

Bond Yields Up in Most Emerging East Asian Economies

The brightening global outlook has pushed up local currency (LCY) government bond yields in major advanced economies, leading to a rise in yields in most emerging East Asian economies between 1 June and 15 August.¹

Advanced economies maintained their growth momentum during the second quarter (Q2) of 2017. Labor market conditions remained firm in the United States (US). Economic growth forecasts in the eurozone were upgraded and Japan also posted relatively strong gross domestic product (GDP) growth.

With economic prospects generally benign, financial risks are receding in emerging East Asia but downside risks loom over a longer time horizon. These include the normalization of the US Federal Reserve's balance sheet, which signals an eventual turn in the global liquidity environment and a possible correction in rising asset valuations.

This issue of the *Asia Bond Monitor* includes two special discussion boxes. Box 1 discusses the potential benefits of the Bond Connect scheme, a significant effort to link the People's Republic of China's (PRC) bond market to the rest of the world. Box 2 outlines a conceptual solution to cope with longevity risk in Asia.

Local Currency Bond Markets in Emerging East Asia Maintain Strong Growth Momentum

Emerging East Asia's LCY bonds outstanding posted further gains in Q2 2017, climbing to nearly USD11.0 trillion at the end of June. Quarter-on-quarter (q-o-q) growth was 3.3% in Q2 2017, up from 1.1% in the previous quarter. On a year-on-year (y-o-y) basis, growth slowed in Q2 2017 to 10.5% from 13.4% in the first quarter (Q1)

of 2017. The region's overall growth was largely driven by the PRC bond market, which is the largest bond market in emerging East Asia.

The region's LCY bond market remains dominated by government bonds, which totaled USD7.2 trillion and accounted for 65.9% of the regional LCY bond market at the end of June. The outstanding amount of LCY corporate bonds reached USD3.7 trillion at the end of June.

As a share of regional GDP, the size of emerging East Asia's LCY bond market inched up to 69.0% in Q2 2017 from 68.5% in Q1 2017. The Republic of Korea and Malaysia have the largest bond markets in the region relative to GDP.

In Q2 2017, total LCY bond issuance in emerging East Asia hit USD1.1 trillion, recording growth of 27.0% q-o-q. On a y-o-y basis, however, total LCY issuance fell 16.6%. Treasuries and other government securities (excluding central bank bonds) accounted for nearly half of the new bond issuance.

Foreign Investor Sentiment Remains Positive

Global growth momentum contributed to the positive investment sentiment toward emerging East Asian bond markets, resulting in increases in the shares of foreign holdings in Q2 2017 in all LCY government bond markets for which data are available.

Compared with the previous quarter, the foreign holdings' share rose by more than 1 percentage point in Indonesia, Malaysia, and Thailand to 39.5%, 27.0%, and 16.2%, respectively, at the end of June. In the PRC, while the foreign holdings' share remains relatively low, it has been on an upward trend since March 2016. Nonresident holdings in the Republic of Korea also inched up to a 10.8% share at the end of March, the latest period for which data are available.

¹ Emerging East Asia comprises the People's Republic of China; Hong Kong, China; Indonesia; the Republic of Korea; Malaysia; the Philippines; Singapore; Thailand; and Viet Nam.

The shares of foreign holdings in the region's LCY corporate bond markets remain at low levels relative to government bonds. In Indonesia, the foreign share stood at 6.3% of the total market at the end of June. In the PRC, foreign holdings accounted for less than 0.5% of the total corporate stock at the end of June. This share was even smaller in the Republic of Korea at less than 0.1% of the total at the end of March.

All four markets for which data are available—Indonesia, the Republic of Korea, Malaysia, and Thailand—posted positive foreign capital flows into their respective bond markets in Q2 2017, driven by improved investor sentiment.

Local Currency Bond Yields Edge Higher

Government bond yield curves shifted upward in most markets in emerging East Asia between 1 June and 15 August, following a rise in bond yields in major advanced economies. The three exceptions were Indonesia, Thailand, and Viet Nam. In the case of Indonesia and Thailand, strong demand from foreign investors pushed bond yields down, while yields in Viet Nam fell following a cut of 25 basis points in the policy rate by the central bank.

The 2-year versus 10-year yield spread widened in most markets in emerging East Asia between 1 June and 15 August. The exceptions were the Republic of Korea, Thailand, and Viet Nam.