

ASIA'S REGIONAL BOND MARKETS EXPAND BUT MANY RISKS LOOM

JAKARTA, INDONESIA (22 November 2012) – Emerging East Asia's local currency bond markets continue to expand and are performing well, but risks loom large on the horizon, warned the Asian Development Bank's (ADB) latest *Asia Bond Monitor*.

"There are a number of downside risks to the local bond markets. The US could fall over the fiscal cliff and the new Chinese leadership has to deal with slowing growth in the world's second largest economy," said Iwan Azis, Head of ADB's Office of Regional Economic Integration. "A surge in volatile capital inflows and rising inflation in the region are also potential threats."

Volatility spillovers from mature markets to local bond markets are another major risk. The report showed that external shocks and volatility are also increasingly being transmitted between domestic markets and between markets across Asia as they expand and their influence grows. This means that regulators in Asia need to monitor and coordinate market policies nationally as well as regionally and globally.

Bond yields fell in most countries in the third quarter on the back of moderating inflation, strong economic performance, and steady investor demand, with the exception of the People's Republic of China (PRC) where concerns over slower economic growth and inflation have pushed yields higher.

The region's bond markets are, however, increasingly diverse in terms of growth rates, issuance, and yields.

At \$6.2 trillion, the region's local currency bond market was 3.5% bigger than at end of June 2012 and 11.0% larger than at the end of September 2011. Government bonds continue to dominate with \$4.1 trillion outstanding at the end of September, 3.1% more than at the end of June.

Some markets, such as Malaysia, Singapore, and the PRC saw solid growth in their government markets over the quarter. However, those of the Republic of Korea and Hong Kong, China grew only a tad while the markets of Indonesia and Viet Nam shrank slightly, due to a sharp drop in issuance by monetary authorities. The amount of Sertifikat Bank Indonesia bills outstanding fell by 23.9% on quarter while State Bank of Viet Nam bills tumbled 62%.

Corporate bond markets continued to expand at a faster rate than their sovereign counterparts though with \$2.2 trillion outstanding at the end of September, up 4.2% on quarter, with most markets posting growth.

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Overall, bond issuance differed sharply between countries over the quarter, however, with gross bond sales rising 38.1% in Malaysia, 13.0% in the Philippines, and 10.5% in the PRC but tumbling 81.3% in Viet Nam, 25.9% in Hong Kong, China and down 8.1% in Thailand.

The report's annual liquidity survey showed an uptick in liquidity in both government and corporate bonds for the region as a whole. The survey showed that increased investor diversity, greater availability of hedging instruments, and more transparency are keys to boosting activity in emerging East Asia's local currency bond markets.

The *Asia Bond Monitor* assesses the markets of the PRC; Hong Kong, China; Indonesia; the Republic of Korea; Malaysia; the Philippines; Singapore; Thailand; and Viet Nam.

ADB, based in Manila, is dedicated to reducing poverty in Asia and the Pacific through inclusive economic growth, environmentally sustainable growth and regional integration. Established in 1966, it is owned by 67 members – 48 from the region. In 2011, ADB approvals including cofinancing totaled \$21.7 billion.
