Global and Regional Market Developments

Financial conditions remain robust with some weakening signs amid heightened uncertainty on recovery prospects.

From 15 June to 27 August, financial conditions in emerging East Asia were largely robust amid accommodative policy stances, but some weakening signs were observed as a rise in COVID-19 cases cast a shadow on the pace of economic recovery (**Table A**).[1] Bond yields declined, equity indexes dropped, and currencies depreciated in emerging East Asia. While liquidity conditions remained accommodative, a decrease in long-term bond yields signaled that the region's economic activities and outlook had been negatively affected by the rising COVID-19 cases and looming uncertainties in the economic recovery.

From 15 June to 27 August, 10-year government bond yields in major advanced economies trended downward (**Figure A**). This tracked investor concerns about the uneven global recovery amid rising cases worldwide (**Box 1**).

The United States (US) Federal Reserve affirmed that the US economy had made substantial progress toward recovery. The unemployment rate fell to 5.2% in August from 5.4% in July and 5.9% in June. However, nonfarm payroll additions fell to 235,000 in August from 1,053,000 in July and from 962,000 in June. US gross domestic product (GDP) growth also accelerated to an annual rate of 6.6% in the second quarter (Q2) of 2021 from 6.3% in the first quarter (Q1) of 2021 and

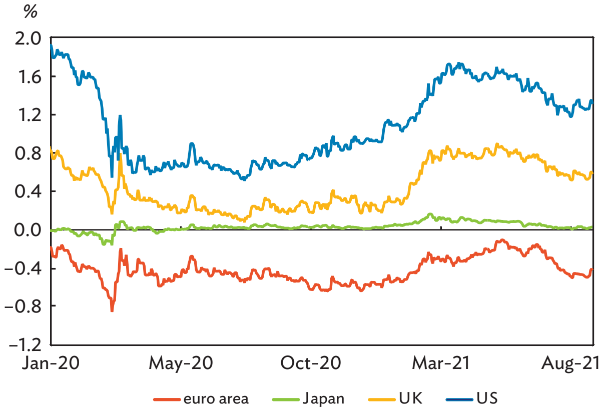
Table A: Changes in Global Financial Conditions

	2-Year Government Bond (bps)	10-Year Government Bond (bps)	5-Year Credit Default Swap Spread (bps)	Equity Index (%)	FX Rate (%)
Major Advanced Economies					
United States	5	(19)	–	6.2	–
United Kingdom	4	(18)	(0.7)	(0.3)	(2.3)
Japan	0.7	(2)	0.8	(2.8)	0.2
Germany	(6)	(19)	(0.5)	0.8	(2.7)
Emerging East Asia					
China, People's Rep. of	(26)	(27)	(2)	(1.0)	(1.0)
Hong Kong, China	3	(7)	–	(11.3)	(0.3)
Indonesia	(31)	(23)	(2)	(0.8)	(1.3)
Korea, Rep. of	9	(15)	(0.5)	(3.8)	(4.5)
Malaysia	(5)	(4)	3	0.6	(1.8)
Philippines	(7)	25	3	(2.7)	(3.8)
Singapore	3	3	–	(3.0)	(1.4)
Thailand	(2)	(23)	(2)	(0.7)	(4.2)
Viet Nam	(3)	(11)	(4)	(4.0)	0.8
Others					
Brazil	(49)	21	2	5.3	(0.5)
India	188	111	15	(7.2)	(3.0)
Mexico	55	28	(5)	3.0	(0.9)
Russian Federation	31	(23)	(8)	1.7	(1.7)
South Africa	(11)	3	4	0.5	(6.5)
Turkey	(5)	(81)	(18)	1.4	2.5

( ) = negative, – = not available, bps = basis points, FX = foreign exchange.
Notes:
1. Data reflect changes between 15 June 2021 and 27 August 2021.
2. A positive (negative) value for the FX rate indicates the appreciation (depreciation) of the local currency against the United States dollar.
Source: Bloomberg LP.

[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.

Figure A: 10-Year Government Bond Yields in Major Advanced Economies (% per annum)



UK = United Kingdom, US = United States.
Note: Data coverage is from 1 January 2020 to 27 August 2021.
Source: Bloomberg LP.

4.5% in the fourth quarter of 2020. The Federal Reserve upgraded its March forecasts for 2021 GDP growth from an annual rate of 6.5% to 7.0% at its Federal Open Market Committee meeting in June. The projection for personal consumption expenditure inflation was adjusted from 2.4% year-on-year (y-o-y) to 3.4% y-o-y. It also forecast a 50 basis points (bps) rate hike in 2023, which was earlier than markets had been expecting. During its July meeting, the Federal Reserve implied there would be further discussion on tapering the current asset purchase program at subsequent meetings. While the current policy rate and asset purchase program remained unchanged, the 2-year yield rose 5 bps on the hawkish statement from the Federal Reserve.

Despite the strong rebound in the US economy, an unchanged federal funds target range, and possible tapering either later this year or early next year, the 10-year yield declined significantly by 19 bps from 15 June to 27 August. The decline in the bond yield partly reflected heightened concerns over the global economic recovery amid the surge of COVID-19 cases and the reimposition of mobility control measures in some markets. Also, the University of Michigan's consumer sentiment index fell from 81.2 in July to 70.3 in August, the lowest reading since December 2011.

In the euro area, GDP growth surged to 14.3% y-o-y in Q2 2021 from a decline of 1.2% y-o-y in the previous quarter. The European Central Bank (ECB) upgraded its 2021 and 2022 GDP forecasts in June to 4.6% and 4.7%, respectively, from its March forecasts of 4.0% and 4.1%. The ECB's inflation forecasts were also adjusted higher in June to 1.9% for 2021 and 1.5% for 2022 from the March forecasts of 1.5% and 1.2%, respectively. More importantly, the ECB adjusted its forward guidance and shifted its inflation target from close to 2.0% to a symmetric inflation target of 2.0%. This shift offers the ECB the flexibility to allow inflation to temporarily run above 2.0% to sustain the economic recovery. Nevertheless, long-term bond yields declined during the review period over concerns about the trajectory of the global economic recovery. Meanwhile, the ECB has maintained an accommodative monetary stance and the liquidity conditions necessary to support economic recovery. At its 22 July monetary policy meeting, it maintained key policy rates and left the existing asset purchase program unchanged. The ECB also reiterated that it expected to conduct asset purchases at a higher volume in the third quarter of 2021 than in prior quarters.

The Bank of Japan (BOJ) noted that while the domestic economy was recovering, growth remained fragile. Japan recorded an annualized GDP growth of 1.3% in Q2 2021, reversing a contraction of 3.7% in Q1 2021. During its June meeting, the BOJ left unchanged its short-term policy rate target of −0.1% and its 10-year Japan Government Bond yield target of 0.0%. It also maintained the current asset purchase program and extended the duration of the purchase of commercial paper and corporate bonds from September 2021 to March 2022. The BOJ kept its monetary policies unchanged at its July meeting and slightly downgraded its 2021 GDP growth forecast to 3.8% from its April forecast of 4.0%, while it upgraded its 2022 forecast to 2.7% from 2.4%.

Similar to advanced economies, emerging East Asian markets witnessed declines in 2-year and 10-year government bond yields between 15 June and 27 August, as economic activity and the recovery outlook were affected by the reintroduction of mobility restriction measures amid rising COVID-19 cases in many regional markets (**Figure B**). As shown in Table A, all regional markets experienced a decline in 10-year government bond yields except for the Philippines and Singapore. The 10-year yield rose in the Philippines as the economy recorded 11.8% y-o-y GDP growth in Q2 2021 after a decline of 3.9% y-o-y in Q1 2021. On 10 August, the Bangko Sentral ng Pilipinas said that it had yet to consider reducing the reserve requirement ratio. Inflation in the

Box 1: Economic Outlook—Strong but Divergent Economic Recovery

COVID-19 vaccination campaigns are under way around the world, but there are substantial differences across regions and economies.[a] A global vaccine divide is emerging between advanced and developing economies, with the former making much faster progress on the vaccination front. However, due to the highly contagious nature of COVID-19, which can easily spread across borders, not even advanced economies will be immune from major renewed outbreaks until the world as a whole reaches a sufficient level of herd immunity. This strengthens the case for reinforcing international cooperation to increase the supply of vaccines to poor, developing economies.

Notwithstanding the stark global vaccine divide, there has been steady, albeit gradual, progress toward global herd immunity. As of 16 August, 4.71 billion vaccine doses had been administered across 183 economies, according to Bloomberg.[b] This was enough to fully vaccinate 30.7% of the global population. The global vaccination rate at the time of writing stood at around 38.2 million doses administered globally per day. At this pace, it will take until February 2022 for 75% of the global population to be vaccinated.

While the COVID-19 vaccination campaign is by far the largest in history, the impressive overall progress in global vaccination masks a lopsided gap in the global distribution of vaccines. Specifically, the regions and economies with the highest income levels are vaccinating their populations more than 20 times faster than the regions and economies with the lowest income levels.

Due to the progress in the global vaccination campaign against COVID-19, both business and consumer confidence have continued to strengthen. More concretely, while there have been some major outbreaks around the world in 2021, most notably in India in March, the overall COVID-19 landscape has become more benign. In response to the improving pandemic situation, in its latest July 2021 *World Economic Outlook Update*, the International Monetary Fund (IMF) projected global economic growth of 6.0% in 2021, following a contraction of 3.2% in 2020 and modest growth of 2.8% in 2019. In 2022, global growth is projected to moderate to 4.9%. The exceptionally high global growth forecasts for 2021 and 2022 reflect a large base effect (i.e., the fact that 2020 was an exceptionally bad year for growth due to the pandemic). The IMF's July gross domestic product growth forecasts for advanced economies are 5.6% in 2021 and 4.4% in 2022, which are 0.5 percentage points and 0.8 percentage points higher, respectively, than the IMF's April forecasts. The sizable upgrading reflects the rapid progress of vaccination and the consequent normalization of the economy. The corresponding growth figures for emerging markets and developing economies are 6.3% in 2021 and 5.2% in 2022. The slower pace of vaccination in these economies rules out any substantial upgrade. In fact, there was a downgrade of 0.4 percentage points relative to the IMF's April forecast for 2021, while there was a modest upgrade of 0.2 percentage points for 2022.

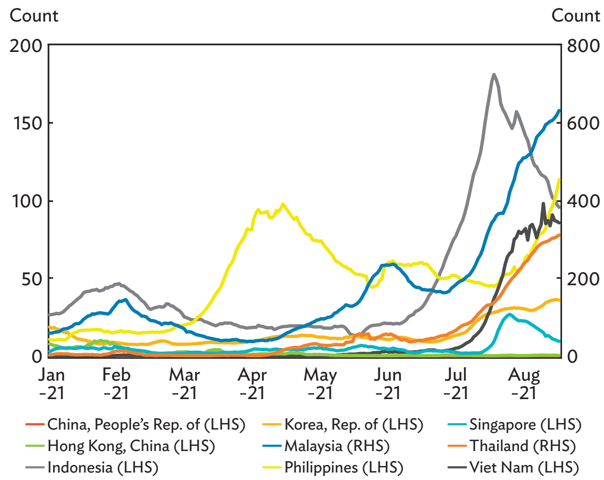
The growth forecasts for emerging East Asia show a similarly mixed pattern. According to the Asian Development Bank's July 2021 *Asian Development Outlook Supplement*, developing Asia is poised to grow a robust 7.2% in 2021 before growth moderates to 5.4% in 2022. The 2021 and 2022 forecasts represent a downgrade and upgrade, respectively, of 0.1 percentage points each from the Asian Development Bank's April forecast. While many parts of developing Asia have suffered major renewed COVID-19 outbreaks in 2021, the overall impact on growth has been limited.

Within emerging East Asia, there is a clear dichotomy between East Asia and Southeast Asia. For example, the People's Republic of China; Hong Kong, China; the Republic of Korea; and Taipei,China are projected to grow a combined 7.5% in 2021 and 5.1% in 2022. In fact, the economy-level growth forecasts of the Republic of Korea and Hong Kong, China have been upgraded by 0.5 percentage points and 1.6 percentage points, respectively, relative to April forecasts. Both are export-driven economies that are benefiting greatly from the robust rebound in global trade. On the other hand, many member economies of the Association of Southeast Asian Nations (ASEAN) have suffered a major COVID-19 outbreak in 2021, forcing them to impose various social distancing restrictions. According to the *Asian Development Outlook Supplement*, the aggregate gross domestic product of ASEAN members is projected to expand 4.0% in 2021, a downgrade of 0.4 percentage points from April, and 5.2% in 2022, a marginal upgrade of 0.1 percentage points.

The short-term economic outlook for emerging East Asia is positive but fraught with a great deal of uncertainty. A surge in COVID-19 cases in major ASEAN economies—such as Indonesia, Malaysia, the Philippines, Thailand, and Viet Nam—has highlighted the vulnerability of economic recovery to renewed pandemic outbreaks. The region will enjoy a broad-based recovery in which strong domestic demand complements robust exports only when it brings the pandemic under some degree of control.

[a] This box was written by Donghyun Park (principal economist) in the Economic Research and Regional Cooperation Department of the Asian Development Bank.
[b] Bloomberg. COVID-19 Tracker. https://www.bloomberg.com/graphics/covid-vaccine-tracker-global-distribution/ (accessed 16 August 2021).

Figure B: 7-Day Smoothed New COVID-19 Cases per Million Population in Emerging East Asia



LHS = left-hand, RHS = right-hand side.
Note: Data coverage is from 1 January to 27 August 2021.
Source: Our World In Data. https://ourworldindata.org/coronavirus (accessed 27 August 2021).

Philippines also remains elevated, and while it has trended downward in June, it spiked again to 4.9% y-o-y in August. (**Table B**).

While regional liquidity conditions were kept largely accommodative and monetary stances remained unchanged, 2-year government bond yields were mostly stable except in the People's Republic of China (PRC) and Indonesia. The PRC recorded declines in both its 2-year and 10-year government bond yields despite reporting GDP growth of 7.9% y-o-y in Q2 2021. The declines were largely driven by a 50-bps reduction in the reserve requirement ratio on 9 July to help support the economy. Indonesia's 2-year bond yield declined following the announcement by Bank Indonesia that it would continue to purchase up to IDR215 trillion of government bonds directly from the government this year. The debt-burden sharing agreement will also be extended until 2022 with planned purchases of up to IDR224 trillion. Bank Indonesia's bond buying program aims to keep interest rates low, facilitate market liquidity, and support government financing.

Consistent with lower long-term bond yields, regional equities and currencies also weakened during the review period. All regional equity markets posted losses from 15 June to 27 August except for Malaysia, which recorded a marginal gain of 0.6% (**Figure C**). The largest equity market decline was in Hong Kong, China (11.3%) as its equity market was negatively affected by PRC regulators' crackdown on various industries such as technology, gaming, and education.

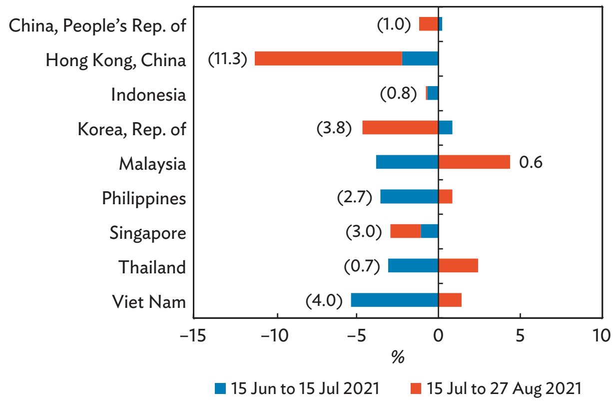
All regional currencies weakened versus the US dollar during the review period except for the Vietnamese dong, which gained a marginal 0.8% (**Figure D**). This, on the

Table B: Inflation in Major Advanced Markets and Emerging East Asia

	Inflation Rate (%)												
Economy	Jul-2020	Aug-2020	Sep-2020	Oct-2020	Nov-2020	Dec-2020	Jan-2021	Feb-2021	Mar-2021	Apr-2021	May-2021	Jun-2021	Jul-2021
United States	1.00	1.30	1.40	1.20	1.20	1.40	1.40	1.70	2.60	4.20	5.00	5.40	5.40
Euro Area	0.40	(0.20)	(0.30)	(0.30)	(0.30)	(0.30)	0.90	0.90	1.30	1.60	2.00	1.90	2.20
Japan	0.30	0.20	0.00	(0.40)	(0.90)	(1.20)	(0.70)	(0.50)	(0.40)	(1.10)	(0.80)	(0.50)	(0.30)
China, People's Rep. of	2.70	2.40	1.70	0.50	(0.50)	0.20	(0.30)	(0.20)	0.40	0.90	1.30	1.10	1.00
Hong Kong, China	(2.30)	(0.40)	(2.20)	(0.40)	(0.30)	(1.00)	2.60	0.50	0.60	0.80	1.00	0.70	3.70
Indonesia	1.54	1.32	1.42	1.44	1.59	1.68	1.55	1.38	1.37	1.42	1.68	1.33	1.52
Korea, Rep. of	0.30	0.70	1.00	0.10	0.60	0.50	0.60	1.10	1.50	2.30	2.60	2.40	2.60
Malaysia	(1.30)	(1.40)	(1.40)	(1.50)	(1.70)	(1.40)	(0.20)	0.10	1.70	4.70	4.40	3.40	2.20
Philippines	2.70	2.40	2.30	2.50	3.30	3.50	4.20	4.70	4.50	4.50	4.50	4.10	4.00
Singapore	(0.40)	(0.40)	0.00	(0.20)	(0.10)	0.00	0.20	0.70	1.30	2.10	2.40	2.40	2.50
Thailand	(0.98)	(0.50)	(0.70)	(0.50)	(0.41)	(0.27)	(0.34)	(1.17)	(0.08)	3.41	2.44	1.25	0.45
Viet Nam	3.39	3.18	2.98	2.47	1.48	0.19	(0.97)	0.70	1.16	2.70	2.90	2.41	2.64

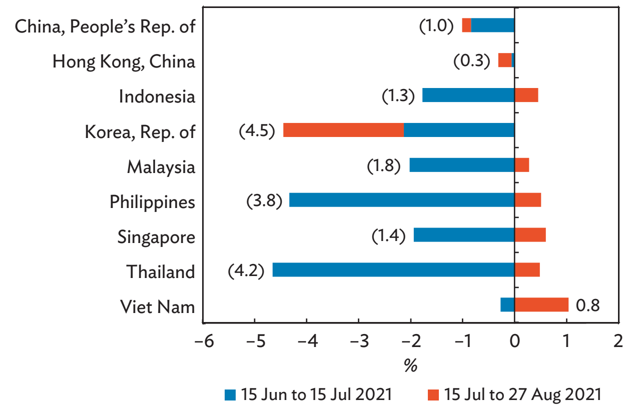
( ) = negative.
Note: Data coverage is from July 2020 to July 2021.
Sources: Various local sources.

Figure C: Changes in Equity Indexes in Emerging East Asia



( ) = negative.
Notes:
1. Changes from 15 June to 15 July 2021 and from 15 July to 27 August 2021.
2. Figures on the chart refer to the net change between the two periods.
Source: *AsianBondsOnline* computations based on Bloomberg LP data.

Figure D: Changes in Spot Exchange Rates versus the United States Dollar



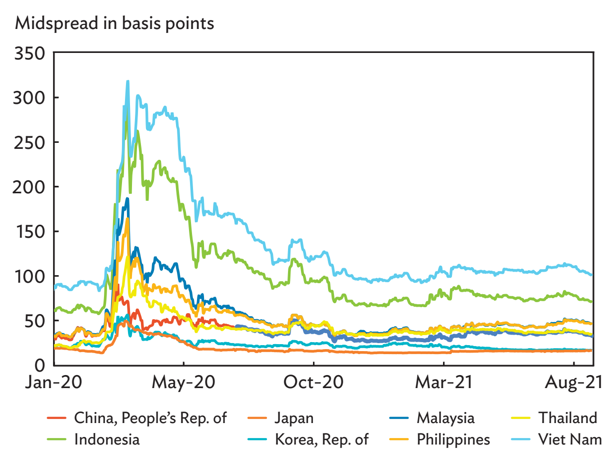
Notes:
1. Changes from 15 June to 15 July 2021 and from 15 July to 27 August 2021.
2. Figures on the chart refer to the net change between the two periods.
3. A positive (negative) value for the foreign exchange rate indicates the appreciation (depreciation) of the local currency against the United States dollar.
Source: *AsianBondsOnline* computations based on Bloomberg LP data.

one hand, reflected a broad strengthening of the US dollar that was driven by a strong economic rebound and the possibility of earlier-than-expected monetary tightening. On the other hand, there was fickle sentiment with regard to risky assets in the region as surging cases weighed on the economic recovery outlook. During the review period, the Korean won weakened the most among all emerging East Asian currencies, partly driven by foreign portfolio outflows in its equity market. The Thai baht also depreciated 4.2% as surging COVID-19 cases loomed over the recovery in the domestic economy, which is largely dependent on tourism and trade. The National Economic and Social Development Council expects tourist visitors in Thailand to reach only 0.15 million in 2021, down from earlier projections of 0.50 million. In 2019, Thailand recorded close to 40 million tourist arrivals.

As shown in Table A, risk premiums in the region remained largely stable with only marginal changes during the review period. Credit default swaps and sovereign stripped spreads trended slightly upward in June, as the Federal Reserve implied there might be a shift in its monetary stance and outbreaks of new COVID-19 cases emerged across the region (**Figures E.1** and **E.2**). Some improvements in credit default swaps were recorded in July and August as many markets released relatively better Q2 2021 GDP figures.

Fickle global investment sentiment was evident in capital flow patterns during the first half of 2021. As shown in

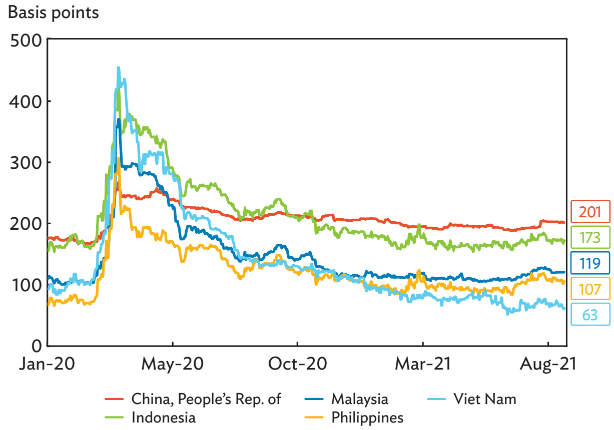
Figure E.1: Credit Default Swap Spreads in Select Asian Markets (senior 5-year)



USD = United States dollar.
Notes:
1. Based on USD-denominated sovereign bonds.
2. Data coverage is from 1 January 2020 to 27 August 2021.
Source: Bloomberg LP.

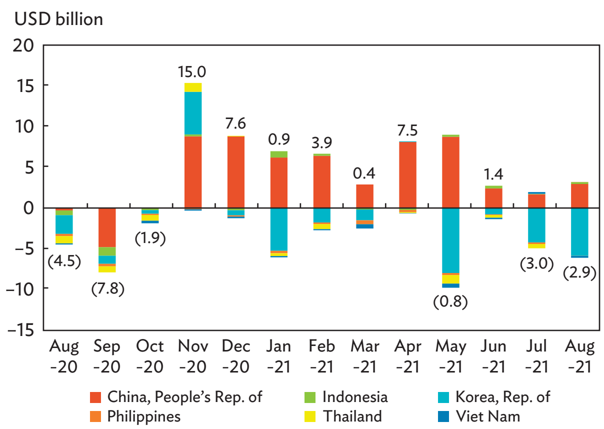
Figures F and **G**, capital outflows have been recorded in regional financial markets around global shocks. In late Q1 2021 and May, capital outflows were recorded in many regional bond and equity markets over concerns of rising US inflation and bond yields, as well as earlier-than-expected monetary normalization by the Federal Reserve. In June and July, capital outflows were observed in

Figure E.2: JP Morgan Emerging Markets Bond Index Sovereign Stripped Spreads



USD = United States dollar.
Notes:
1. Based on USD-denominated sovereign bonds.
2. Data coverage is from 1 January 2020 to 27 August 2021.
Source: Bloomberg LP.

Figure G: Capital Flows into Equity Markets in Emerging East Asia

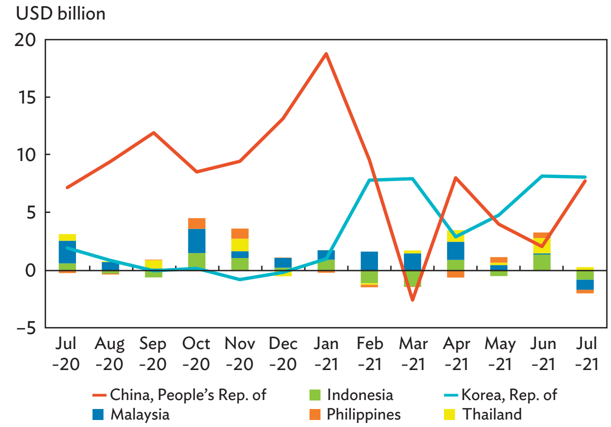


( ) = outflows, USD = United States dollar.
Notes:
1. Data coverage is from 1 August 2020 to 27 August 2021.
2. Figures refer to net inflows (net outflows) for each month.
Source: Institute of International Finance.

many Association of Southeast Asian Nations (ASEAN) markets, tracking a strong US economic rebound as well as looming uncertainty over the regional economic recovery amid rising COVID-19 cases (**Figure H**). Between June and July, the share of foreign holdings fell in nearly all markets, except in the PRC.

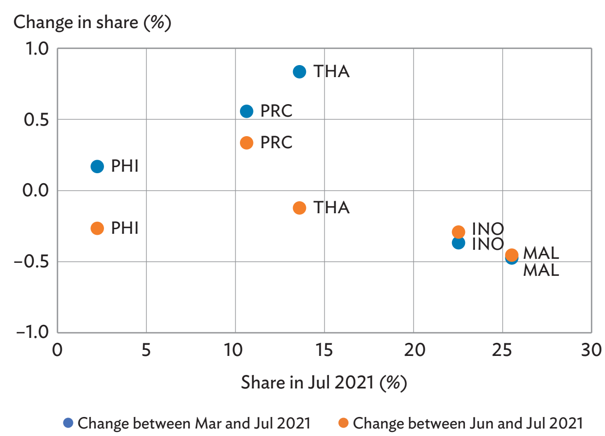
During the recent period of uncertainty, the domestic investor base in emerging East Asian markets played an important role in supporting local currency (LCY) bond

Figure F: Foreign Capital Flows in Local Currency Bond Markets in Emerging East Asia



USD = United States dollar.
Notes:
1. The Republic of Korea and Thailand provided data on bond flows. For the PRC, Indonesia, Malaysia, and the Philippines, month-on-month changes in foreign holdings of LCY government bonds were used as a proxy for bond flows.
2. Data as of 31 July 2021.
3. Figures were computed based on 31 July 2021 exchange rates to avoid currency effects.
Sources: People's Republic of China (*Wind Information*); Indonesia (Directorate General of Budget Financing and Risk Management, Ministry of Finance); Republic of Korea (Financial Supervisory Service); Malaysia (Bank Negara Malaysia); Philippines (Bureau of the Treasury); and Thailand (Thai Bond Market Association).

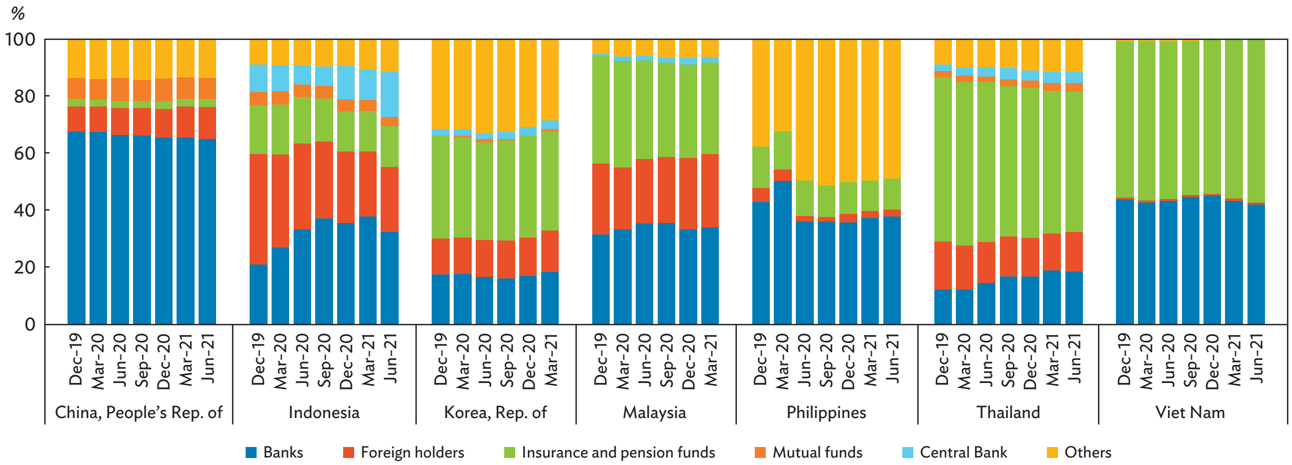
Figure H: Foreign Holdings Share in Local Currency Government Bond Markets in Select Emerging East Asian Economies



INO = Indonesia, MAL = Malaysia, PHI = Philippines, PRC = People's Republic of China, THA = Thailand.
Note: Data coverage is from March to July 2021.
Source: *AsianBondsOnline*.

markets (**Figure I**). During the pandemic, a number of markets have seen increased ownership of bonds by domestic financial institutions, particularly banks, highlighting the importance of further broadening the domestic investor base. The low bond yields amid

Figure I: Investor Profiles of Local Currency Government Bonds in Select Emerging East Asian Markets



Notes:
1. Data coverage is from December 2019 to June 2021 except for the Republic of Korea and Malaysia (March 2021).
2. Others include central banks, governments, individuals, securities companies, custodians, private corporations, and all other investors not elsewhere classified.
Source: *AsianBondsOnline*.

expanding bond markets implied that the region's bond markets still have reasonable market capacity. Notably during the pandemic, a few emerging East Asian central banks conducted small-scale asset purchase programs to support LCY bond market functioning and facilitate monetary policy implementation. The central banks of Indonesia, the Republic of Korea, Malaysia, the Philippines, and Thailand each increased their respective holdings of LCY government bonds. **Box 2** discusses market capacity and LCY asset purchase programs in the region.

Risks to Outlook: Downside Risks Outweigh Upside Risks

The short-term economic outlook for the world and emerging East Asia is clearly positive. The global and regional economies are recovering strongly from the sharp pandemic-induced downturn of 2020, albeit at divergent speeds across subregions and economies. Despite the overall bright outlook, downside risks continue to outweigh upside risks, thanks largely to the persistent uncertainty surrounding the trajectory of the COVID-19 pandemic. Beyond the short-term, there is also a great deal of uncertainty about the contours of the societies and economies that will emerge as COVID-19 recedes. For example, will education and international travel be permanently affected? If so, in what ways?

There are also some upside risks related to COVID-19, especially in the short-term. In particular, global cooperation may speed up the achievement of global herd immunity against the disease. As noted earlier, there is a stark divide between advanced economies and developing economies, with vaccination rates far higher in the former than in the latter. Advanced economies have more vaccines than they can use, while developing economies are suffering severe shortages. However, global herd immunity mandates that all economies, regardless of income level, be adequately vaccinated. If the advanced economies muster the political will to help increase the supply of vaccines to developing economies, they will not only help the world but also help themselves. If this were to happen, we can expect a big boost to global economic growth.

The more immediate risk pertaining to COVID-19 is tilted to the downside. In March, India suffered a massive new outbreak that had a substantial impact on private consumption and domestic demand. As a result, in July the Asian Development Bank downgraded its 2021 growth forecast for India from its April forecast. India has managed to contain the outbreak in recent months, primarily by ramping up the production and administration of vaccines, and its economic prospects are improving again. On the other hand, members of ASEAN have suffered major outbreaks since June, with many economies imposing quarantines and movement restrictions. The reduction of mobility has had a palpable impact on domestic demand and economic growth, which is why the Asian Development Bank downgraded the region's GDP growth forecast for 2021 from 4.4% to 4.0%.

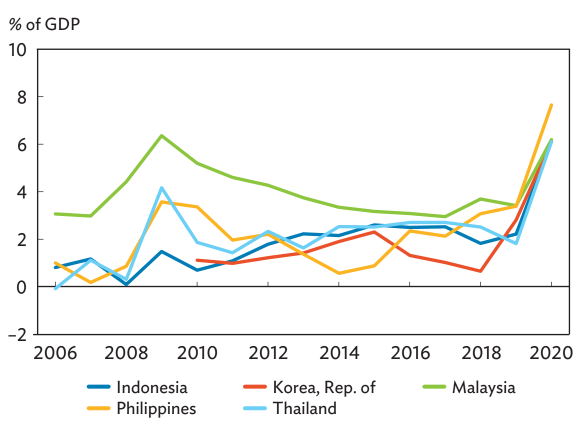
Box 2: Market Capacity and Asset Purchasing Programs in Emerging East Asian Bond Markets

A number of governments in emerging East Asia are facing increased budget funding needs due to the COVID-19 pandemic.[a] Fiscal deficits have risen as a result of the combination of reduced tax revenues due to decreased economic activity and rising expenditures needed to support recovery and mitigate the impacts of the pandemic (**Figure B2.1**). In response, many regional governments, particularly members of the Association of Southeast Asian Nations, have tapped local currency (LCY) bond markets in search of financing, as evidenced by increased LCY government bond issuance in 2020 and the first half of 2021 compared to pre-pandemic levels (**Figure B2.2**).

Concerns over uncertainty in emerging East Asia's economic recovery amid the ongoing pandemic, a strong economic rebound and rising inflation in the United States (US), and the potential for earlier-than-expected changes in monetary stances in advanced economies (particularly by the US Federal Reserve) have led to intermittent foreign portfolio outflows from the region's equity and bond markets (**Figure B2.3**). While foreign investors can be fickle and their holdings dependent upon sudden changes in sentiment, emerging East Asia's domestic financial institutions, particularly commercial banks, have supported regional LCY bond markets during the pandemic (**Figure B2.4**).

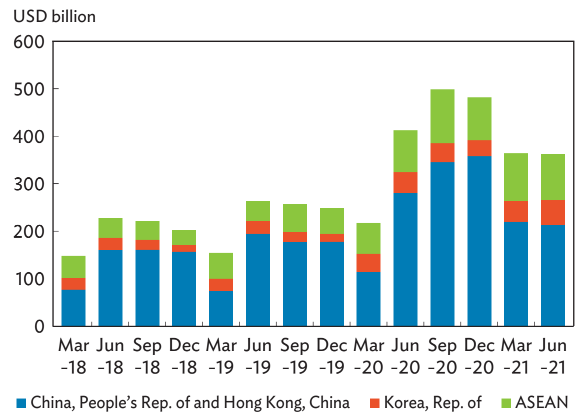
To facilitate the functioning of LCY bond markets, some emerging East Asian central banks deployed modest asset purchases program (i.e., "quantitative easing [QE]-like" programs) for the first time with policy rates well above zero (**Figure B2.5**). Regional central banks have implemented such asset purchase programs to improve

Figure B2.1: Fiscal Deficit in Select Emerging East Asian Markets



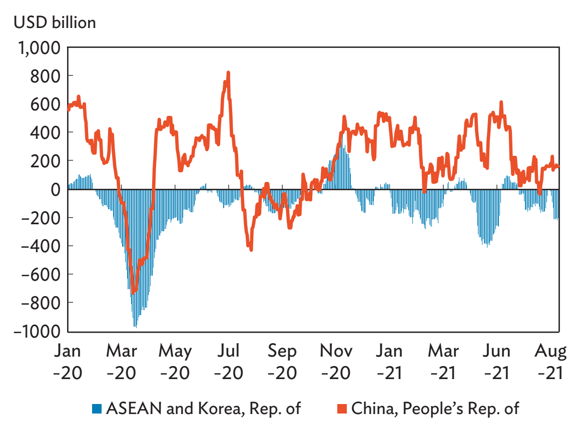
GDP = gross domestic product.
Sources: *Asian Development Outlook Database*; Haver Analytics (accessed 19 August 2021).

Figure B2.2: Quarterly Treasury Bond Issuance



ASEAN = Association of Southeast Asian Nations, USD = United States dollar.
Notes:
1. Data include Treasury bills and bonds and are computed based on the 30 June 2021 exchange rate.
2. ASEAN comprises Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Viet Nam.
Source: *AsianBondsOnline*.

Figure B2.3: Foreign Portfolio Flows



ASEAN = Association of Southeast Asian Nations, USD = United States dollar.
Notes:
1. Data for ASEAN and the Republic of Korea includes Indonesia, the Republic of Korea, Malaysia, the Philippines, Thailand, and Viet Nam.
2. Figures are based on 28-day moving average.
Source: *AsianBondsOnline* computations based on data from the Institute of International Finance (accessed 23 August 2021).

[a] This box was written by Shu Tian (Economist) in the Economic Research and Regional Cooperation Department of the Asian Development Bank.

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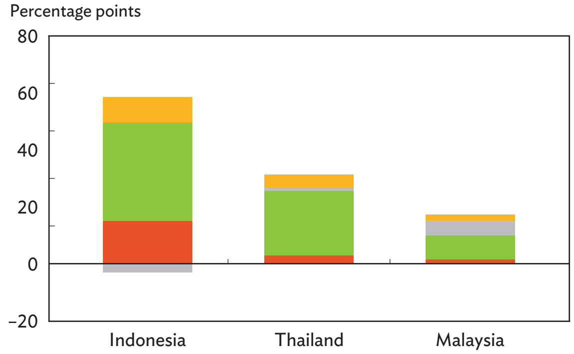
Box 2: Market Capacity and Asset Purchasing Programs in Emerging East Asian Bond Markets

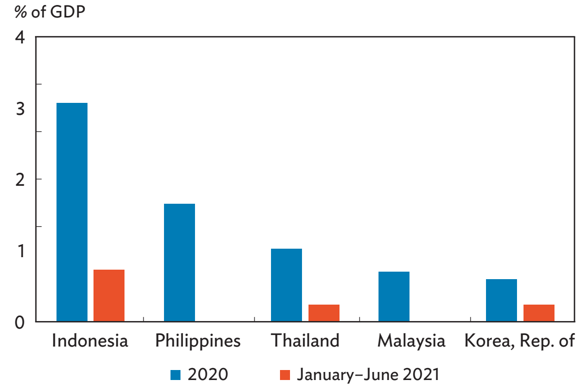
continued

Figure B2.4: Contributions to Change in Local Currency Government Bond Holdings between December 2019 and June 2021



Note: For Malaysia, data are from December 2019 to March 2021.
Sources: Indonesia (Directorate General of Budget Financing and Risk Management, Ministry of Finance); Malaysia (Bank Negara Malaysia); and Thailand (Bank of Thailand).

Figure B2.5: Central Bank Local Currency Bond Purchase Programs in Emerging East Asia



GDP = gross domestic product.
Notes:
1. Share to GDP is based on 2020 GDP.
2. For Indonesia, data for 2021 cover the period 1 January–15 June 2021.
3. Data for Malaysia and the Philippines for the period January to June 2021 are not available.

Sources: National sources and Haver Analytics (accessed 20 August 2021).

bond market liquidity and bolster private investor confidence. Some central banks, such as Bank Indonesia and the Bangko Sentral ng Pilipinas, are also aiming to temporarily ease their respective government's financing pressures.

These asset purchase programs, while not large in scale, have helped stabilize LCY bond markets and kept long-term bond yields low to facilitate the effectiveness of policy rate cuts. Amid market conditions that include adequate foreign exchange reserves, a manageable current account, fair currency valuation, and relatively low inflation risk, these asset purchase programs have been effective as additional tools to complement conventional monetary policy.

With support from domestic investor bases and central banks, interest rate movements in the region in 2020 and the first half of 2021 largely exhibited downward trends, suggesting that there is market capacity to absorb new bond issuances. In 2021, economic reopening and recovery in most regional markets should help narrow budget deficits and free up liquidity to support market capacity. Most regional economies are planning to reduce their budget deficits in 2021, as evidenced by a decline in central bank asset purchases in the first half of 2021.[b]

While these asset purchases are relatively small in scale and function, regional authorities still need to be aware of possible associated risks. A key difference between QE in advanced markets and the asset purchase programs conducted in the region is that QE programs in advanced economies are in G3 currencies (US dollars, euros, or Japanese yen). This implies that there is always demand from global investors for such currencies that act as a "safe haven" and even enjoy increased demand during shocks and market turmoil. On the other hand, LCY asset purchase programs in emerging East Asia target largely domestic investors and these assets will have reduced demand when investment sentiment sours during periods of market turmoil.

Favorable market conditions in emerging East Asia—such as sufficient foreign reserves, robust current account performances, moderate inflation levels, and fair currency valuations—have all contributed to the successful functioning of asset purchase programs in the region. In the unlikely

[b] For example, the People's Republic of China aims to reduce its budget deficit from above 3.6% of GDP in 2020 to 3.2% in 2021, Indonesia is targeting a 5.7% budget-deficit-to-GDP ratio in 2021 versus an actual 6.1% ratio in 2020, and Viet Nam aims for a budget deficit of 4.0% of GDP in 2021 from an estimated 5.0%–5.6% in 2020. Singapore aims for a budget deficit of 2.1% of GDP in 2021 versus 13.9% in 2020 and is drawing upon its reserves to pay for pandemic support measures. Malaysia expects to maintain a budget deficit equivalent to 6.0% of GDP in 2021, similar to 2020. On the other hand, a few markets are raising their budget-deficit-to-GDP target level in 2021. For example, the Philippines has set a budget deficit target of 8.9% of GDP in 2021, up from 7.5% in 2020, and Thailand plans a budget deficit of 3.7% of GDP for fiscal year 2021, compared with 5.0% for fiscal year 2020.

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Box 2: Market Capacity and Asset Purchasing Programs in Emerging East Asian Bond Markets

continued

case that some of these fundamental economic factors change in the future in a particular market, an asset purchase program might trigger inflation fears, capital outflows, and currency depreciation. While these potential risks have yet to materialize, especially given the small scale of these programs, market conditions should be continuously monitored to avoid a buildup of stress in the region's financial systems.

Transparency and communication with investors on these measures are needed to maintain market confidence and central bank credibility. Authorities must also maintain the ability to make policy adjustments and smoothly reverse these programs, if necessary, without causing big swings in either interest rates or the exchange rate.

The ups and downs in the growth trajectory of the Indian and ASEAN economies suggest that Asia and the Pacific has not yet reached a post-COVID-19 normal. Instead, the short-term economic outlook remains hostage to the vagaries of the pandemic. Greater uncertainty in the economic recovery requires more attention be given to monitoring financial stability, particularly with the rapid buildup of private debt before the pandemic. The Bank of Korea hiked the base rate on 26 August to curb debt expansion.

A potential tightening of global financial conditions, which remain relatively benign at the moment, cannot be completely ruled out. Early monetary policy normalization by the Federal Reserve could lead to discrepancies in monetary stances between the US and the region. This would weaken the attractiveness of regional assets, which could lead to capital outflows and put pressure on regional currencies. Currency stress would increase debt burdens on external debt, especially in regional markets with higher external debt exposure. However, the risk to emerging East Asia's financial stability from monetary tightening in advanced economies, especially the US, remains relatively limited. Above all, any shift in the Federal Reserve's monetary policy is likely to be gradual and measured rather than abrupt and unexpected. A clear sign of the Federal Reserve's cautious approach to normalization came at its 27–28 July meeting, when it kept the federal funds rate at between 0.0% and 0.25%. The decision to hold the rate steady largely reflected its assessment of the US economy, which is recovering at a healthy pace thanks to impressive vaccination progress and an aggregate USD3 trillion of fiscal stimulus in response to the pandemic. However, a strong US economic recovery may eventually push up US government bond yields, which would spillover to emerging East Asia and raise regional financing and refinancing costs even in local currencies. Nevertheless, the seemingly strong domestic economy in the US is also subject to a lot of uncertainty, primarily due to the risk of renewed COVID-19 outbreaks. This explains why the Federal Reserve is prioritizing economic growth over inflationary pressures.

Equally important, emerging East Asian economies are recovering strongly, albeit at different speeds. They have strong fundamentals, including ample foreign exchange reserves; low inflation; and sound current account balances. Resilient economies and strong fundamentals place the region in good stead in the event of any possible turmoil that emanates from outside the region. To sum up, notwithstanding the positive short-term economic outlook, risks remain tilted to the downside. Furthermore, the overarching downside risk is still the heavy fog of uncertainty surrounding COVID-19.

As the pandemic calls for more financing resources, debt levels have risen in regional markets. **Box 3** discusses debt levels and ongoing debt expansions in the region. While the region's current debt levels are not overly concerning, there are still a few risks, which means that authorities need to conduct frequent assessments and monitoring. Moreover, long-term bonds account for the majority of LCY bonds outstanding in the region, particularly among members of ASEAN, which suggests that LCY bond markets are contributing to greater resilience via more long-term financing (**Figures J.1** and **J.2**).

The COVID-19 pandemic has raised awareness of social issues and related market risks arising during the pursuit of a resilient and inclusive recovery. This poses new challenges and opportunities for regional investors. **Box 4** discusses emerging social risks and related opportunities that investors face in the era of greater social awareness.

Box 3: Debt Buildup during the Pandemic in Emerging East Asia

During the decade after the global financial crisis (GFC), sustained low interest rates spurred a debt buildup in both the public and private sectors in global emerging markets.[a] With the onset of COVID-19, additional financing needed to fight the pandemic and interest rate cuts by major central banks have further pushed up debt levels in most economies around the world. While global monetary stances have largely remained accommodative, it is important to assess the current debt buildup situation in emerging East Asian economies and how concerning it could be, especially with possible early monetary policy normalization led by the United States (US) Federal Reserve.[b]

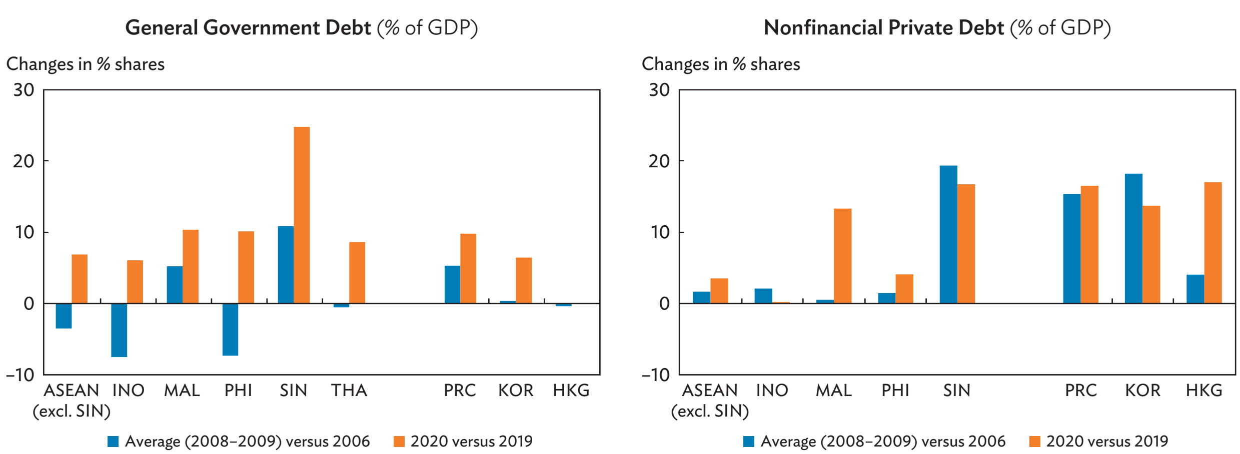
Debt expanded more rapidly during the pandemic compared to the global financial crisis.

Emerging East Asian markets collectively witnessed rapid debt expansions in both the public and private sectors in 2020. **Figure B3.1** shows that Singapore posted the largest increase in the region in 2020 in terms of government debt as a share of gross domestic product (GDP) at 24.7%, followed by Malaysia (10.3%) and the Philippines (10.1%), largely driven by the introduction of stimulus packages during the pandemic. The average increase in the public debt ratio in Association of Southeast Asian Nations (ASEAN) markets (excluding Singapore) in 2020 was 6.9%, which contrasts with a 3.5% decrease during the global financial crisis (GFC) of 2008–2009 relative to the pre-GFC level of 2006. This reflects the different nature of the COVID-19 pandemic from the GFC, as increased financing demand in 2020 by governments was largely driven by the need to provide basic services such as health and education, as well as to tackle economic and social issues.

Nonfinancial private debt also collectively increased during the pandemic, but not necessarily as much as the nonfinancial private debt buildup during the GFC. Relatively higher-income emerging East Asian markets such as Hong Kong, China; Singapore, the People's Republic of China (PRC), the Republic of Korea, and Malaysia saw larger private debt increases than other ASEAN markets in 2020. Malaysia, the Philippines, and Hong Kong, China recorded larger private debt increases in response to the pandemic in 2020 than during the GFC. The average aggregate private debt increases in ASEAN (excluding Singapore) stood at 3.5% and 1.7% in 2020 and the GFC, respectively. Overall, while debt in both the public and private sectors has increased during the pandemic, the pandemic has driven government borrowing more significantly as fighting its impacts requires a lot of public resources.

Figure B3.2 shows the dynamics of debt levels in emerging East Asia. During the decade after the GFC from 2009 to

Figure B3.1: Change in Public and Private Debt during COVID-19 versus the GFC



ASEAN = Association of Southeast Asian Nations; COVID-19 = coronavirus disease; excl. = excluding; GDP = gross domestic product; GFC = global financial crisis; HKG = Hong Kong, China; INO = Indonesia; KOR = Republic of Korea; MAL = Malaysia; PHI = Philippines; PRC= People's Republic of China; SIN = Singapore; THA = Thailand.
Note: Subregional figures for ASEAN are calculated using 2020 GDP (United States dollar equivalent).
Sources: International Monetary Fund. *World Economic Outlook, April 2021*. Washington, DC; Haver Analytics; CEIC Data Company (for public and private debt) (accessed 20 July 2021).

[a] This box was written by Shu Tian (economist) and Shiela Camingue-Romance (economics officer) in the Economic Research and Regional Cooperation Department. Helpful discussions and suggestions from Matteo Lanzafame (senior economist) and Irfan Qureshi (economist) are deeply appreciated.

[b] Emerging East Asia refers to members of the Association of Southeast Asian Nations plus the People's Republic of China; Hong Kong, China; and Republic of Korea.

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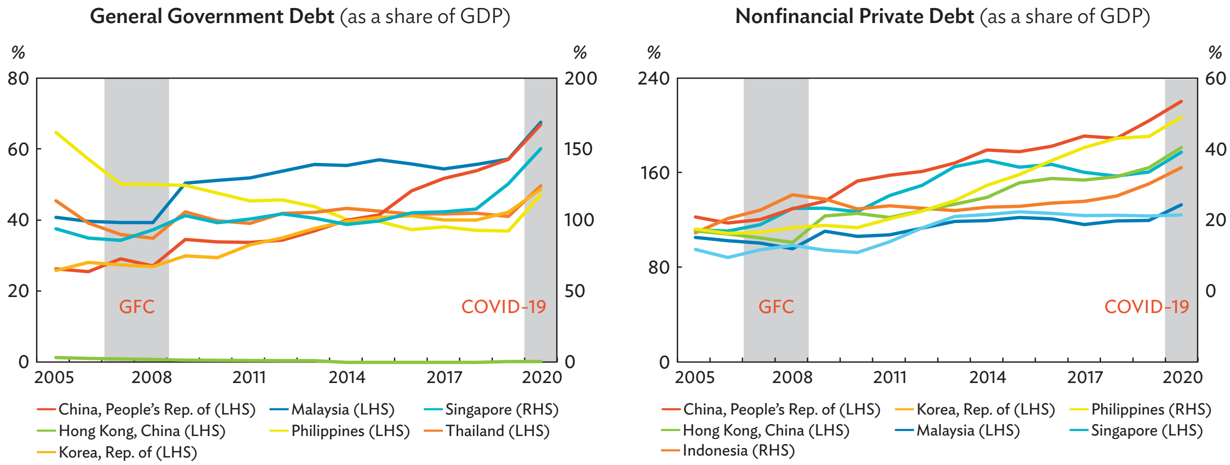
Box 3: Debt Buildup during the Pandemic in Emerging East Asia *continued*

Figure B3.2: Dynamics in Public and Private Debt in Emerging East Asia, 2005–2020



COVID-19 = coronavirus disease, GDP = gross domestic product, GFC = global financial crisis, LHS = right-hand side, RHS = right-hand side.
Sources: International Monetary Fund. *World Economic Outlook, April 2021*. Washington, DC; Haver Analytics; CEIC Data Company (for public and private debt) (accessed 20 July 2021).

2019, most emerging East Asian markets saw relatively stable and steady increases in public debt (as a share of GDP) except for the PRC and Singapore, which posted relatively rapid gains in public debt of 22.5% and 22.3%, respectively. In 2009, the weighted average of public debt in ASEAN and ASEAN excluding Singapore was 45.9% and 37.3%, respectively, which steadily increased to 49.4% and 37.9% by the end of 2019 and further to 59.5% and 45.8% in 2020 amid the introduction of fiscal stimulus packages and easy monetary policies to fight the pandemic.

Turning to the private sector, most emerging East Asian markets witnessed a gradual private debt buildup during the low interest rate era that followed the GFC. The PRC posted the fastest private debt expansion, from 137.0% in 2009 to 205.1% in 2019, partly driven by a relaxed borrowing environment fostered by the economic stimulus package worth about CNY4 trillion introduced in 2008-2009. Markets with relatively developed financial markets—such as Singapore; the Republic of Korea; the PRC; Hong Kong, China; and Malaysia—experienced relatively large gains in private debt, with an average increase of 16.0% in 2020, which continued the debt expansion that occurred in 2019 when average private debt increased 13.7% among these economies. This indicates that the 2020 expansion in private debt might not necessarily be solely driven by financing pandemic-related needs, as the pandemic also subdued economic activities and soured investment sentiment in the private sector.

The region's external debt has risen modestly and its maturity structure has improved during the pandemic.

In 2020, external debt as a share of GDP collectively rose in all emerging East Asian markets. **Figure B3.3** shows the level of external debt increase was much higher in Singapore and Hong Kong, China, given their roles as financial centers. The average external debt expansion in emerging East Asia (excluding Singapore and Hong Kong, China) was 2.4% in 2020, compared with 0.4% in 2019, indicating that regional economies tapped international debt markets to finance pandemic-related needs. However, compared to the 9.2% increase in public debt and 15.0% increase in private debt in 2020, regional markets (excluding Singapore and Hong Kong, China) largely relied on domestic markets to finance investment needs during the pandemic. During the decade following the GFC, external debt levels in ASEAN (excluding Singapore) remained largely stable (**Figure B3.4**). Average external debt levels in ASEAN (excluding Singapore) rose marginally from 36.2% in 2009 to 36.9% in 2019, which further increased to 41.8% in 2020. Overall, the rise in external debt in the region has been modest due in part to the development of local currency funding in domestic financial markets.

One important difference regarding external debt is the difference in maturity structure in 2020 compared to the GFC period. **Figure B3.5** shows the share of short-term

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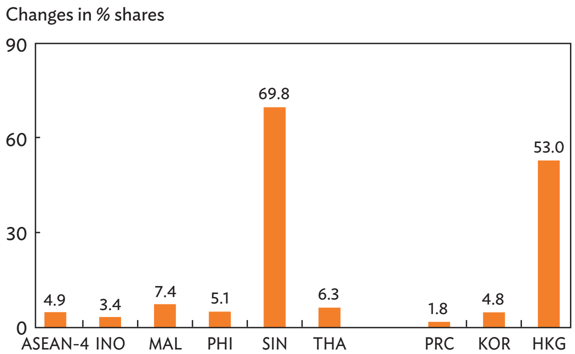
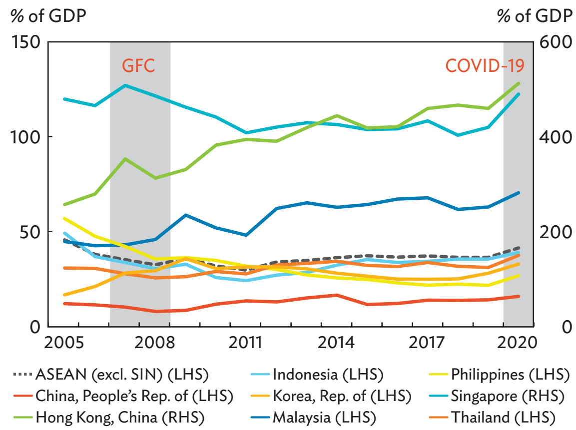
Box 3: Debt Buildup during the Pandemic in Emerging East Asia *continued*

Figure B3.3: Changes in Gross External Debt in 2020



ASEAN = Association of Southeast Asian Nations; HKG = Hong Kong, China; INO = Indonesia; KOR = Republic of Korea; MAL = Malaysia; PHI = Philippines; PRC= People's Republic of China; SIN = Singapore; THA = Thailand.
Note: ASEAN-4 comprises Indonesia, Malaysia, the Philippines, and Thailand.
Source: *AsianBondsOnline* calculations using data from Haver Analytics (accessed 20 July 2021).

Figure B3.4: Dynamics in Gross External Debt in Emerging East Asia, 2005–2020

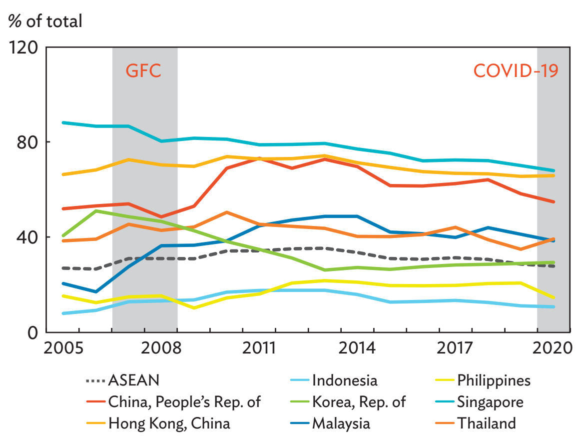


ASEAN = Association of Southeast Asian Nations, COVID-19 = coronavirus disease, excl. = excluding, GDP = gross domestic product, GFC = global financial crisis, LHS = left-hand side, RHS = right-hand side.
Note: Subregional figures for ASEAN are calculated using 2020 GDP (United States dollar equivalent).
Source: *AsianBondsOnline* calculations using data from Haver Analytics (accessed 20 July 2021).

external debt in total external debt rose in many regional markets during the GFC period before declining beginning in 2011. The average share of short-term external debt to total external debt in the region was 49.6% in 2006 and 61.8% in 2010 shortly after the GFC. It then gradually declined to 51.9% in 2019 and further fell to 49.2% in 2020. This indicates that while external debt levels rose during the pandemic, the increase was largely driven by long-term external debt, which provides relatively stable funding and will not trigger immediate liquidity issues. This was the opposite of what occurred during the GFC when the share of short-term external debt increased in most regional markets.

Overall, the buildup of debt in emerging East Asia amid the pandemic has not significantly exacerbated debt conditions in the region and is therefore not that concerning, especially with abundant liquidity in the market and continued accommodative monetary stances globally and regionally. The current low interest rates also enabled refinancing at a relatively low cost, particularly in markets with stronger fiscal positions and better capital market access. As shown in **Figure B3.6**, compared to the average 2008–2009 levels, both short- and long-term government bond yields were significantly lower in 2020 across the region, particularly for long-term funding.

Figure B3.5: Dynamics in the Share of Short-Term External Debt in Emerging East Asia, 2005–2020



ASEAN = Association of Southeast Asian Nations, COVID-19 = coronavirus disease, GDP = gross domestic product, GFC = global financial crisis.
Note: Subregional figures for ASEAN are calculated using 2020 GDP (United States dollar equivalent).
Source: *AsianBondsOnline* calculations using data from Haver Analytics (accessed 20 July 2021).

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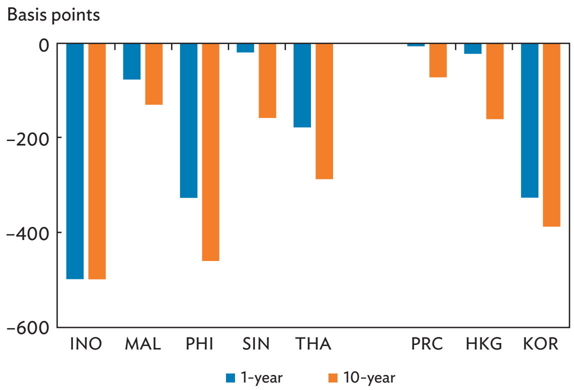
Box 3: Debt Buildup during the Pandemic in Emerging East Asia *continued*

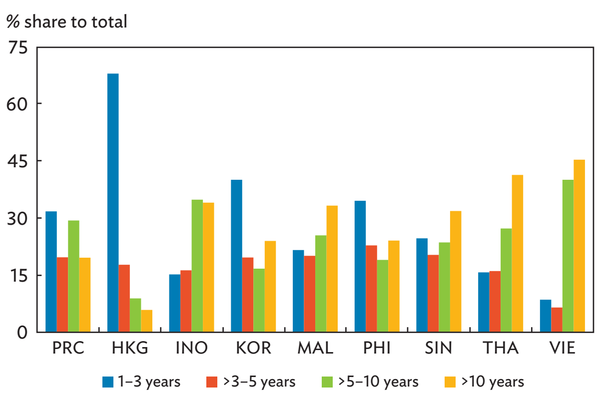
Figure B3.6: Government Bond Yield Changes in Emerging East Asia, 2008–2009 versus 2020



HKG = Hong Kong, China; INO = Indonesia; KOR = Republic of Korea; MAL = Malaysia; PHI = Philippines; PRC= People's Republic of China; SIN = Singapore; THA = Thailand.
Notes: The 2-year (2008–2009) and annual (2020) averages are based on end-of-month bond yields.
Source: *AsianBondsOnline* computations using Bloomberg (accessed 18 August 2021).

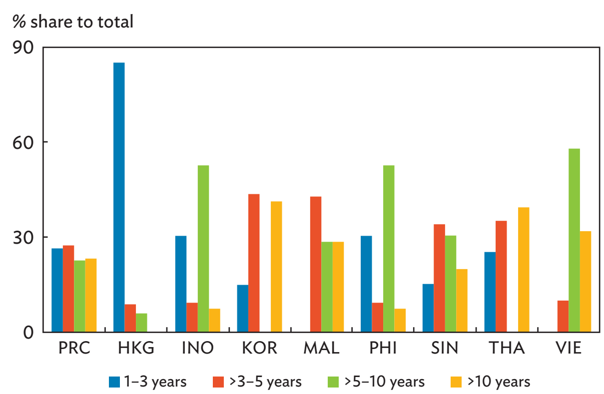
However, the current debt buildup still calls for continuous monitoring. A few risk factors are particularly relevant to regional policy makers. First, at the Federal Open Market Committee meeting in July 2021, the Federal Reserve implied that tapering would start either in late 2021 or early 2022. Combined with a possible earlier-than-expected rate hike in late 2022 or 2023, the discrepancies in monetary stances between the US and most emerging East Asian markets could cause capital outflows and currency stress in the region. This might increase debt burdens, especially in markets with higher levels of external debt. Second, the strong economic rebound and inflation situation in the US could push up its bond yields, which would spill over into emerging markets and thus increase the refinancing cost of debt, even for local currency debt. Third, uncertainty in the trajectory of the economic recovery due to the recent surge in COVID-19 cases could affect debt service capacity in the region, particularly in the private sector. In conclusion, emerging East Asian authorities still need to closely monitor financial conditions to maintain financial stability in the region.

Figure J.1: Maturity Profiles of Local Currency Government Bonds Outstanding in Emerging East Asia



PRC = People's Republic of China; HKG = Hong Kong, China; INO = Indonesia; KOR = Republic of Korea; MAL = Malaysia; PHI = Philippines; SIN = Singapore; THA = Thailand; VIE = Viet Nam.
Notes:
1. Government bonds include Treasury bills and bonds.
2. Data as of the end of June 2021.
Source: *AsianBondsOnline*.

Figure J.2: Maturity Profiles of Local Currency Government Bond Issuance in Emerging East Asia



PRC = People's Republic of China; HKG = Hong Kong, China; INO = Indonesia; KOR = Republic of Korea; MAL = Malaysia; PHI = Philippines; SIN = Singapore; THA = Thailand; VIE = Viet Nam.
Notes:
1. Government bonds include Treasury bills and bonds.
2. Data are based on issuance for the second quarter of 2021.
Source: *AsianBondsOnline*.

Recent rapid developments in social bond markets globally and in the region have provided solutions to address some of these social risks. However, the social areas being addressed by the regional social bond market remain limited. **Box 5** discusses potential social issues that can be further addressed via social or sustainability bond financing.

Box 4: Opening the Pandora's Box of Social Risks—Consequences of Investors

The COVID-19 crisis has been a real turning point for social issues, in particular inequality.[a] It has clearly shown the tragic effects—from an economic and societal perspective—that systemic shocks can have on unequal, nonresilient societies.

Even prior to the pandemic, Moody's Investors Services estimated that USD8 trillion of the debt that it rates was subject to material social risks—that is, four times the amount exposed to climate change risks.[b] However, differently from climate change, there is no real consensus on which kind of social risks should be considered material for investing. Using a stakeholder-based framework, in this article we explore several social risks that have proven their materiality in specific contexts.

The materiality of social risks is expected to increase in the post-pandemic world for several reasons. Investors should thus start integrating social risks along their whole investment value chain—from analysis to engagement and voting—supported by their responsible asset managers.

"S" Is the New "E"

The issue of social inequality has been discussed for years but has never received as much media coverage as much as it has during the COVID-19 crisis. Indeed, while economic growth since the 1980s has led to a decrease in global income inequality due to improved economic conditions in certain developing countries, within-country inequality has increased in developed countries and some middle-income countries such as the People's Republic of China.[c]

In bringing some of these inequalities to the spotlight, the global pandemic has given investors significant opportunities to pursue the "S" pillar within environmental, social, and governance (ESG) investing. For example, in North American equity markets the social pillar (with a focus on employment conditions) had been lagging behind the environmental and governance pillars in terms of investment in previous years. However, the social pillar outperformed the other two pillars in the first quarter of 2020.[d]

Assessing Material Social Risks through a Stakeholder-Based Approach

We consider social risks as being all risks emanating from social factors that can have a material impact on a company and its stakeholders. The "double materiality" concept is considered and expanded here; taking into account how social risks can affect a company's value is not sufficient since how a company either exacerbates or mitigates social issues can, in turn, become a risk that affects its value (**Figure B4**).

A notable example of how double materiality works is the probe around the OxyContin opioid painkillers produced by Purdue Pharma. The company—by enabling the supply of drugs without a legitimate medical purpose—greatly contributed to the dip in the United States' life expectancy in 2015 for the first time in a decade.[e] This complete lack of product responsibility led to a USD8.3 billion settlement with the Department of Justice and several other cases that are still under litigation.[f]

At a macroeconomic level of analysis, it is generally recognized that high levels of social inequality can have a negative impact on economic growth.[g] Research has shown that there seems to be a vicious circle between income inequality and financial instability.[h]

At a microeconomic level, material social risks can be analyzed through a stakeholder-based approach:

1. *Employees*

Labor and capital are considered the most important factors on which economic activity is based. However, the share of income distributed to labor, as opposed to capital, has decreased in most countries in recent decades.[i] Social

[a] This box was written by Caroline Le Meaux, head of ESG research, engagement and voting, Amundi; and Sofia Santarsiero, business solutions and innovation analyst, Amundi. The content is based on a research paper by Amundi Asset Management. 2021. *Opening the Pandora's Box of Social Risks: Consequences for Investors*. https://research-center.amundi.com/article/shifts-narratives-7-opening-pandora-s-box-social-risks-consequences-investors.

[b] *Moody's Investors Services*. 2019. Social Considerations Pose High Credit Risk for 14 Sectors, $8 Trillion Debt. 31 October.

[c] Chancel, L. and T. Pikkety. 2021. *Global Income Inequality, 1820–2020*. 20 July. https://wid.world/news-article/global-income-inequality-1820-2020/.

[d] Amundi Research. 2020. The Coronavirus and ESG Investing, The Emergence of the Social Pillar. *Amundi Insights Paper*. https://research-center.amundi.com/article/coronavirus-and-esg-investing-emergence-social-pillar.

[e] Chatterjee, R. 2020. Life Expectancy Rose Slightly in 2018, as Drug Overdose Deaths Fell. *NPR*. 30 January. https://www.npr.org/sections/health-shots/2020/01/30/801016600/life-expectancy-rose-slightly-in-2018-as-drug-overdose-deaths-fell?t=1623089716621.

[f] Sherman, N. Purdue Pharma to Plead Guilty in $8 bn Opioid Settlement. *BBC News*. 21 October. https://www.bbc.com/news/business-54636002.

[g] Cingano, F. 2014. Trends in Income Inequality and its Impact on Economic Growth. *OECD Social, Employment and Migration Working Papers*. No. 163. http://dx.doi.org/10.1787/5jxrjncwxv6j-en.

[h] Cihak, M. and R. Sahay. 2020. Finance and Inequality. *International Monetary Fund Staff Discussion Notes*. https://www.imf.org/en/Publications/Staff-Discussion-Notes/Issues/2020/01/16/Finance-and-Inequality-45129.

[i] Amundi Research. 2020. The Day After #12—Changing Shares of Labour and Capital Incomes: What Implications for Investors? 21 October. https://research-center.amundi.com/article/day-after-12-changing-shares-labour-and-capital-incomes-what-implications-investors.

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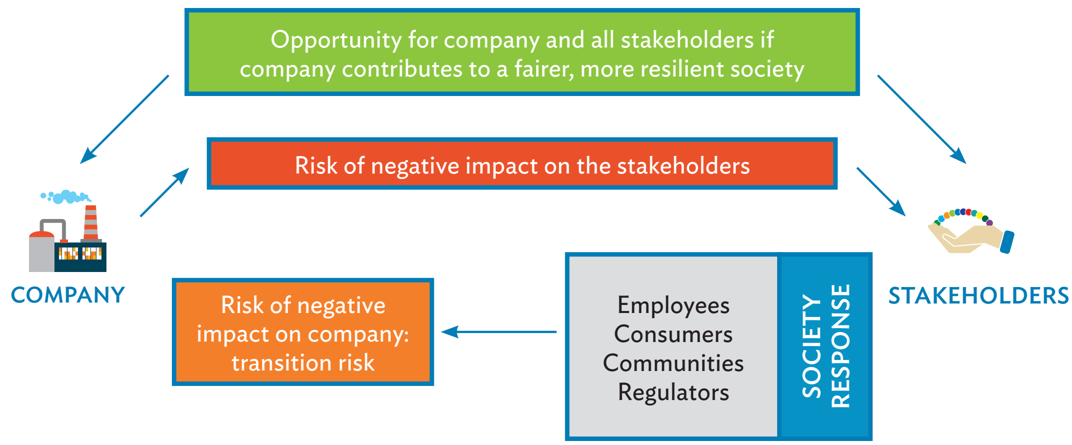
Box 4: Opening the Pandora's Box of Social Risks—Consequences of Investors *continued*

Figure B4: Social Risks and Opportunities



Source: Amundi's interpretation of Climate-Related Risks and Opportunities. 2019. https://ec.europa.eu/finance/docs/policy/190618-climate-related-information-reporting-guidelines_en.pdf.

cohesion—in the form of employees' well-being, protection, and fair pay compared to C-level executives—has been identified as a key driver of financial performance.

2. Consumers

Consumers' impact on the future profitability of a company is immense, as they are capable of deciding whether they will continue to buy from that specific company or if they will turn to a direct competitor. For socially responsible companies, there is a higher likelihood that consumers will adopt pro-company behavior (e.g., purchases, loyalty, advocacy), leading to higher profitability and excess returns.[j]

3. Communities and Society

Companies that have invested resources in building positive relationships with the communities impacted by their operations have more financial value than their peers, all other elements being equal. These relationships can help ensure that operations and profitability are not heavily impacted by social unrest.

4. Regulatory Authorities

Regulatory bodies and governments are powerful key stakeholders that can profoundly impact a firm's operations, business model, and profitability through policies and regulations. Companies that have not taken social-focused regulations into consideration—such as corporate tax reform or minimum wage increases—will experience worse financial results than their peers, as they would be more affected by an expected future wave of policies.

Incorporating Social Risks in the Investment Value Chain

From an investment perspective, investors should consider social risks in terms of the degrees of materiality outlined above. In terms of ESG analysis, asset owners, supported by asset managers and advisors, can identify the most material social factors influencing their portfolios. At Amundi, ESG analysis is performed based on 37 criteria, of which 19 are related to the social pillar. The generic criteria applied to all analyzed sectors include labor conditions and nondiscrimination, health and safety, client and supplier relations, product and societal responsibility, and local communities and human rights, thereby mirroring the stakeholder-based framework proposed.[k]

Investment solutions are also at investors' disposal to help in the process of integrating social risks. A first possibility would be to apply a filter excluding issuers with poor social practices from their portfolios. Asset owners can go one step further and invest in strategies and instruments, such as social

[j] Fornell, C., S. Mithas, F. Morgeson, and M.S. Krishnan. 2006. Customer Satisfaction and Stock Prices: High Returns, Low Risk. *Journal of Marketing*. 70 (1). https://www.researchgate.net/publication/228233854_Customer_Satisfaction_and_Stock_Prices_High_Returns_Low_Risk.

[k] Amundi. Documentation. https://www.amundi.com/int/ESG/Documentation.

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Box 4: Opening the Pandora's Box of Social Risks—Consequences of Investors *continued*

bonds, that directly encourage issuers to modify their business models toward higher social inclusivity and impact.

Within an ESG investment approach, ongoing engagement and consistent voting at annual general meetings are also crucial in terms of setting best practice and encouraging portfolio companies to develop and improve their social responsibility.

The COVID-19 crisis has opened the Pandora's box of social risks, which is unlikely to be closed again. On the bright side, firms with positive social practices are expected to provide attractive investment opportunities in the years to come. Whatever the case may be, we expect social risks to become increasingly material and a key development to watch.

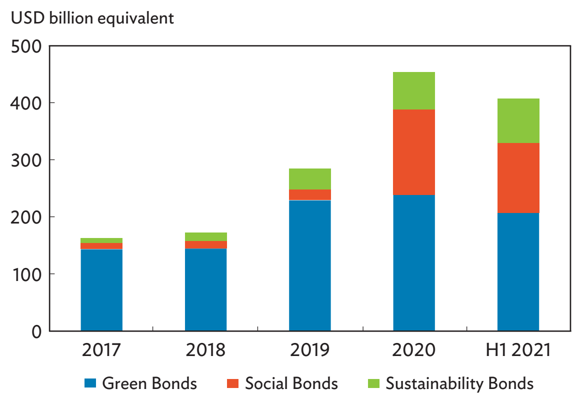
Box 5: Social Bond Issues for Developing Asia

The COVID-19 pandemic has exacerbated a huge financing gap in the developing world as funds are needed to help economies, communities, and people weather the pandemic's impacts and build back better.[1] This has created an opportunity for social bonds to bridge the financing gap and address underlying social issues such as poverty and inequality.[a]

Social bond issuance set new records in 2020 and the first half of 2021, both globally and in Asia and the Pacific (**Figure B5.1**). Yet, the following questions remain: Does social bond financing actually address the region's social challenges? Which social impact areas should issuers prioritize? And finally, should issuers and policy makers first address low-hanging fruit or instead focus on complex and challenging problems?

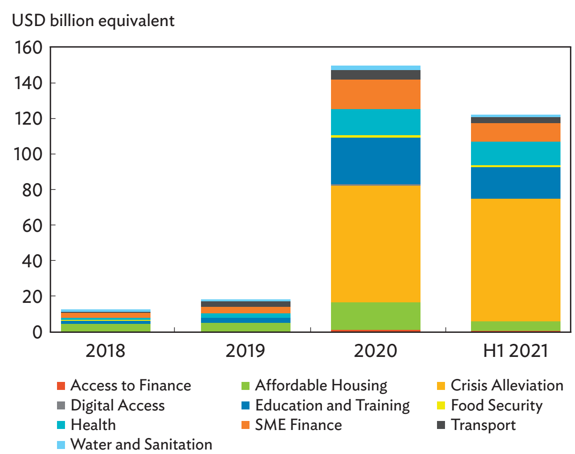
There has been a significant change in social bonds' impact areas in response to COVID-19, most notably a shift from a focus on affordable housing to more pandemic-related projects such as education and training (including unemployment support), and socioeconomic crisis alleviation (**Figure B5.2**).

Figure B5.1: Global Green and Social Bond Issuance, 2017–H1 2021 (USD-equivalent notional)



H1 = first half, USD = United States dollar.
Source: Author's calculations based on review of Bloomberg LP data, issuer social bond frameworks, and reviewer second opinions.

Figure B5.2: Global ICMA-Compliant Social Bond Issuance by Year and SBP Project Type, 2017–H1 2021 (USD-equivalent notional, estimated)



H1 = first half, ICMA = International Capital Market Association, SBP = Social Bond Principles, SMEs = small and medium-sized enterprises, USD = United States dollar.
Sources: Authors' calculations based on review of Bloomberg data, issuer social bond frameworks, and reviewer second opinions.

[a] This section was written by Jane Hughest (lead author), author of *Greed Gone Good: A Roadmap to Creating Social and Financial Value*, and Jason Mortimer, head of sustainable investment—fixed income and senior portfolio manager, Nomura Asset Management. The content is based on Asian Development Bank. 2021. Promoting Social Bonds for Impact Investments in Asia. https://www.adb.org/publications/social-bonds-impact-investments-asia.

[b] Social bonds are fixed-income instruments that raise funds for new and existing projects with positive social outcomes.

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Box 5: Social Bond Issues for Developing Asia *continued*

Social Bonds in Response to COVID-19 Impacts in Developing Asia

Socioeconomic crisis alleviation. The pandemic has exposed the weaknesses, inequities, and shortages associated with health care in many developing economies and highlighted the need for increased investment. Health care investments funded via social bonds can both alleviate the impact of the COVID-19 crisis and improve services to prevent or mitigate such crises in the future.

The combination of rising expenditures to combat COVID-19's impacts and widening government budget deficits also makes a compelling case for the greater use of social bonds. By raising money from private investors to directly address social needs, social bonds can direct capital to the provision of health care and other services for vulnerable and underserved populations.

Food, water, and sanitation. One reason why COVID-19 and other diseases spread in developing economies is that billions of people lack adequate clean water for washing and sanitation, resulting from decades of underinvestment in water infrastructure. COVID-19 has also exposed weaknesses in global food systems by straining supplies, disrupting food chains, and increasing food insecurity for millions of people.

Small and medium-sized enterprises. SMEs account for more than 96% of all businesses in Asia and the Pacific, and more than two-thirds of the region's private sector workforce. However, even before the pandemic SMEs faced numerous obstacles, particularly a lack of access to finance. Providing support to SMEs to overcome the economic shock of the pandemic and associated lockdowns is a socioeconomic necessity with potentially large multiplier effects.

Education and gender equity. The pandemic has negatively impacted educational opportunities in developing economies, dramatically widening the educational deficit. Social bonds can channel funding toward building schools and hiring teachers. Promoting girls' education is one of the most effective ways to drive sustainable development, improve health, reduce conflict, and save lives. Social bonds can also help advance gender equity and empower women by improving working conditions for female employees, decreasing the digital divide between men and women, and providing capital for underfunded women-owned SMEs.

Social Impact Measurement: Supporting an Effective Social Bond Market

As issuance of green, social, and sustainability bonds explodes globally, investor concern is mounting about "greenwashing" and "social-washing," which is when issuers claim that the funds will be used for worthy environmental or social causes but the money ends up elsewhere. The International Capital Market Association recommends that issuers track and report qualitative performance indicators as well as quantitative metrics; and some national authorities are beginning to mandate environmental, social, and governance disclosures. Also, it is becoming more common for issuers to map their bonds' use of proceeds to individual Sustainable Development Goals.

Conclusions: Maximizing Impact in the COVID-19 Era and Beyond

It is challenging for policy makers, issuers, and investors to make investment decisions and plan resource allocation without clear and standardized impact measurement methods. Thankfully, impact measurement is improving and social bonds have proven to be valuable instruments for directing private capital to socioeconomic priorities. From resilience to SME support, gender equity to health care, social bonds are an essential tool for financing the work needed for developing Asia to build back better.