

Asia Bond Monitor Highlights



- The global economy that emerging East Asia faces remains weak, with growth in the United States (US) struggling to gain momentum and the eurozone economies slipping back into recession.¹ At the same time, the growth outlook for the region's economies has also worsened with the People's Republic of China's (PRC) growth expected to be at its lowest since the 2008/09 global financial crisis. The looming fiscal cliff in the US and the unresolved debt crisis in Europe continue to weigh on investor sentiment.
- Despite the uncertainties in global financial markets, the performance of local currency (LCY) bond markets has been robust. Total bonds outstanding in emerging East Asia's LCY bond market grew 3.5% quarter-on-quarter (q-o-q) and 11.0% year-on-year (y-o-y) to reach US\$6.2 trillion in 3Q12, driven by a combination of strong growth in both the government and corporate bond sectors.
- The five most rapidly growing government bond markets in 3Q12 on a q-o-q basis were Malaysia, Singapore, the PRC, the Philippines, and Thailand. The q-o-q growth rates for these five markets were 4.8%, 4.0%, 3.9%, 3.6%, and 1.3%, respectively. The most rapidly growing corporate bond markets in 3Q12 on a q-o-q basis were Singapore, the PRC, Thailand, the Philippines, and the Republic of Korea.
- Issuance in emerging East Asia in 3Q12 totaled US\$826 billion, a decrease of 3.8% on a q-o-q basis and 4.5% on a y-o-y basis. The decline in issuance in 3Q12 was largely due to the decline in central bank issuance of 16.7% q-o-q and 27.7% y-o-y. On the other hand, issuance of treasuries and other government bonds grew 6.0% on both a q-o-q and y-o-y basis in 3Q12. Issuance of corporate bonds grew 7.5% q-o-q and a very impressive 45.4% y-o-y in 3Q12.
- Most government bond yield curves in emerging East Asia have shifted downward since the end of 2Q12, but with different biases toward either flattening or steepening. Only the PRC yield curve shifted upward between end-June and end-October.
- Foreign holdings rose in Indonesia, Thailand, and Malaysia in 3Q12 over their respective levels at the end of 2Q12. On the other hand, the most recent data available for the Republic of Korea showed a slight decline in the share of foreign holdings from 11.1% at the end of 1Q12 to 10.0% at the end of 2Q12.
- Risks to the region's LCY bond markets are biased toward the downside. These risks include (i) the fiscal cliff that threatens the US recovery, (ii) the surge of capital inflows into the region, and (iii) higher inflation on supply-side shocks.
- Our analysis of interactions within Asian domestic financial markets shows the significance of both direct and indirect channels of shock and volatility transmission from mature markets to Asian local bond markets.
- The shocks emanating from mature government bond markets during the US and eurozone crises have had indirect spillovers; the effects were transmitted to domestic money markets, foreign exchange markets, and local bond markets. On the other hand, high-yield US and European Union corporate bond markets transmitted shock spillovers directly into Asian local bond markets. This validates investor perceptions of Asian debt as comprising high-yielding assets.

¹ Emerging East Asia comprises the People's Republic of China; Hong Kong, China; Indonesia; the Republic of Korea; Malaysia; the Philippines; Singapore; Thailand; and Viet Nam.

- Volatility spillovers were directly transmitted to Asian local bond markets during the US and eurozone crises. Their values were generally larger than the shock spillovers. Significant volatility spillovers have also been observed in Asian equity, currency, and money markets, underlining the threat of wider financial market contagion.
- The feedback and transmission of shock and volatility spillovers across Asian domestic financial markets underscores the importance of monitoring and coordinating policies not just within national jurisdictions, but also in the regional and global settings in order to maintain financial stability.
- The 2012 *AsianBondsOnline* Bond Market Liquidity Survey received 122 responses on government bonds and 92 responses on corporate bonds. This year's liquidity survey found that bid-ask spreads for both government and corporate bonds tightened in most markets in 2012, while average trading sizes also increased in most markets.
- Liquidity, as measured by quarterly turnover ratios, improved for most instruments in a number of markets. Some of the most significant improvements in turnover ratios were among central bank and treasury bonds in the PRC, central bank and government bonds in the Republic of Korea, and treasury bills in the Philippines. One of the most important features of the PRC bond market has been its large and vibrant repurchase (repo) market. The turnover ratios for repo transactions are typically higher than those for cash transactions.
- The 2012 survey identified greater investor diversity as the most important structural change needed to improve market liquidity. Foreign investors have continued to expand their share of bond holdings in most markets. Pension funds and insurance companies are rapidly increasing their shares of government bond holdings in both Thailand and the Philippines, while government agency and social security holdings of government bonds in the Republic of Korea are increasing steadily. Retail investors are also increasing their shares in some local bond markets.