Executive Summary

Recent Developments in Financial Conditions in Emerging East Asia

During the review period of 1 June–30 August, financial conditions in emerging East Asia improved over expectations of policy rate cuts in both advanced economies and regional markets amid the continued moderation of inflation.[1] The improvement largely started in July when the United States (US) Federal Reserve hinted at a likely policy rate cut in September. This led to the overall decline of bond yields in both advanced and regional markets during the review period. There was a brief overreaction in financial markets in early August following the release of weak US labor market data and related concerns over a possible recession, which heightened investor risk aversion. Financial markets subsequently corrected, with financial conditions continuing to improve through the rest of the review period.

During the review period, regional financial indicators showed improved performance. Regional currencies collectively appreciated against the US dollar by 3.3% (simple average) and 2.7% (gross-domestic-product-weighted). Risk premiums, as measured by credit default swap spreads, narrowed by 7.4 basis points (simple average) and 5.2 basis points (gross-domestic-product-weighted). However, while regional equity markets gained by 2.4% (simple average), they recorded marginal losses of 3.7% (market-weighted) over weakness in the People's Republic of China's (PRC) economic performance. Excluding the PRC and Hong Kong, China, the region's equity markets gained 4.3% (simple average) and 3.6% (market-weighted). Regional equity markets recorded net portfolio inflows of USD7.6 billion during the review period.

Risks to the outlook for regional financial conditions were broadly balanced. On the upside, a global moderation in inflation and forthcoming rate cuts by central banks could further strengthen financial conditions. Downside risks include geopolitical concerns, a weaker-than-expected economic performance in the PRC, trade tensions between the US and the PRC, as well as recent domestic uncertainty in some Association of Southeast Asian Nations (ASEAN) markets. Regional financial conditions may also be subject to market volatility in response to negative news, similar to what was observed in early August.

Recent Developments in Local Currency Bond Markets in Emerging East Asia

The emerging East Asian local currency (LCY) bond market expanded 2.3% quarter-on-quarter (q-o-q) and 9.2% year-on-year (y-o-y) in the second quarter (Q2) of 2024, totaling USD25.1 trillion at the end of June. Quarterly growth in the region's LCY bonds outstanding in Q2 2024 accelerated from 1.4% q-o-q in the first quarter (Q1) of 2024, supported by faster expansions of Treasury and corporate bonds. Treasury bonds outstanding expanded 2.8% q-o-q in Q2 2024, up from 1.3% q-o-q in the prior quarter, as the PRC increased issuance of sovereign bonds to finance stimulus measures. Meanwhile, growth in the region's corporate bond market rose to 1.5% q-o-q in Q2 2024 from 1.2% q-o-q in Q1 2024 on increased issuance in six of the region's nine markets, led by the PRC where banks ramped up debt sales to meet regulatory capital requirements. Aggregate LCY bonds outstanding in ASEAN markets reached USD2.2 trillion at the end of June and accounted for an 8.9% share of the region's total.

LCY bond issuance in emerging East Asia rebounded in Q2 2024, supported by expansions in both the government and corporate bond segments. Quarterly LCY bond issuance reached USD2.6 trillion at the end of June, posting 15.4% q-o-q growth in Q2 2024 following a 9.1% q-o-q contraction in the prior quarter. Treasury bond issuance expanded 27.0% q-o-q in Q2 2024 to

[1] Emerging East Asia is defined to include member states of the Association of Southeast Asian Nations plus the People's Republic of China; Hong Kong, China; and the Republic of Korea.

USD1.1 trillion, fueled by the PRC's accelerated issuance of local and long-term Treasury bonds intended to support the economy. Issuance of LCY corporate bonds (USD860.9 billion) rebounded in Q2 2024, rising 5.6% q-o-q after a 1.9% q-o-q dip in Q1 2024, as the PRC and most ASEAN markets posted higher corporate debt sales. Strong corporate bond issuance in the PRC was driven by banks raising funds to meet regulatory requirements, while most ASEAN markets recorded increased issuance on improved financial conditions. ASEAN markets' combined issuance of LCY bonds tallied USD602.4 billion in Q2 2024, comprising 23.6% of the region's total.

Emerging East Asian Treasury bonds outstanding and issuance in Q2 2024 were largely concentrated in medium- to long-term maturities. At the end of June, over half of outstanding Treasury bonds (52.6%) and newly issued Treasury bonds (55.9%) had remaining maturities of over 5 years. The size-weighted average tenor of the region's outstanding Treasury bonds was 8.6 years at the end of June, while the size-weighted average tenor of Treasury bonds issued in Q2 2024 was 9.5 years.

Banks and insurance companies continued to hold the largest shares of emerging East Asian LCY bonds. At the end of June, banks held an average share of 36.2% of outstanding LCY bonds in the region, followed by insurance companies with 28.9%.

Recent Developments in ASEAN+3 Sustainable Bond Markets

The sustainable bond market in ASEAN+3 posted a robust annual expansion of 17.4% to reach a size of USD868.1 billion at the end of June.[2] The y-o-y growth of ASEAN+3's outstanding sustainable bonds outpaced corresponding growth in both the European Union 20 (EU-20) (16.5%) and the global (17.0%) sustainable bond markets. A high volume of maturities during the quarter, however, led to q-o-q growth moderating to 1.9% in Q2 2024 from 2.9% in Q1 2024. Within ASEAN+3, ASEAN economies posted the region's fastest growth at 6.4% q-o-q on higher issuance volumes. ASEAN+3 remained the world's second-largest regional sustainable bond market, accounting for 19.0% of the global sustainable bond market at the end of June, following the EU-20's 36.9%. Despite its continued expansion, however, the ASEAN+3 sustainable bond market comprised only 2.3% of the region's total bond market at the end of Q2 2024, which was less than the EU-20 sustainable bond market's 7.8%.

Sustainable bond issuance rebounded in Q2 2024 to USD51.0 billion on a 1.6% q-o-q expansion after contracting 10.7% q-o-q in the prior quarter. ASEAN+3 accounted for 23.1% of the global issuance in Q2 2024. LCY-denominated sustainable bonds accounted for 79.3% of ASEAN+3's total issuance for the quarter, compared with an LCY issuance share of 94.7% in the region's general bond market. About 69.6% of ASEAN+3's sustainable bond issuance in Q2 2024 was financed by short-term maturities (tenors of less than 5 years). Shorter-tenor financing was more prevalent in sustainable bond issuance among non-ASEAN economies (74.4%), while longer-tenor issuances (over 5 years) were more dominant among ASEAN markets (70.6%). In Q2 2024, the size-weighted average tenor of ASEAN+3 sustainable bond issuance was 6.9 years, lagging the corresponding averages in the EU-20 sustainable bond market (9.6 years) and the ASEAN+3 general bond market (8.7 years). ASEAN economies had a longer size-weighted average tenor of 18.0 years, owing to the active participation of the public sector in ASEAN markets.

[2] ASEAN+3 is defined to include member states of ASEAN plus the People's Republic of China; Hong Kong, China; Japan; and the Republic of Korea.