

The Asia Bond Monitor (ABM) reviews the development of East Asian local currency bond markets. It examines market size and composition, market liquidity, investor profile, and returns and volatility. Recent policy reforms and challenges facing these markets are also highlighted. The ABM covers the 10 Association of Southeast Asian Nations member countries plus the People's Republic of China and the Republic of Korea.

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## East Asian Local Currency Bond Markets: Seven Years after the Crisis

### Highlights

- East Asian local currency bond markets tripled in size between 1997 and 2003. But there are large variations across countries, and most markets remain small:
  - Thailand registered the fastest growth, Korea has the largest amount of bonds outstanding, while Malaysia achieved the highest ratio of local currency bonds outstanding to GDP.
  - Government bonds led market growth. Corporate bond markets are growing, but are yet to become a significant source of corporate finance.
  - The ratio of local currency bonds outstanding to GDP in East Asia is about 44%, far below those for Japan and the US. The region accounted for only 3% of local currency bonds outstanding worldwide.
- Although trading volume has increased significantly, liquidity in East Asian bond markets is still low:
  - The annual turnover ratio for government bonds ranges from less than 0.5 in Indonesia to 5.5 in Singapore, compared with over 30 in the US.
  - Bid-ask spreads of East Asian benchmark local currency bonds are much higher than those of equivalent benchmark bonds in developed markets.
- The investor profile for East Asian local currency bond markets is widening, but overall it remains narrow. Although holdings by contractual savings institutions are increasing, commercial banks still hold over half of total government bonds outstanding.
- East Asian local currency bonds show large variations in returns. But portfolio holdings of these bonds exhibit attractive risk/return tradeoffs, offering good potential for global bond portfolio diversification.
- Cross-border investment in East Asian bond markets is small. ASEAN+3 invests less than 2% of its total bond investment worldwide in East Asia.
- The development of East Asian local currency bond markets is helping to address the currency and maturity mismatch problem:
  - A number of indicators suggest that East Asia has substantially reduced its reliance on foreign currency borrowings since the 1997 crisis.

## Acronyms, Abbreviations, and Notes

ABF	Asia Bond Fund
ABM	Asia Bond Monitor
ABMI	Asian Bond Markets Initiative
ADB	Asian Development Bank
AECM	Aggregate Effective Currency Mismatch
ALBI	Asian Local Bond Index
ASEAN	Association of Southeast Asian Nations (Brunei Darussalam, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Viet Nam)
ASEAN+3	ASEAN, People's Republic of China, Japan, Republic of Korea
CSI	contractual savings institution
EMEAP	Executives' Meeting of East Asia Pacific Central Banks
EU15	Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, and United Kingdom (the 15 members of the European Union prior to 1 May 2004)
GDP	gross domestic product
GPF	Government Pension Fund
STRIPS	Separate Trading of Registered Interest and Principal of Securities
WI	When-Issued

### Notes:

1. "\$" denotes US dollars unless otherwise specified.
2. Growth rates are year-on-year unless otherwise specified.

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The *Asia Bond Monitor* is prepared by the Regional Economic Monitoring Unit of the Asian Development Bank (ADB) and does not necessarily reflect the views of ADB's Board of Governors or the countries they represent.

- Local currency bond markets are increasingly becoming an important source of domestic finance.
- Policy measures implemented by East Asia since the 1997 financial crisis include:
  - Strengthening the legal and regulatory framework,
  - Improving the bond issuing process and pricing mechanisms,
  - Promoting demand for local currency bonds,
  - Improving market infrastructure, and
  - Promoting regional cooperation in developing bond markets.
- Going forward, improving market liquidity is a key challenge. The following measures could be considered:
  - Broadening the variety of fixed-income securities,
  - Introducing When-Issued (WI) trading,
  - Introducing Separate Trading of Registered Interest and Principal of Securities (STRIPS), and
  - Developing derivatives markets.