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The *Asia Bond Monitor* (ABM) reviews recent developments in East Asian local currency bond markets along with outlook, risks, and policy challenges. It covers the 10 members of the Association of Southeast Asian Nations (ASEAN) 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

- The global outlook facing emerging East Asia has deteriorated significantly in recent months with weaker growth now expected in Europe and an uncertain pace of recovery in the United States (US).[1] This slowdown—exacerbated by ongoing sovereign debt issues in the eurozone—is heightening risk aversion and generating volatility in global financial markets.

- The recent bouts of financial market volatility are a timely reminder of the region's continued vulnerability to external shocks. Emerging markets have not been spared the impact of dampening market sentiments in developed economies as the end of 3Q11 saw substantial portfolio outflows from the region. However, this trend reversed itself somewhat in October.

- A slowdown in growth and an easing of inflationary pressures in 3Q11 has moved the policy focus in emerging East Asia toward supporting growth. Authorities in many economies had begun tightening liquidity in late 2010, but in most cases they have suspended these efforts.

- The principal impact of the weakening external environment in September–October on benchmark yield curves was either a flattening or simply a downward shifting of the entire government bond yield curve in most markets. The only exceptions to this were in Singapore and Hong Kong, China, where yield curves steepened slightly in October.

- Total bonds outstanding in emerging East Asia's local currency (LCY) market rose 5.5% on a year-on-year (y-o-y) basis—and 1.0% on a quarter-on-quarter (q-o-q) basis—to reach US$5.5 trillion at the end of 3Q11, driven mainly by strong growth in corporate bonds. On a y-o-y basis the region's most rapidly growing LCY bond markets in 3Q11 were Viet Nam, Malaysia, Singapore, and the Republic of Korea.

- Total government bonds outstanding grew only 0.5% q-o-q in 3Q11, reflecting negative or only marginal growth rates in most markets. The People's Republic of China's (PRC) government bond market expanded only 0.1% q-o-q. The region's most rapidly growing government bond markets in 3Q10 on a q-o-q basis were Thailand; Malaysia; Viet Nam; and Hong Kong, China.

- Bonds issued by provinces and other local governments may emerge as a new asset class in the region's LCY bond market over the coming year. In emerging East Asia, Thailand has taken steps to permit the issuance of bonds by its local governments. Furthermore, recent announcements that the PRC government has approved bond issuance by some of its provincial and municipal governments—in their own name—signal another new source of bond issuance.

- Growth of the region's LCY corporate bond market in 3Q11 was 2.0% q-o-q, led by the Republic of Korea and Malaysia.

- LCY bond issuance in emerging East Asia totaled US$829 billion in 3Q11—a 19.9% decline on a y-o-y basis but a 7.6% rise on a q-o-q basis. The principal cause of the y-o-y decline was the curtailment of issuance by central banks and monetary authorities as they either sharply reduced sterilization activities over the last year or shifted to tools other than bills and bonds to reduce liquidity growth.

- The 2011 *AsianBondsOnline* Bond Market Liquidity Survey was conducted from early August through mid-October. During the survey period the central role of liquidity in the health of

[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.

the region's LCY bond market was underscored by the emergence of concerns about European sovereign debt and mixed signals of economic recovery in the US. These factors contributed to a widening of bid–ask spreads in most emerging Asian markets since the last *AsianBondsOnline* survey in 2010.

- The 2011 survey revealed that market participants want governments in the region to issue more investable LCY government bonds to improve market liquidity.

- The region's LCY bond market participants were asked for their views on market structure and policy changes that would help improve bond market liquidity. Greater diversity of investors and traders was once again identified as a key factor in promoting liquidity in emerging East Asia's LCY government and corporate bond markets.

- The risks to the region's outlook are significantly tilted to the downside. These risks include (i) potential spillover from Europe that impairs demand and investment, (ii) growing volatility in global markets and a flight to low-risk investments, (iii) a reduced growth outlook for Asia in 2012, and (iv) moderately high inflation in some markets.

# Introduction: **Global and Regional Market Developments**

The global outlook facing emerging East Asia has deteriorated significantly in recent months with weaker growth now expected in Europe and an uncertain pace of recovery in the United States (US).[2] This slowdown—exacerbated by ongoing sovereign debt issues in the eurozone—is heightening risk aversion and generating volatility in financial markets **(Table A)**.

The real sector in Asia will be impacted through both trade and financial channels, with growth in the region expected to moderate as demand slackens in the developed economies **(Figure A)**. Increased volatility in capital flows and exchange rates, largely driven by the deepening sovereign debt crisis in Europe, could further aggravate the situation **(Figure B)**.

The recent bouts of financial market volatility are a timely reminder of the region's continued vulnerability to external shocks. Emerging markets have not been spared as the uncertain economic outlook intensifies volatility and dampens market sentiment in the developed economies **(Figure C)**. The end of the third quarter witnessed substantial portfolio outflows from the region as heightened risk aversion spread throughout financial markets. Some economies have already witnessed capital

**Table A: Changes in Global Financial Conditions, July–October 2011**

| | **2-Year Government Bond** (bps) | **10-Year Government Bond** (bps) | **5-Year CDS** (bps) | **Equity Index** (%) | **FX Rate** (%) |
|---|---|---|---|---|---|
| **Major Advanced Economies** | | | | | |
| United States | (23.37) | (106.90) | – | (6.45) | – |
| United Kingdom | (34.50) | (103.20) | 21.19 | (7.44) | 0.08 |
| Japan | (1.30) | (9.30) | 2.82 | (10.64) | (3.29) |
| Germany | (107.21) | (98.62) | 43.39 | (17.23) | (4.60) |
| **ASEAN+3** | | | | | |
| China, People's Rep. of | 22.00 | (13.00) | (34.00) | (10.55) | (1.70) |
| Hong Kong, China | (5.00) | (75.10) | (21.00) | (11.31) | (0.17) |
| Indonesia | (86.50) | (118.70) | (61.00) | (3.47) | 3.58 |
| Korea, Rep. of | (19.00) | (46.00) | (50.00) | (10.19) | 0.30 |
| Malaysia | (20.10) | (18.80) | (34.50) | (5.75) | 1.88 |
| Philippines | (129.23) | (64.47) | (46.50) | (0.41) | (1.20) |
| Singapore | (17.00) | (59.00) | 3.00 | (9.02) | 2.27 |
| Thailand | (50.90) | (49.30) | (49.50) | (6.41) | (0.03) |
| Viet Nam | 2.50 | 2.30 | – | (1.05) | 2.06 |
| **Select European Markets** | | | | | |
| Greece | 4,428.10 | 1,220.09 | 1,864.08 | (19.95) | (4.60) |
| Ireland | (504.77) | (365.47) | (39.35) | (21.93) | (4.60) |
| Italy | 214.84 | 132.92 | 264.06 | (9.00) | (4.60) |
| Portugal | 604.49 | 50.37 | 278.91 | (38.20) | (4.60) |
| Spain | 54.19 | 20.07 | 78.63 | (14.65) | (4.60) |

– = not available, ASEAN = Association of Southeast Asian Nations, bps = basis points, CDS = credit default swap, FX = foreign exchange.
Note: Changes from 01 July 2011 to 31 October 2011.
Source: Bloomberg LP, CEIC, and Institute of International Finance (IIF).

[2] 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.

**Figure A: GDP Growth Rates** (seasonally adjusted, annualized, q-o-q, % change)

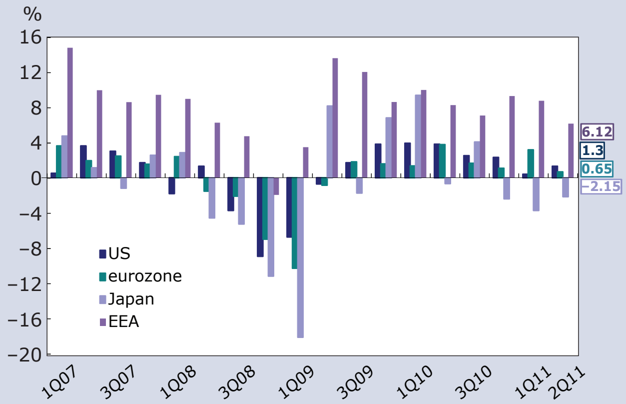



**Figure D: Net Foreign Portfolio Investments in Equities**[b]

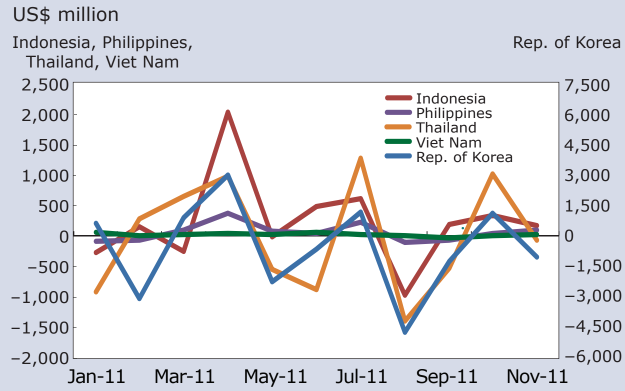



**Figure B: Credit Default Swap Spreads**[a] (senior 5-year)

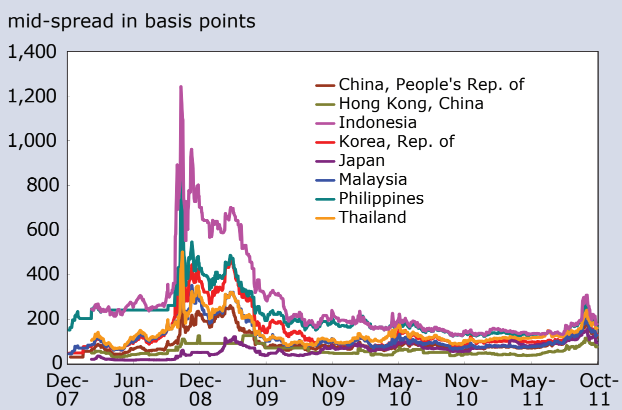



**Figure E: Exposure to US and European Banks** (% of domestic credit as of June 2011)[c]

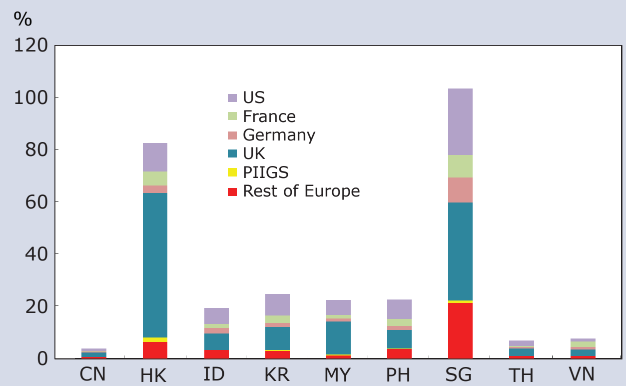



**Figure C: US Equity Volatility and Emerging Market Sovereign Bond Spreads**

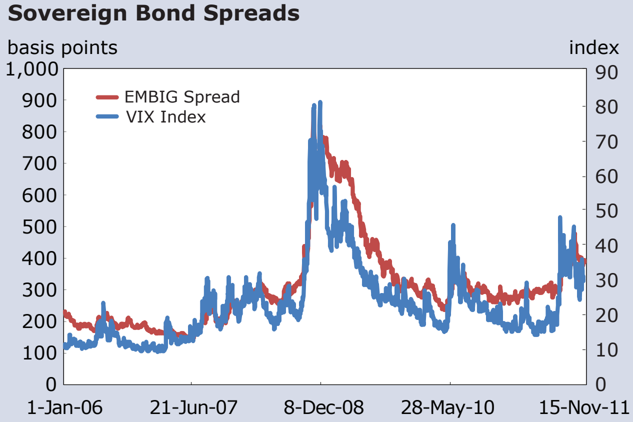



**Figure F: Credit Default Swap Spreads for Select European Markets**[a] (senior 5-year)

**Figure G: JPMorgan EMBI Sovereign Stripped Spreads**

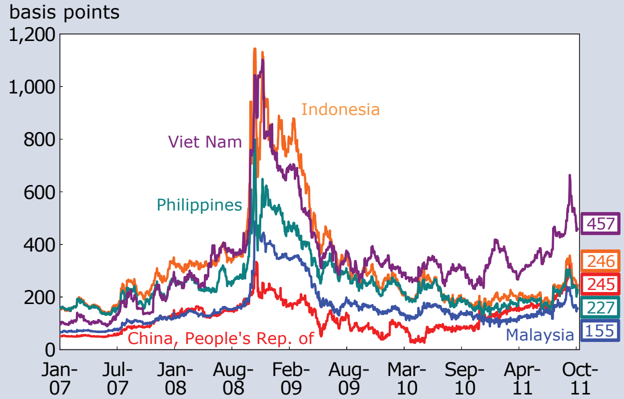
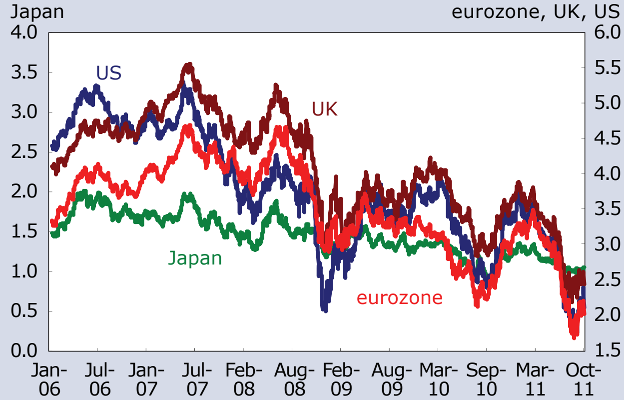



**Figure H: 10-Year Government Bond Yields**
(% per annum)




CN = People's Republic of China; EMBI = Emerging Market Bond Index; EMBIG = Emerging Markets Bond Index Global; HK = Hong Kong, China; ID = Indonesia; KR = Republic of Korea; MY = Malaysia; PH = Philippines; PIIGS = Portugal, Italy, Ireland, Greece, Spain; SG = Singapore; TH = Thailand; UK = United Kingdom; US = United States; VIX = Chicago Board Options Exchange Volatility Index; VN = Viet Nam.
Notes:
a. US$ spread based on sovereign bonds.
b. Data as of 15 November 2011.
c. Domestic credit as of March 2011 used for the Philippines and Viet Nam.
Source: Thomson Reuters and Bloomberg LP.

outflows as leveraged investors and European banks pull back funds from emerging markets, including Asia, to shore up liquidity in domestic markets. However, this trend has reversed itself somewhat in recent weeks and the region's bond markets are again attracting capital inflows **(Figure D)**.

Markets remain focused on the possible outcomes of the European debt crisis and the potential impact on global financial conditions and slowing economic growth. While Asian economies are not home to significant holdings of European sovereign debt, a squeeze in global liquidity and tightening external credit conditions could impact the region, particularly economies and firms that are dependent on external borrowing **(Figures E and F)**.

The re-pricing of liquidity in global markets is raising the cost of credit for Asian companies **(Figure G)**. Market uncertainty and lingering concerns over the health of the banking sector and tighter regulatory capital provisions are squeezing liquidity in credit markets. These developments are making foreign borrowing more expensive, even for the region's higher-rated companies.

Some economies in the region are still dependent on loans from abroad and therefore have significant exposure to the spillover effects of the European sovereign debt crisis. If the crisis worsens affected foreign banks might sell off assets, refuse to roll over maturing loans, or cut credit lines to Asia, especially if they face large losses at home. On the other hand, Asian banks remain well capitalized and can provide ample credit to domestic borrowers if global liquidity dries up. Furthermore, central bank reserves should alleviate any short-term foreign liquidity constraints.

A slowdown in growth and an easing of inflationary pressure in 3Q11 have moved the policy focus in emerging East Asia toward supporting growth. Authorities in the region had begun tightening liquidity in their respective financial systems in late 2010, but in most cases they have since suspended these efforts and are now leaving policy rates unchanged. The policy rate in Indonesia was even reduced recently. Meanwhile, growth prospects for emerging East Asian economies remain relatively robust despite increasing downside risks.

The eurozone debt crisis and volatility in equity markets in recent weeks have increased demand for US treasuries as a safe-haven bid **(Figure H)**. While the US' 3Q11 growth data surprised markets on the upside, there are widespread expectations that the US Federal Reserve will keep rates low to support growth as Europe struggles to contain the debt crisis that is threatening to drag down the global economy.

Total bonds outstanding in emerging East Asia's LCY market expanded 5.5% year-on-year (y-o-y) in 3Q11 to reach US$5.5 trillion, driven by strong growth in the region's corporate bond market. Growth in the region's government bond market slowed to 1.3% y-o-y after posting 2.7% growth in the previous quarter.

Corporate bond market growth remained robust in 3Q11 with 15.4% y-o-y growth, although this was down from 19.7% in 2Q11. On a quarter-on-quarter basis (q-o-q), the region's LCY corporate bond market growth in 3Q11 was 2.0%, led by the Republic of Korea and Malaysia.

At end-March emerging East Asia's share of the global bond market stood at 8.0%, compared with only 2.1% before the onset of the 1997/98 Asian financial crisis **(Table B)**. The two largest markets in the region at the end of 1Q11 were the PRC (4.6% of the global bond market) and the Republic of Korea (1.8%).

The risks to the region's outlook are significantly tilted to the downside. These risks include (i) potential spillover from Europe that impairs demand and investment, (ii) growing volatility in global markets and a flight to low-risk investments, (iii) a reduced growth outlook for Asia in 2012, and (iv) moderately high inflation in some markets.

**Table B: Bonds Outstanding in Major Markets** (US$ billion)

| Economy | March 2011 | | 1996 | |
|---|---|---|---|---|
| | LCY Bonds Outstanding | % of World Total | LCY Bonds Outstanding | % of World Total |
| United States | 25,475 | 38.1 | 10,926 | 42.9 |
| Japan | 11,504 | 17.2 | 4,456 | 17.5 |
| France | 3,421 | 5.1 | 1,261 | 4.9 |
| Germany | 2,815 | 4.2 | 1,888 | 7.4 |
| United Kingdom | 1,727 | 2.6 | 678 | 2.7 |
| Emerging East Asia | 5,321 | 8.0 | 531 | 2.1 |
| of which: PRC | 3,066 | 4.6 | 62 | 0.2 |
| Emerging East Asia excl. PRC | 2,255 | 3.4 | 469 | 1.8 |
| of which: Korea, Rep. of | 1,211 | 1.8 | 283 | 1.1 |
| of which: ASEAN-6 | 878 | 1.3 | 149 | 0.6 |
| Indonesia | 118 | 0.2 | 7 | 0.0 |
| Malaysia | 259 | 0.4 | 71 | 0.3 |
| Philippines | 73 | 0.1 | 28 | 0.1 |
| Singapore | 187 | 0.3 | 25 | 0.1 |
| Thailand | 225 | 0.3 | 19 | 0.1 |
| Viet Nam | 16 | 0.0 | – | – |
| Memo Items: | | | | |
| Brazil | 1,528 | 2.3 | 299 | 1.2 |
| PRC (excl. policy bank bonds) | 2,200 | 3.3 | – | – |
| India | 711 | 1.1 | 81 | 0.3 |
| Russian Federation | 81 | 0.1 | 43 | 0.2 |

– = not available, ASEAN = Association of Southeast Asian Nations, LCY = local currency, PRC = People's Republic of China.
Source: Bank for International Settlements and *AsianBondsOnline*.

# Bond Market Developments in the Third Quarter of 2011

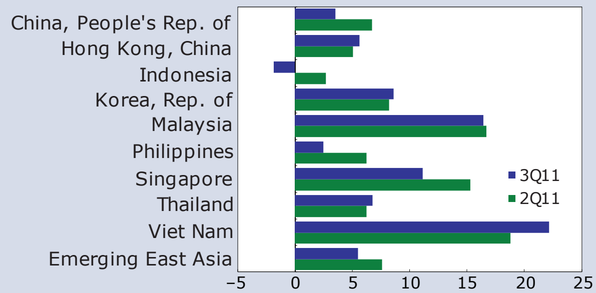
## Size and Composition

### Total bonds outstanding in emerging East Asia's LCY market rose 5.5% y-o-y and 1.0% q-o-q to reach US$5.5 trillion at the end of 3Q11, driven by strong growth in corporate bonds.[3]

The year-on-year (y-o-y) growth rate for emerging East Asia's local currency (LCY) bond market in 3Q11 was 5.5%, down from 7.6% growth recorded in 2Q11 **(Figure 1)**. The government bond market experienced a modest pickup to rise 2.7% y-o-y in 2Q11 before growth slowed to only 1.3% in 3Q11. Growth in the region's corporate bond market was a more robust 15.4% y-o-y in 3Q11, although this was down from 19.7% growth in 2Q11 **(Table 1)**.

The region's most rapidly growing LCY bond markets in 3Q11 on a y-o-y basis were Viet Nam, Malaysia, Singapore, and the Republic of Korea, which saw growth rates of 22.2%, 16.5%, 11.2%, and 8.6%, respectively. On a quarter-on-quarter (q-o-q) basis, Malaysia was the most rapidly growing market at 3.4%, followed by Thailand, the Republic of Korea, and Viet Nam at 3.0%, 2.1%, and 1.8%, respectively. Singapore's LCY bond market was not among the q-o-q growth leaders in 3Q11 due to a 2.2% decline in government bonds outstanding.

**Figure 1: Growth of LCY Bond Markets in 2Q11 and 3Q11** (y-o-y, %)




LCY = local currency, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Growth rates are calculated from LCY base and do not include currency effects.
3. Emerging East Asia growth figure is based on end-September 2011 currency exchange rates and does not include currency effects.
4. For the Philippines, 3Q11 government bonds outstanding figure based on *AsianBondsOnline* estimate. For Singapore, corporate bonds outstanding quarterly figures based on *AsianBondsOnline* estimates. For Japan, 3Q11 government and corporate bonds oustanding carried over from July 2011.

Source: People's Republic of China (*ChinaBond*); Hong Kong, China (Hong Kong Monetary Authority); Indonesia (Bank Indonesia and Indonesia Stock Exchange); Republic of Korea (EDAILY *BondWeb* and The Bank of Korea); Malaysia (Bank Negara Malaysia); Philippines (Bureau of the Treasury and Bloomberg LP); Singapore (Monetary Authority of Singapore, Singapore Government Securities, and Bloomberg LP); Thailand (Bank of Thailand); Viet Nam (Bloomberg LP); and Japan (Japan Securities Dealers Association).

### Total government bonds outstanding grew only 0.5% q-o-q in 3Q11, reflecting marginal or negative growth rates in most markets.

On a q-o-q basis, the LCY government bond markets of Indonesia, Singapore, and the Philippines shrank in 3Q11 by 3.7%, 2.2%, and 0.1%, respectively. The government bond market of the People's Republic of China (PRC) grew only 0.1% q-o-q, while the Republic of Korea's expanded 1.2%. The government bond markets in Hong Kong, China and Viet Nam grew 1.9% and 2.1% q-o-q, respectively. Thailand's government bond market exhibited the most robust q-o-q growth in 3Q11, expanding 4.2%, followed by Malaysia which grew 4.1%. The primary reason for the weak performance of the emerging East Asian LCY government bond market was the sharp reduction of bill and bond issuance by the region's central banks and monetary authorities as they continued to retreat from sterilization activities utilized since 2009 and early 2010.

The stock of treasury bonds grew 12.4% y-o-y while the stock of treasury bills outstanding fell 5.3%. The total stock of treasury bills in the region at the

[3] 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.

**Table 1: Size and Composition of LCY Bond Markets**

| | 3Q10 | | 2Q11 | | 3Q11 | | Growth Rate (LCY-base %) | | | | Growth Rate (US$-base %) | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Amount (US$ billion) | % share | Amount (US$ billion) | % share | Amount (US$ billion) | % share | 3Q10 | | 3Q11 | | 3Q10 | | 3Q11 | |
| | | | | | | | q-o-q | y-o-y | q-o-q | y-o-y | q-o-q | y-o-y | q-o-q | y-o-y |
| **China, People's Rep. of (PRC)** | | | | | | | | | | | | | | |
| **Total** | 2,991 | 100.0 | 3,190 | 100.0 | 3,247 | 100.0 | 3.6 | 21.4 | 0.5 | 3.5 | 5.0 | 23.9 | 1.8 | 8.6 |
| Government | 2,377 | 79.5 | 2,440 | 76.5 | 2,474 | 76.2 | 1.9 | 15.6 | 0.1 | (0.7) | 3.2 | 18.0 | 1.4 | 4.1 |
| Corporate | 614 | 20.5 | 750 | 23.5 | 773 | 23.8 | 10.9 | 50.5 | 1.8 | 20.0 | 12.4 | 53.5 | 3.1 | 25.9 |
| **Hong Kong, China** | | | | | | | | | | | | | | |
| **Total** | 161 | 100.0 | 167 | 100.0 | 170 | 100.0 | 1.0 | 25.4 | 1.6 | 5.7 | 1.4 | 25.3 | 1.5 | 5.3 |
| Government | 87 | 53.7 | 88 | 52.7 | 90 | 52.8 | 0.6 | 61.2 | 1.9 | 3.8 | 1.0 | 61.0 | 1.8 | 3.5 |
| Corporate | 74 | 46.3 | 79 | 47.3 | 80 | 47.2 | 1.5 | (0.3) | 1.2 | 7.8 | 1.9 | (0.4) | 1.2 | 7.4 |
| **Indonesia** | | | | | | | | | | | | | | |
| **Total** | 112 | 100.0 | 118 | 100.0 | 110 | 100.0 | 1.6 | 15.4 | (2.9) | (1.8) | 3.5 | 25.2 | (6.9) | (2.3) |
| Government | 101 | 89.7 | 103 | 87.0 | 95 | 86.3 | 0.6 | 13.9 | (3.7) | (5.6) | 2.5 | 23.6 | (7.7) | (6.0) |
| Corporate | 12 | 10.3 | 15 | 13.0 | 15 | 13.7 | 10.9 | 30.7 | 2.0 | 30.5 | 12.9 | 41.8 | (2.2) | 29.9 |
| **Korea, Rep. of** | | | | | | | | | | | | | | |
| **Total** | 1,122 | 100.0 | 1,274 | 100.0 | 1,179 | 100.0 | 1.8 | 8.7 | 2.1 | 8.6 | 9.1 | 12.3 | (7.4) | 5.1 |
| Government | 496 | 44.2 | 547 | 42.9 | 501 | 42.5 | 1.2 | 4.6 | 1.2 | 4.4 | 8.4 | 8.1 | (8.3) | 1.1 |
| Corporate | 626 | 55.8 | 727 | 57.1 | 678 | 57.5 | 2.3 | 12.1 | 2.9 | 11.9 | 9.6 | 15.8 | (6.8) | 8.3 |
| **Malaysia** | | | | | | | | | | | | | | |
| **Total** | 234 | 100.0 | 269 | 100.0 | 263 | 100.0 | 3.7 | 15.1 | 3.4 | 16.5 | 8.7 | 29.1 | (2.1) | 12.7 |
| Government | 137 | 58.4 | 161 | 59.7 | 158 | 60.1 | 5.1 | 20.9 | 4.1 | 19.8 | 10.1 | 35.6 | (1.4) | 16.0 |
| Corporate | 97 | 41.6 | 108 | 40.3 | 105 | 39.9 | 1.7 | 7.8 | 2.3 | 11.8 | 6.6 | 20.9 | (3.1) | 8.2 |
| **Philippines** | | | | | | | | | | | | | | |
| **Total** | 72 | 100.0 | 75 | 100.0 | 74 | 100.0 | 3.3 | 12.7 | (0.3) | 2.5 | 9.2 | 21.6 | (1.2) | 2.7 |
| Government | 64 | 88.2 | 66 | 87.2 | 65 | 87.4 | 3.8 | 11.8 | (0.1) | 1.6 | 9.8 | 20.7 | (1.0) | 1.8 |
| Corporate | 9 | 11.8 | 10 | 12.8 | 9 | 12.6 | (0.5) | 19.8 | (1.9) | 9.3 | 5.2 | 29.3 | (2.8) | 9.5 |
| **Singapore** | | | | | | | | | | | | | | |
| **Total** | 166 | 100.0 | 199 | 100.0 | 186 | 100.0 | 2.9 | 8.8 | (0.8) | 11.2 | 9.4 | 16.5 | (6.8) | 11.9 |
| Government | 97 | 58.6 | 113 | 56.6 | 104 | 55.8 | 0.0 | 4.5 | (2.2) | 5.8 | 6.3 | 11.9 | (8.1) | 6.5 |
| Corporate | 69 | 41.4 | 87 | 43.4 | 82 | 44.2 | 7.4 | 15.5 | 1.0 | 18.8 | 14.2 | 23.7 | (5.1) | 19.6 |
| **Thailand** | | | | | | | | | | | | | | |
| **Total** | 217 | 100.0 | 222 | 100.0 | 225 | 100.0 | 2.5 | 14.2 | 3.0 | 6.8 | 9.5 | 25.9 | 1.5 | 3.9 |
| Government | 176 | 81.3 | 178 | 80.2 | 183 | 81.1 | 3.3 | 17.3 | 4.2 | 6.5 | 10.5 | 29.2 | 2.7 | 3.6 |
| Corporate | 40 | 18.7 | 44 | 19.8 | 43 | 18.9 | (1.2) | 2.6 | (2.0) | 8.1 | 5.7 | 13.0 | (3.5) | 5.2 |
| **Viet Nam** | | | | | | | | | | | | | | |
| **Total** | 15 | 100.0 | 17 | 100.0 | 17 | 100.0 | (1.1) | 27.6 | 1.8 | 22.2 | (3.2) | 16.8 | 0.6 | 14.4 |
| Government | 14 | 91.7 | 15 | 90.6 | 15 | 90.9 | 0.2 | 25.5 | 2.1 | 21.1 | (1.9) | 14.9 | 0.9 | 13.3 |
| Corporate | 1 | 8.3 | 2 | 9.4 | 2 | 9.1 | (13.2) | 56.5 | (1.6) | 34.7 | (15.1) | 43.2 | (2.8) | 26.1 |
| **Emerging East Asia (EEA)** | | | | | | | | | | | | | | |
| **Total** | 5,089 | 100.0 | 5,531 | 100.0 | 5,471 | 100.0 | 3.0 | 17.4 | 1.0 | 5.5 | 6.2 | 21.2 | (1.1) | 7.5 |
| Government | 3,547 | 69.7 | 3,709 | 67.1 | 3,685 | 67.3 | 1.9 | 14.7 | 0.5 | 1.3 | 4.6 | 18.3 | (0.7) | 3.9 |
| Corporate | 1,542 | 30.3 | 1,822 | 32.9 | 1,786 | 32.7 | 5.8 | 24.3 | 2.0 | 15.4 | 10.1 | 28.2 | (1.9) | 15.9 |
| **EEA Less PRC** | | | | | | | | | | | | | | |
| **Total** | 2,099 | 100.0 | 2,341 | 100.0 | 2,224 | 100.0 | 2.1 | 11.7 | 1.7 | 8.6 | 8.1 | 17.6 | (5.0) | 6.0 |
| Government | 1,171 | 55.8 | 1,269 | 54.2 | 1,211 | 54.4 | 1.9 | 12.6 | 1.3 | 5.7 | 7.6 | 19.1 | (4.6) | 3.4 |
| Corporate | 928 | 44.2 | 1,072 | 45.8 | 1,014 | 45.6 | 2.4 | 10.6 | 2.2 | 12.2 | 8.7 | 15.6 | (5.4) | 9.2 |
| **Japan** | | | | | | | | | | | | | | |
| **Total** | 11,211 | 100.0 | 11,991 | 100.0 | 12,633 | 100.0 | 1.0 | 6.2 | 0.8 | 4.0 | 7.0 | 14.1 | 5.4 | 12.7 |
| Government | 10,134 | 90.4 | 10,887 | 90.8 | 11,475 | 90.8 | 1.1 | 6.9 | 0.8 | 4.5 | 7.1 | 14.8 | 5.4 | 13.2 |
| Corporate | 1,077 | 9.6 | 1,104 | 9.2 | 1,158 | 9.2 | 0.3 | 0.1 | 0.3 | (0.8) | 6.2 | 7.5 | 4.9 | 7.5 |

LCY = local currency, q-o-q = quarter-on-quarter, y-o-y = year-on-year.

Notes:

1. For the Philippines, 3Q11 government bonds outstanding figure based on *AsianBondsOnline* estimate. For Singapore, corporate bonds outstanding quarterly figures based on *AsianBondsOnline* estimates. For Japan, 3Q11 government and corporate bonds oustanding carried over from July 2011.
2. Corporate bonds include issues by financial institutions.
3. Bloomberg LP end-of-period LCY–US$ rates are used.
4. For LCY base, emerging East Asia growth figures are based on end-September 2011 currency exchange rates and do not include currency effects.
5. 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.

Source: People's Republic of China (*ChinaBond*); Hong Kong, China (Hong Kong Monetary Authority); Indonesia (Bank Indonesia and Indonesia Stock Exchange); the Republic of Korea (EDAILY *BondWeb* and The Bank of Korea); Malaysia (Bank Negara Malaysia); the Philippines (Bureau of the Treasury and Bloomberg LP); Singapore (Monetary Authority of Singapore, Singapore Government Securities, and Bloomberg LP); Thailand (Bank of Thailand); Viet Nam (Bloomberg LP); and Japan (Japan Securities Dealers Association).

end of 3Q11—the equivalent of US$162 billion—was relatively small and represented only about 10% of the stock of longer-term treasury bonds in the region. The treasury bond markets that grew the most in 3Q11 on a y-o-y basis were those of Viet Nam (31.3%), Malaysia (11.0%), the Philippines (14.8%), and the PRC (13.3%). The increase in Philippine treasury bonds reflected the government's highly successful debt exchange in July, while the growth rate for the PRC was approximately the same as in 2Q11.

Bonds issued by the PRC's three policy banks—China Development Bank, the Agricultural Development Bank of China, and the Export–Import Bank of China—are an important class of government debt in the PRC. At the end of 3Q11, policy bank bonds outstanding stood at the equivalent of US$1.0 trillion, compared with US$1.1 trillion of PRC treasury bonds and bills outstanding, and US$331 billion worth of People's Bank of China (PBOC) bonds and bills outstanding. Furthermore, the y-o-y growth rate for policy bank bonds was 26.3%, compared with 13.3% for treasury bonds and a more than 50% decline in the stock of PBOC bonds.

The PRC government announced that bonds issued by the China Development Bank would no longer receive a government guarantee after 2011. There were US$698 billion worth of such bonds outstanding at the end of 3Q11.[4]

### Bonds issued by local governments may emerge as a new asset class in the region's LCY bond market.

Regional bonds have been a significant asset class in other emerging markets—such as Latin America—for some time. In emerging East Asia, Thailand has taken steps to permit the issuance of bonds by its local governments.[5] These bonds are issued to finance improved infrastructure, both physical and soft (health, education, and other services).

Recent announcements that the PRC government has approved bond issuance by some of its provincial and municipal governments—in their own name—will result in a new source of bond issuance. For example, Shanghai recently issued CNY7.1 billion worth of local government bonds in November. This follows the recent liberalization of local government debt issuance by Shanghai, Shenzhen, Guangdong, and Zhejiang. Provincial and municipal governments have not been allowed to issue debt in the past. Instead the Ministry of Finance has issued bonds each year on their behalf.

The "local corporate bond" segment of the PRC's corporate bond market grew 45.1% y-o-y in 3Q11, making it the most rapidly growing part of the PRC's corporate bond market. Many of the companies issuing these bonds are owned by provincial or municipal governments. One benefit of bond issuance by local governments is that it could lead to an expansion of publicly available economic and financial data, especially data on the financial assets and liabilities of local governments.

### The corporate bond market in emerging East Asia expanded 15.4% y-o-y and 2.0% q-o-q in 3Q11, reflecting slower corporate bond market growth in a number of economies.

The y-o-y growth rate for the corporate bond market of emerging East Asia in 3Q11 was still quite robust at 15.4%, led by Viet Nam (34.7%), Indonesia (30.5%), the PRC (20.0%), and Singapore (18.8%). However, q-o-q growth in the region's corporate bond market slowed suddenly, as evidenced by a decline from 4.5% in 2Q11 to 2.0% in 3Q11. The growth rate for the Viet Nam corporate bond market turned negative in 3Q11, declining 1.6% q-o-q. Thailand and the Philippines also reported negative q-o-q growth of 2.0% and 1.9%, respectively. Indonesia's corporate bond market expanded a modest 2.0% q-o-q

[4] Bonds issued by the China Development Bank will still be included in the *Asia Bond Monitor's* definition of government bonds due to their public policy role and assumed implicit sovereign support.

[5] Enterprises owned by provincial governments in Malaysia have previously issued bonds, and regional governments in the Republic of Korea and the Philippines have issued LCY bonds in the past.

and Singapore's market only grew 1.0%, while the Hong Kong, China market saw growth of 1.2% q-o-q.

The region's most rapid rates of q-o-q growth in 3Q11—until recently found in the smaller markets—were in the Republic of Korea (2.9%) and Malaysia (2.3%). Meanwhile, the very large PRC corporate bond market, with total bonds outstanding equivalent to US$773 billion (43% of the total regional corporate market), grew 1.8% q-o-q.

The Republic of Korea's corporate bond market grew 11.9% y-o-y in 3Q11. Private sector corporate bonds rose 29.9% y-o-y and 4.5% q-o-q, and accounted for approximately 42% of the Korean corporate bond market. Special public bonds—issued by government-owned companies such as Korea Land and Housing, KEPCO, and Korea Highway—grew at much slower rates of 4.4% y-o-y and 3.3% q-o-q. Finally, financial debentures—bonds issued by the commercial bank subsidiaries of financial sector holding companies (excluding the Korean Development Bank)—declined 1.1% y-o-y and 0.3% q-o-q.

The major growth engine in the Malaysian corporate bond market in 3Q11 was *sukuk* (Islamic bonds), which grew 14.8% y-o-y. The most rapidly growing sub-segment of corporate *sukuk* comprised Islamic medium-term notes (MTNs), which grew 30.0% y-o-y. *Sukuk* constitute almost 60% of the total Malaysian corporate bond market at present. Meanwhile, conventional corporate bonds grew 7.6% y-o-y in 3Q11, with MTNs once again leading the way at 15.0% y-o-y.

## Ratio of Bonds Outstanding to Gross Domestic Product

### The ratio of bonds outstanding to GDP in emerging East Asia fell to 52.6% in 3Q11 from 55.0% in 2Q11.

The ratio of bonds outstanding to gross domestic product (GDP) for the entire region fell to 52.6% in 3Q11 from 55.0% in 2Q11 and from 58.5% in 3Q10 **(Table 2)**. The ratio of government

**Table 2: Size and Composition of LCY Bond Markets**
(% of GDP)

| | 3Q10 | 2Q11 | 3Q11 |
|---|---|---|---|
| **China, People's Rep. of** | | | |
| **Total** | 52.4 | 47.7 | 46.1 |
| Government | 41.6 | 36.5 | 35.1 |
| Corporate | 10.8 | 11.2 | 11.0 |
| **Hong Kong, China** | | | |
| **Total** | 73.1 | 71.3 | 70.9 |
| Government | 39.3 | 37.5 | 37.4 |
| Corporate | 33.8 | 33.8 | 33.5 |
| **Indonesia** | | | |
| **Total** | 16.1 | 14.7 | 13.7 |
| Government | 14.5 | 12.8 | 11.9 |
| Corporate | 1.7 | 1.9 | 1.9 |
| **Korea, Rep. of** | | | |
| **Total** | 111.6 | 112.6 | 104.2 |
| Government | 49.3 | 48.3 | 44.3 |
| Corporate | 62.2 | 64.3 | 59.9 |
| **Malaysia** | | | |
| **Total** | 96.4 | 100.2 | 100.7 |
| Government | 56.3 | 59.8 | 60.5 |
| Corporate | 40.0 | 40.4 | 40.2 |
| **Philippines** | | | |
| **Total** | 36.3 | 34.7 | 34.4 |
| Government | 31.9 | 30.3 | 30.0 |
| Corporate | 4.4 | 4.4 | 4.3 |
| **Singapore** | | | |
| **Total** | 73.5 | 77.4 | 75.7 |
| Government | 43.1 | 43.8 | 42.2 |
| Corporate | 30.4 | 33.6 | 33.5 |
| **Thailand** | | | |
| **Total** | 70.1 | 64.3 | 64.5 |
| Government | 57.0 | 51.6 | 52.3 |
| Corporate | 13.1 | 12.8 | 12.2 |
| **Viet Nam** | | | |
| **Total** | 15.5 | 15.8 | 15.2 |
| Government | 14.2 | 14.3 | 13.8 |
| Corporate | 1.3 | 1.5 | 1.4 |
| **Emerging East Asia** | | | |
| **Total** | 58.5 | 55.0 | 52.6 |
| Government | 40.8 | 36.9 | 35.4 |
| Corporate | 17.7 | 18.1 | 17.2 |
| **Japan** | | | |
| **Total** | 195.7 | 204.8 | 215.7 |
| Government | 176.9 | 185.9 | 195.9 |
| Corporate | 18.8 | 18.9 | 19.8 |

GDP = gross domestic product, LCY = local currency.
Notes:
1. Data for GDP from CEIC. 3Q11 GDP figures carried over from 2Q11, for the Republic of Korea, the Philippines, and Japan.
2. For the Philippines, 3Q11 government bonds outstanding figure based on *AsianBondsOnline* estimate. For Singapore, corporate bonds outstanding quarterly figures based on *AsianBondsOnline* estimates. For Japan, 3Q11 government and corporate bonds oustanding carried over from July 2011.

Source: People's Republic of China (*ChinaBond*); Hong Kong, China (Hong Kong Monetary Authority); Indonesia (Bank Indonesia and Indonesia Stock Exchange); the Republic of Korea (EDAILY *BondWeb* and The Bank of Korea); Malaysia (Bank Negara Malaysia); the Philippines (Bureau of the Treasury and Bloomberg LP); Singapore (Monetary Authority of Singapore, Singapore Government Securities, and Bloomberg LP); Thailand (Bank of Thailand); Viet Nam (Bloomberg LP); and Japan (Japan Securities Dealers Association).

bonds to GDP fell to 35.4% in 3Q11 from 36.9% in 2Q11, while the ratio of corporate bonds to GDP fell only slightly from 18.1% to 17.2% over the same period, reflecting the still vibrant growth of the corporate bond market. Meanwhile, the bond markets of Indonesia; Viet Nam; Hong Kong, China; and the Philippines saw their ratios fall by less than 1 percentage point.

## Issuance

### Issuance in emerging East Asia in 3Q11 totaled US$829 billion, a 19.9% decline on a y-o-y basis, but a modest 7.6% rise on a q-o-q basis.

The principal cause of the y-o-y decline in issuance in 3Q11 was the curtailment of issuance by central banks and monetary authorities as they either sharply reduced sterilization activities over the last year or shifted to tools other than bills and bonds to reduce liquidity growth. Additionally, corporate bond issuance fell on both a q-o-q and y-o-y basis in 3Q11, as companies put plans for sourcing fresh capital funding and refinancing on hold. The y-o-y decline in corporate issuance had only a modest effect on the growth of corporate bonds outstanding since it occurred from exceptionally high levels.

On a q-o-q basis, the largest declines in central bank issuance were in the PRC (–71.9%), Indonesia (–61.7%), the Republic of Korea (–22.6%), and Thailand (–10.2%) **(Table 3)**. Malaysia bucked this trend as Bank Negara Malaysia (BNM) increased bill issuance 24.4% q-o-q. (BNM does not issue long-term bonds.)

The Hong Kong Monetary Authority (HKMA) increased issuance of its Exchange Fund Bills and Notes (EFBNs), which it uses to manage the Hong Kong dollar's peg to the US dollar, by a dramatic 210.1% q-o-q in 3Q11. Meanwhile, the Government of the Special Administrative Region (SAR) increased issuance of SAR Bonds through its Institutional Bond Issuance Program by 540.0% q-o-q, albeit from a modest base of only US$2 billion. Other q-o-q increases in government issuance in 3Q11 took place in the Philippines (556.2%), Thailand (150.2%), and Viet Nam (7.0%). Singapore's government bond issuance fell 8.4% on a q-o-q basis and 2.2% on a y-o-y basis.

Emerging East Asia's LCY corporate bond issuance fell 24.4% y-o-y and 23.2% q-o-q in 3Q11. The largest q-o-q decline in corporate issuance came from the Philippines (74.9%), followed by Indonesia (61.1%), the PRC (40.0%), and Thailand (36.6%). The only two markets to record increases in corporate issuance in 3Q11 were Hong Kong, China (5.0%) and Singapore (36.6%). Singapore's increase in issuance followed a decline of 3.7% in 2Q11.

The recent volatility of issuance levels underlines the importance of placing these data in an historical series. **Figure 2a** highlights the trend of overall decline in central bank issuance since 1Q10. While issuance actually rose slightly in 3Q11, it remains below issuance levels in 1Q10. **Figure 2b** shows that issuance from government entities other than central banks has been rising only modestly since 4Q10. Corporate issuance for the region had been following a similar pattern before falling suddenly in 3Q11. **Figure 2c** shows that total issuance in the region (excluding the PRC) has fluctuated a great deal in recent years. PRC issuance, on the other hand, has been trending downward since 3Q10.

## Money Market Trends and Bills-to-Bonds Ratios

### Bills-to-bonds ratios fell in most emerging East Asian markets in 3Q11.

Total bills-to-bonds ratios fell in 3Q11 in five out of the eight emerging East Asian markets presented in **Figure 3**, which excludes Hong Kong, China due to its unusually high bills-to-bonds ratios. (However, the bills-to-bonds ratio for Hong Kong, China also fell in 3Q11.) The principal reason for the decline in the region's total bills-to-bonds ratio from 0.30 in 2Q11 to 0.25 in 3Q11 was the sharp drop in central banks' bills-to-bonds ratio from 1.17 to 0.92 **(Table 4)**.

**Table 3: LCY-Denominated Bond Issuance** (gross)

| | **LCY** (billion) | | **US$** (billion) | | **Growth Rate** (LCY-base %) | | **Growth Rate** (US$-base %) | |
|---|---|---|---|---|---|---|---|---|
| | **3Q11** | **% share** | **3Q11** | **% share** | **3Q11** | | **3Q11** | |
| | | | | | **q-o-q** | **y-o-y** | **q-o-q** | **y-o-y** |
| **China, People's Rep. of (PRC)** | | | | | | | | |
| **Total** | 1,547 | 100.0 | 242 | 100.0 | (26.6) | (45.1) | (25.6) | (42.4) |
| Government | 1,232 | 79.7 | 193 | 79.7 | (22.1) | (44.5) | (21.1) | (41.8) |
| Central Bank | 164 | 10.6 | 26 | 10.6 | (71.9) | (87.1) | (71.6) | (86.5) |
| Treasury and Other Govt | 1,068 | 69.1 | 167 | 69.1 | 6.9 | 12.6 | 8.3 | 18.1 |
| Corporate | 314 | 20.3 | 49 | 20.3 | (40.0) | (47.1) | (39.2) | (44.5) |
| **Hong Kong, China** | | | | | | | | |
| **Total** | 1,961 | 100.0 | 252 | 100.0 | 192.6 | 3.8 | 192.4 | 3.5 |
| Government | 1,897 | 96.7 | 244 | 96.7 | 211.4 | 2.8 | 211.3 | 2.5 |
| Central Bank | 1,881 | 95.9 | 242 | 95.9 | 210.1 | 2.2 | 209.9 | 1.8 |
| Treasury and Other Govt | 16 | 0.8 | 2 | 0.8 | 540.0 | 357.1 | 539.7 | 355.6 |
| Corporate | 64 | 3.3 | 8 | 3.3 | 5.0 | 44.5 | 5.0 | 44.0 |
| **Indonesia** | | | | | | | | |
| **Total** | 58,802 | 100.0 | 7 | 100.0 | (44.7) | (77.7) | (47.0) | (77.8) |
| Government | 52,982 | 90.1 | 6 | 90.1 | (42.0) | (79.0) | (44.4) | (79.1) |
| Central Bank | 19,822 | 33.7 | 2 | 33.7 | (61.7) | (91.0) | (63.3) | (91.1) |
| Treasury and Other Govt | 33,160 | 56.4 | 4 | 56.4 | (16.2) | 3.3 | (19.6) | 2.8 |
| Corporate | 5,820 | 9.9 | 1 | 9.9 | (61.1) | (49.4) | (62.7) | (49.6) |
| **Korea, Rep. of** | | | | | | | | |
| **Total** | 151,239 | 100.0 | 128 | 100.0 | (12.2) | (6.5) | (20.4) | (9.5) |
| Government | 73,672 | 48.7 | 63 | 48.7 | (16.4) | (8.4) | (24.2) | (11.4) |
| Central Bank | 47,060 | 31.1 | 40 | 31.1 | (22.6) | (17.7) | (29.8) | (20.4) |
| Treasury and Other Govt | 26,612 | 17.6 | 23 | 17.6 | (2.7) | 14.4 | (11.8) | 10.7 |
| Corporate | 77,567 | 51.3 | 66 | 51.3 | (7.8) | (4.7) | (16.4) | (7.7) |
| **Malaysia** | | | | | | | | |
| **Total** | 150 | 100.0 | 47 | 100.0 | 11.3 | 30.4 | 5.4 | 26.2 |
| Government | 125 | 83.4 | 39 | 83.4 | 16.2 | 34.0 | 10.0 | 29.7 |
| Central Bank | 99 | 66.1 | 31 | 66.1 | 24.4 | 30.3 | 17.8 | 26.1 |
| Treasury and Other Govt | 26 | 17.3 | 8 | 17.3 | (7.2) | 50.4 | (12.2) | 45.6 |
| Corporate | 25 | 16.6 | 8 | 16.6 | (8.2) | 14.7 | (13.1) | 11.0 |
| **Philippines** | | | | | | | | |
| **Total** | 448 | 100.0 | 10 | 100.0 | 352.7 | 147.6 | 348.7 | 148.1 |
| Government | 440 | 98.2 | 10 | 98.2 | 556.2 | 150.2 | 550.4 | 150.7 |
| Central Bank | 0 | 0.0 | 0 | 0.0 | – | – | – | – |
| Treasury and Other Govt | 440 | 98.2 | 10 | 98.2 | 556.2 | 150.2 | 550.4 | 150.7 |
| Corporate | 8 | 1.8 | 0.2 | 1.8 | (74.9) | 57.4 | (75.1) | 57.6 |

*continued on next page*

**Table 3** *continued*

| | LCY (billion) | | US$ (billion) | | Growth Rate (LCY-base %) | | Growth Rate (US$-base %) | |
|---|---|---|---|---|---|---|---|---|
| | 3Q11 | % share | 3Q11 | % share | 3Q11 | | 3Q11 | |
| | | | | | q-o-q | y-o-y | q-o-q | y-o-y |
| **Singapore** | | | | | | | | |
| **Total** | 59 | 100.0 | 45 | 100.0 | (5.8) | (3.2) | (11.5) | (2.5) |
| Government | 55 | 91.7 | 42 | 91.7 | (8.4) | (2.2) | (13.9) | (1.5) |
| Central Bank | 0 | 0.0 | 0 | 0.0 | – | – | – | – |
| Treasury and Other Govt | 55 | 91.7 | 42 | 91.7 | (8.4) | (2.2) | (13.9) | (1.5) |
| Corporate | 5 | 8.3 | 4 | 8.3 | 36.6 | (13.7) | 28.4 | (13.1) |
| **Thailand** | | | | | | | | |
| **Total** | 2,989 | 100.0 | 96 | 100.0 | (6.5) | (0.1) | (7.9) | (2.8) |
| Government | 2,797 | 93.6 | 90 | 93.6 | (3.4) | 1.1 | (4.8) | (1.6) |
| Central Bank | 2,489 | 83.3 | 80 | 83.3 | (10.2) | (0.6) | (11.5) | (3.3) |
| Treasury and Other Govt | 308 | 10.3 | 10 | 10.3 | 150.2 | 17.1 | 146.5 | 13.9 |
| Corporate | 192 | 6.4 | 6 | 6.4 | (36.6) | (14.6) | (37.6) | (16.9) |
| **Viet Nam** | | | | | | | | |
| **Total** | 24,956 | 100.0 | 1.2 | 100.0 | 7.0 | 188.5 | 5.8 | 169.9 |
| Government | 24,956 | 100.0 | 1.2 | 100.0 | 7.0 | 272.5 | 5.8 | 248.5 |
| Central Bank | 0 | 0.0 | 0.0 | 0.0 | – | – | – | – |
| Treasury and Other Govt | 24,956 | 100.0 | 1.2 | 100.0 | 7.0 | 272.5 | 5.8 | 248.5 |
| Corporate | 0 | 0.0 | 0.0 | 0.0 | – | – | – | – |
| **Emerging East Asia (EEA)** | | | | | | | | |
| **Total** | – | – | 829 | 100.0 | 7.6 | (19.9) | 5.0 | (19.0) |
| Government | – | – | 687 | 82.9 | 17.2 | (18.9) | 15.0 | (17.9) |
| Central Bank | – | – | 420 | 50.7 | 23.4 | (31.5) | 20.8 | (31.1) |
| Treasury and Other Govt | – | – | 267 | 32.2 | 8.7 | 14.4 | 6.9 | 17.4 |
| Corporate | – | – | 142 | 17.1 | (23.2) | (24.4) | (26.0) | (23.8) |
| **EEA Less PRC** | | | | | | | | |
| **Total** | – | – | 586 | 100.0 | 33.1 | (1.1) | 26.6 | (2.6) |
| Government | – | – | 494 | 84.2 | 46.1 | (0.9) | 40.1 | (2.1) |
| Central Bank | – | – | 395 | 67.3 | 58.4 | (4.6) | 53.2 | (5.9) |
| Treasury and Other Govt | – | – | 99 | 16.9 | 11.8 | 17.4 | 4.6 | 16.3 |
| Corporate | – | – | 93 | 15.8 | (9.7) | (2.1) | (16.4) | (4.8) |
| **Japan** | | | | | | | | |
| **Total** | 50,445 | 100.0 | 43 | 100.0 | 3.2 | 0.8 | (6.5) | (2.4) |
| Government | 46,504 | 92.2 | 39 | 92.2 | 1.8 | 2.0 | (7.7) | (1.3) |
| Central Bank | 0 | 0.0 | 0 | 0.0 | – | – | – | – |
| Treasury and Other Govt | 46,504 | 92.2 | 39 | 92.2 | 1.8 | 2.0 | (7.7) | (1.3) |
| Corporate | 3,941 | 7.8 | 3 | 7.8 | 22.2 | (11.3) | 10.7 | (14.1) |

– = not applicable, LCY = local currency, q-o-q = quarter-on-quarter, y-o-y = year-on-year.

Notes:

1. Corporate bonds include issues by financial institutions.
2. Bloomberg LP end-of-period LCY–US$ rates are used.
3. For LCY base, total emerging East Asia growth figures based on end-September 2011 currency exchange rates and do not include currency effects.
4. For Japan, 3Q11 issuance figures based on *AsianBondsOnline* estimates.

Source: People's Republic of China (*ChinaBond*); Hong Kong, China (Hong Kong Monetary Authority); Indonesia (Bank Indonesia, Indonesia Debt Management Office, and Indonesia Stock Exchange); the Republic of Korea (EDAILY *BondWeb* and The Bank of Korea); Malaysia (Bank Negara Malaysia); the Philippines (Bloomberg LP); Singapore (Singapore Government Securities and Bloomberg LP); Thailand (Bank of Thailand); Viet Nam (Bloomberg LP); and Japan (Japan Securities Dealers Association).

**Figure 2a: Government** (including SOE) **and Central Bank Bond Issuance, 1Q08–3Q11**

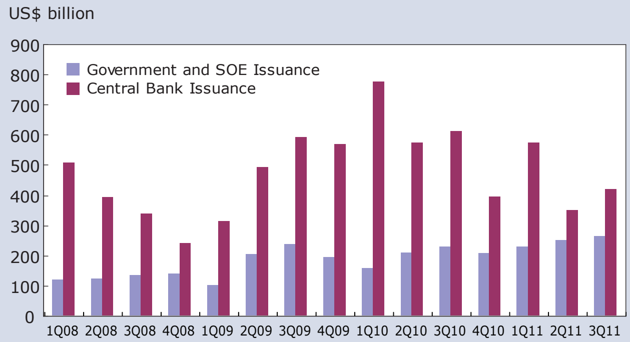



**Figure 2b: Government** (including SOE) **and Corporate Bond Issuance, 1Q08–3Q11**

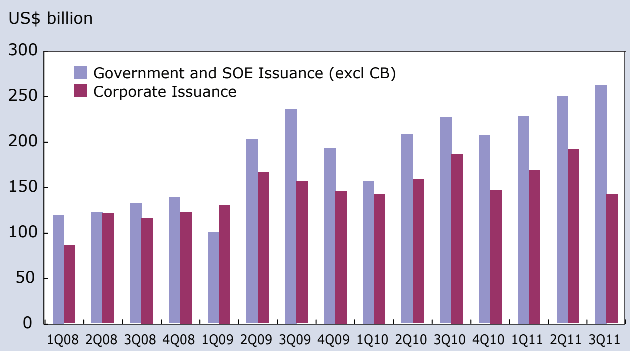
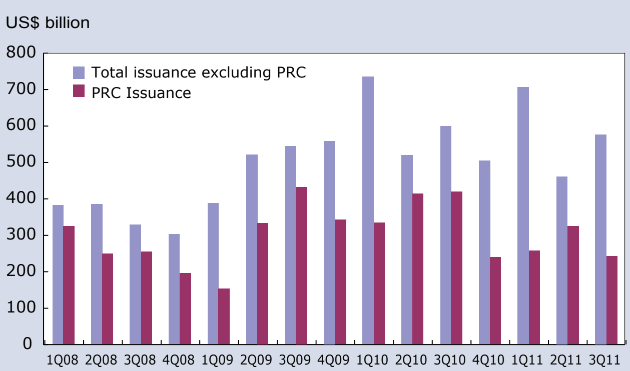
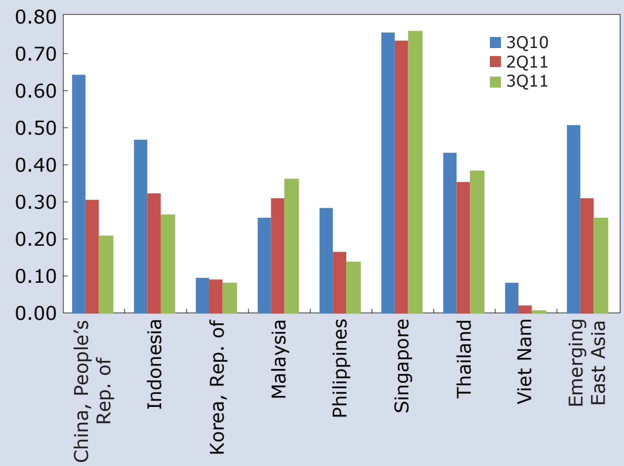



**Figure 2c: Total LCY Bond Issuance, 1Q08–3Q11**




CB = central bank, LCY = local currency, PRC = People's Republic of China, SOE = state-owned enterprise.
Note: In the PRC, government issuance (including SOE issuance) includes policy bank bonds, local government bonds, and savings bonds.
Source: *AsianBondsOnline*.

**Figure 3: Total Bills-to-Bonds Ratios**




Note: Total bills comprise central bank bills plus treasury bills. Bonds comprise long-term bonds (more than 1 year in maturity) issued by central governments and central banks.
Source: *AsianBondsOnline*.

Over the past year the largest decline in central bank bills-to-bonds ratios was in the PRC, which saw a decline from 2.76 in 3Q10 to 1.07 in 2Q11 and further to 0.63 in 3Q11. This reflected a reduction in the PBOC's stock of bills outstanding from US$486 billion in 3Q10 to US$222 billion in 2Q11 and to US$127 billion in 3Q11. The PBOC also reduced its stock of longer-term bonds outstanding, albeit slightly, to US$203 billion from US$208 billion in 2Q11. Thus, the much larger reduction in the stock of bills resulted in the steep decline in the PBOC's bills-to-bonds ratio.

The only other central banks or monetary authorities in the region to substantially reduce their stock of bills outstanding were Bank Indonesia (BI), which reduced *Sertifikat* Bank Indonesia (SBI) outstanding from US$22 billion in 2Q11 to US$17 billion in 3Q11, and The Bank of Korea, which reduced its bills outstanding from US$37 billion in 2Q11 to US$34 billion in 3Q11. Meanwhile, the stock of longer-term bonds issued by most central banks and monetary authorities in the region was either flat or falling in 3Q11.

The ratio of treasury bills-to-bonds for the region remained unchanged at 0.10 in 3Q11. The treasury

**Table 4: Government Bills-to-Bonds Ratios in LCY Bond Markets**

| | 3Q10 | | 2Q11 | | 3Q11 | | Government Bills-to-Bonds Ratio | | | Growth Rate (LCY-base %) 3Q11 | | Growth Rate (US$-base %) 3Q11 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Amount (US$ billion) | % share | Amount (US$ billion) | % share | Amount (US$ billion) | % share | 3Q10 | 2Q11 | 3Q11 | q-o-q | y-o-y | q-o-q | y-o-y |
| **China, People's Rep. of (PRC)** | | | | | | | | | | | | | |
| **Total** | 1,523 | 100.0 | 1,394 | 100.0 | 1,334 | 100.0 | | | | (5.5) | (16.4) | (4.3) | (12.4) |
| **Total Bills** | 588 | 38.6 | 322 | 23.1 | 229 | 17.2 | 0.63 | 0.30 | 0.21 | (29.7) | (62.8) | (28.8) | (61.0) |
| Treasury Bills | 101 | 6.6 | 100 | 7.2 | 102 | 7.6 | 0.13 | 0.12 | 0.11 | 0.9 | (3.8) | 2.2 | 0.9 |
| Central Bank Bills | 486 | 31.9 | 222 | 15.9 | 127 | 9.5 | 2.76 | 1.07 | 0.63 | (43.5) | (75.1) | (42.8) | (73.8) |
| **Total Bonds** | 935 | 61.4 | 1,072 | 76.9 | 1,105 | 82.8 | | | | 1.8 | 12.7 | 3.1 | 18.2 |
| Treasury Bonds | 759 | 49.8 | 864 | 62.0 | 901 | 67.6 | | | | 3.0 | 13.3 | 4.3 | 18.8 |
| Central Bank Bonds | 176 | 11.6 | 208 | 14.9 | 203 | 15.2 | | | | (3.3) | 9.9 | (2.0) | 15.3 |
| **Hong Kong, China** | | | | | | | | | | | | | |
| **Total** | 87 | 100.0 | 88 | 100.0 | 90 | 100.0 | | | | 1.9 | 3.8 | 1.8 | 3.5 |
| **Total Bills** | 75 | 86.6 | 75 | 85.4 | 75 | 83.9 | 6.49 | 5.87 | 5.22 | 0.1 | 0.6 | 0.01 | 0.2 |
| Treasury Bills | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 | – | – | – | – | – | – | – |
| Central Bank Bills | 75 | 86.6 | 75 | 85.4 | 75 | 83.9 | 8.29 | 8.40 | 8.41 | 0.1 | 0.6 | 0.01 | 0.2 |
| **Total Bonds** | 12 | 13.4 | 13 | 14.6 | 14 | 16.1 | | | | 12.6 | 25.0 | 12.5 | 24.5 |
| Treasury Bonds | 3 | 2.9 | 4 | 4.4 | 5 | 6.1 | | | | 41.7 | – | 41.6 | – |
| Central Bank Bonds | 9 | 10.5 | 9 | 10.2 | 9 | 10.0 | | | | 0.0 | (0.9) | (0.05) | (1.2) |
| **Indonesia** | | | | | | | | | | | | | |
| **Total** | 101 | 100.0 | 103 | 100.0 | 95 | 100.0 | | | | (3.7) | (5.6) | (7.7) | (6.0) |
| **Total Bills** | 32 | 31.5 | 25 | 24.2 | 20 | 20.7 | 0.46 | 0.32 | 0.26 | (17.6) | (38.0) | (21.0) | (38.3) |
| Treasury Bills | 3 | 3.3 | 3 | 2.7 | 3 | 2.8 | 0.05 | 0.04 | 0.04 | 1.3 | (20.2) | (2.9) | (20.6) |
| Central Bank Bills | 28 | 28.1 | 22 | 21.5 | 17 | 17.8 | – | – | – | (20.0) | (40.1) | (23.3) | (40.4) |
| **Total Bonds** | 69 | 68.5 | 78 | 75.8 | 75 | 79.3 | | | | 0.8 | 9.4 | (3.4) | 8.8 |
| Treasury Bonds | 69 | 68.5 | 78 | 75.8 | 75 | 79.3 | | | | 0.8 | 9.4 | (3.4) | 8.8 |
| Central Bank Bonds | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 | | | | – | – | – | – |
| **Korea, Rep. of** | | | | | | | | | | | | | |
| **Total** | 424 | 100.0 | 479 | 100.0 | 449 | 100.0 | | | | 3.3 | 9.3 | (6.4) | 5.7 |
| **Total Bills** | 36 | 8.5 | 40 | 8.4 | 34 | 7.5 | 0.09 | 0.09 | 0.08 | (7.6) | (3.5) | (16.3) | (6.7) |
| Treasury Bills | 0 | 0.0 | 3 | 0.6 | 0 | 0.0 | – | – | – | – | – | – | – |
| Central Bank Bills | 36 | 8.5 | 37 | 7.8 | 34 | 7.5 | 0.33 | 0.31 | 0.30 | (0.7) | (3.5) | (10.0) | (6.7) |
| **Total Bonds** | 388 | 91.5 | 439 | 91.6 | 415 | 92.5 | | | | 4.3 | 10.4 | (5.5) | 6.9 |
| Treasury Bonds | 280 | 66.0 | 320 | 66.8 | 301 | 67.2 | | | | 4.0 | 11.2 | (5.8) | 7.7 |
| Central Bank Bonds | 108 | 25.5 | 119 | 24.8 | 113 | 25.3 | | | | 5.2 | 8.4 | (4.7) | 4.9 |
| **Malaysia** | | | | | | | | | | | | | |
| **Total** | 136 | 100.0 | 160 | 100.0 | 158 | 100.0 | | | | 4.1 | 20.0 | (1.4) | 16.1 |
| **Total Bills** | 28 | 20.2 | 37 | 23.3 | 41 | 26.2 | 0.25 | 0.30 | 0.35 | 17.1 | 55.1 | 10.9 | 50.2 |
| Treasury Bills | 1 | 1.0 | 1 | 0.9 | 1 | 0.9 | 0.01 | 0.01 | 0.01 | 0.0 | 0.0 | (5.3) | (3.2) |
| Central Bank Bills | 26 | 19.2 | 36 | 22.4 | 40 | 25.3 | – | – | – | 17.8 | 58.0 | 11.6 | 53.0 |
| **Total Bonds** | 109 | 79.8 | 123 | 76.7 | 117 | 73.8 | | | | 0.2 | 11.0 | (5.1) | 7.5 |
| Treasury Bonds | 109 | 79.8 | 123 | 76.7 | 117 | 73.8 | | | | 0.2 | 11.0 | (5.1) | 7.5 |
| Central Bank Bonds | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 | | | | – | – | – | – |
| **Philippines** | | | | | | | | | | | | | |
| **Total** | 61 | 100.0 | 63 | 100.0 | 62 | 100.0 | | | | 0.2 | 2.2 | (0.7) | 2.4 |
| **Total Bills** | 13 | 21.7 | 9 | 14.0 | 7 | 12.0 | 0.28 | 0.16 | 0.14 | (14.0) | (43.3) | (14.8) | (43.2) |
| Treasury Bills | 13 | 21.7 | 9 | 14.0 | 7 | 12.0 | 0.28 | 0.16 | 0.14 | (14.0) | (43.3) | (14.8) | (43.2) |
| Central Bank Bills | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 | – | – | – | – | – | – | – |
| **Total Bonds** | 48 | 78.3 | 54 | 86.0 | 55 | 88.0 | | | | 2.5 | 14.8 | 1.6 | 15.0 |
| Treasury Bonds | 48 | 78.3 | 54 | 86.0 | 55 | 88.0 | | | | 2.5 | 14.8 | 1.6 | 15.0 |
| Central Bank Bonds | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 | | | | – | – | – | – |

*continued on next page*

**Table 4** *continued*

| | 3Q10 | | 2Q11 | | 3Q11 | | Government Bills-to-Bonds Ratio | | | Growth Rate (LCY-base %) 3Q11 | | Growth Rate (US$-base %) 3Q11 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Amount (US$ billion) | % share | Amount (US$ billion) | % share | Amount (US$ billion) | % share | 3Q10 | 2Q11 | 3Q11 | q-o-q | y-o-y | q-o-q | y-o-y |
| **Singapore** | | | | | | | | | | | | | |
| **Total** | 97 | 100.0 | 113 | 100.0 | 104 | 100.0 | | | | (2.2) | 5.8 | (8.1) | 6.5 |
| **Total Bills** | 41 | 42.5 | 47 | 41.8 | 44 | 42.7 | 0.74 | 0.72 | 0.75 | 0.0 | 6.2 | (6.0) | 7.0 |
| Treasury Bills | 41 | 42.5 | 47 | 41.8 | 44 | 42.7 | 0.74 | 0.72 | 0.75 | 0.0 | 6.2 | (6.0) | 7.0 |
| Central Bank Bills | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 | – | – | – | – | – | – | – |
| **Total Bonds** | 56 | 57.5 | 66 | 58.2 | 59 | 57.3 | | | | (3.7) | 5.4 | (9.5) | 6.2 |
| Treasury Bonds | 56 | 57.5 | 66 | 58.2 | 59 | 57.3 | | | | (3.7) | 5.4 | (9.5) | 6.2 |
| Central Bank Bonds | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 | | | | – | – | – | – |
| **Thailand** | | | | | | | | | | | | | |
| **Total** | 160 | 100.0 | 162 | 100.0 | 171 | 100.0 | | | | 7.2 | 10.3 | 5.7 | 7.3 |
| **Total Bills** | 48 | 29.8 | 42 | 25.7 | 47 | 27.4 | 0.42 | 0.35 | 0.38 | 14.3 | 1.4 | 12.6 | (1.3) |
| Treasury Bills | 5 | 3.2 | 0 | 0.0 | 4 | 2.4 | 0.06 | 0.00 | 0.05 | – | (18.4) | – | (20.6) |
| Central Bank Bills | 42 | 26.6 | 42 | 25.7 | 43 | 25.0 | 1.34 | 1.12 | 1.12 | 4.5 | 3.8 | 2.9 | 1.0 |
| **Total Bonds** | 112 | 70.2 | 120 | 74.3 | 124 | 72.6 | | | | 4.8 | 14.0 | 3.3 | 10.9 |
| Treasury Bonds | 80 | 50.4 | 83 | 51.3 | 86 | 50.2 | | | | 4.9 | 9.9 | 3.4 | 6.9 |
| Central Bank Bonds | 32 | 19.8 | 37 | 23.0 | 38 | 22.4 | | | | 4.5 | 24.6 | 3.0 | 21.2 |
| **Viet Nam** | | | | | | | | | | | | | |
| **Total** | 6 | 100.0 | 6 | 100.0 | 7 | 100.0 | | | | 12.0 | 23.3 | 10.7 | 15.4 |
| **Total Bills** | 0.5 | 7.5 | 0.1 | 1.6 | 0.1 | 1.4 | 0.08 | 0.02 | 0.01 | 0.0 | (76.3) | (1.2) | (77.8) |
| Treasury Bills | 0.5 | 7.5 | 0.1 | 1.6 | 0.1 | 1.4 | 0.08 | 0.02 | 0.01 | 0.0 | (76.3) | (1.2) | (77.8) |
| Central Bank Bills | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 | – | – | – | – | – | – | – |
| **Total Bonds** | 6 | 92.5 | 6 | 98.4 | 7 | 98.6 | | | | 12.2 | 31.3 | 10.9 | 22.9 |
| Treasury Bonds | 6 | 92.5 | 6 | 98.4 | 7 | 98.6 | | | | 12.2 | 31.3 | 10.9 | 22.9 |
| Central Bank Bonds | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 | | | | – | – | – | – |
| **Emerging East Asia (EEA)** | | | | | | | | | | | | | |
| **Total** | 2,594 | 100.0 | 2,568 | 100.0 | 2,470 | 100.0 | | | | (1.9) | (6.7) | (3.8) | (4.8) |
| **Total Bills** | 860 | 33.2 | 597 | 23.3 | 498 | 20.2 | 0.50 | 0.30 | 0.25 | (15.8) | (43.8) | (16.6) | (42.1) |
| Treasury Bills | 166 | 6.4 | 163 | 6.3 | 162 | 6.6 | 0.12 | 0.10 | 0.10 | 0.8 | (5.3) | (0.5) | (2.4) |
| Central Bank Bills | 695 | 26.8 | 434 | 16.9 | 336 | 13.6 | 2.13 | 1.17 | 0.92 | (21.9) | (53.0) | (22.7) | (51.6) |
| **Total Bonds** | 1,734 | 66.8 | 1,971 | 76.7 | 1,972 | 79.8 | | | | 2.3 | 12.0 | 0.0 | 13.7 |
| Treasury Bonds | 1,408 | 54.3 | 1,598 | 62.2 | 1,607 | 65.1 | | | | 2.8 | 12.4 | 0.6 | 14.1 |
| Central Bank Bonds | 325 | 12.5 | 373 | 14.5 | 364 | 14.7 | | | | 0.1 | 10.5 | (2.3) | 11.9 |
| **EEA Less PRC** | | | | | | | | | | | | | |
| **Total** | 1,072 | 100.0 | 1,174 | 100.0 | 1,135 | 100.0 | | | | 2.6 | 8.2 | (3.3) | 5.9 |
| **Total Bills** | 273 | 25.5 | 275 | 23.4 | 269 | 23.7 | 0.34 | 0.31 | 0.31 | 1.4 | (0.3) | (2.4) | (1.6) |
| Treasury Bills | 65 | 6.1 | 63 | 5.4 | 60 | 5.3 | 0.10 | 0.09 | 0.08 | 0.5 | (7.7) | (4.9) | (7.6) |
| Central Bank Bills | 208 | 19.4 | 212 | 18.1 | 209 | 18.4 | 1.40 | 1.28 | 1.30 | 1.7 | 2.0 | (1.6) | 0.3 |
| **Total Bonds** | 799 | 74.5 | 899 | 76.6 | 867 | 76.3 | | | | 3.0 | 11.2 | (3.6) | 8.5 |
| Treasury Bonds | 650 | 60.6 | 734 | 62.5 | 706 | 62.2 | | | | 2.6 | 11.2 | (3.8) | 8.6 |
| Central Bank Bonds | 149 | 13.9 | 165 | 14.1 | 161 | 14.2 | | | | 4.7 | 11.3 | (2.7) | 8.0 |
| **Japan** | | | | | | | | | | | | | |
| **Total** | 8,825 | 100.0 | 9,482 | 100.0 | 9,998 | 100.0 | | | | 0.9 | 4.5 | 5.4 | 13.3 |
| **Total Bills** | 357 | 4.0 | 372 | 3.9 | 389 | 3.9 | 0.04 | 0.04 | 0.04 | 0.0 | 0.7 | 4.5 | 9.1 |
| Treasury Bills | 357 | 4.0 | 372 | 3.9 | 389 | 3.9 | 0.04 | 0.04 | 0.04 | 0.0 | 0.7 | 4.5 | 9.1 |
| Central Bank Bills | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 | – | – | – | – | – | – | – |
| **Total Bonds** | 8,468 | 96.0 | 9,109 | 96.1 | 9,609 | 96.1 | | | | 0.9 | 4.7 | 5.5 | 13.5 |
| Treasury Bonds | 8,468 | 96.0 | 9,109 | 96.1 | 9,609 | 96.1 | | | | 0.9 | 4.7 | 5.5 | 13.5 |
| Central Bank Bonds | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 | | | | – | – | – | – |

– = not applicable, LCY = local currency, q-o-q = quarter-on-quarter, y-o-y = year-on-year.

Notes:

1. Bloomberg LP end-of-period LCY–US$ rates are used.
2. For LCY base, total emerging East Asia growth figures based on end-September 2011 currency exchange rates and do not include currency effects.
3. Total figures per market refer to bills and bonds issued by the central government and the central bank. It excludes bonds issued by policy banks and state-owned enterprises. Bills are defined as securities with original maturities of less than 1 year.
4. For the Philippines, 3Q11 bills-to-bonds figures based on *AsianBondsOnline* estimates. For Japan, 3Q11 bills-to-bonds data carried over from 2Q11.

Source: People's Republic of China (*ChinaBond*); Hong Kong, China (Hong Kong Monetary Authority); Indonesia (Bank Indonesia and Indonesia Stock Exchange); the Republic of Korea (Bloomberg LP); Malaysia (Bank Negara Malaysia); the Philippines (Bureau of the Treasury); Singapore (Monetary Authority of Singapore); Thailand (Bloomberg LP); Viet Nam (Bloomberg LP); and Japan (Japan Securities Dealers Association).

bills-to-bonds ratio changed little or not at all in the PRC, Indonesia, Malaysia, and Viet Nam, while it fell slightly in the Philippines from 0.16 in 2Q11 to 0.14 in 3Q11, and rose modestly in Singapore from 0.72 to 0.75.

The continued decline in the region's ratio of bills-to-bonds for central banks and monetary authorities in 3Q11 was primarily driven by the activities of the PBOC. But even in other markets where the central bank or monetary authority issues debt securities, issuance has generally declined as these institutions rely less on sterilization as a tool for dealing with large capital inflows. They are instead focusing on other measures to mop up excess liquidity such as raising banks' administrative requirements.

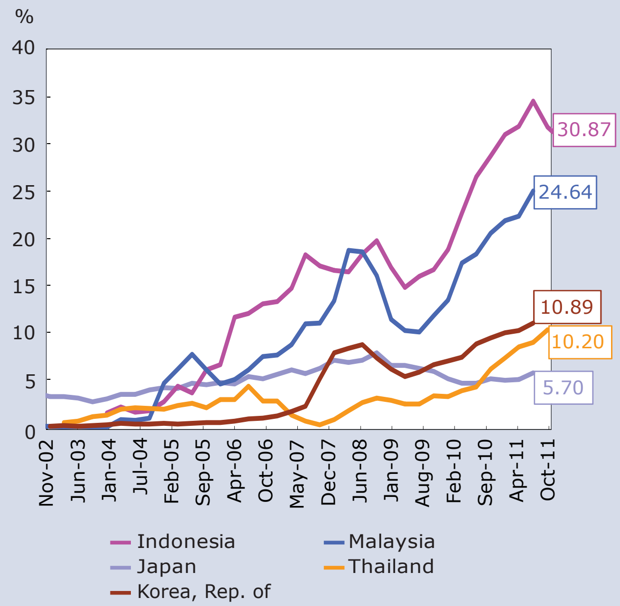
## Foreign Holdings

### Foreign holdings of the region's LCY domestic bonds continued to rise in the first half of 2011.

In the first half of 2011 foreign holdings of emerging East Asian LCY government bonds—as a percentage of total bond holdings—continued to rise in all markets. **Figure 4** highlights this trend in Japan, the Republic of Korea, and Malaysia through end-June. In Malaysia foreign holdings rose to 24.6% of total LCY government bonds outstanding in June from 22.0% in March, and in the Republic of Korea the share of foreign-held debt rose to 10.9% from 10.1%. In Japan foreign holdings of LCY government bonds outstanding rose to 5.7% in June, reversing a declining trend in place since the middle of 2008.

Foreign holdings of Thailand's LCY government bonds rose to 10.2% in 3Q11 from 8.9% in 2Q11. On the other hand, foreign holdings in Indonesia through end-October revealed a modest decline to 30.9% from 31.3% at end-September and 34.0% at end-June. This reduction likely reflects developments in the eurozone in 3Q11 that led to prudential adjustments in global portfolios to guard against uncertainty.

**Figure 4: Foreign Holdings of LCY Government Bonds in Select Asian Economies** (% of total)




LCY = local currency.
Notes: Data for Japan, the Republic of Korea, and Malaysia as of June 2011; Thailand as of September 2011; Indonesia as of October 2011.
Source: *AsianBondsOnline*.

The Republic of Korea has seen a substantial rise in foreign participation in its bond market since 2009, reflecting the (i) removal of a withholding tax on foreign investment in Korean debt in May 2009; (ii) potential for continued appreciation of the Korean won; and (iii) improving performance of the Korean Treasury Bond (KTB) futures market, which has made it easier for market participants to hedge their investment positions. Parliament's approval of the re-imposition of withholding and capital gains taxes in late 2010 slowed investment inflows briefly before they recovered earlier this year. Since then investors have largely ignored the return of the withholding tax. Net foreign inflows into the Republic of Korea averaged KRW2 trillion–KRW3 trillion per month in May and June before falling in August and turning slightly negative in September. However, net foreign inflows into the bond market recovered sharply in October to reach KRW1.6 trillion.

## Government Bond Yield Curves

### Yield curves flattened—or in some cases shifted downward—between end-September and end-October.

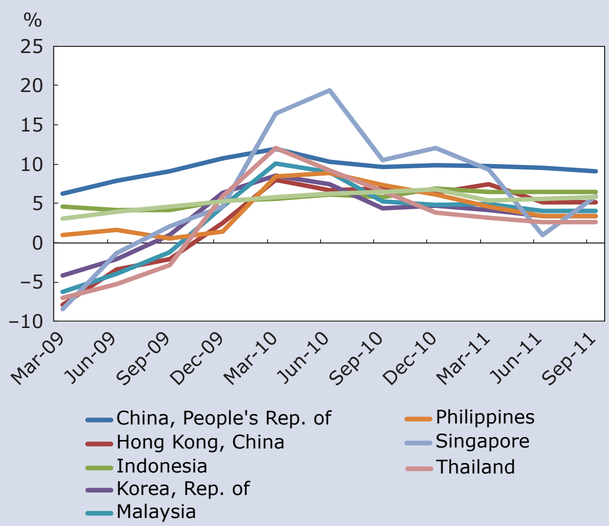
The flattening trend reflects the market's focus on a slowdown in growth and away from concerns over inflation.

The strengthened demand for emerging East Asian government bonds that emerged in the middle of 2010 seems unlikely to dissipate in spite of the current global economic uncertainty and market volatility.

Asian bond markets were largely viewed as a safe haven for most of 2011. However, by the end of 3Q11 the sovereign debt crisis in the eurozone and global market turmoil had brought about comparisons with the crisis period in 2008. GDP growth slowed in most Asian countries in 3Q11 **(Figure 5)** and the region's markets were subject to bouts of volatility.

Despite concerns, LCY bond markets in Asia staged a recovery in October, with most yield curves flattening **(Figure 6)**.

**Figure 5: Real GDP Growth Rates, March 2009-September 2011**




GDP = gross domestic product.
Source: Bloomberg LP.

Inflation in many markets peaked in June–July, though it remains high in some economies, and the focus of the region's policymakers has since turned to supporting growth **(Figure 7)**. Most central banks in the region have adopted a wait-and-see approach and halted the monetary policy normalization cycle as the global economic outlook weakened. Indonesia switched to an accommodative stance and cut its policy rate 25 bps to 6.5% on 11 October, and another 50 bps to a new record-low of 6.0% on 10 November **(Figure 8)**.

### The low debt positions of most emerging East Asian economies make them attractive to investors compared with debt-laden Europe.

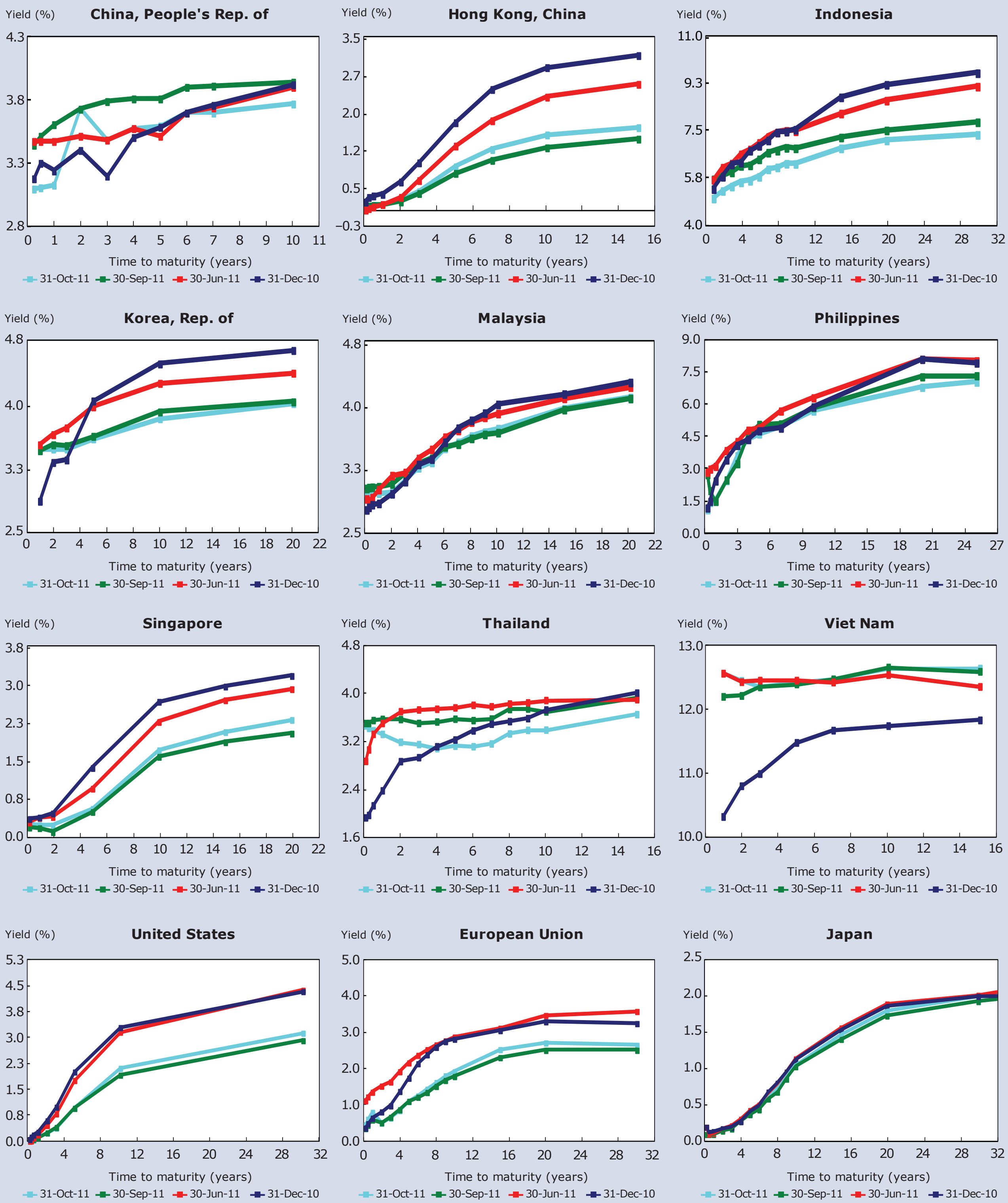
The balance sheets of most Asian economies remain strong **(Figure 9)**. External debt-to-GDP ratios have either declined significantly since 2009, as in the cases of Indonesia and the Philippines, or have stayed at manageable levels.

An early departure from the economic stimulus programs of 2008/09 has provided regional governments with some room for flexibility in their current fiscal policies. The foreign currency reserves of Asian countries have also been increasing over time, creating a buffer against sudden capital outflows **(Figure 10)**. Furthermore, given the region's strong economic fundamentals and high yield differential compared with developed markets, emerging East Asian bond markets are expected to continue attracting strong portfolio inflows.

### Domestic factors, including healthy banking systems, are also strengthening the region's LCY bond market.

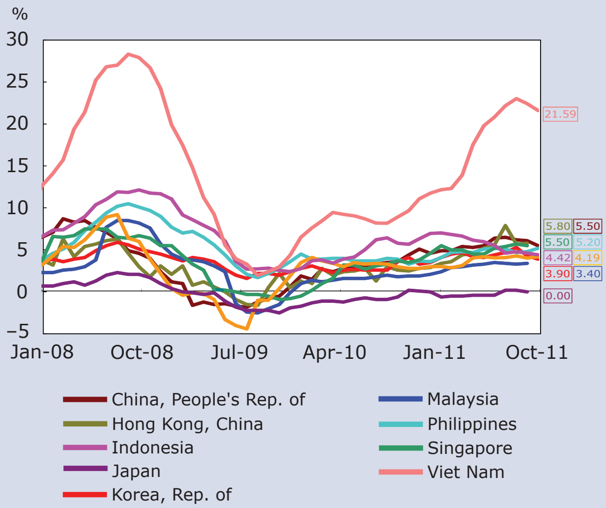
Demand for government bonds is expected to increase further as banking system assets continue to expand **(Figure 11)**. At the end of 2010 the total assets of the banking sector in the region stood at US$19 trillion, a 174% increase over end-2006 levels. Domestic investors, particularly banks, tend to favor domestic securities such as government bonds

**Figure 6: Benchmark Yield Curves—LCY Government Bonds**



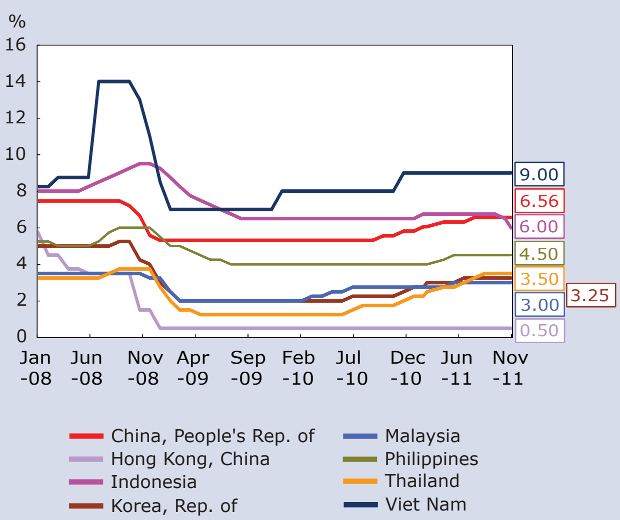

LCY = local currency.
Source: Based on data from Bloomberg LP.

**Figure 7: Headline Inflation Rates, January 2008–October 2011**



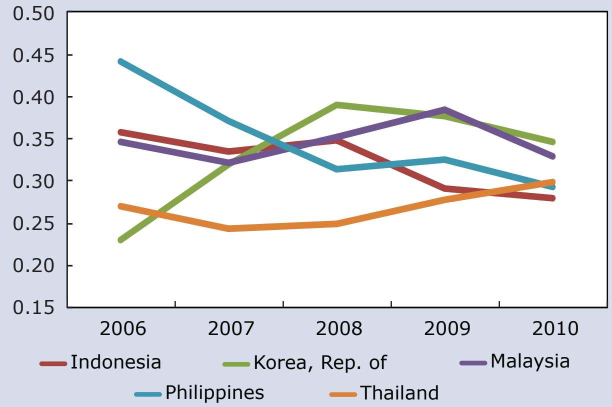

Note: Inflation rates for the People's Republic of China; Hong Kong, China; Japan; Malaysia; the Philippines; and Singapore are September figures.
Source: Bloomberg LP.

**Figure 8: Policy Rates, January 2008–18 November 2011**



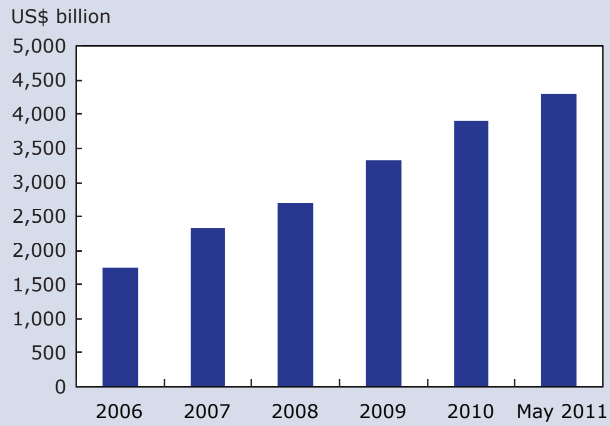

Source: Bloomberg LP except for Viet Nam (State Bank of Viet Nam).

**Figure 9: External Debt-to-GDP Ratios, 2006–2010**




Source: World Bank's World Development Indicators and CEIC.

**Figure 10: Emerging East Asia's Cumulative Foreign Exchange Reserves, 2006–May 2011**

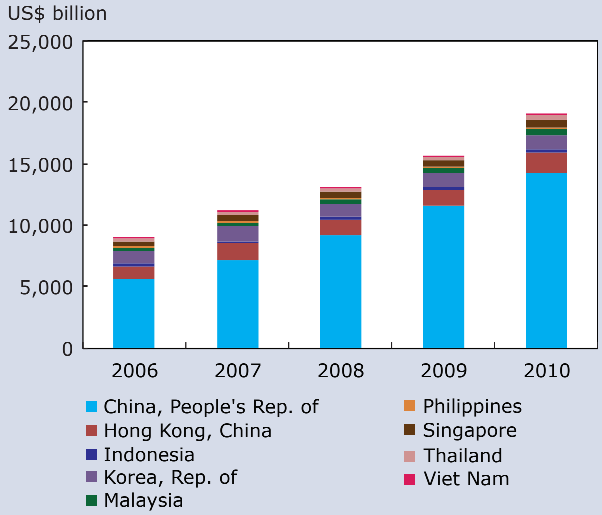



Note: Countries included are the People's Republic of China; Hong Kong, China; Indonesia; the Republic of Korea; Malaysia; the Philippines; Singapore; and Viet Nam.
Source: Bloomberg LP and International Monetary Fund.

for liquidity and liability management purposes. Indeed, the 2011 *AsianBondsOnline* Bond Market Liquidity Survey revealed that market participants want governments in the region to issue more fixed-income instruments to improve market liquidity.

The asset quality of banks has steadily improved since the 2007–09 financial crisis, an event which led bankers in the region to focus on country and liquidity risks by adopting precautionary measures and performing stress tests. For example, banks in the Philippines have maintained an average capital adequacy ratio of 17%, a significantly higher level than the mandatory international standard of 8%. Healthy levels of growth, capitalization, and asset quality have improved the resilience of the region's banking sector.

**Figure 11: Total Banking Sector Assets, 2006–2010**




Source: Local sources.

## The trends highlighted above, both local and global, have led to a continued flattening of most—but not all—government bond market yield curves in the region in 2011.

In some markets yield curves have shift downward, rather than flattened, such as in the PRC. The government bond yield curve of the PRC flattened by shifting upward from the short-end to the belly of the curve in the first half of the year. The PRC's yield curve then shifted upward from the very short-end to the long-end of the curve (10-year maturity) in 3Q11 on the back of rising inflationary pressures and monetary tightening by the PBOC. However, in October the entire curve shifted downward except for a spike in the yield for the 2-year maturity.

Movements in the benchmark yield curves of other LCY bond markets in emerging East Asia are detailed below:

(i) In both the Republic of Korea and Malaysia the government bond yield curve flattened from the short-end to the long-end in the first 9 months of the year before shifting slightly downward in the belly of the curve in October.

(ii) The Thai yield curve shifted upward and flattened sharply from the short-end to the belly of the curve in the first 9 months of the year. In October the entire curve shifted downward, except at the very short-end, and steepened slightly from the belly to the long-end of the curve.

(iii) The yield curves for Hong Kong, China and Singapore flattened and shifted downward from the belly to the long-end in the first 9 months of the year. In October, however, both curves suddenly steepened, essentially following the same trend as the US Treasury bond yield curve.

(iv) In the Philippines yields rose along the entire curve in the first half of the year on the back of rising inflationary pressures and expectations of further policy rate hikes. However, in July–October the entire curve shifted downward except for a few maturities at the short-end of the curve.

(v) Yields for Indonesian government bonds for maturities between the belly and the short-end of the curve rose in the first half of the year. The entire curve then shifted downward in July–October.

(vi) The Vietnamese yield curve shifted upward in the first 10 months of the year, with little difference in yields between the very short-end and very long-end of the curve. The State Bank of Viet Nam (SBV) raised its policy rate several times in the first half of the year to combat rising inflation. The SBV also raised its refinancing rate in October, but it has taken no action on its other formal policy rates since the first half of the year.

## Corporate Bond Credit Spreads

### The movement of high grade and high yield credit spreads varied across the region's markets in 3Q11.

High grade credit spreads in Malaysia have changed only modestly over most of the curve since end-December 2010 **(Figure 12a)**. The most notable changes have been a widening of spreads for the 10-year maturity at end-September, and a decline in spreads at the very long-end of the curve at end-October. The PRC's credit curve shifted significantly upward between end-December 2010 and end-September as monetary conditions tightened. However, the PRC credit spread curve shifted downward in end-October between the 5- and 15-year maturities.

The credit spread curve for high grade bonds in the Republic of Korea shifted sharply upward in 3Q11, after having shifted sharply downward in the first half of the year. Credit spread levels in October, however, were largely unchanged from 3Q11. The Thai credit spread curve for high grade bonds continued to steepen throughout the year. By end-October, Thai credit spreads had risen to their highest levels since end-December 2010, except for the shortest-dated maturities, which remained near their end-December 2010 levels.

The movement of credit spreads for the region's high yield bonds thus far in 2011 has been a less complex story **(Figure 12b)**. Malaysian high yield credit spreads have remained essentially unchanged throughout the year. The PRC's high yield credit spreads were also mostly unchanged from end-December 2010 through end-September, before the entire curve suddenly shifted upward in October. Meanwhile, high yield credit spreads in the Republic of Korea have gradually shifted downward over the course of the year.

The Thai high yield credit spread curve moved in a more complex pattern. In October Thai high yield credit spreads rose at various points along the entire curve, while declining or remaining unchanged at other points on the curve, in what appears to be an almost random pattern.

## G3 Currency Issuance

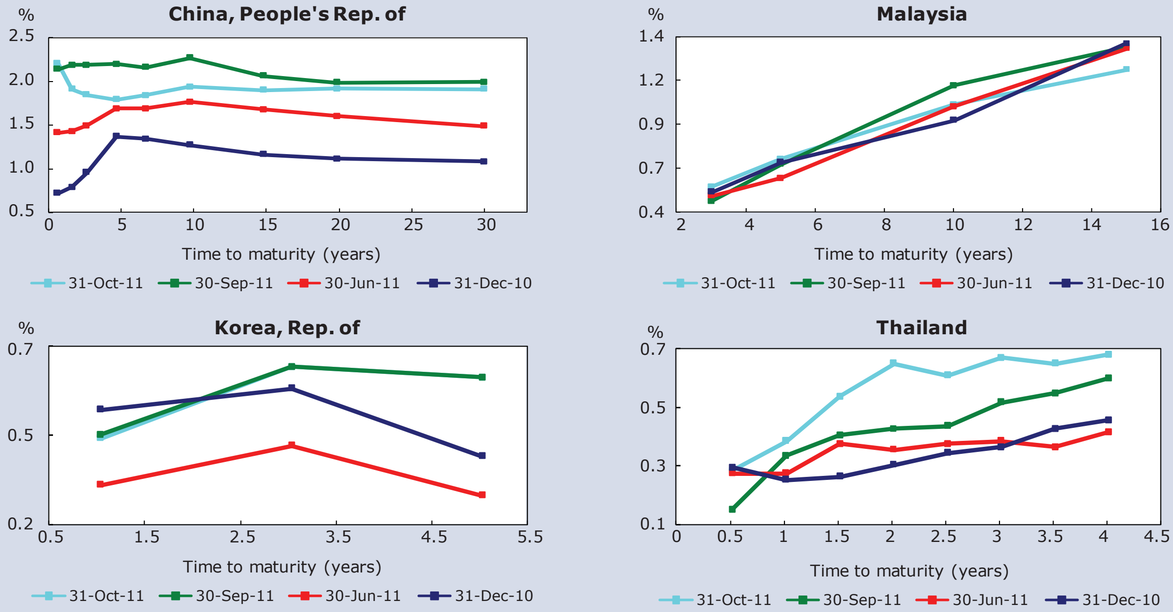
### G3 currency issuance in emerging East Asia in 2011 totaled US$63 billion through the end of October; however, the full-year total may fall short of the record US$87 billion in G3 issuance in 2010.

G3 currency issuance in emerging East Asia reached an impressive US$55.4 billion at end-July but increased only US$7.6 billion in August–October as uncertainty in global markets reduced investor appetite **(Table 5)**. With G3 currency issuance slowing sharply in the second half of 2011, it is unlikely to match the record US$87.2 billion issued in 2010.

G3 currency issuance in the PRC, Indonesia, Malaysia, the Philippines, Singapore, and Thailand was either nil or negligible in August–October. The only market with any significant G3 currency issuance during this period was the Republic of Korea. Issuance from the Republic of Korea rose by US$6.3 billion between the end of July and the end of October, including a US$1 billion bond from Korea Eximbank with a 10-year maturity and a 4.375% coupon, and a US$1 billion bond from Korea National Oil Corp. with a 5-year maturity and a 4.0% coupon. Additionally, Korea Development Bank issued a 1-year *samurai* bond for the equivalent of US$601 million in October. Issuance from Hong Kong, China rose by approximately US$1 billion between end-July and end-October.

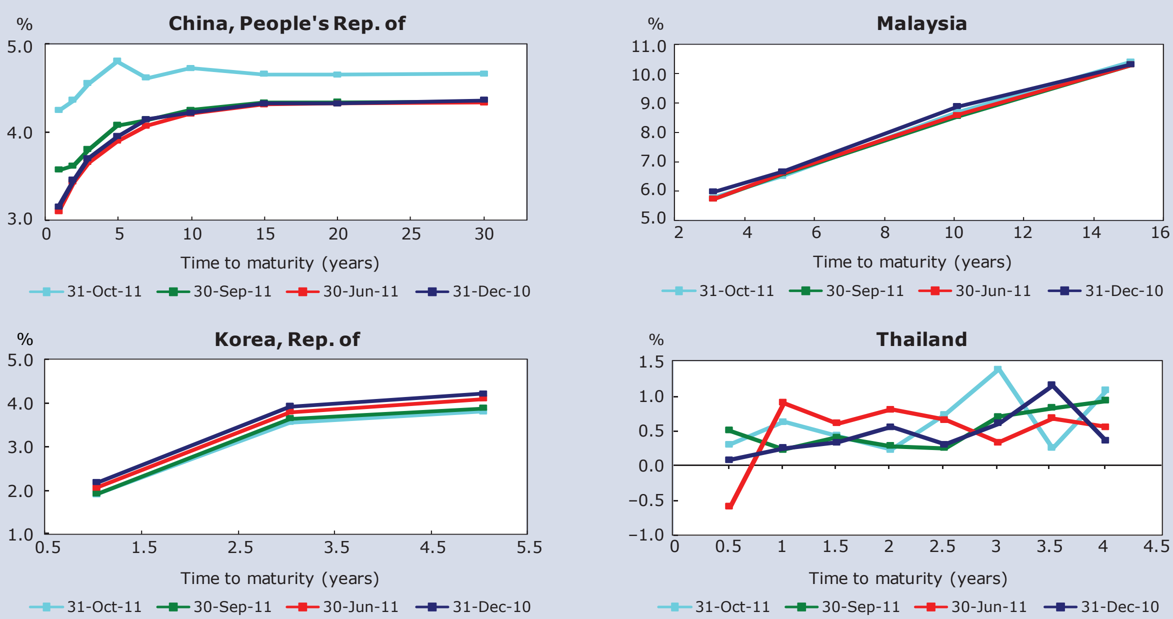
Tighter market conditions since end-July have also reduced the average size of G3 currency issuances. In addition, these issues generally have come from private rather than state-owned companies.

**Figure 12a: Credit Spreads—LCY Corporates Rated AAA vs. Government Bonds**




LCY = local currency.
Note: Credit spreads are obtained by subtracting government yields from corporate indicative yields.
Source: People's Republic of China (*ChinaBond*); Republic of Korea (EDAILY *BondWeb*); Malaysia (Bank Negara Malaysia); and Thailand (ThaiBMA).

**Figure 12b: Credit Spreads—Lower Rated LCY Corporates vs. LCY Corporates Rated AAA**




LCY = local currency.
Notes:
1. For the People's Republic of China, credit spreads are obtained by subtracting corporate indicative yields rated as AAA from corporate indicative yields rated as BBB.
2. For Malaysia, credit spreads are obtained by subtracting corporate indicative yields rated as AAA from corporate indicative yields rated as BBB.
3. For the Republic of Korea, credit spreads are obtained by subtracting corporate indicative yields rated as AAA from corporate indicative yields rated as BBB+.
4. For Thailand, credit spreads are obtained by subtracting corporate indicative yields rated as AAA from corporate indicative yields rated as A.
Source: People's Republic of China (*ChinaBond*); Republic of Korea (EDAILY *BondWeb*); Malaysia (Bank Negara Malaysia); and Thailand (ThaiBMA).

**Table 5: G3 Currency Bond Issuance** (2010 and 1 January–31 October 2011)

| 2010 | | | 1 January–31 October 2011 | | |
|---|---|---|---|---|---|
| **Issuer** | **US$ (million)** | **Issue Date** | **Issuer** | **US$ (million)** | **Issue Date** |
| **China, People's Rep. of** | **15,950** | | **China, People's Rep. of** | **16,309** | |
| Evergrande 13% 2015 | 1,350 | 27-Jan-10 | CNOOC Finance 4.25% 2021 | 1,500 | 26-Jan-11 |
| China Overseas Finance 5.5% 2020 | 1,000 | 10-Nov-10 | Country Garden 11.125% 2018 | 900 | 23-Feb-11 |
| Sino-Ocean Land Capital 8.0% Perpetual | 900 | 27-Jul-10 | China Resources Power 7.25% Perpetual | 750 | 9-May-11 |
| Agile Property 8.875% 2017 | 650 | 28-Apr-10 | Citic Pacific 7.875% Perpetual | 750 | 15-Apr-11 |
| Franshion Capital 6.8% Perpetual | 600 | 12-Oct-10 | ENN Energy 6.0% 2021 | 750 | 13-May-11 |
| MCE Finance 10.25% 2017 | 600 | 17-May-10 | Longfor Properties 9.5% 2016 | 750 | 7-Apr-11 |
| Others | 10,850 | | Others | 10,909 | |
| **Hong Kong, China** | **18,634** | | **Hong Kong, China** | **5,738** | |
| Hutch Whampoa 6.0% Perpetual | 2,000 | 28-Oct-10 | China Resources Land 4.625% 2016 | 750 | 19-May-11 |
| Bank of China (Hong Kong) 5.55% 2020 | 1,600 | 11-Feb-10 | HSBC 1.0599% 2014 | 500 | 31-May-11 |
| Sinochem 4.5% 2020 | 1,500 | 12-Nov-10 | Newford Capital 0.0% 2016 | 500 | 12-May-11 |
| PHBS 6.625% Perpetual | 1,000 | 29-Sep-10 | The Hong Kong Mortgage Corp. 0.5293% 2013 | 450 | 15-Apr-11 |
| Bank of China (Hong Kong) 5.55% 2020 | 900 | 19-Apr-10 | KWG Power Holdings 12.75% 2016 | 350 | 30-Mar-11 |
| Hongkong Electric Finance 4.25% 2020 | 750 | 14-Dec-10 | Others | 2,888 | |
| Others | 10,884 | | | | |
| **Indonesia** | **6,784** | | **Indonesia** | **4,588** | |
| Indonesia Sovereign 5.875% 2020 | 2,000 | 19-Jan-10 | Indonesia (sovereign) 4.875% 2021 | 2,500 | 5-May-11 |
| Indonesia Sovereign (*samurai*) 1.6% 2020 | 717 | 12-Nov-10 | Pertamina 5.25% 2021 | 1,000 | 23-May-11 |
| Indosat 7.375% 2020 | 650 | 29-Jul-10 | Pertamina 6.5% 2041 | 500 | 27-May-11 |
| Others | 3,417 | | Others | 588 | |
| **Korea, Rep. of** | **28,353** | | **Korea, Rep. of** | **26,828** | |
| Korea Eximbank 5.125% 2020 | 1,250 | 29-Jun-10 | Korea Eximbank 4.375% 2021 | 1,000 | 15-Sep-11 |
| Korea Eximbank 4.125% 2015 | 1,000 | 9-Mar-10 | Korea National Oil Corp. 4.0% 2016 | 1,000 | 27-Oct-11 |
| Korea Eximbank 4.0% 2021 | 1,000 | 20-Oct-10 | Korea Development Bank 4.0% 2016 | 750 | 9-Mar-11 |
| Polyvision 0.0% 2013 | 990 | 1-Oct-10 | Korea Eximbank (*samurai*) 0.93% 2013 | 741 | 8-Jul-11 |
| Korea Development Bank 3.25% 2016 | 900 | 9-Sep-10 | Hyundai Capital 4.375% 2016 | 700 | 27-Jan-11 |
| Korea Finance Corp. 3.25% 2016 | 750 | 20-Sep-10 | Korea Eximbank 3.75% 2016 | 700 | 20-Apr-11 |
| Korea National Oil Corp. 2.875% 2015 | 700 | 9-Nov-10 | Posco 5.25% 2021 | 700 | 14-Apr-11 |
| Others | 21,763 | | Korea Development Bank (*samurai*) 1.3% 2012 | 601 | 21-Oct-11 |
| | | | Others | 20,636 | |
| **Malaysia** | **1,950** | | **Malaysia** | **3,100** | |
| 1Malaysia (*sukuk*) 3.928% 2015 | 1,250 | 4-Jun-10 | Wakala Global (*sukuk*) 2.991% 2016 | 1,200 | 6-Jul-11 |
| Others | 700 | | Others | 1,900 | |
| **Philippines** | **8,084** | | **Philippines** | **3,450** | |
| Philippines Sovereign 4.0% 2021 | 2,242 | 6-Oct-10 | Philippines (sovereign) 5.5% 2026 | 1,500 | 30-Mar-11 |
| Philippines Sovereign (*samurai*) 2.32% 2020 | 1,070 | 2-Mar-10 | San Miguel Corp. 2.0% 2014 | 600 | 5-May-11 |
| Philippines Sovereign 6.375% 2034 | 950 | 6-Oct-10 | Energy Development Corp. 6.5% 2021 | 300 | 20-Jan-11 |
| Others | 3,822 | | Others | 1,050 | |
| **Singapore** | **4,111** | | **Singapore** | **1,551** | |
| DBS Bank 2.375% 2015 | 1,000 | 14-Sep-10 | Singtel 4.5% 2021 | 600 | 8-Mar-11 |
| Others | 3,111 | | Others | 951 | |
| **Thailand** | **2,350** | | **Thailand** | **1,370** | |
| Bangkok Bank 4.8% 2020 | 800 | 18-Oct-10 | PTTEP 5.692% 2021 | 700 | 5-Apr-11 |
| Others | 1,550 | | Others | 670 | |
| **Viet Nam** | **1,000** | | **Viet Nam** | **90** | |
| Viet Nam (sovereign) 6.75% 2020 | 1,000 | 29-Jan-10 | HAGL 9.875% 2016 | 90 | 20-May-11 |
| **Emerging East Asia Total** | **87,217** | | **Emerging East Asia Total** | **63,025** | |
| **Memo Items:** | | | **Memo Items:** | | |
| **India** | **13,023** | | **India** | **11,525** | |
| Novelis 8.75% 2020 | 1,400 | 17-Dec-10 | Novelis 8.75% 2020 | 1,400 | 13-Apr-11 |
| ICICI Bank 5.75% 2020 | 1,000 | 16-Nov-10 | Novelis 8.375% 2017 | 1,100 | 13-Apr-11 |
| State Bank of India (London) 4.5% 2015 | 1,000 | 27-Jul-10 | ICICI Bank 4.75% 2016 | 1,000 | 25-May-11 |
| Others | 9,623 | | Others | 8,025 | |
| **Sri Lanka** | **1,573** | | **Sri Lanka** | **1,512** | |

Note: The Philippines' US$2.2 billion 2021 bond and US$950 million 2034 bond sold in October 2010 were part of a dollar bond exchange program. Not included in this table are the Philippines' two sovereign global peso bond issuances—a PHP54.8 billion (US$1.2 billion) 25-year bond in January and a PHP44.1 billion (US$1 billion) 10-year bond in September 2010—and Petron's 7-year global peso bond of PHP20 billion (US$454 million) issued in November 2010.
Source: Bloomberg LP, newspaper and wire reports.

# Market Returns

## Returns on LCY bonds have remained buoyant in most of the region's markets in 2011.

The Asian Bond Fund (ABF) Pan-Asian Bond Index gained 7.3% on a US$ unhedged total return basis in the first 10 months of the year, compared with a 10.2% gain for the full-year 2010 **(Table 6)**. Indonesian bonds were the best performers, gaining 19.1%, followed by the Philippines (12.8%), Singapore (9.0%), the Republic of Korea (7.5%), and the PRC (6.0%). Returns on bonds in Hong Kong, China; Malaysia; and Thailand were lower at 5.2%, 4.4%, and 2.2%, respectively.

In 2010 there were large differences across the region between bond market returns on a US$ unhedged and an LCY total return basis. For example, the US$ unhedged return for Malaysia was 15.6% in 2010, compared with 5.2% on an LCY total return basis. The Thai bond index had a return of 15.4% on a US$ unhedged basis, compared with 5.4% on an LCY total return basis. Finally, Singapore had an 11.3% return on a US$ unhedged basis, compared with 2.5% on an LCY total return basis.

In January–October the US$ unhedged return for Singapore was a substantial 9.0%, only slightly better than the LCY total return of 6.2%. The year-to-date US$ unhedged return for Indonesia was also impressive at 19.0%, but this was only somewhat better than the 17.4% on an LCY total return basis. On the other hand, the PRC's modest US$ unhedged return of 6.0% year-to date compares well with an unimpressive return of 2.4% on an LCY total return basis.

Bond returns have proven superior to the much lower returns being offered in the region's equity markets in 2011, which have turned sharply negative in recent months. In 2010 the MSCI Far East Ex-Japan Index generated a return of 16.7% in US$ terms and 12.5% in LCY terms. In January–October, returns were –11.1% in US$ terms and –11.4% in LCY terms **(Table 7)**. The worst performing markets in US$ terms in the MSCI Index year-to-date have been the PRC (–15.1%); Hong Kong, China (–13.2%); and Singapore (–11.3%).

The better returns of bonds and equities in US dollar terms versus LCY terms can be attributed to the strengthening of the region's currencies year-to-date through October.

**Table 6: iBoxx Asia Bond Fund Index Family Returns**

| Market | Modified Duration (years) | 2010 Returns (%) | | 3Q11 YTD Returns (%) | | 2011 YTD Returns (%) | |
|---|---|---|---|---|---|---|---|
| | | LCY Total Return Index | US$ Unhedged Total Return Index | LCY Total Return Index | US$ Unhedged Total Return Index | LCY Total Return Index | US$ Unhedged Total Return Index |
| China, People's Rep. of | 5.78 | 1.55 | 5.06 | 1.41 | 4.61 | 2.36 | 6.03 |
| Hong Kong, China | 4.19 | 2.04 | 1.79 | 5.73 | 5.50 | 5.13 | 5.21 |
| Indonesia | 6.46 | 19.30 | 23.70 | 13.69 | 15.71 | 17.44 | 19.06 |
| Korea, Rep. of | 4.12 | 8.00 | 10.64 | 4.53 | 0.80 | 5.13 | 7.50 |
| Malaysia | 4.80 | 5.16 | 15.64 | 3.44 | 0.04 | 3.83 | 4.43 |
| Philippines | 6.24 | 14.30 | 19.67 | 7.21 | 7.06 | 10.08 | 12.80 |
| Singapore | 5.94 | 2.51 | 11.34 | 7.00 | 5.72 | 6.20 | 8.96 |
| Thailand | 5.07 | 5.38 | 15.41 | 1.92 | (1.51) | 4.11 | 2.23 |
| Pan-Asian Index | 5.14 | – | 10.21 | – | 4.22 | – | 7.27 |
| HSBC ALBI | 7.68 | – | 11.49 | – | 3.37 | – | 6.57 |
| US Govt. 1–10 years | 3.99 | – | 5.26 | – | 6.05 | – | 5.96 |

– = not applicable, ALBI = Asian Local Bond Index, LCY = local currency, US = United States, YTD = year-to-date.
Notes:
1. The Asian Bond Fund (ABF) indices contain only government debt and government-guaranteed debt obligations.
2. Market bond indices are from iBoxx Index Family. Returns for 2011 are year-to-date as of 31 October 2011.
3. Annual returns are computed for each year using a natural logarithm of end-of-year index value/beginning year index value.
4. Duration as of 31 October 2011.
Source: *AsianBondsOnline* and Bloomberg LP.

**Table 7: MSCI Index Returns**

| Market | 2009 Returns (%) | | 2010 Returns (%) | | 2011 YTD Returns (%) | |
|---|---|---|---|---|---|---|
| | LCY terms | US$ terms | LCY terms | US$ terms | LCY terms | US$ terms |
| China, People's Rep. of | 58.89 | 58.80 | 2.58 | 2.32 | (15.20) | (15.11) |
| Hong Kong, China | 55.28 | 55.20 | 19.98 | 19.67 | (13.31) | (13.21) |
| Indonesia | 90.27 | 120.75 | 25.82 | 31.19 | 5.00 | 6.87 |
| Korea, Rep. of | 56.63 | 69.42 | 22.11 | 25.29 | (7.53) | (5.30) |
| Malaysia | 46.25 | 47.78 | 19.33 | 32.51 | (2.05) | (1.55) |
| Philippines | 55.79 | 60.24 | 23.47 | 30.29 | (2.99) | (0.31) |
| Singapore | 63.02 | 67.29 | 8.08 | 18.45 | (13.28) | (11.27) |
| Thailand | 63.00 | 70.04 | 36.36 | 50.81 | (2.83) | (4.74) |
| Far East ex-Japan Index | 60.32 | 65.01 | 12.50 | 16.69 | (11.39) | (11.06) |
| MSCI US | – | 24.20 | – | 13.18 | – | (0.32) |

– = not applicable, LCY = local currency, MSCI = Morgan Stanley Capital International, US = United States, YTD = year-to-date.
Notes:
1. Market indices are from MSCI country indexes. 2011 returns are year-to-date as of 31 October 2011.
2. Far East ex-Japan includes the People's Republic of China; Hong Kong, China; Indonesia; the Republic of Korea; Malaysia; the Philippines; Singapore; Taipei,China; and Thailand.

Source: *AsianBondsOnline* and Bloomberg LP.

# Policy and Regulatory Developments

## People's Republic of China

### PBOC Expands Deposit Coverage for Reserve Requirement Ratios

On 29 August the People's Bank of China (PBOC) announced that for the purpose of calculating required reserves, margin deposits—such as those paid for issuing bankers' acceptances, letters of guarantee, and letters of credit—would be included among items that must be reserved against. The amount to be set aside as reserves will be divided over stages to allow banks time to adjust, with the largest banks asked to set aside the reserves over three stages and smaller banks over six stages. The corresponding increase in required reserves is estimated to be the equivalent of a 100 bps–150 bps hike in the reserve requirement ratio.

### Local Governments Allowed to Issue Bonds

On 20 October the Ministry of Finance launched a trial program allowing four local governments to issue bonds directly in their own name. The four local authorities granted permission were the provinces of Guangdong and Zheijiang, and the municipalities of Shanghai and Shenzen.

## Hong Kong, China

### Hong Kong, China's Role as Offshore Renminbi Center Expanded

On 17 August the People's Republic of China's (PRC) Vice Premier Li Keqiang gave special attention to Hong Kong, China during his keynote speech at the Forum on the 12th Five Year Plan and Economic, Trade, and Financial Cooperation and Development between the PRC and Hong Kong, China. He stressed that plans for expanding Hong Kong, China's already important role as an offshore financial center would give Hong Kong, China an advantage as an offshore renminbi center. The plans mentioned include allowing Hong Kong, China's insurance companies to open branches in the PRC; the issuance of more sovereign bonds in Hong Kong, China; and the launch of the mini-Qualified Foreign Institutional Investor Program with an initial quota of CNH20 billion, of which 80% is to be invested in the onshore bond market.

## Indonesia

### BI Issues New Regulations on Export Proceeds and Foreign Debt Withdrawals

On 30 September Bank Indonesia (BI) issued new regulations governing export proceeds and foreign debt withdrawals. Under the new policies exporters will be required to transfer their proceeds from offshore banks into domestic banks within a period of 3 months after the date included on the Export Declaration Form. This policy will become effective on 2 January 2012. During the transition period exporters will be given up to 6 months from the date on the Export Declaration Form to comply with the new measure.

Another new regulation issued by BI requires debtors to conduct their foreign borrowing through domestic banks. The new regulations apply to borrowing in cash, non-revolving loan agreements, and debt securities.

According to BI, the main objective of these new policies is to strengthen macroeconomic stability, particularly exchange rate stability. BI governor Darmin Nasution said that the policies will improve the sustainability of foreign exchange flows into the domestic market by reducing dependence on short-term funding.

### Indonesia Passes Bill to Create Financial Services Supervisory Authority

On 28 October Indonesia's House of Representatives passed a bill to create a new financial entity to supervise the country's financial sector by early 2013. The Financial Services Supervisory

Authority (OJK) will assume BI's supervisory role over commercial banks. OJK will also oversee capital markets and non-banking institutions that are currently monitored by the Capital Market and Financial Institution Supervisory Board (Bapepam LK).

## Republic of Korea

### Tax Revision Bill for 2011 Introduced

In September the Ministry of Strategy and Finance introduced its tax revision bill for 2011. The bill aims to facilitate sustainable growth and promote employment, improve fiscal conditions, and foster fair competition. One of the key aspects of the bill is fair taxation: yields derived from issuing foreign currency (FCY) bonds domestically will be taxed just like local currency (LCY) bonds, and capital gains taxes coming from financial products, including derivatives, will be legislated.

### The Bank of Korea and PBOC Expand Bilateral Swap Arrangement

In October the Bank of Korea announced the renewal of its bilateral swap arrangement with the PBOC for 3 years. The size of the swap arrangement was expanded from KRW38 trillion–CNY180 billion to KRW64 trillion–CNY360 billion.

## Malaysia

### SC Issues Revised Guidelines for Corporate Bonds and *Sukuk*

In July the Securities Commission of Malaysia (SC) issued revised guidelines for private debt securities and *sukuk* (Islamic bonds) in line with the broader objectives of the Capital Market Masterplan 2. The revised guidelines replace the earlier Guidelines on Offering Private Debt Securities and Guidelines on the Offering of Islamic Securities, both of which were issued in July 2004. The new measures streamline the approval process and time-to-market for the issuance of corporate bonds and *sukuk*. The revised guidelines also remove the mandatory rating requirement for selected issues and offers, and provide greater disclosure of relevant information for debenture holders. The revised Islamic Security Guidelines provide more clarity to ensure compliance with *sharia'h* (Islamic law) rulings and principles endorsed by the *Sharia'h* Advisory Council of the SC.

### Acts Amended Pursuant to Capital Market Masterplan 2

Amendments to the Securities Act 1993 and Capital Markets and Services Act 2007 (CMSA), pursuant to strategies outlined in the Capital Market Masterplan 2, came into force on 3 October. The amendments include

(i) a legal framework for the private retirement scheme industry,
(ii) licensing provisions in the CMSA,
(iii) regulations pertaining to over-the-counter (OTC) derivatives and a framework for reporting OTC derivative contracts,
(iv) a framework to enable the Audit Oversight Board to grant recognition to foreign auditors, and
(v) authority for the SC to obtain information considered necessary for the purposes of monitoring, mitigating, and managing systematic risks; and to issue directives for managing systemic risk.

## Philippines

### BSP Tightens Rules on Hedging Instruments

Bangko Sentral ng Pilipinas (BSP) imposed stricter rules on hedging instruments, particularly non-deliverable forward (NDF) contracts, to reduce speculation in the foreign exchange market. An NDF is a contract between two parties to buy or sell an asset such as foreign exchange at an agreed price and settlement date in the future. Counterparties settle the difference between the contracted NDF price and the spot price upon maturity. BSP raised the market risk weighting of NDF contracts to reflect the potential systemic risk they generate as a result of increased volatility in the foreign exchange market. The market risk capital charge to be used in the capital adequacy ratio (CAR) computation for banks for the net open position of NDF contracts will be raised from 10% to 15% effective 1 January 2012.

## Singapore

### MAS Announces New Capital Requirements for Singaporean Banks

The Monetary Authority of Singapore (MAS) released new capital rules for banks in Singapore that exceed the levels established under the Basel III agreement. Effective 1 January 2015, MAS will require Singapore-incorporated banks to have a minimum common equity Tier 1 capital adequacy ratio (CAR) of 6.5%, a Tier 1 CAR of 8.0%, and a total CAR of 10.0%. In addition, MAS will require Singapore-incorporated banks to meet the minimum capital adequacy requirements of Basel III by 1 January 2013, which is 2 years ahead of the Basel Committee's 2015 timeline. MAS plans to adopt Basel III's capital standards to improve the consistency, transparency, and quality of the capital base, and to strengthen the risk coverage of capital rules for banks.

## Thailand

### BOT and 11 Commercial Banks Sign MOU for BOT Savings Bond Sale

In August the Bank of Thailand (BOT) and 11 commercial banks signed a memorandum of understanding (MOU) permitting the commercial banks to sell 3- and 7-year BOT savings bonds worth THB50 billion between 26 August and 6 September. The savings bonds were issued to help ensure money market liquidity and provide an alternative investment vehicle for individuals, cooperatives, foundations, and nonprofit organizations.

### Ministry of Finance Adjusts Application Period for LCY Bond Issuance

The Ministry of Finance announced in October that it has approved the adjustment of the application period for issuing LCY bonds in Thailand to three times in a year, covering the months of March, July, and November. The ministry also required that the applicant be able to issue within 9 months of the approval date for the bond issuance. The ministry stated that revisions to the application period would help facilitate and promote LCY bond issuance in Thailand.

## Viet Nam

### SBV Issues Circular on Corporate Bond Purchases by Credit Institutions and Foreign Bank Branches

The State Bank of Viet Nam (SBV) issued a circular enumerating the conditions required for credit institutions and branches of foreign banks to purchase corporate bonds. The circular notes that buyers of corporate bonds must be (i) commercial banks, (ii) finance companies, or (iii) foreign bank branches established under the Law on Credit Institutions. Furthermore, the SBV specified that these institutions must (i) have licenses issued by the SBV that cover the purchase of corporate bonds, (ii) meet SBV requirements on prudent operational ratios, and (iii) have an internal credit rating system of corporate bond issuers.

### Viet Nam Hikes FCY Reserve Requirement Ratios

On 29 August the SBV hiked the FCY reserve requirement ratios for state-owned commercial banks, joint stock commercial banks, joint venture banks, foreign bank branches, and wholly owned foreign banks. The reserve requirement ratio for FCY demand deposits and time deposits of less than 12 months was raised from 7.0% to 8.0%, while the ratio for FCY time deposits of more than 12 months was increased from 5.0% to 6.0%. For the Viet Nam Bank for Agriculture and Rural Development, the Central People's Credit Fund, and cooperative banks, the reserve requirement ratio for FCY demand deposits and time deposits of less than 12 months was raised from 6.0% to 7.0%, while the ratio for deposits with terms of more than 12 months was raised from 4.0% to 5.0%.

# *AsianBondsOnline* Annual Bond Market Liquidity Survey

## Current Trends in the Emerging Asian LCY Bond Market

This year's *AsianBondsOnline* Bond Market Liquidity Survey was conducted from early August through mid-October. It assessed the current state of liquidity in emerging Asia's local currency (LCY) bond markets by looking at major indicators of liquidity: bid–ask spreads, representative trading sizes, and turnover ratios; as well as how market participants view potential changes in policies and improvements to market infrastructure.[6]

During the survey period, the central role of liquidity in the health of the region's LCY bond market was underscored by the emergence of concerns about Europe's sovereign debt crisis as well as the mixed signals of economic recovery in the United States (US). These factors contributed to a widening of bid–ask spreads in most emerging Asian markets since the last *AsianBondsOnline* survey was conducted in 2010.

Liquidity, nevertheless, has remained robust—even amid the wider bid–ask spreads prevalent in most markets—due to demand from domestic investors. The region's central banks and monetary authorities had begun tightening liquidity at the end of 2010, but in most cases these measures have been put on hold in recent months. In Indonesia policy rates have even been reduced to record-low levels. Furthermore, the region's LCY government bond markets are where domestic investors find safety.

The 2011 survey revealed that market participants want governments in the region to issue more investable LCY government bonds to improve market liquidity. Governments in the region have generally pursued cautious fiscal policies and in most cases have begun to withdraw from economic stimulus programs implemented in response to the 2007–09 global financial crisis. Furthermore, central banks and monetary authorities have begun to reduce the volume of bonds and bills outstanding as they pull back from the aggressive sterilization activities undertaken from 2008 until early 2010. As a result, issuance has declined sharply in a number of markets and growth in the region's overall government bond market has fallen. This leaves the region's governments with some degree of fiscal flexibility if the problems facing the US and Europe worsen and lead to a significant spillover into the region's economies.

## Recent Trends in Quarterly Turnover Ratios for LCY Bonds in Emerging East Asia

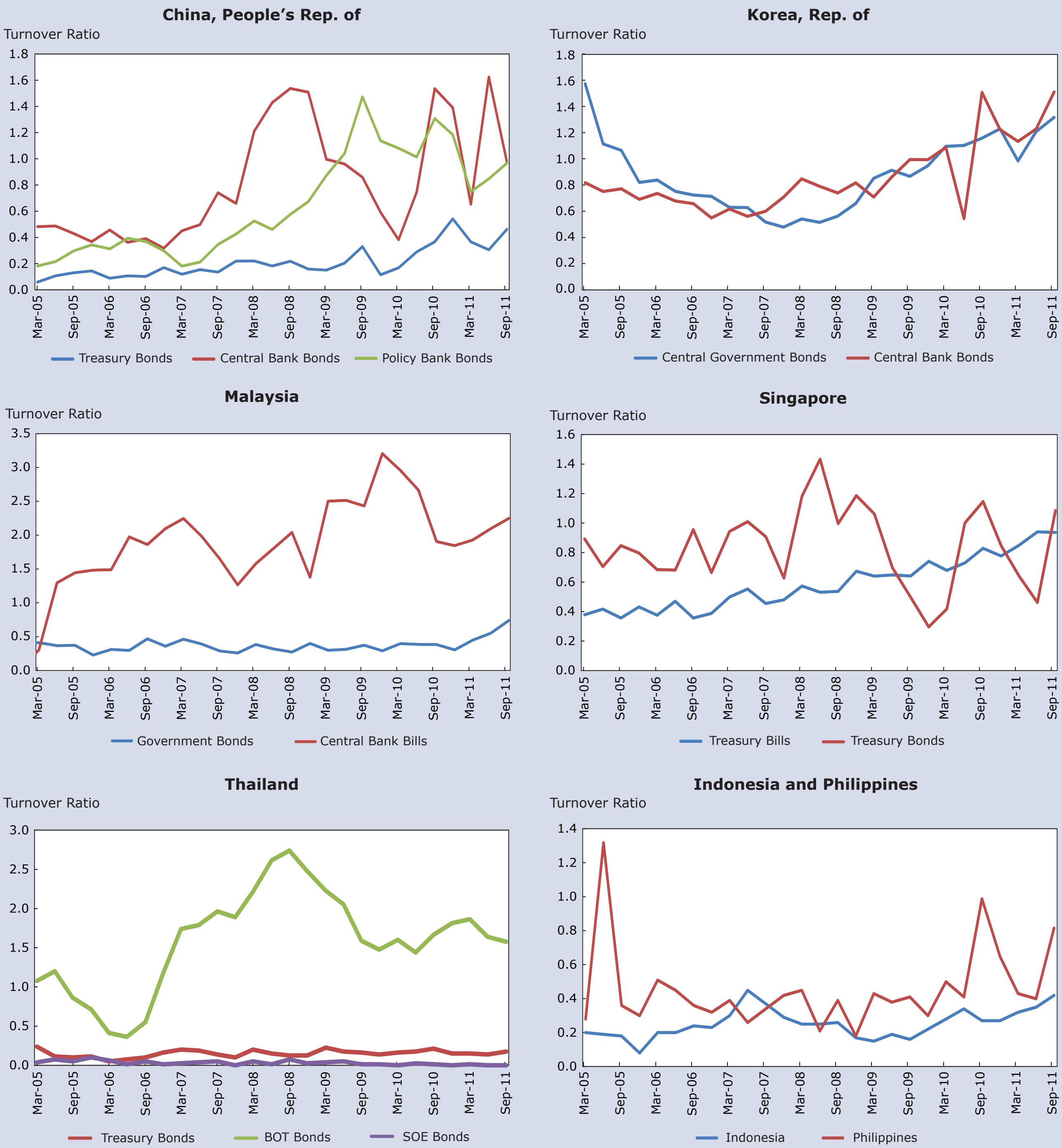
The liquidity of LCY government bonds—as measured by quarterly turnover ratios—has improved in most emerging East Asian markets in 2011 on a year-to-date basis **(Figure 13)**:[7]

- In the People's Republic of China (PRC), quarterly turnover ratios for bonds issued by the People's Bank of China (PBOC) and policy banks rose in 2Q11. The turnover ratio for PBOC bonds and bills then fell sharply in 3Q11 on the back of a continued sharp decline in issuance by the PBOC. However, the turnover ratio for policy bonds continued to rise and at the end of 3Q11 the turnover ratio for policy bank bonds (0.96) essentially converged with that for PBOC bonds (0.97). The turnover ratio for treasury bonds rose modestly in 3Q11 to a level of 0.46.
- In the Republic of Korea, turnover ratios for both central government and central bank bonds continued on their rising trajectories in place since the middle of 2008. These ratios moved in a range between 1.3 and 1.5 in 3Q11.

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

[7] 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.

**Figure 13: Trends in Quarterly LCY Government Bond Turnover Ratios, March 2005–September 2011**




BOT = Bank of Thailand, LCY = local currency, SOE = state-owned enterprises.

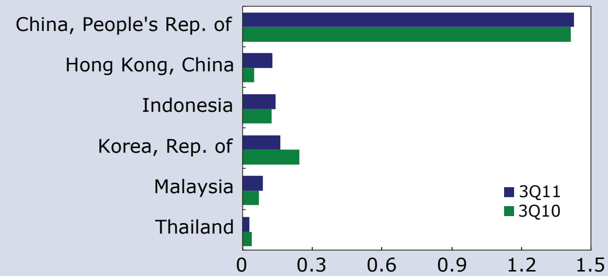
Notes:

1. For the Republic of Korea, central government bonds include treasury bonds and National Housing Bonds.
2. For Malaysia, government bonds include Malaysian Government Securities (MGS) and Government Investment Issues (GII).
3. For the Philippines, 3Q11 government bonds oustanding used to compute the turnover ratio based on *AsianBondsOnline* estimates.
4. Turnover ratios are calculated as LCY trading volume (sales amount only) divided by average LCY value of outstanding bonds during each 3-month period.

Source: *AsianBondsOnline*.

- Malaysia's central bank bills have consistently registered some of the highest turnover ratios in the region over the last several years, climbing as high as 2.2 in 3Q11. Meanwhile, the turnover ratio for Malaysian government bonds rose from only 0.4 in 1Q11 to 0.7 in 3Q11.
- The turnover ratio for Singapore's treasury bills have historically been well below 1.0 but have risen steadily over the last 5 years, reaching a ratio of 0.9 in 3Q11. The turnover ratio for longer-term Singapore Government Securities (SGS) has historically been much higher than the ratio for bills, fluctuating at levels of 1.0 or higher. However, the turnover ratio for SGS has trended downward from a high of 1.4 in 2Q08 to 1.1 in 3Q11.
- Turnover ratios for Thailand's government bonds and state-owned enterprise (SOE) bonds are among the lowest in the region. The turnover ratio for Bank of Thailand (BOT) bonds fluctuates in a much higher range than ratios for government and SOE bonds, and has trended downward from a high of 2.7 in 2Q08 to 1.6 in 3Q11.
- Liquidity ratios for Indonesian and Philippine government bonds have remained at levels of 0.5 or less in recent years. In 3Q11 the turnover ratio for Indonesia rose slightly to 0.4, while in the Philippines the ratio moved sharply upward to 0.8. The Indonesian and Philippine governments have consistently taken measures to lengthen the maturity structure of their respective stocks of government bonds in recent years. They also have reopened existing issues on a regular basis. Issuance in both countries has significantly expanded at the longer-end of the curve with lesser liquidity available at the shorter-end.
- Turnover ratios for corporate bonds were much lower than government bonds in most regional markets in 3Q11, standing at 0.16 or less in Thailand; Malaysia; the Republic of Korea; Indonesia; and Hong Kong, China **(Figure 14)**. The turnover ratios for corporate bonds in the PRC tend to be significantly higher, ranging between 1.4 and 1.7 in recent quarters, and are broadly comparable to turnover ratios for PRC government bonds.

**Figure 14: LCY Corporate Bond Turnover Ratios**




LCY = local currency.
Note: Turnover ratios are calculated as LCY trading volume (sales amount only) divided by average LCY value of outstanding bonds during each 3-month period.
Source: *AsianBondsOnline*.

The 2011 survey received 110 replies to the questionnaire for government bond markets and 83 replies to the questionnaire for corporate bond markets. These replies came from a total of 118 respondents representing trading desk staff and managers, portfolio managers, bond market analysts and strategists, and bond pricing agency staff. The number of responses to the government bond questionnaire was split evenly between domestic-based and foreign firms at 55 each. The number of responses to the corporate bond market questionnaire from domestic firms was 49, while responses to the questionnaire from foreign firms totaled 39. The 2011 *AsianBondsOnline* Bond Market Liquidity Survey is the first to include responses from India.

Respondents were asked to give quantitative and qualitative feedback on measures of liquidity in emerging Asian LCY bond markets, as well as their views on the appropriate policies needed to improve market liquidity and efficiency. Market participants were asked to provide bid–ask spreads and typical transaction sizes for both "on-the-run" and "off-the-run=" government bonds. In the case of corporate bonds, market participants were asked to provide bid–ask spreads at the time when a new bond is issued, and average transaction sizes. **Table 8** summarizes survey results for the region's government bond markets.

**Bid–ask spreads.** The bid–ask spread is perhaps the most commonly used measure of market

**Table 8: LCY Government Bond Market Quantitative Indicators**

| | | PRC | HK | IN | ID | KR | MY | PH | SG | TH | VN | Regional |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Typical Bid–Ask Spread On-the-Run (bps) | Average | 4.0 | 4.7 | 1.0 | 32.9 | 0.7 | 3.3 | 5.3 | 3.8 | 3.3 | 33.5 | 9.2 |
| | Count | 16 | 8 | 4 | 13 | 13 | 8 | 21 | 7 | 10 | 5 | 105 |
| | SD | 2.1 | 3.7 | 0.9 | 18.5 | 0.3 | 2.4 | 2.3 | 1.7 | 1.9 | 24.6 | 12.7 |
| Typical Bid–Ask Spread Off-the-Run (bps) | Average | 5.9 | 6.4 | 2.5 | 61.9 | 1.1 | 5.9 | 19.4 | 3.5 | 6.8 | 34.0 | 14.7 |
| | Count | 8 | 5 | 4 | 9 | 12 | 7 | 21 | 6 | 10 | 5 | 87 |
| | SD | 2.3 | 4.1 | 0.4 | 40.7 | 0.2 | 4.4 | 7.8 | 0.9 | 2.7 | 24.8 | 19.4 |
| Accepted LCY Bond Transaction Size On-the-Run (US$ million) | Average | 15.3 | 5.3 | 1.1 | 2.0 | 8.9 | 3.7 | 3.7 | 18.3 | 1.7 | 3.0 | 6.3 |
| | Count | 16 | 6 | 4 | 15 | 12 | 8 | 21 | 7 | 10 | 4 | 103 |
| | SD | 9.6 | 2.5 | 0.3 | 2.1 | 6.4 | 3.8 | 3.4 | 10.3 | 1.8 | 0.7 | 6.0 |
| Accepted LCY Bond Transaction Size Off-the-Run (US$ million) | Average | 11.8 | 4.7 | 1.1 | 1.1 | 9.8 | 2.6 | 1.0 | 11.7 | 1.2 | 3.0 | 4.8 |
| | Count | 9 | 3 | 4 | 9 | 8 | 7 | 21 | 7 | 8 | 4 | 80 |
| | SD | 10.7 | 1.6 | 0.3 | 0.5 | 7.6 | 1.5 | 0.3 | 5.5 | 1.0 | 0.7 | 4.5 |

bps = basis points; HK = Hong Kong, China; ID = Indonesia; IN = India; KR = Republic of Korea; LCY = local currency; MY = Malaysia; PH = Philippines; PRC = People's Republic of China; SD = standard deviation; SG = Singapore; TH = Thailand; VN = Viet Nam.
Source: *AsianBondsOnline* 2011 LCY Bond Market Survey.

liquidity as it directly measures the cost of executing a trade, although bid–ask spreads are only valid for market-accepted transaction sizes and for a limited period of time. The average reported "on-the run" bid–ask spread for the government benchmark bond (typically a treasury bond) in each of the 10 markets surveyed was 9.2 basis points (bps), somewhat wider than the 7.2 bps from the 2010 survey. The two lowest on-the-run bid–ask spreads were in the Republic of Korea (0.7 bps) and India (1.0 bps), followed by Thailand and Malaysia (3.3 bps each). The widest on-the-run bid–ask spreads were found in Viet Nam (33.5 bps) and Indonesia (32.9 bps). Bid–ask spreads widened in most markets this year due to the uncertain global outlook and the risk of a weakened external performance affecting Asian economies and producing greater financial market volatility.

Liquidity can also be measured by the difference between on-the-run and off-the-run bid–ask spreads, given that greater liquidity among on-the-run bonds results in tighter bid–ask spreads. The greatest differences between on-the-run bid–ask spreads and off-the-run spreads were in Indonesia and the Philippines, where respondents reported differences that averaged 29 bps and 14 bps, respectively. However, in some markets off-the-run bonds are not only less liquid, but they exist in very small volumes and rarely trade. Thus, many respondents report that they are not involved in the off-the-run markets; Indonesia and the PRC are cases in point.

**Average transaction size.** Transaction size is a useful measure of market depth, given that it is an ex-post measure of the quantity of bonds that can be traded at the bid or ask price. In this year's survey, average transaction size (US$ equivalent) for government bonds ranged from a low of US$1.1 million in India to highs of US$8.9 million in the Republic of Korea, US$15.3 million in the PRC, and US$18.3 million in Singapore for on-the run bonds. Off-the-run transaction sizes for government bonds ran from a low of US$1.1 million in India to highs of US$11.7 million in Singapore and US$11.8 million in the PRC.

## Characteristics of Individual Government Bond Markets

The survey also collected data on bid–ask spreads and average trading sizes for the different types of bonds in the larger individual markets, as well as information on developments in market structure**.**

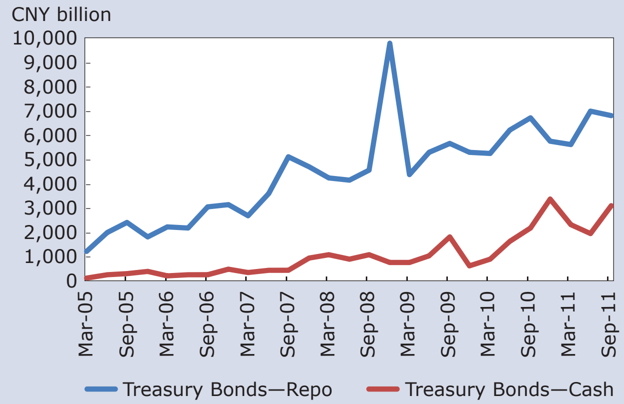
**The PRC.** Bid–ask spreads for the PRC's treasury bills, bonds, and policy bank bonds widened by less than 2 bps between the 2010 and 2011 surveys. Bid–ask spreads for PBOC bills and

**Table 9: LCY Government Bond Survey Results—People's Republic of China**

| | Treasury Bills | Treasury Bonds | Policy Bank Bonds | PBOC Bills | PBOC Bonds |
|---|---|---|---|---|---|
| On-the-Run | | | | | |
| Bid–Ask Spread (bps) | 4.7 | 4.0 | 4.0 | 4.5 | 4.3 |
| Average Trading Size (CNY million) | 98.8 | 97.5 | 75.0 | 215.9 | 122.0 |
| Off-the-Run | | | | | |
| Bid–Ask Spread (bps) | 7.3 | 5.9 | 6.5 | 5.9 | 5.3 |
| Average Trading Size (CNY million) | 73.9 | 75.6 | 43.9 | 81.1 | 78.3 |

bps = basis points, LCY = local currency, PBOC = People's Bank of China.
Source: *AsianBondsOnline* 2011 LCY Bond Market Survey.

**Figure 15: Repo vs. Cash Trading Volume in the People's Republic of China, March 2005-September 2011**




Source: *ChinaBond*.

bonds, however, widened 3.0 bps and 2.8 bps, respectively. These increases reflect the tightening of PBOC monetary policy since the second half of last year. Interestingly, the bid–ask spreads for PBOC bills and bonds were somewhat wider than those for treasury bonds and policy bank bonds **(Table 9)**. PBOC bills and bonds are generally more liquid than other types of government bonds, as can be seen in their larger average trading sizes. However, the PBOC has aggressively reduced its issuance over the last year.

Current bid–ask spreads represent a more typical level than those found in the 2010 survey. At that time, bid–ask spreads in a range of 2 bps–3 bps were unusually low due to the excess liquidity that had been generated by a combination of the PBOC's accommodative monetary policy and the government's aggressive economic stimulus program. The PBOC has since raised its policy rates a number of times and implemented a series of hikes in bank reserve requirements. Most market participants expect that market liquidity will not change much in the very near-term.

One of the PRC's bond market's more attractive features is the availability of hedging instruments such as large and active repurchase (repo) markets that include a market for most classes of government bonds and several types of corporate bonds. **Figure 15** compares the trading volume of treasury bond cash trades with that of comparable repo trades.

Interest rate swaps (IRSs) are another important hedging product in the PRC. The most important benchmark in the PRC's IRS market is the 7-day repo swap, which at the end of 3Q11 comprised 51% of the IRS market compared with 60%–70% in mid-2010. The next most important benchmark is the overnight Shanghai Interbank Offered Rate (SHIBOR) swap, which increased its market share to 35% at the end of 3Q11 compared with 14% in mid-2010. Meanwhile, the 3-month SHIBOR swap saw its market share decline to 10% in 3Q11 from 15% in mid-2010.

Another interesting development over the last year has been the launch of a domestic credit default swap (CDS) market. This market is regulated by the National Association of Financial Market Institutional Investors (NAFMII), which is a trade body set up by the PBOC. The CDS domestic market is divided into two sections: (i) non-tradable bilateral contracts more akin to insurance policies that are known as credit risk mitigation agreements (CRMA), and (ii) tradable contracts known as credit risk mitigation warrants (CRMW). Daily trading volume in the CRMW market is negligible because the banking regulatory authority—the China Banking Regulatory Commission (CBRC)—has yet to decide on precise rules for reflecting the reduction of risk on a financial institution's balance sheet once it buys a particular CRMW contract.

**Republic of Korea**. Korea Treasury Bonds (KTBs) and Monetary Stabilization Bonds (MSBs), which are issued by The Bank of Korea, remained liquid in 2011 based on the survey results presented in **Table 10**. In fact, liquidity in the LCY government bond market of the Republic of Korea improved in 2011, with bid–ask spreads for on-the-run KTBs falling to 0.7 bps from 1.1 bps in 2010, while decreasing to 1.1 bps from 1.7 bps for off-the-run KTBs. Bid–ask spreads for The Bank of Korea bills and MSBs also dropped in 2011, with bid–ask spreads for on-the-run MSBs falling to 0.8 bps from 1.1 bps in 2010.

The average trading sizes for on-the-run and off-the-run KTBs in 2011 stood at KRW10.5 billion and KRW11.6 billion, respectively, up from KRW9.8 billion and KRW9.7 billion in 2010. Bid–ask spread and trading size data in 2011 were collected during the last week of August when net monthly foreign inflows into the Korean bond market had fallen to KRW134 billion from levels of KRW2 trillion–KRW3 trillion in May–July, and just before a small net foreign outflow of KRW2.5 billion in September. Net foreign inflows into the Korean bond market staged a strong recovery in October, climbing to KRW1.3 trillion. The most recently available data from June places the share of foreign holdings in the LCY government bond market in the Republic of Korea market at around 11%.

**Table 10: LCY Government Bond Survey Results—Republic of Korea**

| | Treasury Bonds | Treasury Bills | Central Bank Bonds | Central Bank Bills |
|---|---|---|---|---|
| On-the-Run | | | | |
| Bid–Ask Spread (bps) | 0.7 | 1.3 | 0.8 | 0.8 |
| Average Trading Size (KRW billion) | 10.5 | 8.5 | 8.9 | 8.9 |
| Off-the-Run | | | | |
| Bid–Ask Spread (bps) | 1.1 | 1.5 | 1.1 | 1.1 |
| Average Trading Size (KRW billion) | 11.6 | 8.2 | 8.6 | 8.6 |

bps = basis points, LCY = local currency.
Source: *AsianBondsOnline* 2011 LCY Bond Market Survey.

Improved trading conditions in the Korean market in 2011—at a time when bid–ask spreads have widened for almost all other bond markets—reflects increased participation by both foreign and domestic investors. While the role of foreign investors has been well covered in the financial press, it is not as widely highlighted that domestic investors have become much more active in the government bond market. Domestic investors appreciate the fact that government bonds provide a safer alternative to other investment opportunities. Government efforts at increasing the size and liquidity of key benchmark bonds—often through re-openings—have made KTBs a more attractive investment. The Republic of Korea is one of the markets where investors would like to see a larger supply of government bonds.

**India.** The survey results indicate that Government of India (GOI) bonds are the most liquid government bond in India **(Table 11)**. The average bid–ask spread for on-the-run GOI bonds was 1.0 bps, followed by special government bonds at 2.8 bps and treasury bills at 4.3 bps. GOI bonds are issued by the Reserve Bank of India, but the proceeds are used mainly for funding budgetary expenditures and infrastructure projects. Special government bonds are issued to fertilizer and oil marketing firms to serve as a form of compensation for these companies in lieu of cash subsidies. The average trading size for GOI bonds and treasury bills was the same at INR56.3 million each, and is slightly higher for special government bonds at INR58.3 million.

The Indian LCY government bond market has garnered increased interest from fund managers in the region over the last several years due to its size

**Table 11: LCY Government Bond Survey Results—India**

| | Treasury Bills | Government of India Bonds | Special Government Bonds |
|---|---|---|---|
| On-the-Run | | | |
| Bid–Ask Spread (bps) | 4.3 | 1.0 | 2.8 |
| Average Trading Size (INR million) | 56.3 | 56.3 | 58.3 |

bps = basis points, LCY = local currency.
Source: *AsianBondsOnline* 2011 LCY Bond Market Survey.

and rapid growth. Government bonds outstanding reached the equivalent of US$948 billion at the end of 2Q11, making this market the third largest government bond market in the region after the PRC (US$3.2 trillion) and the Republic of Korea (US$1.3 trillion). More importantly, the Indian government bond market grew 32.1% year-on-year (y-o-y) in 2Q11, making it the most rapidly growing government bond market in the region. The only other major Asian government bond markets to approach this growth rate in 2Q11 were Malaysia and Viet Nam, which grew 20.9% and 18.8% y-o-y, respectively.

The Indian government has taken measures over the last year to open up both the government bond market and the corporate bond market to greater foreign participation. It also has taken steps to develop the repo market and to set up a domestic CDS market. These are positive initial steps, although it will likely take a few more years before these efforts reach fruition.

**Indonesia.** The most liquid government bond instruments in Indonesia are treasury bonds, with liquidity concentrated mainly in benchmark bonds. The Finance Ministry has chosen four state bonds—FR0055, FR0053, FR0056, and FR0054—as its benchmark series for 2011. There is less liquidity in treasury bills due to their small issue size. Liquidity is also limited for *Sertifikat* Bank Indonesia (SBI) because of the 6-month holding period that Bank Indonesia imposes upon investors who purchase these instruments.

The 2011 survey results for Indonesia showed an average on-the-run bid–ask spread of 32.9 bps

**Table 12: LCY Government Bond Survey Results—Indonesia**

| | Treasury Bills | Treasury Bonds | SBI |
|---|---|---|---|
| On-the-Run | | | |
| Bid–Ask Spread (bps) | 36.4 | 32.9 | 36.5 |
| Average Trading Size (IDR billion) | 23.7 | 18.3 | 67.0 |
| Off-the-Run | | | |
| Bid–Ask Spread (bps) | 58.0 | 61.9 | 75.0 |
| Average Trading Size (IDR billion) | 15.1 | 10.1 | 36.3 |

bps = basis points, LCY = local currency, SBI = *Sertifikat* Bank Indonesia.
Source: *AsianBondsOnline* 2011 LCY Bond Market Survey.

for treasury bonds **(Table 12)**. This is the second-highest spread among all emerging Asian markets in this or past years' surveys. (The 33.5 bps spread for Viet Nam's government bonds in the 2011 survey is the highest.) Bid–ask spreads for treasury bills and SBI were slightly wider than for treasury bonds. The average off-the-run bid–ask spreads for all government bond instruments were almost double their comparable on-the-run spreads. The highest off-the run bid–ask spread was for SBI at 75.0 bps, while off-the-run spreads were slightly lower for treasury bills and treasury bonds.

The average on-the-run transaction size for treasury bonds stood at IDR18.3 billion in 2011, while SBI traded at a larger average size of IDR67 billion. The same trend was observed for off-the-run transaction sizes, with the SBI average trading size about three times larger than the average for treasury bonds.

Although government bond liquidity has improved in Indonesia in recent years, the turnover ratio still remains below 0.5. Survey respondents suggested a number of possible steps that the government could take to improve liquidity including (i) issuing treasury bills in larger sizes, (ii) issuing treasury bonds in "super long-dated" maturities well beyond the 40-year maturity that is currently the longest-dated bond in the market, and (iii) taking measures to develop a meaningful repo market to guard against sudden external shocks. While a repo market already exists in Indonesia, the government has yet to implement the regulatory measures needed to support its operation.

**Malaysia.** Unlike other governments in the region, the Malaysian government is still pursuing an aggressive fiscal stimulus program. The large increase in issuance by Bank Negara Malaysia (BNM) stands in stark contrast to most other central banks in the region that have reduced issuance sharply as they withdraw from sterilization measures pursued in the aftermath of the 2007–09 global financial crisis.

Malaysian bid–ask spreads on benchmark government bonds widened modestly to 3.3 bps in 2011 from 2.6 bps in 2010. The bid–ask spread for on-the-run Malaysian Government Securities (MGSs) was used as a proxy for Malaysian benchmark government bonds **(Table 13).** Bid–ask spreads for Government Investment Securities (GIIs) averaged a slightly wider 3.4 bps. The average trading size for MGSs was MYR11.7 million in 2011, almost twice as large as 2010's average trading size of MYR6.2 million. The combination of a much larger average trading size and bid–ask spreads that have widened suggests that the latest round of uncertainty in global financial markets has had only a modest negative effect on the Malaysian government bond market.

**Philippines.** The average bid–ask spread for Philippine treasury bonds widened modestly to 5.3 bps in 2011 from 3.1 bps in 2010 **(Table 14)**. Similarly, the average bid–ask spread for treasury bills climbed to 14.5 bps in 2011 from 10.3 bps in 2010. Average trading sizes for treasury bonds shrank to PHP161.9 million in 2011 from PHP225.6 million in 2010. Typical trading volumes for treasury bills were significantly larger in 2011 at PHP43.0 million compared with PHP28.8 million in 2010 as offshore investors bid actively for the limited supply of short-dated securities to speculate on the Philippine currency.

Bid–ask spreads for Philippine government bonds narrowed considerably during the course of 2011. The average bid–ask spread for government benchmark bonds during the week of 14–18 March was 20.9 bps. By the week of 29 August–2 September, the average bid–ask spread had fallen to 4.2 bps. The high point in spreads in March, which stood in stark contrast to an average bid–ask spread of only 3.1 bps in 2010, was the result of political and social unrest in the Middle East and global financial uncertainty compounded by the 11 March earthquake and tsunami in Japan. The trend toward tighter bid–ask spreads in the latter half of 2011 was noticeable after a July bond swap that created a new series of longer-dated benchmark bonds. This most recent bond exchange was similar to other previous exchanges over the last year in creating greater liquidity at the longer-end of the curve. Prior to 2011, investors in longer-dated bonds were mostly insurance firms and trust companies, and other buy-and-hold investors. The creation of the 20- and 25-year benchmarks in the recent bond exchanges has encouraged greater participation in

**Table 13: LCY Government Bond Survey Results—Malaysia**

| | MGS | GII | BNM Bills | Treasury Bills |
|---|---|---|---|---|
| On-the-Run | | | | |
| Bid–Ask Spread (bps) | 3.3 | 3.4 | 3.9 | 5.3 |
| Average Trading Size (MYR million) | 11.7 | 13.0 | 31.9 | 26.7 |
| Off-the-Run | | | | |
| Bid–Ask Spread (bps) | 5.9 | 5.5 | 4.2 | 4.9 |
| Average Trading Size (MYR million) | 8.4 | 10.0 | 24.6 | 26.7 |

BNM = Bank Negara Malaysia, bps = basis points, GII = Government Investment Issues, LCY = local currency, MGS = Malaysian Government Securities.
Source: *AsianBondsOnline* 2011 LCY Bond Market Survey.

**Table 14: LCY Government Bond Survey Results—Philippines**

| | Treasury Bonds | Treasury Bills |
|---|---|---|
| On-the-Run (large-issued) | | |
| Bid–Ask Spread (bps) | 5.3 | 14.5 |
| Average Trading Size (PHP million) | 161.9 | 43.0 |
| Off-the-Run | | |
| Bid–Ask Spread (bps) | 19.4 | 27.7 |
| Average Trading Size (PHP million) | 45.2 | 39.9 |

bps = basis points, LCY = local currency.
Source: *AsianBondsOnline* 2011 LCY Bond Market Survey.

the government bond sector by banks and other financial institutions.

## Qualitative Indicators for Government Bond Markets

The 2011 *AsianBondsOnline* Bond Market Liquidity Survey asked participants in the region's LCY government and corporate bond markets for their views on market structure and ways to improve liquidity. The "spider charts" included in this section capture market participants' perceptions of the importance of the following structural and policy issues in strengthening and deepening LCY bond markets:

(i) greater diversity of investors and traders,
(ii) easing restrictions on market access,
(iii) easing foreign exchange regulations and restrictions,
(iv) availability of funding for market participants,
(v) tax treatment,
(vi) settlement and custody,
(vii) more efficient hedging instruments, and
(viii) transparency.

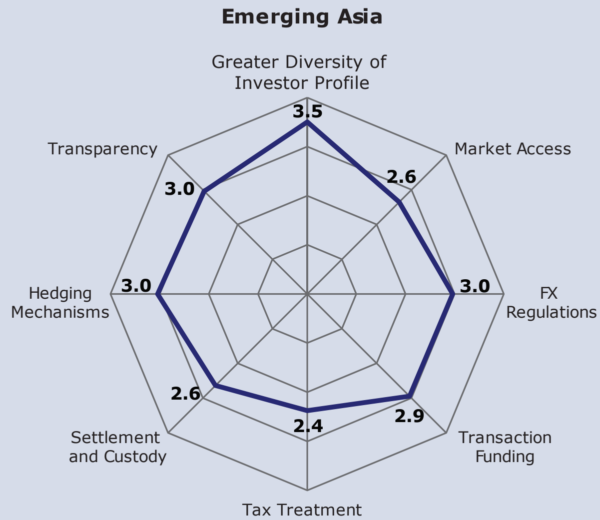
Market participants were asked to characterize each of the above issues by degree of importance, with a corresponding numerical score, as they affect market structure and liquidity:

(i) not important (1),
(ii) somewhat important (2),
(iii) important (3), or
(iv) very important (4).

**Figure 16** summarizes the results as they relate to the structure of the region's LCY government bond market as a whole. The most important structural issue for market participants was investor diversity, which had a score of 3.5, followed by hedging mechanisms, transparency, and foreign exchange regulations, all with scores of 3.0, and transaction funding with a score of 2.9. The lowest scores were for settlement and custody (2.6), market access (2.6), and tax treatment (2.4).

**Greater Diversity of Investors and Traders.** Greater diversity of investors and traders was

**Figure 16: Regional Averages—LCY Government Bond Market Structural Issues**




FX = foreign exchange, LCY = local currency.
Note: Emerging Asia comprises the People's Republic of China; Hong Kong, China; India; Indonesia; Republic of Korea; Malaysia; Philippines; Singapore; Thailand; and Viet Nam.
Source: *AsianBondsOnline* 2011 LCY Bond Market Survey.

viewed as especially important in India (4.0), Thailand (3.9), Viet Nam (3.8), the Philippines (3.6), and the PRC (3.6) **(Figure 17).** Banks and other financial institutions continued to dominate most government bond markets in emerging Asia. For example, at end-September banks' holdings of LCY treasury bonds in the PRC stood at 65% of the total. And in the Republic of Korea, financial institutions—banks, insurance firms, pension funds, and other financial institutions—held about 60% of all LCY government bonds.

**Hedging Mechanisms.** The availability of hedging or derivative instruments (e.g., forwards, futures, options, swaps) had an average score of 3.0 across the region, suggesting that the increased availability of such mechanisms is an important requirement for promoting greater bond market liquidity. This criterion had the highest scores in India and the PRC at 3.5 and 3.4, respectively, followed by the Republic of Korea at 3.2 and Hong Kong, China; the Philippines; Thailand; and Viet Nam at 3.0 each.

A number of hedging instruments are currently available in emerging Asian markets. For example, in

**Figure 17: Structural Issues for Individual LCY Government Bond Markets**

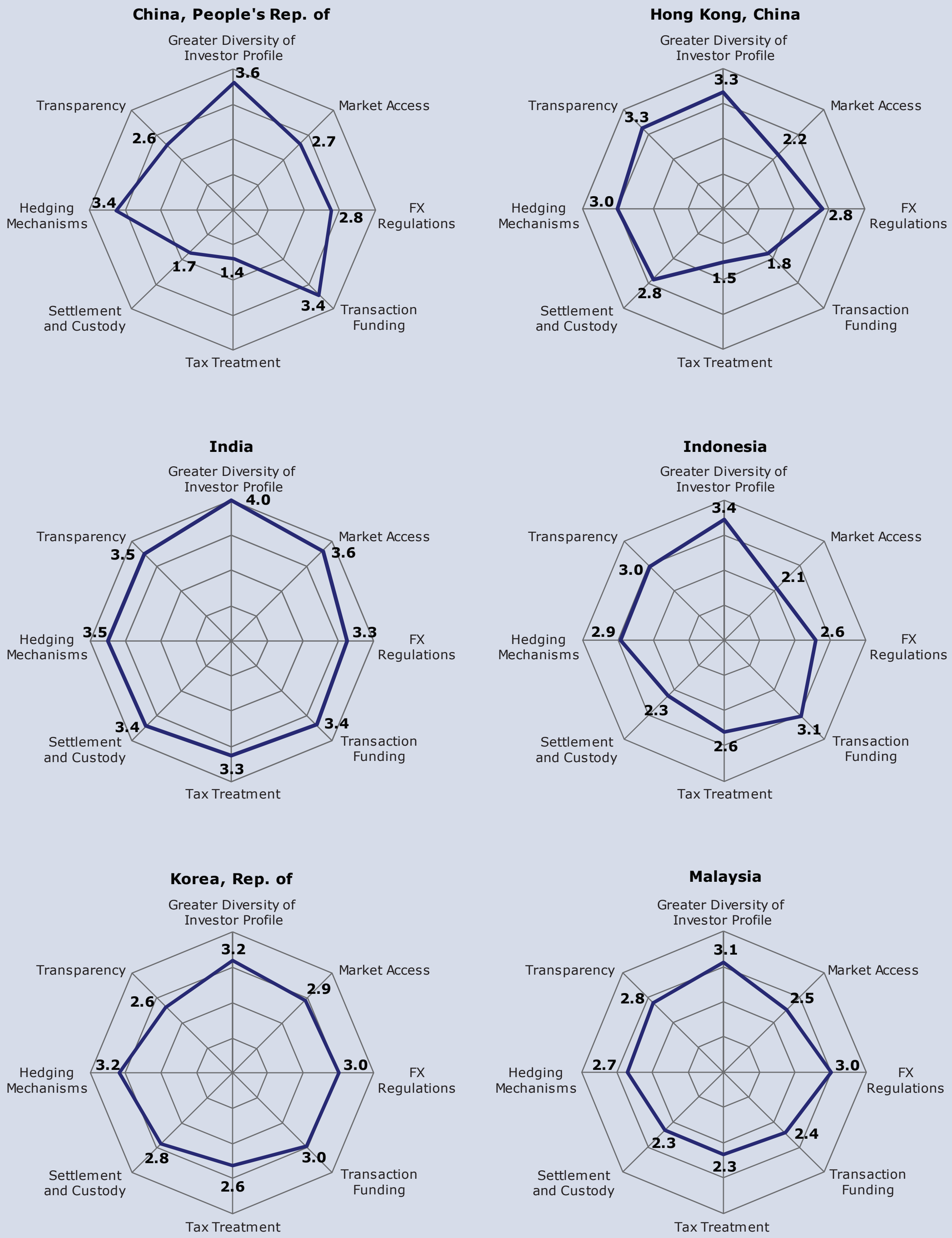



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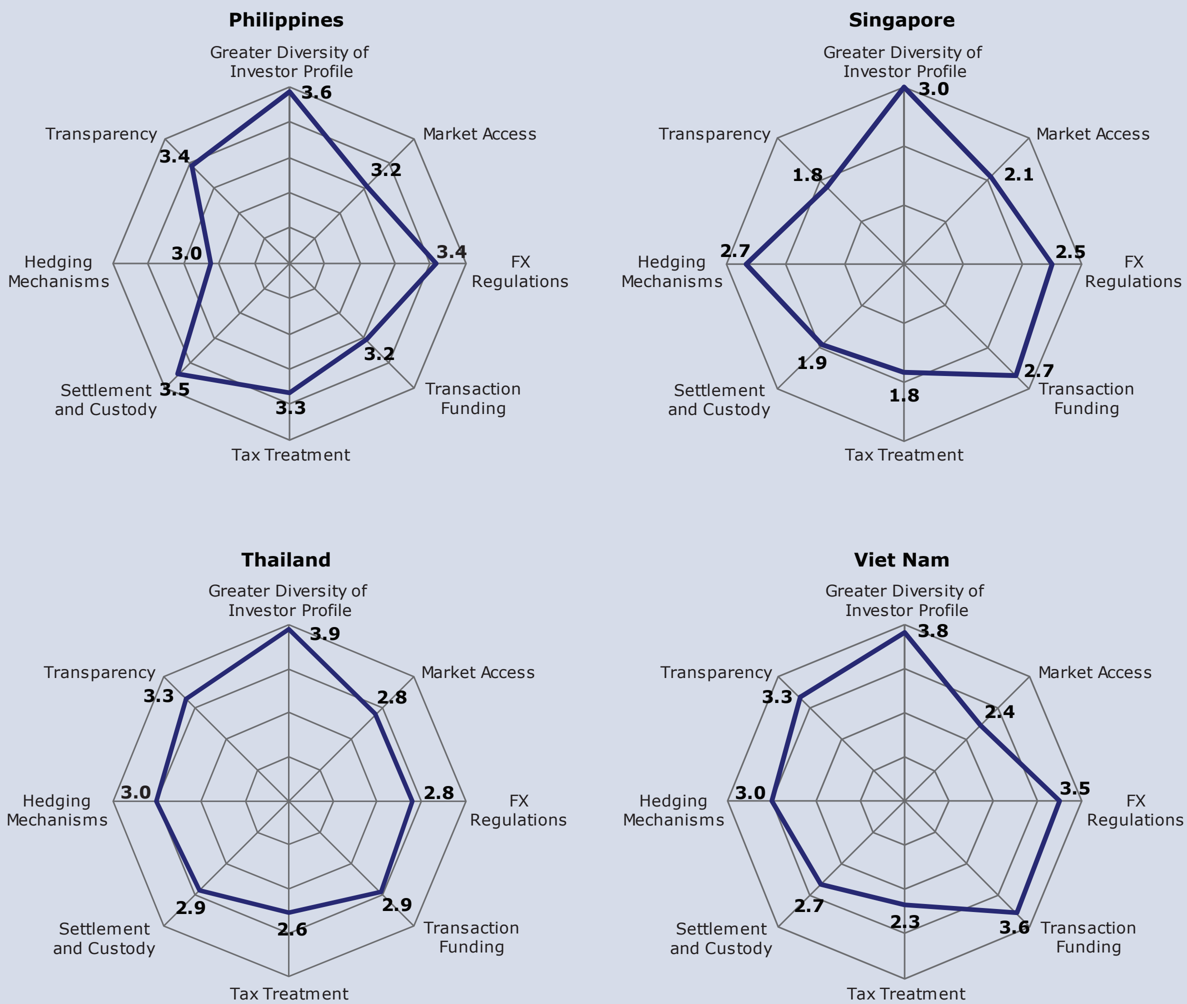
**Figure 17** *continued*




FX = foreign exchange, LCY = local currency.
Source: *AsianBondsOnline* 2011 LCY Bond Market Survey.

Hong Kong, China, interest rate and cross-currency swaps are available and relatively liquid, as are 3-year Exchange Fund Note (EFN) futures. Interest rate and cross-currency swaps are also offered in the PRC. In the Republic of Korea, 3-, 5-, and 10-year Korean Treasury Bond (KTB) futures are offered, but currently only the 3-year KTB futures are liquid. The Korean government, however, recently changed settlement procedures for 10-year KTB futures from a physical to a cash basis.

**Foreign Exchange Regulations.** Government bond market participants generally rated foreign exchange regulations as being an important factor in market liquidity, with a regional average score of 3.0. Participants in several markets in particular highlighted the importance of the relationship between foreign exchange regulations and bond market liquidity, including Viet Nam (3.5), the Philippines (3.4), and India (3.3). The importance of foreign exchange regulations as a structural obstacle to further development of the LCY bond market was given a score of 3.0 in the Republic of Korea and Malaysia, but only 2.8 in the PRC.

**Transparency.** Transparency was deemed an important issue by most government bond market participants in the region, garnering a score of

3.0. Specifically, participants rated transparency as being important in India (3.5); the Philippines (3.4); Thailand (3.3); Hong Kong, China (3.3); and Viet Nam (3.3).

**Transaction Funding.** Transaction funding rose to an average score of 2.9 this year from 2.6 in last year's survey-primarily due to an overall tightening of monetary policy and funding availability in most markets, especially the PRC and Republic of Korea.

**Other Indicators.** The other indicators included in the survey on bond market liquidity—market access, tax treatment, and settlement and custody—had a regional average of between 2.4 and 2.6, suggesting that these issues were less important for market participants when compared with the five indicators detailed above.

## Corporate Bond Markets

Corporate bond market participants were asked to respond to questions similar to the ones put to government bond market participants, albeit with several differences. **Table 15** compiles the responses from corporate bond market participants with regard to average issue sizes, bid–ask spreads, and average trading sizes**.**

**Average issue size.** The largest average issue sizes were in the PRC (US$341 million), Singapore (US$201 million), and Malaysia (US$177 million).

**Bid–ask spreads.** Bid–ask spreads for corporate bonds are typically much wider than those for government bonds, reflecting lower levels of liquidity. In many cases corporate bond liquidity is limited to the months immediately following issuance.

The highest bid–ask spreads came from Viet Nam (103.1 bps), Indonesia (70.0 bps), and the Philippines (52.9 bps). The lowest bid–ask spreads came from the Republic of Korea (1.7 bps) and India (5.6 bps). Corporate bid–ask spreads for the PRC (6.9 bps), Malaysia (8.2 bps), and Thailand (9.9 bps) comprised the central range of the region's corporate bond market.

**Average trading size.** The largest average trading sizes for corporate bond trades were in the PRC (US$8.0 million); the Republic of Korea (US$7.3 million); and Hong Kong, China (US$5.1 million). Other markets ranged from highs of US$3.5 million in Viet Nam and US$2.1 million in Malaysia to lows of US$0.7 million in Indonesia and US$0.4 million in the Philippines.

## Inter-Market Comparisons

**The PRC.** The survey results show that the PRC's medium-term notes (MTNs) and commercial paper were the most liquid instruments in the secondary market in 2011 with average bid–ask spreads of only 5.6 bps for MTNs. SOE bonds were the next most liquid, with bid–ask spreads of

**Table 15: LCY Corporate Bond Market Quantitative Indicators**

| | | PRC | HK | IN | ID | KR | MY | PH | SG | TH | VN | Regional |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Typical Issue Size of Corporate Bonds (US$ million) | Average | 340.5 | 33.7 | 44.5 | 70.2 | 52.5 | 176.6 | 144.3 | 200.8 | 65.0 | 87.4 | 121.6 |
| Typical Bid-Ask Spread for New Corporate Issues (bps) | Average | 6.9 | 28.1 | 5.6 | 70.0 | 1.7 | 8.2 | 52.9 | 19.0 | 9.9 | 103.1 | 30.5 |
| | Count | 13 | 4 | 4 | 8 | 5 | 3 | 21 | 5 | 9 | 4 | 76 |
| | SD | 3.6 | 13.3 | 3.1 | 42.2 | 0.5 | 6.5 | 27.1 | 8.4 | 6.4 | 50.4 | 34.0 |
| Typical Transaction Size of LCY Corporate Bonds (US$ million) | Average | 8.0 | 5.1 | 1.1 | 0.7 | 7.3 | 2.1 | 0.4 | 1.4 | 1.0 | 3.5 | 3.1 |
| | Count | 13 | 4 | 4 | 9 | 7 | 3 | 20 | 6 | 9 | 6 | 81 |
| | SD | 3.0 | 1.0 | 0.3 | 0.3 | 3.2 | 0.9 | 0.2 | 0.9 | 0.7 | 1.4 | 2.8 |

bps = basis points; HK = Hong Kong, China; ID = Indonesia; IN = India; KR = Republic of Korea; LCY = local currency; MY = Malaysia; PH = Philippines; PRC = People's Republic of China; SD = standard deviation; SG = Singapore; TH = Thailand; VN = Viet Nam.
Source: *AsianBondsOnline* 2011 LCY Bond Market Survey.

**Table 16: LCY Corporate Bond Survey Results—People's Republic of China**

| | SOE Bonds | Local Corporate Bonds | MTN | Commercial Bank Bonds | Commercial Paper |
|---|---|---|---|---|---|
| Bid–Ask Spread (bps) | 6.9 | 11.9 | 5.6 | 10.2 | 4.5 |
| Average Trading Size (CNY million) | 51.2 | 33.7 | 53.8 | 32.5 | 72.1 |

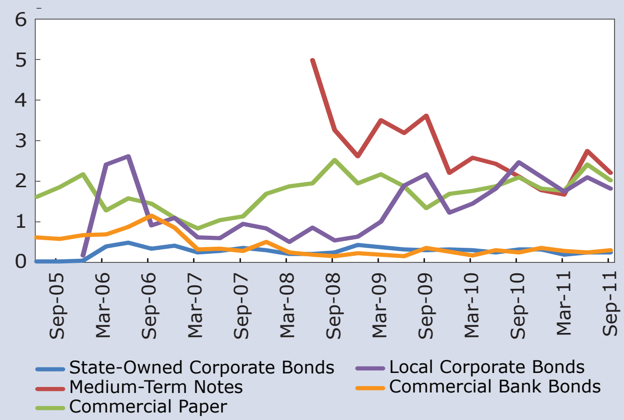
bps = basis points, LCY = local currency, MTN = medium-term notes, SOE = state-owned enterprise.
Source: *AsianBondsOnline* 2011 LCY Bond Market Survey.

6.9 bps **(Table 16)**. Compared with the previous year the bid–ask spreads for all types of corporate bonds widened, implying tighter liquidity and greater volatility in the overall bond market, which is consistent with the monetary tightening measures taken by the PBOC beginning in late 2010. The average trading size fell between 2010 and 2011 as well.

Local corporate bonds and commercial bank bonds are less liquid than the other three main types of corporate bonds in the PRC as reflected in their wider bid–ask spreads and lower average trading sizes. Commercial bank bonds are issued mostly in the form of subordinated debt for purposes of improving capital adequacy ratios. The higher level of liquidity seen in MTNs and commercial paper is attributed to the fact that the NAFMII approval process for MTNs and commercial paper is much faster than that of the National Development and Reform Commission (NDRC), which is the approval platform for SOE bonds. Furthermore, banks, which are the largest holder of bonds, prefer the shorter 3–5 year maturities that are the most common in the MTN market.

The survey's bid–ask spread data and average trading size data are consistent with current trends in turnover ratios for the main types of PRC corporate bonds: MTNs and commercial paper have the highest turnover ratios, while SOE bonds and commercial bank bonds have much lower turnover ratios. What is striking about the PRC's corporate bond market is that the turnover ratios for MTNs and commercial paper move in a range similar to or even higher than those for bonds in the more liquid government sector (e.g., policy bank bonds and PBOC bonds). The turnover ratio for bonds issued by SOEs was low at 0.23 at end-September, while that for commercial bank bonds was only somewhat higher at 0.30 **(Figure 18)**. The turnover ratio for local corporate bonds, however, was significantly higher at 1.81 and the turnover ratios for MTNs and commercial paper were even higher at 2.19 and 2.02, respectively.

**Figure 18: Trends in the PRC's LCY Corporate Bond Turnover Ratios, September 2005-September 2011**




LCY = local currency, PRC = People's Republic of China.
Source: *ChinaBond*.

**Republic of Korea.** The survey results show that special public bonds and financial debentures are the most liquid types of corporate bonds in the Republic of Korea, with larger issue sizes and lower bid–ask spreads (1.4 bps and 1.3 bps, respectively) than corporate bonds issued by private sector companies (2.4 bps) **(Table 17)**. The bid–ask spreads for all three types of corporate bonds narrowed in 2011, implying a modest improvement in liquidity in the corporate bond market. As mentioned above, the private corporate sector is the most rapidly growing segment of the corporate bond market in the Republic of Korea, expanding at rates of around 22% y-o-y in recent quarters

**Table 17: LCY Corporate Bond Survey Results—Republic of Korea**

| | Special Public Bonds | Financial Debentures | Private Corporate Bonds |
|---|---|---|---|
| Average Issue Size (KRW billion) | 103.0 | 53.6 | 8.6 |
| Bid–Ask Spread (bps) | 1.4 | 1.3 | 2.4 |
| Average Trading Size (KRW billion) | 8.6 | 8.6 | 8.6 |

bps = basis points, LCY = local currency.
Source: *AsianBondsOnline* 2011 LCY Bond Market Survey.

compared with much slower or negligible y-o-y growth rates for special public bonds and financial debentures. However, private corporate bonds are issued in smaller sizes and typically are purchased by buy-and-hold investors.

The two largest LCY corporate bond issuances in the Republic of Korea in 3Q11 were both from Korea Land & Housing Corp: a 10-year bond worth KRW1,150 billion with a coupon rate of 3.25% and a 3-year bond worth KRW520 billion at a 4.21% coupon. The next two largest issues were from privately owned corporations: steel maker POSCO and the petrochemical company Honam at KRW500 billion each.

**Malaysia**. The Malaysian LCY corporate bond market's average bid–ask spread declined significantly from 16.0 bps in 2010 to 8.2 bps in 2011, while the average trading size fell from US$2.9 million to US$2.1 million. Furthermore, the typical issue size for Malaysian corporate bonds rose from US$131.8 million in 2010 to US$176.6 million in 2011. Finally, Malaysia's corporate bond turnover ratio rose slightly in 3Q11 to 0.09 from 0.08 in 2Q11.

The improvement in liquidity in the Malaysian corporate bond market seems to be largely the result of issuance that remains substantial at a time when issuance has slowed in most of the region's other markets. The size of the Malaysian corporate bond market rose 11.8% y-o-y to reach US$105 billion in 3Q11. Approximately 53% of total corporate bonds outstanding consist of MTNs—both conventional and Islamic. MTNs are the fastest growing segment of Malaysia's corporate bond market, rising by 25.0% y-o-y in 3Q11.

Some of the more important corporate bond issues in Malaysia in 3Q11 were subordinated debt issues from Public Bank (MYR3.0 billion), Maybank (MYR2.0 billion), and CIMB Bank (MYR1.5 billion). Malaysian issuance is actually more diversified than in some other Asian markets. For example, YTL Power International issued MYR2.2 billion in bonds, and public sector transport infrastructure company Prasarana issued MYR2.0 billion of Islamic bonds.

**Indonesia.** The overall rapid growth of the Indonesian corporate bond market in 2011—and the vastly increased supply of new bonds—pushed the average bid–ask spread down to 70.0 bps from 99.7 bps in 2010. Average trading size, however, has remained roughly the same: US$0.7 million this year compared with US$0.8 million last year.

Corporate bond issuance in 3Q11 totaling IDR5.8 trillion was dominated by banks and automotive financing companies. Bank Sumut issued IDR1.0 billion of conventional and subordinated bonds in July. Toyota Astra Financial Services issued IDR1.2 trillion of bonds in three tranches in July. Property firm Agung Podomoro Land issued IDR1.2 trillion of bonds in August for the purpose of funding its automotive financing business. Finally, automotive leasing company Serasi Autoraya raised a total of IDR900 billion in July.

**Singapore.** Singapore's average bid–ask spread for LCY corporate bonds widened in 2011 to 19.0 bps from 10.4 bps in 2010. The Singapore data was collected in late September and likely reflects the anxiety present in global financial markets at that time. Singapore's average trading size of US$1.4 million in 2011 was down from US$2.8 million in 2010. The widening of spreads and reduced trading sizes may reflect the 15.0% y-o-y reduction in corporate bond issuance in the first three quarters of 2011 to SGD12.3 billion.

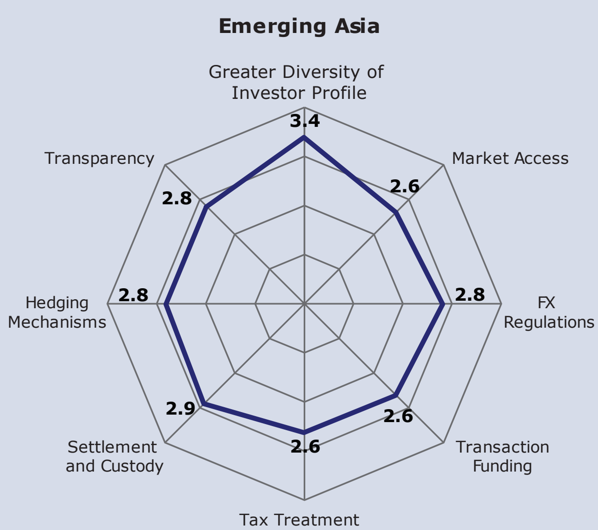
The largest drop in issuance in 2011 occurred among government-linked companies. The previous year saw a great deal of issuance from this sector, including a SGD1.0 billion 40-year issue from Temasek Financial. Total issuance from government-linked companies amounted to SGD5.3 billion in the first three quarters of 2010. On the other hand, the Housing and Development Board accounted for the entire SGD3.4 billion of issuance from government-linked companies in the first three quarters of 2011. The banking sector issued SGD1.1 billion of new bonds in the first three quarters of 2011, most notably a SGD1.0 billion subordinated bond from UOB Bank and a smaller SGD100 million certificate of deposit from OCBC Bank. Issuance from Singaporean firms other than banks and government-linked companies amounted to SGD17.8 billion in the first three quarters of 2011, representing a 15.8% decline from the same period in 2010.

## Qualitative Indicators for Corporate Bond Markets

**Figure 19** summarizes market participants' feedback on corporate bond market structures in the region. The results are broadly similar to those from the government bond survey. For example, the most important structural issue for participants in the region's LCY corporate bond market was once again greater diversity of investors based on a score of 3.4. Responses to the corporate survey for market access were identical to that of the government survey at 2.6. Tax treatment produced a score of 2.6 in the corporate bond survey compared with 2.4 in the government bond survey. Meanwhile, settlement and custody had a score of 2.9 in the corporate bond survey versus 2.6 in the government survey. Unique aspects of the region's corporate bond market that influenced participant responses are detailed below:

- Taxes paid on government bonds are waived for certain types of investors in government bonds in a number of jurisdictions, but only Malaysia exempts corporate bonds from taxes. Thus, tax payments are a more important issue for corporate, rather than government, bond investors.
- Settlement and custody is a more important issue in the corporate bond market than in the government bond market. Governments enforce a fair degree of uniformity for settlement and custody procedures for government bonds. Settlement and custody procedures for corporate bonds, however, are less standardized. In some markets they may even vary according to different settlement and custody procedures that have been set up by a particular bond's underwriters.

**Figure 19: Regional Averages—LCY Corporate Bond Market Structural Issues**




FX = foreign exchange, LCY = local currency.
Note: Emerging Asia comprises the People's Republic of China; Hong Kong, China; India; Indonesia; Republic of Korea; Malaysia; Philippines; Singapore; Thailand; and Viet Nam.
Source: *AsianBondsOnline* 2011 LCY Bond Market Survey.

Scores from the corporate bond market survey were lower than scores from the government bond survey for all other categories: foreign exchange regulations, transaction funding, hedging mechanisms, and transparency.

Foreign exchange regulations are simply a lower priority for corporate bond investors, who typically have a wider range of concerns than government bond investors.

The lower scores for transaction funding and hedging mechanisms reflect the lower levels of liquidity in the corporate bond market compared with government bonds. Many corporate bonds eventually disappear from the market altogether once they end up being in the portfolio of buy-and-hold investors.

Transparency—stated in general terms for the market as a whole—is also somewhat less important to corporate bond market investors because they rely primarily upon the prospectuses that are provided when a new bond is issued.

Responses on structural issues differed significantly across the region's corporate bond markets **(Figure 20)**. The four markets in which survey participants were seeking the most structural changes were India, the Philippines, Viet Nam, and Malaysia. Scores for India were above 3.0 for all structural issues except for transparency (2.8). Scores for the Philippines were above 3.0 for all categories except for transaction funding (2.7) and hedging mechanisms (2.7). Scores for Viet Nam were above 3.0 for all categories except for market access (2.7), tax treatment (2.8), and hedging mechanisms (2.8). Scores for Malaysia were above 3.0 for all categories except for tax treatment (2.7), settlement and custody (2.8), and transparency (2.7).

Thailand registered mixed results with scores of 3.0 or higher for diversity of investor profile, foreign exchange regulations, tax treatment, and transparency.

The lowest scores, which indicate less overall need for structural and policy reforms and adjustments, came from Singapore; the PRC; and Hong Kong, China. Among all categories, only diversity of investor profile attracted a score higher than 3.0 in any of these markets.

Scores for Indonesia were also quite low. The only categories rated 3.0 or higher by respondents were greater diversity of investor profile (3.2) and tax treatment (3.0). The Republic of Korea was the only corporate bond market to score diversity of investor profile at a level below 3.0. In fact, all of the Republic of Korea's scores were below 3.0 except for foreign exchange regulations (3.4) and hedging mechanisms (3.0).

**Figure 20: Structural Issues for Individual LCY Corporate Bond Markets**

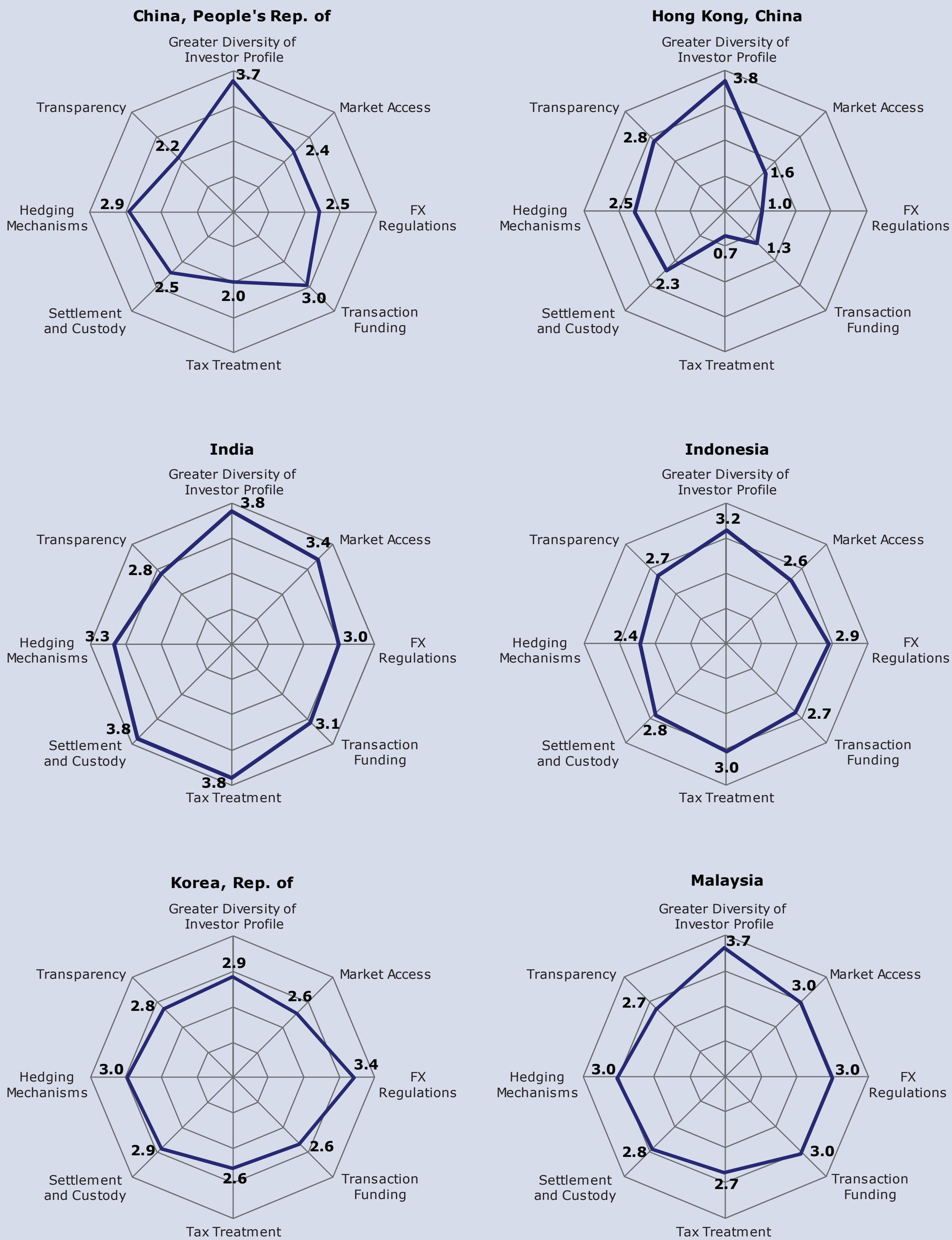



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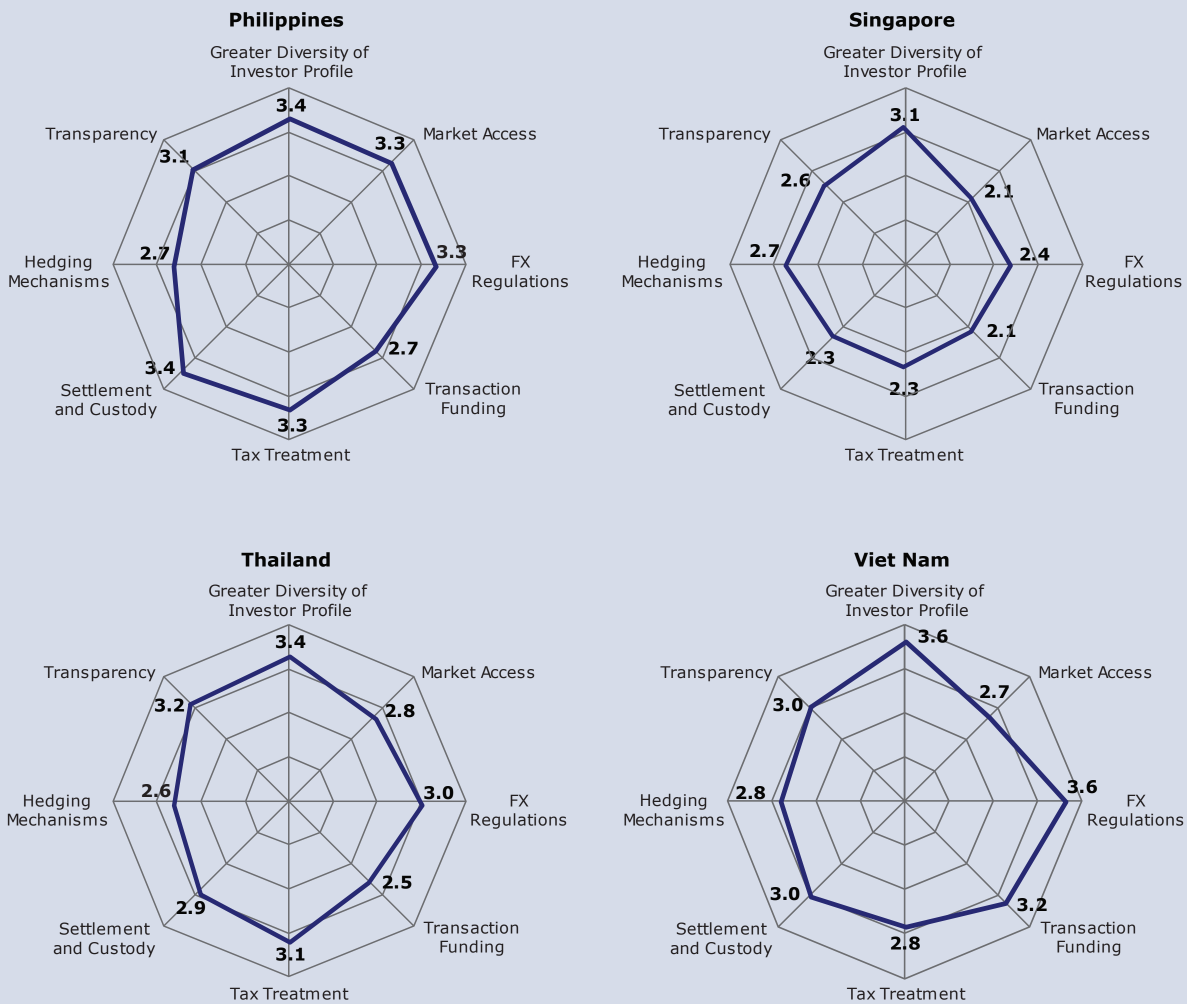
**Figure 20** *continued*




FX = foreign exchange, LCY = local currency.
Source: *AsianBondsOnline* 2011 LCY Bond Market Survey.

# Market Summaries

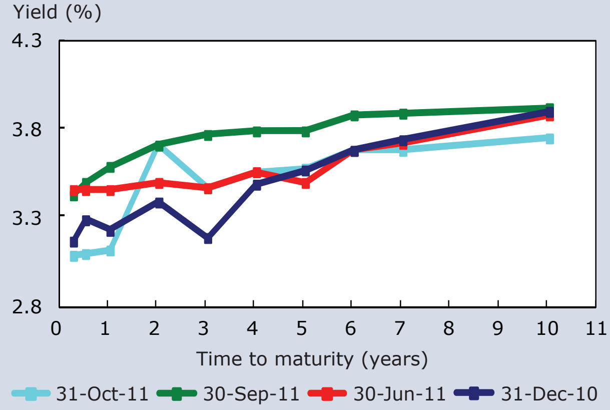
## People's Republic of China—Update

### Yield Movements

The People's Republic of China's (PRC) government bond yield curve shifted downward in October, reflecting expectations of an end to the monetary tightening efforts of the People's Bank of China (PBOC) **(Figure 1)**. Yields declined the most on the shorter-end of the curve, falling between 34 basis points (bps) and 47 bps on all tenors of 1 year or less. For tenors longer than 2 years, yields fell 17 bps–30 bps.

Due to a spike in the 2-year rate, the spread between 2- and 10-year government bonds narrowed to 4 bps at end-October. Excluding the 2-year rate, the yield curve exhibited overall steepening due to a much larger drop in shorter-term yields.

**Figure 1: People's Republic of China's Benchmark Yield Curve—LCY Government Bonds**




LCY = local currency.
Source: Bloomberg LP.

Inflation remained at elevated levels in the third quarter, with a slight tapering off in August and September. After hitting a high of 6.5% year-on-year (y-o-y) in July, inflation fell to 6.2% in August and 6.1% in September. Due to this slowdown in the inflation rate, the PBOC took measures to tighten the money supply only once in 3Q11, expanding the reserve requirement coverage to include margin deposits. Market expectations are for the PBOC to hold off on any further tightening measures given concerns over the eurozone's sovereign debt crisis and continued weakness in developed markets.

The PRC's gross domestic product (GDP) growth rate slowed to 9.1% y-o-y in 3Q11 from 9.5% in 2Q11. In addition, the trade surplus fell in August to US$17.8 billion from US$31.5 billion in July. The cumulative trade surplus for January–August fell 10.0% y-o-y to US$92.7 billion.

New loans granted in July totaled CNY492.6 billion, down CNY25.2 billion from the same month last year. New loans, however, were up in August compared with August 2010, reaching CNY548.5 billion for an annual increase of CNY9.3 billion. Meanwhile, liquidity growth also slowed in August. The M2 money supply expanded 13.5% y-o-y in August following 14.7% growth in July. The PBOC's money supply growth target for the year is 16.0%.

Risk aversion due to a possible Greek default caused turmoil in the financial markets. Central Huijin Investment, the PRC's investment arm, was forced to purchase shares in various PRC banks in October to mitigate the fall in stock market valuations.

### Size and Composition

The amount of outstanding local currency (LCY) bonds in the PRC market reached CNY20.7 trillion (US$3.3 trillion) at end-September, representing a y-o-y increase of 3.5% and a quarter-on-quarter (q-o-q) rise of 0.5% **(Table 1)**.

**Table 1: Size and Composition of the LCY Bond Market in the People's Republic of China**

| | **Amount** (billion) | | | | | | | | **Growth Rates** (%) | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **Jun-11** | | **Jul-11** | | **Aug-11** | | **Sep-11** | | **Jun-11** | | **Jul-11** | **Aug-11** | **Sep-11** | | |
| | **CNY** | **US$** | **CNY** | **US$** | **CNY** | **US$** | **CNY** | **US$** | **y-o-y** | **q-o-q** | **m-o-m** | **m-o-m** | **y-o-y** | **q-o-q** | **m-o-m** |
| Total | 20,619 | 3,190 | 20,726 | 3,220 | 20,813 | 3,263 | 20,720 | 3,247 | 6.7 | 1.9 | 0.5 | 0.4 | 3.5 | 0.5 | (0.4) |
| Government | 15,773 | 2,440 | 15,811 | 2,456 | 15,871 | 2,488 | 15,788 | 2,474 | 1.0 | 1.0 | 0.2 | 0.4 | (0.7) | 0.1 | (0.5) |
| Treasury Bonds | 6,943 | 1,074 | 7,050 | 1,095 | 7,179 | 1,126 | 7,276 | 1,140 | 14.4 | 3.1 | 1.5 | 1.8 | 13.7 | 4.8 | 1.4 |
| Central Bank Bonds | 2,785 | 431 | 2,550 | 396 | 2,385 | 374 | 2,116 | 331 | (41.3) | (7.2) | (8.4) | (6.5) | (52.4) | (24.0) | (11.3) |
| Policy Bank Bonds | 6,045 | 935 | 6,211 | 965 | 6,307 | 989 | 6,396 | 1,002 | 25.9 | 2.8 | 2.7 | 1.5 | 26.3 | 5.8 | 1.4 |
| Corporate | 4,846 | 750 | 4,916 | 764 | 4,942 | 775 | 4,932 | 773 | 30.8 | 4.7 | 1.4 | 0.5 | 20.0 | 1.8 | (0.2) |
| **Policy Bank Bonds** | | | | | | | | | | | | | | | |
| China Development Bank | 4,285 | 663 | 4,340 | 674 | 4,396 | 689 | 4,455 | 698 | 23.8 | 2.4 | 1.3 | 1.3 | 21.6 | 4.0 | 1.3 |
| Export–Import Bank of China | 684 | 106 | 750 | 116 | 775 | 121 | 780 | 122 | 42.3 | 5.6 | 9.7 | 3.3 | 53.2 | 14.0 | 0.6 |
| Agricultural Devt. Bank of China | 1,077 | 167 | 1,122 | 174 | 1,137 | 178 | 1,162 | 182 | 25.6 | 2.8 | 4.2 | 1.3 | 30.2 | 7.9 | 2.2 |

LCY = local currency, m-o-m = month-on-month, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Treasury bonds include savings bonds and local government bonds.
3. Bloomberg LP end-of-period LCY–US$ rate is used.
4. Growth rates are calculated from LCY base and do not include currency effects.
Source: *ChinaBond* and Bloomberg LP.

LCY government bonds outstanding fell 0.7% y-o-y and grew only 0.1% q-o-q in 3Q11, while corporate bonds rose 20.0% y-o-y and 1.8% q-o-q. In the government sector, the y-o-y decline was due to a drop in central bank bonds outstanding, which fell 52.4% y-o-y and 24.0% q-o-q. In contrast, treasury bonds grew 13.7% y-o-y and 4.8% q-o-q, while policy bank bonds grew 26.3% y-o-y and 5.8% q-o-q.

The reduction in central bank bonds reflected the rise in commercial bank reserve requirements, which has forced the PBOC to reduce its repurchase (repo) sales. Also, demand for central bank bonds fell in 3Q11 in anticipation of monetary tightening.

## Corporate Bonds

Local corporate bonds grew 45.1% y-o-y and medium-term notes (MTNs) grew 37.2% in 3Q11, while state-owned corporate bonds grew only 4.0% **(Table 2)**. Commercial paper outstanding fell 8.1% y-o-y and asset- and mortgage-backed securities outstanding fell 54.9% due to a lack of issuance since 4Q08.

On a q-o-q basis, most categories of outstanding corporate bonds fell with the exception of MTNs and local corporate bonds. Commercial paper fell 10.3% q-o-q, while commercial bank bonds fell 0.5% and state-owned corporate bonds fell 0.1%.

The amount of MTNs outstanding continued to grow rapidly in 3Q11 due to their ease of issuance and quick approval process compared to other forms of debt. In fact, MTNs consistently enjoyed double-digit q-o-q growth rates for several quarters prior to 4Q10. The decline in 3Q11 in amounts outstanding for most corporate bonds is likely the result of expectations of monetary tightening as well as the financial turmoil caused by concerns over a Greek default.

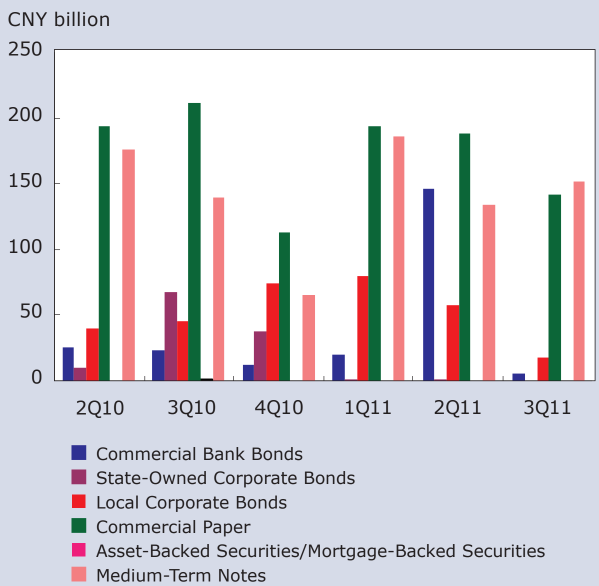
Issuance of corporate bonds slowed in 3Q11 from 2Q11 **(Figure 2)**, with the exception of MTNs, due to market volatility. In particular, commercial bank

**Table 2: Corporate Bonds Outstanding in Key Sectors**

| | Amount (CNY billion) | | | | | | Growth Rates (%) | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | q-o-q | | | | | y-o-y |
| | 2Q10 | 3Q10 | 4Q10 | 1Q11 | 2Q11 | 3Q11 | 3Q10 | 4Q10 | 1Q11 | 2Q11 | 3Q11 | 3Q11 |
| Commercial Bank Bonds | 608.5 | 609.0 | 609.5 | 625.0 | 758.8 | 755.2 | 0.1 | 0.1 | 2.5 | 21.4 | (0.5) | 24.0 |
| State-Owned Corporate Bonds | 781.1 | 842.6 | 879.6 | 879.6 | 877.1 | 876.4 | 7.9 | 4.4 | – | (0.3) | (0.1) | 4.0 |
| Local Corporate Bonds | 461.7 | 501.3 | 569.4 | 653.1 | 714.1 | 727.3 | 8.6 | 13.6 | 14.7 | 9.3 | 1.9 | 45.1 |
| Commercial Paper | 615.4 | 670.6 | 653.0 | 683.3 | 687.1 | 616.5 | 9.0 | (2.6) | 4.6 | 0.6 | (10.3) | (8.1) |
| Asset-/Mortgage-Backed Securities | 26.5 | 21.9 | 18.2 | 10.8 | 10.1 | 9.9 | (17.2) | (16.8) | (41.0) | (6.1) | (2.2) | (54.9) |
| Medium-Term Notes | 1,151.2 | 1,289.5 | 1,353.6 | 1,532.5 | 1,621.4 | 1,768.6 | 12.0 | 5.0 | 13.2 | 5.8 | 9.1 | 37.2 |

– = not available, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Source: *ChinaBond.*

**Figure 2: Corporate Bond Issuance in Key Sectors, 2Q10–3Q11**




Source: *ChinaBond.*

bond issuances fell dramatically from 2Q11. In 2Q11, the bulk of commercial bank bond issuance was for capital raising efforts in anticipation of Basel III.

Only a handful of issuers dominate the PRC's corporate bond market **(Table 3)**. At end-October, the top 30 corporate bond issuers accounted for CNY2.85 trillion, or about 56%, of total corporate bonds outstanding. Furthermore, the 10 largest corporate issuers accounted for CNY1.97 trillion, or nearly 69%, of this total.

State-owned companies (defined as majority-owned by the government) dominate the corporate bond market in the PRC. Among the top 30 corporate bond issuers, 24 are state-owned, with a total of CNY2.57 trillion worth of bonds outstanding.

## Investor Profile

**Treasury bonds**. Banks remain the largest category of investors in the PRC's treasury bond market, holding a slightly larger share of these bonds at end-September (65%) than at end-June (64%) **(Figure 3)**. The share held by the second largest group of holders, special members, dropped to 25% in September from 26% in June. Special members comprise the PBOC, Ministry of Finance, policy banks, China Government Securities Depository Trust and Clearing Co., and China Securities Depository and Clearing Corporation.

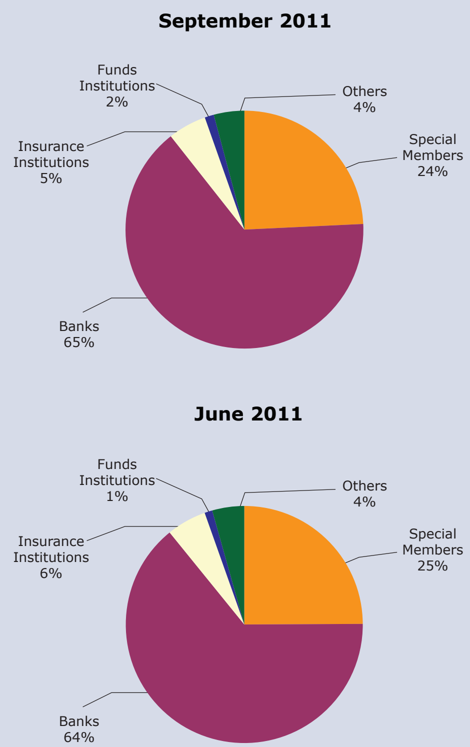
**Corporate bonds**. Banks remained the largest holder of corporate bonds in September **(Figure 4)**. The share of most major investors remained unchanged with the exception of fund institutions, whose share of ownership increased to 20% in September from 19% in June, and insurance institutions, whose share declined to 21% from 22%.

**Table 3: Top 30 Issuers of LCY Corporate Bonds in the People's Republic of China** (as of October 2011)

| Issuers | Outstanding Amount | | State-Owned | Privately-Owned | Listed Company | Type of Industry |
|---|---|---|---|---|---|---|
| | LCY Bonds (CNY billion) | LCY Bonds (US$ billion) | | | | |
| 1. Ministry of Railways | 593.0 | 93.3 | Yes | No | No | Transportation |
| 2. State Grid Corporation of China | 259.5 | 40.8 | Yes | No | No | Public Utilities |
| 3. China National Petroleum | 206.0 | 32.4 | Yes | No | No | Energy |
| 4. Bank of China | 196.9 | 31.0 | Yes | No | Yes | Banking |
| 5. Industrial and Commercial Bank of China | 160.0 | 25.2 | Yes | No | Yes | Banking |
| 6. China Petroleum & Chemical | 131.5 | 20.7 | Yes | No | Yes | Energy |
| 7. China Construction Bank | 120.0 | 18.9 | Yes | No | Yes | Banking |
| 8. Central Huijin Investment | 109.0 | 17.2 | Yes | No | No | Diversified Financial |
| 9. Agricultural Bank of China | 100.0 | 15.7 | Yes | No | Yes | Banking |
| 10. Petrochina | 97.5 | 15.3 | Yes | No | Yes | Energy |
| 11. Bank of Communications | 76.0 | 12.0 | No | Yes | Yes | Banking |
| 12. China Guodian | 65.6 | 10.3 | Yes | No | No | Public Utilities |
| 13. Industrial Bank | 62.1 | 9.8 | No | Yes | Yes | Banking |
| 14. China Three Gorges Project | 51.5 | 8.1 | Yes | No | No | Public Utilities |
| 15. China Southern Power Grid | 51.0 | 8.0 | Yes | No | No | Public Utilities |
| 16. Shenhua Group | 48.4 | 7.6 | Yes | No | No | Energy |
| 17. China Huaneng Group | 44.2 | 7.0 | Yes | No | No | Public Utilities |
| 18. China Telecom | 40.0 | 6.3 | Yes | No | Yes | Telecommunications |
| 19. Citic Group | 40.0 | 6.3 | Yes | No | No | Diversified Financial |
| 20. State-Owned Capital Operation and Management Center of Beijing | 40.0 | 6.3 | Yes | No | No | Diversified Financial |
| 21. Metallurgical Corporation of China | 39.6 | 6.2 | Yes | No | Yes | Capital Goods |
| 22. China Power Investment | 39.1 | 6.2 | Yes | No | No | Public Utilities |
| 23. China Minsheng Bank | 38.3 | 6.0 | No | Yes | Yes | Banking |
| 24. China United Network Communications | 38.0 | 6.0 | No | Yes | Yes | Telecommunications |
| 25. Shanghai Pudong Development Bank | 37.2 | 5.9 | No | Yes | Yes | Banking |
| 26. Shougang Group | 37.0 | 5.8 | Yes | No | No | Raw Materials |
| 27. China Guangdong Nuclear Power Holding | 32.7 | 5.1 | Yes | No | No | Public Utilities |
| 28. COFCO | 31.6 | 5.0 | Yes | No | No | Retail |
| 29. Aluminum Corporation of China | 31.0 | 4.9 | Yes | No | Yes | Raw Materials |
| 30. China Merchants Bank | 30.0 | 4.7 | No | Yes | Yes | Banking |
| **Total Top 30 LCY Corporate Issuers** | **2846.7** | **448.0** | | | | |
| **Total LCY Corporate Bonds** | **5074.2** | **772.9** | | | | |
| **Top 30 as % of Total LCY Corporate Bonds** | **56%** | **58%** | | | | |

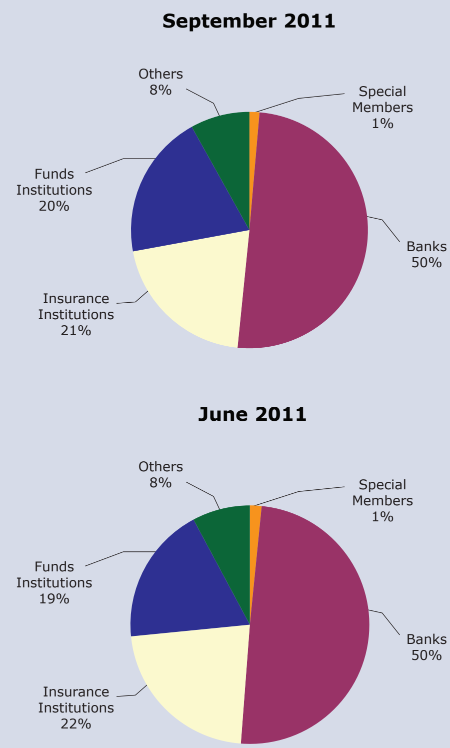
LCY = local currency.
Source: Bloomberg LP and Wind.

**Figure 3: Treasury Bonds Investor Profile**




Source: *ChinaBond*.

**Figure 4: Corporate Bonds Investor Profile**



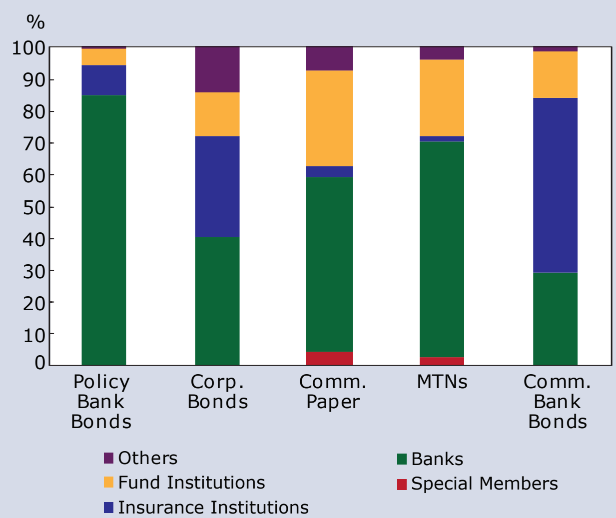

Source: *ChinaBond*.

**Figure 5** presents the investor profile across different bond categories, with banks as the largest holder of policy bank bonds at end-September, holding more than 80% of outstanding policy bank bonds. Meanwhile, insurance institutions were the largest holder of commercial bank bonds.

## Interest Rate Swaps

The total notional amount traded in the interest rate swap (IRS) market expanded 152.7% y-o-y and 19.5% q-o-q in 3Q11, reaching CNY789.8 billion at end-September on 6,332 transactions **(Table 4)**. The 7-day repo rate remained the most widely used benchmark in 3Q11, accounting for 51.4% of the total notional amount traded. The overnight SHIBOR accounted for 35.3% of the total on significant growth of 567.4% y-o-y and 70.1% q-o-q. These two benchmarks advanced the most because the primary participants in the PRC's onshore

**Figure 5: Investor Profile across Bond Categories** (as of September 2011)




MTNs = medium-term notes.
Note: Others includes security companies, non-bank financial institutions, individuals, and exchanges.
Source: *ChinaBond*.

**Table 4: Notional Values of the PRC's Interest Rate Swap Market**

| Interest Rate Swap Benchmarks | Notional Amount (CNY billion) | % of Total Notional Amount | Number of Transactions | Growth Rate (%) | |
|---|---|---|---|---|---|
| | 3Q11 | | | q-o-q | y-o-y |
| 7-Day Repo Rate | 406.3 | 51.4% | 4,163 | 9.8% | 101.9% |
| Overnight SHIBOR | 278.6 | 35.3% | 1,100 | 70.1% | 567.4% |
| 3-Month SHIBOR | 81.7 | 10.3% | 936 | (9.6%) | 48.4% |
| 1-Year Term Deposit Rate | 23.1 | 2.9% | 124 | (34.6%) | 60.8% |
| 6-Month Lending Rate | 0.0 | 0.0% | 1 | (20.0%) | – |
| 1-Year Lending Rate | 0.1 | 0.0% | 8 | 368.4% | 18.7% |
| **Total** | **789.8** | **100.0%** | **6,332** | **19.5%** | **152.7%** |

– = not applicable, PRC = People's Republic of China, q-o-q = quarter-on-quarter, repo = repurchase, SHIBOR = Shanghai Interbank Offered Rate, y-o-y = year on year.
Source: *ChinaMoney*, *Wind*, and *AsianBondsOnline*.

IRS market are commercial banks with funding exposure mainly in the form of repo transactions. Therefore, banks desire to use the repo rate as the base rate to hedge their funding.

## Policy, Institutional, and Regulatory Developments

### PBOC Expands Deposit Coverage for Reserve Requirement Ratios

On 29 August, the PBOC announced that for the purposes of calculating required reserves, margin deposits, such as those paid for issuing bankers' acceptances; letters of guarantee; and letters of credit would be included. The amount to be set aside as reserves will be divided over stages to allow banks time to adjust, with the largest banks asked to set aside the reserves over three stages and smaller banks over six stages. The increase in reserves is estimated to be the equivalent of a 100 bps–150 bps hike in the reserve requirement ratio.

### Local Governments Allowed to Issue Bonds

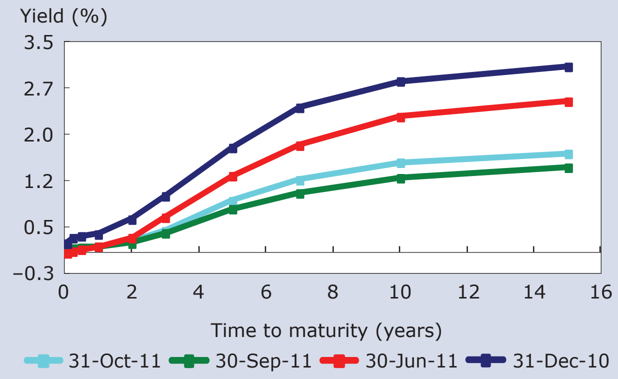
On 20 October, the Ministry of Finance launched a trial program allowing four local governments to issue bonds directly. The four local authorities granted permission are the provinces of Guangdong and Zheijiang, and the municipalities of Shanghai and Shenzen.

# Hong Kong, China—Update

## Yield Movements

The yield curve for Hong Kong, China's Exchange Fund Bills and Notes (EFBNs) rose for most maturities in October, with the exception of maturities at the very short-end of the curve. The 10-year tenor rose the most at 26 basis points (bps), followed by the 15-year tenor, which rose 23 bps **(Figure 1)**. Yields in the middle of the curve (3- to 7-years) rose an average of 12 bps. In contrast, yields for the 6-month and 1-year tenor remained unchanged, while shorter-term tenors fell 1 bp–4 bps. Due to the large drop in yields at the longer-end of the curve, the spread between the 2- and 10-year maturities rose to 129 bps from 107 bps at end-September.

**Figure 1: Hong Kong, China's Benchmark Yield Curve—EFBNs**




EFBN = Exchange Fund Bills and Notes.
Source: Bloomberg LP.

The yield curve's movement from end-June to end-September showed a strong shift downward, especially at the longer-end. The downward shift, in spite of rising consumer prices, was due to the Special Administrative Region's currency peg to the United States (US) dollar and its status as an international finance center. As a result, interest rates in Hong Kong, China are highly correlated with US interest rates. The US yield curve shifted downward from end-June to end-September, particularly at the longer-end, where the 10-year tenor fell 105 bps. However, in October the yield curve rose slightly, with the 10-year tenor rising 20 bps.

Consumer price inflation in Hong Kong, China hit an all-time high in July, rising to 7.9% year-on-year (y-o-y) from 5.6% in June. The rise in inflation was strongly influenced by a lower base for rental prices in July 2010 due to government relief measures. In August, consumer price inflation fell to 5.6% y-o-y, comparable to the inflation rate in June, but still higher than in prior years.

On the other hand, if the government's relief measures are excluded, consumer price inflation actually rose in August to 6.3% y-o-y from 5.8% in July. The rise in consumer prices has been driven mostly by increases in food prices as well as housing related costs such as rentals and utilities.

Local demand continues to remain robust as indicated by strong retail sales growth. The average growth rate in sales for 2Q11 was 28.1% y-o-y, with sales growth accelerating in July and August to 29.1% and 29.0%, respectively. Demand was further helped by strong spending in the tourism sector. However, demand was negatively affected by the continued slowdown in developed markets, leading to weakened export growth. On a quarter-on-quarter (q-o-q) basis, exports fell 9.4% in 2Q11. On a y-o-y basis, export growth fell to 7.7% in 2Q11 from 24.6% in 1Q11. Slower export growth led to weakening gross domestic product (GDP) growth for the last two quarters with GDP growth at 4.3% in 3Q11 and 5.3% in 2Q11 from 7.5% in 1Q11.

**Table 1: Size and Composition of the LCY Bond Market in Hong Kong, China**

| | **Amount** (billion) | | | | | | | | **Growth Rate** (%) | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **Jun-11** | | **Jul-11** | | **Aug-11** | | **Sep-11** | | **Jun-11** | | **Jul-11** | **Aug-11** | **Sep-11** | | |
| | **HKD** | **US$** | **HKD** | **US$** | **HKD** | **US$** | **HKD** | **US$** | **y-o-y** | **q-o-q** | **m-o-m** | **m-o-m** | **y-o-y** | **q-o-q** | **m-o-m** |
| Total | 1,300 | 167 | 1,311 | 168 | 1,315 | 169 | 1,320 | 170 | 5.4 | 0.5 | 0.9 | 0.3 | 5.7 | 1.6 | 0.4 |
| Government | 684 | 88 | 694 | 89 | 697 | 90 | 697 | 90 | 2.6 | 0.5 | 1.5 | 0.4 | 3.8 | 1.9 | 0.0 |
| Exchange Fund Bills | 585 | 75 | 585 | 75 | 585 | 75 | 585 | 75 | 0.6 | 0.2 | 0.01 | 0.0 | 0.6 | 0.1 | 0.0 |
| Exchange Fund Notes | 70 | 9 | 70 | 9 | 70 | 9 | 70 | 9 | (0.9) | (0.4) | 0.0 | 0.0 | (0.9) | 0.0 | 0.0 |
| HKSAR Bonds | 30 | 4 | 40 | 5 | 43 | 5 | 43 | 5 | 87.5 | 9.1 | 33.3 | 6.3 | 117.9 | 41.7 | 0.0 |
| Corporate | 615 | 79 | 616 | 79 | 617 | 79 | 623 | 80.0 | 8.7 | 0.5 | 0.2 | 0.2 | 7.8 | 1.2 | 0.9 |

HKSAR = Hong Kong Special Administrative Region, LCY = local currency, m-o-m = month-on-month, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Bloomberg LP end-of-period LCY–US$ rates are used.
3. Growth rates are calculated from LCY base and do not include currency effects.
4. The amount of corporate bonds outstanding for July, August, and September were estimated based on the compounded monthly growth rate between March and June.
Source: Hong Kong Monetary Authority and Bloomberg LP.

## Size and Composition

The size of Hong Kong, China's local currency (LCY) bond market grew 5.7% y-o-y to reach HKD1.3 trillion (USD170.0 billion) at end-September **(Table 1)**. On a q-o-q basis, LCY bonds outstanding grew at a pace of 1.6%.

Total LCY government bonds outstanding rose 3.8% y-o-y as of end-September, while q-o-q growth was 1.9%. Government bonds include Exchange Fund Bills (EFBs), Exchange Fund Notes (EFNs), and bonds issued under the Institutional Bond Issuance Programme (HKSAR Bonds).

The growth in total government bonds outstanding was largely attributed to the growth of HKSAR Bonds, which expanded 117.9% y-o-y to HKD42.5 billion as of end-September. On the other hand, the stock of EFNs declined slightly by 0.9% to HKD69.6 billion. EFBs grew only slightly by 0.6% y-o-y in the same period.

HKD10.0 billion worth of 3-year HKSAR Bonds were issued in July, HKD2.5 billion in 10-year bonds were sold in August, and HKD3.5 billion of 20-year HKSAR bonds were sold in September.

LCY corporate bonds outstanding reached HKD622.9 billion at end-September, reflecting growth of 7.8% y-o-y and 1.2% q-o-q. The top 18 non-bank corporate issuers in Hong Kong, China accounted for about 14% of total corporate bonds outstanding (Table 2). Hong Kong, China's top corporate issuer of LCY bonds was the state-owned Hong Kong Mortgage Corporation (HKMC), with bonds valued at HKD22.3 billion at end-September. Sun Hung Kai Properties (Capital Market) Ltd. was the next largest issuer with outstanding bonds of HKD12.4 billion, while CLP Power Hong Kong Financing Ltd. was in the third spot with HKD9.9 billion.

Financial firms dominated the list of the top 18 non-bank corporate issuers, accounting for all but four of the firms. Six state-owned companies were included on the list, while 12 were privately owned. Among the companies included in Table 2, only one is listed on the Hong Kong Exchange.

**Table 2: Top 18 Non-Bank Corporate Issuers in Hong Kong, China** (as of September 2011)

| Issuers | Outstanding Amount | | State-Owned | Privately-Owned | Listed Company | Type of Industry |
|---|---|---|---|---|---|---|
| | LCY Bonds (HKD billion) | LCY Bonds (US$ billion) | | | | |
| 1. The Hong Kong Mortgage Corporate Ltd. | 22.32 | 2.87 | Yes | No | No | Finance |
| 2. Sun Hung Kai Properties (Capital Market) Ltd. | 12.37 | 1.59 | No | Yes | No | Finance |
| 3. CLP Power Hong Kong Financing Ltd. | 9.90 | 1.27 | No | Yes | No | Finance |
| 4. Kowloon-Canton Railway Corporation | 6.60 | 0.85 | Yes | No | No | Transportation |
| 5. MTR Corporation (C.I.) Ltd. | 5.20 | 0.67 | Yes | No | Yes | Transportation |
| 6. Swire Pacific MTN Financing Ltd. | 4.30 | 0.55 | No | Yes | No | Finance |
| 7. Hongkong Electric Finance Ltd. | 4.21 | 0.54 | No | Yes | No | Finance |
| 8. The Link Finance (Cayman) 2009 Ltd. | 3.98 | 0.51 | No | Yes | No | Finance |
| 9. HKCG (Finance) Limited | 2.76 | 0.35 | No | Yes | No | Finance |
| 10. Airport Authority Hong Kong | 2.75 | 0.35 | Yes | No | No | Trannsportation |
| 11. Cheung Kong Bond Finance Ltd. | 2.45 | 0.31 | No | Yes | No | Finance |
| 12. Wharf Finance Ltd. | 2.29 | 0.29 | No | Yes | No | Finance |
| 13. Hysan (MTN) Ltd. | 1.80 | 0.23 | No | Yes | No | Finance |
| 14. Urban Renewal Authority | 1.70 | 0.22 | Yes | No | No | Property Development |
| 15. Bauhinia MBS Ltd. | 1.56 | 0.20 | Yes | No | No | Finance |
| 16. Cheung Kong Finance (MTN) Ltd. | 1.51 | 0.19 | No | Yes | No | Finance |
| 17. Henderson Land MTN Ltd. | 0.88 | 0.11 | No | Yes | No | Finance |
| 18. The Hongkong Land Notes Company Ltd. | 0.20 | 0.03 | No | Yes | No | Finance |
| **Total Top 18 Non-Bank LCY Corporate Issuers** | **86.57** | **11.12** | | | | |
| **Total LCY Corporate Bonds** | **622.92** | **80.01** | | | | |
| **Top 18 as % of Total LCY Corporate Bonds** | **13.9%** | **13.9%** | | | | |

LCY = local currency.
Note: Based on Central Money Markets Unit data on tradeable non-bank debt securities issued and outstanding as of 1 July 2011.
Source: Hong Kong Monetary Authority.

# Policy, Institutional, and Regulatory Developments

## Hong Kong, China's Role as Offshore Renminbi Center Expanded

On 17 August, the People's Republic of China's (PRC) Vice Premier Li Keqiang gave special attention to Hong Kong, China during his keynote speech at the Forum on the 12th Five Year Plan and economic, trade, and financial cooperation and development between the PRC and Hong Kong, China. He stressed that plans for expanding Hong Kong, China's already important role as an offshore financial center would give Hong Kong, China an advantage as an offshore renminbi center. The plans mentioned include allowing Hong Kong, China's insurance companies to open branches in the PRC; the issuance of more sovereign bonds in Hong Kong, China; and the launch of the mini-Qualified Foreign Institutional Investor Program with an initial quota of CNH20 billion.

## Box 1: Offshore Renminbi Bond Market

The first steps to create an offshore renminbi market were taken in 2003 when banks in Hong Kong, China were permitted to offer renminbi deposits. The amount of these deposits jumped in 2009 after PRC authorities introduced a pilot trade settlement scheme that was subsequently liberalized and expanded. As a result, the renminbi is now deliverable in Hong Kong, China. By 2010 the range of renminbi products was expanded, allowing for the creation of renminbi-denominated insurance and investment products. The CNH traded at a premium against the CNY spot rate,[1] indicating strong demand for the renminbi in the offshore market in Hong Kong, China **(Figure B1.1)**. However, increased market volatility in September has led to the CNH currently trading at a discount. The CNH market is unique as no country has attempted an offshore currency market while retaining capital controls and a tight grip on its onshore currency market.

**The rapid growth of CNH deposits derives from anticipated appreciation of the renminbi and its expanded use in trade settlement.** In 2004 CNH deposits totaled CNH895 million **(Figure B1.2)**. By September 2011 they totaled CNH622.2 billion. The two critical factors driving CNH market growth have been (i) speculation over the renminbi's appreciation and (ii) expansion in cross-border renminbi trade settlement, resulting in a sharp rise in CNH remittances into Hong Kong, China **(Figure B1.3)**. The proportion of renminbi trade settlement in total trade in goods at the end of 2Q11 was about 8% compared with 1.3% in 2Q10. Demand for CNH has also been in helped in part by regulations released in July 2010 allowing corporations unlimited renminbi purchases in Hong Kong, China.

**Offshore renminbi bond market growth is critical for CNH market development.** In 2007 PRC authorities began allowing financial institutions, such as policy and commercial banks, to issue renminbi bonds in Hong Kong, China. By 2010 issuance rules were liberalized to allow foreign companies to issue CNH bonds, with McDonalds first in line. In August 2011 mainland non-financial companies were allowed to issue CNH bonds; the first to issue was Baosteel Group. The "dim sum bond market," as it was christened by market participants, has grown phenomenally, supported by burgeoning CNH deposits. In 2007 bonds totaling CNH10 billion were issued in the dim sum market **(Figure B1.4)**. As of September 2011 there were 325 dim sum bond issues from 85 issuers for a total of CNH228 billion (CNH160 billion worth of

**Figure B1.1: CNH versus CNY, August 2010-September 2011**

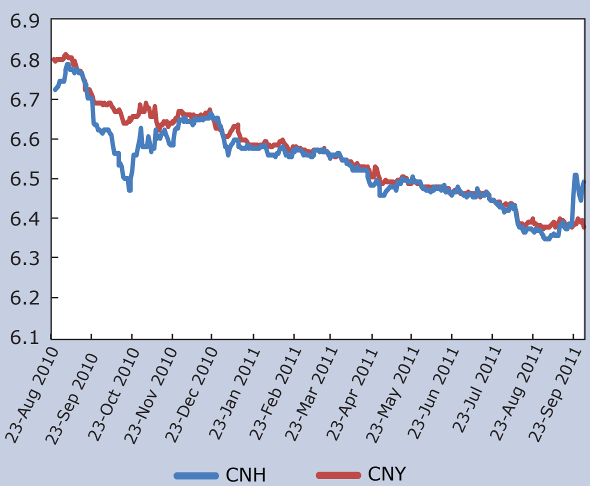
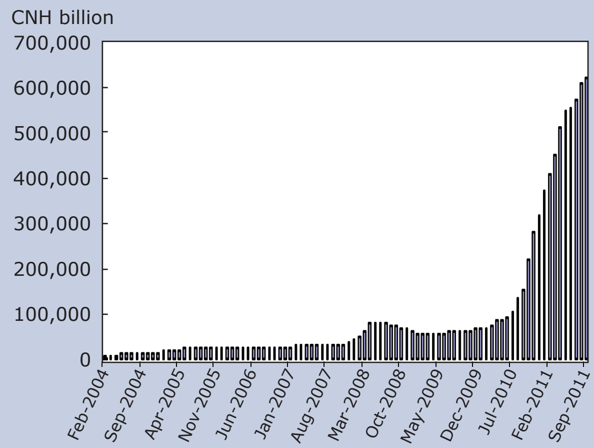



**Figure B1.2: CNH Deposits, February 2004-September 2011**




Source: Hong Kong Monetary Authority and Bloomberg LP.

[1] CNH is the three-letter currency code commonly used for offshore renminbi. CNY refers to onshore renminbi traded within the PRC.

bonds and CNH68 billion worth of certificates of deposit.)

**Strong demand for CNH bonds has led to lower yields versus CNY bonds, making them an attractive source of debt finance.** In December 2009 the Asian Development Bank (ADB) issued onshore CNY bonds with a spread of 57 basis points (bps) over comparable PRC onshore government bonds. However, in October 2010 ADB's offshore CNH bonds were issued 81 bps below comparable PRC onshore government bonds. The International Finance Corporation (IFC) has issued a CNY bond with a spread of 45 bps over comparable PRC government bonds, while its CNH bond, issued in January 2011, had a spread of 182 bps below comparable PRC government bonds. More recently, in August the PRC government conducted a multi-tranche CNH bond auction. The 3-year bonds were issued at a coupon of 0.6% while the prevailing yield on the mainland was 3.65%. The 5-year bonds were issued at a rate of 1.40% while the prevailing onshore yield was 3.80%. The 7-year and 10-year bonds were issued at coupon rates of 1.94% and 2.36%, respectively, while the comparable onshore yields were at 3.90% and 3.94%, respectively. On average the PRC issued the bonds at a spread of 225 bps lower than onshore borrowing costs.

**There are limits on available sourcing of CNH to limit speculative flows.** Individual purchases are still limited by the CNH20,000 per day cap. While corporations may buy any amount of CNH, banks must note whether the purchase will be used for trade settlement or for other purposes. Banks may square their short positions in CNH from trade settlement transactions with the Clearing Bank (Bank of China [Hong Kong]), but their ability to do so is constrained by the existing supply of CNH for non-trade transactions. Furthermore, banks are limited in their open position to 10% of their renminbi assets or liabilities (depending on whether the bank is net long or net short). Access to the mainland bond and equity markets are subject to approval and quotas (such as through the Qualified Foreign Institutional Investor [QFII] Programme). In October the PRC released rules allowing CNH funds to be used as direct investment into the mainland.

**The CNH bond market is still relatively young in terms of duration and issue size.** The duration of CNH bonds issued (excluding certificates of deposit) is on the relatively short-end, with 2 years being the most common tenor. In 2007 the average tenor was 2.1 years. By September 20111 it had lengthened slightly to 3.6 years **(Table B1.1)**.

**Figure B1.3: CNH Remittances**

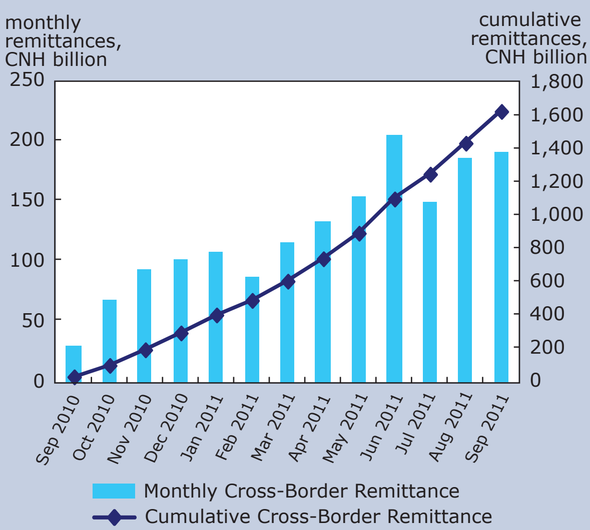
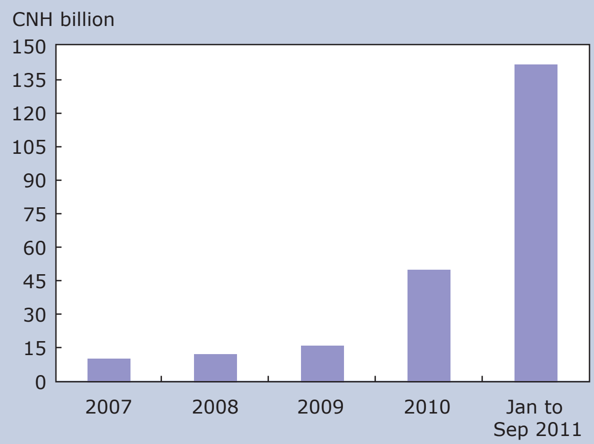



**Figure B1.4: CNH Issuance per Year, 2007–2011**




Source: Hong Kong Monetary Authority and Bloomberg LP.

**Table B1.1: Weighted Average of CNH Bond Tenor, 2007–2011**

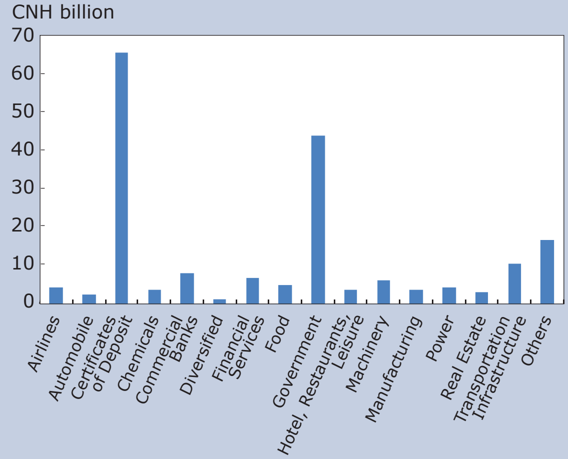
| Year | Weighted Average Tenor |
|---|---|
| 2007 | 2.10 |
| 2008 | 2.33 |
| 2009 | 2.25 |
| 2010 | 3.32 |
| Jan to Sep 2011 | 3.61 |

Source: CMU HKMA and *AsianBondsOnline*.

The weighted tenor would be lower if CNH certificates of deposit were included, as these certificates of deposit have tenors as short as 3 months. There are only three 10-year CNH bonds; one issued by ADB and the other two by the PRC government. The short tenors of CNH bonds make the market less attractive for longer-term investors and investment funds. The PRC government still remains the largest issuer in CNH bonds **(Figure B1.5)**. But even PRC government bonds are issued in smaller sizes in the CNH market than in the CNY market. By sector, the largest issuers are the PRC government and commercial banks. One reason for the lack of diversity in issuers is that it was only in August that the PRC began allowing mainland non-financial companies to issue CNH bonds.

The PRC intends to expand and develop the CNH bond market. Hong Kong, China was given special focus at the forum on the 12th Five Year Program for National Economic and Social Development, Trade, and Financial Co-operation and Development between the Mainland and Hong Kong. Top officials have said the PRC will further expand Hong Kong, China's role as an offshore renminbi center. PRC's Vice-Premier Li Keqiang, during a recent visit to Hong Kong, China, indicated a number of measures including (i) launching the RMB QFII/mini-QFII program; (ii) allowing Hong Kong, China insurance companies to enter the mainland market; (iii) expanding of treasury bond auctions in Hong Kong, China; (iv) allowing Hong Kong, China enterprises to invest in the mainland using renminbi; and (v) expanding the trade settlement program nationwide. Also, PBOC governor Zhou Xiaochuan has said that mainland non-financial institutions will be allowed to issue CNH bonds.

**Figure B1.5: Outstanding CNH Bonds by Sector (as of August 2011)**




Source: Hong Kong Monetary Authority.

**Synthetic renminbi bonds have recently appeared in Hong Kong, China.** Synthetic renminbi bonds are denominated in renminbi but cleared and settled in US dollars. Most synthetic renminbi bond issuers are PRC-based property companies, which find synthetic bonds advantageous since it is easier to remit US dollar proceeds to the PRC for property purchases than it is to remit CNH proceeds. The advantage for investors is that synthetic renminbi bonds provide investors a way of investing in the CNH bond market without the need to source CNH.

**Continued growth in the size of the CNH bond market is expected, while further development of the market will help to promote liquidity.** The CNH bond market will continue to grow rapidly as issuers seek lower borrowing costs and investors seek exposure to renminbi assets. A more liquid CNH bond market requires a mature and established benchmark yield curve, a wider base of issuers and investors, and the creation of swap and hedging facilities. The creation of a benchmark yield curve will be further aided by the expansion of CNH treasury bond issuances.

# Indonesia—Update

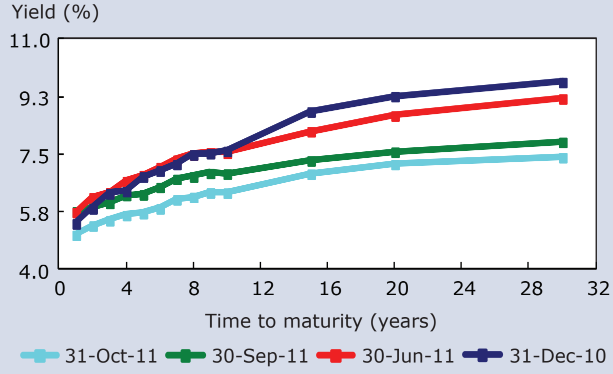
## Yield Movements

The government bond yield curve in Indonesia continued to flatten between end-June and end-September, as bond yields fell across all tenors except at the very short-end of the curve **(Figure 1)**. By end-October, bond yields had fallen across all tenors compared with end-September, resulting in the shifting of the entire government bond yield curve downward. Yields at the very short-end fell the most, shedding 71 basis points (bps), while yields from the 2-year maturity through the 10-year maturity fell 52 bps–65 bps. Yields at the long-end of the curve fell 38 bps–46 bps. The spread between the 2- and 10-year maturities narrowed to 100 bps at end-October, compared with 135 bps at end-June and 102 bps at end-September.  The overall bullish trend in Indonesia's government bond market can be viewed as a positive response to measures taken by Indonesian authorities.

Consumer price inflation slowed to 4.4% year-on-year (y-o-y) in October from 4.6% in September on account of lower prices for most food items. On a month-on-month (m-o-m) basis, consumer prices fell 0.1% in October—after rising 0.3% in the previous month—driven by lower prices of food, jewelry, and transportation. Core inflation, which excludes volatile food and oil prices, eased to 4.4% y-o-y from 4.9% in September.

On 10 November Bank Indonesia's (BI) Board of Governors decided to lower its benchmark interest rate by 50 bps to 6.00%. This was the second consecutive rate cut following a 25 bps cut in October. The latest cut brings the BI rate to a new record-low level. According to BI, the move was in line both with decreasing inflationary pressures and BI's efforts to narrow the interest rate term structure. The rate cut was also intended to help minimize the impact on the domestic economy of worsening global economic prospects.

**Figure 1: Indonesia's Benchmark Yield Curve—LCY Government Bonds**




LCY = local currency.
Source: Bloomberg LP.

Indonesia's economy expanded 6.5% y-o-y in 3Q11, growing at the same pace as in 2Q11. In 3Q11, domestic consumption remained as the main driver of growth and continued to support the economy. In addition, exports and investments continued to post strong annual growth of 18.5% and 7.14% y-o-y, respectively. On a quarter-on-quarter (q-o-q) basis, gross domestic product (GDP) growth was reported at 3.5% in 3Q11, up from 2.9% in 2Q11.

## Size and Composition

The size of Indonesia's local currency (LCY) bond market shrank on both a y-o-y and q-o-q basis in 3Q11 **(Table 1)**. Total bonds outstanding stood at IDR982.4 trillion (US$110 billion) at end-3Q11, after rising to IDR1.0 quadrillion in 2Q11.

As of end-September, outstanding LCY government bonds had fallen 5.6% y-o-y to IDR847.8 trillion. Negative growth in LCY bonds in 3Q11 was mainly attributed to the significant drop in the stock of central bank bills known as *Sertifikat* Bank Indonesia (SBI). The stock of central government bonds (treasury bills and bonds issued by the

Ministry of Finance) posted modest growth on a y-o-y basis.

**Central Government Bonds.** The stock of central government bonds rose 8.0% y-o-y to IDR696.6 trillion at end-3Q11. On a q-o-q basis, the growth in central government bonds was negligible.

Issuance by the central government in 3Q11 totaled IDR33.2 trillion, representing a 3.3% increase over 3Q10. However, treasury issuance fell 16.2% on a q-o-q basis. LCY bond issues during the quarter consisted of treasury bills, fixed-rate treasury bonds, and *sukuk* (Islamic) treasury bills and treasury bonds. The government issued its first *sukuk* treasury bills during an auction on 2 August as part of efforts to diversify Islamic debt instruments and increase their liquidity.

As of 28 September, the government's total gross bond sales (including international bond issuance) in 2011 had reached IDR155.2 trillion, and the government's net financing (defined as gross issuance less redemption and buyback) had reached IDR83.2 trillion. The 2011 revised state budget included an estimated deficit of IDR150.8 trillion, equivalent to 2.1% of GDP.

In September the Finance Ministry conducted a series of bond buybacks in the secondary market as part of government measures to stabilize the bond market. A total of IDR3.13 trillion in bond buybacks were recorded between 14 September and 23 September, surpassing the Finance Ministry's planned amount of IDR3.07 trillion in bond buybacks for the full-year 2011.

**Central Bank Bills.** The stock of central bank bills continued to decline sharply in 3Q11. Outstanding SBI stood at IDR151.2 trillion at end-September, representing declines of 40.1% y-o-y and 20.0% q-o-q. During the quarter, BI conducted only three auctions (one per month) of 9-month SBI and 9-month *shari'ah* (Islamic law)-compliant SBI.

**Corporate Bonds.** Corporate bonds continued to post double-digit growth in 3Q11 on a y-o-y basis, rising 30.5% to IDR134.6 trillion. On a q-o-q basis,

**Table 1: Size and Composition of the LCY Bond Market in Indonesia**

| | **Amount** (billion) | | | | | | | | **Growth Rate** (%) | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **Jun-11** | | **Jul-11** | | **Aug-11** | | **Sep-11** | | **Jun-11** | | **Jul-11** | **Aug-11** | **Sep-11** | | |
| | **IDR** | **US$** | **IDR** | **US$** | **IDR** | **US$** | **IDR** | **US$** | **y-o-y** | **q-o-q** | **m-o-m** | **m-o-m** | **y-o-y** | **q-o-q** | **m-o-m** |
| Total | 1,012,001 | 118 | 1,017,591 | 120 | 1,012,034 | 119 | 982,415 | 110 | 2.7 | (1.7) | 0.6 | (0.5) | (1.8) | (2.9) | (2.9) |
| Government | 880,021 | 103 | 883,783 | 104 | 877,026 | 103 | 847,778 | 95 | (1.4) | (3.1) | 0.4 | (0.8) | (5.6) | (3.7) | (3.3) |
| Central Govt. Bonds | 691,033 | 81 | 700,183 | 82 | 703,979 | 82 | 696,561 | 78 | 11.2 | 2.4 | 1.3 | 0.5 | 8.0 | 0.8 | (1.1) |
| Central Bank Bills | 188,988 | 22 | 183,600 | 22 | 173,047 | 20 | 151,217 | 17 | (30.3) | (19.1) | (2.9) | (5.7) | (40.1) | (20.0) | (12.6) |
| Corporate | 131,980 | 15 | 133,808 | 16 | 135,008 | 16 | 134,637 | 15 | 41.9 | 8.9 | 1.4 | 0.9 | 30.5 | 2.0 | (0.3) |

LCY = local currency, m-o-m = month-on-month, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Bloomberg LP end-of-period LCY–US$ rates are used.
3. Growth rates are calculated from LCY base and do not include currency effects.
Source: Bank Indonesia, Indonesia Stock Exchange, and Bloomberg LP.

however, growth in corporate bonds was only a marginal 2.0%.

Corporate bonds comprise a small percentage of Indonesia's LCY bond market, accounting for only 14% of total LCY bonds outstanding at end-September. Furthermore, the top 30 corporate bond issuers in Indonesia account for almost 80% of total corporate bonds outstanding **(Table 2)**. The top three issuers in 3Q11 remained the same as in 2Q11: (i) state-power firm PLN was the top issuer with outstanding LCY bonds valued at IDR15.1 trillion, (ii) Bank Pan Indonesia was next with outstanding bonds of IDR6.9 trillion, and (iii) telecommunications firm Indosat was the third-largest issuer with outstanding bonds of IDR6.4 trillion.

Of the top 30 LCY corporate bond issuers at end-September, 70% of the firms were from the banking and financial sectors. The list of top 30 issuers was also dominated by privately owned firms. About two-thirds of the top 30 issuers have shares listed on the Indonesia Stock Exchange, indicating that these firms are tapping both the equity and bond markets as funding sources.

In 3Q11 LCY corporate bond issuance was IDR5.8 trillion, which was down on both a y-o-y and q-o-q basis. Due to uncertain market conditions resulting from the debt crisis in the eurozone, a number of firms decided to postpone planned bond issuances scheduled for the second half of the year.

New corporate bond issues in 3Q11 were dominated by firms from the banking and financial sectors. Furthermore, corporate bond issues in 3Q11 were all conventional bonds except for one subordinated bond issue. **Table 3** highlights notable corporate bond issues in 3Q11.

Automotive financing firm Toyota Astra Financial Services issued IDR1.2 trillion of bonds in three tranches in July. The proceeds from the bond sale will be used to bolster the company's working capital. The bonds comprised the following tranches:

- 370-day bonds worth IDR595 billion, coupon of 7.85%;
- 2-year bonds worth IDR121 billion, coupon of 9.0%; and
- 3-year bonds worth IDR484 billion, coupon of 9.5%.

Property firm Agung Podomoro Land issued IDR1.2 trillion worth of bonds in August. Proceeds from the bond sale will be used to fund its automotive financing business. The bonds consisted of the following series:

- 3-year bonds worth IDR325 billion, coupon of 10.0%; and
- 5-year bonds worth IDR875 billion, coupon of 11.0%.

Bank Sumut issued a total of IDR1.0 trillion of conventional and subordinated bonds in July. The bonds consisted of the following series:

- 5-year bonds worth IDR600 billion, coupon of 10.13%; and
- 7-year subordinated bonds worth IDR400 billion, coupon of 11.35%.

Automotive leasing company Serasi Autoraya raised a total of IDR900 billion from a three-tranche bond sale. The bonds consisted of the following series:

- 1-year bonds worth IDR245 billion, coupon of 7.9%;
- 2-year bonds worth IDR185 billion, coupon of 9.1%; and
- 4-year bonds worth IDR470 billion, coupon of 10.2%.

## Investor Profile

**Central Government Bonds.** At end-September, banks were the top holder of LCY government bonds in Indonesia **(Figure 2)**, although their share of 34.3% was down from a 36.3% share in September 2010.

**Table 2: Top 30 Issuers of LCY Corporate Bonds in Indonesia** (as of September 2011)

| Issuers | Outstanding Amount | | State-Owned | Privately-Owned | Listed Company | Type of Industry |
|---|---|---|---|---|---|---|
| | LCY Bonds (IDR billion) | LCY Bonds (US$ billion) | | | | |
| 1. PLN | 15,100 | 1.69 | Yes | No | No | Energy |
| 2. Bank Pan Indonesia | 6,900 | 0.77 | No | Yes | Yes | Banking |
| 3. Indosat | 6,350 | 0.71 | No | Yes | Yes | Telecommunications |
| 4. Bank Tabungan Negara | 5,450 | 0.61 | Yes | No | Yes | Banking |
| 5. Jasa Marga | 5,000 | 0.56 | Yes | No | Yes | Toll Roads, Airports, and Harbors |
| 6. Adira Dinamika Multifinance | 4,903 | 0.55 | No | Yes | Yes | Finance |
| 7. Federal International Finance | 4,742 | 0.53 | No | Yes | No | Finance |
| 8. Bank Danamon Indonesia | 4,050 | 0.45 | No | Yes | Yes | Banking |
| 9. Indonesia Eximbank | 3,941 | 0.44 | Yes | No | No | Banking |
| 10. Bank Jabar Banten | 3,750 | 0.42 | No | Yes | Yes | Banking |
| 11. Bank Tabungan Pensiunan Nasional | 3,650 | 0.41 | No | Yes | Yes | Banking |
| 12. Indofood Sukses Makmur | 3,574 | 0.40 | No | Yes | Yes | Food and Beverages |
| 13. Bank Mandiri | 3,500 | 0.39 | Yes | No | Yes | Banking |
| 14. Astra Sedaya Finance | 3,480 | 0.39 | No | Yes | No | Finance |
| 15. Telekomunikasi Indonesia | 3,000 | 0.34 | Yes | No | Yes | Telecommunications |
| 16. Bank CIMB Niaga | 2,980 | 0.33 | No | Yes | Yes | Banking |
| 14. Perum Pegadaian | 2,664 | 0.30 | Yes | No | No | Finance |
| 18. Bank Permata | 2,250 | 0.25 | No | Yes | Yes | Banking |
| 19. Oto Multiartha | 2,000 | 0.22 | No | Yes | No | Finance |
| 20. Bank Rakyat Indonesia | 2,000 | 0.22 | Yes | No | Yes | Banking |
| 21. Wahana Ottomitra Multiartha | 1,990 | 0.22 | No | Yes | Yes | Finance |
| 22. Summit Oto Finance | 1,865 | 0.21 | No | Yes | No | Finance |
| 23. Medco Energi Internasional | 1,500 | 0.17 | No | Yes | Yes | Petroleum and Natural Gas |
| 24. Excelcomindo Pratama | 1,500 | 0.17 | No | Yes | Yes | Telecommunications |
| 25. Bank DKI | 1,500 | 0.17 | No | Yes | No | Banking |
| 26. Bank Internasional Indonesia | 1,500 | 0.17 | No | Yes | Yes | Banking |
| 27. BCA Finance | 1,489 | 0.17 | No | Yes | No | Finance |
| 28. Bank OCBC NISP | 1,480 | 0.17 | No | Yes | Yes | Banking |
| 29. Bentoel International Investama | 1,350 | 0.15 | No | Yes | Yes | Tobacco |
| 30. Berlian Laju Tanker | 1,340 | 0.15 | No | Yes | Yes | Transportation |
| **Total Top 30 LCY Corporate Issuers** | **104,797** | **11.71** | | | | |
| **Total LCY Corporate Bonds** | **134,637** | **15.04** | | | | |
| **Top 30 as % of Total LCY Corporate Bonds** | **77.8%** | **77.8%** | | | | |

LCY = local currency.
Source: Indonesia Stock Exchange.

The share of LCY government bonds held by foreign investors rose from 28.3% at end-September 2010 to 31.3% at end-September 2011. However, foreign investors' share actually declined from 34.0% at end-June. Beginning in early September, foreign holdings of LCY bonds declined on the back of fears that global financial conditions would worsen due to the unresolved eurozone debt crisis. A sell-off in LCY government bonds by offshore investors resulted in a sharp drop in their holdings to IDR218.1 trillion at end-September from a high of IDR251.2 trillion on 9 September **(Figure 3)**. Since the BI rate cut on 11 October, however, foreign holdings of LCY government bonds have recovered somewhat.

Nearly two-thirds of all LCY government bonds held by foreigners are in long-dated tenors (5 years or more) **(Figure 4)**. The share of long-dated tenors among foreign-held bonds has declined slightly from about 67% at end-2010 and 71% at end-2009. Offshore holdings of short-dated tenors (bonds with maturities of less than 1 year) dipped to 7.7% at end-September, compared with 10.2% at end-2010.

**Table 3: Notable Corporate Issuance in 3Q11**

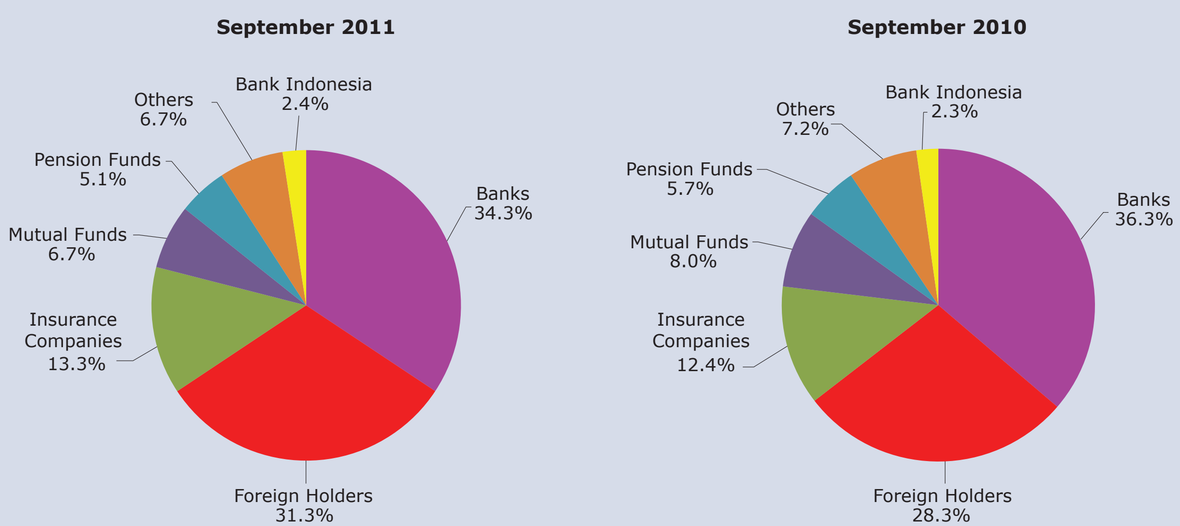
| Corporate Issuers | Amount Issued (IDR billion) |
|---|---|
| Toyota Astra Financial Services | 1,200 |
| Agung Podomoro Land | 1,200 |
| Bank Sumut | 1,000 |
| Serasi Autoraya | 900 |
| Others | 1,520 |
| **Total** | **5,820** |

Source: Indonesia Stock Exchange.

BI's share of government debt rose marginally to 2.4% at end-September compared with the same period a year earlier. However, BI's holdings of LCY bonds rose significantly, especially during the latter part of the month, to reach IDR17.0 trillion. This represented a quadrupling of BI's holdings of LCY bonds in the month of September from end-August due to intervention in the foreign exchange market as BI bought government bonds to counter the sharp depreciation of the Indonesian rupiah against the dollar. The central bank has said that it will continue to intervene until the foreign exchange market stabilizes.

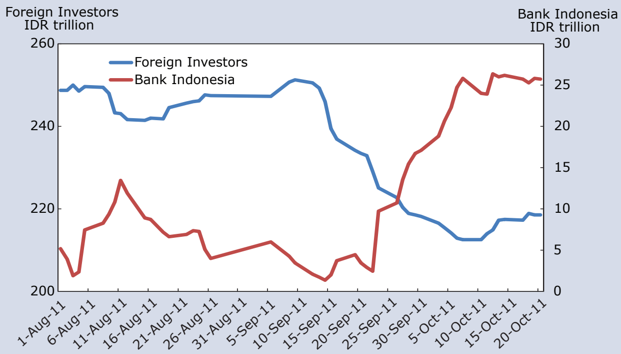
The holdings of LCY government debt by insurance companies was steady at 13.0% at end-September compared with the same month a year earlier. Meanwhile, the shares held by mutual funds and pension funds fell slightly on a y-o-y basis to about 7% and 5%, respectively.

**Figure 2: LCY Government Bonds Investor Profile**



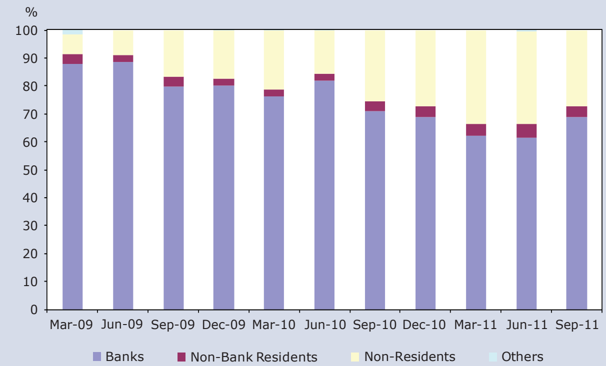

LCY = local currency.
Source: Indonesia Debt Management Office.

**Figure 3: LCY Government Bond Holdings of Foreign Investors and Bank Indonesia, August–October 2011**



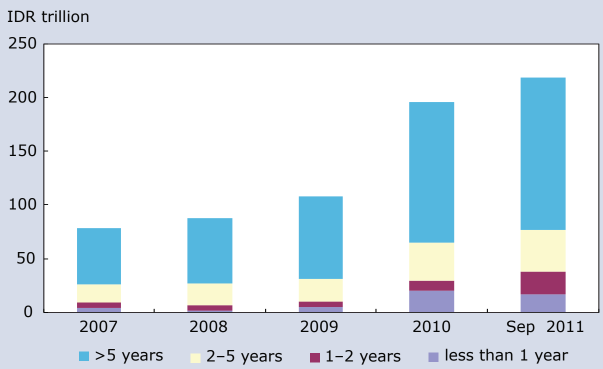

LCY = local currency
Source: Indonesia Debt Management Office.

**Figure 5: LCY Central Bank Bills Investor Profile, March 2009–September 2011**




LCY = local currency.
Source: Bank Indonesia.

**Figure 4: Foreign Holdings of LCY Government Bonds by Maturity, 2007–2011**




LCY = local currency.
Source: Indonesia Debt Management Office.

**Central Bank Bills.** At end-September, banks were still the largest investor in SBI with a share of about 70%, which was up from 62% at end-2Q11 and nearly identical to end-3Q10 **(Figure 5)**. The share of banks' holdings of SBI reached a high of 89% in June 2009.

Foreign investors trimmed their holdings of SBI to a share of 27.4% at end-September from 33.1% at end-June. The foreign share of SBI government debt was still higher than the 25.7% share at end-September 2010. The share of foreign holdings reached a high of 38.9% at end-May before steadily dropping to its current level. The BI regulation that came into effect in May and extended the SBI minimum holding period to 6 months may have led foreign investors to shift to other short-dated instruments such as treasury bills.

## Rating Changes

On 24 August, the Japan Credit Rating Agency (JCR) affirmed Indonesia's long-term foreign currency (FCY) senior debt rating at BBB– and long-term LCY senior debt rating at BBB **(Table 4)**. The outlook for both ratings was stable. According to JCR, its ratings reflect Indonesia's sustainable economic growth outlook, which is underpinned by solid domestic demand, a reduced public debt burden, and resilience to external shocks.

**Table 4: Selected Sovereign Ratings and Outlook for Indonesia**

| | Moody's | S&P | Fitch | R&I | JCR |
|---|---|---|---|---|---|
| Sovereign FCY LT Ratings | Ba1 | BB+ | BB+ | BB+ | BB– |
| Outlook | Stable | Positive | Positive | Positive | Stable |

FCY = foreign currency, LT = long term.
Source: Rating agencies.

On 14 November, Ratings and Investment Information (R&I) affirmed Indonesia's foreign FCY sovereign ratings at BB+ with positive outlook. R&I also affirmed its FCY short-term debt rating for Indonesia at a–3. According to R&I, Indonesia's economy is becoming more resilient to the deteriorating external environment. R&I also stated that the rating could be upgraded if Indonesia can maintain macroeconomic stability in the face of the global economic and financial instability.

## Policy, Institutional, and Regulatory Developments

### BI Issues New Regulations on Export Proceeds and Foreign Debt Withdrawals

On 30 September BI issued new regulations governing export proceeds and foreign debt withdrawals. Under the new policies exporters will be required to transfer their proceeds from offshore banks into domestic banks within a period of 3 months after the date included on the Export Declaration Form. This policy will become effective on 2 January 2012. During the transition period exporters will be given up to 6 months from the date on the Export Declaration Form to comply with the new measure.

Another new regulation issued by BI requires debtors to conduct their foreign borrowing through domestic banks. The new regulations apply to borrowing in cash, non-revolving loan agreements, and debt securities.

According to BI, the main objective of these new policies is to strengthen macroeconomic stability, particularly exchange rate stability. BI governor Darmin Nasution said that the policies will improve the sustainability of foreign exchange flows into the domestic market by reducing dependence on short-term funding.

### Indonesia's First Project-Based *Sukuk* Auction Fails

The Finance Ministry did not accept offers for its planned issue of project-based *sukuk* on 11 October as the Islamic bonds failed to attract a high number of investors. Investors who bid also sought higher yields for the two *sukuk* series (6-years and 21-years). The bonds would have been Indonesia's maiden issue of project-based *sukuk* and were to be backed by over 1,000 infrastructure projects such as roads and railways.

### Indonesia Raises IDR11 trillion from its Eighth Series of Retail Bonds

The government raised IDR11 trillion from the sale of its eighth series of retail bonds (ORI008) issued on 26 October. The initial target set by the government was IDR10 trillion, but the government increased the size with final bids reaching IDR12.3 trillion. The retail bonds carried a coupon rate of 7.3% and a maturity of 3 years.

### Indonesia Passes Bill to Create Financial Services Supervisory Authority

On 28 October Indonesia's House of Representatives passed a bill that will pave the way for the creation of a new financial superbody to supervise the country's financial sector by early 2013. The Financial Services Supervisory Authority (OJK) will assume Bank Indonesia's current supervisory role on commercial banks. OJK will also oversee capital markets and non-banking institutions that are currently monitored by the Capital Market and Financial Institution Supervisory Board (Bapepam LK).

### Indonesia Raises US$1 Billion from Global *Sukuk* Sale

On 14 November, the Indonesian government successfully raised US$1 billion from the sale of global *sukuk*. The sale was Indonesia's second issue of global *sukuk* following an initial sale of US$650 million in April 2009. The most recent *sukuk* carried a maturity of 7-years and was priced to yield 4.0%. (The *sukuk* issued in April 2009 carried a maturity of 5-years and a coupon of 8.8%.) The global *sukuk* generated as much as US$6.5 billion in demand from about 250 investors.

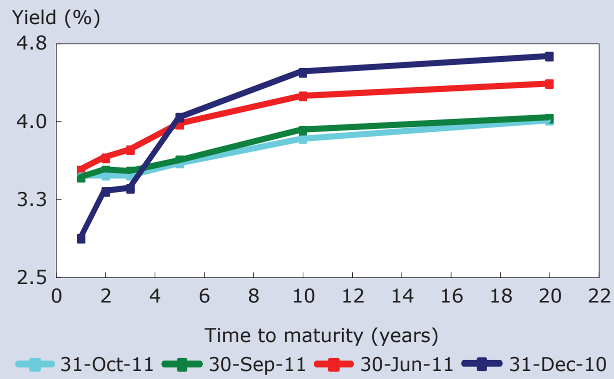
# Republic of Korea—Update

## Yield Movements

Government bond yields in the Republic of Korea dropped for all tenors between end-June and end-September, and fell further for most tenors in October **(Figure 1)**. Between end-June and end-September, the decline in yields ranged from 7 basis points (bps) in the 1-year tenor to 35 bps in the 5-year tenor. In October, yields fell for tenors longer than 1 year, with the 10-year tenor recording the largest monthly drop.

The government bond yield curve continued to flatten as the spread between 2- and 10-year tenors narrowed 22 bps between end-June and end-September, and tightened further by 3 bps in October.

**Figure 1: The Republic of Korea's Benchmark Yield Curve—LCY Government Bonds**




LCY = local currency.
Source: Bloomberg LP.

The Bank of Korea kept its base rate—the 7-day repurchase rate—steady at 3.25% for the fifth consecutive month in November, after increases totaling 75 bps in the first half of the year. In its monetary policy decision dated 11 November, the central bank's Monetary Policy Committee cited expectations of a moderate global economic recovery—amid uncertainty in international financial markets—and a sustained long-term growth trend in the domestic economy.

Consumer price inflation in October stood at 3.9% year-on-year (y-o-y), down from 4.3% in September, 5.3% in August, and 4.7% in July. On a month-on-month (m-o-m) basis, consumer prices fell 0.2% in October.

Advance estimates of real gross domestic product (GDP) for 3Q11 showed a quarter-on-quarter (q-o-q) growth rate of 0.7%, compared with the previous quarter's growth rate of 0.9%. This was due to an easing in the growth of private consumption and gross fixed capital formation in 3Q11, and in spite of increases in the growth of government consumption and the export of goods and services. On the supply side, the agriculture–forestry–fishing and electricity–gas–water supply sectors contracted in 3Q11, while manufacturing growth eased slightly. On a y-o-y basis, real GDP growth in 3Q11 remained unchanged from the previous quarter at 3.4%.

## Size and Composition

The local currency (LCY) bond market in the Republic of Korea expanded 8.6% y-o-y and 2.1% q-o-q to reach KRW1,389 trillion (US$1,179 billion) at end-September **(Table 1)**. Government bonds outstanding stood at KRW590.4 trillion, up 4.4% y-o-y and 1.2% q-o-q. Central government bonds—largely consisting of Korea Treasury Bonds (KTBs)—climbed 5.5% y-o-y and 1.1% q-o-q, leveling off at KRW391.2 trillion. The Bank of Korea's Monetary Stabilization Bonds (MSBs) rose 3.0% y-o-y and 1.4% q-o-q to reach KRW169.4 trillion. On the other hand, industrial financial debentures—bonds issued by the Korea Development Bank (KDB)—declined 1.5% y-o-y but rose 1.0% q-o-q to KRW29.8 trillion.

The LCY corporate bond market grew 11.9% y-o-y and 2.9% q-o-q to reach KRW798.6 trillion at end-September. Private corporate bonds again

**Table 1: Size and Composition of the LCY Bond Market in the Republic of Korea**

| | **Amount** (billion) | | | | | | | | **Growth Rate** (%) | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **Jun-11** | | **Jul-11** | | **Aug-11** | | **Sep-11** | | **Jun-11** | | **Jul-11** | **Aug-11** | **Sep-11** | | |
| | **KRW** | **US$** | **KRW** | **US$** | **KRW** | **US$** | **KRW** | **US$** | **y-o-y** | **q-o-q** | **m-o-m** | **m-o-m** | **y-o-y** | **q-o-q** | **m-o-m** |
| Total | 1,359,924 | 1,274 | 1,367,933 | 1,298 | 1,381,012 | 1,295 | 1,389,038 | 1,179 | 8.2 | 2.3 | 0.6 | 1.0 | 8.6 | 2.1 | 0.6 |
| Government | 583,484 | 547 | 586,553 | 556 | 590,027 | 553 | 590,429 | 501 | 4.4 | 1.5 | 0.5 | 0.6 | 4.4 | 1.2 | 0.1 |
| Central Bank Bonds | 167,030 | 156 | 168,740 | 160 | 169,920 | 159 | 169,420 | 144 | (0.3) | (0.9) | 1.0 | 0.7 | 3.0 | 1.4 | (0.3) |
| Central Government Bonds | 386,942 | 362 | 389,662 | 370 | 392,690 | 368 | 391,213 | 332 | 8.2 | 2.2 | 0.7 | 0.8 | 5.5 | 1.1 | (0.4) |
| Industrial Finance Debentures | 29,512 | 28 | 28,151 | 27 | 27,417 | 26 | 29,796 | 25 | (12.7) | 5.2 | (4.6) | (2.6) | (1.5) | 1.0 | 8.7 |
| Corporate | 776,440 | 727 | 781,380 | 741 | 790,985 | 741 | 798,609 | 678 | 11.3 | 3.0 | 0.6 | 1.2 | 11.9 | 2.9 | 1.0 |

LCY = local currency, m-o-m = month-on-month, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Bloomberg LP end-of-period LCY–US$ rates are used.
3. Growth rates are calculated from LCY base and do not include currency effects.
Source: EDAILY *BondWeb* and The Bank of Korea.

boosted the market's expansion, as the outstanding amount surged 29.9% y-o-y and 4.5% q-o-q to reach KRW331.9 trillion. Special public bonds outstanding were valued at KRW261.6 trillion, recording steady growth rates of 4.4% y-o-y and 3.3% q-o-q. On the other hand, financial debentures (excluding KDB bonds) declined 0.3% q-o-q and 1.1% y-o-y, leveling off at KRW205.1 trillion.

As of end-September, the top 30 issuers of LCY corporate bonds had a cumulative outstanding balance of KRW495.7 trillion, comprising 62% of total corporate bonds outstanding **(Table 2)**. Korea Land & Housing Corp. was still the largest corporate issuer at KRW57.6 trillion. About 77% of the top 30 issuers were banks, insurance companies, securities houses, or other financial firms.

LCY corporate bond issuance for 3Q11 amounted to KRW77.6 trillion, of which 46% were private corporate bonds, 30% financial debentures, and 24% special public bonds. Issuance of corporate bonds in 3Q11 was down 7.8% from 2Q11 largely due to a 21.4% quarterly drop in private corporate bond issuance. Compared with the previous year, corporate bond issuance fell 4.7% due to annual declines in the issuance of special public bonds and financial debentures.

The two largest LCY corporate bond issuances in the Republic of Korea in 3Q11 were made by Korea Land & Housing Corp: a 10-year bond worth KRW1,150 billion with a coupon rate of 3.25% and a 3-year bond worth KRW520 billion at a 4.21% coupon.

## Investor Profile

As of end-June, the general government—comprising the central government, local government, and social security funds—and insurance companies and pension funds were the two largest investor groups in LCY government bonds with 23% shares each **(Figure 2)**. The next largest investor groups were banks and other financial institutions with 18% shares

**Table 2: Top 30 Issuers of LCY Corporate Bonds in the Republic of Korea** (as of September 2011)

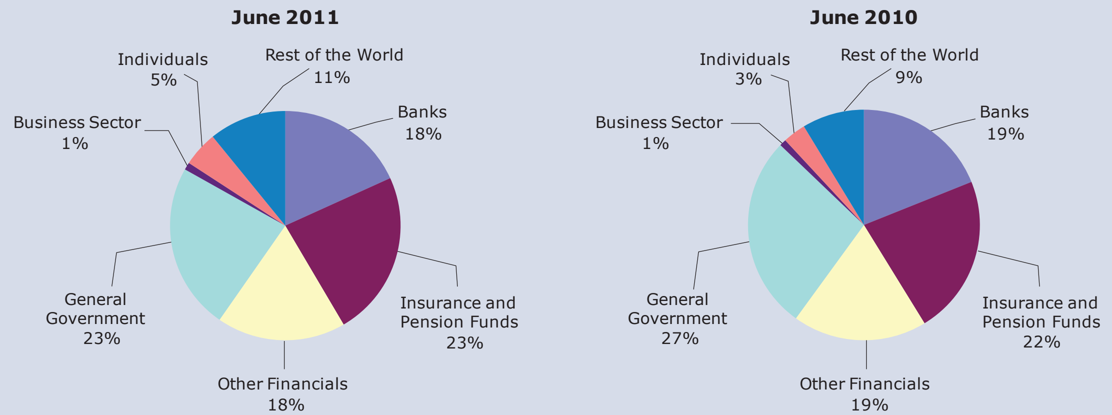
| Issuers | Outstanding Amount | | State-Owned | Privately-Owned | Listed on | | Type of Industry |
|---|---|---|---|---|---|---|---|
| | LCY Bonds (KRW billion) | LCY Bonds (US$ billion) | | | KOSPI | KOSDAQ | |
| 1. Korea Land & Housing Corp. | 57,645 | 48.9 | Yes | No | No | No | Real Estate |
| 2. Korea Housing Finance Corp. | 36,968 | 31.4 | Yes | No | No | No | Financial |
| 3. Korea Finance Corp. | 31,050 | 26.4 | Yes | No | No | No | Financial |
| 4. Industrial Bank of Korea | 30,634 | 26.0 | Yes | No | Yes | No | Bank |
| 5. Korea Deposit Insurance Corp. | 23,290 | 19.8 | Yes | No | No | No | Insurance |
| 6. Korea Electric Power Corp. | 23,230 | 19.7 | Yes | No | Yes | No | Utility |
| 7. Daewoo Securities | 21,745 | 18.5 | Yes | No | Yes | No | Securities |
| 8. Kookmin Bank | 21,527 | 18.3 | No | Yes | No | No | Bank |
| 9. Shinhan Bank | 18,597 | 15.8 | No | Yes | No | No | Bank |
| 10. Korea Highway | 18,130 | 15.4 | Yes | No | No | No | Infrastructure |
| 11. Woori Bank | 18,052 | 15.3 | Yes | No | No | No | Bank |
| 12. Woori Investment and Securities | 18,031 | 15.3 | Yes | No | Yes | No | Securities |
| 13. Korea Investment and Securities | 14,814 | 12.6 | No | Yes | No | No | Securities |
| 14. Small & Medium Business Corp. | 14,563 | 12.4 | Yes | No | No | No | Financial |
| 15. Hana Bank | 14,314 | 12.2 | No | Yes | No | No | Bank |
| 16. Korea Rail Network Authority | 12,745 | 10.8 | Yes | No | No | No | Infrastructure |
| 17. Tong Yang Securities | 11,981 | 9.2 | No | Yes | Yes | No | Securities |
| 18. Korea Gas Corp. | 11,490 | 9.8 | Yes | No | Yes | No | Utility |
| 19. Nonghyup (National Agricultural Cooperative Federation) | 10,870 | 9.2 | Yes | No | No | No | Bank |
| 20. Mirae Asset Securities | 10,587 | 9.0 | No | Yes | Yes | No | Securities |
| 21. Hyundai Securities | 9,438 | 8.0 | No | Yes | Yes | No | Securities |
| 22. Shinhan Card | 9,364 | 7.9 | No | Yes | No | No | Financial |
| 23. Korea Water Resources | 7,790 | 6.6 | Yes | No | Yes | No | Utility |
| 24. Shinhan Financial Group | 7,530 | 6.4 | No | Yes | Yes | No | Financial |
| 25. Hyundai Capital Services | 7,282 | 6.2 | No | Yes | No | No | Securities |
| 26. Hana Daetoo Securities | 7,238 | 6.1 | No | Yes | No | No | Securities |
| 27. Korea Railroad Corp. | 7,190 | 6.1 | Yes | No | No | No | Infrastructure |
| 28. Standard Chartered First Bank Korea | 6,910 | 5.9 | No | Yes | No | No | Bank |
| 29. Korea Eximbank | 6,800 | 5.8 | Yes | No | No | No | Bank |
| 30. KB Kookmin Card | 5,940 | 5.0 | No | Yes | No | No | Financial |
| **Total Top 30 LCY Corporate Issuers** | **495,747** | **420.8** | | | | | |
| **Total LCY Corporate Bonds** | **798,609** | **677.9** | | | | | |
| **Top 30 as % of Total LCY Corporate Bonds** | **62.1%** | **62.1%** | | | | | |

KOSPI = Korea Composite Stock Price Index, KOSDAQ = Korean Securities Dealers Automated Quotations, LCY = local currency.
Source: *AsianBondsOnline*, EDAILY *BondWeb*, and Bloomberg LP.

each, followed by foreign investors with an 11% share. Between June 2010 and June 2011, the share held by the general government declined 4 percentage points, while the shares for banks and other financial institutions fell 1 percentage point each. Meanwhile, the shares of foreign investors and individual investors saw gains of 2 percentage points each, while the share for insurance firms and pension funds rose 1 percentage point.

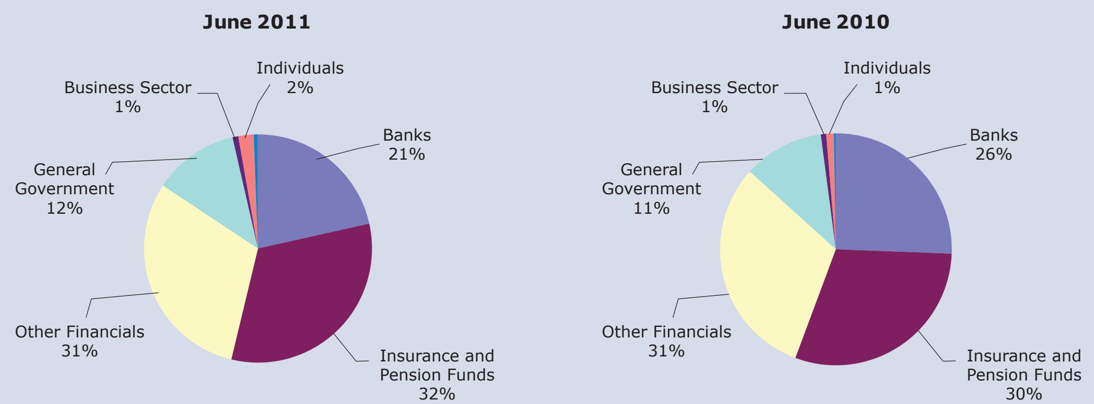
Insurance firms and pension funds remained the largest investor group in LCY corporate bonds at end-June, holding 32% of the total, followed closely by other financial institutions at 31% **(Figure 3)**. Between June 2010 and June 2011, the share for insurance firms and pension funds climbed 2 percentage points, while shares for the general government and individual investors rose 1 percentage point each. In contrast, shares for banks plunged 5 percentage points.

**Figure 2: LCY Government Bonds Investor Profile**




LCY = local currency.
Source: *AsianBondsOnline* and The Bank of Korea.

**Figure 3: LCY Corporate Bonds Investor Profile**




LCY = local currency.
Source: *AsianBondsOnline* and The Bank of Korea.

## Rating Changes

In November Fitch Ratings affirmed the Republic of Korea's foreign currency (FCY) long-term issuer default rating at A+ and revised its outlook from stable to positive **(Table 3)**. It also affirmed its LCY long-term issuer default rating at AA with a stable outlook. According to Fitch, the Republic of Korea's sovereign creditworthiness is strengthening amid improvements in its sovereign and external balance sheets. It noted that the country's fiscal prudence and moderate public debt are its key rating strengths, and that its external liquidity has been improving thanks to increasing foreign reserves and declining reliance on short-term external debt. The ratings agency, however, mentioned that the country faces certain risks such as the volatile global economic and financial environment and its heavy external debt refinancing burden in 2012.

**Table 3: Selected Sovereign Ratings and Outlook for Republic of Korea**

| | Moody's | S&P | Fitch | R&I |
|---|---|---|---|---|
| Sovereign FCY LT Ratings | A1 | A | A+ | A+ |
| Outlook | Stable | Stable | Positive | Stable |

FCY = foreign currency, LT = long term.
Source: Rating agencies.

## Policy, Institutional, and Regulatory Developments

### Tax Revision Bill for 2011 Introduced

In September the Ministry of Strategy and Finance introduced its tax revision bill for 2011. The bill aims to facilitate sustainable growth and promote employment, improve fiscal conditions, and foster fair competition. One of the key aspects of the bill is fair taxation: yields derived from issuing FCY bonds domestically will be taxed just like LCY bonds, and capital gains taxes coming from financial products, including derivatives, will be legislated.

### The Bank of Korea and People's Bank of China Expand Bilateral Swap Arrangement

In October the Bank of Korea announced the renewal of its bilateral swap arrangement with the People's Bank of China for 3 years. The size of the swap arrangement was expanded from KRW38 trillion–CNY180 billion to KRW64 trillion–CNY360 billion.

### FSCMA Revision to Allow Hedge Funds

The Financial Services Commission (FSC) reported that the government approved on 27 September the proposed revision of the Enforcement Decree of the Financial Investment Services and Capital Markets Act (FSCMA), which will allow for the entry of locally based hedge funds into the Republic of Korea's capital market. The revision also allows hedge funds to invest in a wider range of asset classes, eases the restrictions on derivatives trading and leverage, and increases the diversity of hedge fund investors.

### Macroprudential Stability Levy Imposed

The government imposed a macroprudential levy on the non-deposit FCY liabilities of banks effective 1 August. The levy applies to 56 financial institutions including 13 commercial banks, 37 foreign bank branches, Korea Eximbank, Industrial Bank of Korea, Korea Development Bank, Korea Finance Corporation, Bank of National Agricultural Cooperative Federation, and the National Federation of Fisheries Cooperatives. The levy was introduced in order to help mitigate capital flow volatility, including sudden outflows. The levy is 0.5% or less of face value depending on debt maturity.

# Malaysia—Update

## Yield Movements

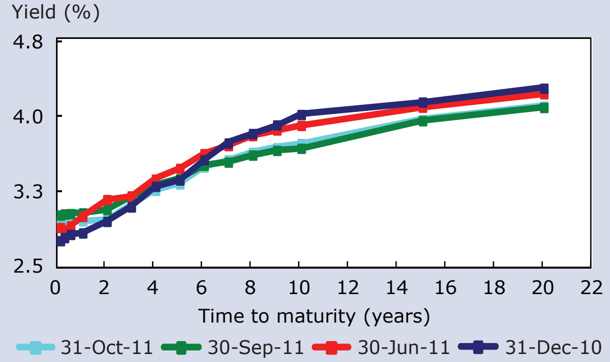
Between end-June and end-September, the yield curve for Malaysian local currency (LCY) government bonds flattened, with rates rising at the very short-end while falling along the rest of the curve. In October, yields fell at the very-short end to the belly of the curve, but rose slightly at the long-end, reflecting concerns over global economic stability **(Figure 1)**. Yields at the very short-end to the belly fell between 2 basis points (bps) and 10 bps in October, while yields at the long end rose between 1 bp and 5 bps. The drop at the short-end and the rise at the long-end of the curve widened the yield spread between 2- and 10-year maturities to 76 bps from 60 bps at end-September.

In May, Bank Negara Malaysia (BNM) decided to increase its overnight policy rate by 25 bps to 3.00% from 2.75%. Also, BNM increased the statutory reserve requirement ratio by 100 bps from 2.00% to 3.00%. BNM decided to keep its overnight policy rate at 3.00% during its Monetary Policy Meeting on 11 November.

Malaysia's consumer price inflation slightly rose to 3.4% year-on-year (y-o-y) in September from 3.3% in August. During the first 9 months of the year, the consumer price index has increased 3.2%.

Malaysia's real gross domestic product (GDP) growth increased to 5.8% y-o-y in 3Q11, compared with revised 4.3% growth in 2Q11, due driven by stronger domestic demand. Domestic demand grew 9.0% y-o-y in 3Q11, supported by public consumption growth which surged to 21.7% y-o-y in 3Q11 from 6.6% in 2Q11. Meanwhile, private sector spending posted 7.3% y-o-y growth in 3Q11 following a 6.4% growth in 2Q11. Growth in gross fixed capital formation also improved to 6.1% y-o-y in 3Q11 versus 3.2% in the previous quarter.

**Figure 1: Malaysia's Benchmark Yield Curve—LCY Government Bonds**




LCY = local currency.
Source: Bloomberg LP.

On the supply side, all sectors except mining posted higher growth rate. Service sector recorded 7.0% y-o-y growth in 3Q11, slightly higher than the 6.8% growth posted in 2Q11. The increase was mainly due to favorable performance by the wholesale and retail trade subsector which grew 9.0% y-o-y in 3Q11, as well as the communication, and transportation and storage subsectors which increased 8.7% and 6.1%, respectively. Meanwhile, manufacturing sector rose 5.1% in 3Q11 from 2.1% in 2Q11. Agriculture and construction sectors also posted higher growth at 8.2% and 3.0%, respectively.

## Size and Composition

The total amount of outstanding LCY bonds increased 16.5% y-o-y to MYR840 billion at end-September, as LCY government and corporate bonds each posted double-digit growth **(Table 1)**. Outstanding LCY government bonds rose 19.8% y-o-y to MYR505 billion, led by central bank bills, which expanded 58.0%. Excluding central bank bills, outstanding LCY government bonds increased 10.9% y-o-y. Meanwhile, outstanding LCY corporate bonds increased 11.8% y-o-y to MYR335 billion.

**Table 1: Size and Composition of the LCY Bond Market in Malaysia**

| | **Amount** (billion) | | | | | | | | **Growth Rate** (%) | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **Jun-11** | | **Jul-11** | | **Aug-11** | | **Sep-11** | | **Jun-11** | | **Jul-11** | **Aug-11** | **Sep-11** | | |
| | **MYR** | **US$** | **MYR** | **US$** | **MYR** | **US$** | **MYR** | **US$** | **y-o-y** | **q-o-q** | **m-o-m** | **m-o-m** | **y-o-y** | **q-o-q** | **m-o-m** |
| Total | 812.2 | 269.0 | 817.8 | 275.5 | 836.2 | 281.4 | 840.0 | 263.4 | 16.7 | 3.7 | 0.7 | 2.2 | 16.5 | 3.4 | 0.4 |
| Government | 484.9 | 160.6 | 490.3 | 165.2 | 500.6 | 168.5 | 505.0 | 158.4 | 20.9 | 2.9 | 1.1 | 2.1 | 19.8 | 4.1 | 0.9 |
| Central Government Bonds | 376.1 | 124.5 | 383.6 | 129.2 | 388.6 | 130.7 | 376.8 | 118.2 | 13.5 | 1.3 | 2.0 | 1.3 | 10.9 | 0.2 | (3.0) |
| Central Bank Bills | 108.4 | 35.9 | 106.3 | 35.8 | 111.6 | 37.6 | 127.7 | 40.0 | 57.0 | 8.8 | (1.9) | 5.0 | 58.0 | 17.8 | 14.4 |
| Others | 0.5 | 0.2 | 0.5 | 0.2 | 0.5 | 0.2 | 0.5 | 0.1 | (52.1) | – | – | – | (52.1) | – | – |
| Corporate | 327.3 | 108.4 | 327.5 | 110.3 | 335.6 | 112.9 | 335.0 | 105.0 | 11.1 | 4.9 | 0.1 | 2.5 | 11.8 | 2.3 | (0.2) |

– = not applicable, LCY = local currency, m-o-m = month-on-month, q-o-q = quarter-on-quarter, y-o-y = year-on-year.

Notes:
1. Calculated using data from national sources.
2. Bloomberg LP end-of-period LCY–US$ rate is used.
3. Growth rates are calculated from LCY base and do not include currency effects.
4. "Others" refers to Khazanah Bonds issued by Khazanah Nasional Berhad and Cagamas Bonds and Notes, Bithaman Ajil Islamic Securities, Sanadat ABBA Cagamas, and Sanadat Mudharabah Cagamas issued by Cagamas Berhad.

Source: Bank Negara Malaysia, Fully Automated System for Issuing/Tendering (FAST), and Bloomberg LP.

On a quarter-on-quarter (q-o-q) basis, total LCY bonds outstanding increased 3.4% in 1Q11, with government and corporate bonds growing 4.1% and 2.3% q-o-q, respectively.

Issuance of government bonds—Malaysian Government Securities (MGSs) and Government Investment Issues (GIIs)—increased 50.4% y-o-y to MYR25.9 billion in 3Q11 from MYR17.2 billion in 3Q10. Government bond issuance is expected to total MYR90.2 billion in 2011—55.2% higher than the MYR58.1 billion in government bonds issued in 2010—of which MYR75.0 billion had already been issued by end-September.

Meanwhile, issuance of LCY corporate bonds increased 14.7% y-o-y to MYR24.8 billion in 3Q11. Among the largest corporate issues during 3Q11 were the subordinated debt issues of Public Bank (MYR3.0 billion), Maybank (MYR2.0 billion), and CIMB Bank (MYR1.5 billion). Also, YTL Power International issued MYR2.2 billion worth of 7-year notes. Prasarana issued MYR2.0 billion of *sukuk* (Islamic bonds) in August, while MISC issued a total of MYR1.3 billion of *sukuk* in July and September. Another notable *sukuk* issuance in 3Q10 was MYR750 million worth of 5-year notes by the Kuwait-based Gulf Investment Corporation.

At end-June, the top 30 corporate issuers in Malaysia accounted for 51.0% of total LCY corporate bonds outstanding **(Table 2)**. Cagamas Bhd, Khazanah Nasional, and Binariang GSM remained the biggest issuers of LCY corporate bonds at the end of 2Q11, with outstanding amounts of MYR20.0 billion, MYR13.2 billion, and MYR11.3 billion, respectively.

## Investor Profile

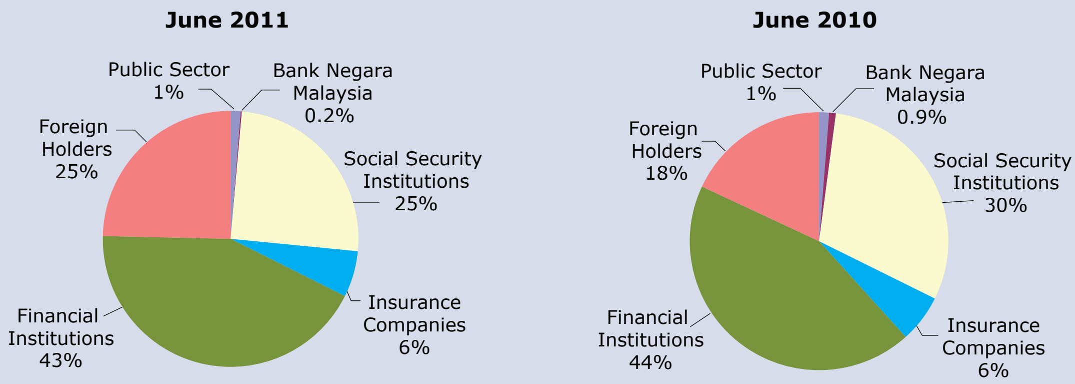
As of end-September, financial institutions were the largest holders of MGSs and GIIs, with 51.0% of total outstanding government bonds, followed by social security institutions at 26.5%. Insurance companies comprised 5.6% of the total **(Figure 2)**. Meanwhile, the share of government bonds outstanding held by foreign investors rose to

**Table 2: Top 30 LCY Corporate Issuers in Malaysia** (as of September 2011)

| Issuers | Outstanding Amount (MYR billion) | | | | | State-Owned | Privately-Owned | Listed Company | Type of Industry |
|---|---|---|---|---|---|---|---|---|---|
| | BONDS | IBONDS | MTN | IMTN | TOTAL | | | | |
| 1. Cagamas | | | 9.39 | 10.56 | 19.95 | Yes | No | No | Finance |
| 2. Khazanah | | 13.20 | | | 13.20 | Yes | No | No | Quasi-Govt. and Other |
| 3. Binariang GSM | | 3.02 | | 8.28 | 11.30 | No | Yes | No | Transport, Storage, and Comm. |
| 4. Maybank | 8.10 | 1.50 | | | 9.60 | No | Yes | Yes | Finance |
| 5. Malakoff Corp | | 1.70 | | 5.60 | 7.30 | No | Yes | No | Finance |
| 6. Prasarana | 5.10 | 2.00 | | | 7.10 | Yes | No | No | Finance |
| 7. CIMB Bank | 7.00 | | | | 7.00 | No | Yes | No | Finance |
| 8. Public Bank | 1.20 | | 4.87 | | 6.07 | No | Yes | Yes | Finance |
| 9. KL International Airport | 1.60 | 4.26 | | | 5.86 | Yes | No | No | Transport, Storage, and Comm. |
| 10. Project Lebuhraya | | 5.82 | | | 5.82 | No | Yes | Yes | Transport, Storage, and Comm. |
| 11. Rantau Abang Capital Bhd | | | | 5.80 | 5.80 | No | Yes | No | Quasi-Govt. and Other |
| 12. Senai Desaru Expressway Bhd | | | | 5.58 | 5.58 | No | Yes | No | Construction |
| 13. Valuecap | 5.10 | | | | 5.10 | Yes | No | No | Finance |
| 14. 1Malaysia Development Bhd | | | | 5.00 | 5.00 | Yes | No | No | Finance |
| 15. AM Bank | 0.49 | | 4.48 | | 4.96 | No | Yes | Yes | Finance |
| 16. Jimah Energy Ventures | | | | 4.54 | 4.54 | No | Yes | No | Utilities |
| 17. Bank Pembangunan Malaysia | 1.00 | | 2.40 | 0.90 | 4.30 | Yes | No | No | Finance |
| 18. Celcom Transmission | | | | 4.20 | 4.20 | No | Yes | No | Transport, Storage, and Comm. |
| 19. Tanjung Bin | | | | 4.07 | 4.07 | No | Yes | No | Utilities |
| 20. YTL Power International | | | 3.63 | | 3.63 | No | Yes | Yes | Utilities |
| 21. RHB Bank | 0.60 | | 3.00 | | 3.60 | No | Yes | No | Finance |
| 22. Danga Capital | | | | 3.60 | 3.60 | Yes | No | No | Finance |
| 23. Cekap Mentari | 3.50 | | | | 3.50 | No | Yes | Yes | Finance |
| 24. Sarawak Energy | | | | 3.00 | 3.00 | Yes | No | Yes | Energy, Gas, and Water |
| 25. GOVCO Holdings | | | | 3.00 | 3.00 | Yes | No | No | Quasi-Govt. and Other |
| 26. CIMB Group | 2.13 | | 0.50 | 0.35 | 2.98 | No | Yes | Yes | Finance |
| 27. The Export-Import Bank of Korea | | | 2.98 | | 2.98 | Yes | No | No | Finance |
| 28. Hijrah Pertama | | 2.92 | | | 2.92 | No | Yes | No | Finance |
| 29. Malaysia Airports Capital | | | | 2.50 | 2.50 | No | Yes | No | Finance |
| 30. Gulf Investment Corporation | 1.00 | | | 1.35 | 2.35 | No | No | No | Finance |
| **Total Top 30 LCY Corporate Issuers** | | | | | **170.81** | | | | |
| **Total LCY Corporate Bonds** | | | | | **334.97** | | | | |
| **Top 30 as % of Total LCY Corporate Bonds** | | | | | **51.0%** | | | | |

IBONDS = Islamic bonds, IMTN = Islamic medium-term notes, LCY = local currency, MTN = medium-term notes.
Source: Bank Negara Malaysia, Fully Automated System for Issuing/Tendering (FAST).

**Figure 2: LCY Government Bonds Investor Profile**




LCY = local currency.
Source: Bank Negara Malaysia.

24.6% at end-June from 21.5% at end-December 2010 and 18.1% at end-June 2010.

## Policy, Institutional, and Regulatory Developments

### Securities Commission Issues Revised Guidelines for Corporate Bonds and *Sukuk*

In July the Securities Commission of Malaysia (SC) issued revised guidelines for private debt securities and *sukuk* in line with the broader objectives of the Capital Market Masterplan 2. The revised guidelines replace the earlier Guidelines on Offering Private Debt Securities and Guidelines on the Offering of Islamic Securities, both of which were issued in July 2004. The new measures streamline the approval process and time-to-market for the issuance of corporate bonds and *sukuk*. The revised guidelines also remove the mandatory rating requirement for selected issues and offers, and provide greater disclosure of relevant information for debenture holders. The revised Islamic Security Guidelines provide more clarity to ensure compliance with *sharia'h* (Islamic law) rulings and principles endorsed by the *Sharia'h* Advisory Council of the SC.

### Acts Amended Pursuant to Capital Market Masterplan 2

Amendments to the Securities Act 1993 and Capital Markets and Services Act 2007 (CMSA), pursuant to strategies outlined in the Capital Market Masterplan 2, came into force on 3 October. The amendments include

(i) a legal framework for the private retirement scheme industry,
(ii) licensing provisions in the CMSA,
(iii) regulations pertaining to over-the-counter (OTC) derivatives and a framework for reporting OTC derivative contracts,
(iv) a framework to enable the Audit Oversight Board to grant recognition to foreign auditors, and
(v) authority for the SC to obtain information considered necessary for the purpose of monitoring, mitigating and managing systematic risks; and to issue directives for managing systemic risk.

# Philippines—Update

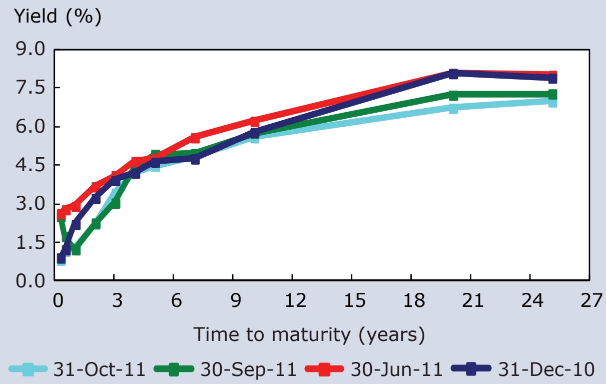
## Yield Movements

The Philippine government bond yield curve flattened from the belly through the end of the curve between the beginning of the year and end-October **(Figure 1)**. Yields for all tenors declined year-to-date, with the exception of the 4- and 7-year tenors, due to a lack of liquid benchmarks. Yields for tenors between 3 months and 5 years dropped between 5 basis points (bps) and 97 bps, while yields for 10-year through 25-year tenors decreased 19 bps–131 bps.

Between end-June and end-October, the yield curve shifted downward as domestic liquidity fanned buying momentum and concerns over inflation abated. Yields for tenors between 3 months and 2 years declined between 139 bps—173 bps as foreign investment flowed back into Philippine government securities on easing inflation expectations. The rest of the curve fell between 28 bps and 130 bps, with the recently issued 20-year jumbo bond posting the biggest drop. Spreads between 2- and 10-year yields widened to 323 bps in October from 245 bps in June after the yield on the 2-year tenor fell almost 140 bps.

Consumer price inflation quickened slightly to 5.2% year-on-year (y-o-y) in October from 4.8% in September, using the 2006-based consumer price index (CPI) series. The 2000-based CPI series produced a 5.3% y-o-y increase in October and a 4.6% rise in September. Year-to-date inflation averages through October using the 2006- and 2000-based series were 4.8% and 4.5%, respectively, which are both still within the government's target range of 3.0%–5.0% for 2011. October inflation was greatly affected by higher utility and food indices, including upward adjustments in electricity and water rates, and tight supply conditions due to typhoon-related production disruptions. Bangko Sentral ng Pilipinas (BSP) noted that the uptick in inflation would be temporary and forecast that future inflation would be well-anchored in its target range.

**Figure 1: Philippines' Benchmark Yield Curve—LCY Government Bonds**




LCY = local currency.
Source: Bloomberg LP.

Gross domestic product (GDP) growth in the Philippines fell to 3.4% y-o-y in 2Q11 from 4.9% in 1Q11, based on 2000 price levels. Reduced government spending, sluggish export growth resulting from the global economic slowdown, and consumption weakened by escalating consumer prices all contributed to lower GDP growth in 2Q11. The government revised its 2011 GDP forecast to a range of 4.5%–5.5% from the original 7.0%–8.0%, and its 2012 GDP forecast to 5.0%–6.0% from 5.5%–6.5%. Growth targets for exports and imports were also lowered to 5% and 13%, respectively in 2011 from original estimates of 9%–10% for exports and 17%–18% for imports.

The Philippines' faltering growth rate has been the prime concern of the government, especially with inflation expectations well within the target range. As a result, BSP held its policy rates and reserve requirement ratios steady in its last two policy meetings in September and October. BSP's overnight reverse repurchase rate (borrowing facility) was left at 4.5% and its overnight repurchase rate (lending facility) was left at 6.5%. The reserve requirement ratio for banks was left at 21%.

**Table 1: Size and Composition of the LCY Bond Market in the Philippines**

| | **Amount** (billion) | | | | | | | | **Growth Rate** (%) | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **Jun-11** | | **Jul-11** | | **Aug-11** | | **Sep-11** | | **Jun-11** | | **Jul-11** | **Aug-11** | **Sep-11** | | |
| | PHP | US$ | PHP | US$ | PHP | US$ | PHP | US$ | y-o-y | q-o-q | m-o-m | m-o-m | y-o-y | q-o-q | m-o-m |
| Total | 3,264 | 75 | 3,237 | 77 | 3,256 | 77 | 3,260 | 74.5 | 6.2 | 3.3 | (0.8) | 0.6 | 2.7 | -0.1 | 0.1 |
| Government | 2,847 | 66 | 2,822 | 67 | 2,848 | 67 | 2,851 | 65 | 5.6 | 3.2 | (0.9) | 0.9 | 1.9 | 0.2 | 0.1 |
| Treasury Bills | 381 | 9 | 345 | 8 | 341 | 8 | 333 | 7.613 | (32.8) | (4.6) | (9.4) | (1.2) | (42.4) | (12.6) | (2.3) |
| Treasury Bonds | 2,346 | 54 | 2,360 | 56 | 2,389 | 57 | 2,401 | 55 | 17.5 | 4.9 | 0.6 | 1.3 | 14.9 | 2.3 | 0.5 |
| Others | 119 | 3 | 117 | 3 | 117 | 3 | 117 | 3 | (9.7) | (2.7) | (1.7) | 0.0 | (11.2) | (1.7) | 0.0 |
| Corporate | 417 | 10 | 415 | 10 | 409 | 10 | 409 | 9.35 | 10.9 | 3.6 | (0.5) | (1.5) | 9.3 | (1.9) | 0.2 |

LCY = local currency, m-o-m = month-on-month, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Bloomberg end-of-period LCY–US$ rates are used.
3. Growth rates are calculated from LCY base and do not include currency effects.
4. "Others" includes government-guaranteed bonds such as National Power Corporation and Power Sector Assets and Liabilities Management.
Source: Philippine Bureau of the Treasury and Bloomberg LP.

## Size and Composition

The expansion of the local currency (LCY) bond market remained modest in 3Q11. Issuance of treasury and corporate bonds buoyed overall growth, compensating for the contraction in treasury bill and other government debt issuance.

Total LCY bonds outstanding grew to PHP3.3 trillion (US$74.5 billion) at end-September, up 2.7% y-o-y **(Table 1)**. This was lower than the 6.2% y-o-y growth rate at end-June as reduced expenditure by the national government reduced funding requirements. LCY bonds outstanding were relatively flat in 3Q11 as growth in treasury bonds was offset by declines in all other government and corporate securities. Government bonds (including treasury bills and government-controlled companies) rose 1.9% y-o-y to PHP2.9 trillion at end-September, while corporate bonds grew 9.3% y-o-y to PHP409 billion. However, the share of treasury bills in the government's total debt stock shrank to PHP333 billion for a decline of 12.6% quarter-on-quarter (q-o-q), while that of longer-term treasury bonds surged 14.9% y-o-y to PHP2.4 trillion.

In 3Q11 significant new government bond issuances included the 10.5- and 20-year treasury bonds from the July bond exchange. Significant corporate issues in 3Q11 included the notes of Filinvest Land Inc. (FLI) and SM Investments Corp (SMIC). FLI's 5-year corporate notes carried a coupon of 6.1962% and totaled PHP3 billion. SMIC's PHP5 billion issue consisted of 7-year bonds totaling PHP916 million with a 5.75% coupon and 10-year bonds totaling PHP4.1 billion with a 6.625% coupon.

## Corporate Bond Market Development

At end-September, total outstanding LCY corporate bonds stood at PHP409 billion. Less than 50 firms had corporate bonds outstanding, with the top 30 issuers accounting for almost 94% of the total.

Except for Manila North Tollways and Tanduay Distilleries, all 30 of the top corporate borrowers are listed on the Philippine Stock Exchange. San Miguel Brewery was the largest issuer with PHP38.8 billion of bonds outstanding. Banco de Oro Unibank was the second-largest with PHP36.5 billion and Ayala Corporation was next with PHP26.0 billion **(Table 2).**

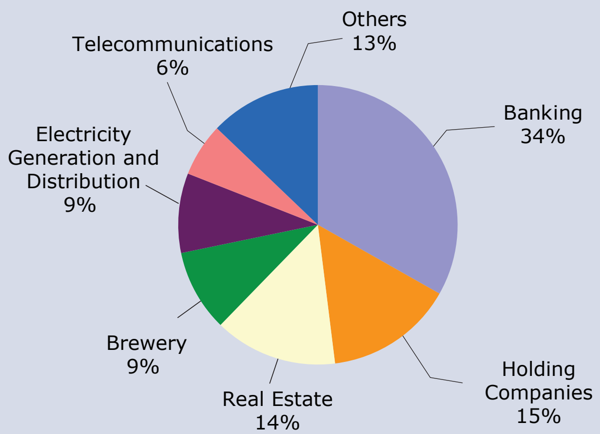
**Table 2: Top 30 Issuers of LCY Corporate Bonds in the Philippines** (as of September 2011)

| Issuers | Outstanding Amount | | State-Owned | Privately-Owned | Listed Company | Type of Industry |
|---|---|---|---|---|---|---|
| | LCY Bonds (PHP billion) | LCY Bonds (US$ billion) | | | | |
| 1. San Miguel Brewery, Inc. | 38.80 | 0.89 | No | Yes | Yes | Brewery |
| 2. Banco De Oro Unibank, Inc. | 36.50 | 0.83 | No | Yes | Yes | Banking |
| 3. Ayala Corporation | 26.00 | 0.59 | No | Yes | Yes | Diversified Operations |
| 4. SM Investments Corporation | 21.40 | 0.49 | No | Yes | Yes | Diversified Operations |
| 5. Philippine National Bank | 21.25 | 0.49 | No | Yes | Yes | Banking |
| 6. Manila Electric Company | 18.82 | 0.43 | No | Yes | Yes | Electricity Distribution |
| 7. Metropolitan Bank & Trust Company | 18.50 | 0.42 | No | Yes | Yes | Banking |
| 8. Rizal Commercial Banking Corporation | 16.00 | 0.37 | No | Yes | Yes | Banking |
| 9. Ayala Land, Inc. | 15.51 | 0.35 | No | Yes | Yes | Real Estate |
| 10. Robinsons Land Corporation | 15.00 | 0.34 | No | Yes | Yes | Real Estate |
| 11. JG Summit Holdings, Inc. | 13.31 | 0.30 | No | Yes | Yes | Diversified Operations |
| 12. Globe Telecom, Inc. | 12.72 | 0.29 | No | Yes | Yes | Telecommunications |
| 13. Philippine Long Distance Telephone Co | 12.50 | 0.29 | No | Yes | Yes | Telecommunications |
| 14. Energy Development Corporation | 12.00 | 0.27 | No | Yes | Yes | Electricity Generation |
| 15. Bank of the Philippine Islands | 10.00 | 0.23 | No | Yes | Yes | Banking |
| 16. Petron Corporation | 10.00 | 0.23 | No | Yes | Yes | Oil Refining and Marketing |
| 17. SM Development Corporation | 10.00 | 0.23 | No | Yes | Yes | Real Estate |
| 18. First Philippine Holdings Corporation | 8.49 | 0.19 | No | Yes | Yes | Electricity Generation and Distribution |
| 19. Allied Banking Corporation | 8.00 | 0.18 | No | Yes | Yes | Banking |
| 20. Filinvest Land, Inc. | 8.00 | 0.18 | No | Yes | Yes | Real Estate |
| 21. Aboitiz Power Corporation | 6.88 | 0.16 | No | Yes | Yes | Electricity Generation |
| 22. Megaworld Corporation | 6.38 | 0.15 | No | Yes | Yes | Real Estate |
| 23. Metrobank Card Corporation | 6.30 | 0.14 | No | Yes | Yes | Diversified Financial Services |
| 24. Manila North Tollways Corporation | 5.28 | 0.12 | No | Yes | No | Public Thoroughfares |
| 25. China Banking Corporation | 5.00 | 0.11 | No | Yes | Yes | Banking |
| 26. Tanduay Distilleries, Inc. | 5.00 | 0.11 | No | Yes | No | Beverages |
| 27. United Coconut Planters Bank | 4.52 | 0.10 | No | Yes | Yes | Banking |
| 28. Manila Water Company, Inc. | 4.00 | 0.09 | No | Yes | Yes | Water Distribution |
| 29. SM Prime Holdings, Inc. | 3.99 | 0.09 | No | Yes | Yes | Real Estate Management Services |
| 30. Union Bank of the Philippines | 3.75 | 0.09 | No | Yes | Yes | Banking |
| **Total Top 30 LCY Corporate Issuers** | **383.91** | **8.77** | | | | |
| **Total LCY Corporate Bonds Outstanding** | **409.19** | **9.35** | | | | |
| **Top 30 as % of Total LCY Corporate Bonds Outstanding** | **93.8%** | **93.8%** | | | | |

LCY = local currency.
Source: Bloomberg LP.

Among LCY corporate bonds outstanding, banks were the dominant issuers of subordinated debt (34%) as they continued to improve their capitalization and ensure compliance with Basel III requirements **(Figure 2)**. Holding companies ranked second (15%) and real estate developers and operators were third (14%). Electric generation and distribution companies and a brewery shared the fourth spot with 9% of the total each. Telecommunications firms comprised 6% of the total and other companies from various industries accounted for the remaining 13%.

**Figure 2: LCY Corporate Bond Issuers by Industry**
(as of September 2011)




LCY = local currency.
Source: Bloomberg LP.

## Benchmark Government Securities Bid–Ask Spreads

In 2011 the most traded government securities with the most frequent bid–ask (two-way) quotes were monitored to identify liquidity trends in the LCY government bond market **(Tables 3 and 4)**. Government securities with the highest level of activity were products of the government's series of bond swaps. The data used to capture the bid–ask spreads for these securities were obtained from the Bloomberg pages of the money brokers operating in the Philippines.

Bid–ask spreads for benchmark government securities tightened from 7 January through 28 October **(Figure 3)**, narrowing from almost 13 bps during the first half of the year to less

**Table 3: Benchmark Government Securities Monitored from January to October 2011**

| Series | ISIN | Outstanding Amount (as of August 2011) | | Coupon (%) | Maturity Date | Years to Maturity |
|---|---|---|---|---|---|---|
| | | PHP billion | US$ billion | | | |
| FXTN 5-67 | PIBD0514A673 | 107.93 | 2.55 | 6.250 | 27-Jan-14 | 2.42 |
| FXTN 7-48 | PIBD0716A488 | 136.77 | 3.24 | 7.000 | 27-Jan-16 | 4.42 |
| FXTN 10-42 | PIBD1016I420 | 66.87 | 1.58 | 9.125 | 4-Sep-16 | 5.03 |
| FXTN 25-8 | PIBD2535L086 | 166.01 | 3.93 | 8.125 | 16-Dec-35 | 24.38 |

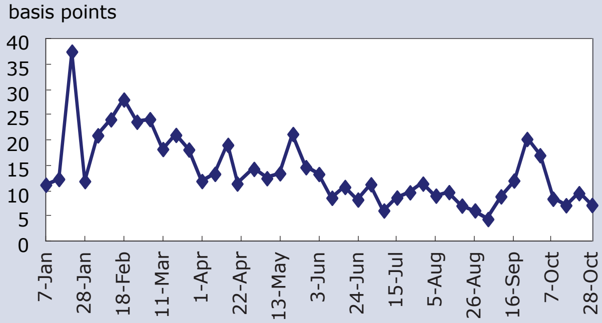
ISIN = International Securities Identification Number.
Source: Philippine Bureau of the Treasury.

**Table 4: Additional Benchmark Government Securities Monitored from July to October 2011**

| Series | ISIN | Outstanding Amount (as of August 2011) | | Coupon (%) | Maturity Date | Years to Maturity |
|---|---|---|---|---|---|---|
| | | PHP billion | US$ billion | | | |
| RTB 10-2 | PIID1021C027 | 63.68 | 1.51 | 7.375 | 3-Mar-21 | 9.54 |
| FXTN 10-53 | PIBD1021D531 | 32.46 | 0.77 | 6.500 | 28-Apr-21 | 9.69 |
| FXTN 10-54 | PIBD1022G545 | 67.62 | 1.60 | 6.375 | 19-Jan-22 | 10.42 |
| FXTN 20-17 | PIBD2031G171 | 255.84 | 6.06 | 8.000 | 19-Jul-31 | 19.95 |

ISIN = International Securities Identification Number.
Source: Philippine Bureau of the Treasury.

**Figure 3: Benchmark Government Securities Bid-Ask Spreads, 7 January–28 October 2011**




Note: 1 basis point = 0.01 percentage point.
Source: *AsianBondsOnline*.

than 10 bps in 3Q11 on improving liquidity. However, there were some notable spikes within this overall trend. Spreads widened to 37 bps during the week of 17–21 January following the partial issuance of 20-year bonds by the Bureau of the Treasury (BTR) despite lack of demand. This fueled more selling pressures causing loss-limit stops to be triggered. Inflation concerns also heightened that same week as transportation costs and oil prices rose. During the week of 16–20 May, average spreads rose 21 bps as Philippine inflation forecasts were raised and the Greek debt problem worsened. More recently, average spreads widened 20 bps during the week of 19–23 September after European finance ministers ruled out further economic stimulus measures and Italy's debt rating was downgraded by Standard & Poor's (S&P).

In 3Q11 the series with the tightest bid–ask spreads were FXTN 20-17 and FXTN 25-08 with averages of 2 bps and 7 bps, respectively. The 3Q11 averages of the following series were also in the single digits: FXTN 10-42 (8 bps), RTB 10-2 (8 bps), FXTN 10-53 (9 bps), and FXTN 10-54 (9 bps). Bid–ask spreads for FXTN 5-67 widened in 3Q11 and became less frequent. The average bid–ask spread for FXTN 5-67 widened from 10 bps in 1H11 to 24 bps in 3Q11. Meanwhile, two-way quotes for FXTN 7-48 also became less frequent.

# Foreign Currency Bonds

## Philippines Buys Back FCY Debt

In October the government bought back a total of US$1.3 billion of outstanding EUR- and US$-denominated bonds. The government aims to convert its foreign currency (FCY) obligations to LCY bonds as part of its debt liability management efforts. The equivalent of US$17.5 billion of outstanding FCY-denominated bonds is eligible for repurchase. In line with the buyback exercise, the government raised US$50 million through a reopening of its bond maturing on 23 October 2034 with a coupon of 6.375% per annum. The bond was sold at a price of 117.5 to yield 5.077%. The proceeds from the sale will be used to partially fund the repurchase of eligible bonds under the buyback program.

# Policy, Institutional, and Regulatory Developments

## PSE Readies for Interconnectivity with ASEAN Exchanges

The Philippine Stock Exchange (PSE) extended its trading hours starting in October in preparation for increased connectivity with Bursa Malaysia, the Singapore Exchange, and the Stock Exchange of Thailand under the Association of Southeast Asian Nations (ASEAN) Exchange Collaboration project. The project is the first step in a plan to develop a single market data and order routing network for Southeast Asian capital markets. PSE lengthened its trading hours of 9:30 a.m. to 12 noon by 1 hour to close at 1 p.m. In January 2012 the bourse will further extend its hours to include an afternoon trading session. The ASEAN Exchange Collaboration project named SunGard Financial Systems as the technology provider for the cross-border trading platform in June. The trading link is programmed to start in March 2012, with Indonesia and Viet Nam expected to join in the latter part of 2012.

## BTr Sells Retail Treasury Bonds

The Bureau of the Treasury (BTr) issued PHP110 billion of 10- and 15-year Retail Treasury Bonds (RTBs) in October. Of the total amount, PHP54.97 billion of 10-year RTBs was issued and PHP55.12 billion of 15-year RTB was sold. BTr's bond sinking fund purchased PHP53 billion of the total to secure the government's maturing obligations. The 10-year and 15-year RTBs carry coupons of 5.75% and 6.25%, respectively. RTBs have the same features as treasury bonds with the exception of coupons that are paid quarterly and individual investments as low as PHP5,000.

In March BTr issued a total of PHP104 billion of 5- and 10-year RTBs, with coupons of 6.0% and 7.375%, respectively.

## BIR Issues Tax Rules on PERA Act

The Personal Equity and Retirement Account (PERA) Act will be implemented after the Bureau of Internal Revenue (BIR) has issued the relevant tax regulations covering investments in and transactions involving PERA accounts. The PERA investment scheme aims to encourage people to save for retirement by granting tax exemptions. PERA products have been described as an alternative to the Social Security System and the Government Service Insurance System. PERA contributions will be exempted from (i) final withholding tax on interest, (ii) capital gains tax on the sale of bonds and shares, (iii) 10% tax on cash and property dividends, and (iv) regular income tax. The tax rules will become effective on 1 January 2012.

## BSP Tightens Rules on Hedging Instruments

BSP imposed stricter rules on hedging instruments, particularly non-deliverable forward (NDF) contracts, to reduce speculation in the foreign exchange market. An NDF is a contract between two parties to buy or sell an asset such as foreign exchange at an agreed price and settlement date in the future. Counterparties settle the difference between the contracted NDF price and the spot price upon maturity. BSP raised the market risk weighting of NDF contracts to reflect the potential systemic risk they generate as a result of increased volatility in the foreign exchange market. The market risk capital charge to be used in the capital adequacy ratio (CAR) computation for banks for the net open position of NDF contracts will be raised from 10% to 15% effective 1 January 2012.

# Singapore—Update

## Yield Movements

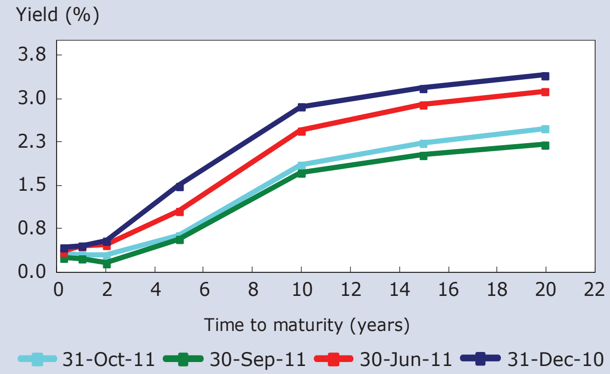
Between end-June and end-September the yield curve for local currency (LCY) government bonds in Singapore shifted downward across all maturities. Furthermore, the curve flattened as yields dropped more at the belly and the long-end of the curve than at the short-end. During the month of October, yields rose slightly higher across all maturities, but are still below end-June levels **(Figure 1)**. Between end-June and end-October, yields for the 3- and 12-month tenors dropped 3 basis points (bps) and 14 bps, respectively, while yields from the belly to the long-end of the curve fell between 17 bps and 63 bps. The yield spread between 2- and 10-year maturities at end-October was about the same as the spread of 149 bps at end-September, but narrower than the spread of 188 bps at end-June.

On 14 October the Monetary Authority of Singapore (MAS) announced that it would continue with a policy of modest and gradual appreciation of the Singapore dollar while reducing the slope of the policy band to the prevailing level of the Singapore dollar nominal effective exchange rate (S$NEER). There will be no changes to the width of the policy band and the level at which it is centered.

Headline consumer price inflation in Singapore slightly eased to 5.5% year-on-year (y-o-y) in September after rising 5.7% in August and 5.4% in July. Transport costs eased to 11.4% y-o-y in September from 12.5% in January; housing costs decelerated to 9.6% y-o-y in September from 9.9% y-o-y in August; while food price inflation was slightly higher at 3.1% y-o-y in September from 3.0% y-o-y in August. Core inflation, which excludes private road transportation and accommodation costs, stood at 2.1% in September. Core inflation is expected to ease in 2012 and headline inflation is expected to stay elevated in the near term.

According to the Ministry of Trade and Industry (MTI), Singapore's economy expanded 6.1% y-o-y in 3Q11, an improvement from 1.0% growth in 2Q11. The increase in the rate of economic growth in 3Q11 was due to a turnaround in the manufacturing sector, particularly the biomedical manufacturing subsector. The manufacturing sector expanded 14.2% y-o-y in 3Q11 after posting a 5.6% decline in the previous quarter. The construction sector posted marginal growth of 0.3% in 3Q11, while the services sector expanded 3.7% following 4.0% growth in 2Q11. MTI expects Singapore's gross domestic product (GDP) growth to average 5.0% for the whole of 2011.

**Figure 1: Singapore's Benchmark Yield Curve–LCY Government Bonds**




LCY = local currency.
Source: Bloomberg LP.

## Size and Composition

The total amount of outstanding LCY bonds increased 11.2% y-o-y to SGD242.9 billion (US$185.4 billion) at end-September **(Table 1)**. Outstanding Singapore Government Securities (SGS) bills and bonds rose 5.8% y-o-y to SGD135.5 billion. However, on a quarter-on-quarter (q-o-q) basis, outstanding LCY bonds fell 0.8% in 3Q11, with government bonds declining 3.7% as SGD6.8 billion worth of SGS bonds matured in July against only SGD3.8 billion of new issuance in July–September. Issuance of SGS bonds dropped 15.6% y-o-y and 26.9% q-o-q in 3Q11.

On the other hand, SGS bills outstanding have remained flat at SGD57.9 billion since January, with

**Table 1. Size and Composition of the LCY Bond Market in Singapore**

| | Amount (billion) | | | | | | | | Growth Rate (%) | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Jun-11 | | Jul-11 | | Aug-11 | | Sep-11 | | Jun-11 | | Jul-11 | Aug-11 | Sep-11 | | |
| | SGD | US$ | SGD | US$ | SGD | US$ | SGD | US$ | y-o-y | q-o-q | m-o-m | m-o-m | y-o-y | q-o-q | m-o-m |
| Total | 244.8 | 199.3 | 239.2 | 198.7 | 240.1 | 199.3 | 242.9 | 185.8 | 15.3 | 4.1 | (2.3) | 0.4 | 11.2 | (0.8) | 1.2 |
| Government | 138.5 | 112.7 | 133.9 | 111.2 | 133.9 | 111.2 | 135.5 | 103.6 | 8.1 | 3.9 | (3.3) | – | 5.8 | (2.2) | 1.2 |
| Bills | 57.9 | 47.1 | 57.9 | 48.1 | 57.9 | 48.1 | 57.9 | 44.3 | 9.0 | – | – | – | 6.2 | – | – |
| Bonds | 80.6 | 65.6 | 76.0 | 63.1 | 76.0 | 63.1 | 77.6 | 59.4 | 7.5 | 6.9 | (5.7) | – | 5.4 | (3.7) | 2.1 |
| Corporate | 106.3 | 86.5 | 105.3 | 87.5 | 106.2 | 88.2 | 107.4 | 82.2 | 26.3 | 4.3 | (0.9) | 0.8 | 18.8 | 1.0 | 1.2 |

– = data not available, LCY = local currency, m-o-m = month-on-month, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Government bonds are calculated using data from national sources. Corporate bonds are based on *AsianBondOnline* estimates.
2. Bloomberg LP end-of-period LCY–US$ rate is used.
3. Growth rates are calculated from LCY base and do not include currency effects.
Source: Monetary Authority of Singapore, Singapore Government Securities, and Bloomberg LP.

y-o-y growth slowing to 6.2% at end-September from 9.0% at end-June.

Meanwhile, outstanding LCY corporate bonds increased 18.8% y-o-y to SGD107.4 billion at end-September, down from the 26.3% y-o-y growth posted at end-June. On a q-o-q basis, outstanding LCY corporate bonds inched up 1.0% at end-September.

Notable issues in 3Q11 included the Housing and Development Board's SGD600 million 10-year bond in July, SGD400 million 3-year bond in August, and SGD625 million 5-year bond and SGD650 million 10-year bond in September. Also, Joynote issued SGD320 million worth of 7-year bonds and United Overseas Land sold SGD300 million worth of 3-year bonds.

The top 30 corporate issuers in Singapore are mainly from the financial and consumer sectors, and accounted for 46.9% of total corporate bonds outstanding at end-September **(Table 2)**. The Housing and Development Board remained the biggest issuer with SGD8.8 billion of outstanding bonds at the end of 3Q11, followed by CapitaLand and Temasek Financial I with outstanding amounts of SGD4.9 billion and SGD3.6 billion, respectively.

## Rating Changes

In August, Standard & Poor's (S&P) affirmed Singapore's AAA long-term and A-1+ short-term sovereign credit ratings, with a stable outlook for both **(Table 3)**.

## Policy, Institutional, and Regulatory Developments

### MAS Announces New Capital Requirements for Singaporean Banks

MAS released new capital rules for banks in Singapore that exceed the levels established under the Basel III agreement. Effective 1 January 2015, MAS will require Singapore-incorporated banks to have a minimum common equity Tier 1 capital adequacy ratio (CAR) of 6.5%, a Tier 1 CAR of 8.0%, and a total CAR of 10.0%. In addition, MAS will require Singapore-

**Table 2: Top 30 LCY Corporate Issuers in Singapore** (as of September 2011)

| Issuers | Outstanding Amount | | State-Owned | Privately-Owned | Listed Company | Type of Industry |
|---|---|---|---|---|---|---|
| | LCY Bonds (SGD billion) | LCY Bonds (US$ billion) | | | | |
| 1. Housing and Development Board | 8.8 | 6.7 | Yes | No | No | Financial |
| 2. Capitaland | 4.9 | 3.7 | No | Yes | Yes | Financial |
| 3. Temasek Financial I | 3.6 | 2.8 | No | Yes | No | Financial |
| 4. United Overseas Bank | 3.3 | 2.5 | No | Yes | Yes | Financial |
| 5. DBS Bank Singapore | 3.0 | 2.3 | No | Yes | Yes | Financial |
| 6. SP Power Assets | 2.5 | 1.9 | No | Yes | No | Utilities |
| 7. Land Transport Authority | 2.4 | 1.8 | Yes | No | No | Industrial |
| 8. Public Utilities Board | 2.1 | 1.6 | Yes | No | No | Utilities |
| 9. Oversea-Chinese Banking | 2.0 | 1.6 | No | Yes | Yes | Financial |
| 10. Singapore Airlines | 1.7 | 1.3 | No | Yes | Yes | Consumer |
| 11. F&N Treasury | 1.3 | 1.0 | No | Yes | No | Financial |
| 12. Keppel Land | 1.2 | 0.9 | No | Yes | Yes | Financial |
| 13. City Developments | 1.1 | 0.8 | No | Yes | Yes | Consumer |
| 14. Capitamall Trust | 1.0 | 0.8 | No | Yes | Yes | Financial |
| 15. PSA Corporation | 1.0 | 0.8 | No | Yes | No | Consumer |
| 16. Hyflux | 0.9 | 0.7 | No | Yes | Yes | Industrial |
| 17. Joynote Limited | 0.9 | 0.7 | No | Yes | No | Financial |
| 18. Singtel Group Treasury | 0.9 | 0.7 | No | Yes | No | Communications |
| 19. Overseas Union Enterprise | 0.8 | 0.6 | No | Yes | Yes | Consumer |
| 20. GLL IHT PTE | 0.8 | 0.6 | No | Yes | No | Financial |
| 21. Olam International | 0.8 | 0.6 | No | Yes | Yes | Consumer |
| 22. Mapletree Treasury Services | 0.7 | 0.6 | No | Yes | No | Financial |
| 23. Capitaland Treasury | 0.7 | 0.6 | No | Yes | No | Financial |
| 24. Sembcorp Financial Services | 0.7 | 0.5 | No | Yes | No | Industrial |
| 25. Singapore Press Holdings | 0.6 | 0.5 | No | Yes | Yes | Communications |
| 26. Neptune Orient Lines | 0.6 | 0.4 | No | Yes | Yes | Industrial |
| 27. Capitamalls Asia Treasury | 0.6 | 0.4 | No | Yes | No | Financial |
| 28. United Overseas Land | 0.6 | 0.4 | No | Yes | Yes | Financial |
| 29. Singapore Post | 0.5 | 0.4 | No | Yes | Yes | Industrial |
| 30. Keppel Corporation | 0.5 | 0.4 | No | Yes | Yes | Diversified |
| **Total Top 30 LCY Corporate Issuers** | **50.4** | **38.5** | | | | |
| **Total LCY Corporate Bonds Outstanding** | **107.4** | **82.2** | | | | |
| **Top 30 as % of Total LCY Corporate Bonds Outstanding** | **46.9%** | **46.9%** | | | | |

LCY = local currency.
Source: Bloomberg LP.

**Table 3: Selected Sovereign Ratings and Outlook for Singapore**

| | Moody's | S&P | Fitch |
|---|---|---|---|
| Sovereign FCY LT Ratings | Aaa | AAA | AAA |
| Outlook | Stable | Stable | Stable |

FCY = foreign currency, LT = long-term.
Source: Ratings agencies.

incorporated banks to meet the minimum capital adequacy requirements of Basel III by 1 January 2013, which is 2 years ahead of the Basel Committee's 2015 timeline. MAS plans to adopt Basel III's capital standards to improve the consistency, transparency, and quality of the capital base, and to strengthen the risk coverage of capital rules for banks.

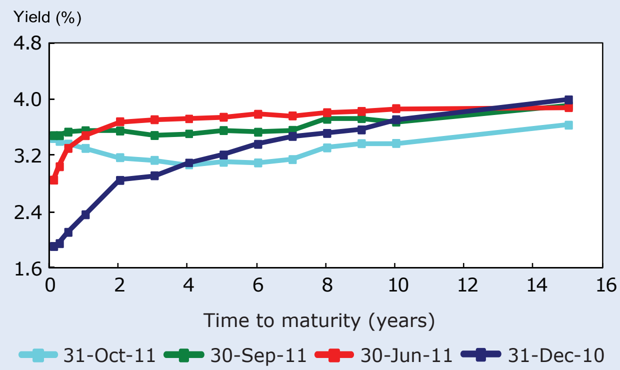
# Thailand—Update

## Yield Movements

Thailand's government bond yields fell for most tenors between end-June and end-September, and dropped for all tenors in October **(Figure 1)**. Yields for all tenors ranging from 2- to 10-years decreased in 3Q11, with the largest drop of 25 basis points (bps) for the 6-year tenor. In October the decline in yields was relatively large from the belly to the longer-end of the curve, with the 5-year tenor registering the largest decline at 45 bps.

Meanwhile, the yield spread between 2- and 10-year tenors narrowed by 6 bps between end-June and end-September, but widened by 8 bps in October.

**Figure 1: Thailand's Benchmark Yield Curve—LCY Government Bonds**




LCY = local currency.
Source: Bloomberg LP.

The Bank of Thailand's (BOT) Monetary Policy Committee decided on 19 October to hold the policy interest rate—the 1-day repurchase rate—steady at 3.5%. The decision was made on the back of expected inflationary pressures amid massive flooding in Thailand, which has dampened agricultural and manufacturing production, as well as uncertainty in the global economy that is expected to weaken export growth. In 3Q11 the BOT raised the policy interest rate by a total of 50 bps, including one 25 bps hike on 24 August and another on 13 July.

Consumer price inflation in Thailand stood at 4.2% year-on-year (y-o-y) in October, the highest level since June. Higher inflation in October was largely triggered by flood damage to farmlands and crops that resulted in a 9.9% y-o-y spike in food prices. Compared with the previous month, consumer prices climbed 0.2% in October.

The real gross domestic product (GDP) growth rate of Thailand rose to 3.5% y-o-y in 3Q11 from 2.7% in the previous quarter, as growth in exports and in private investment strengthened. The y-o-y growth rate for exports of goods increased to 27.3% in 3Q11 from 19.4% in 2Q11. Growth in private investment also climbed to 9.1% y-o-y in 3Q11 from 8.6% in 2Q11. On the supply side, the manufacturing sector expanded 3.1% y-o-y in 3Q11 following a 0.1% contraction in the previous quarter.

## Size and Composition

The local currency (LCY) bond market in Thailand had a total outstanding size of THB7.1 trillion (US$229 billion) at end-September, up 8.7% y-o-y and 4.8% from end-June **(Table 1)**. The y-o-y growth rate at end-September was also higher than the 6.2% y-o-y growth rate registered at end-June.

Total government bonds outstanding at end-September climbed 8.9% y-o-y and 6.5% from end-June to reach THB5.8 trillion. Government bonds and treasury bills, which accounted for 48.2% of total government bonds, expanded 8.2% y-o-y and 9.9% quarter-on-quarter (q-o-q) to reach THB2.8 trillion. BOT bonds outstanding, which comprised 43.5% of total government bonds, grew 12.7% y-o-y and 4.5% from end-June to level off at THB2.5 trillion. The outstanding bonds of state-owned enterprise and other

**Table 1: Size and Composition of the LCY Bond Market in Thailand**

| | **Amount** (billion) | | | | | | | | **Growth Rate** (%) | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Jun-11 | | Jul-11 | | Aug-11 | | Sep-11 | | Jun-11 | | Jul-11 | Aug-11 | Sep-11 | | |
| | THB | US$ | THB | US$ | THB | US$ | THB | US$ | y-o-y | q-o-q | m-o-m | m-o-m | y-o-y | q-o-q | m-o-m |
| Total | 6,820 | 222 | 6,870 | 231 | 6,903 | 231 | 7,149 | 229 | 6.2 | 0.3 | 0.7 | 0.5 | 8.7 | 4.8 | 3.6 |
| Government | 5,466 | 178 | 5,523 | 186 | 5,566 | 186 | 5,823 | 187 | 5.6 | 0.0 | 1.0 | 0.8 | 8.9 | 6.5 | 4.6 |
| Government Bonds and Treasury Bills | 2,557 | 83 | 2,625 | 88 | 2,630 | 88 | 2,809 | 90 | (0.4) | 0.9 | 2.7 | 0.2 | 8.2 | 9.9 | 6.8 |
| Central Bank Bonds | 2,427 | 79 | 2,414 | 81 | 2,462 | 82 | 2,535 | 81 | 15.7 | (0.9) | (0.5) | 2.0 | 12.7 | 4.5 | 3.0 |
| State-Owned Enterprise and Other Bonds | 482 | 16 | 484 | 16 | 474 | 16 | 479 | 15 | (6.1) | 0.0 | 0.4 | (2.2) | (4.8) | (0.8) | 1.1 |
| Corporate | 1,354 | 44 | 1,346 | 45 | 1,337 | 45 | 1,326 | 43 | 9.0 | 1.2 | (0.5) | (0.7) | 8.1 | (2.0) | (0.8) |

LCY = local currency, m-o-m = month-on-month, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Bloomberg end-of-period LCY–US$ rates are used.
3. Growth rates are calculated from LCY base and do not include currency effects.
Source: Bank of Thailand (BOT) and Bloomberg LP.

entities at end-September recorded declines of 4.8% y-o-y and 0.8% q-o-q.

LCY corporate bonds outstanding reached THB1.3 trillion at end-September, growing 8.1% y-o-y but falling 2.0% from end-June. New issuance of corporate bonds in 3Q11 is estimated to have fallen 22.8% y-o-y and 42.7% q-o-q. The two largest corporate bond issuances in 3Q11 were Glow Energy's 10-year bond worth THB5.6 billion with a coupon of 5.0% and Charoen Pokphand Food's 30-year bond worth THB4.0 billion at a 5.42% coupon.

The top 30 issuers of LCY corporate bonds in Thailand accounted for 70% of total LCY corporate bonds outstanding at end-September **(Table 2)**. PTT was the largest corporate issuer with total bonds outstanding of THB183.5 billion, followed by Siam Cement with THB110.0 billion. About one-third of the 30 largest issuers consisted of financial institutions, while 80% were publicly listed companies.

## Investor Profile

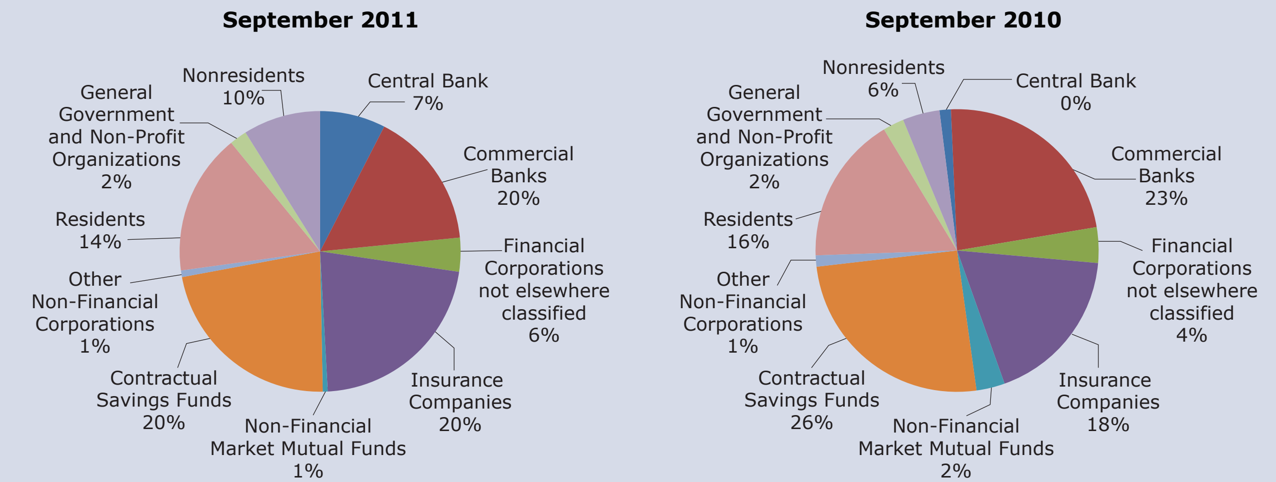
At end-September, contractual savings funds, commercial banks, and insurance companies were the three largest investor groups in LCY government bonds in Thailand, with each group accounting for 20% of the total **(Figure 2)**. Resident investors were the next largest holder with a share of 14%. Between September 2010 and September 2011, the shares of the central bank and foreign investors increased 7 and 4 percentage points, respectively. In contrast, the shares of all other investor groups dropped, with the largest decline being felt by contractual savings funds at 6 percentage points.

**Table 2: Top 30 Issuers of LCY Corporate Bonds in Thailand** (as of September 2011)

| Issuers | Outstanding Amount | | State-Owned | Privately-Owned | Listed Company | Type of Industry |
|---|---|---|---|---|---|---|
| | LCY Bonds (THB billion) | LCY Bonds (US$ billion) | | | | |
| 1. PTT Public Company | 183.5 | 5.9 | Yes | No | Yes | Energy |
| 2. Siam Cement Public Company | 110.0 | 3.5 | Yes | No | Yes | Diversified |
| 3. Krung Thai Bank | 55.4 | 1.8 | Yes | No | Yes | Financial |
| 4. PTT Exploration and Production Company | 49.0 | 1.6 | Yes | No | Yes | Energy |
| 5. Bank of Ayudhya | 41.5 | 1.3 | No | Yes | Yes | Financial |
| 6. PTT Chemical | 35.4 | 1.1 | Yes | No | Yes | Basic Materials |
| 7. Charoen Pokphand Foods | 33.9 | 1.1 | No | Yes | Yes | Consumer |
| 8. Thai Airways International | 31.3 | 1.0 | Yes | No | Yes | Consumer |
| 9. Thanachart Bank | 28.0 | 0.9 | No | Yes | No | Financial |
| 10. Kasikorn Bank | 25.1 | 0.8 | No | Yes | Yes | Financial |
| 11. DAD SPV Company LTD | 24.0 | 0.8 | Yes | No | No | Financial |
| 12. Ayudhya Capital Auto Lease | 22.3 | 0.7 | No | Yes | No | Financial |
| 13. Toyota Leasing Thailand | 21.9 | 0.7 | No | Yes | No | Consumer |
| 14. Banpu | 21.3 | 0.7 | No | Yes | Yes | Energy |
| 15. Thai Oil | 20.8 | 0.7 | Yes | No | Yes | Energy |
| 16. Glow Energy | 20.6 | 0.7 | No | Yes | Yes | Utilities |
| 17. Krung Thai Card | 20.1 | 0.6 | Yes | No | Yes | Financial |
| 18. Siam Commercial Bank | 20.0 | 0.6 | No | Yes | Yes | Financial |
| 19. Quality Houses | 18.0 | 0.6 | No | Yes | Yes | Consumer |
| 20. TMB Bank | 17.3 | 0.6 | No | Yes | Yes | Financial |
| 21. Bangkok Expressway | 17.1 | 0.5 | No | Yes | Yes | Consumer |
| 22. True Corporation | 16.1 | 0.5 | No | Yes | Yes | Communications |
| 23. Advanced Info Service | 15.5 | 0.5 | No | Yes | Yes | Communications |
| 24. Kiatnakin Bank | 15.4 | 0.5 | No | Yes | Yes | Financial |
| 25. Thanachart Capital | 13.5 | 0.4 | No | Yes | Yes | Financial |
| 26. Ratchaburi Electricity Generating | 13.3 | 0.4 | No | Yes | Yes | Utilities |
| 27. Mitr Phol Sugar Corporation | 12.9 | 0.4 | No | Yes | No | Consumer |
| 28. Italian-Thai Development Public Company | 12.4 | 0.4 | No | Yes | Yes | Industrial |
| 29. Minor International Public Company | 12.4 | 0.4 | No | Yes | Yes | Consumer |
| 30. Bangkok Mass Transit System | 12.0 | 0.4 | No | Yes | No | Industrial |
| **Total Top 30 LCY Corporate Issuers** | **939.9** | **30.1** | | | | |
| **Total LCY Corporate Bonds** | **1,336.9** | **42.9** | | | | |
| **Top 30 as % of Total LCY Corporate Bonds** | **70.3%** | **70.3%** | | | | |

LCY = local currency.
Source: Bloomberg LP.

**Figure 2: LCY Government Bonds Investor Profile**




LCY = local currency.
Source: Bank of Thailand.

# Policy, Institutional, and Regulatory Developments

## BOT and BOJ Collaborate to Provide Liquidity and Assist Flood-Affected Companies in Thailand

In October the BOT announced its collaboration with the Bank of Japan (BOJ) to set up a Thai baht lending facility, with Japanese government securities serving as collateral, in order to aid companies affected by the recent flooding. This facility will also expand the range of liquidity provisioning measures in Thailand to ensure financial stability amid slowing economic growth.

## BOT Revises 2011 Growth Outlook Downward

The BOT's Monetary Policy Committee revised its economic growth outlook for Thailand downward in October, lowering its GDP growth forecast for 2011 to 2.6% from an earlier forecast of 4.1% made in July. The BOT's revision came amid expectations of a weakening global economy—with greater downside risks to the United States (US) economy and the eurozone's sovereign debt problems—as well as disruptions to domestic agricultural and manufacturing production due to the massive flooding.

## BOT and 11 Commercial Banks Sign MOU for BOT Savings Bond Sale

In August the BOT and 11 commercial banks signed a memorandum of understanding (MOU) authorizing the commercial banks to sell 3- and 7-year BOT savings bonds worth THB50 billion between 26 August and 6 September. The savings bonds were issued to help ensure money market liquidity and provide an alternative investment vehicle for individuals, cooperatives, foundations, and nonprofit organizations.

## Ministry of Finance Adjusts Application Period for LCY Bond Issuance

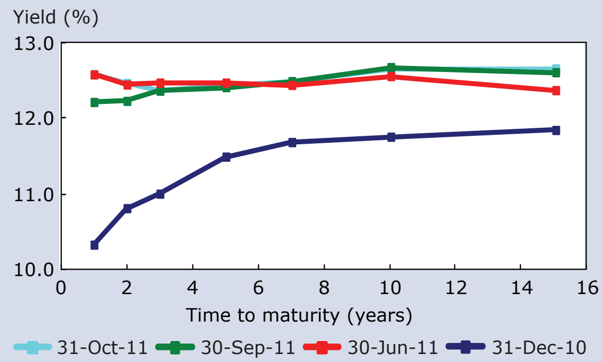
The Ministry of Finance announced in October that it has approved the adjustment of the application period for issuing LCY bonds in Thailand to three times in a year, covering the months of March, July, and November. The ministry also required that the applicant be able to issue within 9 months of the approval date for the bond issuance. The ministry stated that revisions to the application period would help facilitate and promote LCY bond issuance in Thailand.

# Viet Nam—Update

## Yield Movements

Between end-June and end-September government bond yields in Viet Nam fell at the short-end of the curve but rose at the long-end, after rising for all tenors in 1H11, resulting in a steeper curve. Yields fell the most for the 1-year tenor, dropping 36 basis points (bps), while yields for 2-, 3-, and 5-year tenors declined 22 bps, 10 bps, and 6 bps, respectively **(Figure 1)**. As a result, the yield spread between 2- and 10-year maturities widened to 44 bps at end-September from a spread of 11 bps at end-June. More recently, there was a significant rise at the short-end of the curve in October: 1- and 2-year tenors rose 37 bps and 24 bps, respectively, bringing them back to their end-June levels. This reflected the State Bank of Viet Nam's (SBV) move to hike its refinancing rate from 14.0% to 15.0%. Meanwhile, the SBV has been holding its base interest rate at 9.0% since December 2010 and maintaining its discount rate and reverse repurchase rate at 13.0% and 14.0%, respectively.

**Figure 1: Viet Nam's Benchmark Yield Curve—LCY Government Bonds**




LCY = local currency.
Source: Bloomberg LP.

Controlling inflation remained a top priority of the SBV in the second half of 2011. Consumer price inflation in October reached 21.6% year-on-year (y-o-y), the highest in emerging East Asia. However, the annual rise in consumer prices actually began slowing in September. Price increases in recent months have mainly been attributed to higher costs for food, education, and housing and construction materials.

The country's cumulative gross domestic product (GDP) in the first 9 months of the year was estimated to have grown 5.8% y-o-y, up slightly from the 5.6% y-o-y growth recorded in the first 6 months of the year. It was, however, down from the 6.5% y-o-y growth during the same period last year. In January–September, the agriculture, forestry, and fishery sector, which comprises 21.5% of GDP, grew 2.4% y-o-y; the industry and construction sector (40.7% of GDP) expanded 6.6% y-o-y; and the services sector (37.8% of GDP) grew 6.2% y-o-y.

## Size and Composition

Viet Nam's local currency (LCY) government and corporate bonds outstanding each posted double-digit annual growth rates at end-September. The bond market as a whole expanded 22.2% y-o-y and 1.8% quarter-on-quarter (q-o-q) to reach VND353 trillion (US$17 billion) at end-September **(Table 1)**.

Total LCY government bonds outstanding stood at VND321 trillion at end-September, representing growth of 21.1% y-o-y and 2.1% q-o-q. The quarterly increase in government bonds was mainly due to the net treasury bond issuance of VND15.7 trillion in 3Q11, which represented 12.0% q-o-q growth; however, this growth was offset by a 4.9% q-o-q drop in other government bonds (bonds issued by Viet Nam Development Bank and other state-owned enterprises) to VND175 trillion at end-September.

Total LCY corporate bonds outstanding expanded 34.7% y-o-y to VND32 trillion in 3Q11, but fell

**Table 1: Size and Composition of the LCY Bond Market in Viet Nam**

| | **Amount** (billion) | | | | | | | | **Growth Rate** (%) | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **Jun-11** | | **Jul-11** | | **Aug-11** | | **Sep-11** | | **Jun-11** | | **Jul-11** | **Aug-11** | **Sep-11** | | |
| | VND | US$ | VND | US$ | VND | US$ | VND | US$ | y-o-y | q-o-q | m-o-m | m-o-m | y-o-y | q-o-q | m-o-m |
| Total | 347,278 | 17 | 354,648 | 17 | 352,673 | 17 | 353,370 | 17 | 18.3 | 5.0 | 2.1 | (0.6) | 22.2 | 1.8 | 0.2 |
| Government | 314,479 | 15 | 322,160 | 16 | 320,285 | 15 | 321,112 | 15 | 17.9 | 6.2 | 2.4 | (0.6) | 21.1 | 2.1 | 0.3 |
| Treasury Bonds | 130,413 | 6 | 139,790 | 7 | 142,135 | 7 | 146,087 | 7 | 8.3 | 12.0 | 7.2 | 1.7 | 23.3 | 12.0 | 2.8 |
| Central Bank Bonds | – | – | – | – | – | – | – | – | – | – | – | – | – | – | – |
| Viet Nam Development Bank Bonds, State-Owned Enterprise Bonds, and Other Bonds | 184,067 | 9 | 182,370 | 9 | 178,150 | 9 | 175,025 | 8 | 26.0 | 2.5 | (0.9) | (2.3) | 19.3 | (4.9) | (1.8) |
| Corporate | 32,799 | 2 | 32,488 | 2 | 32,388 | 2 | 32,258 | 2 | 21.7 | (5.9) | (0.9) | (0.3) | 34.7 | (1.6) | (0.4) |

– = not applicable, LCY = local currency, m-o-m = month-on-month, q-o-q = quarter-on-quarter, y-o-y = year-on-year.

Notes:

1. Bloomberg LP end-of-period LCY–US$ rates are used.
2. Growth rates are calculated from LCY base and do not include currency effects.

Source: Bloomberg LP.

slightly by 1.6% on a quarterly basis as there was no new corporate bonds issuance in 3Q11.

The top 15 corporate issuers in Viet Nam are mainly commercial banks and real estate developers. Total bonds outstanding among the 15 largest issuers comprised 95.3% of all corporate bonds outstanding at end-September **(Table 2)**. Vietin Bank is the largest corporate issuer in the country with total bonds outstanding of VND7.1 trillion.

### Rating Changes

On 19 August Standard & Poor's lowered Viet Nam's LCY long-term sovereign credit rating from BB to BB– **(Table 3)**. The rating agency also affirmed its foreign currency (FCY) long-term and short-term sovereign credit ratings for Viet Nam at BB– and B, respectively. According to the rating agency, the LCY and FCY ratings are now similar because the Vietnamese dong's pegged exchange rate limits monetary policy independence and domestic financial and capital markets are in the early stages of development.

## Policy, Institutional, and Regulatory Developments

### SBV Issues Circular on Corporate Bond Purchases by Credit Institutions and Foreign Bank Branches

The SBV issued a circular enumerating the conditions required for credit institutions and branches of foreign banks to purchase corporate bonds. The circular notes that buyers of corporate bonds must be (i) commercial banks, (ii) finance companies, or (iii) foreign bank branches established under the Law on Credit Institutions. Furthermore, SBV specified that these institutions must (i) have licenses issued by SBV that cover the purchase of corporate bonds, (ii) meet SBV requirements on prudent operational ratios, and (iii) have an internal credit rating system of corporate bond issuers.

**Table 2: Top 15 LCY Corporate Issuers in Viet Nam** (as of September 2011)

| Issuers | Outstanding Amount | | State-Owned | Privately-Owned | Listed Company | Type of Industry |
|---|---|---|---|---|---|---|
| | LCY Bonds (VND billion) | LCY Bonds (US$ billion) | | | | |
| 1. Vietin Bank | 7,095 | 0.34 | No | Yes | Yes | Finance |
| 2. Asia Commercial Joint Stock Bank | 5,090 | 0.24 | No | Yes | Yes | Finance |
| 3. Vincom | 5,000 | 0.24 | No | Yes | Yes | Real Estate |
| 4. Vietnam Techcombank | 3,880 | 0.19 | No | Yes | No | Finance |
| 5. Agribank Securities | 2,000 | 0.10 | No | Yes | Yes | Finance |
| 6. Sacombank | 2,000 | 0.10 | No | Yes | Yes | Finance |
| 7. Vietnam Maritime Commercial Bank | 1,000 | 0.05 | No | Yes | No | Finance |
| 8. Minh Phu Seafood | 900 | 0.04 | No | Yes | No | Fisheries |
| 9. Hoa Phat Group | 800 | 0.04 | No | Yes | Yes | Industrial |
| 10. An Binh Bank | 600 | 0.03 | No | Yes | No | Finance |
| 11. HAGL | 530 | 0.03 | No | Yes | Yes | Real Estate |
| 12. Kinh Bac City Development | 500 | 0.02 | No | Yes | Yes | Real Estate |
| 13. Vinpearl | 500 | 0.02 | No | Yes | Yes | Resorts/Theme Parks |
| 14. HCMC General Import Export & Investment | 450 | 0.02 | No | Yes | Yes | Trade |
| 15. Vietnam Steel | 400 | 0.02 | No | Yes | No | Industrial |
| **Total Top 15 LCY Corporate Issuers** | **30,745** | **1.48** | | | | |
| **Total LCY Corporate Bonds** | **32,258** | **1.55** | | | | |
| **Top 15 as % of Total LCY Corporate Bonds Outstanding** | **95.3%** | **95.3%** | | | | |

LCY = local currency.
Source: Bloomberg LP.

**Table 3: Selected Sovereign Ratings and Outlook for Viet Nam**

| | Moody's | S&P | Fitch |
|---|---|---|---|
| Sovereign FCY LT Rating | B1 | BB– | B+ |
| Outlook | Negative | Negative | Stable |

FCY = foreign currency, LT = long-term.
Source: Rating agencies.

## Viet Nam Hikes FCY Reserve Requirement Ratios

On 29 August the SBV hiked the FCY reserve requirement ratios for state-owned commercial banks, joint stock commercial banks, joint venture banks, foreign bank branches, and wholly owned foreign banks. The reserve requirement ratio for FCY demand deposits and time deposits of less than 12 months was raised from 7.0% to 8.0%, while the ratio for FCY time deposits of more than 12 months was increased from 5.0% to 6.0%. For the Viet Nam Bank for Agriculture and Rural Development, the Central People's Credit Fund, and cooperative banks, the reserve requirement ratios for FCY demand deposits and time deposits of less than 12 months was raised from 6.0% to 7.0%, while the ratio for deposits with terms of more than 12 months was raised from 4.0% to 5.0%.

## SBV Issues Circular to Set Maximum LCY Mobilizing Interest Rates

On 28 September the SBV issued a circular to fix the maximum mobilizing interest rates at 6.0% per annum for demand and time deposits less than 1 month, and at 14.0% per annum for time deposits over 1 month. These rates are applicable to entities and individuals at credit institutions and foreign bank branches. The local People's Credit Funds were permitted an exemption and may apply a maximum LCY mobilizing rate of 14.5% per annum.

## SBV Hikes Refinancing Rate in October

The SBV raised its refinancing rate, one of its three policy rates, by 100 basis points to 15.0% effective 10 October 2011. The move was the fifth increase in the refinancing rate this year.

**Asia Bond Monitor**
November 2011

This publication reviews recent developments in East Asian local currency bond markets along with the outlook, risks, and policy options. It covers the 10 members of the Association of Southeast Asian Nations plus the People's Republic of China; Hong Kong, China; and the Republic of Korea.

It was prepared by the Asian Development Bank's Office of Regional Economic Integration, headed by Iwan J. Azis with Senior Director Ramesh Subramaniam. The production of the Asia Bond Monitor was led by Sabyasachi Mitra and John Stuermer with support from the ***AsianBondsOnline*** team (www.asianbondsonline.adb.org).

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