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The *Asia Bond Monitor* (ABM) reviews recent developments in East Asian local currency bond markets, along with the outlook, risks, and policy options. The ABM covers the 10 Association of Southeast Asian Nations member countries plus the People's Republic of China; Hong Kong, China; and the Republic of Korea.

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Emerging East Asian Local Currency Bond Markets: A Regional Update

Highlights

Bond Market Developments in the First Half of 2007

- Aggregate local currency bonds outstanding in emerging East Asia grew 10% in the first half of 2007, expanding faster than gross domestic product in most markets.
 - Government local currency bond markets grew 10% in the first half of the year, partly because central banks issued more debt to absorb excess liquidity derived from the region's large capital inflows.
 - Corporate bond markets grew slower than most government markets for the first time in 18 months, due partly to the rising cost of short-term finance.
 - Turnover ratios were mostly higher in the first half of 2007 than in 2006 as steepening yield curves led investors to reassess the term structures of their bond portfolios, while in some markets new regulations also encouraged increased trading.
 - Yield curves generally steepened in 2007. Short-term rates fell slightly in response to the liquidity surge, while long-term rates rose in response to the reemergence of inflationary expectations.
 - Despite further currency appreciation, local currency index returns were lower during the first half, reflecting steeper yield curves.
 - Continued reforms and liberalization have led to credit-rating upgrades for several of the region's economies, laying the groundwork for more rapid expansion of bond markets.
- #### Outlook, Risks, and Policy Challenges
- Recent financial market turmoil and a slight easing of economic activity are expected to moderate global GDP growth in 2008.

Continued overleaf

Acronyms, Abbreviations, and Notes

ABM	Asia Bond Monitor
ABS	asset-backed securities
ADB	Asian Development Bank
ASEAN	Association of Southeast Asian Nations
BIBOR	Bangkok Interbank Offered Rate
BNM	Bank Negara Malaysia
BNMN	Bank Negara Monetary Notes
CDO	collateralized debt obligation
CHIBOR	China Interbank Offered Rate
CSRC	China Securities Regulatory Commission
EU	European Union
GDP	gross domestic product
HIBOR	Hong Kong Interbank Offered Rate
IMF	International Monetary Fund
JIBOR	Jakarta Interbank Offered Rate
KLIBOR	Kuala Lumpur Interbank Offered Rate
KORIBOR	Korea Interbank Offered Rate
LCY	local currency
MBS	mortgage-backed securities
MRT3	Metro Rail Transit
NDRC	National Development and Reform Commission
NRSRO	nationally recognized statistically rating organizations
OECD	Organisation for Economic Co-operation and Development
OREI	Office of Regional Economic Integration
OTC	over-the-counter
PHIBOR	Philippine Interbank Offered Rate
PRC	People's Republic of China
REIT	real estate investment trust
RMBS	residential mortgage-backed securities
SEC	Securities and Exchange Commission
SHIBOR	Shanghai Interbank Offered Rate
SIBOR	Singapore Interbank Offered Rate
SGS	Singapore Government Securities
SOE	state-owned enterprises
SIVs	structured investment vehicles
TIBOR	Tokyo Interbank Offered Rate
UK	United Kingdom
YTD	year-to-date

bp = basis points

Note: To conform with market practice, the *Asia Bond Monitor* uses two-letter official ISO Country Codes and three-letter currency codes rather than ADB's standard symbols.

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- In external markets, the expansion of global liquidity and increasing demand for high-yielding assets resulted in complex new instruments entering debt markets—often without consideration of the underlying risk—and kicking off a wave of imprudent financing.
- The rising cost of funds—beginning in mid-2004—led to defaults in late 2006 and early 2007, resulting in a further round of declines in asset prices.
- In emerging East Asia, strong economic growth and robust financial sector conditions—together with relatively small exposure to US subprime mortgages—have helped limit spillover effects of the US subprime turbulence to the region.
- Although the region is more resilient than in previous periods of financial market turbulence, several risks remain:
 - generally deteriorating global economic growth and credit conditions;
 - prolonged financial market volatility;
 - a sharper-than-expected slowdown in US growth; and
 - a resurgence of inflationary pressures that could spill over into local currency bond markets.
- The recent external financial market turbulence underscores the need to address several shortcomings in the region's debt markets—not only in the markets themselves, but also in the regulatory and supervisory systems in which they operate:
 - improving transparency by better valuation and accounting of off-balance sheet risks;
 - strengthening risk assessment and risk management among financial institutions, regulators, and credit rating agencies;
 - enhancing the enabling environment for local currency bond markets; and
 - increasing regional cooperation in monitoring and regulating financial markets, and in developing financial institutions' risk management techniques.

About the Asian Development Bank

ADB, based in Manila, is dedicated to reducing poverty in the Asia and Pacific region through pro-poor sustainable economic growth, social development, and good governance. Established in 1966, it is owned by 67 members—48 from the region. In 2006, it approved loans and grants for projects totaling \$8.5 billion, and technical assistance amounting to almost \$242 million.