Executive Summary

Recent Developments in Emerging East Asian Financial Conditions

Long-term bond yields declined and yield curves flattened in emerging East Asia on a dimming economic outlook.[1] Despite continued inflationary pressure and accelerated monetary tightening, a moderating growth outlook and mounting downside risks contributed to declining yields on 10-year local currency (LCY) government bonds and flattening yield curves, as proxied by narrowing spreads between 10-year and 2-year bond yields between 15 June and 24 August. Regional currencies also collectively depreciated against the United States (US) dollar by an average of 1.8% (simple) and 2.1% (gross-domestic-product-weighted) during the review period. Short-term bond yields rose in a few markets as central banks accelerated monetary tightening to tame inflation and safeguard financial stability.

Financial conditions eased modestly on improved market sentiment, especially since mid-July. From 15 June to 24 August, the region witnessed risk premiums narrowing by an average of 9 basis points (simple) and 11 basis points (gross-domestic-product-weighted), as well as a weighted average gain of 1.8% in all equity markets except the People's Republic of China (PRC) and Hong Kong, China. In August, regional equity markets experienced net portfolio inflows of USD4.2 billion, a reversal from outflows of USD1.8 billion in July. The improvement in financial conditions, especially since the second half of July, was supported by optimism over better-than-expected corporate earnings and expectations of a possible peak in inflation in the US, and thus a milder-than-expected tightening path by the US Federal Reserve.

The risk to the outlook of regional financial conditions is tilted to the downside. Moderating economic growth remains a key short-term risk, together with mounting uncertainties regarding inflationary pressure, the pace of the Federal Reserve's monetary tightening, lingering impacts of the pandemic, potential spillovers from a faster-than-expected slowdown in the PRC, and the possibility of greater-than-expected spillovers from the Russian invasion of Ukraine. Over the medium-term, asset vulnerability associated with high-emitting sectors during their transition to net-zero emissions, and the need to provide sufficient finance to fund low-carbon projects and support the transition of high-emitting projects in a sustainable way, pose new challenges to the financial sector.

Recent Developments in Local Currency Bond Markets in Emerging East Asia

LCY bond markets in emerging East Asia experienced record-high issuance in the second quarter (Q2) of 2022. By the end of June, LCY bonds outstanding in regional markets reached USD22.9 trillion on quarterly issuance of USD2.4 trillion. The sizable issuance was largely driven by increased financing needs from the PRC to stimulate its economy. The PRC accounted for 68.1% of emerging East Asian bond issuance during Q2 2022. Member economies of the Association of Southeast Asian Nations (ASEAN) had outstanding bonds totaling USD2.0 trillion at the end of June, representing 8.6% of all emerging East Asian bonds outstanding. ASEAN members' combined issuance climbed to USD418.1 billion during Q2 2022 on growth of 10.3% quarter-on-quarter (q-o-q), accounting for 17.5% of the region's total issuance during the quarter.

The public sector continued to dominate regional bond markets in Q2 2022. LCY government bonds totaled USD14.5 trillion and comprised 63.1% of emerging East Asia's outstanding LCY bonds at the end of June. During the quarter, LCY government bond issuance tallied USD1.6 trillion, posting q-o-q growth of 25.9% as governments borrowed to support economic recovery. Meanwhile, private sector bond issuance contracted 4.9% q-o-q, with total corporate debt financing of USD812.6 billion, due to the weak economic outlook and rising borrowing costs.

[1] Emerging East Asia is defined to include Cambodia; the People's Republic of China; Hong Kong, China; Indonesia; the Republic of Korea; the Lao People's Democratic Republic; Malaysia; the Philippines; Singapore; Thailand; and Viet Nam.

Relatively more shorter-tenor government bonds were issued during Q2 2022. Emerging East Asia's LCY government bond market is largely dominated by medium- to longer-term maturities, with 55.2% of outstanding government bonds at the end of June carrying a maturity of over 5 years. During Q2 2022, however, 50.5% of government bond issuance carried a tenor of 5 years or less, and the share of government bonds with tenors of 1–3 years climbed to 33.4% of total issuance from 25.9% in the previous quarter, reflecting increased financing needs over the short and medium terms.

A softened economic outlook dented investment appetite in the ASEAN+3 sustainable bond market in Q2 2022. However, the market still expanded to a size of USD503.5 billion at the end of June on issuance of USD61.0 billion, which reflected a 5.2% q-o-q contraction. The amount of ASEAN+3 sustainable bonds outstanding as a share of the global market slid to 15.3% at the end of June from 16.7% in March. While the private sector dominated issuances of sustainable bonds in the region, the negative economic outlook led the public sector's share to rise to 11.0% at the end of June from 9.8% at the end of March. The term structure of the region's sustainable bond market remained focused on short and medium tenors, with a size-weighted average tenor of 4.3 years for outstanding bonds at the end of Q2 2022 and 4.6 years for bonds issued during the quarter.