Highlights

Between 31 December and 15 February, 2-year and 10-year government bond yields in most advanced economies and emerging East Asian markets edged higher on the back of an improved global economic outlook and progress on vaccinations.[1] Optimism over the economic recovery and accommodative monetary stances boosted investment sentiment around the world during the review period.

While most emerging East Asian economies saw their gross domestic product (GDP) contract in 2020, economic performance generally improved in the fourth quarter (Q4) of 2020. Bucking the regional trend, the People's Republic of China (PRC) and Viet Nam posted positive growth in 2020.

Buoyed by the better economic outlook, financial conditions improved. Most regional central banks maintained their accommodative monetary stances to support the fragile recovery. Improved sentiment lifted most equity markets and regional currencies between 31 December and 15 February. Risk premiums were broadly unchanged during the review period. Capital flows into the region's equities and bond markets also recovered in Q4 2020.

Downside risks in 2021 have receded compared to the previous year on the back of the coronavirus disease (COVID-19) vaccine rollouts. However, the uncertain trajectory of the pandemic remains the biggest risk to the global economic recovery. This risk is exacerbated by uneven vaccine rollouts across economies. Another risk is a rise in asset prices due to the increased liquidity generated by central banks in the region. A sudden downturn in equity prices or a reversal in monetary stances by central banks in response to inflationary pressures could destabilize financial markets. One factor in this is the passage of the USD1.9 trillion fiscal stimulus program in the United States, which has raised further concerns of inflation and Federal Reserve tightening. This could cause a pullback of capital from emerging markets.

Emerging East Asia's local currency bond market rose to an aggregate size of USD20.1 trillion at the end of December.

Local currency (LCY) bonds outstanding in emerging East Asia reached USD20.1 trillion at the end of December. Overall growth of the region's bond market slowed to 3.1% quarter-on-quarter (q-o-q) in Q4 2020 from 4.8% q-o-q in the third quarter (Q3) of 2020. On a year-on-year (y-o-y) basis, growth inched up to 18.1% in Q4 2020 from 17.4% in Q3 2020. Emerging East Asia's LCY bond market size expanded to the equivalent of 97.7% of the region's GDP at the end of Q4 2020 from 95.9% in Q3 2020.

Government bonds accounted for 61.8% of the regional LCY bond stock at the end of December. The region's government bond stock reached USD12.4 trillion, posting growth of 3.6% q-o-q and 19.5% y-o-y. Corporate bonds accounted for the remaining 38.2%. The region's corporate bond stock amounted to USD7.7 trillion at the end of December, growing by 2.2% q-o-q and 16.1% y-o-y.

The PRC remained the region's largest bond market, accounting for 77.4% of emerging East Asia's total bond stock at the end of December. This was followed by the Republic of Korea (12.1%) and the aggregate among members of the Association of Southeast Asian Nations (9.0%).[2]

LCY bond issuance in emerging East Asia totaled USD2.0 trillion in Q4 2020. Government bond issuance accounted for 54.8% of the quarterly total and stood at USD1.1 trillion. Government bond issuance declined 23.5% q-o-q but rose 47.3% y-o-y. Issuance of corporate bonds reached USD0.9 trillion, contracting 0.9% q-o-q but expanding 17.3% y-o-y.

The March issue of the *Asia Bond Monitor* includes a box discussing differences between the development of corporate bond markets in East Asia and Latin America,

[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.
[2] LCY bond statistics for the Association of Southeast Asian Nations include the markets of Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Viet Nam.

and the implications of such differences for financial resilience. This issue also contains three special sections: (i) environmental, social, and governance (ESG) bonds in ASEAN+3; (ii) recent developments in social bonds; and (iii) key findings of *AsianBondsOnline*'s 2020 bond market liquidity survey.[3]

Box: A Comparison of the Expansion of Corporate Bond Markets in East Asia and Latin America

Corporate bond issuance steadily increased in East Asian and Latin American economies between 2010 and 2019. The ratio of corporate debt issuance to GDP rose from 119% to 144% in East Asia and from 34% to 42% in Latin America. In contrast with the common growth trend, bonds were issued largely through domestic markets and in domestic currency in East Asia, while bonds were largely issued in international markets and in foreign currency in Latin America. As a result, Latin America is more vulnerable to changes in global market conditions and currency fluctuations than East Asia.

Special Section: Environmental, Social, and Governance Bonds in ASEAN+3

ESG bonds outstanding in ASEAN+3 markets reached a size of over USD265 billion at the end of December 2020. Green bonds continued to dominate the ESG bond stock, however, their share of the total has declined due to an increase in issuance of social bonds and sustainability bonds. At the end of December, the PRC accounted for the largest share of ESG bonds outstanding in ASEAN+3 markets, followed by Japan and the Republic of Korea.

Special Section: Social Bonds—Recent Developments and Trends

A Primer and Recent Developments in Asia

The ESG bond market has grown significantly over the last few years in response to growing demand. The green bond segment dominates the ESG bond market, with green bond issuance growing to about USD240 billion and social bond issuance reaching around USD150 billion in 2020. Issuance in Asia has been dominated by government-related agency issuers in high-income economies such as Japan and the Republic of Korea. Yet, developing Asia's urgent economic and social development funding needs strengthen the case for a robust social bond market.[4] This section also discusses the impediments to market growth and the regulatory measures needed to further develop the social bond market in the region.

A Nascent Opportunity for ESG Investing

The unprecedented growth of social bonds amid COVID-19 points to the potential of social bonds in financing projects with positive social impacts while also providing new opportunities for institutional investors. Investing in social bonds is beneficial for institutional investors for several reasons. First, the risk–return profile of a social bond is in line with that of a traditional bond from the same issuer. Second, social bonds provide a platform for engagement with corporate issuers. Third, social bonds provide investors with a mechanism to signal their commitment to global social issues and measure the social impact of their investments. Since the market shake-up caused by COVID-19 is expected to persist, investing in social bonds at an early stage will allow institutional investors to support the development of this innovative instrument and reap the benefits of the expected market expansion.

Promoting Social Bonds for Impact Investments in Asia

This section explores how the focus of social bonds has evolved amid the COVID-19 pandemic and contains a detailed discussion on key social areas that could be targeted. A two-pronged approach is proposed to optimize the use of social bonds in financing economic recovery from COVID-19. The approach involves (i) targeting urgent short-term needs such as employment generation, small business support, and healthcare provision; and (ii) funding longer-term programs to reduce poverty and strengthen resilience against future shocks. Lastly, the section touches on the challenges and recent developments in social impact assessment.

[3] ASEAN+3 comprises the 10 members of ASEAN plus the PRC, Japan, and the Republic of Korea.
[4] Developing Asia comprises the 46 developing member economies of the Asian Development Bank.

Special Section: *AsianBondsOnline* 2020 Bond Market Liquidity Survey

AsianBondsOnline conducts an annual bond market liquidity survey to review the state of liquidity in the region's LCY bond markets and identify areas of weakness for further development. Overall, liquidity conditions diverged across regional markets in 2020. While most survey participants from the PRC, Indonesia, Malaysia, and Viet Nam noted improved liquidity, those from the Republic of Korea, the Philippines, Singapore, and Thailand observed decreased liquidity. Respondents from Hong Kong, China reported stable liquidity conditions. Survey participants also noted that liquidity was greatly impacted by market sentiment, the global COVID-19 pandemic, and changes in domestic bond yields.

In nearly all markets, government bond turnover ratios declined the most during the second quarter of the year and steadily fell through Q4 2020. On the other hand, movements in corporate bond turnover ratios were mixed in 2020. The survey, which was conducted in Q4 2020, found that bid–ask spreads for government bonds and corporate bonds were largely unchanged from the 2019 survey results.

Survey participants ranked hedging mechanisms for both government bonds and corporate bonds as the most important market development priority, implying a need to expand the availability of hedging instruments. In contrast, settlement and custody scored the highest for both bond segments, reflecting relatively efficient settlement processes across the region's bond markets.