ADB Asia Bond Monitor 2008

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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

Recent Bond Market Developments

- During the first half of 2008, emerging East Asia's local currency bond markets grew slower from end-2007; bonds outstanding-to-GDP fell marginally—trends that continued into the second half.
- Government bond issuance continues to dominate the market, driven by deficit financing and monetary sterilization, while corporate bond market activity slowed as borrowing costs increased and credit dried up.
- Government bond yield movements in emerging East Asia went through three distinct phases in 2008:
  - — most yield curves shifted up during the first half as many central banks raised interest rates to fight inflation;
  - — yield curves shifted downward from July to early September as the severity of the global credit crisis deepened and inflationary expectations peaked;
  - — global credit markets seized-up in September and the combination of an investor "flight-to-quality" and emergency measures drove yields in government bonds lower.
- Returns on local currency bonds were lackluster in 2008 as investors reduced exposure to high-risk assets amid tightening global liquidity and increased market volatility.
- Foreign holdings of local currency government bonds rose as investors shed riskier assets, a sign of growing confidence in emerging East Asia's bond markets.
- In the first half, market liberalization, product innovation, and diversification continued despite simmering global market turmoil; but most were placed on standby as the crisis deepened.

Outlook, Risks, and Policy Challenges

- Contagion from the US credit turmoil rapidly hit global financial markets, with significant spillover into the real economy.
- Concern over rising inflation, which dominated policy discussions in emerging East Asia in the first half of 2008, have given way to policies addressing deteriorating economic growth.

Continued overleaf

Acronyms, Abbreviations, and Notes

1H08	First half, 2008
1H07	First half, 2007
ABF	Asian Bond Fund
ABM	Asia Bond Monitor
ABS	asset-backed securities
ABMI	Asian Bond Markets Initiative
ACN	Asia Currency Note
ADB	Asian Development Bank
ALBI	Asian Local Bond Index (HSBC)
ASEAN	Association of Southeast Asian Nations
BI	Bank Indonesia
BIDS	Bond Information and Dissemination System
BNM	Bank Negara Malaysia
BNMN	Bank Negara Monetary Notes
BOK	Bank of Korea
BOT	Bank of Thailand
BSP	Bangko Sentral ng Pilipinas
Btr	Bureau of the Treasury (Philiipines)
CBO	Collateralized bond obligation
CDO	Collateralized Debt Obligation
CDS	credit default swap
CGIM	credit guarantee and investment mechanism
CHIBOR	China Interbank Offered Rate
CLO	Collateralized loan obligations
CP	Commercial Paper
CSS	Contractual Savings Sectors
CSV	Contractual Savings Vehicles
CTB	Chamber of Thrift Banks
DvP	delivery versus payment
EB	exchangeable bond
ECB	European Central Bank
EFBN	Exchange Fund Bills and Notes
EMEAP	Executives Meeting of East Asia-Pacific Central Banks
ETP	Electronic trading platform
EU	European Union
FAST	Fully Automated System for Issuing/ Tendering
FSC	Financial Supervisory Commission
G7	Group of Seven industrialized nations
GDP	gross domestic product
GOCC	government-owned and controlled corporations or GOCCS
HKMA	Hong Kong Monetary Authority
IMF	International Monetary Fund
ITC	Investment trust companies
Korea	Republic of Korea
KORIBOR	Korea Interbank Offered Rate
KOSPI	Korea Composite Stock Price Index
KTB	Korea Treasury Bond
KTBi	Korea Treasury Bond (inflation linked)
LCY	local currency
MAS	Monetary Authority of Singapore
MBS	mortgage-backed securities
MGS	Malaysian Government Security
MOF	Ministry of Finance
MOFE	Ministry of Finance and Economy
MPC	Monetary Policy Committee
MSB	Monetary Stabilization Bond
MTM	mark-to-market
NPL	nonperforming loans
OECD	Organisation for Economic Co-operation and Development
OREI	Office of Regional Economic Integration
OTC	over–the-counter
PBIF	Pan Asian Bond Index Fund
PBOC	People’s Bank of China
PDEx	Philippine Dealing and Exchange Corp.
PDMO	Public Debt Management Office
PRC	People’s Republic of China
REIT	real estate investment trust
RENTAS	Reduction of Real Time Electronic Transfer of Funds
repo	repurchase agreement

- Against this backdrop and the need to stabilize troubled financial markets, monetary policy has shifted to a more accommodative stance in most countries, a trend likely to continue into 2009.
- The acceleration of capital outflows, coupled with tightened credit could choke off funds for investment and raise financing costs.
- Tight dollar liquidity, deleveraging, and weakening regional currencies may dampen foreign investor interest in local currency corporate bonds.
- Given the expected slowdown in global and regional growth, economies which have relatively comfortable fiscal balances and public debt are likely to introduce fiscal stimulus packages, boosting government bond issuance.
- Apart from immediate market stabilization measures, lessons from the current crisis can be applied to future policies to strengthen the development of local currency bond markets:
  - — Strengthen international supervisory and regulatory coordination, cooperation, convergence, and surveillance;
  - — Strengthen risk assessment and risk management;
  - — Promote consistent standards and mutual recognition;
  - — Improve transparency by better valuation and accounting of off-balance sheet instruments;
  - — Prudently liberalize cross-border financial services and capital accounts;
  - — Devise countercyclical policies for the financial sector;
  - — Strengthen or expand existing regional initiatives such as the Asian Bond Markets Initiative and Asian Bond Fund.

RTB	retail treasury bond
S$NEER	Singapore dollar nominal effective exchange rate
SBI	Sertifikat Bank Indonesia
SBV	State Bank of Viet Nam
SC	Malaysia Securities Commission
SDA	special deposit accounts
SEC	Securities and Exchange Commission (Philippines)
SGS	Singapore Government Securities
SGX	Singapore Exchange
SRO	self-regulating organization
TF	task force
ThaiBMA	Thai Bond Market Association
UK	United Kingdom
US	United States
US Fed	United States Federal Reserve
y-o-y	year-on-year
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.

The *Asia Bond Monitor* November 2008 was prepared by ADB’s Office of Regional Economic Integration and does not necessarily reflect the views of ADB's Board of Governors or the countries they represent.

Emerging East Asian Local Currency Bond Markets at a Glance

1: Size of Emerging East Asian Local Currency Bond Markets

	1H08	Growth Rate (%)	
	Amount (USD billion)	Y-o-Y 1H08	YTD 1H08
China, People's Rep. of	2,004.22	31.86	11.41
Hong Kong, China	92.64	(6.85)	(5.47)
Indonesia	82.88	(2.65)	(4.48)
Korea, Rep. of	985.91	7.91	3.88
Malaysia	187.49	27.19	12.76
Philippines	56.67	10.59	6.22
Singapore	138.58	15.36	7.66
Thailand	150.23	16.16	7.13
Viet Nam	11.90	75.49	27.76
Total Emerging East Asia	3,710.53	20.74	8.15
Government	2,690.20	22.16	9.13
Corporate	1,020.33	17.17	5.67

Sources: People's Republic of China (ChinaBond); Hong Kong, China (Hong Kong Monetary Authority); Indonesia (Indonesia Stock Exchange and Bank Indonesia); Republic of Korea (KoreaBondWeb); Malaysia (Bank Negara Malaysia); Philippines (Bureau of the Treasury); Singapore (Monetary Authority of Singapore); Thailand (Bank of Thailand); and Viet Nam (Bloomberg).

Total bonds outstanding grew more slowly in the first half of 2008 than in 2007. New government issuance continues to dominate.

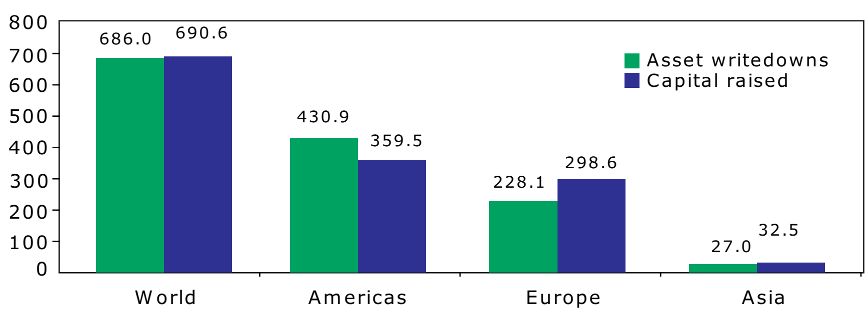
2: 10-Year Selected LCY Government Bond Yields

Markets	basis points change 1 Jan 08–31 Oct 08	1-Jan-08 Closing
US	-7.01	4.023
EU	-43.00	4.330
Japan	-3.40	1.510
PRC	-135.00	4.460
Hong Kong, China	-105.90	3.441
Indonesia	728.30	10.018
Malaysia	15.50	4.142
Korea, Rep. of	-21.00	5.700
Philippines	289.42	6.583
Singapore	27.00	2.680
Thailand	-118.40	4.955
Viet Nam	592.50	9.075

Source: Based on data from Bloomberg.

Yield curves shift downward as inflation eases and fear of economic slowdown increases.

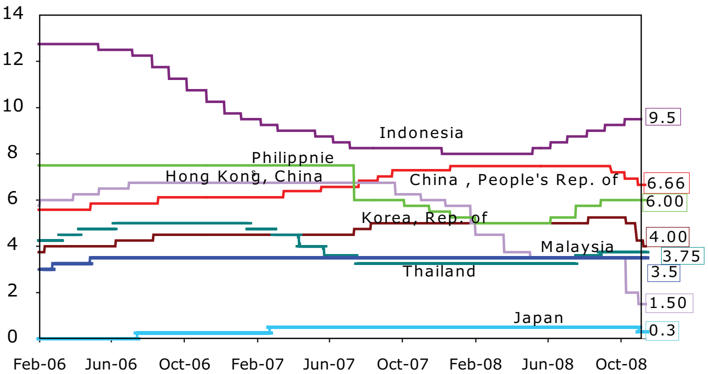
3: Writedowns and capital raised by major banks since the third quarter of 2007
(USD billions)



Source: Bloomberg, October 2008.

Asia is less exposed to global financial contagion.

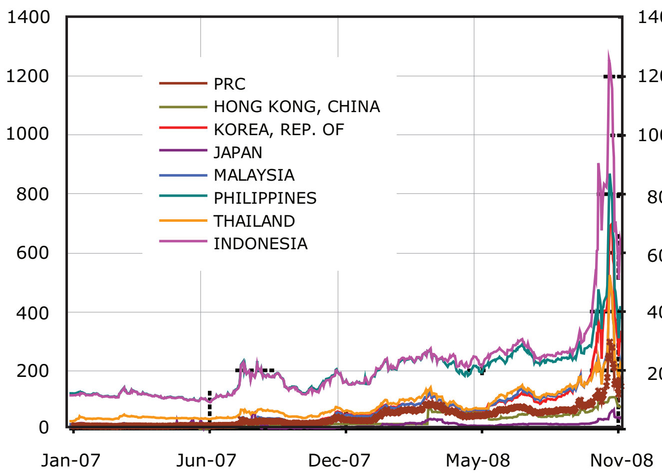
4: Policy Rates (% per annum)



Source: Bloomberg.

Bias shifting toward looser monetary policies as inflation eases and oil prices slide.

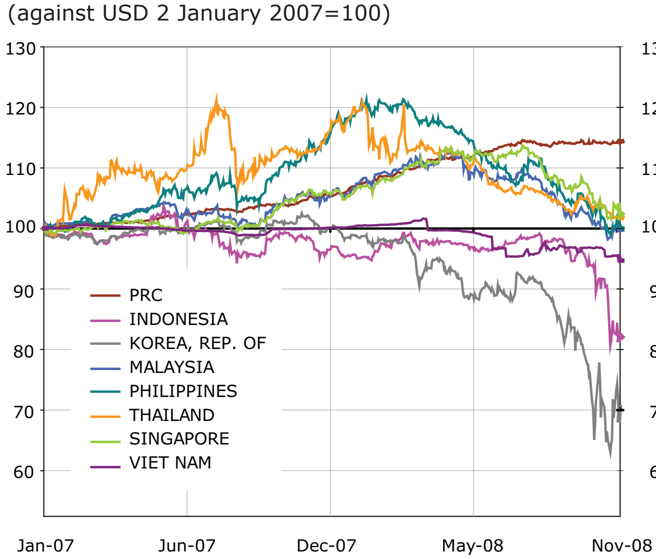
5: Credit Default Swap Spreads—Senior 5-year
(Mid spread in basis points)



Source: Thomson Datastream.

Risk premium remains elevated, more so for lower-rated sovereigns and high-risk corporates.

6: Exchange Rate Indexes
(against USD 2 January 2007=100)



Source: *AsianBondsOnline* calculations based on Bloomberg data.

Tighter dollar liquidity has weakened Asian currencies and may dampen foreign investor interest in local currency corporate bonds.

About the Asian Development Bank

ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries substantially reduce poverty and improve the quality of life of their people. Despite the region's many successes, it remains home to two thirds of the world's poor. Nearly 1.7 billion people in the region live on $2 or less a day. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

Based in Manila, ADB is owned by 67 members, including 48 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance. In 2007, it approved $10.1 billion of loans, $673 million of grant projects, and technical assistance amounting to $243 million.

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