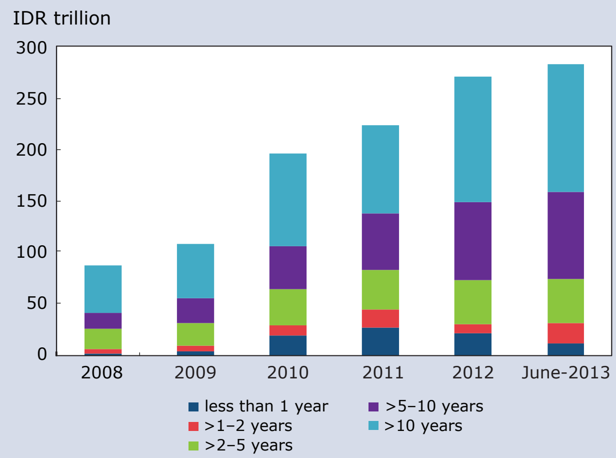


LCY = local currency.
Source: Indonesia Debt Management Office.

Rating Changes

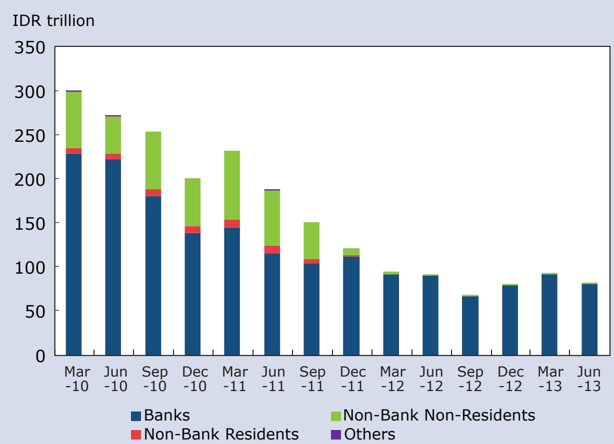
On 2 May, Standard and Poor's (S&P) revised Indonesia's ratings outlook to stable from positive and affirmed its long-term and short-term sovereign credit ratings at BB+ and B, respectively. According to S&P, Indonesia's weakening policy environment may ultimately have a negative impact on the country's growth prospects and its generally sound economic conditions. S&P also noted that the external sector is experiencing vulnerability as evidenced by the

Figure 4: Foreign Holdings of LCY Central Government Bonds by Maturity



LCY = local currency.
Source: Indonesia Debt Management Office.

Figure 5: LCY Central Bank Bills Investor Profile



LCY = local currency.
Source: Bank Indonesia.

current account deficit and increasing private sector external debt.

On 22 July, the Japan Credit Rating Agency (JCR) affirmed Indonesia's sovereign credit rating at BBB–. The outlook for the rating was stable. JCR took note of the following factors in its decision to affirm Indonesia's ratings: (i) sustainable economic growth outlook, (ii) low-level of public debt, and (iii) resilience to external shocks.

Policy, Institutional, and Regulatory Developments

MOF to Conduct Debt Switch of US$-Denominated Bonds

In May, the Ministry of Finance (MOF) announced plans to exchange some of its outstanding US$-denominated bonds for longer-term debt as part of this year's liability management strategy. The government in the past has conducted debt switches involving IDR-denominated bonds.

Parliament Approves 2013 Revised State Budget

In June, Indonesia's House of Representatives approved the 2013 revised state budget, which paved the way for the government to raise fuel prices. The revised budget includes a deficit target equivalent to 2.4% of GDP, up from 1.6% in the original budget. The fuel price hike took effect on 22 June, with prices for gasoline rising 44% and diesel rising 22%.

BI's First FX Swap Auction Oversubscribed

BI's first foreign exchange (FX) swap auction received a warm response from market participants, with bids reaching US$1.2 billion compared with a target of US$500 million. BI awarded a total of US$600 million worth of FX swaps in its first auction held on 17 July. The FX swap action is BI's newest monetary tool to help boost rupiah liquidity in the market and increase FX reserves.

BI Tightens Monetary Policy in August

In a meeting held on 15 August, the central bank said that it will continue to strengthen its policy mix to curb inflation and maintain a more sustainable balance of payments. BI will continue to conduct monetary operations to absorb excess liquidity. In line with this, the central bank plans to issue a new short-term instrument—a BI Deposit Certificate—which will only be sold to domestic banks and will not be offered to foreign investors. BI will also raise the secondary reserve requirement of banks to 4.0% from the current 2.5%, while keeping the primary reserve requirement at 8.0%. The central bank also plans to revise the loan-to-deposit ratio reserve requirements. Other measures to be undertaken by BI include the following: (i) conduct rupiah long-term exchange rate stabilization in line with economic fundamentals, (ii) conduct supervisory actions to control relatively high credit growth among several banks and sectors, and (iii) improve policies to develop the domestic FX market and increase the FX supply.

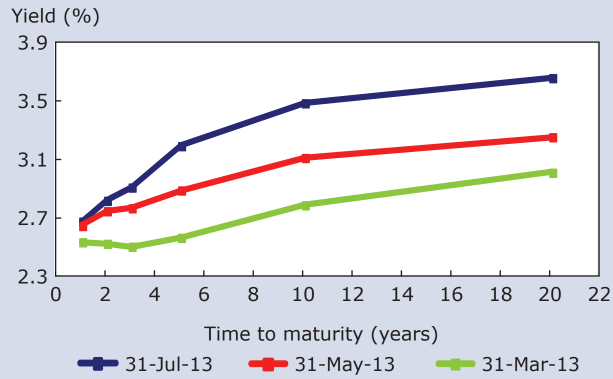
On 29 August, BI's Board of Governors decided to introduce supplementary measures to strengthen its monetary and macro-prudential policy mix to curb inflation, stabilize the rupiah exchange rate, ease the current account deficit, and ensure macroeconomic and financial system stability. BI decided to raise its benchmark rate 50 basis points (bps) to 7.0%. It also raised the lending facility rate 25 bps to 7.0% and the deposit facility rate 50 bps to 5.25%. The minimum holding period for its central bank certificates, or *Sertifikat* Bank Indonesia, was reduced from 6 months to 1 month.

Republic of Korea

Yield Movements

Local currency (LCY) government bond yields in the Republic of Korea rose for all tenors between end-March and end-July, with the yield hikes ranging from 14 basis points (bps) for the 1-year tenor to 69 bps for the 10-year tenor (**Figure 1**). Yields for all tenors initially climbed between end-March and end-May, and further rose through end-July amid concerns that the United States (US) Federal Reserve could start tapering its asset purchase program later this year. Meanwhile, the yield spread between 2- and 10-year tenors widened 40 bps between end-March and end-July.

Figure 1: The Republic of Korea's Benchmark Yield Curve—LCY Government Bonds



LCY = local currency.
Source: Bloomberg LP.

The Bank of Korea's Monetary Policy Committee decided on 8 August to keep the base rate—the 7-day repurchase rate—steady at 2.50%. In its monetary policy decision, the committee took note of external events—such as the sustained moderate recovery in the US, the ongoing sluggishness in the euro area, and the economic slowdown in emerging markets, particularly the PRC—as well as domestic events including the country's moderate economic growth, an uptick in inflationary pressures, the stabilization of domestic financial markets, and the appreciation of the Korean won. Consumer price inflation moderated in August to 1.3% year-on-year (y-o-y) from 1.4% in July.

The Republic of Korea's real gross domestic product (GDP) growth stood at 1.1% quarter-on-quarter (q-o-q) and 2.3% y-o-y in 2Q13, based on preliminary estimates of The Bank of Korea. On a q-o-q basis, GDP expansion was bolstered by positive growth in final consumption expenditure, gross fixed capital formation, and exports of goods and services on the demand side, and the agriculture/forestry/fishing, construction, manufacturing, and services sectors on the production side. A supplementary budget of KRW17.3 trillion was announced in April to be utilized through the remainder of 2013 to help stimulate the domestic economy.

The Bank of Korea in July revised upward its GDP growth outlook for 2013 to 2.8% from its previous forecast of 2.6% made in April. The revised GDP growth rate projections for 1H13 and 2H13 stood at 1.9% and 3.7% y-o-y, respectively. By expenditure type, the central bank reported that its revised 2013 growth rates for private consumption, facilities investment, exports, and imports were lower compared with the earlier forecasts made in April. On the other hand, the revised 2013 growth rate for construction investment was higher than the April forecast. The central bank also stated in the same report that the headline inflation rate for 2013 would average 1.7%, compared with an April forecast of 2.3%.

Manufacturing production in the Republic of Korea posted a 0.2% month-on-month (m-o-m) decrease in July following a 0.5% increase in June, according to Statistics Korea data. However, on a y-o-y basis, manufacturing production grew 0.8% in July following a 2.6% decrease in June.

The country's current account surplus shrank to US$6.8 billion in July from US$7.2 billion in June, according to data culled from The Bank of Korea, despite a 13.0% m-o-m rise in the trade surplus in goods; exports of goods climbed 6.7% m-o-m, which was more significant than the 5.9% increase in merchandise imports. The narrowing of the current account surplus mainly stemmed from a 67.4% m-o-m fall in the service account surplus. The merchandise trade surplus for the month of August stood at US$4.9 billion, higher than July's US$2.5 billion, based on figures from the Ministry of Trade, Industry, and Energy, as merchandise exports rose to US$46.4 billion in August from July's US$45.8 billion, and merchandise imports fell to US$41.4 billion from US$43.3 billion. On a y-o-y basis, merchandise exports expanded 7.7% in August and imports of goods increased 0.8%.

Total external debt rose to US$411.8 billion at end-June from US$410.3 billion at end-March, based on data from The Bank of Korea. The quarterly uptick can be largely attributed to an increase in long-term external debt. Between end-March and end-June, the country's short-term external debt decreased from US$122.2 billion to US$119.6 billion, while long-term external debt rose from US$288.0 billion to US$292.1 billion. Meanwhile, banks' external debt fell to US$183.1 billion at end-June from US$184.3 billion at end-March.

The domestic stock market has exhibited volatility in recent months. The Korea Stock Price Composite Index (KOSPI) fell from 2,001 in May to 1,863 in June, before climbing to 1,914 in July. According to The Bank of Korea, the rebound in July resulted from diminished concerns over the US Federal Reserve's quantitative easing exit strategy, the reduced possibility of a hard landing in the PRC, and favorable earnings reports from listed companies.

The banking sector posted lower earnings in 2Q13 compared with the previous quarter. According to the Financial Supervisory Service (FSS), the net income of domestic banks stood at KRW1.1 trillion in 2Q13, down 35.3% on a q-o-q basis and 48.0% on a y-o-y basis. The drop mainly came from a decline in interest income, amid falling interest rates, and losses in the valuation of securities. Meanwhile, the FSS also reported that the delinquency rate of domestic banks' LCY-denominated loans fell 0.3 percentage points in June to 1.0% as newly delinquent loans declined and the status of a number of existing delinquent loans improved.

Size and Composition

Total LCY bonds outstanding in the Republic of Korea grew 10.6% y-o-y and 2.2% q-o-q to reach KRW1,650 trillion (US$1.4 trillion) at the end of 2Q13 (**Table 1**). Growth for the quarter was higher compared with 2Q12. Outstanding LCY government bonds amounted to KRW637.3 trillion at end-June, growing 6.0% y-o-y and 2.3% q-o-q. This growth can be attributed to the government's supplementary budget to stimulate economic activity that required additional issuance of Korea

Table 1: Size and Composition of the LCY Bond Market in the Republic of Korea

	Outstanding Amount (billion)						**Growth Rate** (%)			
	2Q12		1Q13		2Q13		2Q12		2Q13	
	KRW	US$	KRW	US$	KRW	US$	q-o-q	y-o-y	q-o-q	y-o-y
Total	1,491,463	1,302	1,614,631	1,453	1,650,267	1,445	2.1	9.7	2.2	10.6
Government	601,162	525	622,659	560	637,277	558	(0.05)	3.0	2.3	6.0
Central Bank Bonds	164,580	144	167,830	151	165,420	145	(2.0)	(1.5)	(1.4)	0.5
Central Government Bonds	408,361	357	426,699	384	439,059	384	1.1	5.5	2.9	7.5
Industrial Finance Debentures	28,221	25	28,130	25	32,798	29	(5.0)	(4.4)	16.6	16.2
Corporate	890,301	777	991,972	893	1,012,990	887	3.6	14.7	2.1	13.8

( ) = negative, LCY = local currency, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Bloomberg LP end-of-period LCY–US$ rates are used.
3. Growth rates are calculated from LCY base and do not include currency effects.
Sources: EDAILY *BondWeb* and The Bank of Korea.

Treasury Bonds (KTBs). LCY central government bonds rose 7.5% y-o-y and 2.9% q-o-q to KRW439.1 trillion, led by increases in KTBs. Industrial finance debentures also expanded 16.2% y-o-y and 16.6% q-o-q, leveling off at KRW32.8 trillion. Meanwhile, outstanding central bank bonds, or Monetary Stabilization Bonds (MSBs), increased 0.5% on a y-o-y basis, but contracted 1.4% on a q-o-q basis, and stood at KRW165.4 trillion at end-June.

Issuance of LCY government bonds quickened at a double-digit pace in 2Q13, growing 14.2% y-o-y and 15.1% q-o-q to reach KRW76.3 trillion at end-June. Issuance of central government bonds rose 8.2% y-o-y and 8.7% q-o-q to KRW24.4 trillion, central bank bonds increased 5.3% y-o-y and 3.8% q-o-q to KRW44.7 trillion, and industrial finance debentures issued by the Korea Development Bank (KDB) surged 321.7% y-o-y and 952.4% q-o-q to KRW7.1 trillion.

Corporate LCY bonds outstanding reached KRW1,013 trillion at end-June, growing 13.8% y-o-y and 2.1% q-o-q. Private sector corporate bonds accounted for 46% of the corporate bond market in 2Q13, expanding 20.1% y-o-y and 3.2% q-o-q in nominal terms. Special public bonds, which are issued by government-owned corporations, accounted for one-third of total corporate bonds and increased 13.3% y-o-y and 1.9% q-o-q. Financial debentures (excluding KDB bonds) accounted for 21% of total corporate bonds and had the smallest increase in 2Q13 compared with other types of corporate bonds, rising 2.4% y-o-y and 0.2% q-o-q.

Issuance of LCY corporate bonds was down 7.4% y-o-y and 6.9% q-o-q during 2Q13 amid less bond issuance from private corporations (down 10.4% y-o-y and 9.9% q-o-q) and special public companies (down 13.5% y-o-y and 12.2% q-o-q). On the other hand, issuance of financial debentures (excluding KDB bonds) rose 9.1% y-o-y and 8.1% q-o-q.

As of end-June, the top 30 LCY corporate bond issuers had outstanding bonds of KRW635.0 trillion, accounting for 63% of total LCY corporate bonds **(Table 2)**. Korea Land & Housing Corporation was the largest issuer of corporate bonds with bonds outstanding of KRW58.7 trillion.

In 2Q13, the five largest LCY corporate bond issues included Posco's KRW800 billion 30-year bond offering a coupon of 4.3%, Woori Bank's KRW500 billion 30-year bond at 4.4%, Korea Land & Housing Corporation's KRW400 billion 3-year bond at 2.83%, SK Telecom's KRW400 billion 60-year bond at 4.21%, and Woori Bank's KRW350 billion 10-year bond at 3.9% **(Table 3)**.

Liquidity

Liquidity in the LCY government bond market appears to have improved in 2Q13, as the turnover ratio for government bonds climbed to 1.27 from 1.09 in 1Q13 and 1.01 in 4Q12. By type of government bond, the turnover ratio for central government bonds, mostly KTBs, increased to 1.32 in 2Q13 from 1.20 in 1Q13, while the turnover ratio for MSBs rose to 1.39 in 2Q13 from 1.04 in 1Q13 **(Figure 2)**.

Liquidity also appears to have improved in 2Q13 in the KTB futures market, with the total number of contracts traded rising to 13.2 million from 9.8 million in 1Q13 and 9.3 million in 4Q12, led by greater trading of 3-year KTB futures **(Figure 3)**. In 2Q13, about 73% of the total KTB futures contracts traded were for the 3-year tenor, an increase of about 11 percentage points from the previous quarter, while the remainder were for the 10-year tenor.

Liquidity in the LCY corporate bond market was unchanged in 2Q13, as the turnover ratio for corporate bonds remained at 0.14. Between 1Q13 and 2Q13, the turnover ratio for financial debentures inched up from 0.29 to 0.33, while it fell for special public bonds from 0.16 to 0.13, and for private corporate bonds from 0.07 to 0.06 **(Figure 4)**.

Investor Profile

Insurance companies and pension funds were the largest investor group in LCY government

Table 2: Top 30 Issuers of LCY Corporate Bonds in the Republic of Korea

Issuers	Outstanding Amount		State-Owned	Listed on		Type of Industry
	LCY Bonds (KRW billion)	LCY Bonds (US$ billion)		KOSPI	KOSDAQ	
1. Korea Land & Housing	58,735.0	51.4	Yes	No	No	Real Estate
2. Korea Housing Finance	57,307.6	50.2	Yes	No	No	Financial
3. Korea Finance	45,590.0	39.9	Yes	No	No	Financial
4. Korea Deposit Insurance	43,960.0	38.5	Yes	No	No	Insurance
5. Industrial Bank of Korea	32,524.7	28.5	Yes	Yes	No	Bank
6. KDB Daewoo Securities	31,623.6	27.7	Yes	Yes	No	Securities
7. Korea Electric Power	30,270.0	26.5	Yes	Yes	No	Utillity
8. Korea Investment and Securities	27,698.2	24.3	No	No	No	Securities
9. Woori Investment and Securities	27,625.9	24.2	Yes	Yes	No	Securities
10. Mirae Asset Securities	23,487.2	20.6	No	Yes	No	Securities
11. Korea Expressway	20,090.0	17.6	Yes	No	No	Infrastructure
12. Kookmin Bank	18,905.2	16.6	No	No	No	Bank
13. Tong Yang Securities	18,740.8	16.4	No	Yes	No	Securities
14. Shinhan Bank	18,258.2	16.0	No	No	No	Bank
15. Korea Rail Network Authority	15,490.0	13.6	Yes	No	No	Infrastructure
16. Small & Medium Business	15,005.0	13.1	Yes	No	No	Financial
17. Hana Daetoo Securities	14,169.4	12.4	No	No	No	Securities
18. Korea Gas	13,665.0	12.0	Yes	Yes	No	Utility
19. Woori Bank	13,462.5	11.8	Yes	No	No	Bank
20. Hana Bank	12,315.0	10.8	No	No	No	Bank
21. Hyundai Securities	11,755.1	10.3	No	Yes	No	Securities
22. Shinhan Investment	11,223.2	9.8	No	No	No	Securities
23. Samsung Securities	10,098.3	8.8	No	Yes	No	Securities
24. Standard Chartered First Bank Korea	9,990.0	8.7	No	No	No	Bank
25. Korea Water Resources	9,987.0	8.7	Yes	Yes	No	Utility
26. Shinhan Card	9,350.3	8.2	No	No	No	Financial
27. Korea Eximbank	9,110.0	8.0	Yes	No	No	Bank
28. Hyundai Capital Services	8,295.0	7.3	No	No	No	Securities
29. Korea Student Aid Foundation	8,270.0	7.2	Yes	No	No	Financial
30. Korea Railroad	7,960.0	7.0	Yes	No	No	Infrastructure
Total Top 30 LCY Corporate Issuers	**634,962.3**	**556.0**				
Total LCY Corporate Bonds	**1,012,990.0**	**887.0**				
Top 30 as % of Total LCY Corporate Bonds	**62.7%**	**62.7%**				

KOSDAQ = Korean Securities Dealers Automated Quotations, KOSPI = Korea Composite Stock Price Index, LCY = local currency.
Notes:
1. Data as of end-June 2013.
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on Bloomberg and EDAILY *BondWeb* data.

Table 3: Notable LCY Corporate Bond Issuance in 2Q13

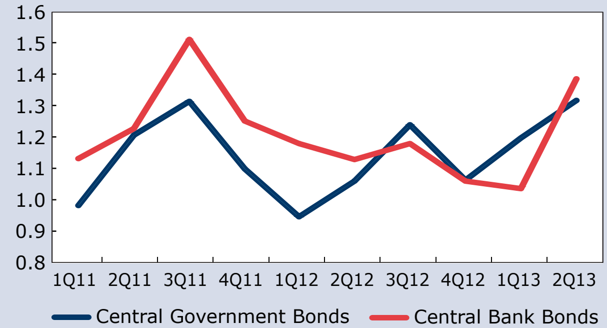
Corporate Issuers	Coupon Rate (%)	Issued Amount (KRW billion)
Kookmin Bank		
7-year bond	3.61	300.0
Korea Land & Housing Corp.		
3-year bond	2.83	400.0
Posco		
30-year bond	4.30	800.0
SK Telecom		
60-year bond	4.21	400.0
Woori Bank		
10-year bond	3.90	350.0
30-year bond	4.40	500.0

LCY = local currency.
Source: Bloomberg LP.

bonds, holding 26% of the total as of end-March, an increase of 1 percentage point from the same month in the previous year (**Figure 5**). General government entities—the central government, local governments, and social security funds—held 22% of the total, and stood as the second-largest holder of LCY government bonds at end-March; their share, however, slipped 2 percentage points from March 2012. The share of banks' holdings of LCY government bonds fell 1 percentage point from a year earlier, leveling off at 18% in March 2013. Meanwhile, the share of foreign investors holdings of LCY government bonds fell from 11% to 9% over the same period.

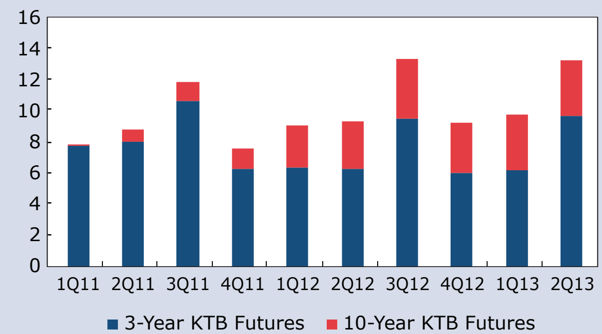
Insurance companies and pension funds remained the largest investor group in LCY corporate bonds, holding 33% of the total at end-March (**Figure 6**). They were followed by financial companies other than banks, insurance firms, and pension funds, with a share of 28%, banks at 15%, the general government at 12%, households and nonprofit organizations at 8%, non-financial companies at 3%, and foreign investors at 1%. Compared with the same month in the previous year, the shares of households and nonprofit organizations, and non-financial businesses, climbed 3 percentage points and 1 percentage point, respectively, while those of banks and other financial companies fell 3 percentage points and 1 percentage point, respectively.

Figure 2: Turnover Ratios for Central Government and Central Bank Bonds



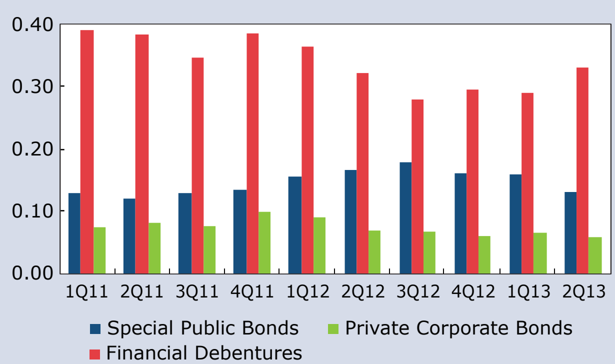
Note: Central government bonds include Korea Treasury Bonds and National Housing Bonds.
Sources: The Bank of Korea and EDAILY *BondWeb*.

Figure 3: Trading Volume for KTB Futures Contracts (millions of contracts)



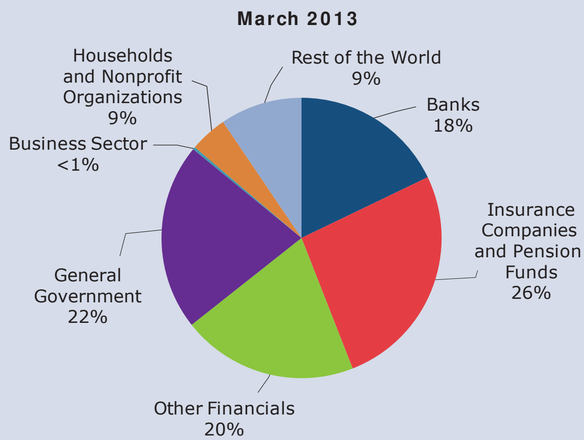
KTB = Korea Treasury Bond.
Source: Korea Exchange.

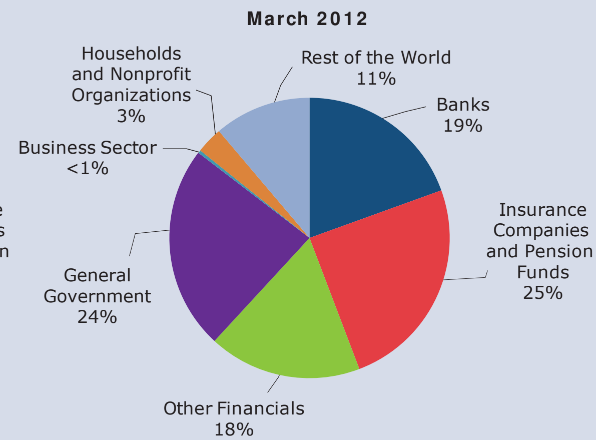
Figure 4: Turnover Ratios for Special Public Bonds, Financial Debentures, and Private Corporate Bonds



Source: EDAILY *BondWeb*.

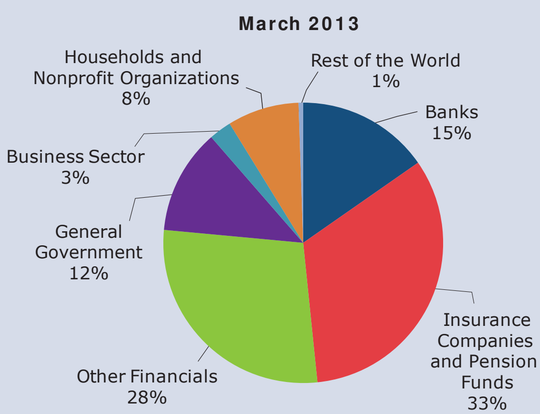
Figure 5: LCY Government Bonds Investor Profile

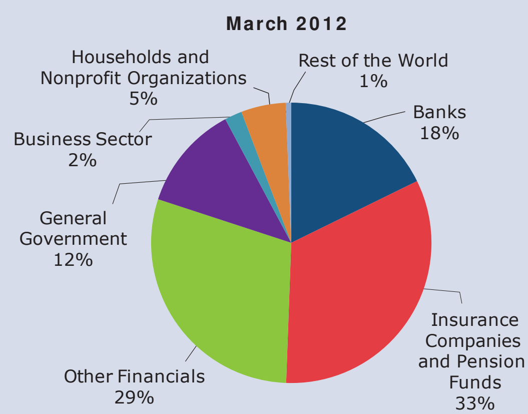




LCY = local currency.
Source: *AsianBondsOnline* and The Bank of Korea.

Figure 6: LCY Corporate Bonds Investor Profile





LCY = local currency.
Source: *AsianBondsOnline* and The Bank of Korea.

Rating Changes

On 11 June, Rating and Investment Information (R&I) affirmed the Republic of Korea's LCY and foreign currency (FCY) issuer ratings at AA– and A+, respectively, with the outlook remaining stable for both.

On 22 August, Fitch Ratings affirmed the Republic of Korea's long-term FCY issuer default rating (IDR) at AA–, the long-term LCY IDR at AA, the short-term FCY IDR at F1+, and the country ceiling at AA+, with the outlook remaining stable for both long-term ratings.

Policy, Institutional, and Regulatory Developments

MOSF Announces Amendments to Regulations on KTB Issuance and Primary Dealer System

The Republic of Korea's Ministry of Strategy and Finance (MOSF) announced in July amendments to regulations on KTB issuance and the primary dealer system, with the amendments aimed at attracting greater primary dealer participation in the primary and secondary markets. The amendments extend the (i) differential knock-down rates for 10-, 20-, and 30-year bonds to 3 bps from 2 bps; (ii) threshold of primary dealers' non-competitive purchasing option to 10%; and (iii) quote spreads for long-term bonds given their yield volatility. MOSF stated that the amendments would be implemented sometime between the 10-year KTB auction starting on 15 July and the end of 2013.

FSC Introduces Measures to Invigorate Corporate Bond Market

The Republic of Korea's Financial Services Commission (FSC) announced measures in July to invigorate the country's corporate bond market and prevent the worsening of corporate funding conditions and the possible spillover of "destabilizing factors" from the market to the real economy. Specifically, the FSC measures include (i) a liquidity support program through government issuance of primary collateralized bond obligations, (ii) tax incentives for dividends of corporate bond funds with more than 30% of bonds rated BBB– or below, (iii) improvements in the Qualified Institutional Buyer system, (iv) easing of relevant regulations to boost demand for corporate bonds, (v) revisions to the regulations on asset-backed securities, (vi) reforms in the credit rating system, (vii) enhancements to the system for corporate bond issuance, (viii) improvements in the system for corporate bond management, and (ix) strengthening the effectiveness and transparency of the bond distribution system.

Republic of Korea Introduces 2013 Supplementary Budget, KTB Market Stabilization Measures

MOSF reported in April that a supplementary budget of KRW17.3 trillion will be utilized to help stimulate the domestic economy through the remainder of 2013. Of the amount, KRW12.0 trillion will be used to finance government revenue shortfalls and the remaining KRW5.3 trillion will be spent to supplement the government's budget expenditures. Under the 2013 supplementary budget, government expenditures will amount to KRW349 trillion, which is KRW7 trillion higher than what was specified in the original 2013 budget. Also, government revenues in the 2013 supplementary budget are projected to reach KRW360.8 trillion, which is KRW11.8 trillion less than in the original budget.

MOSF reported that the 2013 supplementary budget calls for an additional net increase in issuance of KTBs amounting to KRW15.8 trillion. Since this will likely trigger upward pressure on interest rates, thereby imposing a burden on the market, MOSF has decided to reduce the issue amount for buy-backs. Against this backdrop, total issuance of KTBs for the year is projected to reach KRW88.5 trillion, which is KRW8.8 trillion higher than the previous estimate of KRW79.7 trillion. In addition, MOSF reported that it intends to continue with the monthly issuance of KTBs at similar levels. It will continue to optimize the proportions of KTBs by maturity (3-, 5-, 10-, 20-, and 30-year tenors), with plans to increase the issuance of "on-the-run" KTBs. MOSF will also conduct flexible application of "partial knock-down rates" and ensure that primary dealers' obligations are strengthened.

Basel III Capital Regulations to Apply to Bank Holding Companies

The FSC announced in August that the Basel III capital regulations will apply to bank holding companies effective 1 December 2013. These regulations establish the minimum capital requirement ratios for bank holding companies at 4.5% for common equity capital, 6.0% for Tier 1 capital, and 8.0% for total capital. A capital conservation buffer will also be introduced to bank holding companies starting in 2016.

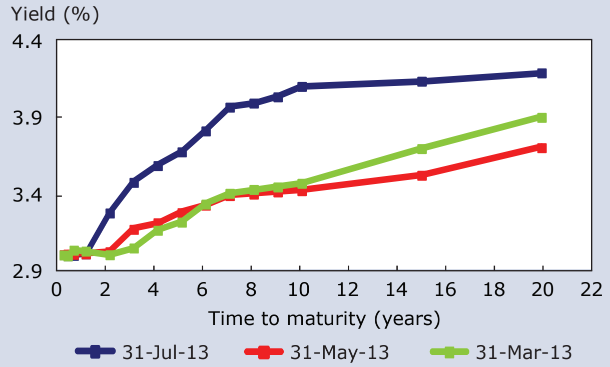
Malaysia

Yield Movements

Malaysia's local currency (LCY) government bond yield curve slightly flattened between end-March and end-May, as yields dropped across the length of the curve, with the exception of tenors between 2 years and 5 years. Yields of longer-dated tenors (maturities more than 6 years) slumped the most, falling between 17 basis points (bps) and 20 bps.

By end-July, however, the yield curve steepened between the shorter-end, where yields continued to slide, and the belly through the longer-end, where yields continued their upward trend. Yields for tenors of 2 years and longer rallied—by as much as 68 bps for 10-year Malaysian Government Securities (MGSs). In contrast to the rest of the curve, yields fell for short-term instruments with maturities of 1 year or less, with decreases ranging from 0.1 bps for the 1-year tenor to 1.1 bps for the 3-month tenor. The yield spread between 2- and 10-year tenors widened to 43 bps at end-July from 1 bp at end-June (**Figure 1**).

Figure 1: Malaysia's Benchmark Yield Curve—LCY Government Bonds



LCY = local currency.
Source: Bloomberg LP.

Yields surged on concerns that the United States (US) Federal Reserve might taper its asset purchase program and that inflation might be accelerating. Consumer price inflation in Malaysia rose to 2.0% year-on-year (y-o-y) in July, following 1.8% in both June and May. The increase reflected higher food and housing costs, which inched up 3.9% and 1.9% y-o-y. On a month-on-month (m-o-m) basis, Malaysia's inflation increased 0.2% in July.

In its Monetary Policy Committee meeting on 11 July, Bank Negara Malaysia (BNM) decided to keep its overnight policy rate unchanged at 3.0%. BNM has kept its benchmark rate at the same level since May 2011. The central bank expects private consumption to remain steady, underpinned by income growth and stable labor market conditions, although sustained weakness in the external sector may affect the overall growth momentum. BNM also expects capital spending in domestic-oriented industries and the ongoing implementation of infrastructure projects to support investment activity.

Malaysia's economic growth has slowed but still remains robust in 2013, supported by buoyant domestic demand amid weakness in the external sector. Real gross domestic product (GDP) growth picked up slightly in 2Q13, rising to 4.3% y-o-y from 4.1% in 1Q13. Government consumption, which rose 11.1% y-o-y in 2Q13, cushioned the moderation in private consumption, which slowed to 7.2% in 2Q13 from 7.5% in the previous quarter. Total exports of goods and services, on the other hand, fell 5.2% y-o-y in 2Q13. On a quarter-on-quarter (q-o-q) and seasonally adjusted basis, the economy recorded growth of 1.4% in 2Q13. With continued weaknesses in the external economy, BNM has revised downward its 2013 GDP growth forecast to 4.5%–5.0% from 5.0%–6.0%.

Size and Composition

Total LCY bonds outstanding in Malaysia rose 6.4% y-o-y to MYR993.5 billion (US$314.4 billion) at end-June; LCY government bonds increased 5.1% and LCY corporate bonds grew 8.2%. On a quarter-on-quarter (q-o-q) basis, however, total

Table 1: Size and Composition of the LCY Bond Market in Malaysia

	Outstanding Amount (billion)						Growth Rate (%)			
	2Q12		1Q13		2Q13		2Q12		2Q13	
	MYR	US$	MYR	US$	MYR	US$	q-o-q	y-o-y	q-o-q	y-o-y
Total	934	294	996	322	994	314	2.3	15.0	(0.2)	6.4
Government	559	176	589	190	588	186	1.6	15.3	(0.2)	5.1
Central Government Bonds and Bills	417	131	446	144	459	145	2.3	10.9	2.8	10.0
Central Bank Bills	142	45	136	44	123	39	(0.3)	31.0	(10.1)	(13.7)
Sukuk Perumahan Kerajaan	0	0	6	2	6	2	–	–	0.0	–
Corporate	375	118	407	132	406	128	3.2	14.6	(0.3)	8.2

( ) = negative, – = not applicable, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Bloomberg LP end-of-period LCY–US$ rate is used.
3. Growth rates are calculated from LCY base and do not include currency effects.
Sources: Bank Negara Malaysia Fully Automated System for Issuing/Tendering (FAST) and Bloomberg LP.

LCY bonds outstanding declined 0.2% in 2Q13 (**Table 1**).

Government Bonds. LCY government bonds outstanding stood at MYR587.5 billion at end-June, rising 5.1% y-o-y. About 63% of total government bonds outstanding were conventional bonds, while 37% were *sukuk* (Islamic bonds). Growth in the government bond market was driven by central government bonds, specifically Government Investment Issues (GIIs) and *Sukuk Perumahan Kerajaan* (SPK). Central government bonds and bills, which accounted for 77.3% of the total government bonds, grew 10.1% y-o-y to MYR458.8 billion. Outstanding SPK amounted to MYR6.2 billion. In contrast, total central bank bills outstanding slumped 13.7% y-o-y and 10.1% q-o-q due to a decline in monetary note issuance by BNM.

Government bond issuance fell 3.1% q-o-q to MYR101.1 billion in 2Q13, as issuance volumes declined for central government bills and central bank bills. On a y-o-y basis, the issuance of government bonds also saw negative growth of 0.2% due to a drop in central government bond issuance, particularly MGSs.

Corporate Bonds. Malaysia's LCY corporate bonds outstanding expanded 8.2% y-o-y to MYR406 billion (US$128.5 billion) at end-June, but edged slightly lower by 0.3% on a q-o-q basis. Some 67% of the total LCY corporate bonds were *sukuk*, while conventional bonds accounted for 33%. Medium-term notes (MTNs) accounted for 74.0% of total *sukuk* and 49.5% of total corporate bonds outstanding.

Corporate issuance declined in 2Q13, continuing a trend in place since 4Q12. Total LCY corporate bond issuance dropped to MYR20.6 billion, down 29.1% y-o-y and 29.3% q-o-q, due to a decline in *sukuk* issuance, particularly Islamic commercial paper and MTNs. Of the total issuance during the quarter, conventional bonds accounted for 58.3% of the total, while *sukuk* registered 41.7%.

Bond issuance from corporate entities was heavily concentrated among a handful of corporates, as the top 30 issuers accounted for 93.0% of the total issuance for the quarter. **Table 2** lists some notable corporate bonds issued during 2Q13.

The largest corporate issuer in 2Q13 was TNB Northern Energy (TNB NE), a wholly owned subsidiary of state-owned Tenaga Nasional. TNB NE sold MYR1.63 billion worth of *sukuk* consisting of 39 series with tenures ranging from 4 years to 23 years. The proceeds from the bond sale will be used to finance construction, delivery,

Table 2: Notable LCY Corporate Bond Issuance in 2Q13

Corporate Issuers	Coupon Rate (%)	Issued Amount (MYR million)	Corporate Issuers	Coupon Rate (%)	Issued Amount (MYR million)
TNB Northern Energy			17-year *sukuk*	4.42	50
4-year *sukuk*	3.55	30	17.5-year *sukuk*	4.46	50
4.5-year *sukuk*	3.59	30	18-year *sukuk*	4.48	50
5-year *sukuk*	3.63	30	18.5-year *sukuk*	4.52	55
5.5-year *sukuk*	3.67	30	19-year *sukuk*	4.55	50
6-year *sukuk*	3.71	30	19.5-year *sukuk*	4.59	55
6.5-year *sukuk*	3.75	30	20-year *sukuk*	4.62	55
7-year *sukuk*	3.79	30	20.5-year *sukuk*	4.66	55
7.5-year *sukuk*	3.83	35	21-year *sukuk*	4.69	50
8-year *sukuk*	3.87	30	21.5-year *sukuk*	4.73	55
8.5-year *sukuk*	3.91	30	22-year *sukuk*	4.76	50
9-year *sukuk*	3.95	30	22.5-year *sukuk*	4.80	55
9.5-year *sukuk*	3.99	35	23-year *sukuk*	4.83	55
10-year *sukuk*	4.03	35	Cagamas		
10.5-year *sukuk*	4.06	35	3-month Islamic commercial paper	3.21	500
11-year *sukuk*	4.08	35	1-year Islamic MTNs	3.23	50
11.5-year *sukuk*	4.11	35	1-year medium term notes	3.30	70
12-year *sukuk*	4.13	35	2-year Islamic MTNs	3.40	80
12.5-year *sukuk*	4.16	35	3-year Islamic MTNs	3.40	450
13-year *sukuk*	4.18	35	Perbadanan Tabung Pendidikan Tinggi Nasional		
13.5-year *sukuk*	4.21	45	10-year Islamic MTNs	3.80	100
14-year *sukuk*	4.23	40	15-year Islamic MTNs	4.19	100
14.5-year *sukuk*	4.26	45	15-year Islamic MTNs	4.19	500
15-year *sukuk*	4.28	45	Telekom Malaysia		
15.5-year *sukuk*	4.32	50	10-year Islamic MTNs	3.93	250
16-year *sukuk*	4.35	50	10-year Islamic MTNs	3.95	400
16.5-year *sukuk*	4.39	50			

LCY = local currency, MTNs = medium-term notes.
Source: Bank Negara Malaysia Bond Info Hub.

and working capital requirements for a 1,071.43 megawatt gas-fired power plant in Prai, Penang. The bond was rated AAAIS by Malaysian Rating Corp Berhad.

Other notable issuances in 2Q13 came from state-owned companies such as national mortgage corporation Cagamas, which issued MYR1.15 billion worth of conventional bonds and *sukuk*, and Perbadanan Tabung Pendidikan Tinggi Nasional (National Higher Education Fund Corporation), which raised a total of MYR700 million from IMTNs carrying 10- and 15-year maturities. Meanwhile, publicly-listed Telekom Malaysia also issued MYR650 million worth of AAA-rated 10-year *sukuk*.

Table 3 provides a breakdown of the top 30 LCY corporate bond issuers as of end-June. The amount of LCY bonds outstanding of the top 30 corporate bond issuers in Malaysia stood at MYR223.2 billion, representing 55.0% of total corporate bonds outstanding. Financial firms comprised 14 of the 30 largest corporate

Table 3: Top 30 Issuers of LCY Corporate Bonds in Malaysia

Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
	LCY Bonds (MYR billion)	LCY Bonds (US$ billion)			
1. Project Lebuhraya Usahasama.	30.60	9.68	No	Yes	Transport, Storage, and Communications
2. Cagamas	20.65	6.53	Yes	No	Finance
3. Khazanah	18.70	5.92	Yes	No	Quasi-Govt.
4. Pengurusan Air	11.28	3.57	Yes	No	Energy, Gas, and Water
5. Prasarana	9.91	3.14	Yes	No	Finance
6. Binariang GSM	9.89	3.13	No	No	Transport, Storage, and Communications
7. Maybank	9.70	3.07	No	Yes	Finance
8. CIMB Bank	7.00	2.21	No	No	Finance
9. Cagamas MBS	6.03	1.91	No	No	Finance
10. Senai Desaru Expressway	5.57	1.76	No	No	Construction
11. Sarawak Energy	5.50	1.74	Yes	No	Energy, Gas, and Water
12. Perbadanan Tabung Pendidikan Tinggi Nasional	5.40	1.71	Yes	No	Quasi-Govt.
13. Turus Pesawat	5.31	1.68	Yes	No	Quasi-Govt.
14. Malakoff Power	5.10	1.61	No	No	Finance
15. Public Bank	5.07	1.61	No	Yes	Finance
16. Aman Sukuk	5.03	1.59	Yes	No	Construction
17. Celcom Networks	5.00	1.58	No	No	Transport, Storage, and Communications
18. 1Malaysia Development	5.00	1.58	Yes	No	Finance
19. Hong Leong Bank	4.86	1.54	No	Yes	Finance
20. KL International Airport	4.86	1.54	Yes	No	Transport, Storage, and Communications
21. Manjung Island Energy	4.85	1.53	No	No	Energy, Gas, and Water
22. Putrajaya Holdings	4.76	1.51	No	No	Finance
23. AM Bank	4.71	1.49	No	No	Finance
24. RHB Bank	4.60	1.46	No	No	Finance
25. YTL Power International	4.32	1.37	No	Yes	Energy, Gas, and Water
26. Tanjung Bin Power	4.20	1.33	No	No	Energy, Gas, and Water
27. Jimah Energy Ventures	4.03	1.28	No	No	Energy, Gas, and Water
28. Danainfra Nasional	3.90	1.23	Yes	No	Finance
29. Rantau Abang Capital	3.80	1.20	No	No	Quasi-Govt.
30. Danga Capital	3.60	1.14	No	No	Finance
Total Top 30 LCY Corporate Issuers	**223.21**	**70.63**			
Total LCY Corporate Bonds	**406.04**	**128.48**			
Top 30 as % of Total LCY Corporate Bonds	**55.0%**	**55.0%**			

LCY = local currency.
Notes:
1. Data as of end-June 2013.
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on Bank Negara Malaysia Fully Automated System for Issuing/Tendering (FAST) data.

bond issuers, with bonds outstanding worth MYR94.9 billion.

Highway-operator Project Lebuhraya Usahasama. (PLUS) remained the largest issuer with outstanding bonds valued at MYR30.6 billion. Among the top 30 issuers, 19 were privately-owned companies, five of which were listed on Bursa Malaysia.

Investor Profile

Financial institutions remained the largest holder of MGSs and GIIs, accounting for 42.3% of total government debt outstanding at end-March (**Figure 2**), which was down slightly from 43.3% in March 2012 and 44.1% in June 2012. In absolute terms, the holdings of financial institutions stood at MYR187 billion at end-March, up from MYR174.7 billion a year earlier.

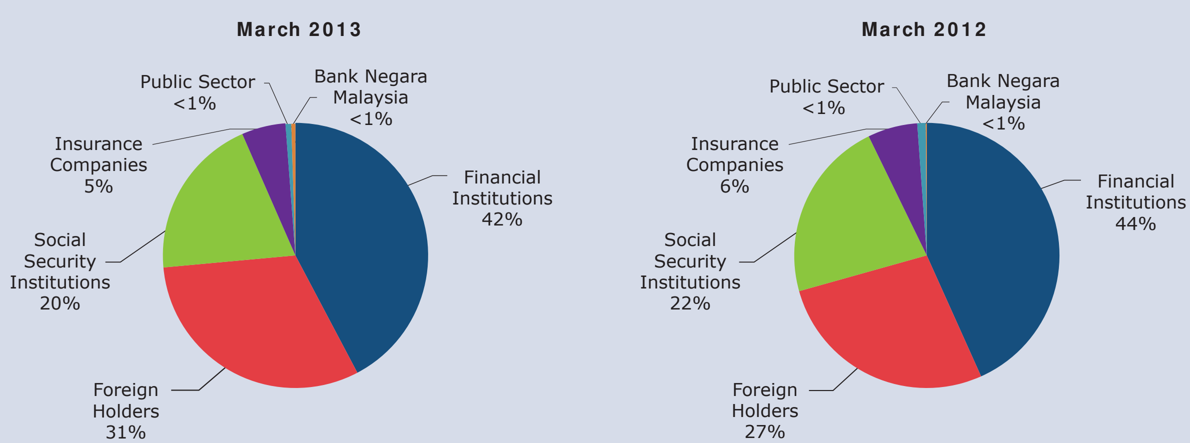
Foreign investors comprised the second-largest investor group with 31.2% of total government bonds outstanding. This number has steadily risen from 10% in March 2009 as a result of the appreciation of the ringgit versus the US dollar. Meanwhile, the holdings of social security institutions fell to 19.9% at end-March from 22.2% a year earlier due to a decrease in the Employees Provident Fund's holdings.

Domestic commercial and Islamic banks increased their already dominant share of the Malaysian corporate bond market at the end of 2012 to 48% from 44% at the end of 2011 (**Figure 3**). Holdings of insurance companies remained at 30% of the total corporate bonds in 2012, while holdings of corporate bonds by the Employees Provident Fund fell to 10% from 13% of the total in 2011. Holdings of corporate bonds by insurance companies have more than doubled since 2006 (**Table 4**) and continued to rise in 2012 in nominal terms, but holdings of corporate bonds by Employees Provident Fund have risen much more slowly over the last 7 years and even declined in 2012.

Rating Changes

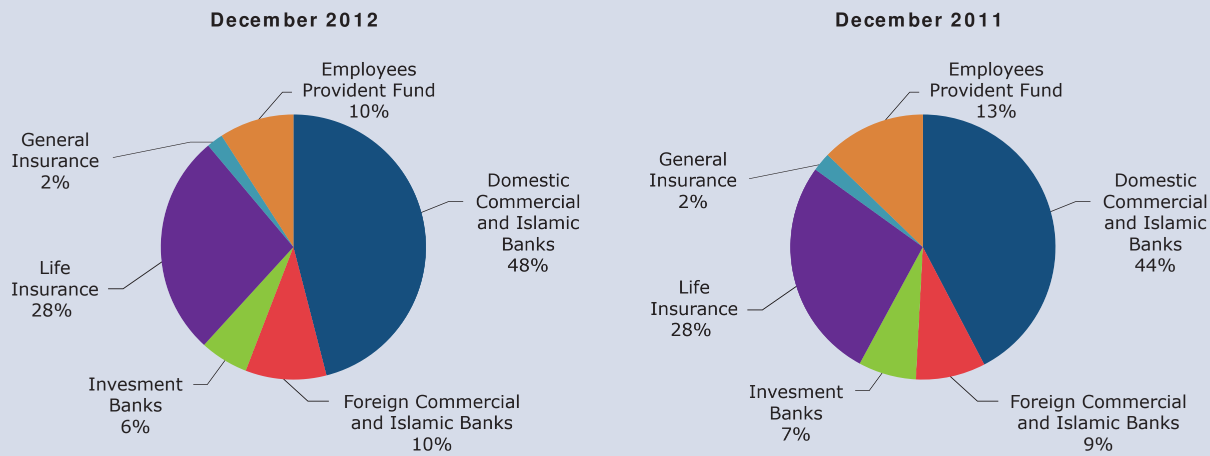
In July, Standard & Poor's Ratings Services (S&P) affirmed Malaysia's long-term foreign currency (FCY) and LCY ratings at A– and A, respectively. S&P also maintained its long-term rating outlook at stable on account of the country's strong external

Figure 2: LCY Government Bonds Investor Profile



LCY = local currency.
Source: Bank Negara Malaysia.

Figure 3: LCY Corporate Bonds Investor Profile



LCY = local currency.
Source: Bank Negara Malaysia.

Table 4: Corporate Bonds Held By Insurance Companies and the Employees Provident Fund in Malaysia (MYR billion)

	2006	2007	2008	2009	2010	2011	2012
Malaysia Total	**88.0**	**102.2**	**106.2**	**122.8**	**141.7**	**147.5**	**160.3**
Insurance	54.4	63.4	67.3	85.3	100.5	102.8	122.1
Employees Provident Fund	33.6	38.8	39.0	37.5	41.1	44.7	38.2
as % of Total Corporate Bonds	**46%**	**44%**	**40%**	**43%**	**46%**	**44%**	**40%**

Source: Bank Negara Malaysia and Employees Provident Fund.

position and monetary flexibility, and in spite of its weak fiscal performance. The rating agency expects government reform efforts to continue along with other economic reform policies.

In the same month, Fitch Ratings (Fitch) downgraded Malaysia's credit outlook to negative from stable, with the long-term FCY and LCY issuer default ratings affirmed at A– and A, respectively. Fitch cited Malaysia's public finances as its key rating weakness with worsening prospects for budgetary reform and fiscal consolidation. The rating agency believes that it will be difficult for the government to achieve its interim 3% federal budget deficit target in 2015 without additional consolidation measures.

In August, Moody's Investors Service (Moody's) maintained a stable outlook for Malaysia and an A3 rating for LCY and FCY government bonds based on its assessment of moderate economic resiliency that is supported by a highly open, medium-sized economy and a well-diversified external sector. Moody's said the high degree of government financial strength is underpinned by the country's strong external position and high savings rate compared with its peers. It added that Malaysia has strong and well-managed corporate and banking sectors, and that its state-owned enterprises were undergoing needed reform. Moody's noted, however, that Malaysia's economic growth has been relatively dependent on public sector expenditure.

Policy, Institutional, and Regulatory Developments

Malaysia Enacts Financial Services Act and Islamic Financial Services Act

Malaysia enacted a new single legislative framework for conventional and Islamic financial services effective 30 June. The Financial Services Act 2013 (FSA) and the Islamic Financial Services Act 2013 (IFSA) repealed and consolidated the provisions included in several previous laws: the Banking and Financial Institutions Act 1989, Islamic Banking Act 1983, Insurance Act 1996, Takaful Act 1984, Payment Systems Act 2003, and Exchange Control Act 1953.

The new legislation provides clearly defined regulatory objectives and establishes accountability for BNM in pursuing its principal objective of safeguarding financial stability. It sets forth transparent assessment criteria for authorizing institutions to engage in regulated financial transactions. The acts include provisions to regulate financial holding companies and non-regulated entities in order to take account of systemic risks that can emerge from the interaction between regulated and unregulated institutions, activities, and markets. The IFSA provides a comprehensive legal framework that is fully consistent with *sharia'h* (Islamic law) in all aspects of regulation and supervision, from licensing to the winding-up of an institution.

BNM Implements Measures to Mitigate Household Debt Risks

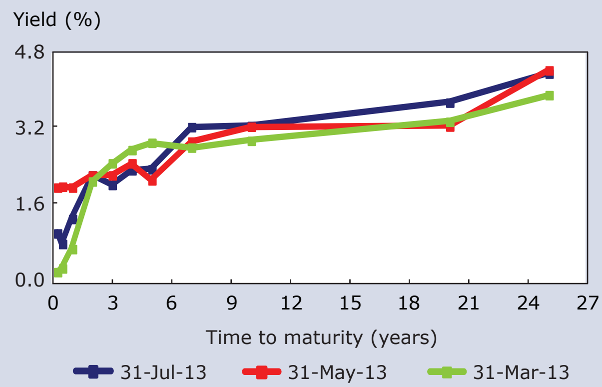
BNM implemented measures to limit risks stemming from rising household debt. The measures set limits for mortgages and personal loans—including a maximum tenure of 10 years for personal financing and 35 years for financing for residential and non-residential properties—and prohibit the offering of pre-approved personal financing products.

Philippines

Yield Movements

Between end-March and end-May, Philippine local currency (LCY) government bond yields rose for most tenors (**Figure 1**). The rise in yields was most evident for tenors of 1 year and below, with yields rising between 127 basis points (bps) and 175 bps. Yields for 10- and 25-year bonds increased 29 bps and 51 bps, respectively. The rise in yields was due to a sell-off at the end of May driven by speculation that the United States (US) Federal Reserve would soon start tapering its quantitative easing program. In contrast, yields for 3-, 5-, and 7-year bonds fell between 25 bps and 78 bps.

Figure 1: Philippines' Benchmark Yield Curve—LCY Government Bonds



LCY = local currency.
Source: Bloomberg LP.

Between end-May and end-July, yields fell for most tenors. Yields for tenors of 1 year and below plunged between 65 bps and 119 bps, while yields for 3- and 4-year bonds fell 20 bps and 14 bps, respectively. The fall in yields was due to a correction in the market after the aforementioned sell-off in late May. Yields fell in the Philippines in July due to continued high liquidity in the market and as a result of the Bangko Sentral ng Pilipinas (BSP) lowering the Special Deposit Account (SDA) rate to 2.0% at its 25 April meeting of the Monetary Board and limiting the access of banks to the facility. Data from BSP showed that SDA deposits totaled PHP1.79 trillion during the week of 8–12 July, down 1.5% from PHP1.82 trillion at end-May and 3.5% from PHP1.86 trillion at end-April. Funds from these accounts may have shifted to government securities or time deposits as SDA investors typically have low risk appetites.

Economic data in the Philippines continues to be positive. Inflation remained benign, enabling the pursuit of expansionary fiscal and monetary policy goals. Consumer price inflation was 2.1% year-on-year (y-o-y) in August, bringing year-to-date inflation to the slow and steady rate to 2.8%, which is below BSP's 2013 target range of 3%–5%. This led BSP to hold its policy rates steady during its two most recent Monetary Board meetings on 13 June and 25 July.

In 2Q13, the Philippine economy grew 7.5% y-o-y, following a revised 7.7% growth in 1Q13. The growth was mainly due to strong business and consumer sentiment, as well as sustained government capital expenditure. This growth was also supported by the strong performance of the services sector, which offset the negative contribution of exports. Exports declined in 2Q13 due to continued weakness in the global economy. However, industry participants are hopeful that global demand will benefit from the gradual recovery of the US economy and efforts in Japan to revive its moribund economy.

Size and Composition

The Philippine LCY bond market grew at a robust rate of 12.1% y-o-y as of end-June, led by both treasury bills and bonds (**Table 1**). Total LCY bonds reached PHP4.1 trillion (US$95 billion) at end-June, up 1.9% from PHP4 trillion at end-March. Government securities accounted for the majority of bonds outstanding, totaling PHP3.5 trillion, while corporate bonds summed to PHP540.8 billion.

Table 1: Size and Composition of the LCY Bond Market in the Philippines

	Outstanding Amount (billion)						Growth Rate (%)			
	2Q12		1Q13		2Q13		2Q12		2Q13	
	PHP	US$	PHP	US$	PHP	US$	q-o-q	y-o-y	q-o-q	y-o-y
Total	3,646	87	4,008	98	4,086	95	2.3	11.8	1.9	12.1
Government	3,151	75	3,476	85	3,545	82	1.0	10.8	2.0	12.5
Treasury Bills	255	6	290	7	295	7	(4.7)	(33.1)	1.9	15.7
Treasury Bonds	2,772	66	3,073	75	3,137	73	1.8	18.1	2.1	13.2
Others	124	3	113	3	113	3	(2.4)	6.4	0.0	(8.5)
Corporate	495	12	532	13	541	13	11.5	18.7	1.7	9.3

( ) = negative, LCY = local currency, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Bloomberg end-of-period LCY–US$ rates are used.
3. Growth rates are calculated from LCY base and do not include currency effects.
4. Data for government bonds as of end-May 2013.
5. "Others" comprises bonds issued by government agencies, instrumentalities, and corporations with which repayment was guaranteed by the central government. These include issues of Power Sector Assets and Liabilities Management (PSALM), National Food Authority, and others.
6. Peso Global Bonds (PHP-denominated bonds payable in US$) and multi-currency Retail Treasury Bonds (RTBs) are not included. As of end-June 2013, the Government of the Philippines and Petron Corporation had PHP129.7 billion and PHP20 billion of outstanding Peso Global Bonds, respectively. There was a total of PHP6 billion of outstanding multi-currency treasury bonds as of end-May 2013.
Sources: Bureau of the Treasury and Bloomberg LP.

Government Bond Market Development. Outstanding fixed-income instruments issued by the Philippine government and government-controlled companies rose 12.5% y-o-y and 2.0% quarter-on-quarter (q-o-q) to close at PHP3.5 trillion at end-May. Treasury bills advanced at the fastest pace—15.7% y-o-y and 1.9% q-o-q—to stand at PHP295.1 billion at end-May. Treasury bonds expanded 13.2% y-o-y and 2.1% q-o-q to PHP3.1 trillion. Meanwhile, fixed-income instruments issued by government-controlled companies registered a decline of 8.5% y-o-y to PHP113.5 billion at the end of 2Q13.

In terms of issuance in 2Q13, PHP90.9 billion worth of treasury bills were sold compared with PHP30 billion of treasury bonds. The government has programmed LCY borrowing of PHP150 billion through its regular auction schedule in 3Q13: PHP60 billion of treasury bills with 91-, 182-, and 364-day tenors; PHP60 billion of treasury bonds with 3- and 5-years tenors; and PHP30 billion of 10-year Retail Treasury Bonds (RTBs). As of end-July, PHP20 billion and PHP30 billion had been raised through treasury bills and bonds, respectively.

Corporate Bond Market Development. As of end-June, total outstanding LCY corporate bonds grew 9.3% y-o-y and 1.7% q-o-q to reach PHP540.8 billion (US$13 billion). The sole issuer of corporate bonds in 2Q13 was the Energy Development Corporation, which raised PHP14 billion worth of 7- and 10-year bonds **(Table 2)**.

Only 51 companies are actively tapping the capital market in the Philippines. The top 31 issuers accounted for 92.2% of the total amount of LCY corporate bonds outstanding (PHP540.8 billion) at end-June **(Table 3)**. Out of the top 31 bond issuers, only five companies are privately-held corporations and the rest are publicly listed with the Philippine Stock Exchange (PSE). San Miguel Brewery (SMB) remained the largest corporate issuer in the country with PHP45.2 billion of outstanding debt. Ayala Corporation followed SMB as the next largest borrower with PHP40 billion. Banco de Oro Unibank was in the third spot with PHP38 billion of outstanding bonds.

Table 2: Notable LCY Corporate Bond Issuance in 2Q13

Corporate Issuer	Coupon Rate (%)	Issued Amount (PHP billion)
Energy Development Corp.		
7-year bond	4.16	7.00
10-year bond	4.73	7.00

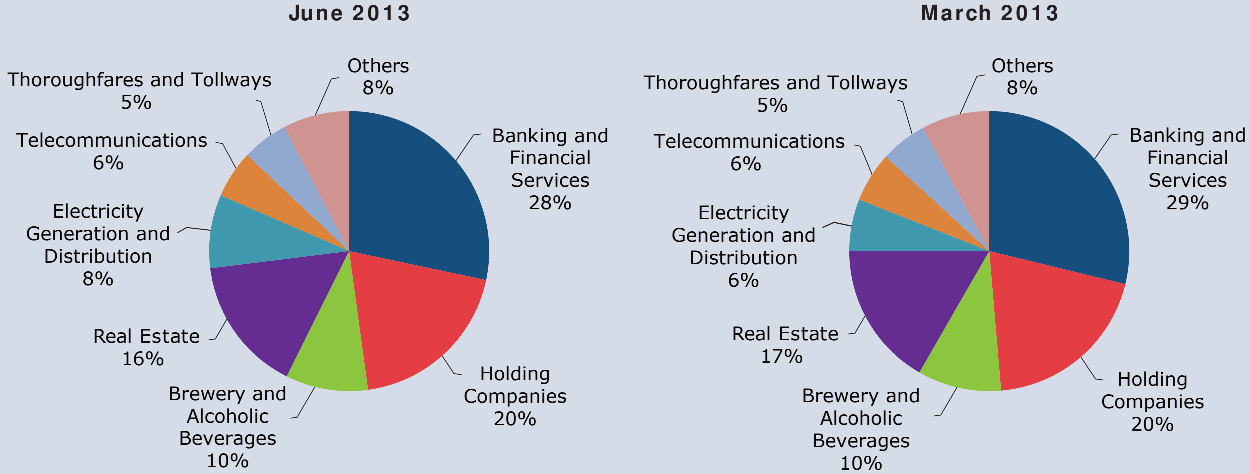
Source: Bloomberg LP.

Table 3: Top 31 Issuers of LCY Corporate Bonds in the Philippines

Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
	LCY Bonds (PHP billion)	LCY Bonds (US$ billion)			
1. San Miguel Brewery	45.2	1.0	No	Yes	Brewery
2. Ayala Corporation	40.0	0.9	No	Yes	Diversified Operations
3. BDO Unibank	38.0	0.9	No	Yes	Banking
4. SM Investments	36.1	0.8	No	Yes	Diversified Operations
5. Ayala Land	31.2	0.7	No	Yes	Real Estate
6. Energy Development	26.0	0.6	No	Yes	Electricity Generation
7. Philippine National Bank	21.9	0.5	No	Yes	Banking
8. Manila Electric	19.4	0.4	No	Yes	Electricity Distribution
9. Philippine Long Distance Telephone	17.3	0.4	No	Yes	Telecommunications
10. Maynilad Water Services	16.6	0.4	No	Yes	Water
11. Filinvest Land	14.5	0.3	No	Yes	Real Estate
12. SM Development	14.3	0.3	No	Yes	Real Estate
13. Rizal Commercial Banking	14.0	0.3	No	Yes	Banking
14. Petron	13.6	0.3	No	Yes	Oil Refining and Marketing
15. JG Summit Holdings	13.3	0.3	No	Yes	Diversified Operations
16. Security Bank	13.0	0.3	No	Yes	Banking
17. First Metro Investment	12.0	0.3	No	No	Investment Banking
18. MTD Manila Expressway	11.5	0.3	No	No	Transport Services
19. South Luzon Tollway	11.0	0.3	No	No	Transport Services
20. Globe Telecom	10.0	0.2	No	Yes	Telecommunications
21. GT Capital Holdings	10.0	0.2	No	Yes	Investment Companies
22. Metropolitan Bank & Trust	10.0	0.2	No	Yes	Banking
23. Robinsons Land	10.0	0.2	No	Yes	Real Estate
24. United Coconut Planters Bank	9.5	0.2	No	No	Banking
25. Allied Banking	8.0	0.2	No	Yes	Banking
26. Megaworld	6.4	0.1	No	Yes	Real Estate
27. Manila North Tollways	6.1	0.1	No	No	Public Thoroughfares
28. Bank of the Philippine Islands	5.0	0.1	No	Yes	Banking
29. China Banking	5.0	0.1	No	Yes	Banking
30. SM Prime Holdings	5.0	0.1	No	Yes	Real Estate
31. Tanduay Distilleries	5.0	0.1	No	Yes	Alcoholic Beverages
Total Top 31 LCY Corporate Issuers	**498.8**	**11.6**			
Total LCY Corporate Bonds	**540.8**	**12.5**			
Top 31 as % of Total LCY Corporate Bonds	**92.2%**	**92.2%**			

LCY = local currency.
Notes:
1. Data as of end-June 2013.
2. Petron Corporation has PHP20 billion of Global Peso Bonds outstanding that are not included in this table.
3. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on Bloomberg data.

Figure 2: LCY Corporate Bond Issuers by Industry



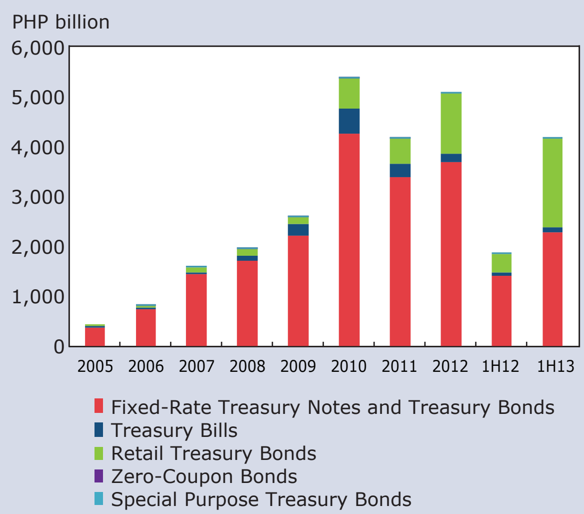
LCY = local currency.
Source: Bloomberg LP.

The diversity of LCY corporate bond issuers in 2Q13 was comparable with that in 1Q13 (**Figure 2**). Banks and financial service companies, including investment houses, remained the leading issuers of debt in 2Q13 with 28.3% of the total as BSP moved toward more stringent liquidity and capital requirements. The market share of most industries remained unchanged, except for electricity generation and distribution, which rose to 8.5% in 2Q13 from 6.0% in 1Q13, and real estate, which fell to 15.7% from 16.7%. Firms from industries as diverse as (i) electricity generation and distribution, (ii) telecommunications, and (iii) thoroughfares and tollways continued to have shares of total corporate bonds outstanding in the single-digit levels.

As the sole fixed-income exchange in the country, the Philippine Dealing and Exchange Corporation (PDEx) captures the secondary trading of listed fixed-income issues. The volume of secondary trading of government securities surged between 2005 and end-2012 (**Figure 3**). From an annual trading volume of PHP437.7 billion in 2005, trading volume increased to PHP5 trillion in 2012. The largest annual volume was recorded in 2010, when secondary trading reached PHP5.4 trillion.

Total trading volume for the first half of 2013 increased 125.0% y-o-y to PHP4.2 trillion, from PHP1.9 trillion in the same period in the previous year, equivalent to 82.4% of the total trade volume in 2012. Between January 2005 and June 2013, treasury bonds accounted for almost 76.9% of all trades in the secondary market as investors sought greater capital gains and interest income from these securities.

Figure 3: PDEx Trade Volume Trends—Government Securities

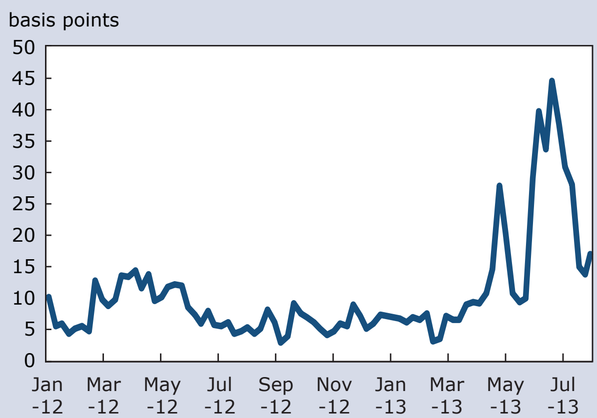


Note: PDEx reports one side of the trade only.
Source: Philippine Dealing and Exchange Corporation (PDEx).

Benchmark Government Securities Bid–Ask Spreads. Liquidity in the secondary trading market for government securities is an indication of market sentiment and investor confidence. Bid–ask spreads and trading volume trends are common indicators of liquidity in the secondary market. *AsianBondsOnline* monitored the most traded treasury bonds with the most frequent bid–ask (two-way) quotes in the Philippine market from 6 January 2012 to 31 July 2013. The data used to capture the bid–ask spreads for these securities were obtained from the Bloomberg pages of money brokers operating in the Philippines.

Bid–ask spreads for benchmark government securities continued to tighten in 2012, reflecting a trend discussed in previous editions of the *Asia Bond Monitor* (**Figure 4**). From January through July, bid–ask spreads averaged 16 bps. The average bid–ask spread stood at 7 bps in 1Q13 before increasing to 23 bps in 2Q13 due to rising risk aversion amid speculation that the US Federal Reserve would start to taper its quantitative easing program. For the month of July, bid–ask spreads narrowed to an average of 21 bps on renewed risk appetite resulting from the announcement of Moody's Investors Service (Moody's) that it would undertake a review of the Philippine government's rating for a possible upgrade to investment grade.

Figure 4: Weekly Average Bid–Ask Spreads of the Philippines' Most Active Government Securities



Note: The following were included among the monitored government securities: (i) FXTN 7-51, (ii) FXTN 10-42, (iii) RTB 10-2, (iv) FXTN 10-54, (v) FXTN 10-55, (vi) RTB15-1, (vii) RTB15-2, (viii) FXTN 20-17, (ix) RTB 20-1, (x) FXTN RTB 25-1, and (xi) FXTN 25-8.
Source: *AsianBondsOnline*.

From 1 April to 31 July, the two series with the tightest bid–ask spreads were FXTN 20-17 and RTB 25-1, with an average of 12 bps and 15 bps, respectively. The other series considered the most liquid were (i) RTB 15-1 (15.8 bps), (ii) RTB 20-1 (17 bps), (iii) RTB 10-2 (18.7 bps), and (iv) FXTN 10-54 (19.5 bps). FXTN 25-08 and FXTN 10-55 had bid–ask spreads of 21.3 bps and 22.5 bps, respectively.

Investor Profile

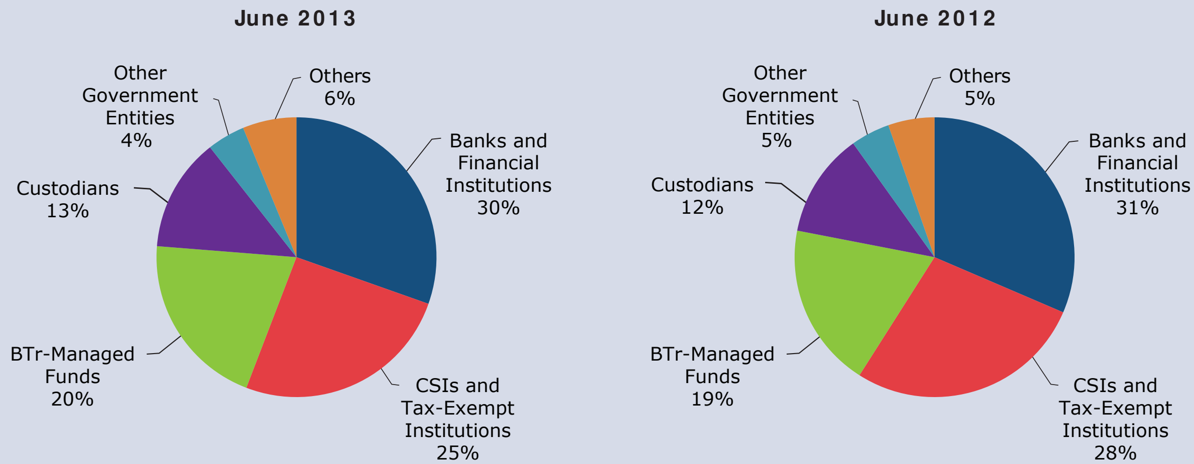
The largest grouping of investors of government securities in 2Q13 comprised banks and financial institutions with 30.4% of the total (**Figure 5**). This was slightly lower than its share of 31.4% in 2Q12. Contractual savings institutions—including the Social Security System (SSS), Government Service Insurance System (GSIS), Pag-ibig, and life insurance companies—and tax-exempt institutions—such as trusts and other tax-exempt entities—accounted for 25.4% in 2Q13, down from 27.6% in 2Q12. Meanwhile, the share of funds being managed by the Bureau of the Treasury (BTr), which includes the Bond Sinking Fund, increased to 20.5% in 2Q13 from 19.0% in 2Q12. The participation of custodians increased to 13.2% from 12.1% in the same period. Other government entities and other investors, which include individuals and private corporations, increased to 10.6% in 2Q13 from 9.9% in 2Q12.

Rating Changes

S&P Raises the Philippines' Long-Term FCY Debt to Investment Grade

Standard & Poor's (S&P) upgraded its rating for the Philippines' long-term foreign currency (FCY)-denominated debt to BBB– from BB+, with a stable outlook. S&P stated that the upgrade reflected a strengthening external profile, moderating inflation, and the government's declining reliance on FCY debt. S&P expects the Philippines to

Figure 5: LCY Government Bonds Investor Profile



BTr = Bureau of the Treasury, CSIs = contractual savings institutions, LCY = local currency.
Source: Bloomberg LP.

move toward a near-balanced external position because of persistent current account surpluses being driven by large net transfers from Filipinos working abroad that more than offset ongoing trade deficits.

R&I Raises the Philippines' FCY Issuer Rating Outlook to Positive

Rating and Investment Information (R&I) raised its outlook for the Philippines' FCY issuer rating of BBB– from stable to positive. R&I cited the country's strong growth due to robust consumption being driven by remittances from overseas Filipino workers, rising public investment and exports, and stable inflation as contributors to the change in outlook. R&I also stated that it will consider a rating upgrade if the fundamentals for economic growth are solidified and steady increases in per capita income become more promising.

Policy, Institutional, and Regulatory Developments

BSP Further Limits Access to SDA Facility

On 9 May, the Monetary Board of BSP approved revised guidelines on the access of banks and trust departments and entities (acting as trustees) to the BSP's Special Deposit Account (SDA) facility. BSP will gradually reduce the SDA placements of investment management accounts of trust entities until the end of the year. The Monetary Board also stated that the low inflation environment and strong domestic growth prospects provided flexibility for BSP to restructure its monetary policy tools.

BSP Approves Further Amendments to Regulations on FX Transactions

On 5 July, BSP released additional amendments to the Manual of Regulations on Foreign Exchange (FX) Transactions. To broaden investment options available in the domestic capital market, BSP will allow (i) custodian banks to register non-resident investments in PSE-listed equity securities of non-residents and (ii) non-resident issuers to convert the peso proceeds from the onshore sale of their PSE-listed equity securities to FX, conditional upon prior BSP approval. To facilitate legitimate banking transactions that require payment in FX, BSP will allow prepayment of BSP-registered short-term loans.

BSP Maintains Policy Rates

On 25 July, the Monetary Board of BSP decided to keep its key policy rates—the overnight borrowing and lending rates—steady at 3.5% and 5.5%, respectively. The reserve requirement ratios and the interest rate for its SDA facility were also left unchanged. The decision to hold the policy rates at their current levels reflected the Monetary Board's assessment that the inflation environment remains benign, with inflation expected to remain on target through the remainder of 2013 and all of 2014. The Monetary Board also noted possible upside pressures to inflation, which include the modest pace of global economic growth, power rate adjustments, and continued increases in liquidity due to capital inflows.

Philippine BTr Raises PHP150 Billion From Sale of RTBs

On 5 August, BTr ended the offer period for RTBs after raising a total of PHP150 billion. The RTBs carry a maturity of 10 years and a yield of 3.25%. The banks were given until 13 August to sell the RTBs to the public. Banks were also required to sell at least 20% of the RTBs to retail buyers, net of the PHP26.9 billion sold to government-owned corporations. Philippine Treasurer Rosalia De Leon stated that the success of the offer reflected the level of liquidity in the market.

Singapore

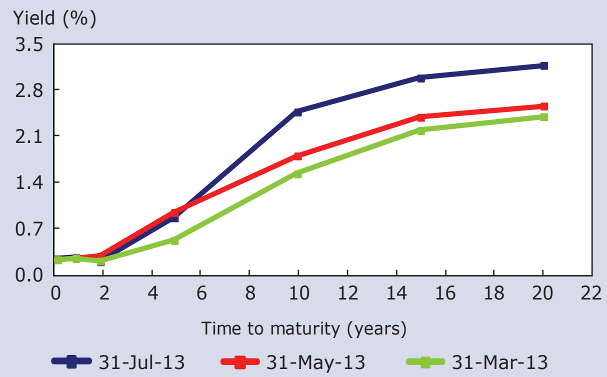
Yield Movements

Between end-July and end-May, the yield curve for Singapore's local currency (LCY) government bonds rose at the longer-end but remained stable at the shorter-end, resulting in a steepening of the curve (**Figure 1**). Yields declined 8 basis points (bps) for both the 2- and 5-year tenors. Yields at the longer-end of the curve—including 10-, 15-, and 20-year tenors—rose between 59 bps and 66 bps. As a result, the yield spread between 2- and 10-year tenors widened to 225 bps at end-July from 151 bps at end-May.

On 15 July, Moody's announced its decision to downgrade the outlook for Singapore's banking system from stable to negative due to a recent period of rapid loan growth and rising real estate prices. According to Moody's, Singapore's banking system has been operating in a favorable low interest rate environment amid strong economic growth. With the risk of a turn in the interest rate cycle, Moody's views the trends of asset inflation and credit growth as vulnerabilities that are likely to lead to credit costs rising from their current low base.

According to the Ministry of Trade and Industry (MTI), Singapore's economy expanded 3.8% year-on-year (y-o-y) in 2Q13 after posting nearly flat growth of 0.2% in 1Q13. On a quarter-on-quarter (q-o-q) and seasonally adjusted annualized basis, the economy grew 15.5% in 2Q13, up substantially from 1.7% in the previous quarter. In 2Q13, growth in the construction sector eased to 5.1% y-o-y from 5.8% in 1Q13, while the services sector expanded at an accelerated pace of 5.5% y-o-y from 2.7% in the previous quarter. The manufacturing sector expanded 0.2% y-o-y in 2Q13 after contracting 6.7% in 1Q13. MTI also announced that it has upgraded the gross domestic product (GDP) growth forecast for 2013 from 1.0%–3.0% to 2.5%–3.5%.

Figure 1: Singapore's Benchmark Yield Curve–LCY Government Bonds



LCY = local currency.
Source: Bloomberg LP.

Consumer price inflation in Singapore climbed to 1.8% y-o-y in June from 1.6% in May. This was mainly due to petrol pump prices, which increased with the recent pick-up in global oil prices. In addition, healthcare costs rose 4.3%, housing and recreation prices each advanced 3.0%, and education costs grew 2.9%. On a month-on-month (m-o-m) basis, consumer price inflation eased slightly to 0.2% in June from 0.4% in May.

Size and Composition

The size of Singapore's LCY bond market stood at SGD303 billion (US$239 billion) at end-June, representing modest growth of 2.1% q-o-q (**Table 1**). On a y-o-y basis, the bond market grew 14.7%, driven by both the government and corporate sectors of the bond market

Government Bonds. LCY government bonds outstanding at end-June rose 1.9% q-o-q and 14.9% y-o-y to SGD187 billion. Growth in the government bond market was largely driven by a substantial increase in Monetary Authority of Singapore (MAS) bills, which have been issued since April 2011 as part of MAS' money market operations. In 2Q13, the stock of MAS bills rose

Table 1: Size and Composition of the LCY Bond Market in Singapore

	Outstanding Amount (billion)						Growth Rate (%)			
	2Q12		1Q13		2Q13		2Q12		2Q13	
	SGD	US$	SGD	US$	SGD	US$	q-o-q	y-o-y	q-o-q	y-o-y
Total	264	209	297	239	303	239	2.0	11.6	2.1	14.7
Government	163	129	184	148	187	148	0.8	13.3	1.9	14.9
Central Govt. Bills and Bonds	143	113	147	118	138	109	(0.8)	3.0	(6.1)	(3.4)
MAS Bills	20	16	37	30	50	39	13.3	–	33.3	143.1
Corporate	101	80	113	91	116	91	3.9	8.8	2.5	14.5

( ) = negative, – = not applicable, LCY = local currency, MAS = Monetary Authority of Singapore, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Government bonds are calculated using data from national sources. Corporate bonds are based on *AsianBondsOnline* estimates.
2. Government bills and bonds do not include the special issue of Singapore Government Securities held by the Singapore Central Provident Fund (CPF).
3. Bloomberg LP end-of-period LCY–US$ rate is used.
4. Growth rates are calculated from LCY base and do not include currency effects.
Sources: Monetary Authority of Singapore, Singapore Government Securities, and Bloomberg LP.

33.3% q-o-q and 143.1% y-o-y to SGD50 billion. Meanwhile, outstanding Singapore Government Securities (SGSs), comprising treasury bills and bonds, fell 6.1% q-o-q and 3.4% y-o-y.

Corporate Bonds. Singapore's LCY corporate bonds outstanding were estimated to stand at SGD116 billion at end-June, expanding 2.5% q-o-q and 14.5% y-o-y.

At end-June, the amount of LCY bonds outstanding of the top 30 corporate bond issuers in Singapore reached SGD64.1 billion, representing 55.4% of the total corporate bond market (**Table 2**). The Housing and Development Board ranked as the top corporate issuer in Singapore with outstanding bonds valued at SGD14.4 billion, followed by DBS Bank with bonds outstanding of SGD5.0 billion. The third largest corporate issuer was CapitaLand—one of the largest real estate and real estate fund management companies headquartered in Singapore—with a total bond stock amounting to SGD4.8 billion.

Corporate issuers from the financial sector dominated the list of the top 30 LCY corporate bond issuers in Singapore. Other major issuers were from the utilities, industrial, real estate, telecommunications, transportation, and energy sectors. Only three companies on the list were state-owned firms.

Corporate bond issuance reached SGD3.8 billion in 2Q13, down from SGD4.1 billion in 1Q13. A total of 26 bond series were issued by 25 companies during 2Q13, with maturities ranging from 1 year to 10 years, and coupon rates between 1.0% and 7.125%. Two perpetual bonds were also issued in 2Q13. **Table 3** lists notable corporate bonds issued in 2Q13.

Policy, Institutional, and Regulatory Developments

MAS Introduces Debt Servicing Framework for Property Loans

On 28 June, MAS announced its plan to introduce a total debt servicing ratio framework for all property loans granted by financial institutions to individuals. This will require financial institutions to take into consideration borrowers' other outstanding debt obligations when granting property loans in order to strengthen credit underwriting practices among financial institutions and encourage financial prudence among borrowers. MAS will also refine rules related to the application of the existing loan-to-value (LTV) limits on housing loans. These refinements seek to ensure the effectiveness of the LTV limits that were put in place to cool demand in the housing market. In particular, they aim to prevent circumvention of the tighter LTV limits on second and subsequent housing loans.

Table 2: Top 30 Issuers of LCY Corporate Bonds in Singapore

Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
	LCY Bonds (SGD billion)	LCY Bonds (US$ billion)			
1. Housing and Development Board	14.4	11.4	Yes	No	Financial
2. DBS Bank	5.0	3.9	No	Yes	Financial
3. CapitaLand	4.8	3.8	No	Yes	Financial
4. United Overseas Bank	4.5	3.6	No	Yes	Financial
5. Temasek Financial I	3.6	2.8	No	No	Financial
6. Oversea-Chinese Banking	2.7	2.1	No	Yes	Financial
7. SP PowerAssets	2.4	1.9	No	No	Utilities
8. Public Utilities Board	2.1	1.7	Yes	No	Utilities
9. Land Transport Authority	1.8	1.4	Yes	No	Industrial
10. GLL IHT Pte	1.8	1.4	No	No	Real Estate
11. Olam International	1.6	1.3	No	Yes	Consumer
12. Keppel Corp	1.5	1.2	No	Yes	Industrial
13. Mapletree Treasury Services	1.3	1.1	No	No	Financial
14. Overseas Union Enterprise	1.3	1.0	No	Yes	Consumer
15. Temasek Financial III	1.3	1.0	No	No	Financial
16. Neptune Orient Lines	1.3	1.0	No	Yes	Industrial
17. City Developments	1.3	1.0	No	Yes	Consumer
18. CapitaMalls Asia Treasury	1.1	0.9	No	No	Financial
19. Keppel Land	1.1	0.9	No	Yes	Real Estate
20. PSA Corporation	1.0	0.8	No	No	Consumer
21. CapitaMall Trust	1.0	0.8	No	Yes	Financial
22. F&N Treasury Pte	1.0	0.8	No	No	Financial
23. Hyflux	1.0	0.8	No	Yes	Industrial
24. Singtel Group Treasury	0.9	0.7	No	No	Telecommunications
25. Singapore Airlines	0.8	0.6	No	No	Transportation
26. Swiber Holdings	0.8	0.6	No	Yes	Energy
27. Global Logistic Properties	0.8	0.6	No	Yes	Industrial
28. CapitaLand Treasury	0.7	0.6	No	No	Financial
29. Joynote	0.7	0.6	No	No	Financial
30. Sembcorp Financial Services	0.7	0.6	No	No	Industrial
Total Top 30 LCY Corporate Issuers	**64.1**	**50.5**			
Total LCY Corporate Bonds	**115.7**	**91.3**			
Top 30 as % of Total LCY Corporate Bonds	**55.4%**	**55.4%**			

LCY = local currency.
Notes:
1. Data as of end-June 2013.
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on Bloomberg data.

Table 3: Notable LCY Corporate Bond Issuance in 2Q13

Corporate Issuers	Coupon Rate (%)	Issued Amount (SGD million)
Capitaland Ltd.		
7-year bond	1.85	1,300
TML Holdings Pte Ltd.		
5-year bond	4.25	350
GLL IHT Pte Ltd.		
perpetual bonds	4.70	200
7-year bond	4.10	125
ABJA Investment		
10-year bond	4.95	300
Tiger Airways		
perpetual bond	2.00	220
Swiber Holdings Ltd.		
4-year bond	7.13	160

LCY = local currency.
Source: Bloomberg LP.

BOJ and MAS Sign Cross-Border Collateral Arrangement

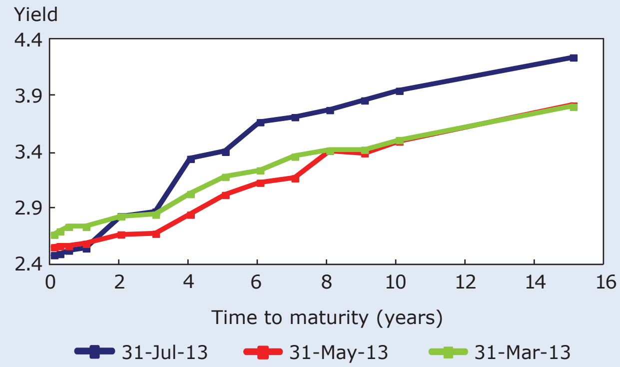
On 26 July, the Bank of Japan (BOJ) and MAS established a cross-border collateral arrangement to enhance financial stability in Singapore. Under the arrangement, eligible financial institutions operating in Singapore may obtain Singapore dollar liquidity from MAS by pledging Japanese government securities. This widens the range of acceptable collateral in MAS' liquidity facility and permits greater flexibility in the liquidity management of eligible financial institutions, including Japanese banks, operating in Singapore. This collaboration reinforces BOJ and MAS' commitment to the long-standing economic and financial relationship between Japan and Singapore.

Thailand

Yield Movements

Thailand's local currency (LCY) government bond yields fell for tenors of 1 year or less and rose for tenors of more than 1 year between end-March and end-July, resulting in a steepening of the yield curve (**Figure 1**). The largest drop in yields during this period was for the 6-month tenor at 21 basis points (bps), while the largest hikes were for the 9-, 10-, and 15-year tenors at 44 bps each. Between end-March and end-May, yields fell for all tenors except the 15-year. However, between end-May and end-July, yields rose for most tenors, especially for tenors of more than 1 year, while falling for tenors of 1 year or less. Meanwhile, the yield spread between the 2- and 10-year tenors widened 43 bps between end-March and end-July to reach 111 bps.

Figure 1: Thailand's Benchmark Yield Curve—LCY Government Bonds



LCY = local currency.
Source: Bloomberg LP.

The fall in short-term LCY government bond yields in Thailand between end-March and end-July followed the 28–29 May decision of the Bank of Thailand's (BOT) Monetary Policy Committee to lower the policy rate—the 1-day repurchase rate—by 25 bps to 2.50%. In its subsequent meetings on 9–10 July and 21 August, the committee decided to keep the policy rate steady at 2.50%. On the other hand, the rise in medium- to long-term yields during this period mainly reflected market expectations of a tapering in the United States (US) Federal Reserve's purchase of Treasuries and agency mortgage-backed securities, which triggered an increase in the sell-off by foreign investors of THB-denominated medium- to long-term government bonds.

Consumer price inflation moderated to 1.6% year-on-year (y-o-y) in August from 2.0% in July. The price index for food and nonalcoholic beverages rose 2.7% following a 2.8% increase in July. Meanwhile, the price index for non-food and beverage items climbed 1.1% y-o-y in August, lower than the 1.6% hike posted in the previous month.

Real gross domestic product (GDP) growth decelerated to 2.8% y-o-y in 2Q13 from 5.4% y-o-y in 1Q13 amid slower growth in domestic demand and exports. On the expenditure side, the y-o-y growth rate between 1Q13 and 2Q13 fell from 4.4% to 2.4% for private consumption, from 5.8% to 4.5% for gross fixed capital formation, from 8.3% to 2.8% for total exports, and from 8.1% to 4.1% for total imports, whereas it rose from 2.9% to 5.8% for government spending. On the production side, growth in the non-agriculture sector slowed to 3.0% y-o-y in 2Q13 from 5.8% in 1Q13, as the y-o-y growth rate for the manufacturing sector fell to –1.0% from 4.9%, while growth in the agriculture sector slipped to 0.1% y-o-y in 2Q13 from 0.8% in the previous quarter. In August, the Government of Thailand's Cabinet approved measures—covering the areas of private consumption, private investment, government spending, and exports—aimed at promoting stable economic growth.

For the month of July, manufacturing production dropped 4.5% y-o-y after contracting 3.2% in June, according to Bank of Thailand data.

The country's current account deficit widened to US$708.9 million in July from US$664.3 million in June. The m-o-m increase was on the back of a 56.2% monthly drop in the merchandise trade surplus, which stood at US$257.6 million in July, as merchandise imports rose 1.7% m-o-m while merchandise exports slipped 0.1% m-o-m. Moreover, the deficit in the net services, primary income, and secondary income account narrowed 22.8% m-o-m to US$966.4 million in July.

Size and Composition

LCY bonds outstanding in Thailand totaled THB8.9 trillion (US$286 billion) at the end of 2Q13, reflecting increases of 3.0% q-o-q and 10.6% y-o-y (**Table 1**). The growth rates for 2Q13, however, were lower compared with 2Q12. The value of LCY government bonds outstanding, which accounted for 79% of the overall bond market at the end of 2Q13, climbed 3.4% q-o-q and 8.7% y-o-y, slower than the growth posted in 2Q12. Central government bonds reached THB3.2 trillion at the end of 2Q13 on moderating growth rates of 4.3% q-o-q and 7.7% y-o-y. Central bank bonds rose at a slower pace than central government bonds—2.4% q-o-q and 4.6% y-o-y—to level off at THB3.1 trillion, while state-owned enterprise (SOE) and other bonds grew 3.4% q-o-q and 40.5% y-o-y to reach THB676 billion at the end of 2Q13.

Issuance of LCY government bonds fell 3.2% q-o-q and 24.2% y-o-y in 2Q13. This was on the back of reduced issuance from the central bank (–0.6% q-o-q and –24.3% y-o-y) and central government (–19.5% q-o-q and –36.8% y-o-y). Meanwhile, issuance of SOE bonds had a mixed performance in 2Q13, falling 20.1% q-o-q but rising 55.3% y-o-y.

LCY corporate bonds outstanding amounted to THB1.9 trillion at the end of 2Q13, up 1.8% q-o-q and 18.5% y-o-y. The top 30 corporate issuers had combined bonds outstanding of THB1.2 trillion, which comprised 61.7% of total corporate bonds, with PTT and Siam Cement as the two largest corporate bond issuers (**Table 2**). Issuance of LCY corporate debt securities jumped 76.3% q-o-q and 137.5% y-o-y in 2Q13 on the back of a sharp rise in debt issues with tenors of 1 year or less.

The two largest corporate bonds issued in 2Q13 were Siam Cement's 4-year bond worth THB25 billion and with a coupon rate of 4.0%, and True Corporation's 4-year bond valued at THB7.8 billion and carrying a coupon of 5.8% (**Table 3**). The two bond issues with the highest coupon rates in 2Q13 were Property Perfect's 2-year bond worth THB2 billion and offering a 6.05% coupon and True Corporation's 4-year bond at 5.8% coupon. Mitr Phol Sugar Corporation issued the bond with the longest tenor at 12 years.

Table 1: Size and Composition of the LCY Bond Market in Thailand

	Outstanding Amount (billion)						Growth Rate (%)			
	2Q12		1Q13		2Q13		2Q12		2Q13	
	THB	US$	THB	US$	THB	US$	q-o-q	y-o-y	q-o-q	y-o-y
Total	8,027	254	8,621	295	8,882	286	4.1	17.7	3.0	10.6
Government	6,444	204	6,779	232	7,007	226	4.8	17.9	3.4	8.7
Government Bonds and Treasury Bills	3,000	95	3,098	106	3,231	104	8.0	17.3	4.3	7.7
Central Bank Bonds	2,963	94	3,026	103	3,099	100	1.7	22.1	2.4	4.6
State-Owned Enterprise and Other Bonds	481	15	654	22	676	22	4.5	(0.2)	3.4	40.5
Corporate	1,583	50	1,842	63	1,875	60	1.6	16.9	1.8	18.5

( ) = negative, LCY = local currency, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Bloomberg end-of-period LCY–US$ rates are used.
3. Growth rates are calculated from an LCY base and do not include currency effects.
Sources: Bank of Thailand (BOT) and Bloomberg LP.

Table 2: Top 30 Issuers of LCY Corporate Bonds in Thailand

Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
	LCY Bonds (THB billion)	LCY Bonds (US$ billion)			
1. PTT	180.0	5.8	Yes	Yes	Energy
2. Siam Cement	131.5	4.2	Yes	Yes	Diversified
3. Krung Thai Bank	75.1	2.4	Yes	Yes	Financial
4. Charoen Pokphand Foods	64.5	2.1	No	Yes	Consumer
5. Bank of Ayudhya	59.7	1.9	No	Yes	Financial
6. Kasikorn Bank	47.1	1.5	No	Yes	Financial
7. Thanachart Bank	40.5	1.3	No	No	Financial
8. Siam Commercial Bank	40.0	1.3	No	Yes	Financial
9. Thai Airways International	39.7	1.3	Yes	Yes	Consumer
10. Ayudhya Capital Auto Lease	37.4	1.2	No	No	Financial
11. PTT Global Chemical	33.3	1.1	Yes	Yes	Basic Materials
12. Thai Oil	27.8	0.9	Yes	Yes	Energy
13. TMB Bank	27.7	0.9	No	Yes	Financial
14. Toyota Leasing Thailand	27.1	0.9	No	No	Consumer
15. Mitr Phol Sugar	25.2	0.8	No	No	Consumer
16. Banpu	25.2	0.8	No	Yes	Energy
17. PTT Exploration and Production Company	24.2	0.8	Yes	Yes	Energy
18. Indorama Ventures	23.9	0.8	No	Yes	Basic Materials
19. DAD SPV	22.5	0.7	Yes	No	Financial
20. Krung Thai Card	22.5	0.7	Yes	Yes	Financial
21. Tisco Bank	20.3	0.7	No	No	Financial
22. Bangkok Bank	20.0	0.6	No	Yes	Financial
23. IRPC	19.6	0.6	Yes	Yes	Energy
24. Bangkok Expressway	19.2	0.6	No	Yes	Consumer
25. Glow Energy	19.1	0.6	No	Yes	Utilities
26. Quality Houses	18.0	0.6	No	Yes	Real Estate
27. Pruksa Real Estate	17.0	0.5	No	Yes	Real Estate
28. True Corporation	16.7	0.5	No	Yes	Communications
29. Land & Houses	16.5	0.5	No	Yes	Real Estate
30. Minor International	16.4	0.5	No	Yes	Consumer
Total Top 30 LCY Corporate Issuers	**1,157.4**	**37.3**			
Total LCY Corporate Bonds	**1,875.3**	**60.4**			
Top 30 as % of Total LCY Corporate Bonds	**61.7%**	**61.7%**			

LCY = local currency.
Notes:
1. Data as of end-June 2013.
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsiaBondsOnline* calculations based on Bloomberg data.

Table 3: Notable LCY Corporate Bond Issuance in 2Q13

Corporate Issuers	Coupon Rate (%)	Issued Amount (THB billion)
Bank Ayudhya		
2-year bond	3.48	6.0
Charoen Phokpand Foods		
5-year bond	3.93	6.0
Siam Cement		
4-year bond	4.00	25.0
Toyota Leasing (Thailand)		
3-year bond	3.21	5.4
True Corporation		
4-year bond	5.80	7.8

LCY = local currency.
Source: Bloomberg LP.

The bond is worth THB2.4 billion and carries a 5.0% coupon.

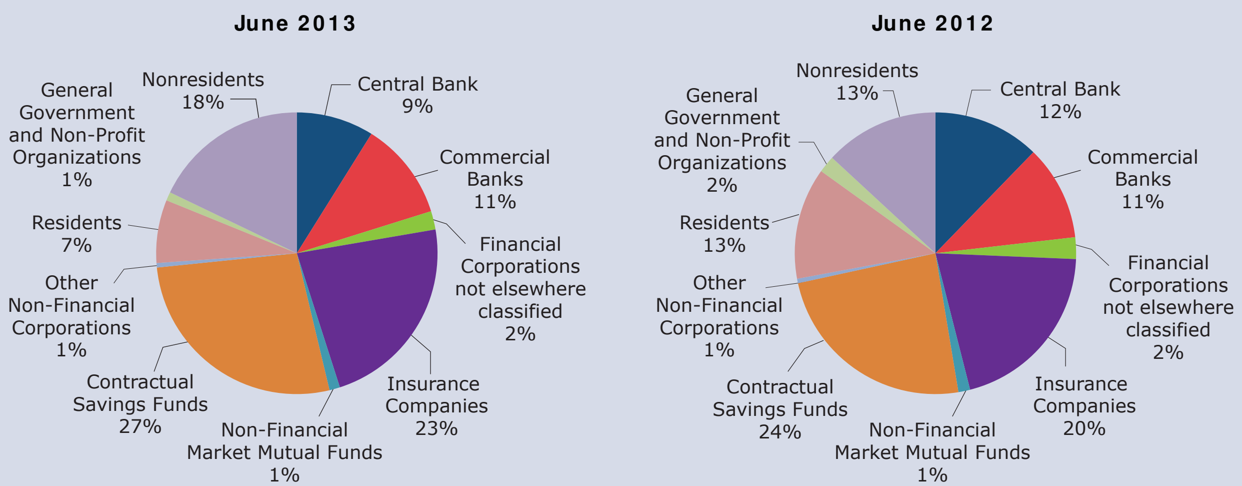
Investor Profile

Contractual savings funds remained the largest investor group in Thailand's LCY government bond market at the end of June, accounting for 27% of the total, followed by insurance companies with a 23% share (**Figure 2**).

Between June 2012 and June 2013, the shares of contractual savings funds, insurance companies, and nonresidents all increased, while those of the central bank, general government and non-profit organizations, and residents all fell. The share of nonresidents posted the biggest increase at 5 percentage points.

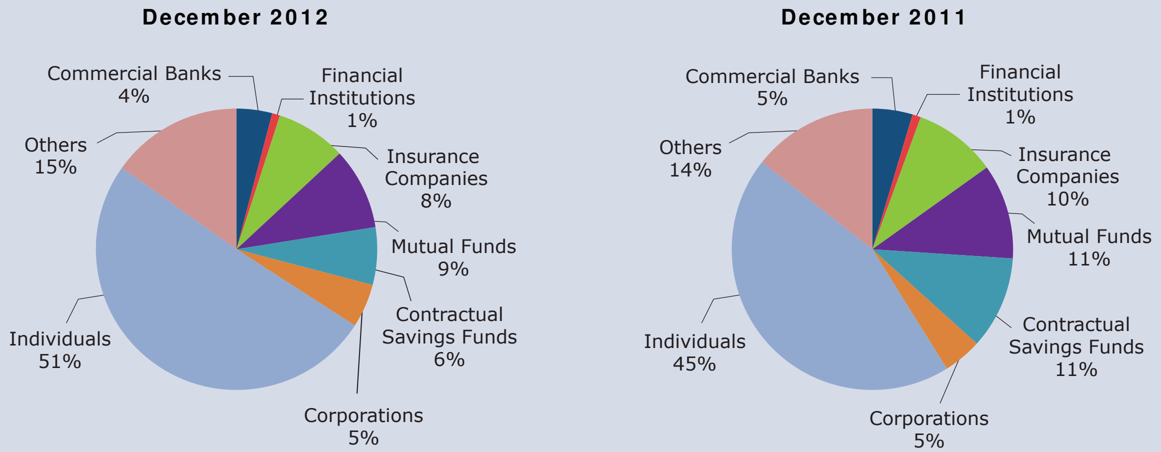
Retail investors remained the largest investor group in LCY corporate bonds, according to the most recent data, holding 51% of the total at end-December 2012 (**Figure 3**). They were followed by other investors—such as the government, cooperatives, foundations, and temples—with a combined 15% share, then mutual funds (9%), insurance companies (8%), contractual savings funds (6%), non-financial corporations (5%), commercial banks (4%), and other financial institutions (1%). Compared with end-December 2011, the share of individual retail investors rose 6 percentage points, while the share of the combined group of government, cooperatives, foundations, and temples rose 1 percentage point. In contrast, the shares of commercial banks, contractual savings funds, insurance companies, and mutual funds, all fell compared with end-December 2011.

Figure 2: LCY Government Bonds Investor Profile



LCY = local currency.
Note: Government bonds exclude central bank bonds and state-owned enterprise bonds.
Sources: *AsianBondsOnline* and Bank of Thailand.

Figure 3: LCY Corporate Bonds Investor Profile



LCY = local currency.
Source: ThaiBMA.

Rating Changes

On 8 March, Fitch Ratings (Fitch) announced that it had upgraded Thailand's long-term foreign currency (FCY) issuer default rating (IDR) to BBB+ from BBB with a stable outlook, affirmed the long-term LCY IDR at A– with a stable outlook, upgraded the short-term FCY IDR to F2 from F3, and upgraded the country ceiling to A– from BBB+. In making its rating decisions, Fitch cited key rating drivers such as the economy's resilience to shocks, sound external finances, and low gross general government indebtedness, among other factors.

Policy, Institutional, and Regulatory Developments

Thailand's Cabinet Approves Measures to Promote Stable Economic Growth

The Government of Thailand's Cabinet agreed during its 6 August meeting on the implementation by the relevant government offices of measures focusing on private consumption, private investment, government spending, and exports. These measures, aimed at promoting stable economic growth, include (i) offering tax incentives to boost the tourism industry and promote the organization of seminars, (ii) promoting investments in the agro-processing industry, (iii) accelerating budget disbursements for fiscal years 2013 and 2014, (iv) expanding exports into potential new markets, and (v) increasing the access of small and medium-sized enterprises (SMEs) to financing.

MOF Permits Two Foreign Entities to Issue LCY Bonds in Thailand

The Ministry of Finance (MOF) announced in May that it was permitting two foreign entities to sell THB-denominated bonds and debentures in Thailand, totaling THB14 billion, between 1 May 2013 and 31 January 2014. These two entities and their respective authorized bond issuance amounts are (i) Australia and New Zealand Banking Corporation (THB8 billion) and (ii) Westpac Banking Corporation (THB6 billion).

Amendments Approved to Regulations Governing REITs

Thailand's Securities and Exchange Commission (SEC) announced in July that the Capital Market Supervisory Board approved amendments to regulations governing the creation and management of real estate investment trusts (REITs). The amendments will allow an REIT trustee to participate in more REIT-related businesses for as long as the trustee is independent from the REIT manager. Measures preventing conflicts of interest among REIT-related businesses will also be put in place.

Viet Nam

Yield Movements

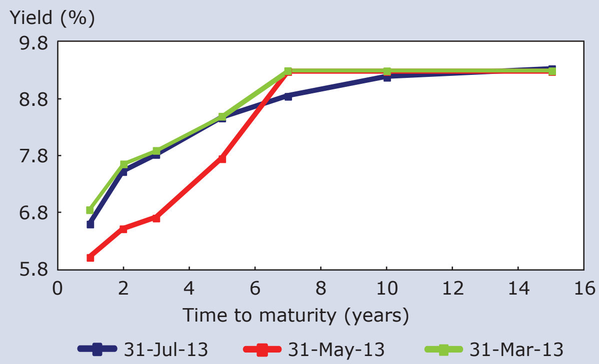
Between end-March and end-May, Viet Nam's local currency (LCY) government bond yield curve shifted downward as yields plunged sharply for tenors between 1 year and 5 years (**Figure 1**). Yields slumped the most at the shorter-end of the curve, dropping as much as 116 basis points (bps) for 3-year government bonds and 113 bps for 2-year bonds.

By end-July, yields for instruments with maturities of 5 years or less rose between 58 bps and 111 bps. The 2- and 3-year benchmark yields edged up to 7.55% and 7.85% at end-July from 6.55% and 6.74%, respectively, at end-May. In contrast, yields of longer-dated tenors (maturities of 7 years or more) continued to slide, narrowing the spread between 2- and 10-year tenors to 165 bps at end-July from 275 bps at end-May.

The volatility of Viet Nam's government bond yields reflects turbulence in the economy. In 2Q13, inflationary pressures and a currency devaluation dampened investor demand. Consumer price inflation has declined since May 2012 to reach single-digit rates, but picked up for a second consecutive month in July, reaching 7.3% year-on-year (y-o-y). July's inflation rate was the highest in 14 months and follows recent lows in the first half of the year. The price indices for 10 out of 11 baskets of goods increased on a y-o-y basis, with only postal services and telecommunications showing a decline. The price index for health care costs saw the steepest increase at 80.2%, while the price indices for other baskets posted increases of between 2.2% and 15.7%. The government has set an annual inflation target of 6.0%–6.5%.

Concerns that the Vietnamese dong would further weaken also prompted LCY bond yields to rise. The Viet Nam dong depreciated to a record-low VND21,243–US$1 in July following the central bank's decision to devalue the reference rate by 1% versus the US dollar for the first time since 2011.

Figure 1: Viet Nam's Benchmark Yield Curve—LCY Government Bonds



LCY = local currency.
Source: Bloomberg LP.

Viet Nam's economic growth remained subdued as weak domestic demand and high levels of non-performing loans in the banking system continued to constrain growth. In 2Q13, gross domestic product (GDP) growth was at 5.0% y-o-y, up slightly from 4.8% in 1Q13 and 4.7% in 2Q12, but still raising concerns that it may fall short of the government's annual target of 5.5%. Growth in retail revenues slowed to 11.9% in 1H13 from 19.5% in the same period in 2012. To address bad debts in the banking sector, Viet Nam Asset Management Company (VAMC) began operations on 26 July with an initial charter capital of VND500 billion (US$25 million).

Size and Composition

Total LCY bonds outstanding in Viet Nam grew 26.8% y-o-y to VND578.0 trillion at end-June, as the rise in issuance of government bonds more than offset the decline in the corporate sector. On a quarter-on-quarter (q-o-q) basis, however, total LCY government and corporate bonds outstanding declined 8.1% and 22.5%, respectively, in 2Q13 (**Table 1**).

Table 1: Size and Composition of the LCY Bond Market in Viet Nam

	Outstanding Amount (billion)						Growth Rate (%)			
	2Q12		1Q13		2Q13		2Q12		2Q13	
	VND	US$	VND	US$	VND	US$	q-o-q	y-o-y	q-o-q	y-o-y
Total	455,892	22	632,319	30	577,997	27	10.5	28.5	(8.6)	26.8
Government	417,525	20	610,310	29	560,938	26	12.6	33.5	(8.1)	34.3
Treasury Bonds	185,403	9	310,537	15	324,054	15	11.7	42.0	4.4	74.8
Central Bank Bonds	58,078	3	112,857	5	43,586	2	–	–	(61.4)	(25.0)
State-Owned Enterprise Bonds	174,044	8	186,916	9	193,298	9	(0.2)	(4.4)	3.4	11.1
Corporate	38,367	2	22,009	1	17,059	1	(7.9)	(8.7)	(22.5)	(55.5)

( ) = negative, – = not applicable,LCY = local currency, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Bloomberg LP end-of-period LCY–US$ rates are used.
2. Growth rates are calculated from LCY base and do not include currency effects.
Source: Bloomberg LP.

Government Bonds. LCY government bonds outstanding stood at VND560.9 trillion at end-June, rising 34.3% y-o-y due to increased issuance of treasury bonds and state-owned enterprise (SOE) bonds.

In 2Q13, government issuance amounted to VND53.9 trillion, driven by issuance of treasury bonds and bills of VND34.7 trillion, and issuance by SOEs of VND19.3 trillion. The largest issuer among government-owned corporations was Viet Nam Development Bank, which issued bonds amounting to VND14.3 trillion. Viet Nam Bank for Social Policies and Hanoi Treasury raised VND4.0 trillion and VND1.0 trillion, respectively.

Corporate Bonds. The size of Viet Nam's corporate bond market has shrunk by half since 2Q12, plummeting 55.5% y-o-y to VND17.1 trillion in 2Q13. On a q-o-q basis, bonds outstanding fell 22.5% from VND22.0 trillion in 1Q13. Corporate bonds with maturities of 1–3 years were offering yields ranging from 7.5% to 17.25% in 2Q13, compared with 7.0% to 15.7% a year earlier.

Amid difficult market conditions, new issuance in Viet Nam's LCY corporate bond market has been non-existent since 1Q13. The most recent LCY corporate bond issuance occurred in October 2012 when Lam Son Sugar—a manufacturer and trader of sugar, malt, alcoholic and non-alcoholic drinks, and other sugar-based products and animal feeds—issued a 2-year VND150 billion bond with a 12% coupon.

As of end-June, the top 15 issuers in Viet Nam accounted for 98.0% of total LCY corporate bonds outstanding (**Table 2**). The composition of the top three LCY corporate issuers remained unchanged from 1Q13, led by real estate company HAGL with bonds outstanding of VND4.1 trillion. Techcom Bank and Asia Commercial Joint Stock Bank followed with VND3 trillion each.

Policy, Institutional, and Regulatory Developments

Viet Nam Devalues its Currency, Cuts Interest Rate Ceiling for Short-Term Deposits

Viet Nam recently devalued its currency by 1% versus the US dollar. Effective 28 June, the VND–US$ reference rate was adjusted from VND20,828 to VND21,036 per US$1. The stated objectives of the devaluation were to improve the country's trade balance and increase its foreign exchange reserves.

The State Bank of Viet Nam (SBV) announced a cut in the interest rate ceiling for VND deposits with

Table 2: Top 15 Issuers of LCY Corporate Bonds in Viet Nam

Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
	LCY Bonds (VND billion)	LCY Bonds (US$ billion)			
1. HAGL	4,110.00	0.19	No	Yes	Real Estate
2. Techcom Bank	3,000.00	0.14	No	No	Finance
3. Asia Commercial Joint Stock Bank	3,000.00	0.14	No	Yes	Finance
4. Vinpearl	2,000.00	0.09	No	Yes	Resorts and Theme Parks
5. Vincom	1,000.00	0.05	No	Yes	Real Estate
6. Minh Phu Seafood	700.00	0.03	No	Yes	Fisheries
7. Hoa Phat Group	600.00	0.03	No	Yes	Miscellaneous Manufacturing
8. Kinh Bac City Development	500.00	0.02	No	Yes	Real Estate
9. Development Investment	350.00	0.02	No	No	Building and Construction
10. Phu Hoang Anh	350.00	0.02	No	No	Real Estate
11. Binh Chanh Construction	300.00	0.01	No	Yes	Building and Construction
12. Saigon Telecommunication	300.00	0.01	No	Yes	Technology
13. Thu Duc Housing Development	208.87	0.01	No	Yes	Real Estate
14. Lam Son Sugar	150.00	0.01	No	No	Diversified
15. Quoc Cuong Gia	150.00	0.01	No	No	Building and Construction
Total Top 15 LCY Corporate Issuers	**16,718.87**	**0.79**			
Total LCY Corporate Bonds	**17,058.99**	**0.80**			
Top 15 as % of Total LCY Corporate Bonds	**98.0%**	**98.0%**			

LCY = local currency.
Notes:
1. Data as of end-June 2013.
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on Bloomberg data.

tenors between 1 month and less than 6 months by another 50 bps to 7%, effective 28 June. The move aims to support economic growth. Short-term lending rates for five prioritized sectors—agriculture, exports, supporting industries, high-tech businesses, and small and medium-sized enterprises (SMEs)—will now be capped at 9% rather than 10%.

SBV to Perform Settlement for Government Bond Transactions Beginning in 2Q14

The method of payment for government bonds will be changed to real-time gross settlement (RTGS) from multilateral netting. Starting in 2Q14, SBV will perform the settlement for government bond transactions, instead of the Bank for Investment and Development of Viet Nam. Only member banks of the Viet Nam Securities Depository are allowed to directly participate in the government bond settlement system, while members such as securities companies will make payments for government bond transactions through a settlement bank.

VAMC Begins Operation

On 26 July, Viet Nam Asset Management Company (VAMC) started operations with initial registered capital of VND500 billion. VAMC was created to better manage non-performing loans (NPLs) and promote credit growth in the country's banking system. VAMC—which is wholly state-owned and -managed, and supervised by SBV—will purchase the bad debts of credit institutions in one of two ways: by buying NPLs at their book value through the issuance of VAMC's special bonds or by buying NPLs at market value using other financing sources. Special bonds are 5-year zero-coupon bonds issued in exchange for banks' bad debts, which the lenders can use as collateral to access refinancing funds from the central bank. VAMC will only buy NPLs that meet five conditions: (i) the debts must arise from lending or the purchase of bonds, or from other activities prescribed by SBV; (ii) collateral assets must have proper title documentation; (iii) debts and collateral assets must be legal; (iv) borrowers must still be in operation and otherwise contactable and verifiable; and (v) the balances of bad loans or outstanding bad debts of borrowers cannot be lower than the level prescribed by SBV. Lenders NPL ratios of 3% and above will be required to sell their bad debts to VAMC or else face external audit.