Emerging East Asia’s LCY bond market as a share of the region’s gross domestic product increased to 95.6% at the end of September from 91.6% at the end of June. The rising share of bonds outstanding to gross domestic product was due to regional governments’ increased financing needs to combat the adverse effect of the COVID-19 pandemic.

In Q3 2020, LCY bond issuance totaled USD2.2 trillion on growth of 6.4% q-o-q and 39.8% y-o-y. Growth was largely driven by government bonds, which rose 11.4% q-o-q and 51.8% y-o-y. On the other hand, issuance of corporate bonds marginally contracted by 0.6% on a q-o-q basis but was up 24.3% y-o-y.

The November issue of the Asia Bond Monitor includes four special discussion boxes. Three boxes analyze the impact of COVID-19 on the regional economy and its financial markets, and one box reviews the role of LCY bond financing amid exchange rate volatility. Also included in this issue is a special section on financing sustainable development, which presents four boxes on how sustainable finance can contribute to green and inclusive development in the post-COVID-19 era and a theme chapter on bank efficiency and bond market development.

This box examines the impact of COVID-19 on global financial markets and capital flow dynamics. Data show that the pandemic has had a big impact on sovereign bond yields in both advanced economies and emerging market economies (EMEs). The impact was more pronounced across financial markets in EMEs. Fiscal stimulus and monetary policy easing had a bigger effect on sovereign bond yields and stock prices in advanced economies, with spillover effects in EMEs. Despite capital outflows from EMEs in the initial stages of the pandemic, policy measures were effective in restoring confidence, which led to net inflows into EME equities and bond markets in Q3 2020. This points to the need for EMEs to strengthen policy measures to address financial market volatility and manage capital flows.

Box 2: The Effect of COVID-19 on Financial Stability in ASEAN

ASEAN’s relatively high level of globalization and financial openness suggests that COVID-19 will adversely affect the region’s economic growth and financial stability. The region suffered during the 1997/98 Asian financial crisis and, to a limited extent, during the 2007–2009 global financial crisis. In 2020, expansionary monetary policies and fiscal stimulus packages have contributed to the restoration of financial stability in ASEAN. In addition to domestic policy measures, regional financial safety nets such as the Chiang Mai Initiative Multilateralization and the ASEAN Disaster Risk Financing and Insurance scheme can also mitigate financial turbulence. Policy recommendations in the context of regional cooperation that can reduce the negative economic impact of the pandemic include (i) establishing an ASEAN task force on pandemics to facilitate the coordination and alignment of policy responses among member economies, (ii) building-up an ASEAN pandemic network to share information and knowledge on health care, and (iii) strengthening regional financial safety nets.

Box 3: Local Currency Bond Markets and Exchange Rate Risks

The 1997/98 Asian financial crisis underlined the importance of developing LCY bond markets to boost financial resilience. LCY bond markets mobilize private sector savings and channel them into long-term investments. They also mitigate currency and maturity mismatches on the balance sheets of public and private institutions. This discussion box shows that LCY bond markets serve as useful financing instruments in emerging markets during periods of exchange rate volatility by lowering possible exchange rate risk exposure among financing entities. The impact of COVID-19 has demonstrated the importance of developing deep and balanced LCY bond markets to boost financial sector resilience.

Box 4: The Duration of Recoveries from Economic Shocks Like COVID-19

It will take some time before the global economy recovers from the COVID-19 pandemic. Analysis of past economic downturns finds that it takes about 4 years for economic output and 3 years for employment to recover from such an impactful event. The severity of the recession, presence of a financial crisis, and depth of supply and demand shocks are all significant factors that affect the time to recovery. In addition, trade openness contributes to a faster recovery.

Special Section: Financing a Sustainable Recovery

Box 5: Environmental and Social Externalities and Economic Growth and Development

The 2016 Paris Agreement reflected the international community’s recognition of the disastrous effects of climate change and environmental destruction, and the global commitment to take action to achieve the United Nations Sustainable Development Goals. Rapid environmental pollution has been linked to climate change; hence, a virtuous or a vicious cycle can ensue between a country’s environmental state and its economic growth. Social development can also contribute to sustainable economic growth. Investment in areas such as education, sanitation, health care, gender equality, and affordable housing fosters social development, which in turn promotes economic development and inclusive growth that reaches vulnerable groups. Economy-level evidence points to a significant and positive impact of improved environmental, social, and governance policies on economic growth when adopting sustainable and socially responsible practices. The nexus between
environmental and social factors on one hand and economic growth on the other is the blueprint for sustainable development in the future.

Box 6: Development of Green and Social Finance in Developing Asia amid the COVID-19 Pandemic

The economies of Asia and the Pacific need to invest USD1.5 trillion annually from 2016 to 2030 to achieve the United Nations Sustainable Development Goals. The COVID-19 pandemic has heightened awareness of the need to support vulnerable groups and improve public health and sanitation. Amid declining tax revenue and increased spending to fight the pandemic, the public sector is facing greater constraints to financing such huge demands. Thus, the region needs to leverage and mobilize more resources from the private sector to finance investment and promote sustainable development that reduces poverty, benefits vulnerable groups, and decreases inequality. Around the world, a growing awareness of social finance has been observed in 2020, as evident in the rapid growth in social bond issuance and large-scale COVID-19 bond financing. Developing Asia is actively utilizing financial markets to finance social investments, with its social bond issuance ranked second among different regions of the world. Social and green finance will support environmentally sound and inclusive post–COVID-19 growth in developing Asia.

Box 7: Why Environmental and Social Externalities Matter for Financial Markets

This box reviews extant knowledge on why environmental and social externalities matter for the financial sector and investors. Practicing social responsibility provides social capital to hedge against systematic and idiosyncratic risks, and against environmental and social shocks as well as related regulatory risks. Delivering positive social and environmental impacts can also match stakeholder preferences and contribute to meeting funding needs.

Box 8: Economic Consequences of Green and Social Finance

Green and social finance mobilizes funding resources for investments with environmental and social impacts. Besides generating positive externalities, green and social finance also delivers economic benefits. This box reviews the economic benefits of green and social finance such as reduced financing costs, a broadened investor base, higher company valuations, and greater innovation. There is also evidence showing that a shift to green operation creates more jobs.

Theme Chapter: Bank Efficiency and Bond Markets—Evidence from Asia and the Pacific

The theme chapter investigates the link between bond market development and the profit and cost efficiencies of banks. The bond market is relevant for different aspects of banking sector operations. On the one hand, government bonds offer alternative risk-free assets for depositors and thus compete with bank deposits, while corporate bonds serve as an alternative direct financing instrument to bank loans for high-quality clients. On the other hand, government bonds serve as a liquidity management instrument to shorten the maturity profile of asset portfolios, while corporate bonds serve as a financing instrument that allow banks to tap longer-term funding. This study finds that banks consistently become more profit-efficient but less cost-efficient in economies with relatively more developed bond markets. Results also show that the structure of the bond market has an impact on bank efficiency. The study highlights the important role of well-functioning and balanced bond markets in financing economic development.

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1 Based on estimates of the United Nations Economic and Social Commission for Asia and the Pacific.
2 Developing Asia refers to the 36 developing member economies of the Asian Development Bank.