Asia Bond Monitor Highlights

ADB

Key Trends

- Local currency (LCY) bond yields rose in most economies in emerging East Asia between 31 August and 15 October on the back of continued interest rate hikes by the United States (US) Federal Reserve. The exceptions were the People's Republic of China (PRC) and Viet Nam, where 2-year and 10-year yields fell.
- In the PRC, the fall in yields followed reserve requirement ratio cuts by the central bank, with the latest coming on 7 October. In Viet Nam, yields fell amid improved interbank liquidity.
- The global outlook remains positive, particularly in the US. While economic growth has slowed somewhat in the euro area, the European Central Bank is on track to end monthly asset purchases after December.
- All equity markets in the region fell during the review period in line with the sell-off in US equity markets in October. The sharp rise in US Treasuries in early October, combined with other factors such as ongoing global trade tensions and the Federal Reserve's interest rate hikes, prompted the sell-off in equities in the US and across the region. Equity markets fell further a week later after the International Monetary Fund cut its growth forecasts for the PRC and the US due to their ongoing trade dispute.
- All emerging East Asian currencies depreciated during the review period except for the Hong Kong dollar and the Thai baht, which were relatively stable. A stronger US dollar, driven by robust US economic growth, continued to weigh on regional currencies. The recent slump in equity markets in October further weakened local currencies as foreign investors pulled out from the region.
- Credit default swap spreads in the region remained relatively stable as global risk aversion toward emerging markets receded somewhat. However, in most markets in the region, the sharp rise in US Treasury yields in early October resulted in an uptick in credit default swap spreads which have since remained elevated.
- Foreign holdings of LCY government bonds slightly fell across emerging East Asia in the third quarter of 2018, except in the PRC where the share of foreign holdings rose due to ongoing bond market liberalization; and slightly in the Philippines. However, the foreign holdings share of the PRC's LCY government bonds outstanding remained relatively small at around 5%.
- Emerging East Asia's LCY bond market expanded 4.3% q-o-q in the third quarter of 2018 to reach a size of USD12.8 trillion at the end September. The PRC continued to drive the region's bond market expansion.

Risks to the Bond Market

- Downside risks to emerging East Asian bond markets are increasing. One immediate concern is elevated risk aversion toward emerging markets, highlighted by the sharp depreciation of the Argentine peso and Turkish lira since the beginning of the year.
- The pace of US monetary policy normalization may occur more rapidly than what the markets expect. Faster-than-expected normalization cannot be discounted given the current strength of the US economy.
- Finally, while the global economy is growing at a healthy pace, escalating trade tensions could adversely affect the growth outlook.

AsianBondsOnline Annual Bond Market Liquidity Survey

- *AsianBondsOnline* conducts a survey once a year to assess liquidity conditions in the region's LCY bond market. This year's survey was conducted between the last week of September and the first 2 weeks of October.
- The overall assessment of market participants was that liquidity conditions were mixed. Stable to slightly worse liquidity conditions were noted in Indonesia, the Republic of Korea, Malaysia, and the Philippines. Better liquidity conditions were noted in the PRC; Hong Kong, China; Singapore; Thailand; and Viet Nam.
- Among qualitative indicators, the lack of well-functioning hedging mechanisms for both government and corporate bonds was identified as the most important common structural issue that requires attention from regional authorities.

Theme Chapter: Assessing the Impact of the Asian Bond Markets Initiative on Bond Market Development in Asia

- The theme chapter empirically examines the role of the Asian Bond Markets Initiative (ABMI) on bond markets in Asia. While the impact of ABMI on the region's bond markets is widely recognized, there have been very few empirical assessments. To assess the impact, the theme chapter analyzes and compares the bond market development paths of Asia and Latin America.
- After controlling for the major determinants of bond market development, the empirical results indicate that ABMI has significantly contributed to corporate bond market development in Asia by facilitating more issuance of corporate bonds. However, due to strict regulations on transactions in domestic currencies with and between nonresidents, most Asian economies are not yet able to borrow abroad in their respective domestic currency even though their LCY bond market has grown in size.