Executive Summary

Bond Yields Decline in Emerging East Asia amid Uncertain Growth Prospects

Between 1 June and 15 August, local currency (LCY) government bond yields trended lower for most markets in emerging East Asia on account of dim global growth prospects, easing monetary policy stances, and investor flight for safe-haven assets.[1]

Downside risks are weighing on the region's economic prospects as the global growth outlook is expected to further weaken. Among headwinds, the largest risk stems from the persistent and intensifying trade tensions between the People's Republic of China (PRC) and the United States (US). Emerging East Asia is also sensitive to both a faster-than-expected economic slowdown in the PRC and a possible recession in the US. In addition, the regional trade environment faces challenges from rising tensions between Japan and the Republic of Korea.

Foreign Investor Sentiment Remains Positive in Regional Bond Markets

At the end of June, foreign investor holdings were mostly stable in emerging East Asian LCY bond markets on positive sentiment as the US Federal Reserve signaled a possible policy rate cut, which was subsequently announced on 31 July. The foreign holdings' share inched up in the PRC's LCY bond market on expectations the government will provide additional stimulus measures to prop up the economy. Indonesia also saw an increase in its foreign holdings' share on account of a ratings upgrade from S&P Global Ratings. In the Republic of Korea, Malaysia, and the Philippines, foreign holdings declined on a variety of domestic factors.

Local Currency Bonds Outstanding in Emerging East Asia Reach USD15.3 Trillion at the End of June

The amount of LCY bonds outstanding in emerging East Asia rose to USD15.3 trillion at the end of June, posting quarter-on-quarter (q-o-q) growth of 3.5% and year-on-year (y-o-y) growth of 14.2% in the second quarter (Q2) of 2019.

The PRC accounted for the largest share of the region's aggregate bond stock at the end of June with a 75.3% share of the total, followed by the Republic of Korea at 13.2%. The total bond stock of member economies of the Association of Southeast Asian Nations accounted for a 9.8% share of emerging East Asia's LCY bond total.[2]

The region's government bond stock reached USD9.4 trillion at the end of June on growth of 3.7% q-o-q and 13.6% y-o-y in Q2 2019, while the corporate bond stock rose to USD5.8 trillion on growth of 3.3% q-o-q and 15.0% y-o-y during the same period.

Emerging East Asia's LCY bonds outstanding as a share of regional gross domestic product climbed to 82.7% at the end of June from 81.4% at the end of March. On an individual economy basis, the Republic of Korea and Malaysia had the highest share of LCY bonds to gross domestic product in the region.

The region's total LCY bond issuance was USD1.6 trillion in Q2 2019, which represented growth of 12.2% q-o-q amid a recovery in corporate bond issuance and modest growth in government bond issuance. On a y-o-y basis, however, issuance growth moderated in Q2 2019 to 16.4% from 39.4% in the previous quarter.

[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.
[2] LCY bond statistics for the Association of Southeast Asian Nations include the markets of Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Viet Nam.

In August, the region saw the third company to have its bonds listed on the Cambodia Securities Exchange via the bond listing of Advanced Bank of Asia. The issuance comprised an KHR84.8 billion bond with a maturity of 3 years and an annual coupon rate of 7.75%.

The September issue of the *Asia Bond Monitor* features three special topic boxes. Box 1 analyzes the impact of US monetary policy uncertainty on emerging market currencies. Box 2 discusses the importance of domestic capital markets as a long-term financing source for corporates in emerging markets. Box 3 focuses on reform of the widely used benchmark rate in financial markets, the London Interbank Offered Rate (LIBOR), and discusses the challenges of transitioning to alternative benchmark interest rates.

Box 1: Impact of United States Monetary Policy Uncertainty on Emerging Asian Exchange Rates

Using a news-based index as a measure of US monetary policy uncertainty, this discussion box examines how US monetary policy uncertainty impacts the exchange rates of 10 Asian economies. Findings indicate that while the exchange rates of these economies are not systematically affected by US monetary policy uncertainty, exchange rate volatility increases in some economies amid greater uncertainty in US monetary policy. With increased uncertainty over the path of US interest rates comes a greater variety of opinions among market participants about exchange rate behavior, leading to more diverse trading, and thus, more volatile exchange rates.

Box 2: The Growing Importance of Domestic Capital Markets

This box examines the growth of domestic capital market financing vis-à-vis international market financing by firms in East Asia between 1990 and 2016. It finds that contrary to predictions, domestic capital market financing in East Asia has grown faster than international capital market financing since the 1990s, particularly since the global financial crisis. Based on the experiences of individual East Asian economies, the box highlights the benefits of developing domestic capital markets and draws lessons that can be applied to other emerging markets.

Box 3: Moving On from the London Interbank Offered Rate

This box provides an overview of the global regulatory effort to transition away from LIBOR, the widely used benchmark rate in global financial markets. Issues surrounding LIBOR have undermined its credibility and sustainability, resulting in concerted action among financial regulators to identify alternative risk-free rates (RFRs). This box summarizes the actions taken by the Financial Stability Board and the working groups established to review and reform benchmarks rates, and ultimately coordinate the worldwide transition to the use of alternative RFRs. The box also discusses the transitional challenges facing the global financial system in switching from LIBOR to alternative RFRs.