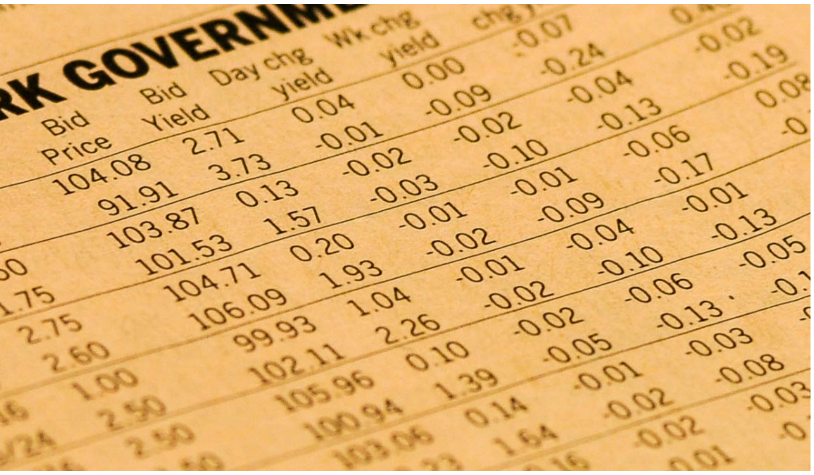

ASIA BOND MONITOR

SEPTEMBER 2016

ASIAN DEVELOPMENT BANK

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ASIA BOND MONITOR
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ADB recognizes "China" as the People's Republic of China; "Hong Kong" as Hong Kong, China; "Korea" as the Republic of Korea; "Vietnam" as Viet Nam; and "Hanoi" as Ha Noi.
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Highlights

Bond Market Outlook

Local currency (LCY) bond yields declined in most emerging East Asian economies between 1 June and 15 August.[1] The 2-year and 10-year yields fell in all emerging East Asian economies except in Thailand (2-year) and Viet Nam (10-year). The declines were driven by global investors seeking higher yields as well as the monetary easing measures being conducted by some central banks, which served to increase investor appetite for emerging market assets.

While the United Kingdom's (UK) decision to leave the European Union (EU) via a referendum held on 23 June temporarily led to rising volatility in global financial markets and affected emerging East Asia by causing currencies to depreciate and some yields to rise, markets have since recovered and the economic impact on emerging East Asia of what has come to be known as "Brexit" is likely to be muted. A special discussion box is included in this issue of the *Asia Bond Monitor* detailing the likely impacts of Brexit on the region (see Brexit—What Does It Mean for Asia?).

Stronger growth in emerging East Asia than in developed economies during the review period resulted in the appreciation of the region's currencies and rising equity markets. While the International Monetary Fund downgraded its 2016 global growth forecast in July to 3.1% from 3.2% in April, the Asian Development Bank is projecting developing Asia to grow 5.6% in 2016.[2]

During the review period, the Republic of Korea was the biggest gainer in terms of currency appreciation due to the won's safe-haven status and a one-notch ratings upgrade to AA by S&P Global Ratings in August, while Hong Kong, China's equity market was the biggest gainer on account of the planned linking of its stock exchange with the Shenzhen Stock Exchange.

Credit default swap markets around the world have also shrugged off the impact of the UK referendum, with spreads since falling in all markets except the UK and Greece.

While financial markets are calm, there are rising risks to emerging East Asia's bond markets. As the sole major developed economy to show growth, the likelihood of a policy rate hike in the United States could prompt capital outflows from the region. Furthermore, the full impact of Brexit has yet to be seen and if the UK's transition is marred by problems, volatility could return. Lastly, if negative interest rates in the EU and Japan continue, it will reduce monetary authorities' flexibility in the event of another major financial shock. Negative rates also reduce banking profitability and can exacerbate capital inflows to emerging markets. This issue of the *Asia Bond Monitor* includes a special discussion box on the impacts of negative interest rates (see Negative Interest Rates—What Are the Implications for Emerging Asia?).

Local Currency Bond Market Growth in Emerging East Asia

Emerging East Asia's LCY bond market reached a size of USD10,034 billion at the end of June, up 6.0% quarter-on-quarter (q-o-q) and 21.8% year-on-year (y-o-y). The PRC is still the region's largest LCY bond market in terms of absolute size at USD6,904 billion.

The region's LCY bond market is dominated by government bonds, which represented 63.3% of the total bond stock. Corporate bonds account for the remaining 36.7% share.

Emerging East Asia's total LCY bonds outstanding as a percentage of regional gross domestic product (GDP) climbed to 68.1% in the second quarter (Q2) of 2016 from 65.3% in the previous quarter, mainly driven by government bonds outstanding, which increased to the equivalent of 43.1% of GDP from 39.9%, offsetting the marginal decline in corporate bonds as a percentage of GDP. The Republic of Korea again led the region with bonds outstanding equal to 129.5% of GDP, followed

[1] Emerging East Asia comprises the People's Republic of China; Hong Kong, China; Indonesia; the Republic of Korea; Malaysia; the Philippines; Singapore; Thailand; and Viet Nam.
[2] Developing Asia comprises the 45 regional developing member economies of the Asian Development Bank.

by Malaysia at 98.1%. The two smallest markets in GDP terms were Indonesia and Viet Nam at 16.7% and 22.6%, respectively.

In Q2 2016, issuance of LCY bonds in emerging East Asia totaled USD1,323 billion, recording double-digit growth on both a q-o-q and y-o-y basis that was driven by robust bond issuance in the PRC. LCY bond sales in the PRC, which accounted for 67.6% of the regional total in Q2 2016, were buttressed by local government bond issues.

Structural Developments in Local Currency Bond Markets

Foreign investors continued to chase emerging East Asian LCY government bonds in Q2 2016 in a search for yield amid a low interest rate environment globally. Foreign holdings' share of the LCY government bond market was up at the end of June compared with the end of March in Indonesia, Malaysia, and Thailand. In contrast, the share of foreign holdings in the Republic of Korea's LCY government bond market slipped at the end of March compared with the end of December.

For corporate bonds, foreign holdings' shares generally remained weak in the two markets for which data are available. In Indonesia, the share of foreign holdings in the LCY corporate bond market continued its year-long decline at the end of June, while the share of foreign holdings remained insignificant in the Republic of Korea at the end of March.

Foreign capital flows into emerging East Asia's LCY bond market were generally strong in Q2 2016. Positive inflows were recorded in Indonesia, Malaysia, and Thailand, while the Republic of Korea experienced net bond outflows.

Local Currency Bond Yields

Yields of LCY government bonds fell in most emerging East Asian markets between 1 June and 15 August, with the yield curve shifting downward in most markets. This trend was a reflection of the weak global economic environment, particularly among the major advanced economies, and benign inflation that has led to a continuation of monetary easing policies in the EU and Japan. The persistence of low global yields has increased the attractiveness of emerging East Asian bonds, resulting in decreasing bond yields in the region.

With economic growth remaining subdued and inflation on the decline, the 2-year versus 10-year yield spread fell for all markets in emerging East Asia between 1 June and 15 August with the exception of Viet Nam.

Credit spreads between AAA-rated corporate bonds and government bonds fell for all tenors in the PRC and the Republic of Korea, and rose for all tenors in Malaysia. Meanwhile, lower-rated credit spreads narrowed in the PRC but widened in the Republic of Korea and in Malaysia.

Introduction: Emerging East Asian Bond Yields Decline

Local currency (LCY) bond yields generally declined in emerging East Asia between 1 June and 15 August.[3] Yields on 2-year and 10-year LCY government bonds were down for all emerging East Asian markets with the exception of Thailand's 2-year yield, which gained 2 basis points (bps), and Viet Nam's 10-year yield, which inched up 1 bp **(Table A)**. The fall in yields was fueled by expectations of new or additional monetary easing in some markets, including the People's Republic of China, Indonesia, the Republic of Korea, and Malaysia. Stronger foreign demand for the region's LCY bonds due to low global interest rates also contributed to the drop in yields, as did the subdued global economic outlook.

The United Kingdom's (UK) vote on 23 June on whether to remain in the European Union (EU) was a major shock to global financial stability. The unexpected result in favor of leaving the EU, which has come to be known as "Brexit," initially caused tremors in markets around the world before they quickly recovered and stabilized. The same pattern was evident in emerging East Asian markets where some currencies weakened in the immediate aftermath of the Brexit vote **(Figure A)**. The Brexit shock initially lifted the region's bond yields too, although bond markets have since remained calm. The overall impact of Brexit on emerging East Asia is likely to remain muted **(Box 1)**.

Due to safe-haven demand for dollar assets, yields in the United States (US) declined in the immediate aftermath of the Brexit vote before eventually rising again. However, bond yields were down overall in the US during the review period. Among several major advanced economies, the UK—somewhat paradoxically as the epicenter of Brexit—

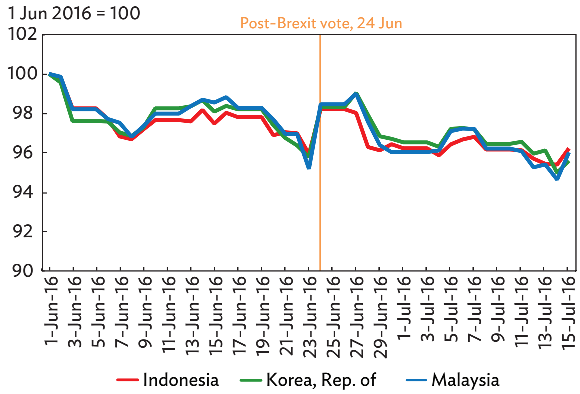
Table A: Changes in Global Financial Conditions

	2-Year Government Bond (bps)	10-Year Government Bond (bps)	5-Year Credit Default Swap Spread (bps)	Equity Index (%)	FX Rate (%)
Major Advanced Economies					
United States	(17)	(28)	–	4.3	–
United Kingdom	(27)	(84)	2	12.1	(10.7)
Japan	6	3	(2)	(2.8)	7.6
Germany	(10)	(21)	(2)	5.2	(0.04)
Emerging East Asia					
China, People's Rep. of	(16)	(34)	(23)	7.3	(0.9)
Hong Kong, China	(21)	(35)	–	10.5	0.2
Indonesia	(75)	(104)	(52)	9.9	4.2
Korea, Rep. of	(21)	(36)	(16)	3.4	7.7
Malaysia	(43)	(45)	(39)	3.9	3.5
Philippines	(44)	(114)	(24)	6.1	0.3
Singapore	(19)	(49)	–	2.7	2.5
Thailand	2	(27)	(34)	9.4	3.1
Viet Nam	(3)	1	(43)	6.4	0.6
Select European Markets					
Greece	(26)	80	43	(10.7)	(0.04)
Ireland	(5)	(43)	(5)	(6.1)	(0.04)
Italy	(4)	(39)	0.02	(4.6)	(0.04)
Portugal	(6)	(41)	(14)	(0.7)	(0.04)
Spain	(4)	(52)	(51)	(2.2)	(0.04)

( ) = negative, – = not available, bps = basis points, FX = foreign exchange.
Notes:
1. Data reflect changes between 1 June and 15 August 2016.
2. A positive (negative) value for the FX rate indicates the appreciation (depreciation) of the local currency against the US dollar.
Sources: *AsianBondsOnline*, Bloomberg LP, and Institute of International Finance.

[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.

Figure A: Local Currency vs. the US Dollar in Select Emerging East Asian Economies



US = United States.
Note: An increase (decrease) in the value means depreciation (appreciation) of the local currency against the US dollar.
Source: Based on data from Bloomberg LP.

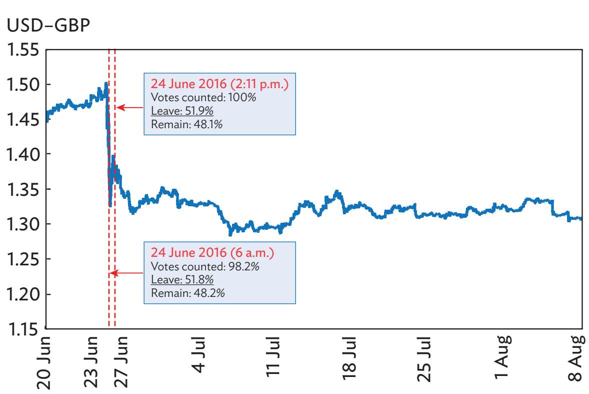
saw the largest drop in yields following stimulus measures launched by the Bank of England to calm market nerves. These measures included a 25 bps reduction in the bank rate and an expansion of the asset purchase program. Nevertheless, the effects of Brexit are still being felt, with the pound sterling down more than 10% against the US dollar between 1 June and 15 August. In other advanced economies, however, the markets see Brexit as having minimal impact.

The global economic outlook remains subdued and the world economy still awaits a robust turnaround. According to the International Monetary Fund's latest July forecasts, global output is projected to expand 3.1% in 2016 and 3.4% in 2017, both of which are down 0.1 percentage points from April forecasts. Among the advanced economies, where sluggish growth persists, the US

Box 1: Brexit—What Does It Mean for Asia?

The United Kingdom (UK) voted to leave the European Union (EU) on 23 June 2016. The "Brexit" vote was greeted with negative reactions in global financial markets. The pound sterling immediately fell against the US dollar to a level not seen since the mid-1980s and stock markets also declined **(Figure B1)**. However, the short-term damage from this unexpected outcome does not appear to be catastrophic. Critically, unlike with the global financial crisis, Brexit does not reflect a fundamental weakness in the global financial system.

Figure B1: Pound Sterling vs. the US Dollar



GBP = British pound, USD = United States dollar.
Note: All times are British Summer Time (GMT+1).
Source: Bloomberg LP.

Furthermore, the fact that the UK will remain inside the EU for at least 2 years will allow time for the UK to sort out its future relationships with the EU, which will ultimately determine the magnitude of the damage.

While Brexit has often been cited as a potential risk to global growth, the economic costs of Brexit are likely to be borne primarily by the UK. Many analysts are predicting that post-Brexit political and economic uncertainty will push the UK into recession. Estimates of the impact on gross domestic product (GDP) in 2016/17 typically range from −4.0% to −1.0%. Long-term impact estimates vary widely from a GDP contraction of 9.7% to a gain of 4.0%.

Brexit may also affect the EU to the extent that it recasts the dynamics of trade, investment, and financial sector relationships between the EU and UK. The effects on the EU's GDP growth are likely to be much smaller than the impact on the UK's. Exports to the UK accounted for only about 6.4% of the EU's total merchandise exports in 2015. According to the Bertelsmann Foundation, Brexit could lower the eurozone's GDP growth by between 0.01 and 0.03 percentage points per year. Following the referendum, Goldman Sachs reduced its average annual growth projection for the EU in 2016 and 2017 from 1.5% to 1.25%.

A more immediate concern for the EU are the implications of the vote for Europe's regional integration project. Calls

continued on next page

Box 1: Brexit—What Does It Mean for Asia? *continued*

for similar referendums in other markets are testing the EU's credibility and creating uncertainty in financial markets in Europe and beyond. As mentioned, global financial markets suffered a large correction in response to Brexit. The correction was partly an overreaction, especially since the outcome was an unexpected shock in light of growing market expectations. While markets stabilized after a few days, some international coordination for safeguarding global financial stability may be warranted.

The direct trade implications of Brexit for emerging Asia are expected to be small. The region's exports to the UK accounted for only about 2.0% of its total merchandise exports in 2015. Therefore, a slowdown in the UK is unlikely to significantly affect Asia via the trade channel. However, Brexit will affect free trade agreements between Asian economies and the EU since the composition of the EU's membership will change when the UK leaves. Currently, there are 16 Asia–EU free trade agreements at various stages of implementation.

There is a dearth of estimates of Brexit's impact on Asia's growth. Based on the Goldman Sachs estimates of Brexit's impact on the EU, the spillover effect in Asia is expected to generate an average annual decline in GDP of less than 0.1 percentage points in 2016 and 2017. On the other hand, Nomura slashed its Asia (ex-Japan and Australia) growth forecast for 2016 from 5.9% to 5.6% due to Brexit's expected impacts via the trade, financial, and confidence channels.

In addition to trade, financial spillovers such as capital flow reversals can adversely affect emerging Asia. If Brexit-induced uncertainties in global financial markets turn out to be large, it could destabilize the region's financial markets. Asia may then face capital flow and exchange rate volatility which, in turn, would adversely affect financial and economic stability. While Asian currencies fell on 24 June due to investors' flight to safety, the fall was not nearly as large as the plunge in the pound sterling. Furthermore, the region's markets recovered a few days later in tandem with global markets.

Overall, there is little cause for undue concern about the economic effects of Brexit on emerging Asia. The limited relative importance of the UK to the region as an export market means that the direct trade effects are limited. While financial spillovers pose a potential risk, their impact is likely to be limited. Nevertheless, Brexit is a timely reminder of the need for the region to maintain its resilience against external shocks through macroeconomic stability and structural reforms.

remains the sole bright spot. The prospects for emerging markets are mixed, with growth upgrades for Brazil and the Russian Federation, and downgrades for Nigeria and South Africa. Mirroring the sluggish world economy, global trade is projected to grow 2.7% in 2016 and 3.9% in 2017. Against the backdrop of a difficult global outlook, developing Asia continues to lead the world in growth.[4] According to the Asian Development Bank's July forecast, developing Asia will grow 5.6% in 2016 and 5.7% in 2017, while the People's Republic of China will grow a healthy 6.5% in 2016 and 6.3% in 2017 as it transitions to a more sustainable and balanced growth trajectory.

Overall, tepid global growth has pushed down bond yields in emerging East Asia, as has monetary easing in some markets. The benign inflation outlook has given central banks greater scope to support growth, though inflation may begin to pick up due to a rise in oil prices stemming from talks among oil-producing economies to freeze production to boost prices. However, this rise may be limited as the price increase will be supply-driven and oil inventories remain high. According to the Asian Development Bank's July forecasts, inflation in developing Asia will remain moderate at 2.8% in 2016 and 3.0% in 2017.

Notwithstanding that there is some scope for monetary easing, most emerging East Asian central banks adopted a wait-and-see attitude during the 1 June–15 August review period and kept their policy rates unchanged. A few pursued monetary expansion to help boost growth. Bank Indonesia further cut its benchmark interest rate by 25 bps in June, resulting in a cumulative 1 percentage point reduction year-to-date through 18 August.[5]

[4] Developing Asia comprises the 45 regional developing member economies of the Asian Development Bank.
[5] Bank Indonesia shifted its policy rate from the reference rate (6.50%) to the 7-day reverse repurchase rate (5.25%) effective 19 August.

The Bank of Korea (1.25%) in June and Bank Negara Malaysia (3.00%) in July lowered their key interest rates by 25 bps. All three central banks have indicated that there is still room for further easing.

Emerging East Asia's equity and currency markets recorded gains as well. Equity markets were up for all emerging East Asian markets during the review period. The biggest gainer was the stock market in Hong Kong, China, which was up 10.5% on plans to link it to Shenzhen's stock market. (The connection will allow investors on the Hong Kong Stock Exchange to trade stocks on the Shenzhen Stock Exchange, and vice versa, opening up both stock markets to new investors.) The Indonesian and Thai stock markets also posted strong growth, rising 9.9% and 9.4%, respectively. In Thailand, sentiment was boosted by the approval of a new constitution by voters in August, which restored a measure of political stability. A major positive for all of the region's markets was improving US economic data. In addition, all emerging East Asian currencies appreciated vis-à-vis the US dollar during the review period except for the Chinese renminbi, which fell 0.9%. The Korean won appreciated the most, climbing 7.7% due to its safe-haven status and its ratings upgrade by S&P Global Ratings to AA in August. The Indonesian rupiah and Malaysian ringgit rose 4.2% and 3.5%, respectively, buoyed by strong inflows into their bond markets.

Credit default swap (CDS) spreads across emerging East Asia rose during the week of the Brexit vote before subsequently falling, indicating Brexit's limited impact on the region to date **(Figure B)**. Rising CDS spreads the day after the Brexit vote were most evident in Indonesia and Malaysia among emerging East Asian economies. As expected, the immediate impact was more pronounced in Europe, where spreads significantly increased in Ireland, Italy, Portugal, and Spain. However, spreads trended downward by the end of June **(Figure C)**. Similar to the pattern observed for CDS spreads, the volatility index declined after the initial Brexit shock wore off; better US economic data also contributed to the decline **(Figure D)**. Given the immediate adverse impact on investment sentiment and rising uncertainty following Brexit, bond yields shot up temporarily in a number of other economies **(Figures E1, E2, and F)**.

Foreign holdings of LCY government bonds rose in major emerging East Asian markets during the review period. Indonesia and Malaysia continued to attract overseas funds into their LCY government bond markets. At the end of June, foreign investors were the largest sovereign bondholders in Indonesia and Malaysia with shares of 39.1% and 34.5%, respectively **(Figure G)**. This finding is consistent with the recent broader trend of increased demand for emerging market assets by foreign investors in search of higher returns.

The overall environment for emerging East Asian LCY bond markets remains benign, notwithstanding the Brexit shock. However, a number of downside risks loom on the horizon:

The prospect of an interest rate hike by the US Federal Reserve, which would prompt capital withdrawals from emerging markets, has reappeared as the effects of Brexit fade. Concerns about global financial stability in the wake of Brexit influenced the Federal Reserve's decision to keep rates steady. But now that a measure of stability has returned to global markets, the Federal Reserve will be guided primarily by domestic factors. However, there is still considerable uncertainty regarding the timing of the US rate hike. While Federal Reserve Chair Janet Yellen, during the annual Jackson Hole Summit on 26 August, strengthened the case for raising rates, the disappointing nonfarm payroll data in August (151,000 versus 275,000 in July), lowers the likelihood of a Federal Reserve rate hike.

Brexit is still unfolding and remains a significant source of uncertainty for global financial markets. The initial storm of market instability in the immediate aftermath of the 23 June vote has passed and a measure of calm has been restored. However, negotiations between the UK and the EU on the specific terms of the UK's exit have yet to start and are subject to a great deal of uncertainty. A disorderly and contentious exit is likely to rattle markets in Europe and elsewhere. The Brexit risk is magnified by legacy balance sheet problems that still plague the European banking system. In particular, Italian banks are saddled with a dangerous amount of nonperforming loans that are equivalent to almost one-fifth of its GDP. Europe's financial fragility is compounded by the weakness of the real economy, which has yet to find a firm footing since the global financial crisis.

Negative and low interest rates in advanced economies pose a risk to financial stability in emerging markets. While the world is currently fixated on the Federal

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

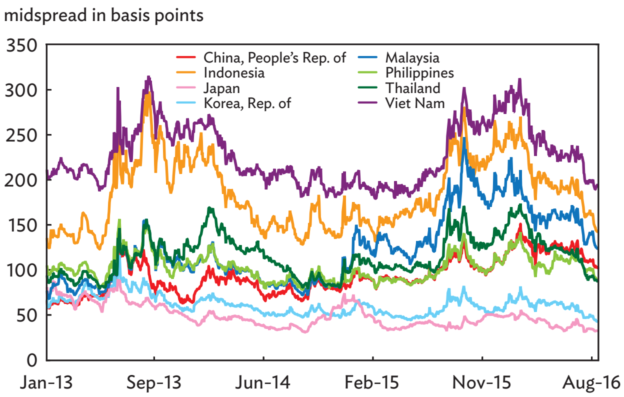


Figure C: Credit Default Swap Spreads for Select European Markets[a, b] (senior 5-year)

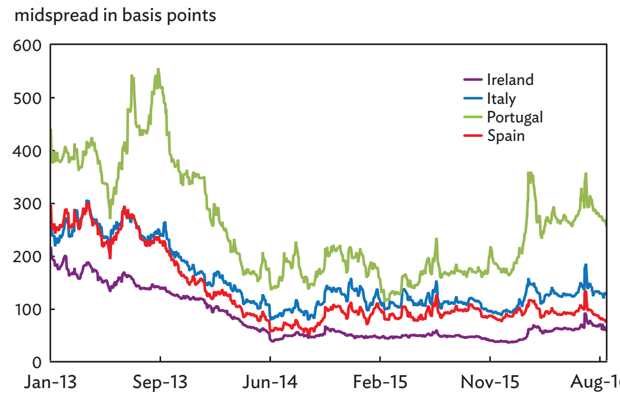


Figure D: United States Equity Volatility and Emerging Market Sovereign Bond Spreads[b] (% per annum)

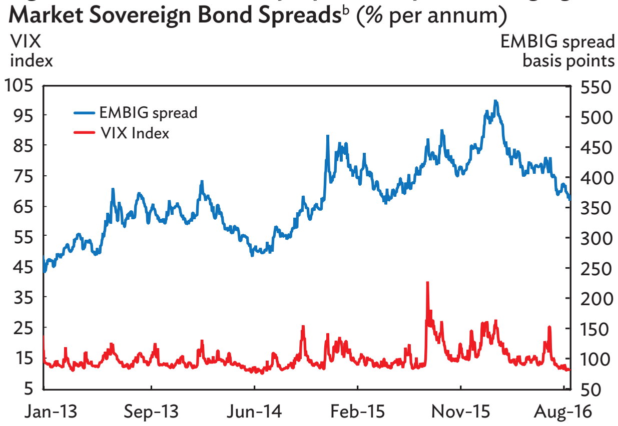


Figure E1: 10-Year Government Bond Yields[b] (% per annum)

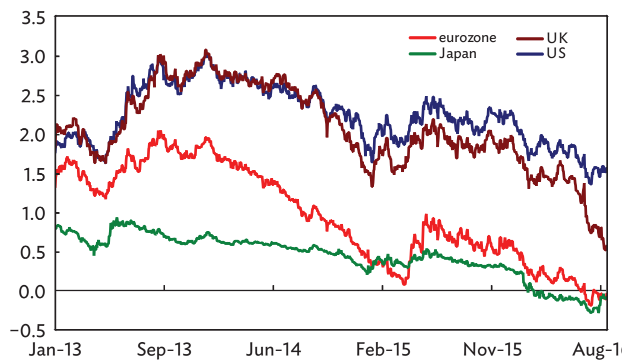


Figure E2: 10-Year Government Bond Yields[b] (% per annum)

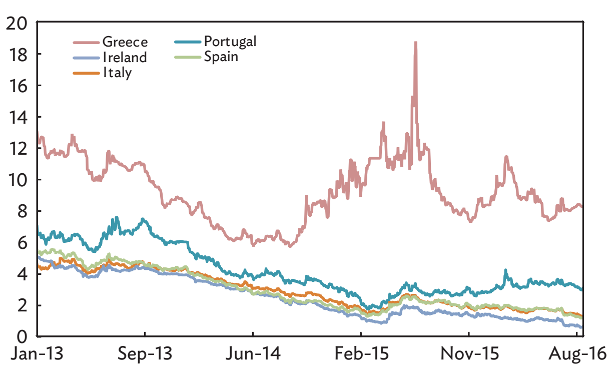
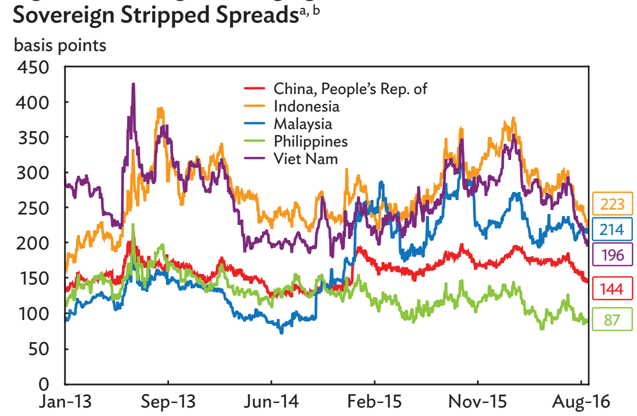


Figure F: JPMorgan Emerging Markets Bond Index Sovereign Stripped Spreads[a, b]



EMBIG = Emerging Markets Bond Index Global, UK = United Kingdom, US = United States, VIX = Chicago Board Options Exchange Volatility Index.

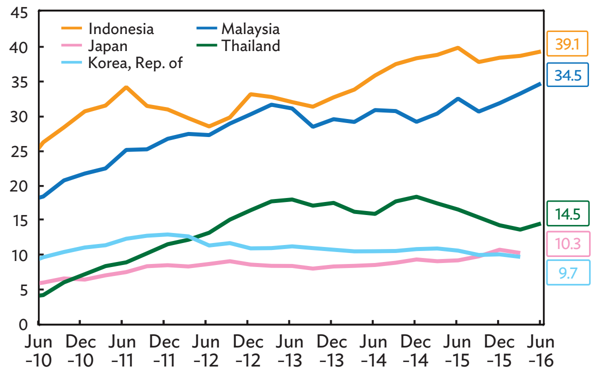
Notes:

[a] In United States dollar and based on sovereign bonds.

[b] Data as of 15 August 2016.

Sources: *AsianBondsOnline* and Bloomberg LP.

Figure G: Foreign Holdings of Local Currency Government Bonds in Select Asian Economies (% of total)



Note: Data as of end-June 2016 except for Japan and the Republic of Korea (end-March 2016).
Sources: *AsianBondsOnline*.

Reserve's interest rate hike decision, the exceptionally loose monetary policies pursued by central banks in advanced economies since the global financial crisis have encouraged potentially volatile capital flows into emerging markets. Some advanced economy central banks, including the European Central Bank and Bank of Japan, have set rates below zero. This has reduced room for additional monetary easing in these advanced economies should another shock occur. Furthermore, negative interest rates can impair the profitability of banks and the soundness of the banking sector as a whole, which may have spillover effects abroad. They can also affect emerging markets more directly, for example, by amplifying capital inflows **(Box 2)**.

Box 2: Negative Interest Rates—What Are the Implications for Emerging Asia?

Since Sweden experimented with the first negative interest rate policy (NIRP) in July 2009, a number of other advanced economies have followed suit. As of June 2016, these included Denmark, Hungary, and Switzerland; and most significantly, the eurozone and Japan. As a supplement to quantitative easing, NIRPs aim to raise inflation, and thus mitigate potentially harmful deflationary pressures, and revive investment and consumption via credit expansion. In the cases of Denmark and Switzerland, a major motivation for a NIRP was to stop rapid currency appreciation and stabilize exchange rates. In the short-term, NIRPs have lowered interest rates as intended, but inflation has not picked up as much as expected due to stagnant growth and anemic demand. A NIRP also partly mirrors the low return on capital in a low-growth economic environment.

Although a NIRP directly and immediately affects the banking system of the implementing economy, it can also influence emerging Asian markets through indirect channels. All other things being equal, a NIRP can have the following potential effects:

1) Capital flows and currency appreciation

Negative interest rates may encourage financial institutions in advanced economies to seek opportunities elsewhere. In light of the uncertain growth prospects of the advanced economies, relatively fast-growing emerging markets with solid fundamentals become tempting destinations for global investors. Many of those emerging markets are in developing Asia, a region comprising the 45 developing member economies of the Asian Development Bank, which forecasts growth in developing Asia to reach 5.6% in 2016 and 5.7% in 2017.

A NIRP complicates the global economic climate by increasing the volatility of capital flows in emerging markets. These capital flows are sensitive to uncertainty in the global economic environment (e.g., the prospect of a Federal Reserve rate hike being heightened by developments at the Jackson Hole Summit and subsequently lowered by the release of August nonfarm payroll data in the US, which came in below market expectations). As shown in **Figure B2.1**, during the early years of near-zero interest rates in the United States (US) in 2009–2011, capital inflows, particularly in the form of portfolio and other investment, surged in emerging Asia. Outflows became evident starting in mid-2014 when the prospect of a US interest rate hike increased. There is a risk that volatile capital flows in search of higher short-term returns can jeopardize the financial stability of emerging Asian markets, especially those that have more open capital accounts. A wide range of external shocks—including US interest rate normalization, a disorderly Brexit process, or heightened global risk aversion due to a great deal of uncertainty—can exacerbate such risk. Therefore, emerging market policy makers must closely monitor capital flows.

Low and negative interest rates also widen the interest rate gap between advanced markets and emerging Asian markets, which can typically lead to local currency appreciation.

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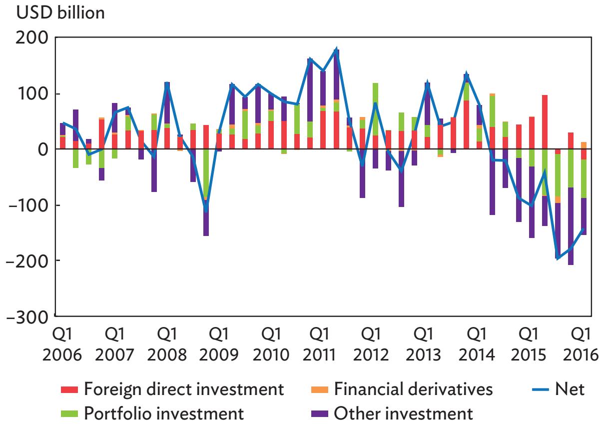
Box 2: Negative Interest Rates—What Are the Implications for Emerging Asia? *continued*

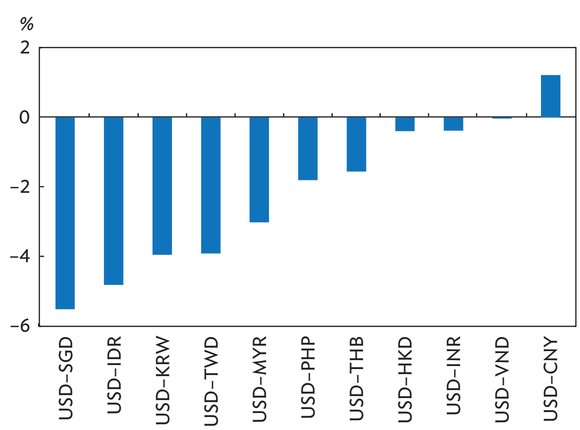
Figure B2.1: Net Capital Flows in Emerging Asia



Q1 = first quarter, USD = United States dollar.
Note: Emerging Asia consists of the People's Republic of China; Hong Kong, China; India; Indonesia; the Republic of Korea; Malaysia; the Philippines; Singapore; Taipei,China; Thailand; and Viet Nam.
Source: Haver Analytics.

During the first half of 2016, many major Asian currencies strengthened against the US dollar, albeit moderately **(Figure B2.2)**. A stronger currency hampers the growth of the region's export-oriented economies. It also contributes to deflationary pressures, which are evident in some countries and pose a risk to financial stability.

Figure B2.2: Appreciation (Depreciation) of US Dollar against Major Asian Currencies



CNY = Chinese yuan, HKD = Hong Kong dollar, IDR = Indonesian rupiah, INR = Indian rupee, KRW = Korean won, MYR = Malaysian ringgit, PHP = Philippine peso, SGD = Singapore dollar, THB = Thai baht, TWD = NT dollar, USD = United States dollar, VND = Vietnamese dong.
Note: A positive (negative) value indicates the appreciation (depreciation) of the US dollar against the local currency.
Source: *Wind Info*.

2) Low-interest rate contagion and low-yield bond markets

Negative and low interest rates in advanced economies give emerging Asian economies greater scope to cut their own interest rates against the backdrop of slowing growth and muted inflation. During the first half of 2016, several emerging Asian economies sequentially reduced their interest rates to spur growth and fend off deflationary pressures **(Table B2)**. As long as global monetary easing continues, including NIRPs in advanced economies, there is the chance of further interest rate cuts in emerging Asian markets. However, when a number of central banks pursue monetary expansion at the same time, its effectiveness can be compromised. For example, currency depreciation will not provide a competitive advantage when other currencies are also weakening vis-à-vis the US dollar.

Table B2: Interest Rate Cuts in Emerging Asian Markets

17 March 2016	Indonesia	Reference rate lowered from 7.00% to 6.75%
5 April 2016	India	Repo rate lowered from 6.75% to 6.50%
9 June 2016	Republic of Korea	7-day repo rate reduced from 1.50% to 1.25%
16 June 2016	Indonesia	Reference rate and 7-day repo rate lowered from 6.75% and 5.50% to 6.50% and 5.25%
30 June 2016	Taipei,China	Discount rate cut from 1.50% to 1.375%

Source: *AsianBondsOnline*.

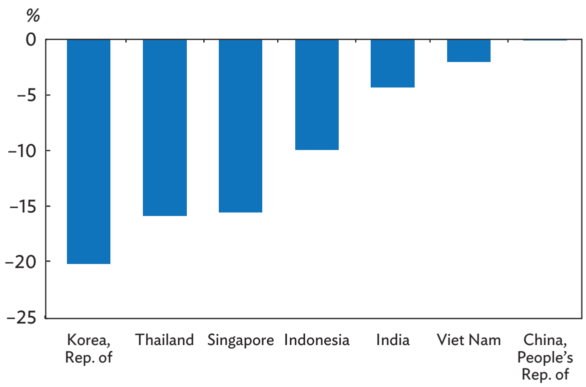
Financial markets also feel the effects of NIRPs, which have a significant impact on global asset allocation, especially with regard to debt vehicles. In global bond markets, yield curves generally shift downward and become flat, or even inverted as in the cases of Japan and the United Kingdom. Low long-term interest rates signal market expectations of a gradual economic recovery.

Negative yields on sovereign and corporate bonds increase the difficulty of maintaining long-term asset management products such as insurance products, corporate annuities, and pension funds. Such asset management products are typically mandated to invest a significant portion of their portfolios in debt instruments and hold them to maturity in order to receive stable coupon and principal payments. But negative interest rates make this trading strategy less profitable. As a result, some of their investments are reallocated to high-yield debt instruments in emerging markets, driving down yields in these markets. Indeed, major emerging Asian bond markets witnessed a drop in bond yields in the first half of 2016 **(Figure B2.3)**.

continued on next page

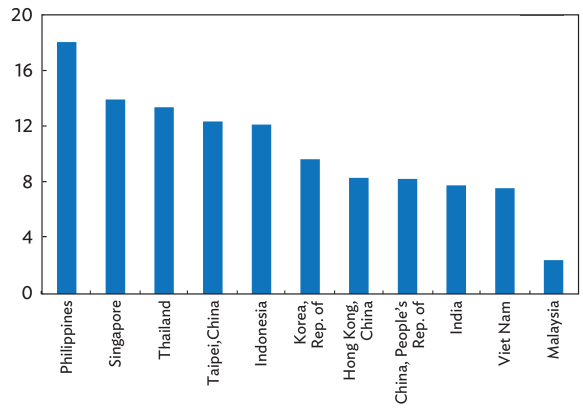
Box 2: Negative Interest Rates—What Are the Implications for Emerging Asia? *continued*

Figure B2.3: Changes in Month-End Yields-to-Maturity on 10-Year Sovereign Bonds in Major Emerging Asian Markets, January–June 2016



Source: *Wind Info*.

Figure B2.4: Price Changes in Month-End MSCI Equity Market Indices in Major Emerging Asian Markets, January–June 2016



MSCI = Morgan Stanley Capital International.
Source: *Wind Info*.

3) Booming financial markets and potential assets bubbles

In the climate of low global interest rates, asset prices will increase given lower discount rates on future cash flows. In fact, global real estate markets and commodity markets rose during the first half of the 2016. Higher valuations and the prospect of capital gains also attract more investment into stock markets. Major emerging Asian stock markets have surged during the first half of 2016 **(Figure B2.4)**.

Bond Market Developments in the Second Quarter of 2016

Size and Composition

Emerging East Asia's local currency bond market exceeded the USD10.0 trillion mark at the end of June.

The size of emerging East Asia's local currency (LCY) bond market climbed to USD10,034 billion at the end of June, up 6.0% quarter-on-quarter (q-o-q).[6] Growth in the second quarter (Q2) of 2016 accelerated from the 3.8% q-o-q hike posted in the first quarter (Q1) of 2016 **(Figure 1a)**. All individual emerging East Asian markets posted positive q-o-q growth during the review period, except for the Philippines where the bond market contracted.

In terms of contribution to the q-o-q expansion, growth in emerging East Asia's bond market was largely driven by gains in the People's Republic of China (PRC). Growth in the LCY bond markets of the Republic of Korea and Hong Kong, China also contributed to the q-o-q expansion.

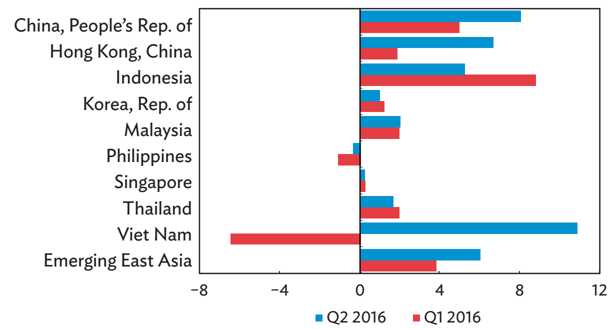
The PRC led the region with outstanding LCY bonds valued at USD6,904 billion at the end of June. Its share of emerging East Asia's total bond stock further increased to 68.8% in Q2 2016 from 68.0% in the previous quarter and 65.1% a year earlier. On a q-o-q basis, the PRC's LCY bond market posted 8.0% growth, driven by its government bond market, which recorded a 12.6% expansion in Q2 2016. On the other hand, the LCY corporate bond market contracted 0.6% q-o-q.

Growth in the PRC's LCY government bond market was largely due to increases in local government bonds as local government units continued to refinance existing debt and reduce borrowing costs by swapping debt for municipal bonds. Local governments also issued new bonds to help finance projects. The decline in LCY corporate bonds outstanding was mostly due to less issuance of commercial paper after several defaults and a scam that defrauded investors.

The Republic of Korea had the next largest amount of outstanding LCY bonds at USD1,792 billion at the end of June, which reflected a 1.0% q-o-q gain. Growth came largely from increases in Korean Treasury Bills and Korean Treasury Bonds. The stock of central bank bills was broadly unchanged and the stock of industrial finance debentures declined in Q2 2016. The corporate bond market, which accounts for a majority of the Republic of Korea's aggregate bond stock, grew marginally by 0.5% q-o-q in Q2 2016.

The LCY bond market in Thailand expanded to USD295 billion at the end of June, rising 1.6% q-o-q. Growth was largely driven by increases in the stock of government bonds, particularly central bank bonds and state-owned enterprise bonds. The increase in the stock of central bank bonds can be attributed to the Bank of Thailand's efforts to mop up liquidity to arrest the appreciation of the Thai baht. LCY corporate bonds also contributed to the q-o-q growth rate in Q2 2016.

Figure 1a: Growth of Local Currency Bond Markets in Q1 2016 and Q2 2016 (q-o-q, %)



q-o-q = quarter-on-quarter, Q1 = first quarter, Q2 = second quarter.
Notes:
1. Calculated using data from national sources.
2. Growth rates are calculated from local currency base and do not include currency effects.
3. Emerging East Asia growth figures are based on 30 June 2016 currency exchange rates and do not include currency effects.
4. For Singapore, corporate bonds outstanding data based on *AsianBondsOnline* estimates.

Sources: People's Republic of China (*ChinaBond* and *Wind Info*); Hong Kong, China (Hong Kong Monetary Authority); Indonesia (Bank Indonesia; Directorate General of Budget Financing and Risk Management, Ministry of Finance; 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); and Viet Nam (Bloomberg LP and Vietnam Bond Market Association).

[6] 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.

At the end of June, the LCY bond market in Malaysia reached USD289 billion on an expansion of 2.0% q-o-q. Much of this growth stemmed from an increase of 2.5% q-o-q in the government bond market that was led by Malaysian Government Securities and Government Investment Issues. The stock of central bank bills contracted during the quarter in review as Bank Negara Malaysia only resumed issuance of bills in June after its last issuance in October of last year. The corporate bond market segment also contributed to overall bond market growth, rising 1.4% q-o-q in Q2 2016.

Malaysia is home to the largest *sukuk* (Islamic bonds) market in emerging East Asia. It is also the only market in the region where *sukuk* account for a majority share of the LCY bond market at 54.6%. Among government bonds, 40.4% comprise *sukuk*, while the corporate bond market is dominated by *sukuk* with a 72.2% share.

In Singapore, the LCY bond market stood at USD233 billion at the end of June on marginal 0.2% q-o-q growth, the same pace as in the previous quarter. Growth stemmed solely from an increase in the stock of corporate bonds, which gained 2.0% q-o-q. On the other hand, the aggregate stock of Singapore Government Securities (SGS) bills and bonds declined as redemptions of maturing SGS bonds exceeded new issuance, while SGS bills recorded a marginal increase. The stock of Monetary Authority of Singapore bills slipped due to lower volume of issuance during the review period.

At the end of June, the outstanding size of LCY bonds in Hong Kong, China climbed to USD226 billion on strong 6.6% q-o-q growth. The government bond segment rose 5.8% q-o-q on account of increases in the stock of Exchange Fund Bills. LCY corporate bonds also increased during Q2 2016, expanding at a pace of 7.8% q-o-q as corporates took advantage of lower borrowing costs.

In Indonesia, the LCY bond market reached a size of USD152 billion at the end of June, posting growth of 5.2% q-o-q that stemmed largely from increases in the stock of central government bonds as the government awarded more than its targeted amount in 11 out of the 13 auctions held during the quarter. Following revisions to the 2016 revised state budget, the Government of Indonesia is now looking at funding a wider budget deficit estimated at IDR296.7 trillion, or the equivalent of 2.35% of gross domestic product (GDP), from the original estimate of IDR273.2 trillion, or the equivalent of 2.15% of GDP. While the deficit is expected to be funded by increased collections resulting from the Tax Amnesty Law, the government will still need to issue more bonds to help finance the deficit. Central bank bills, known as *Sertifikat* Bank Indonesia, and corporate bonds also posted increases during the review period.

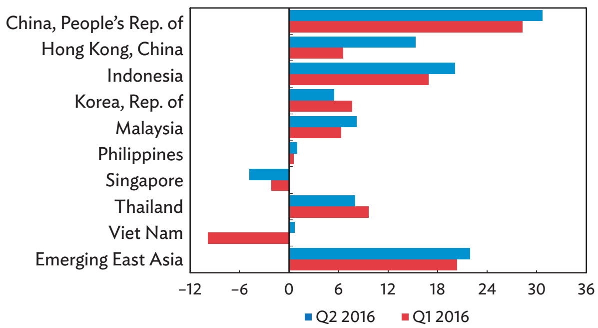
The only LCY bond market that contracted in Q2 2016 was that of the Philippines as the total bond stock fell to USD99 billion at the end of June on a 0.4% q-o-q decline. The drop was due to decreases in the stock of Treasury bonds and corporate bonds amid a lower volume of new issuance. On the other hand, the stock of Treasury bills rose while the stock of other government bonds, comprising the bonds of government agencies and corporations, was unchanged in Q2 2016.

Viet Nam's LCY bonds outstanding of USD43 billion at the end of June represented the smallest market in the region. However, its 10.8% q-o-q growth was the fastest in emerging East Asia in Q2 2016 even if this growth rate was impacted by a low base effect. The gains were led by increases in the stock of government bonds, particularly Treasury bonds and central bank bills. The corporate bond segment also contributed to the growth, supported by new debt issuance from three corporate firms. The stock of state-owned enterprise bonds contracted during the review period.

On a year-on-year (y-o-y) basis, overall growth in emerging East Asia's LCY bond market accelerated to 21.8% in Q2 2016 from 20.3% y-o-y in the previous quarter **(Figure 1b)**. The fastest-growing bond markets in the region were those of the PRC; Indonesia; and Hong Kong, China; all of which posted double-digit y-o-y growth in Q2 2016. All other markets in the region recorded y-o-y growth rates of between 5.4% and 8.2% during the review period with the exception of the Philippines and Viet Nam, which each had growth rates of less than 1.0% y-o-y, and Singapore, whose LCY bond market contracted 4.9% y-o-y.

Government bonds continued to dominate emerging East Asia's LCY bond market, further increasing their share to 63.3% of the region's total bond stock at the end of June, up more than 2 percentage points from a 61.2% share at the end of March **(Table 1)**. The outstanding

Figure 1b: Growth of Local Currency Bond Markets in Q1 2016 and Q2 2016 (y-o-y, %)



Q1 = first quarter, Q2 = second quarter, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Growth rates are calculated from local currency base and do not include currency effects.
3. Emerging East Asia growth figures are based on 30 June 2016 currency exchange rates and do not include currency effects.
4. For Singapore, corporate bonds outstanding data based on *AsianBondsOnline* estimates.

Sources: People's Republic of China (*ChinaBond* and *Wind Info*); Hong Kong, China (Hong Kong Monetary Authority); Indonesia (Bank Indonesia; Directorate General of Budget Financing and Risk Management, Ministry of Finance; 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); and Viet Nam (Bloomberg LP and Vietnam Bond Market Association).

size of government bonds in the region reached USD6,347 billion, up 9.7% q-o-q and 29.3% y-o-y in Q2 2016.

The PRC's government bond market, the largest in the region at a size of USD4,706 billion, accounted for 74.1% of emerging East Asia's LCY government bond total at the end of June. The Republic of Korea followed with an LCY government bond market valued at USD741 billion. Next was Thailand at USD220 billion. All other LCY government bond markets in the region were valued at between USD131 billion and USD160 billion at the end of June. The only exceptions were the Philippines and Viet Nam whose LCY government bonds outstanding were less than USD100 billion.

The region's LCY corporate bond market totaled USD3,687 billion at the end of June on growth of 0.2% q-o-q and 10.8% y-o-y. The PRC also has the largest LCY corporate bond market in the region with outstanding bonds of USD2,198 billion at the end of June, accounting for nearly 60% of the region's total. The Republic of Korea's corporate bond stock of USD1,051 billion was the next largest at the end of June, representing a 28.5% share of the region's total. It is the only market to have a larger share of corporate bonds than government bonds in its total bond stock.

As a share of GDP, the size of emerging East Asia's LCY bond market stood at the equivalent of 68.1% at the end of June, up from 65.3% at the end of March **(Table 2)**. The increase was driven mainly by government bonds, which climbed to the equivalent of 43.1% of GDP in Q2 2016 from 39.9% in the previous quarter, while corporate bonds fell to 25.0% in Q2 2016 from 25.3% in Q1 2016. The Republic of Korea's LCY bond market led the region in terms of size relative to GDP at 129.5%. Malaysia was the next largest at 98.1%. In contrast, Indonesia (16.7%) and Viet Nam (22.6%) had the smallest LCY bond markets when measured as a percentage of GDP.

Emerging East Asia's LCY government bonds continued to attract foreign interest.

Foreign investors have turned to emerging market assets amid a relatively low interest rate environment in global financial markets. As monetary policies remain accommodative in most developed economies, foreign funds' search for yield has resulted in increased demand for emerging East Asia's LCY government bonds.

The share of LCY government bonds outstanding held by foreign investors climbed in most emerging East Asian markets for which data are available. At the end of June, foreign investor holdings of government bonds had risen on a q-o-q basis in Indonesia, Malaysia, and Thailand **(Figure 2)**. Malaysia saw the largest increase as its share of foreign holdings rose 1.5 percentage points to 34.5% at the end of June.

In Indonesia, foreign investors continued to shore up their holdings of IDR-denominated government bonds, further increasing their share of the market to 39.1% at the end of June. Indonesia's foreign holdings' share is the largest among all of the region's LCY government bond markets. Foreign funds continue to invest in Indonesian government bonds as its yields are among the highest in emerging East Asia.

In both Indonesia and Malaysia, foreign investors were the largest investor group in Q2 2016. Capital inflows into these bond markets also supported the recovery of their respective currencies vis-à-vis the US dollar.

Table 1: Size and Composition of Local Currency Bond Markets

	Q2 2015		Q1 2016		Q2 2016		Growth Rate (LCY-base %)				Growth Rate (USD-base %)			
							Q2 2015		Q2 2016		Q2 2015		Q2 2016	
	Amount (USD billion)	% share	Amount (USD billion)	% share	Amount (USD billion)	% share	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														
Total	5,666	100.0	6,583	100.0	6,904	100.0	6.0	15.4	8.0	30.6	6.0	15.4	4.9	21.8
Government	3,603	63.6	4,306	65.4	4,706	68.2	6.9	13.9	12.6	40.0	6.9	13.9	9.3	30.6
Corporate	2,063	36.4	2,277	34.6	2,198	31.8	4.4	18.1	(0.6)	14.2	4.4	18.1	(3.5)	6.5
Hong Kong, China														
Total	196	100.0	212	100.0	226	100.0	(1.5)	2.0	6.6	15.2	(1.4)	2.0	6.6	15.1
Government	109	55.5	123	58.2	131	57.7	(1.3)	(0.4)	5.8	19.8	(1.3)	(0.4)	5.8	19.7
Corporate	87	44.5	89	41.8	96	42.3	(1.6)	5.1	7.8	9.6	(1.6)	5.1	7.8	9.5
Indonesia														
Total	125	100.0	144	100.0	152	100.0	2.4	13.8	5.2	20.1	0.4	1.3	5.5	21.2
Government	107	85.7	125	86.7	131	86.5	2.0	14.5	5.0	21.3	(0.1)	1.9	5.3	22.4
Corporate	18	14.3	19	13.3	20	13.5	5.0	9.9	6.4	13.0	2.9	(2.1)	6.6	14.1
Korea, Rep. of														
Total	1,756	100.0	1,788	100.0	1,792	100.0	3.1	10.0	1.0	5.4	2.5	(0.2)	0.2	2.1
Government	722	41.1	734	41.1	741	41.3	2.0	15.0	1.6	5.9	1.5	4.3	0.9	2.5
Corporate	1,033	58.9	1,054	58.9	1,051	58.7	3.8	6.8	0.5	5.1	3.3	(3.1)	(0.2)	1.7
Malaysia														
Total	285	100.0	293	100.0	289	100.0	0.2	2.1	2.0	8.2	(1.6)	(13.1)	(1.3)	1.3
Government	161	56.5	161	55.1	160	55.4	(0.7)	(0.6)	2.5	5.9	(2.5)	(15.4)	(0.8)	(0.8)
Corporate	124	43.5	131	44.9	129	44.6	1.4	6.0	1.4	11.0	(0.5)	(9.8)	(1.9)	4.0
Philippines														
Total	103	100.0	102	100.0	99	100.0	(0.8)	3.3	(0.4)	0.9	(1.7)	(0.03)	(2.9)	(3.5)
Government	86	83.9	85	82.7	82	82.8	(0.5)	2.0	(0.3)	(0.4)	(1.4)	(1.3)	(2.9)	(4.8)
Corporate	17	16.1	18	17.3	17	17.2	(2.0)	10.5	(0.6)	7.9	(2.9)	6.9	(3.1)	3.2
Singapore														
Total	245	100.0	233	100.0	233	100.0	3.0	5.5	0.2	(4.9)	4.9	(2.4)	0.3	(4.8)
Government	147	59.8	136	58.6	135	57.8	2.8	4.2	(1.1)	(8.0)	4.7	(3.6)	(1.0)	(7.9)
Corporate	99	40.2	96	41.4	98	42.2	3.4	7.4	2.0	(0.3)	5.4	(0.6)	2.1	(0.3)
Thailand														
Total	284	100.0	291	100.0	295	100.0	3.1	4.6	1.6	8.0	(0.7)	0.4	1.6	3.9
Government	216	76.0	217	74.5	220	74.4	3.1	4.2	1.5	5.8	(0.7)	(0.04)	1.5	1.8
Corporate	68	24.0	74	25.5	75	25.6	3.2	6.2	2.0	14.9	(0.6)	1.9	2.0	10.6
Viet Nam														
Total	44	100.0	39	100.0	43	100.0	(0.8)	7.1	10.8	0.7	(2.0)	4.6	10.8	(1.4)
Government	43	97.5	38	95.8	42	95.9	(1.7)	6.3	11.0	(0.9)	(2.9)	3.8	10.9	(3.0)
Corporate	1	2.5	2	4.2	2	4.1	52.7	48.9	8.0	62.4	50.8	45.5	8.0	59.0
Emerging East Asia														
Total	8,705	100.0	9,684	100.0	10,034	100.0	4.6	12.5	6.0	21.8	4.4	8.9	3.6	15.3
Government	5,195	59.7	5,925	61.2	6,347	63.3	5.2	12.1	9.7	29.3	4.8	9.2	7.1	22.2
Corporate	3,510	40.3	3,760	38.8	3,687	36.7	3.9	13.0	0.2	10.8	3.6	8.5	(1.9)	5.0
Japan														
Total	8,877	100.0	9,841	100.0	10,812	100.0	0.6	2.3	0.7	2.6	(1.4)	(15.4)	9.9	21.8
Government	8,224	92.6	9,148	93.0	10,062	93.1	0.7	2.6	0.8	3.1	(1.2)	(15.1)	10.0	22.4
Corporate	653	7.4	693	7.0	749	6.9	(1.2)	(2.2)	(0.9)	(3.3)	(3.1)	(19.1)	8.1	14.8

( ) = negative, LCY = local currency, q-o-q = quarter-on-quarter, Q1 = first quarter, Q2 = second quarter, USD = United States dollar, y-o-y = year-on-year.

Notes:

1. For Singapore, corporate bonds outstanding data based on *AsianBondsOnline* estimates.
2. Corporate bonds include issues by financial institutions.
3. Bloomberg LP end-of-period LCY—USD rates are used.
4. For LCY base, emerging East Asia growth figures based on 30 June 2016 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.

Sources: People's Republic of China (*ChinaBond* and *Wind Info*); Hong Kong, China (Hong Kong Monetary Authority); Indonesia (Bank Indonesia; Directorate General of Budget Financing and Risk Management, Ministry of Finance; 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 Vietnam Bond Market Association); and Japan (Japan Securities Dealers Association).

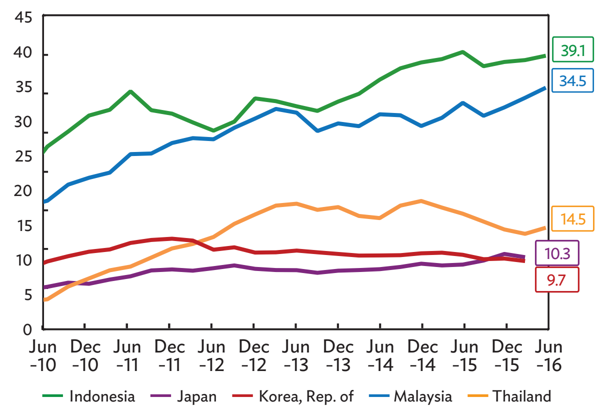
Table 2: Size and Composition of Local Currency Bond Markets (% of GDP)

	Q2 2015	Q1 2016	Q2 2016
China, People's Rep. of			
Total	52.9	61.0	64.8
Government	33.6	39.9	44.2
Corporate	19.3	21.1	20.6
Hong Kong, China			
Total	65.2	68.2	72.0
Government	36.2	39.6	41.6
Corporate	29.0	28.5	30.5
Indonesia			
Total	15.1	16.2	16.7
Government	12.9	14.0	14.5
Corporate	2.2	2.2	2.3
Korea, Rep. of			
Total	128.9	129.8	129.5
Government	53.0	53.3	53.5
Corporate	75.9	76.5	76.0
Malaysia			
Total	95.3	97.4	98.1
Government	53.8	53.7	54.3
Corporate	41.4	43.8	43.8
Philippines			
Total	35.8	34.8	33.9
Government	30.0	28.8	28.1
Corporate	5.8	6.0	5.8
Singapore			
Total	83.0	78.0	78.3
Government	49.6	45.7	45.3
Corporate	33.4	32.3	33.0
Thailand			
Total	72.2	74.7	75.0
Government	54.8	55.7	55.8
Corporate	17.3	19.0	19.2
Viet Nam			
Total	23.8	20.7	22.6
Government	23.2	19.8	21.7
Corporate	0.6	0.9	0.9
Emerging East Asia			
Total	59.3	65.3	68.1
Government	35.4	39.9	43.1
Corporate	23.9	25.3	25.0
Japan			
Total	220.9	221.3	222.2
Government	204.7	205.7	206.8
Corporate	16.3	15.6	15.4

GDP = gross domestic product, Q1 = first quarter, Q2 = second quarter.
Notes:
1. Data for GDP are from CEIC.
2. For Singapore, corporate bonds outstanding data based on *AsianBondsOnline* estimates.

Sources: People's Republic of China (*ChinaBond* and *Wind Info*); Hong Kong, China (Hong Kong Monetary Authority); Indonesia (Bank Indonesia; Directorate General of Budget Financing and Risk Management, Ministry of Finance; 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 Vietnam Bond Market Association); and Japan (Japan Securities Dealers Association).

Figure 2: Foreign Holdings of Local Currency Government Bonds in Select Asian Economies (% of total)



LCY = local currency.
Note: Data as of end-June 2016 except for Japan and the Republic of Korea (end-March 2016).
Source: *AsianBondsOnline*.

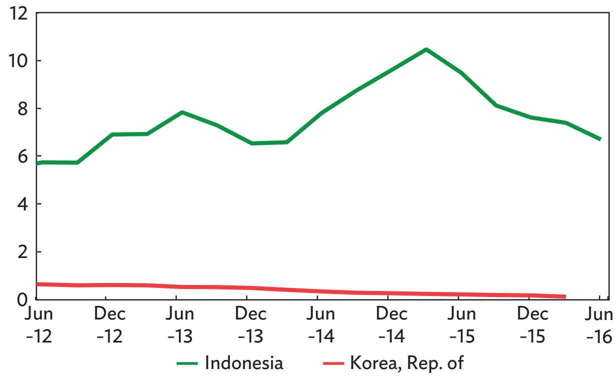
In Thailand, foreign holdings' share of the LCY government bond market climbed nearly 1 percentage point to 14.5% in Q2 2016. In contrast, foreign investors' holdings of LCY government bonds in the Republic of Korea slipped to a share of 9.7% at the end of March, the most recent quarter for which data are available, from a 10.1% share at the end of December.

Foreign investor interest in Indonesian LCY corporate bonds continued to moderate in Q2 2016. The share of foreign holdings in the Indonesian LCY corporate bond market has steadily declined since March 2015, falling to 6.7% at the end of June from 7.4% at the end of March **(Figure 3)**. In the Republic of Korea, where the LCY bond market is dominated by corporate bonds, foreign investors hold an insignificant 0.1% share of the total LCY corporate bond stock at the end of March.

Net foreign capital flows into emerging East Asia's bond markets remained strong in Q2 2016.

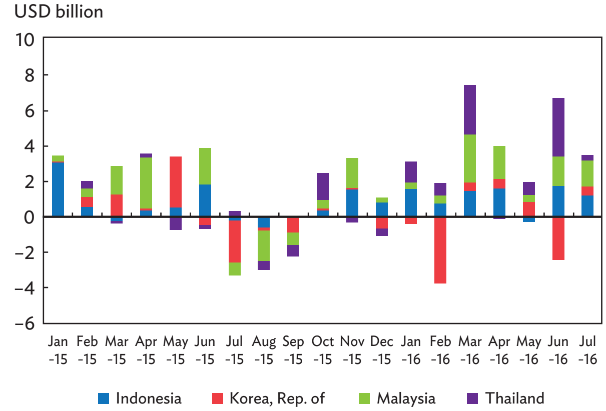
Foreign investors remain interested in emerging East Asian bonds as evidenced by strong inflows in Q2 2016. All markets with available data, with the exception of the Republic of Korea, recorded positive foreign bond flows during the quarter **(Figure 4)**.

Figure 3: Foreign Holdings of Local Currency Corporate Bonds in Indonesia and the Republic of Korea
(% of total)



Note: For Indonesia, data as of 1 July 2016. For the Republic of Korea, data as of end-March 2016.
Sources: Based on data from Otoritas Jasa Keuangan and the Bank of Korea.

Figure 4: Foreign Bond Flows in Select Emerging East Asian Markets



Notes:
1. The Republic of Korea and Thailand provide data on bond flows. For Indonesia and Malaysia, month-on-month changes in foreign holdings of local currency government bonds were used as a proxy for bond flows.
2. Data provided as of July 2016.
3. Figures were computed based on 31 July 2016 exchange rates to avoid currency effects.

Sources: Directorate General of Budget Financing and Risk Management, Ministry of Finance; Financial Supervisory Service; Bank Negara Malaysia; and Thai Bond Market Association.

Global interest rates remain low as most central banks have kept their monetary policies accommodative. Only in the United States (US) has there been an indication that monetary policy may tighten. The low-interest-rate environment has led to increased demand for riskier assets given the low returns in most developed economies.

Malaysia recorded the largest net foreign capital flows into its LCY bond market in the region in Q2 2016, followed by Thailand. In Indonesia, net foreign capital inflows in Q2 2016, while still positive, were lower compared with Q1 2016 due to an outflow in May following the release of weak economic data. The Republic of Korea recorded net foreign capital outflows from its LCY bond market in Q2 2016 on account of a huge amount of bond redemptions in June.

Emerging East Asia's LCY bond issuance registers double-digit growth in Q2 2016.

LCY bond issuance in emerging East Asia amounted to USD1,323 billion in Q2 2016, posting double-digit growth that was largely driven by robust issuance in the PRC **(Table 3)**.

The PRC's LCY bond issuance stood at USD894 billion (CNY5,944 billion) in Q2 2016, representing 67.6% of the regional total. On an LCY basis, this figure was up 43.8% q-o-q and 52.2% y-o-y, mainly as a result of relatively strong issuance of government bonds—specifically, local government bonds—that more than offset the fall in the issuance of corporate bonds.

In Hong Kong, China, LCY bond issues were valued at USD98 billion (HKD760 billion) on LCY-based growth of 6.9% q-o-q and 27.6% y-o-y that was buoyed by relatively large sales in both the government and corporate bond sectors. The government remained the dominant source of bonds, accounting for 83.7% of the market's total issuance. Government bond issuance was higher in Q2 2016 on both a q-o-q and y-o-y basis.

LCY bond issuance in the Republic of Korea was down in Q2 2016—both from the previous quarter and from the second quarter of the previous year—leveling off at USD154 billion (KRW177,348 billion). The negative q-o-q growth largely stemmed from less issuance of corporate bonds, while the negative y-o-y growth was brought about by lower bond sales by both the central bank and the corporate sector.

The combined LCY bond issuance in Q2 2016 in the region's six Southeast Asian economies—Indonesia, Malaysia, the Philippines, Singapore, Thailand, and

Table 3: Local-Currency–Denominated Bond Issuance (gross)

	Q2 2015		Q1 2016		Q2 2016		Growth Rate (LCY-base %)		Growth Rate (USD-base %)	
							Q2 2016		Q2 2016	
	Amount (USD billion)	% share	Amount (USD billion)	% share	Amount (USD billion)	% share	q-o-q	y-o-y	q-o-q	y-o-y
China, People's Rep. of										
Total	630	100.0	641	100.0	894	100.0	43.8	52.2	39.6	41.9
Government	370	58.8	360	56.2	685	76.6	96.1	98.3	90.4	85.0
Central Bank	0	0.0	0	0.0	0	0.0	–	–	–	–
Treasury and Other Govt.	370	58.8	360	56.2	685	76.6	96.1	98.3	90.4	85.0
Corporate	260	41.2	281	43.8	209	23.4	(23.3)	(13.6)	(25.5)	(19.4)
Hong Kong, China										
Total	77	100.0	92	100.0	98	100.0	6.9	27.6	6.9	27.5
Government	70	91.7	80	87.8	82	83.7	2.0	16.5	1.9	16.4
Central Bank	70	90.9	80	87.6	80	81.5	(0.4)	14.5	(0.5)	14.4
Treasury and Other Govt.	0.6	0.8	0.2	0.2	2	2.2	931.3	251.1	931.0	250.7
Corporate	6	8.3	11	12.2	16	16.3	42.6	149.8	42.6	149.6
Indonesia										
Total	9	100.0	16	100.0	14	100.0	(15.1)	56.8	(14.9)	58.3
Government	7	79.4	15	93.5	11	81.7	(25.8)	61.3	(25.6)	62.9
Central Bank	0.2	1.9	3	18.0	2	16.0	(24.4)	1203.3	(24.2)	1216.0
Treasury and Other Govt.	7	77.5	12	75.5	9	65.7	(26.1)	32.8	(26.0)	34.1
Corporate	2	20.6	1	6.5	2	18.3	139.2	39.5	139.7	40.9
Korea, Rep. of										
Total	201	100.0	159	100.0	154	100.0	(2.5)	(21.1)	(3.3)	(23.6)
Government	79	39.3	76	47.5	76	49.0	0.7	(1.6)	(0.0)	(4.7)
Central Bank	46	23.1	39	24.7	40	25.9	2.1	(11.5)	1.4	(14.3)
Treasury and Other Govt.	33	16.3	36	22.8	36	23.2	(0.8)	12.4	(1.6)	8.9
Corporate	122	60.7	84	52.5	78	51.0	(5.5)	(33.7)	(6.2)	(35.8)
Malaysia										
Total	16	100.0	16	100.0	15	100.0	0.6	0.7	(2.7)	(5.7)
Government	8	51.8	7	46.0	7	45.3	(0.9)	(11.8)	(4.1)	(17.4)
Central Bank	0	0.0	0	0.0	0	2.8	–	–	–	–
Treasury and Other Govt.	8	51.8	7	46.0	7	42.5	(7.0)	(17.3)	(10.0)	(22.5)
Corporate	8	48.2	9	54.0	8	54.7	1.8	14.2	(1.5)	7.0
Philippines										
Total	2	100.0	4	100.0	4	100.0	(4.0)	62.3	(6.4)	55.3
Government	2	80.6	4	93.4	4	96.2	(1.1)	93.8	(3.6)	85.3
Central Bank	0	0.0	0	0.0	0	0.0	–	–	–	–
Treasury and Other Govt.	2	80.6	4	100.0	4	96.2	(1.1)	93.8	(3.6)	85.3
Corporate	0.5	19.4	0.3	6.6	0.1	3.8	(44.0)	(67.9)	(45.4)	(69.3)
Singapore										
Total	77	100.0	58	100.0	63	100.0	8.0	(17.7)	8.1	(17.7)
Government	73	94.6	56	95.9	60	94.6	6.6	(17.7)	6.7	(17.7)
Central Bank	66	85.6	53	90.7	52	81.8	(2.5)	(21.3)	(2.4)	(21.3)
Treasury and Other Govt.	7	9.0	3	5.2	8	12.8	165.9	17.2	166.1	17.2
Corporate	4	5.4	2	4.1	3	5.4	41.3	(18.4)	41.4	(18.4)
Thailand										
Total	66	100.0	70	100.0	74	100.0	5.0	17.1	5.0	12.7
Government	54	81.6	60	85.0	63	85.4	5.4	22.5	5.4	17.9
Central Bank	41	62.8	54	77.0	54	73.5	0.2	36.9	0.2	31.8
Treasury and Other Govt.	12	18.8	6	8.1	9	11.9	54.3	(25.9)	54.3	(28.6)
Corporate	12	18.4	11	15.0	11	14.6	2.7	(6.9)	2.7	(10.4)

continued on next page

Table 3 *continued*

	Q2 2015		Q1 2016		Q2 2016		Growth Rate (LCY-base %)		Growth Rate (USD-base %)	
							Q2 2016		Q2 2016	
	Amount (USD billion)	% share	Amount (USD billion)	% share	Amount (USD billion)	% share	q-o-q	y-o-y	q-o-q	y-o-y
Viet Nam										
Total	10	100.0	14	100.0	7	100.0	(51.5)	(33.6)	(51.5)	(35.0)
Government	10	95.7	14	98.9	7	98.7	(51.6)	(31.6)	(51.6)	(33.0)
Central Bank	8	81.4	9	65.5	1	21.3	(84.3)	(82.6)	(84.3)	(83.0)
Treasury and Other Govt.	1	14.3	5	33.3	5	77.4	12.6	259.5	12.5	252.0
Corporate	0.4	4.3	0.2	1.1	0.1	1.3	(42.9)	(79.2)	(42.9)	(79.6)
Emerging East Asia										
Total	1,088	100.0	1,070	100.0	1,323	100.0	26.0	27.7	23.6	21.5
Government	673	61.9	671	62.7	994	75.1	50.6	54.5	48.0	47.6
Central Bank	232	21.3	239	22.3	230	17.4	(3.6)	0.5	(3.7)	(0.9)
Treasury and Other Govt.	441	40.6	433	40.4	764	57.8	81.2	84.3	76.5	73.1
Corporate	415	38.1	399	37.3	329	24.9	(15.6)	(16.2)	(17.5)	(20.7)
Japan										
Total	404	100.0	435	100.0	469	100.0	(1.2)	(2.3)	7.7	15.9
Government	379	93.7	412	94.8	440	94.0	(2.1)	(2.0)	6.8	16.3
Central Bank	0	0.0	0	0.0	0	0.0	–	–	–	–
Treasury and Other Govt.	379	93.7	412	94.8	440	94.0	(2.1)	(2.0)	6.8	16.3
Corporate	26	6.3	23	5.2	28	6.0	14.4	(7.0)	24.8	10.4

( ) = negative, – = not applicable, LCY = local currency, q-o-q = quarter-on-quarter, Q1 = first quarter, Q2 = second quarter, USD = United States dollar, y-o-y = year-on-year.
Notes:
1. Corporate bonds include issues by financial institutions.
2. Bloomberg LP end-of-period LCY—USD rates are used.
3. For LCY base, emerging East Asia growth figures are based on 30 June 2016 currency exchange rates and do not include currency effects.
Sources: People's Republic of China (*ChinaBond*); Hong Kong, China (Hong Kong Monetary Authority); Indonesia (Bank Indonesia; Directorate General of Budget Financing and Risk Management, Ministry of Finance; and Indonesia Stock Exchange); Republic of Korea (EDAILY *Bondweb* and the Bank of Korea); Malaysia (Bank Negara Malaysia); Philippines (Bloomberg LP); Singapore (Singapore Government Securities and Bloomberg LP); Thailand (Bank of Thailand and ThaiBMA); Viet Nam (Bloomberg LP and Vietnam Bond Market Association); and Japan (Japan Securities Dealers Association).

Viet Nam—totaled USD177 billion, which was down USD2 billion from Q1 2016 and USD3 billion from Q2 2015. The q-o-q drop was induced by lower bond sales in Indonesia, the Philippines, and Viet Nam, while the y-o-y decrease was the result of lower bond sales in Singapore and Viet Nam.

Indonesia's LCY bond issuance activity in Q2 2016 weakened when compared with the previous quarter but improved relative to the second quarter of the previous year, leveling off at USD14 billion (IDR180,081 billion). The q-o-q fall was due to lower government bond sales, while the y-o-y uptick stemmed from increases in both government and corporate bond issues.

In Malaysia, LCY bond sales in Q2 2016 totaled USD15 billion (MYR62 billion), which in LCY terms was marginally higher than in either Q1 2016 or Q2 2015.

The Philippines LCY bond issuance in Q2 2016 was marginally down from the previous quarter, but substantially higher than in the second quarter of the previous year, mainly due to increased issuance of Treasury bills and Treasury bonds.

Issuance of LCY bonds in Singapore climbed on a q-o-q basis in Q2 2016 but slipped on a y-o-y basis, with total issuance at USD63 billion (SGD85 billion).

In Thailand, LCY bond sales rose on both a q-o-q and y-o-y basis to USD74 billion (THB2,596 billion) in Q2 2016, backed by stronger issuance of central bank bills and bonds.

Viet Nam's LCY bond sales fell precipitously in Q2 2016, mainly resulting from a substantial reduction in bond issuance by the central bank, to USD7 billion (VND149,031 billion).

Intra-emerging East Asian LCY bond issuance decreased 17.6% q-o-q and 49.3% y-o-y to USD1.7 billion in Q2 2016. Issuers from the PRC sold USD584 million worth of bonds denominated in Hong Kong dollars and Malaysian ringgit. Four issuers from Hong Kong, China sold renminbi-denominated bonds and one issuer sold Singapore dollar-denominated bonds for a combined total that was equivalent to USD487 million. Three banks from the Republic of Korea issued USD221 million worth of bonds denominated in renminbi, Hong Kong dollars, and Singapore dollars. Two banks from Malaysia sold USD142 million worth of renminbi- and Hong Kong dollar-denominated bonds. Two Singaporean issuers raised the equivalent of USD271 million through the sale of Hong Kong dollar-denominated bonds.

Emerging East Asia's G3 currency bond issuance declined 2.5% y-o-y in January–July.

Emerging East Asia's G3 currency bond issuance amounted to USD119.2 billion in the first 7 months of 2016, accounting for 65.3% of the full-year 2015 total **(Table 4)**.[7] The January–July issuance was 2.5% less than during the same period a year earlier because of lower bond sales from the PRC, Malaysia, and the Philippines. The US dollar continued to be the dominant G3 currency of choice among issuers in the region, comprising an 86.7% share of January–July issuance, followed by the euro with 12%. By economy, the PRC's G3 currency bond issuance remained the largest in the region with a 54.6% share of the total.

The PRC recorded USD65.1 billion worth of G3 currency bond issuance in the January–July period, down 5.2% compared with the first 7 months of the previous year. The single largest issuance during the review period was Proven Honour Capital's USD2 billion 10-year bond guaranteed by Huawei Investment & Holding Company that was sold in May at a 4.125% coupon. The largest issuer was China Development Bank, which raised a total of USD6.4 billion from selling five USD-denominated bonds and two EUR-denominated bonds.

G3 currency bond issuance in the Republic of Korea was valued at USD16.7 billion in the January–July period, which was second only to the PRC and 21.3% larger compared with the same period a year earlier. Korea Eximbank issued the largest amount of G3 currency bonds during the review period among all Korean issuers at USD4.5 billion.

Aggregate G3 currency bond issuance from Hong Kong, China reached USD14.0 billion in January–July, the third most among individual markets in the region. CK Hutchison accounted for the most G3 bond issuance with the equivalent of USD2.2 billion in EUR-denominated bonds, which consisted of a 7-year bond worth EUR1.35 billion and a 12-year bond worth EUR650 million. The bonds carried coupon rates of 1.25% and 2.0%, respectively.

In Southeast Asia, total G3 currency bond issues were valued at USD23.3 billion over the January–July period, down 15.1% from the same period in the previous year. Indonesia posted USD11.1 billion worth of G3 issuance, of which about 63% comprised sovereign G3 currency bond sales and about 32% was USD-denominated foreign exchange bills issued by the central bank. Malaysia's issuance of USD3.8 billion, reflecting a 51.0% y-o-y decline, largely came from the USD1.5 billion dual-tranche, USD-denominated *sukuk* sale of the central government in April and USD897 billion worth of bonds from Maybank. The Philippines' G3 currency issuance during the review period comprised a USD2 billion 25-year sovereign bond issued in March with a 3.7% coupon. The USD6.1 billion of G3 currency bond issuance in Singapore in January–July was up 6.8% y-o-y and mostly came from financial institutions United Overseas Bank, Temasek Financial, and DBS Bank. G3 currency bond sales in Thailand were generated entirely from two corporate issuers whose bonds combined to total USD375 million.

On a monthly basis, G3 currency issuance from emerging East Asian issuers exhibited an upward trend over the course of Q2 2016, starting at USD18.0 billion in April and reaching USD22.1 billion in June. In July, G3 currency bond issuance slipped to USD19.9 billion **(Figure 5)**.

Most emerging East Asian government bond yield curves fell due to monetary easing in a number of markets and increased demand for higher-yielding assets.

Globally, the economic environment remains weak, particularly among the major advanced economies. The European Union's (EU) GDP growth fell to 0.3% q-o-q in Q2 2016 from 0.5% q-o-q in Q1 2016. On a y-o-y basis, growth in the EU slowed to 1.6% in Q2 2016 from 1.7%

[7] G3 currency bonds are bonds denominated in either euros, Japanese yen, or US dollars.

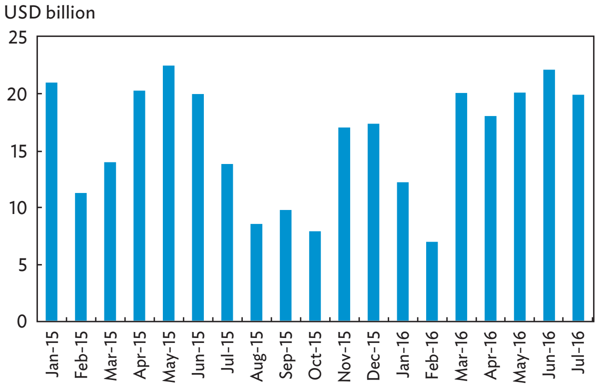
Table 4: G3 Currency Bond Issuance

2015		
Issuer	**Amount (USD million)**	**Issue Date**
China, People's Rep. of	**103,527**	
China Construction Bank 4.65% Perpetual	3,050	16-Dec-15
Sinopec 2.5% 2020	2,500	28-Apr-15
Bank of Communications 5% Perpetual	2,450	29-Jul-15
China Construction Bank 3.875% 2025	2,000	13-May-15
CNOOC Finance 3.5% 2025	2,000	5-May-15
ICBC 4.875% 2025	2,000	21-Sep-15
China Cinda Finance (2015) 4.25% 2025	1,700	23-Apr-15
Evergrande Real Estate Group 9% Perpetual	1,500	29-Dec-15
Others	86,327	
Hong Kong, China	**18,702**	
Shimao Property 8.375% 2022	1,100	10-Feb-15
Hong Kong, China (Sovereign) *Sukuk* 1.894% 2020	1,000	3-Jun-15
Others	16,602	
Indonesia	**15,572**	
Indonesia (Sovereign) 4.75% 2026	2,250	8-Dec-15
Indonesia (Sovereign) 4.125% 2025	2,000	15-Jan-15
Indonesia (Sovereign) 5.125% 2045	2,000	15-Jan-15
Perusahaan Penerbit SBSN *Sukuk* 4.325% 2025	2,000	28-May-15
Indonesia (Sovereign) 3.375% 2025	1,397	30-Jul-15
Others	5,925	
Korea, Rep. of	**23,348**	
Korea Eximbank 2.875% 2025	1,250	21-Jan-15
Korea Eximbank 2.25% 2020	1,000	21-Jan-15
Korea Eximbank 3.25% 2025	1,000	10-Nov-15
Others	20,098	
Lao People's Dem. Rep.	**182**	
Malaysia	**8,496**	
Petronas Capital 3.5% 2025	1,500	18-Mar-15
Petronas Capital 4.5% 2045	1,500	18-Mar-15
Petronas Global *Sukuk* 2.707% 2020	1,250	18-Mar-15
Others	4,246	
Philippines	**4,256**	
Philippines (Sovereign) 3.95% 2040	2,000	20-Jan-15
Royal Capital BV 5.5% Perpetual	450	26-Aug-15
Others	1,806	
Singapore	**8,346**	
Global Logistics Properties 3.875% 2025	1,000	4-Jun-15
DBS Bank 1.625% 2018	1,000	6-Aug-15
BOC Aviation 3% 2020	750	30-Mar-15
Others	5,596	
Thailand	**176**	
Emerging East Asia Total	**182,605**	
Memo Items:		
India	**10,919**	
Bharti Airtel 4.375% 2025	1,000	10-Jun-15
Others	8,919	
Sri Lanka	**3,649**	

1 January–31 July 2016		
Issuer	**Amount (USD million)**	**Issue Date**
China, People's Rep. of	**65,140**	
Proven Honour Capital 4.125% 2026	2,000	6-May-16
Export-Import Bank of China 2% 2021	1,250	26-Apr-16
China Development Bank 0.5% 2021	1,117	1-Jun-16
China Development Bank 0.875% 2018	1,117	3-Feb-16
Export-Import Bank of China 2.875% 2026	1,000	26-Apr-16
Sinopec 2.125% 2019	1,000	3-May-16
Three Gorges Finance 3.15% 2026	1,000	2-Jun-16
Bank of China (Luxembourg) 2.25% 2021	1,000	12-Jul-16
Others	55,656	
Hong Kong, China	**14,032**	
CK Hutchison 1.25% 2023	1,508	8-Apr-16
China Overseas Finance 0% 2023	1,500	5-Jan-16
Others	11,024	
Indonesia	**11,082**	
Perusahaan Penerbit SBSN *Sukuk* 4.55% 2026	1,750	29-Mar-16
Indonesia (Sovereign) 2.625% 2023	1,676	14-Jun-16
Indonesia (Sovereign) 3.75% 2028	1,676	14-Jun-16
Perusahaan Penerbit SBSN *Sukuk* 3.4% 2021	750	29-Mar-16
Bank Indonesia 0% 2016	500	22-Jan-16
Others	4,730	
Korea, Rep. of	**16,689**	
Korea Development Bank 3% 2026	1,000	13-Jan-16
Korea Eximbank 1.75% 2019	1,000	26-May-16
Korea Eximbank 2.625% 2026	1,000	26-May-16
Korea Eximbank 0.375% 2019	859	15-Mar-16
Hyundai Capital America 2.5% 2019	600	18-Mar-16
Others	12,230	
Malaysia	**3,751**	
Malaysia (Sovereign) *Sukuk* 3.179% 2026	1,000	27-Apr-16
Danga Capital 3.035% 2021	750	1-Mar-16
Maybank 3.905% 2026	500	29-Apr-16
Others	1,501	
Philippines	**2,000**	
Philippines (Sovereign) 3.7% 2041	2,000	1-Mar-16
Singapore	**6,128**	
BOC Aviation 3.875% 2026	750	27-Apr-16
United Overseas Bank 3.5% 2026	700	16-Mar-16
Temasek Financial 0.5% 2022	670	1-Mar-16
United Overseas Bank 0.25% 2021	559	9-Mar-16
Temasek Financial 1.5% 2028	559	1-Mar-16
Others	2,890	
Thailand	**375**	
Emerging East Asia Total	**119,198**	
Memo Items:		
India	**4,079**	
ICICI Bank 4% 2026	700	18-Mar-16
Others	3,379	
Sri Lanka	**2,916**	

USD = United States dollar.
Notes:
1. Data exclude certificates of deposit.
2. G3 currency bonds are bonds denominated in either euros, Japanese yen, or US dollars.
Source: *AsianBondsOnline* calculations based on data from Bloomberg LP.

Figure 5: G3 Currency Bond Issuance



USD = United States dollar.
Note: G3 currency bonds are bonds denominated in either euros, Japanese yen, or US dollars.
Source: *AsianBondsOnline* calculations based on Bloomberg LP data.

in the prior quarter. In Japan, GDP growth slowed to an annualized rate of 0.7% in Q2 2016 from 2.1% in Q1 2016.

Markets have shown resilience after an initial bout of volatility following the United Kingdom's (UK) referendum on leaving the EU, suggesting that the economic impact outside of the UK is likely to be minimal. At the same time, the European Central Bank (ECB) left its existing monetary easing measures unchanged in its July meeting as the outlook for global economic growth for the rest of the year had not significantly improved. The ECB noted that economic risks remained tilted to the downside.

In Japan, the central bank expanded its quantitative easing operations, doubling the targeted amount of annual exchange-traded fund purchases to JPY6 trillion, increasing its US dollar lending program, and allowing financial institutions to use Japanese Government Bonds as collateral for US dollar borrowing.

Global inflation has thus far been benign in 2016. Japan moved into deflationary territory in April and continued to report negative inflation of –0.4% y-o-y in July. In the EU, inflation has firmed up somewhat in recent months, with July inflation coming in at 0.2% y-o-y, up from 0.1% y-o-y in June, due to higher energy prices. However, the ECB has noted that inflation is likely to remain subdued.

Oil prices have been rising in 2016, while peaking in June, which has helped to stabilize inflation. However, prices remain low overall. There was a temporary spike in oil prices in August, which has since leveled off, following news that the Organization of the Petroleum Exporting Countries would freeze production. It is unlikely that oil prices will provide a significant boost to inflation given low global growth reducing demand at the same time that oil inventories remain high.

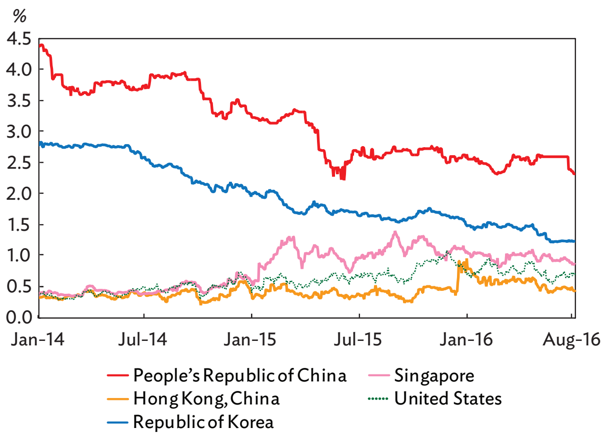
US monetary policy is increasingly diverging from the policies of other advanced economies due to its economic recovery. While the US is the most likely to raise policy rates among developed markets, there is still uncertainty regarding the timing. Recent language from the Federal Reserve raised the likelihood of a policy rate hike this year but the disappointing nonfarm payroll data for August decrease the probability.

Due to weakness in global economic growth and the inflation outlook, low global yields have persisted, making bond yields in emerging East Asia relatively attractive. This has led to bond yields falling in most markets in emerging East Asia. The 2-year rate has steadily declined since 1 June in all regional bond markets with the exception of Thailand. The 2-year yield in a number of markets that closely track US yields—including Hong Kong, China, the Republic of Korea, and Singapore—showed a spike toward the end of May before declining. The rise in yields at the end of May followed the release of the minutes of the April Federal Reserve meeting, which said that markets were underestimating the likelihood of a rate hike **(Figures 6a and 6b)**.

The 10-year yield in most emerging East Asian markets showed a decline from 1 June, with the exception of Viet Nam, where the 10-year yield remained broadly stable **(Figures 7a and 7b)**.

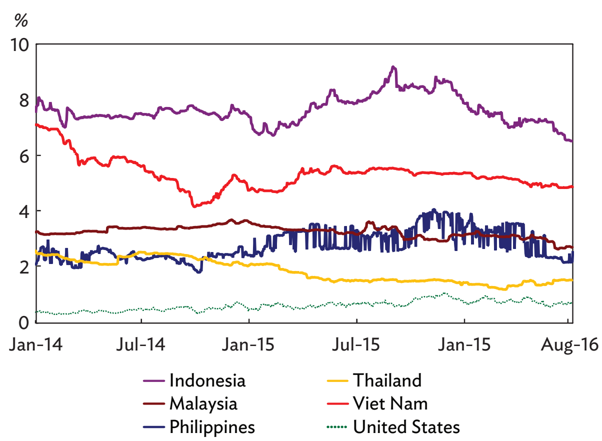
Economic growth has firmed in emerging East Asian economies as most have shown stable or slight improvement in GDP growth except for Malaysia. The PRC's Q2 2016 GDP growth was unchanged at 6.7% y-o-y from the prior quarter, while Hong Kong, China's GDP growth rose to 1.7% y-o-y in Q2 2016 from 0.8% y-o-y in Q1 2016. Over the same period, Indonesia's GDP growth improved to 5.2% y-o-y from 4.9% y-o-y, growth in the Republic of Korea improved to 3.3% y-o-y from 2.8% y-o-y, the Philippines' GDP growth accelerated to 7.0% y-o-y from 6.8% y-o-y, Singapore's GDP growth remained unchanged at 2.1% y-o-y, growth in Thailand

Figure 6a: 2-Year Local Currency Government Bond Yields



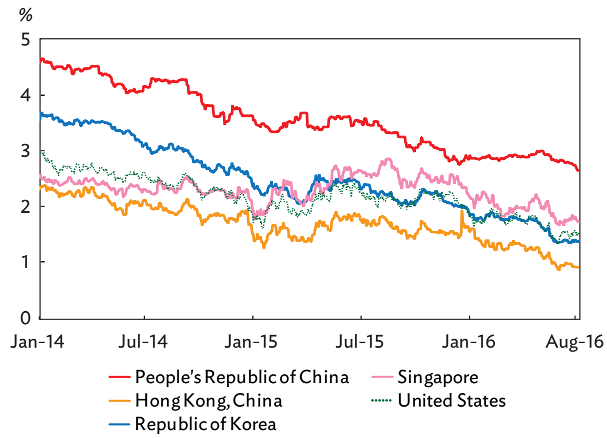
Note: Data as of 15 August 2016.
Source: Based on data from Bloomberg LP.

Figure 6b: 2-Year Local Currency Government Bond Yields



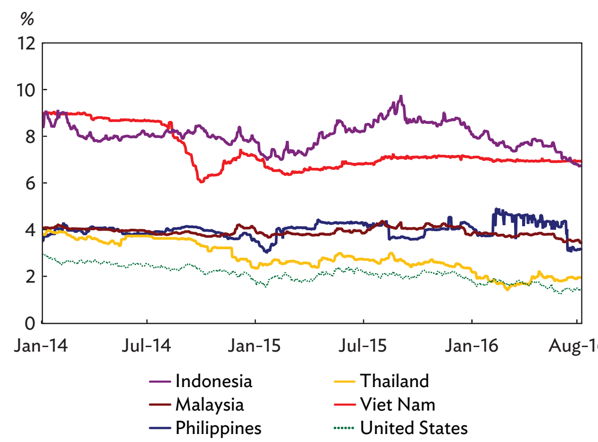
Note: Data as of 15 August 2016.
Source: Based on data from Bloomberg LP.

Figure 7a: 10-Year Local Currency Government Bond Yields



Note: Data as of 15 August 2016.
Source: Based on data from Bloomberg LP.

Figure 7b: 10-Year Local Currency Government Bond Yields



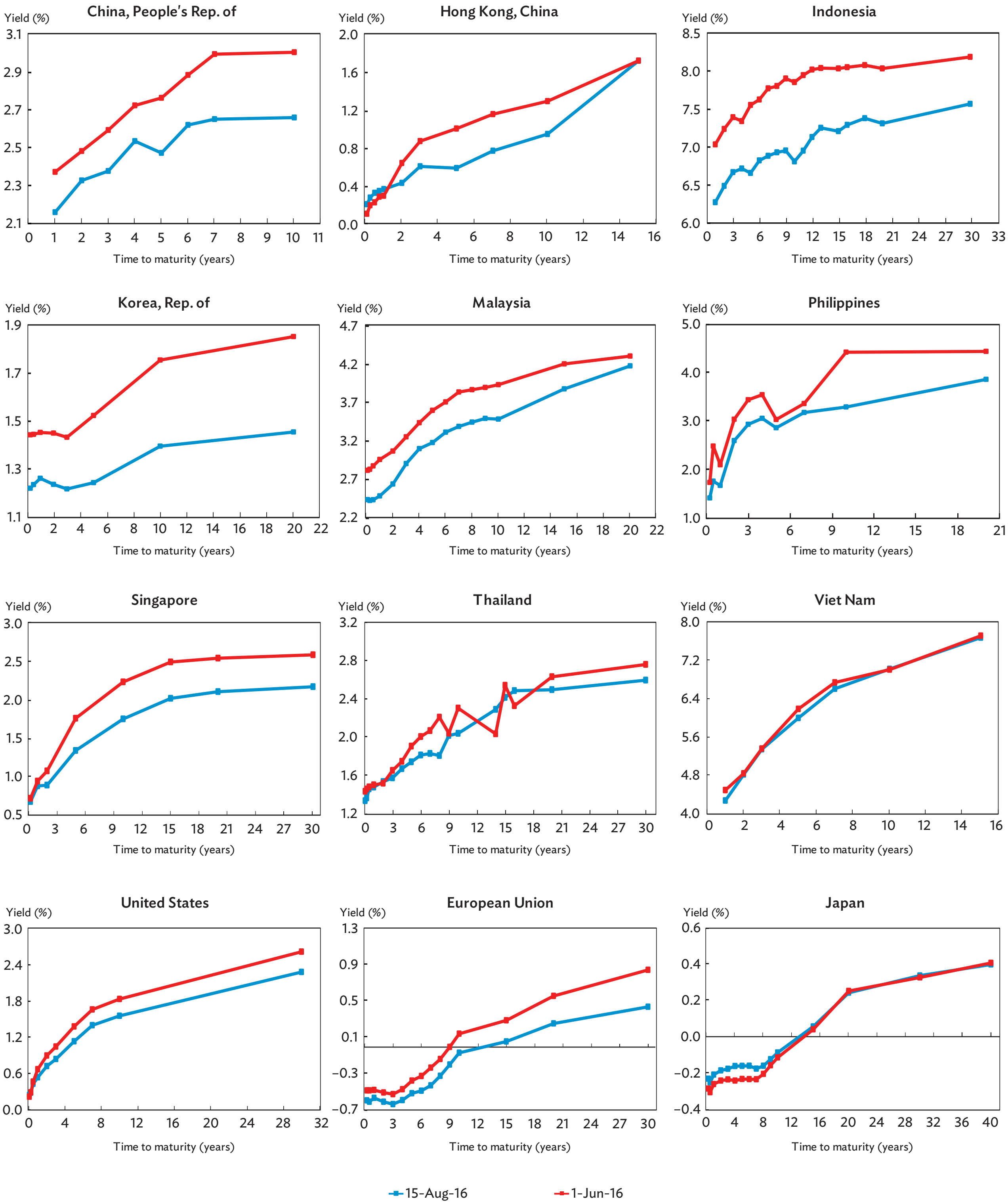
Note: Data as of 15 August 2016.
Source: Based on data from Bloomberg LP.

rose to 3.5% y-o-y from 3.2% y-o-y, and Viet Nam's GDP growth rose to 5.5% y-o-y in the first half of the year, unchanged from the first 3 months of the year. In contrast, Malaysia's GDP growth fell to 4.0% y-o-y in Q2 2016 from 4.2% y-o-y in Q1 2016.

Given stronger GDP growth than in most developed economies, yields generally fell for all emerging East Asian markets between 1 June and 15 August due to strong demand. In fact, the entire yield curve shifted downward during the review period in all regional markets except Hong Kong, China, Thailand, and Viet Nam **(Figure 8)**.

While oil prices have improved in 2016, overall inflation rates in most emerging East Asian economies have trended downward. Viet Nam is one exception as inflation has been trending upward since the start of the year. While Thailand has moved out of deflation, July saw a dip in inflation to 0.1% y-o-y **(Figure 9a)**. Inflation in the Philippines has also been rising in 2016, partly due to spending related to the election held in May **(Figure 9b)**.

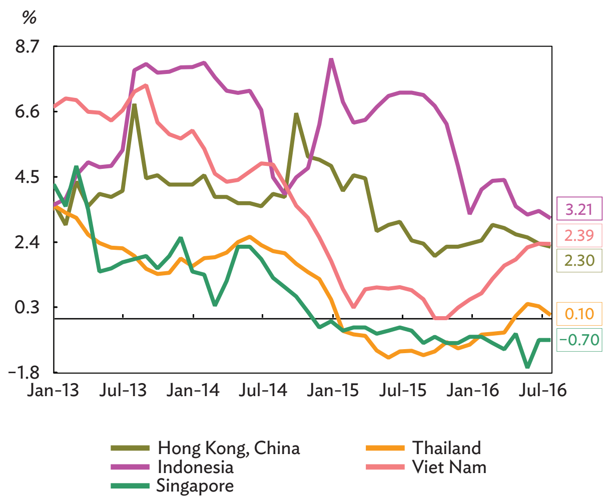
Figure 8: Benchmark Yield Curves—Local Currency Government Bonds



Source: Based on data from Bloomberg LP.

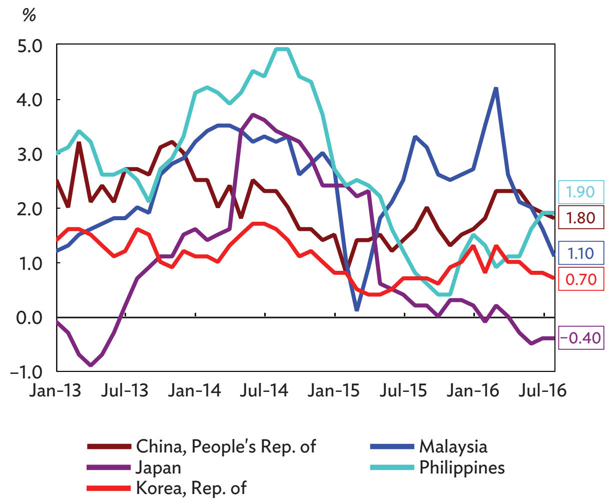
With declining inflation and improving but generally subdued economic growth, emerging East Asian yields also fell partly as the result of additional monetary easing in some markets. The Republic of Korea reduced its policy rate by 25 basis points in June and Malaysia reduced its policy rate in July, citing preemptive easing in order to arrest potential fallout from the UK's decision to leave the EU **(Figures 10a and 10b)**. Indonesia also reduced its policy rate in June. However, in August, the central bank adopted a new policy rate benchmark, switching to the 7-day repurchase rate. While the PRC last reduced its reserve requirement ratios in February, the market has been expecting the PRC to engage in monetary easing, further contributing to the fall in yields.

Figure 9a: Headline Inflation Rates



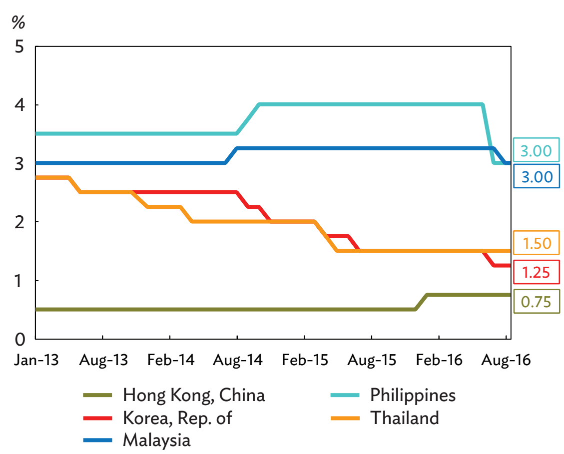
Note: Data as of July 2016.
Source: Based on data from Bloomberg LP.

Figure 9b: Headline Inflation Rates



Note: Data as of July 2016.
Source: Based on data from Bloomberg LP.

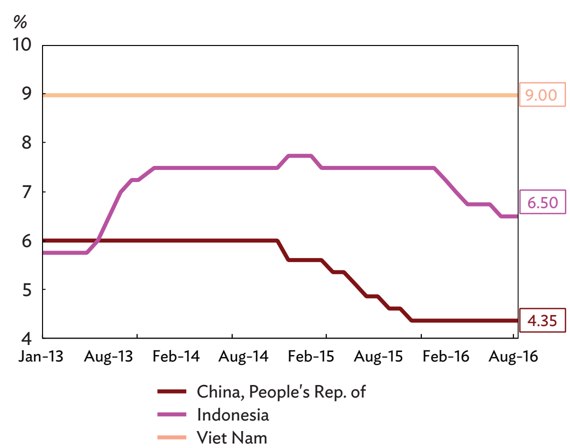
Figure 10a: Policy Rates



Notes:
1. Data as of 15 August 2016.
2. The policy rate of the Philippines was adjusted to 3.0% from 4.0% in June following the shift in the Bangko Sentral ng Pilipinas' monetary operations to an interest rate corridor system.

Source: Based on data from Bloomberg LP.

Figure 10b: Policy Rates



Note: Data as of 15 August 2016.
Source: Based on data from Bloomberg LP.

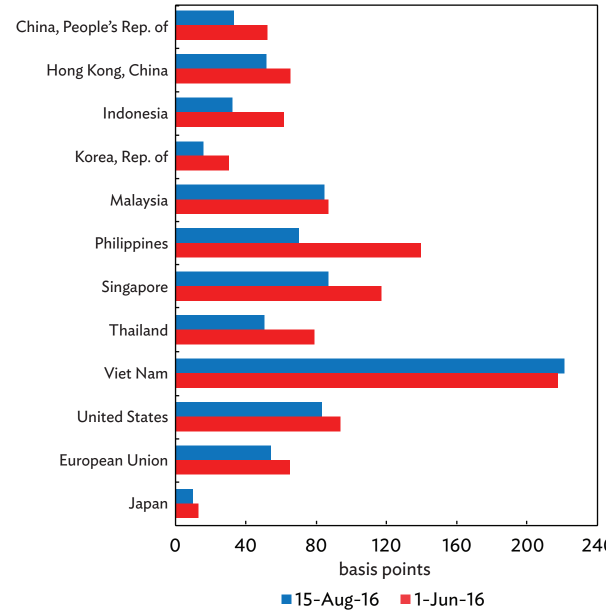
With economic growth remaining subdued and inflation declining, the 2-year versus 10-year yield spread fell between 1 June and 15 August for all markets in emerging East Asia except Viet Nam **(Figure 11)**.

The AAA-rated corporate yield versus government yield spread fell in the PRC and the Republic of Korea but rose in Malaysia.

Credit spreads between AAA-rated corporate bonds and government bonds fell for all tenors in the PRC and the Republic of Korea between 1 June and 15 August **(Figure 12a)**. In Malaysia, credit spreads rose for all tenors during the review period.

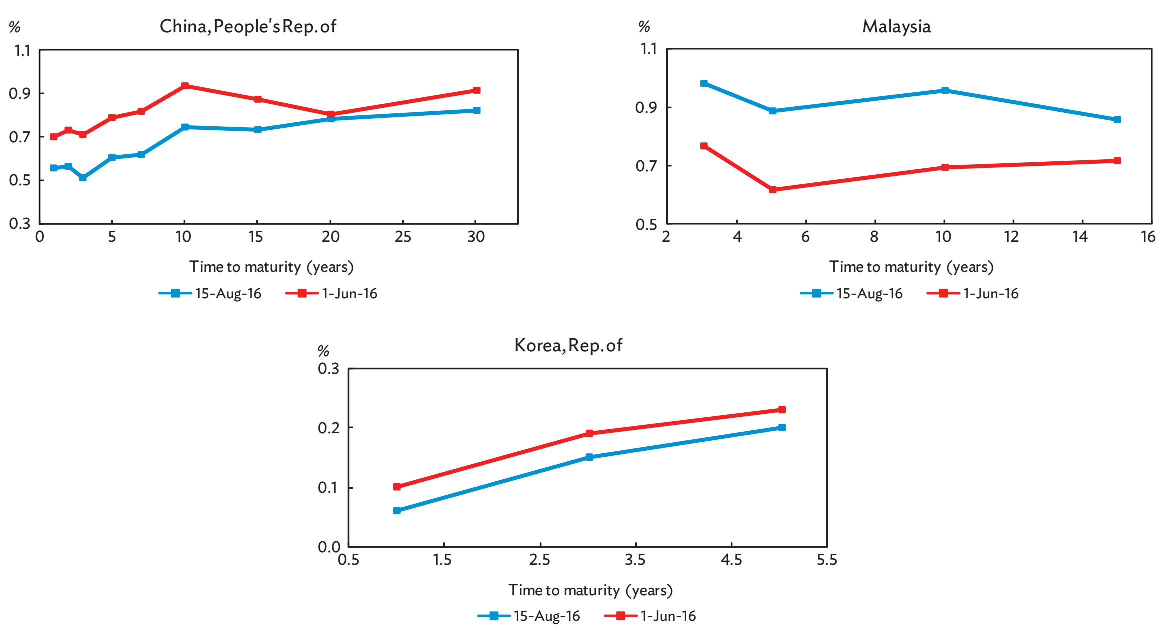
Lower-rated credit spreads also fell in the PRC during the review period, while rising in the Republic of Korea and Malaysia **(Figure 12b)**.

Figure 11: Yield Spreads Between 2-Year and 10-Year Government Bonds



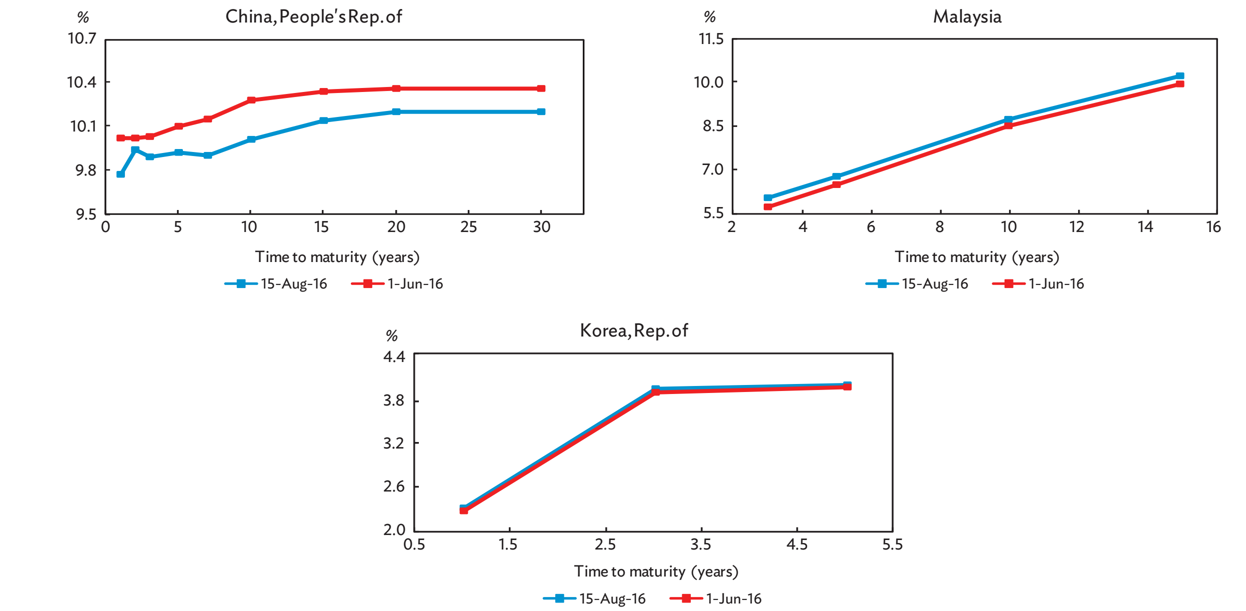
Source: Based on data from Bloomberg LP.

Figure 12a: Credit Spreads—Local Currency Corporates Rated AAA vs. Government Bonds



Notes:
1. Credit spreads are obtained by subtracting government yields from corporate indicative yields.
2. For Malaysia, data on corporate bond yields are as of 31 May 2016 and 12 August 2016.
3. For the Republic of Korea, latest credit spread data are as of 12 August 2016.
Sources: People's Republic of China (*Wind Info*), Republic of Korea (EDAILY *BondWeb*), and Malaysia (Bank Negara Malaysia).

Figure 12b: Credit Spreads—Lower-Rated Local Currency Corporates vs. AAA



Notes:
1. For the People's Republic of China and the Republic of Korea, credit spreads are obtained by subtracting corporate indicative yields rated AAA from corporate indicative yields rated BBB+.
2. For Malaysia, credit spreads are obtained by subtracting corporate indicative yields rated AAA from corporate indicative yields rated BBB.
3. For Malaysia, data on corporate bond yields are as of 31 May 2016 and 12 August 2016.
4. For the Republic of Korea, latest credit spread data are as of 12 August 2016.

Sources: People's Republic of China (*Wind Info*), Republic of Korea (EDAILY *BondWeb*), and Malaysia (Bank Negara Malaysia).

Policy and Regulatory Developments

People's Republic of China

Green Bonds Program Expanded

On 6 April, the government launched a pilot program to allow People's Republic of China (PRC)-based issuers to issue and list green bonds on the Shanghai Stock Exchange. To qualify as a green bond, the most important requirement is that only green assets and projects can be funded by the proceeds of the bond.

World Bank Group to Issue Special Drawing Rights-Denominated Bonds in the Interbank Bond Market

On 21 August, the PRC approved the International Bank for Reconstruction and Development of the World Bank Group to issue Special Drawing Rights-denominated bonds in the PRC's interbank bond market. The issue size will be SDR2 billion and the bond will be settled in renminbi.

Hong Kong, China

Hong Kong, China Issues Silver Bonds

On 10 August, Hong Kong, China issued HKD3 billion worth of Silver Bonds under the Retail Bond Issuance Programme. The bonds, which can only be subscribed to by Hong Kong, China residents aged 65 years or older, pay interest on a semiannual basis. The coupon is based on the average rate of consumer price inflation in Hong Kong, China for the past 6 months or 2%, whichever is higher.

Indonesia

Finance Ministry Removes Withholding Tax on Interest Payments for Foreign Currency Government Bonds

In June, Indonesia's Ministry of Finance provided tax incentives to investors in conventional and Islamic foreign currency (FCY)-denominated government bonds by removing the withholding tax on interest payments. A withholding tax of 15% had been levied for Indonesian residents while a 20% tax was levied for nonresidents. The removal of the withholding tax will help lower the government's borrowing costs on its FCY government bonds. This will also help corporate bonds receive better pricing as government bonds are normally used as a benchmark for pricing. The regulation is effective retroactively from 1 January 2016.

Parliament Approves Tax Amnesty Law

In June, Parliament approved the Tax Amnesty Law to lure wealthy residents to repatriate funds parked in tax havens. The new law levies tax rates of 2.0%–5.0% for assets that are declared and repatriated and 4.0%–10.0% for assets that are only declared. Investment instruments have been prepared by the government for the placement of repatriated funds, which will need to be placed in the Indonesian capital market for a period of at least 3 years.

The government estimates that the measures will attract IDR4,000 trillion in declared assets and IDR1,000 trillion in repatriated funds. The government expects to raise IDR165 trillion in revenues from this program, which will help fund the larger deficit included in the 2016 revised budget. The tax amnesty program runs from 18 July 2016 to 31 March 2017.

Republic of Korea

Financial Services Commission Introduces Plan to Develop "Mega-Investment Banks"

The Financial Services Commission (FSC) announced in August its plan to develop "mega-investment banks" by enabling investment banks to acquire more than KRW10 trillion of equity capital and to broaden their scope of new business. The FSC stated that it plans for securities firms with more than KRW4 trillion of equity capital to be allowed to sell promissory notes and conduct foreign exchange transactions; for securities firms with equity capital of nearly KRW10 trillion to create investment management accounts and conduct property trust business; and for securities firms with equity capital of less than KRW4 trillion to be subjected to certain reforms to enable them to secure enough capital for corporate financing purposes. The plan is envisioned to take effect starting in 2017.

Financial Services Commission to Apply Foreign Currency Liquidity Coverage Ratio to Banks

The FSC reported in June its plan to apply an FCY liquidity coverage ratio rule in 2017. The rule will require commercial banks to hold 60% of their foreign exchange debt in the form of high-quality liquid assets starting in 2017, with the ratio increasing to 70% in 2018 and 80% in 2019.

Malaysia

Bank Negara Malaysia and Financial Markets Association of Malaysia Announce Kuala Lumpur USD–MYR Reference Rate

In June, Bank Negara Malaysia (BNM) and the Financial Markets Association of Malaysia announced the adoption of a new methodology for the computation of the Malaysian ringgit's exchange rate. The new rate shall be known as the Kuala Lumpur USD–MYR Reference Rate. Effective 18 July, the new reference rate will be based on the daily weighted average volume of the interbank USD–MYR foreign exchange spot rate transactions of domestic financial institutions between 8 a.m. and 3 p.m. BNM stated that the new methodology promotes transparency and is based on underlying trades, while the previous methodology was based on the submission of quotations by selected banks. In addition, the official closing time for the onshore ringgit foreign exchange market will be extended from 5 p.m. to 6 p.m.

Bank Negara Malaysia and Otoritas Jasa Keuangan Sign Bilateral Agreement

In August, BNM and Otoritas Jasa Keuangan signed a bilateral agreement under the Association of Southeast Asian Nations Banking Integration Framework to further promote banking and financial integration between Malaysia and Indonesia. The implementation of the agreement will involve BNM allowing Qualified Association of Southeast Asian Nations Banks from Indonesia to operate in Malaysia. The agreement envisions a greater role for Malaysian and Indonesian banks in facilitating cross-border trade and investment between the two markets.

Philippines

Bangko Sentral ng Pilipinas Further Liberalizes Foreign Exchange Rules

The Bangko Sentral ng Pilipinas announced in August that its Monetary Board approved further liberalization of its foreign exchange rules and regulations in line with the Philippine economy's increasing integration with the global economy. The new measures include, among others, increasing the amount of foreign exchange that local residents, both individuals and corporations, can purchase from the banking system, as well as allowing the sale of foreign exchange by banks and their foreign exchange entities for resident-to-resident transactions.

Singapore

Monetary Authority of Singapore's Renminbi Investments Included in Official Foreign Reserves

The Monetary Authority of Singapore announced that it would include renminbi financial investments as part of its Official Foreign Reserves beginning in June. The Monetary Authority of Singapore cited the following reasons for this move: (i) the PRC having taken significant steps to liberalize foreign institutional investors' access to its foreign exchange and securities markets, and (ii) the International Monetary Fund's announcement that it will include the renminbi in the Special Drawing Rights basket of currencies beginning in October.

Singapore Launches First Listed Private Equity Bonds

Astrea III, which is ultimately backed by Singapore's state-owned Temasek Holdings, successfully launched a series of private equity bonds in June. The bonds are backed by 34 private equity funds with interests in more than 590 companies, the first-of-its-kind bond series to be listed in Singapore. The issued bonds are designed to make private equity more accessible to a wider range of institutional and individual investors. The issuance amounted to USD510 million and comprised four classes of 10-year bonds—A-1 (SGD228 million), A-2 (USD170 million), B (USD100 million), and C (USD70 million)—ordered according to seniority and maturity, and with interest rates of 3.90%, 4.65%, 6.50%, and 9.25%, respectively. Class A-1 bonds are redeemable starting in year 3, while Class A-2 bonds can be redeemed starting in year 5.

Thailand

Bank of Thailand Releases Plan for Bond Issuance Program for the Second Half of 2016

In June, the Bank of Thailand (BOT) announced its plan to increase the maximum issuance sizes of all bills and fixed-coupon bonds, except for the 3-year floating-rate bond, as a response to potentially rapid changes in market liquidity conditions and large swings in the appetite for bonds amid heightened volatility in the global financial markets. Auction days and issuance frequencies for all types of BOT bonds will remain the same. Depending on liquidity conditions and the issuance calendar for Treasury bills, the central bank will also consider issuing 1-month BOT bills on an occasional basis.

Bank of Thailand Eases Rules for Ownership of Foreign Securities

On 5 July, the BOT issued a memorandum allowing Thailand's citizens direct investment access to foreign securities, effective 20 July. Individuals and corporations with deposits or securities of at least THB100 million can directly invest a maximum amount each year of USD5 million in foreign securities. Corporate treasuries will also be allowed to both issue and invest in onshore and offshore FCY-denominated debt beginning 28 July. Previously, stricter rules only allowed for firms to borrow foreign currency from financial institutions and invest in FCY-denominated securities that were issued offshore. This comes as part of the central bank's effort to dampen the strengthening of the Thai baht vis-à-vis the US dollar.

Viet Nam

State Bank of Vietnam Raises Prudential Ratios for Credit Institutions and Foreign Banks

In May, the State Bank of Vietnam revised its regulation on prudential ratios for credit institutions and foreign banks. The revision included increasing the ceiling limits on the purchase or investment of government bonds by banking institutions from 15% to 25% of their short-term funding source. The investment cap for foreign banks was also raised to 35% of their short-term funding source.

Market Summaries

People's Republic of China

Yield Movements

Between 1 June and 15 August, the People's Republic of China's (PRC) government bond yield curve shifted downward as yields fell for all tenors **(Figure 1)**. Yields dropped the most at the longer-end of the curve, with the 7-year and 10-year tenors falling 34 basis points (bps) each. The 2-year tenor fell the least, declining 16 bps, which led to the 2-year versus 10-year yield spread narrowing to 33 bps on 15 August from 52 bps on 1 June.

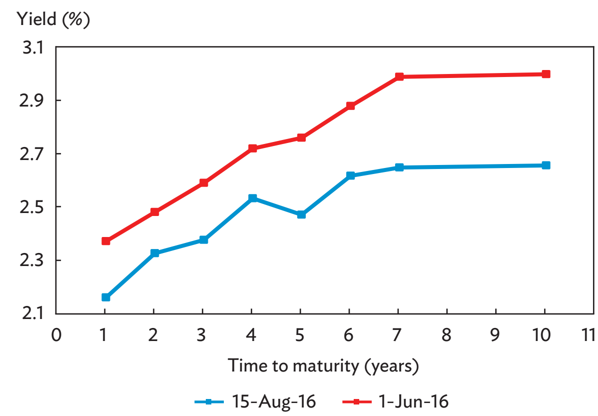
The fall in the PRC's yields was driven by recent macroeconomic data and demand factors for government bonds. The PRC's gross domestic product growth rate stood at 6.7% year-on-year (y-o-y) in the second quarter (Q2) of 2016, unchanged from the prior quarter. This growth rate is lower than that of the fourth quarter of 2015 when the PRC's economy expanded at a rate of 6.8%. Most analysts expect the PRC's economic growth to be slower moving forward compared to prior years.

Weak external demand has weighed on the economy. In United States dollar terms, exports fell 4.4% y-o-y in July, though this was a slightly better performance than June's 4.8% y-o-y drop. In addition, consumer price inflation has been on a downward trend, with consumer prices rising 1.8% y-o-y in July versus 1.9% y-o-y in June. Through the first 7 months of 2016, the inflation rate peaked at 2.3% y-o-y in February, March, and April.

Economic data also point to a softening economy in the PRC, which has pushed down yields and raised market expectations that the People's Bank of China will engage in another round of easing. The central bank last reduced reserve requirement ratios by 50 bps in February.

Yields in the PRC had risen early in the year due to increased supply risk in the LCY government bond market. While issuances of local government bonds have continued, markets have become increasingly concerned with credit risk in the corporate bond market sector. In a May 2016 news report, Deutsche Bank noted that there have been 40 defaults from bond issuers this year through April. As a result, there has been increased demand for safer assets such as government bonds, which has contributed to a fall in yields.

Figure 1: The People's Republic of China's Benchmark Yield Curve—Local Currency Government Bonds



Source: Based on data from Bloomberg LP.

Size and Composition

LCY bonds in the PRC rose 8.0% quarter-on-quarter (q-o-q) and 30.6% y-o-y in Q2 2016, leading to CNY45.9 trillion (USD6.9 trillion) worth of bonds outstanding at the end of June **(Table 1)**.

Government Bonds. LCY government bonds outstanding rose 12.6% q-o-q in Q2 2016 versus 5.2% q-o-q in the prior quarter. The LCY government bond market grew 40.0% on a y-o-y basis. Treasury bonds were the main driver of q-o-q growth, rising 19.5% q-o-q. Within Treasury bonds, growth continues to be driven by the issuance of local government bonds. Outstanding local government bonds grew 45.5% q-o-q in Q2 2016. The rapid rise in issuance was due to an ongoing exchange of local government debt for bonds. In the first 6 months of 2016, total local government bond issuance stood at CNY3.6 trillion. In contrast,

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

	Outstanding Amount (billion)						Growth Rates (%)			
	Q2 2015		Q1 2016		Q2 2016		Q2 2015		Q2 2016	
	CNY	USD	CNY	USD	CNY	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**35,137**	**5,666**	**42,485**	**6,583**	**45,897**	**6,904**	**6.0**	**15.4**	**8.0**	**30.6**
Government	22,344	3,603	27,791	4,306	31,286	4,706	6.9	13.9	12.6	40.0
Treasury Bonds	11,284	1,820	15,856	2,457	18,955	2,851	9.9	19.3	19.5	68.0
Central Bank Bonds	428	69	428	66	428	64	0.0	(12.5)	0.0	0.0
Policy Bank Bonds	10,632	1,715	11,507	1,783	11,902	1,790	4.2	9.9	3.4	11.9
Corporate	12,793	2,063	14,694	2,277	14,611	2,198	4.4	18.1	(0.6)	14.2
Policy Bank Bonds										
China Development Bank	6,538	1,054	6,816	1,056	6,976	1,049	3.2	5.2	2.3	6.7
Export–Import Bank of China	1,797	290	1,913	296	1,988	299	6.1	21.4	3.9	10.6
Agricultural Devt. Bank of China	2,297	370	2,778	430	2,939	442	5.7	16.1	5.8	28.0

( ) = negative, CNY = Chinese yuan, q-o-q = quarter-on-quarter, Q1 = first quarter, Q2 = second quarter, USD = United States dollar, 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 local currency–USD rate is used.
4. Growth rates are calculated from local currency base and do not include currency effects.
Sources: *ChinaBond, Wind Info*, and Bloomberg LP

local governments issued CNY3.8 trillion during the whole of 2015. Out of the CNY3.5 trillion issued during the first half of 2016, CNY900 billion comprised new local government bonds issuance with the remainder coming from a debt swap. New bond issuance is already approaching the CNY1.18 trillion quota set by the PRC for total local government bond issuance for full-year 2016. The rise in issuance was also driven by maturing obligations in 2016, with an estimated CNY2.8 trillion due to mature in 2016, as well as increased funding demand driven by various local government projects.

Policy bank bonds continued to increase in Q2 2016, albeit at a slower pace than in the previous quarter, expanding 3.4% q-o-q and 11.9% y-o-y. The outstanding amount of central bank bonds remained unchanged in Q2 2016 from the prior quarter due to a lack of new issuance.

Corporate Bonds. Corporate bonds outstanding fell 0.6% q-o-q but rose 14.2% y-o-y to reach CNY14.6 trillion at the end of June **(Table 2)**. Within the major bond categories, commercial bank bonds and Tier 2 notes and local corporate bonds expanded 3.4% q-o-q and 3.6% q-o-q, respectively. Strong issuance by commercial banks and insurance companies also continued in Q2 2016. However, state-owned enterprise bonds, commercial paper, and medium-term notes outstanding all posted declines during the quarter. The largest decline was in commercial paper, which fell 6.7% q-o-q, as demand waned following several commercial paper defaults and the discovery of a trading scam involving two employees at Agricultural Bank of China.

Overall issuance levels declined in Q2 2016 versus Q1 2016 **(Figure 2)**. The overall decline in corporate bond issuance was due to increasing risk aversion among investors resulting from a rising number of corporate bond defaults. Medium-term note issuance still remains the highest among the major bond categories (excluding commercial paper) due to its relatively easy issuance process.

A relatively small number of issuers dominate the PRC's corporate bond market **(Table 3)**. At the end of June, the top 30 corporate bond issuers accounted for CNY5.6 trillion worth of corporate bonds outstanding, or about 38.6% of the total market. Out of the top 30, the 10 largest issuers accounted for CNY3.7 trillion.

The top 30 issuer list has become dominated by banks, owing to the continued issuance of commercial bank bonds as banks accelerate their fundraising. Among the top 30 corporate issuers at the end of June, 14 were in the banking industry.

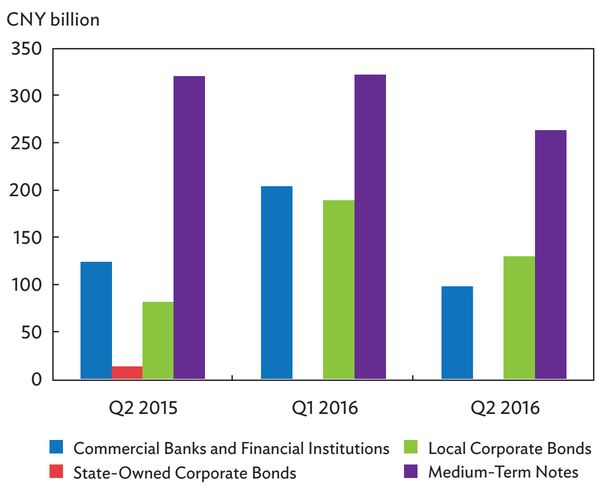
Table 4 presents the most notable corporate bond issuances in Q2 2016. The list mainly comprises financial institutions and infrastructure-related companies,

Table 2: Corporate Bonds Outstanding in Key Categories

	Amount (CNY billion)			Growth Rate (%)			
				Q2 2015		Q2 2016	
	Q2 2015	Q1 2016	Q2 2016	q-o-q	y-o-y	q-o-q	y-o-y
Commercial Bank Bonds and Tier 2 Notes	1,719	2,196	2,271	1.0	25.5	3.4	32.1
SOE Bonds	617	583	575	1.0	(0.3)	(1.4)	(6.8)
Local Corporate Bonds	2,443	2,690	2,787	1.0	17.1	3.6	14.1
Commercial Paper	2,249	2,820	2,632	1.0	22.1	(6.7)	17.1
Medium-Term Notes	4,043	4,512	4,496	1.0	8.4	(0.4)	11.2

( ) = negative, CNY = Chinese yuan, q-o-q = quarter-on-quarter, Q1 = first quarter, Q2 = second quarter, SOE = state-owned enterprise, y-o-y = year-on-year.
Sources: *ChinaBond* and *Wind Info*.

Figure 2: Corporate Bond Issuance in Key Sectors



CNY = Chinese yuan, Q1 = first quarter, Q2 = second quarter.
Sources: *ChinaBond* and *Wind Info*.

reflecting the fundraising efforts of banks and the significant financing needs of the oil industry.

Investor Profile

Treasury Bonds and Policy Bank Bonds. Banks held 69.9% of all Treasury bonds, including policy bank bonds, at the end of June **(Figure 3)**. This share was down from a year earlier. The holdings of funds institutions, such as mutual funds, have steadily increased over time, comprising 12.3% of all Treasury bonds and policy bank bonds at the end of June, up from 6.4% a year earlier.

Corporate Bonds. Banks were no longer the largest holder of LCY corporate bonds at the end of June. Their share of the corporate bond market fell to 19.5% at the end of June from 25.6% a year earlier **(Figure 4)**. Fund institutions became the dominant holder of corporate bonds, driven by mutual funds seeking higher yields, with a share of the outstanding stock that rose to 41.8% at the end of June from 26.0% a year earlier.

Figure 5 presents investor profiles across corporate bond categories at the end of June. Funds institutions were the dominant holder of both local corporate bonds and medium-term notes. On the other hand, the share of banks' holdings declined from a year earlier. Banks and insurance companies were the dominant holders of commercial bank bonds at the end of June, with banks holding the majority of common bonds and insurance companies holding the most subordinated bonds.

Liquidity

Interest rate swap volumes rose 17.7% q-o-q, driven mostly by an increase in 7-day repurchase transactions. The 7-day repurchase interest rate swap is the most popular interest rate swap, accounting for nearly 91% of total transaction volume in Q2 2016 **(Table 5)**.

Figure 6 presents the turnover ratio of government bonds, broken down into Treasury bonds and policy bank bonds. There was a surge in trading activity for both types of government bonds in Q2 2016 due to increased demand for safer assets owing to credit concerns in the corporate bond market.

Table 3: Top 30 Issuers of Local Currency Corporate Bonds in the People's Republic of China

	Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
		LCY Bonds (CNY billion)	LCY Bonds (USD billion)			
1.	China Railway	1,258.5	189.31	Yes	No	Transportation
2.	State Grid Corporation of China	472.1	71.01	Yes	No	Public Utilities
3.	China National Petroleum	410.0	61.67	Yes	No	Energy
4.	Industrial and Commercial Bank of China	283.0	42.57	Yes	Yes	Banking
5.	Agricultural Bank of China	260.0	39.11	Yes	Yes	Banking
6.	Bank of China	258.9	38.94	Yes	Yes	Banking
7.	China Construction Bank	212.0	31.89	Yes	Yes	Banking
8.	Petrochina	181.0	27.23	Yes	Yes	Energy
9.	Industrial Bank	176.0	26.47	No	Yes	Banking
10.	Shanghai Pudong Development Bank	169.6	25.51	No	Yes	Banking
11.	Bank of Communications	149.0	22.41	No	Yes	Banking
12.	State Power Investment	136.2	20.49	Yes	No	Energy
13.	China Minsheng Bank	135.1	20.32	No	Yes	Banking
14.	Bank of Beijing	122.9	18.49	Yes	Yes	Banking
15.	Central Huijin Investment	109.0	16.40	Yes	No	Diversified Financial
16.	China Citic Bank	107.5	16.17	No	Yes	Banking
17.	Senhua Group	106.0	15.94	Yes	No	Energy
18.	China Petroleum and Chemical	98.5	14.82	Yes	Yes	Energy
19.	China United Network Communications	91.0	13.69	Yes	Yes	Telecommunications
20.	China Everbright Bank	88.9	13.37	Yes	Yes	Banking
21.	China Datang	86.7	13.04	Yes	Yes	Energy
22.	China Three Gorges Project	85.5	12.86	Yes	No	Public Utilities
23.	China Guangfa Bank	84.5	12.71	No	Yes	Banking
24.	Shaanxi Coal and Chemical Industry Group	83.5	12.56	Yes	Yes	Energy
25.	Huaxia Bank	80.4	12.09	Yes	No	Banking
26.	Tianjin Infrastructure Construction & Investment Group	79.4	11.94	Yes	No	Industrial
27.	China Merchants Bank	79.0	11.88	No	Yes	Banking
28.	Haitong Securities	78.0	11.73	Yes	Yes	Brokerage
29.	China Huarong Asset Management	77.0	11.58	Yes	Yes	Asset Management
30.	China Southern Power Grid	74.0	11.13	Yes	No	Public Utilities
Total Top 30 LCY Corporate Issuers		**5,633.20**	**847.35**			
Total LCY Corporate Bonds		**14,611.50**	**2,197.88**			
Top 30 as % of Total LCY Corporate Bonds		**38.6%**	**38.6%**			

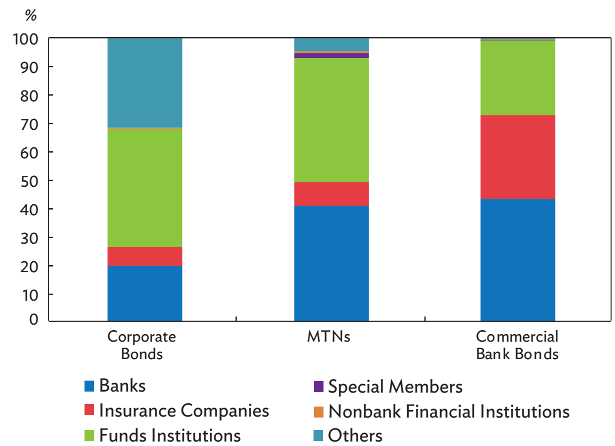
CNY = Chinese yuan, LCY = local currency, USD = United States dollar.
Notes:
1. Data as of end-June 2016.
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on Bloomberg LP data.

Table 4: Notable Local Currency Corporate Bond Issuance in Q2 2016

Corporate Issuers	Coupon Rate (%)	Issued Amount (CNY billion)
China Railway		
5-year bond	3.35	15
10-year bond	3.46	20
Industrial Bank		
10-year bond	3.74	30
Haitong Securities		
4-year bond	3.60	15
China Guangfa Bank		
5-year bond	3.52	15
China Cinda Asset Masnagement		
10-year bond	3.70	10
Ping An Life Insurance		
10-year bond	3.82	10

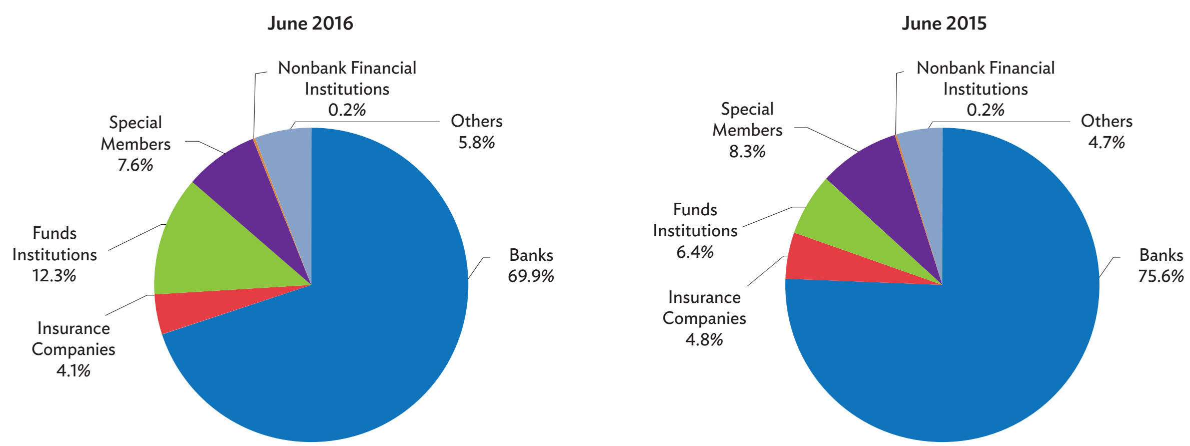
CNY = Chinese yuan, Q2 = second quarter.
Source: Based on data from Bloomberg LP.

Figure 5: Investor Profile across Bond Categories



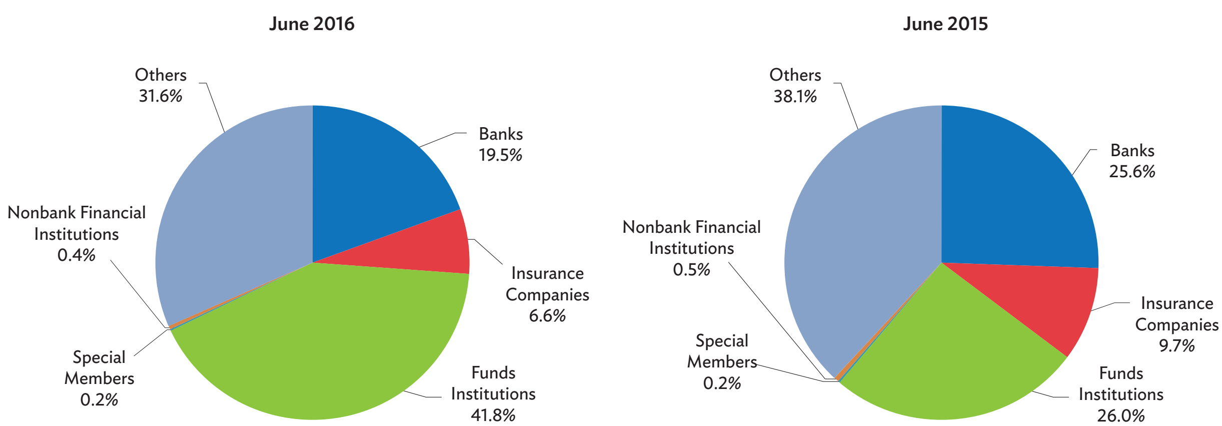
MTNs = medium-term notes.
Note: Data as of end-June 2016.
Source: *ChinaBond*.

Figure 3: Local Currency Treasury Bonds and Policy Bank Bonds Investor Profile



Source: *ChinaBond*.

Figure 4: Local Currency Corporate Bonds Investor Profile



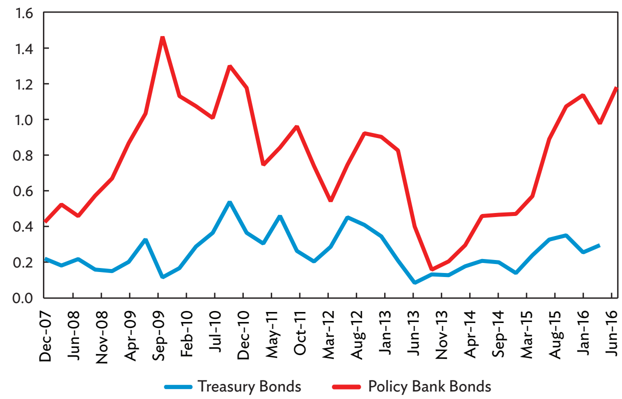
Source: *ChinaBond*.

Table 5: Notional Values of the People's Republic of China's Interest Rate Swap Market in Q2 2016

Interest Rate Swap Benchmarks	Notional Amount (CNY billion)	Percentage of Total Notional Amount (%)	Growth Rate (%)
	Q2 2016		q-o-q
7-Day Repo Rate	2,145.2	90.6	30.4
Overnight SHIBOR	53.0	2.2	(55.9)
3-Month SHIBOR	154.7	6.5	(33.9)
1-Year Term Deposit Rate	7.1	0.3	26.1
1-Year Lending Rate	8.0	0.3	23.6
3-Year Lending Rate	0.6	0.02	40.0
Total	**2,368.5**	**100.0**	**17.7**

( ) = negative, CNY = Chinese yuan, q-o-q = quarter-on-quarter, Q2 =second quarter, Repo = repurchase, SHIBOR = Shanghai Interbank Offered Rate.
Notes:
1. Growth rate computed based on notional amounts.
2. London Interbank Offered Rate, 1-Year Loan Prime Rate, and 5-Year Lending Rate had no transaction for Q2 2016.
Sources: *AsianBondsOnline* and *ChinaMoney*.

Figure 6: Turnover Ratios for Government Bonds



Source: *ChinaBond*.

Policy, Institutional, and Regulatory Developments

Green Bonds Program Expanded

On 6 April, the government launched a pilot program to allow PRC-based issuers to issue and list green bonds on the Shanghai Stock Exchange. To qualify as a green bond, the most important requirement is that only green assets and projects can be funded by the proceeds of the bond.

World Bank Group to Issue Special Drawing Rights-Denominated Bonds in the Interbank Bond Market

On 21 August, the PRC approved the International Bank for Reconstruction and Development of the World Bank Group to issue Special Drawing Rights-denominated bonds in the PRC's interbank bond market. The issue size will be SDR2 billion and the bond will be settled in renminbi.

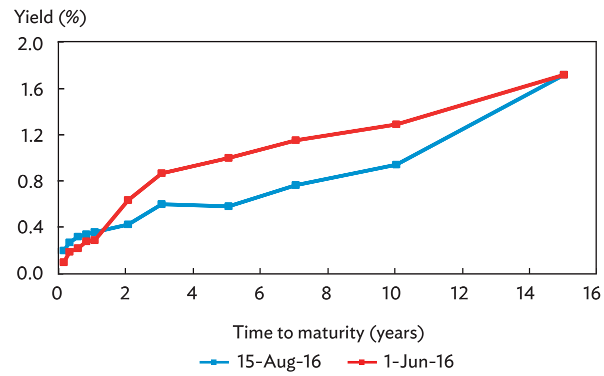
Hong Kong, China

Yield Movements

Hong Kong, China's Exchange Fund Bills and Notes yield curve, which generally tracks United States interest rate movements, shifted downward for most tenors between 1 June and 15 August. Yields for all tenors of 2 years or longer fell with the exception of the 15-year tenor, which remained unchanged. The largest decline was the yield for the 5-year tenor, which fell 42 basis points (bps). For tenors of 1 year or less, yields rose between 6 bps and 10 bps. The 2-year versus 10-year yield spread fell to 51 bps on 15 August from 65 bps on 1 June **(Figure 1)**.

Hong Kong, China's economy somewhat stabilized in the second quarter (Q2) of 2016, with gross domestic product growing 1.7% year-on-year (y-o-y) after growing only 0.8% y-o-y in the prior quarter. The increase in economic growth in Q2 2016 was largely due to improvements in external demand. Domestic demand further weakened, with personal consumption expenditures rising 0.6% y-o-y in Q2 2016 versus 1.2% in the previous quarter. Exports of goods rose 2.0% y-o-y in Q2 2016 after a decline of 3.6% y-o-y in the prior quarter. The government's forecast for full-year 2016 remains unchanged at 1.0%–2.0%. Inflationary pressures remain subdued given low external inflation. Consumer price inflation continued its downward trend, with consumer prices rising 2.3% y-o-y in July from 2.4% y-o-y in June.

Figure 1: Hong Kong, China's Benchmark Yield Curve—Exchange Fund Bills and Notes



Source: Based on data from Bloomberg LP.

Size and Composition

Hong Kong, China's local currency (LCY) bond market grew 6.6% quarter-on-quarter (q-o-q) and 15.2% y-o-y to reach HKD1,755 billion (USD226 billion) at the end of June **(Table 1)**. The q-o-q growth was mostly driven by increases in Exchange Fund Bills (EFBs) and corporate bonds.

The outstanding amount of EFBs rose 7.3% q-o-q in Q2 2016 on a relatively high level of new issuance of HKD618 billion for the quarter.

Table 1: Size and Composition of the Local Currency Bond Market in Hong Kong, China

	Outstanding Amount (billion)						Growth Rate (%)			
	Q2 2015		Q1 2016		Q2 2016		Q2 2015		Q2 2016	
	HKD	USD	HKD	USD	HKD	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**1,523**	**196**	**1,646**	**212**	**1,755**	**226**	**(1.5)**	**2.0**	**6.6**	**15.2**
Government	846	109	957	123	1,013	131	(1.3)	(0.4)	5.8	19.8
Exchange Fund Bills	689	89	800	103	859	111	0.4	0.7	7.3	24.6
Exchange Fund Notes	64	8	56	7	53	7	(4.1)	(5.9)	(5.3)	(16.3)
Government Bonds	93	12	101	13	101	13	(11.3)	(4.5)	0.0	8.5
Corporate	677	87	688	89	742	96	(1.6)	5.1	7.8	9.6

( ) = negative, HKD = Hong Kong dollar, q-o-q = quarter-on-quarter, Q1 = first quarter, Q2 = second quarter, USD = United States dollar, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Bloomberg LP end-of-period local currency–USD rates are used.
3. Growth rates are calculated from local currency base and do not include currency effects.
Sources: Hong Kong Monetary Authority and Bloomberg LP.

The Hong Kong Monetary Authority (HKMA) issued EFBs in Q2 2016 to help mop up liquidity due to increased inflows into Hong Kong, China's stock market ahead of its linking with the Shenzhen Stock Exchange.

Exchange Fund Notes (EFNs) further declined in Q2 2016, falling 5.3% q-o-q and 16.3% y-o-y, as HKMA preferred instead to issue Hong Kong Special Administrative Region (HKSAR) government bonds. In Q2 2016, the amount of HKSAR government bonds was unchanged on a q-o-q basis but rose 8.5% y-o-y on increased issuance, including an HKD2.5 billion 5-year HKSAR government bond and an HKD1.2 billion 10-year HKSAR government bond under the Institutional Bond Programme. In addition, an HKD10.0 billion 3-year HKSAR government bond was issued under the Retail Bond Programme.

The amount of corporate bonds outstanding rose 7.8% q-o-q and 9.6% y-o-y in Q2 2016 as issuers took advantage of lower Hong Kong dollar interest rates.

The top 30 nonbank issuers in Hong Kong, China had outstanding LCY bonds amounting to HKD140.2 billion at the end of June, representing 18.9% of total corporate bonds outstanding. The top 30 list of issuers was dominated by real estate firms and the financing vehicles of corporates **(Table 2)**. The Hong Kong Mortgage Corporation remained the top issuer with outstanding bonds of HKD29.39 billion. It was followed by the Link Finance (Cayman) 2009 with HKD8.9 billion of bonds outstanding and Sun Hung Kai Properties (Capital Market) with HKD8.85 billion. Among the top 30 nonbank issuers at the end of June, 6 were state-owned companies, and 8 were Hong Kong Exchange-listed firms.

The top 5 nonbank issuances in Q2 2016 came from Bestgain Real Estate Lyra, the Hong Kong Mortgage Corporation, Sun Hung Kai Properties (Capital Market), Hong Kong Electric Finance, and Swire Properties **(Table 3)**.

Policy, Institutional, and Regulatory Developments

Hong Kong, China Issues Silver Bonds

On 10 August, Hong Kong, China issued HKD3 billion worth of Silver Bonds under the Retail Bond Issuance Programme. The bonds, which can only be subscribed to by Hong Kong, China residents aged 65 years or older, pay interest on a semiannual basis. The coupon is based on the average rate of consumer price inflation in Hong Kong, China for the past 6 months or 2%, whichever is higher.

Table 2: Top 30 Nonbank Corporate Issuers in Hong Kong, China

	Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
		LCY Bonds (HKD billion)	LCY Bonds (USD billion)			
1.	The Hong Kong Mortgage Corporation	29.39	3.79	Yes	No	Finance
2.	The Link Finance (Cayman) 2009	8.90	1.15	No	No	Finance
3.	Sun Hung Kai Properties (Capital Market)	8.85	1.14	No	No	Real Estate
4.	CLP Power Hong Kong Financing	8.46	1.09	No	No	Finance
5.	MTR Corporation (C.I.)	8.22	1.06	Yes	Yes	Transportation
6.	Hongkong Electric Finance	6.98	0.90	No	No	Finance
7.	HKCG (Finance)	6.94	0.89	No	No	Finance
8.	Swire Pacific	6.68	0.86	No	Yes	Diversified
9.	Wharf Finance	6.13	0.79	No	No	Finance
10.	NWD (MTN)	5.50	0.71	No	Yes	Finance
11.	Wheelock Finance	4.04	0.52	No	No	Finance
12.	Bestgain Real Estate Lyra	3.65	0.47	No	No	Real Estate
13.	Swire Properties MTN Financing	3.54	0.46	No	No	Finance
14.	Kowloon-Canton Railway	3.40	0.44	Yes	No	Transportation
15.	Urban Renewal Authority	3.30	0.43	Yes	No	Real Estate
16.	Emperor International Holdings	2.75	0.35	No	Yes	Real Estate
17.	Yue Xiu Property	2.30	0.30	No	No	Real Estate
18.	Chueng Kong Finance (MTN)	2.21	0.28	No	No	Finance
19.	Tencent Holdings	2.20	0.28	No	Yes	Comunications
20.	Airport Authority Hong Kong	2.05	0.26	Yes	No	Transportation
21.	Bohai International Capital	2.00	0.26	No	No	Iron and Steel
22.	China Energy Reserve and Chemicals Group Overseas	2.00	0.26	No	No	Oil
23.	Hong Kong Science and Technology Parks	1.71	0.22	Yes	No	Real Estate
24.	Cathay Pacific MTN Financing	1.70	0.22	No	Yes	Finance
25.	Wharf Finance (No. 1)	1.44	0.19	No	No	Finance
26.	Hysan (MTN)	1.40	0.18	No	Yes	Real Estate
27.	Nan Fung Treasury	1.31	0.17	No	No	Real Estate
28.	Henderson Land MTN	1.19	0.15	No	Yes	Finance
29.	Cheung Kong Bond Securities (02)	1.00	0.13	No	No	Finance
30.	Dragon Drays	1.00	0.13	No	No	Diversified
Total Top 30 Nonbank LCY Corporate Issuers		**140.19**	**18.07**			
Total LCY Corporate Bonds		**742.00**	**95.63**			
Top 30 as % of Total LCY Corporate Bonds		**18.9%**	**18.9%**			

LCY = local currency.
Notes:
1. Data as of end-June 2016.
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on Hong Kong Monetary Authority data.

Table 3: Notable Local Currency Corporate Bond Issuance in Q2 2016

Corporate Issuers	Coupon Rate (%)	Issued Amount (HKD billion)
The Hong Kong Mortgage Corporation		
1-year bond	0.92	2.00
1-year bond	0.81	0.74
1-year bond	0.92	0.68
1-year bond	0.80	0.50
1-year bond	0.92	0.50
2-year bond	1.21	1.00
3-year bond	1.44	1.00
Bestgain Real Estate Lyra		
3-year bond	2.50	3.65
Sun Hung Kai Properties (Capital Market)		
10-year bond	2.50	0.50
10-year bond	2.56	0.34
Swire Properties		
7-year bond	2.25	0.20
10-year bond	2.65	0.20
Hong Kong Electric Finance		
15-year bond	2.58	0.31

HKD = Hong Kong dollar, Q2 = second quarter.
Source: Central Moneymarkets Unit, Hong Kong Monetary Authority.

Indonesia

Yield Movements

Between 1 June and 15 August, local currency (LCY) government bond yields in Indonesia declined for all tenors, which caused the entire yield curve to shift downward **(Figure 1)**. The yield for the 10-year maturity dropped the most, shedding 104 basis points (bps). Bond yields for all other tenors from the shorter-end through the longer-end of the curve declined an average of 80 bps. As a result, the yield spread between the 2-year and 10-year maturities narrowed to 32 bps on 15 August from 62 bps on 1 June.

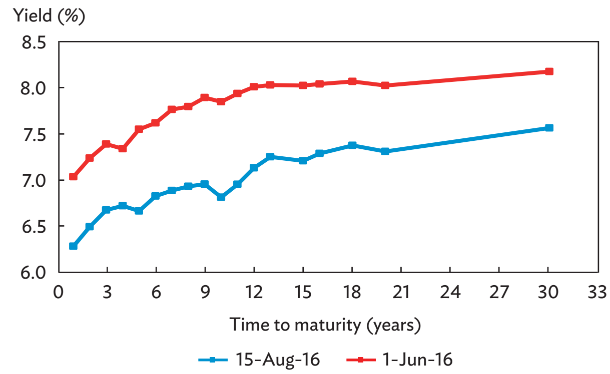
Declining yields across the length of the curve reflected, in part, strong demand from foreign investors as they continued to shore up their holdings of IDR-denominated bonds in search of yields. The delay in the United States Federal Reserve's interest rate hike has led offshore funds into emerging market assets amid a relatively low interest rate environment globally.

Also supportive of the overall drop in yields were more stable macroeconomic factors, including a generally benign inflation outlook, a stable Indonesian rupiah vis-à-vis the United States dollar, and a narrower current account deficit. In addition, policy and regulatory reforms initiated by the government, such as the Tax Amnesty Law, have helped boost sentiment in the LCY bond market (see Policy and Regulatory Developments).

The overall decline in yields across the curve was also driven by Bank Indonesia's accommodative monetary policy stance as it lowered the benchmark policy rate by 25 bps in June, reducing the previous policy rate by a cumulative 100 bps since the start of the year. Subsequently, Bank Indonesia introduced a new policy rate—the 7-day reverse repurchase rate—on 19 August to achieve a more "effective monetary policy transmission."

In its Bank of Governors meeting on 18–19 August, Bank Indonesia decided to keep the 7-day reverse repurchase rate steady at 5.25%. Bank Indonesia also kept unchanged the deposit facility rate at 4.50%, while it lowered by 100 bps the lending facility rate to 6.00%. Bank Indonesia noted that there is room for further monetary easing as long as macroeconomic stability is maintained.

Figure 1: Indonesia's Benchmark Yield Curve—Local Currency Government Bonds



Source: Based on data from Bloomberg LP.

Inflation is expected to remain within Bank Indonesia's target range of 3.0%–5.0% for full-year 2016. Consumer price inflation slowed to 3.6% year-on-year (y-o-y) in April and further to 3.3% y-o-y in May. A slight uptick in inflation to 3.5% y-o-y was noted in June, which coincided with increased demand for goods and services during the Muslim fasting month of Ramadan. However, inflation subsequently eased again to 3.2% y-o-y in July and 2.8% in August.

Indonesia's real gross domestic product (GDP) growth climbed to 5.2% y-o-y in the second quarter (Q2) of 2016 from 4.9% y-o-y in the first quarter (Q1) of 2016 on faster growth in consumption spending by the private sector (5.0% y-o-y) and the government (2.9% y-o-y). On the other hand, investment growth eased to 5.1% y-o-y and both exports and imports contracted during the quarter in review. On a quarter-on-quarter (q-o-q) and nonseasonally adjusted basis, real GDP growth climbed to 4.0% in Q2 2016 after contracting 0.4% in Q1 2016.

Size and Composition

The LCY bond market in Indonesia reached a size of IDR2,003.0 trillion (USD152 billion) at the end of June, climbing 5.2% q-o-q and 20.1% y-o-y in Q2 2016 **(Table1)**. Growth was driven by increases in both government and corporate bonds. Conventional bonds accounted for the largest component of the

Table 1: Size and Composition of the Local Currency Bond Market in Indonesia

	Outstanding Amount (billion)						Growth Rate (%)			
	Q2 2015		Q1 2016		Q2 2016		Q2 2015		Q2 2016	
	IDR	USD	IDR	USD	IDR	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**1,668,177**	**125**	**1,903,610**	**144**	**2,003,006**	**152**	**2.4**	**13.8**	**5.2**	**20.1**
Government	1,429,181	107	1,649,687	125	1,732,935	131	2.0	14.5	5.0	21.3
Central Govt. Bonds	1,356,434	102	1,575,115	119	1,646,846	125	3.9	19.9	4.6	21.4
of which: *Sukuk*	156,209	12	204,222	15	218,948	17	7.6	54.2	7.2	40.2
Central Bank Bills	72,748	5	74,572	6	86,089	7	(24.3)	(37.7)	15.4	18.3
of which: *Sukuk*	8,458	0.6	7,038	0.5	7,470	0.6	(4.0)	24.5	6.1	(11.7)
Corporate	238,996	18	253,923	19	270,071	20	5.0	9.9	6.4	13.0
of which: *Sukuk*	7,944	0.6	9,216	0.7	9,561	0.7	12.2	14.2	3.7	20.4

( ) = negative, IDR = Indonesian rupiah, q-o-q = quarter-on-quarter, Q1 = first quarter, Q2 = second quarter, USD = United States dollar, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Bloomberg LP end-of-period local currency–USD rates are used.
3. Growth rates are calculated from local currency base and do not include currency effects.
4. The total stock of nontradable bonds as of end-June stood at IDR260.5 trillion.
Sources: Bank Indonesia; Directorate General of Budget Financing and Risk Management, Ministry of Finance; Indonesia Stock Exchange; Otoritas Jasa Keuangan; and Bloomberg LP.

aggregate bond stock with an 88.2% share of the total at the end of June. *Sukuk* (Islamic bonds) represented an 11.8% share.

Government Bonds. The outstanding amount of government bonds expanded to IDR1,732.9 trillion at the end of June, rising 5.0% q-o-q and 21.3% y-o-y. Growth stemmed largely from central government bonds, which comprise debt securities issued by the Ministry of Finance. The stock of central bank bills, known as *Sertifikat* Bank Indonesia (SBI), while smaller in size also contributed to overall growth in Q2 2016.

Central Government Bonds. The outstanding size of central government bonds, which comprise Treasury bills and bonds, reached IDR1,646.8 trillion at the end of June, up 4.6% q-o-q and 21.4% y-o-y. The government awarded more than its targeted amount in 11 out of the 13 auctions it conducted in Q2 2016, taking advantage of lower borrowing costs and increased demand from both onshore and offshore investors.

Domestic investors began shoring up their government bond portfolios following a regulation passed by Otoritas Jasa Keuangan earlier this year requiring insurance companies and pension funds to hold 20% of their portfolio in government bonds (conventional and *sukuk*) in 2016 and 30% in 2017. Also, foreign investors remain attracted to Indonesia's government bond market amid the low interest rate environment in the global market.

In Q2 2016, central government bond issuance stood at IDR118.3 trillion, down 26.1% q-o-q but up 32.8% y-o-y. On a q-o-q basis, issuance slowed due to the base effects generated by the high level of retail *sukuk* issuance in Q1 2016. New bond issuance in Q2 2016 comprised the government's weekly auctions of conventional and Islamic Treasury instruments. All seven auctions of Islamic bills and project-based *sukuk* during the quarter were awarded either in full or above target.

Following revisions to the 2016 budget that were approved by Parliament in late June, the government needs to fund a larger deficit estimated at IDR296.7 trillion, or the equivalent of 2.35% of GDP, which is up from IDR273.2 trillion, or 2.15% of GDP. As a result, net government securities issuance increased from IDR327.2 trillion to IDR364.9 trillion. The bulk of the issuance (74%) will be issued in local currency and the remaining amount (24%) will be sourced from international bond issuance. The budget deficit is expected to be funded partly by increased revenue collections from the Tax Amnesty Law.

Central Bank Bills. The outstanding amount of central bank bills, or SBI, climbed to IDR86.1 trillion at the end of June on double-digit growth rates of 15.4% q-o-q and 18.3% y-o-y. The central bank issues SBI as part of its monetary policy tools for liquidity management. Bank Indonesia auctions both conventional and shariah-compliant SBI on a monthly basis for maturities of 9 months and 1 year. Total issuance of SBI reached

IDR28.9 trillion in Q2 2016, down 24.4% q-o-q. On a y-o-y basis, however, SBI issuance increased 13 fold in Q2 2016 due to a low base effect as Bank Indonesia temporarily ceased issuance of conventional SBI in Q2 2015 while opting to utilize other tools for managing liquidity.

Corporate Bonds. The outstanding size of LCY corporate bonds in Indonesia totaled IDR270.1 trillion at the end of June, posting growth of 6.4% q-o-q and 13.0% y-o-y in Q2 2016. The corporate bond segment constitutes a small share of the LCY bond market in Indonesia, accounting for only 13.5% at the end of June. Conventional bond issues continued to comprise a majority of the corporate bond total, representing a share of 96.5%.

At the end of June, the top 30 LCY corporate bond issuers in Indonesia had aggregate LCY bonds outstanding that reached IDR207.3 trillion **(Table 2)**. These 30 issuers together comprised 76.7% of the total LCY corporate bond stock, with 20 firms among them tapping both the bond and equity markets for their financing needs. Eleven state-owned firms were among the top 30 corporate issuers at the end of June, including the three largest. The top 30 list was dominated in Q2 2016 by firms from the banking and financial sectors, while a few names from capital-intensive industries (e.g., energy, telecommunications, building construction, and property and real estate) were also included.

The top three issuers of corporate bonds at the end of June were all state-owned firms. Leading the list was Indonesia Eximbank, which maintained its rank as the largest corporate bond issuer in Indonesia in Q2 2016. Its aggregate bond stock increased to IDR25.5 trillion at the end of June, accounting for a 9.5% share of the total corporate bond stock. Climbing to the second spot was Bank Rakyat Indonesia, which ranked ninth in Q1 2016, with an outstanding bond stock of IDR12.0 trillion. Energy firm PLN dropped to the third spot with outstanding bonds valued at IDR11.7 trillion.

The volume of new corporate debt issues more than doubled in Q2 2016 to IDR32.9 trillion, up 139.2% q-o-q. On a y-o-y basis, new corporate debt issuance rose 39.5% in Q2 2016. In Q2 2016, a total of 21 firms tapped the debt securities market for their funding requirements, taking advantage of lower borrowing costs. Most issuers of corporate bonds were from the banking and financial sectors. A total of 47 bond series were issued during the quarter, all of which were conventional bonds except for Maybank Indonesia's issuance of *sukuk mudharabah* (profit-sharing bonds).

Table 3 lists some of the largest corporate bond issuers in Q2 2016. Bank Rakyat Indonesia issued a total of IDR4,350 billion worth of bonds in three tranches in May, the largest issuance in terms of aggregate size in Q2 2016. Indonesia Eximbank also raised IDR4,000 billion from a triple-tranche bond sale in June, while Federal International Finance raised IDR3,375 billion from a dual-tranche bond sale in April.

In Q2 2016, the new corporate bonds issued were mostly short-dated in terms of maturity, with 33 out of 47 bond series carrying maturities of 3 years or less. There were nine bond series carrying a maturity of 5 years and four bond series with 7 years. Among the new corporate bond issuance in Q2 2016, the longest-dated bond series was a 10-year maturity issued by Pelindo Gerbang Nusantara.

Foreign Currency Bonds. In June, the Indonesian government raised a total of EUR3.0 billion from a dual-tranche offering. The bond sale comprised a EUR1.5 billion 7-year bond priced to yield 2.772% with a coupon rate of 2.625%, and a EUR1.5 billion 12-year bond priced to yield 3.906% with a coupon rate of 3.75%. The bonds were well received, with the order book reaching EUR8.36 billion.

Also in June, the government sold JPY100 billion worth of samurai bonds via private placement to institutional investors in Japan. The offering comprised JPY62 billion of 3-year bonds with a coupon rate of 0.83% and JPY38 billion of 5-year bonds with a coupon rate of 1.16%. The samurai bonds were issued without a guarantee from the Japan Bank for International Cooperation.

Investor Profiles

Central Government Bonds. Foreign investors continued to shore up their holdings of Indonesian LCY government bonds, increasing their share to 39.1% of total LCY central government bonds outstanding at the end of June 2016 from 38.2% a year earlier **(Figure 2)**. In absolute value terms, foreign investors held a total of IDR644.0 trillion of central government bonds at the end of June. Foreign funds continue to invest in Indonesian government bonds

Table 2: Top 30 Issuers of Local Currency Corporate Bonds in Indonesia

	Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
		LCY Bonds (IDR billion)	LCY Bonds (USD billion)			
1.	Indonesia Eximbank	25,539	1.93	Yes	No	Banking
2.	Bank Rakyat Indonesia	12,000	0.91	Yes	Yes	Banking
3.	PLN	11,733	0.89	Yes	No	Energy
4.	Indosat	11,033	0.84	No	Yes	Telecommunications
5.	Bank Tabungan Negara	10,950	0.83	Yes	Yes	Banking
6.	Adira Dinamika Multifinance	10,198	0.77	No	Yes	Finance
7.	Astra Sedaya Finance	9,395	0.71	No	No	Finance
8.	Telekomunikasi Indonesia	8,995	0.68	Yes	Yes	Telecommunications
9.	Bank Internasional Indonesia	8,880	0.67	No	Yes	Banking
10.	Federal International Finance	7,681	0.58	No	No	Finance
11.	Bank Pan Indonesia	7,560	0.57	No	Yes	Banking
12.	Perum Pegadaian	7,059	0.53	Yes	No	Finance
13.	Bank CIMB Niaga	6,865	0.52	No	Yes	Banking
14.	Bank Permata	6,482	0.49	No	Yes	Banking
15.	Sarana Multigriya Finansial	6,241	0.47	Yes	No	Finance
16.	Jasa Marga	5,900	0.45	Yes	Yes	Toll Roads, Airports, and Harbors
17.	Bank OCBC NISP	4,785	0.36	No	Yes	Banking
18.	Waskita Karya	4,675	0.35	Yes	Yes	Building Construction
19.	Toyota Astra Financial Services	4,591	0.35	No	No	Finance
20.	Agung Podomoro Land	4,575	0.35	No	Yes	Property and Real Estate
21.	Indofood Sukses Makmur	4,000	0.30	No	Yes	Food and Beverages
22.	Surya Artha Nusantara Finance	3,541	0.27	No	No	Finance
23.	Bank Mandiri	3,500	0.26	Yes	Yes	Banking
24.	Medco-Energi International	3,500	0.26	No	Yes	Petroleum and Natural Gas
25.	Bumi Serpong Damai	3,315	0.25	No	Yes	Property and Real Estate
26.	Indomobil Finance Indonesia	3,114	0.24	No	No	Finance
27.	Antam	3,000	0.23	Yes	Yes	Mining
28.	Wahana Ottomitra Multiartha	2,828	0.21	No	Yes	Finance
29.	Mandiri Tunas Finance	2,825	0.21	No	No	Finance
30.	Summarecon Agung	2,500	0.19	No	Yes	Property and Real Estate
Total Top 30 LCY Corporate Issuers		**207,260**	**15.69**			
Total LCY Corporate Bonds		**270,071**	**20.44**			
Top 30 as % of Total LCY Corporate Bonds		**76.7%**	**76.7%**			

IDR = Indonesian rupiah, LCY = local currency, USD = United States dollar.
Notes:
1. Data as of end-June 2016.
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on Indonesia Stock Exchange data.

Table 3: Notable Local Currency Corporate Bond Issuance in Q2 2016

Corporate Issuers	Coupon Rate (%)	Issued Amount (IDR billion)
Bank Rakyat Indonesia		
370-day bond	7.50	1,212
3-year bond	8.20	2,437
5-year bond	8.70	701
Indonesia Eximbank		
370-day bond	7.50	688
3-year bond	8.20	1,060
5-year bond	8.70	2,252
Federal International Finance		
370-day bond	8.50	868
3-year bond	9.15	2,507
Bank Pan Indonesia		
5-year bond	9.15	2,000
7-year bond	9.60	100
Waskita Karya		
3-year bond	9.25	2,000
Bank OCBC NISP		
370-day bond	7.50	837
2-year bond	8.00	380
3-year bond	8.25	783
Astra Sedaya Finance		
370-day bond	7.95	770
3-year bond	8.50	1,230

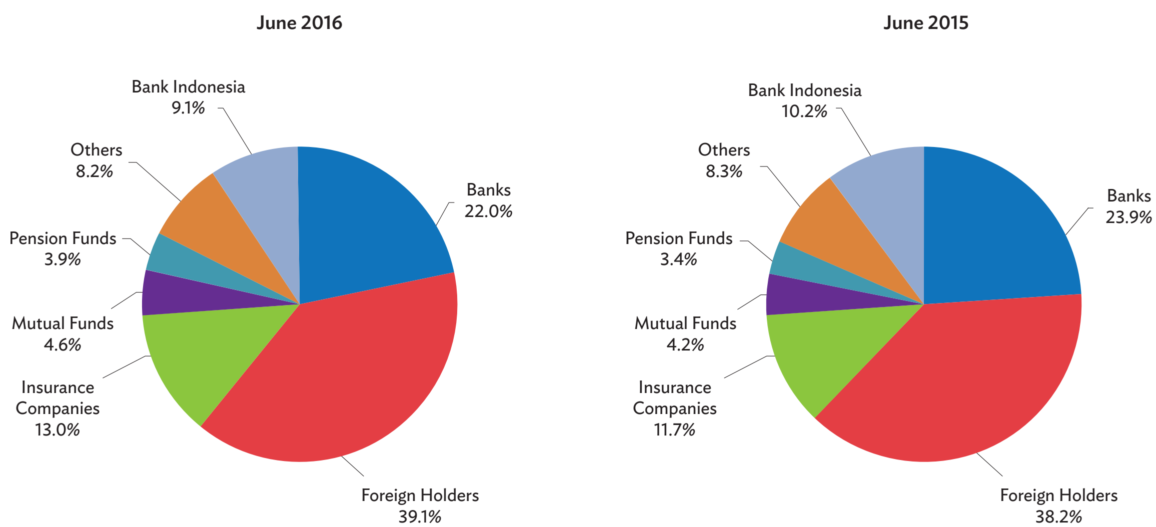
IDR = Indonesian rupiah, Q2 = second quarter.
Source: Indonesia Stock Exchange.

as the yields are among the highest in emerging East Asia. In addition, foreign governments and central banks also hold Indonesian LCY government bonds as part of their foreign reserves.

Foreign investors increased their holdings of long-term maturities, with a 47.7% share of their holdings at the end of June placed in bonds with maturities of more than 10 years, compared with 44.7% at the end of December. **(Figure 3)**. About 35.9% of their holdings were in medium-dated tenors, which are those with maturities of between more than 5 years and 10 years. Bonds with maturities of 2 years or less accounted for only 5.3% of aggregate foreign holdings.

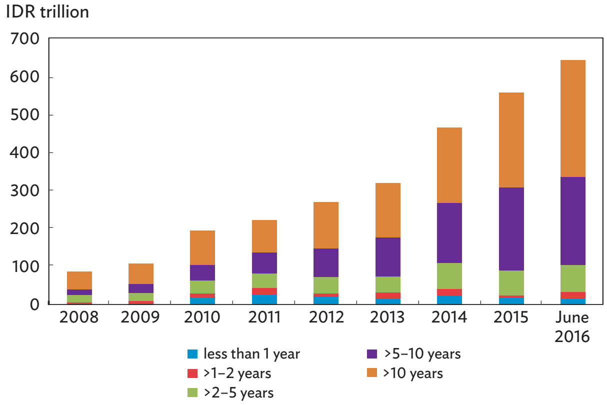
Among domestic investors, banking institutions were the largest holders of Indonesian Treasury instruments in Q2 2016. However, their share declined to 22.0% at the end of June from 23.9% a year earlier. On the other hand, insurance companies and pension funds increased their holdings of central government bonds at the end of June to 13.0% and 3.9%, respectively. Partly contributing to this increase was the regulation issued by Otoritas Jasa Keuangan earlier this year requiring insurance companies and pension funds to keep 20% of their portfolios in government bonds in 2016 and 30% in 2017.

Figure 2: Local Currency Central Government Bonds Investor Profile



Source: Directorate General of Budget Financing and Risk Management, Ministry of Finance.

Figure 3: Foreign Holdings of Local Currency Central Government Bonds by Maturity

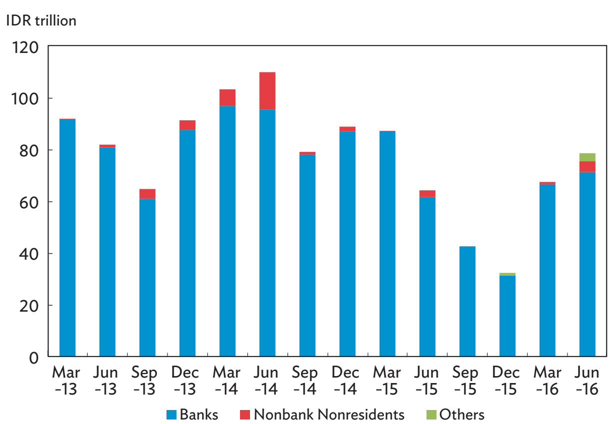


IDR = Indonesian rupiah.
Source: Directorate General of Budget Financing and Risk Management, Ministry of Finance.

Other nonbank investors, particularly mutual funds and other investors, recorded increases in their holdings of central government bonds, although their shares of the total remained small at less than 10.0% each. Meanwhile, Bank Indonesia's holdings of Treasury instruments declined to 9.1% at the end of June from 10.2% a year earlier.

Central Bank Bills. Central bank bills, or SBI, were still largely held by banking institutions, which had a share of 90.7% at the end of June **(Figure 4)**. Nonbank nonresident investors accounted for a 5.3% share, while the remaining 4.0% was accounted for by other investors.

Figure 4: Local Currency Central Bank Bills Investor Profile



IDR = Indonesian rupiah.
Notes:
1. For end-September and end-December 2015, nonresidents had no holdings of *Sertifikat* Bank Indonesia (SBI).
2. For end-March 2016, nonresidents held IDR0.9 trillion of SBI.
Source: Bank Indonesia.

Ratings Update

In June, S&P Global Ratings affirmed Indonesia's sovereign credit rating at BB+. The outlook on the rating was positive. S&P Global Ratings cited Indonesia's improved policy and institutional settings, credible monetary policy, and buoyant economic growth as the key factors in its decision.

Policy, Institutional, and Regulatory Developments

Finance Ministry Removes Withholding Tax on Interest Payments for Foreign Currency Government Bonds

In June, Indonesia's Ministry of Finance provided tax incentives to investors in conventional and Islamic foreign currency-denominated government bonds by removing the withholding tax on interest payments. A withholding tax of 15% had been levied for Indonesian residents while a 20% tax was levied for nonresidents. The removal of the withholding tax will help lower the government's borrowing costs on its foreign currency government bonds. This will also help corporate bonds receive better pricing as government bonds are normally used as a benchmark for pricing. The regulation is effective retroactively from 1 January 2016.

Parliament Approves Tax Amnesty Law

In June, Parliament approved the Tax Amnesty Law to lure wealthy residents to repatriate funds parked in tax havens. The new law levies tax rates of 2.0%–5.0% for assets that are declared and repatriated and 4.0%–10.0% for assets that are only declared. Investment instruments have been prepared by the government for the placement of repatriated funds, which will need to be placed in the Indonesian capital market for a period of at least 3 years.

The government estimates that the measures will attract IDR4,000 trillion in declared assets and IDR1,000 trillion in repatriated funds. The government expects to raise IDR165 trillion in revenues from this program, which will help fund the larger deficit included in the 2016 revised budget. The tax amnesty program runs from 18 July 2016 to 31 March 2017.

Parliament Approves 2016 Revised State Budget

On 28 June, the Indonesian Parliament approved the revised 2016 state budget, which widened the programmed budget deficit to IDR296.7 trillion, or the equivalent of 2.35% of GDP from the equivalent of 2.15% of GDP in the original budget. The revised state budget estimates revenue of IDR1,786.2 trillion against spending of IDR2,082.9 trillion. Parliament also approved cuts in diesel subsidies and in the budgets for most ministries. The underlying macroeconomic assumptions for the revised budget were (i) annual GDP growth of 5.2%, (ii) annual inflation of 4.0%, (iii) an exchange rate of IDR13,500 per USD1, (iv) a 3-month Treasury bill rate of 5.5%, and (v) an Indonesian crude oil price of USD40 per barrel.

Republic of Korea

Yield Movements

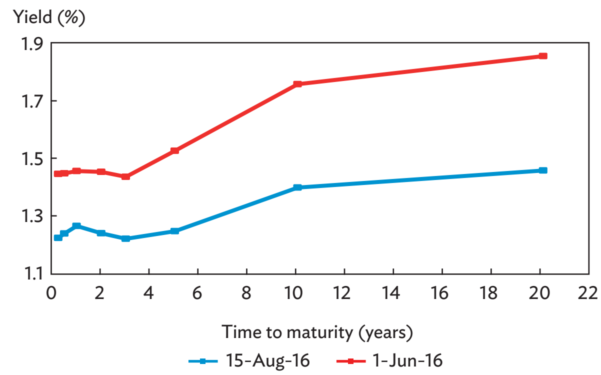
Yields on local currency (LCY) government bonds fell for all maturities between 1 June and 15 August, resulting in a downward shift in the yield curve **(Figure 1)**. The decrease in yields ranged from 19 basis points (bps) for the 1-year tenor to 41 bps for the 30-year tenor. The fall in yields was influenced by the Bank of Korea's policy rate cut in June, the United Kingdom's decision to leave the European Union, and declines in Treasury bond yields in major economies. The yield spread between the 2-year and 10-year tenors narrowed 15 bps during the review period.

The Bank of Korea's Monetary Policy Board decided in its 14 July and 11 August meetings to maintain the base rate at 1.25%. The last policy rate cut occurred on 9 June when the board lowered the base rate by 25 bps.

Real gross domestic product (GDP) growth stood at 0.8% quarter-on-quarter (q-o-q) and 3.3% year-on-year (y-o-y) in the second quarter (Q2) of 2016, up from first quarter growth rates of 0.5% q-o-q and 2.8% y-o-y. The higher q-o-q growth in Q2 2016 was led by stronger household spending, domestic investment, and exports on the expenditure side; and more buoyant economic activity in the manufacturing and utility sectors on the production side. The stronger y-o-y growth in the second quarter also stemmed from more robust household spending, domestic investment, and exports; as well as faster growth in construction, manufacturing, and services sectors. In its economic outlook announced in July, the Bank of Korea forecast real GDP growth of 2.4% y-o-y for the second half of 2016 and 2.7% for full-year 2016.

Consumer price inflation remained relatively low, with the Consumer Price Index (CPI) inflation rate slipping to 0.4% y-o-y in August from 0.7% y-o-y in July. The Bank of Korea forecast in July that consumer price inflation would rise to 1.3% y-o-y in the second half of 2016 and settle at 1.1% for full-year 2016.

Figure 1: The Republic of Korea's Benchmark Yield Curve—Local Currency Government Bonds



Source: Based on data from Bloomberg LP.

Size and Composition

LCY bonds outstanding in the Republic of Korea expanded 1.0% q-o-q and 5.4% y-o-y in Q2 2016, leveling off at KRW2,064.0 trillion (USD1,792 billion) at the end of June **(Table 1)**. The outstanding stock of LCY government bonds climbed 1.6% q-o-q and 5.9% y-o-y in Q2 2016 to reach KRW853.0 trillion at the end of June, bolstered by an expansion in LCY central government bonds.

Q2 2016 issuance of LCY government bonds tallied KRW87.0 trillion, up 0.7% q-o-q but down 1.6% y-o-y. The q-o-q uptick was driven by increases in the issuance of Korea Treasury Bonds and Monetary Stabilization Bonds. The y-o-y downturn was mainly led by lower Monetary Stabilization Bond issuance.

The outstanding size of LCY corporate bonds in the Republic of Korea expanded 0.5% q-o-q and 5.1% y-o-y in Q2 2016, buoyed by increases in stocks of financial debentures and the bonds of privately owned corporates, leveling off at KRW1,211.0 trillion at the end of June. In Q2 2016, LCY corporate bond issuance was valued at KRW90.4 trillion, down 5.5% q-o-q and 33.7% y-o-y.

The top 30 corporate issuers of LCY bonds had a cumulative outstanding bond stock worth KRW768.4 trillion (or 63.5% of total LCY corporate bonds outstanding) at the end of June, led by Korea Housing Finance Corporation **(Table 2)**. The relatively large LCY corporate bond issuances in Q2 2016 were from two domestic banks—Industrial Bank of Korea and NongHyup Bank—and from a railway operator—Korea Rail Network Authority **(Table 3)**.

Table 1: Size and Composition of the Local Currency Bond Market in the Republic of Korea

	Outstanding Amount (billion)						Growth Rate (%)			
	Q2 2015		Q1 2016		Q2 2016		Q2 2015		Q2 2016	
	KRW	USD	KRW	USD	KRW	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**1,958,273**	**1,756**	**2,044,415**	**1,788**	**2,064,024**	**1,792**	**3.1**	**10.0**	**1.0**	**5.4**
Government	805,593	722	839,618	734	853,009	741	2.0	15.0	1.6	5.9
Central Bank Bonds	188,310	169	181,390	159	181,420	158	1.8	8.2	0.02	(3.7)
Central Government Bonds	527,583	473	566,919	496	583,402	507	2.7	8.6	2.9	10.6
Industrial Finance Debentures	89,700	80	91,309	80	88,188	77	(1.6)	120.5	(3.4)	(1.7)
Corporate	1,152,680	1,033	1,204,797	1,054	1,211,015	1,051	3.8	6.8	0.5	5.1

( ) = negative, KRW = Korean won, q-o-q = quarter-on-quarter, Q1 = first quarter, Q2 = second quarter, USD = United States dollar, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Bloomberg LP end-of-period local currency–USD rates are used.
3. Growth rates are calculated from local currency base and do not include currency effects.
4. Central government bonds include Korea Treasury bonds, National Housing bonds, and Seoul Metro bonds.
Sources: EDAILY *BondWeb* and The Bank of Korea.

Investor Profile

Insurance companies and pension funds comprised the largest investor group in LCY government bonds in the Republic of Korea with holdings equivalent to 31.8% of the total LCY government bond stock at the end of March **(Figure 2)**. Nonfinancial corporations were the smallest investor group with less than a 1% share. In the 12 months through the end of March, households and nonprofit institutions recorded the biggest increase in their share of LCY government bond holdings with a gain of 1.2 percentage points, while banks posted the biggest decline at 1.8 percentage points.

In the LCY corporate bond market, insurance companies and pension funds are also the largest investor group with holdings constituting 37.4% of the total corporate bond market at the end of March **(Figure 3)**. In the 12 months through the end of March, this investor group and other financial institutions (except banks) posted relatively large increases in corporate bond holding shares of 2.0 and 2.1 percentage points, respectively. Over the same period, the share of LCY corporate bonds held by households and nonprofit institutions posted the sharpest y-o-y drop at −2.3 percentage points.

Foreign investors' net LCY bond outflow in the Republic of Korea declined to KRW1,229 billion in Q2 2016 from KRW4,149 billion in the previous quarter. On a monthly basis, net foreign bond investment turned negative in June at −KRW2,748 billion following positive amounts of KRW888 billion and KRW631 billion in May and April, respectively **(Figure 4)**. In July, foreign investors' net bond investment totaled KRW588 billion.

Ratings Update

S&P Global Ratings announced in August that it had raised its long-term sovereign credit rating on the Republic of Korea to AA from AA−, giving the new rating a stable outlook, and has affirmed its short-term rating at A-1+. S&P Global Ratings stated that its rating upgrade was due to the Republic of Korea's "strong record of steady growth," which has "generated a prosperous economy, greater fiscal and monetary flexibility, and continual improvements in external metrics." The rating agency also stated that despite expectations of slower GDP growth in the next 3–5 years compared with pre-global financial crisis growth levels, it believes that the economy's prospects are "superior" to that of most developed economies.

Rating and Investment Information (R&I) reported in July that it has affirmed its foreign currency issuer and domestic currency issuer ratings on the Republic of Korea at A+ and AA−, respectively, giving stable outlooks for both ratings. R&I stated that its rating affirmation was made based on the Republic of Korea's "sluggish" economic recovery, "prudent" fiscal management amid "modest" government debt levels, and "consistent" surpluses in the current account.

Table 2: Top 30 Issuers of Local Currency Corporate Bonds in the Republic of Korea

	Issuers	Outstanding Amount		State-Owned	Listed on		Type of Industry
		LCY Bonds (KRW billion)	LCY Bonds (USD billion)		KOSPI	KOSDAQ	
1.	Korea Housing Finance Corporation	92,724	80.5	Yes	No	No	Housing Finance
2.	NH Investment & Securities	59,816	51.9	Yes	Yes	No	Securities
3.	Mirae Asset Daewoo Securities	55,327	48.0	No	Yes	No	Securities
4.	Korea Land & Housing Corporation	50,705	44.0	Yes	No	No	Real Estate
5.	Korea Investment and Securities	48,329	42.0	No	No	No	Securities
6.	Mirae Asset Securities	40,282	35.0	No	Yes	No	Securities
7.	Industrial Bank of Korea	38,942	33.8	Yes	Yes	No	Banking
8.	Hana Financial Investment	34,824	30.2	No	No	No	Securities
9.	Korea Deposit Insurance Corporation	29,650	25.7	Yes	No	No	Insurance
10.	Korea Electric Power Corporation	23,970	20.8	Yes	Yes	No	Electricity, Energy, and Power
11.	Hyundai Securities	23,491	20.4	No	No	No	Securities
12.	Korea Expressway	22,000	19.1	Yes	No	No	Transport Infrastructure
13.	Korea Rail Network Authority	19,160	16.6	Yes	No	No	Transport Infrastructure
14.	Kookmin Bank	18,673	16.2	No	No	No	Banking
15.	Shinhan Bank	18,563	16.1	No	No	No	Banking
16.	Woori Bank	17,865	15.5	Yes	Yes	No	Banking
17.	Samsung Securities	17,757	15.4	No	Yes	No	Securities
18.	Daishin Securities	16,514	14.3	No	Yes	No	Securities
19.	NongHyup Bank	15,960	13.9	Yes	No	No	Banking
20.	Korea Gas	15,429	13.4	Yes	Yes	No	Gas Utility
21.	Small & Medium Business Corporation	13,510	11.7	Yes	No	No	SME Development
22.	Korea Eximbank	12,260	10.6	Yes	No	No	Banking
23.	Korea Student Aid Foundation	11,690	10.1	Yes	No	No	Student Loan
24.	Standard Chartered First Bank Korea	11,380	9.9	No	No	No	Banking
25.	Hyundai Capital Services	10,489	9.1	No	No	No	Consumer Finance
26.	Korea Water Resources Corporation	10,441	9.1	Yes	No	No	Water
27.	Shinhan Card	10,169	8.8	No	No	No	Credit Card
28.	Korea Railroad Corporation	9,680	8.4	Yes	No	No	Transport Infrastructure
29.	Shinyoung Securities	9,659	8.4	No	Yes	No	Securities
30.	NongHyup	9,190	8.0	Yes	No	No	Diversified
Total Top 30 LCY Corporate Issuers		**768,448.1**	**667.2**				
Total LCY Corporate Bonds		**1,211,015.0**	**1,051.4**				
Top 30 as % of Total LCY Corporate Bonds		**63.5%**	**63.5%**				

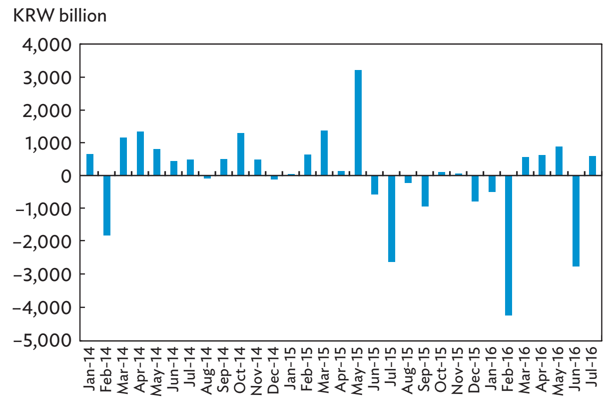
KOSDAQ = Korean Securities Dealers Automated Quotations, KOSPI = Korea Composite Stock Price Index, KRW = Korean won, LCY = local currency, USD = United States dollar.
Notes:
1. Data as of end-June 2016.
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Sources: *AsianBondsOnline* calculations based on Bloomberg LP and EDAILY *BondWeb* data.

Table 3: Notable Local Currency Corporate Bond Issuance in Q2 2016

Corporate Issuers	Coupon Rate (%)	Issued Amount (KRW billion)
NongHyup Bank		
0.75-year bond	1.32	470
1-year bond	1.34	770
1-year bond	1.34	500
5-year bond	1.69	400
Industrial Bank of Korea		
3-year bond	1.56	640
10-year bond	2.37	400
Korea Rail Network Authority		
30-year bond	2.13	390

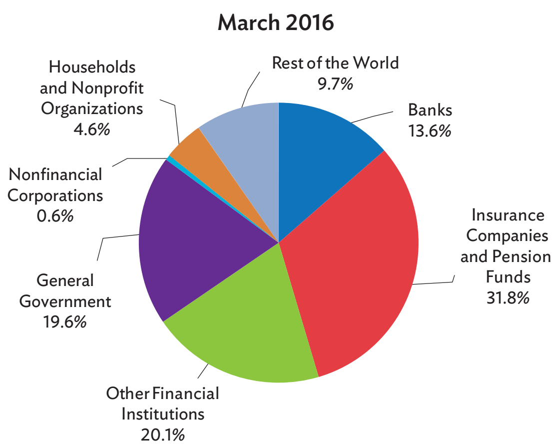
KRW = Korean won, Q2 = second quarter.
Note: Coupon rates for 0.75- and 1-year bonds of NongHyup Bank are indicative yields at end-June 2016.
Source: Based on data from Bloomberg LP.

Figure 4: Net Foreign Investment in Local Currency Bonds in the Republic of Korea



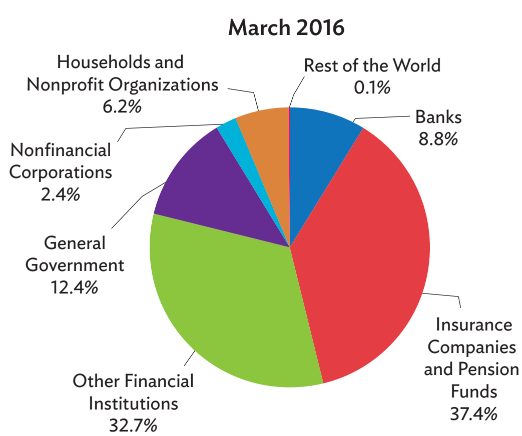
KRW = Korean won.
Source: Financial Supervisory Service.

Figure 2: Local Currency Government Bonds Investor Profile



Sources: *AsianBondsOnline* and The Bank of Korea.

Figure 3: Local Currency Corporate Bonds Investor Profile



Sources: *AsianBondsOnline* and The Bank of Korea.

Policy, Institutional, and Regulatory Developments

Financial Services Commission Introduces Plan to Develop “Mega-Investment Banks”

The Financial Services Commission (FSC) announced in August its plan to develop “mega-investment banks” by enabling investment banks to acquire more than KRW10 trillion of equity capital and to broaden their scope of new business. The FSC stated that it plans for securities firms with more than KRW4 trillion of equity capital to be allowed to sell promissory notes and conduct foreign exchange transactions; for securities firms with equity capital of nearly KRW10 trillion to create investment management accounts and conduct property trust business; and for securities firms with equity capital of less than KRW4 trillion to be subjected to certain reforms to enable them to secure enough capital for corporate financing purposes. The plan is envisioned to take effect starting in 2017.

Financial Services Commission to Apply Foreign Currency Liquidity Coverage Ratio to Banks

The FSC reported in June its plan to apply a foreign currency liquidity coverage ratio rule in 2017. The rule will require commercial banks to hold 60% of their foreign exchange debt in the form of high-quality liquid assets starting in 2017, with the ratio increasing to 70% in 2018 and 80% in 2019.

Malaysia

Yield Movements

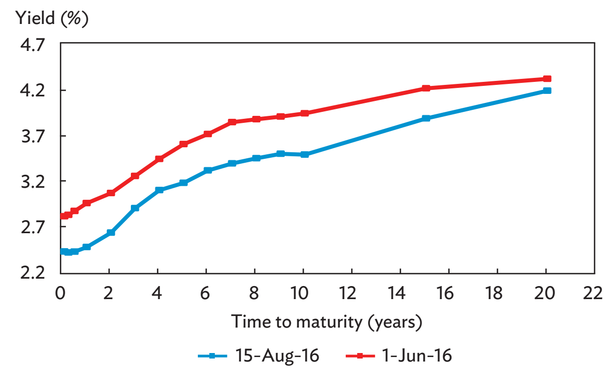
Between 1 June and 15 August, Malaysian local currency (LCY) government bond yields fell for all tenors on lowered expectations of a United States Federal Reserve interest rate hike this year and the unexpected policy rate cut by Bank Negara Malaysia (BNM) in July **(Figure 1)**. Except for the 20-year tenor, which fell only 13 basis points (bps), yields for all tenors fell 41 bps on average. The 2-year versus 10-year spread was barely changed during the review period at 85 bps from 87 bps.

In its monetary policy meeting on 13 July, BNM decided to lower its overnight policy rate by 25 bps to 3.0%. The ceiling and floor rates for the overnight policy rate corridor were also reduced to 3.25% and 2.75%, respectively. BNM's decision to cut rates was seen by the market as a preemptive move due to heightened risks to global and domestic growth prospects, following the United Kingdom's referendum on leaving the European Union, commonly known as "Brexit." Brexit has also further dampened market expectations of a Federal Reserve rate hike this year, providing more support to domestic bonds.

Foreign holdings of LCY bonds remained high in the second quarter (Q2) of 2016 as demand for higher-yielding emerging East Asian LCY bonds persists amid low global interest rates. Data from BNM showed an increase in foreign holdings of central government debt securities from MYR191 billion in March to MYR207 billion in June and to MYR213 billion in July. As a result, the Malaysian ringgit remained supported during the review period despite a temporary depreciation due to Brexit and oil price volatilities.

Inflation continued to decelerate from 2.6% year-on-year (y-o-y) in March to 1.6% y-o-y in June and further to 1.1% y-o-y in July, as communications and transportation prices continued to post y-o-y decreases. In its monetary policy meeting on 13 July, BNM lowered its forecast for full-year 2016 inflation to 2.0%–3.0% from 2.5%–3.5%, citing as reasons the lapse in the impact of the Goods and Services Tax implemented last year and low global energy prices.

Figure 1: Malaysia's Benchmark Yield Curve—Local Currency Government Bonds



Source: Based on data from Bloomberg LP.

Malaysia's economic growth slowed to 4.0% y-o-y in Q2 2016 from 4.2% y-o-y in Q1 2016, primarily due to an accelerated contraction in the agriculture sector of 7.9% y-o-y following a decline of 3.8% y-o-y in Q1 2016. All other industries posted annual increases in Q2 2016. The slower growth was driven by continued weakness in exports, which increased 1.0% y-o-y in Q2 2016. On the other hand, economic growth was supported by the accelerated increase in gross fixed capital formation of 6.1% y-o-y in Q2 2016, up from only 0.1% y-o-y in the previous quarter. Private final consumption expenditure and government spending also posted larger annual increases in Q2 2016.

Size and Composition

The Malaysian LCY bond market grew 2.0% quarter-on-quarter (q-o-q) to MYR1,163 billion (USD289 billion) at the end of June **(Table 1)**. The rise was most notable in the government bond sector as the amount of outstanding corporate bonds barely changed from the previous quarter. On a y-o-y basis, the LCY bond market expanded at a faster pace of 8.2%. Total government bonds outstanding amounted to MYR644 billion, while corporate bonds totaled MYR519 billion. The share of *sukuk* (Islamic bonds) in Malaysia's LCY bond market continued to exceed that of conventional bonds, with a majority share of 55% at the end of June.

Table 1: Size and Composition of the Local Currency Bond Market in Malaysia

	Outstanding Amount (billion)						Growth Rate (%)			
	Q2 2015		Q1 2016		Q2 2016		Q2 2015		Q2 2016	
	MYR	USD	MYR	USD	MYR	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**1,076**	**285**	**1,141**	**293**	**1,163**	**289**	**0.2**	**2.1**	**2.0**	**8.2**
Government	608	161	628	161	644	160	(0.7)	(0.6)	2.5	5.9
Central Government Bonds	557	148	579	148	600	149	4.9	9.6	3.8	7.9
of which: *Sukuk*	209	55	223	57	232	57	7.1	9.9	3.9	10.8
Central Bank Bills	23	6	22	6	15	4	(59.1)	(73.6)	(29.1)	(34.5)
of which: *Sukuk*	4	1	0	0	0	0	(78.4)	(88.1)	–	(100.0)
Sukuk Perumahan Kerajaan	28	7	28	7	28	7	14.3	80.0	0.0	1.8
Corporate	468	124	512	131	519	129	1.4	6.0	1.4	11.0
of which: *Sukuk*	337	89	366	94	375	93	2.7	11.8	2.5	11.3

( ) = negative, – = not applicable, MYR = Malaysian ringgit, q-o-q = quarter-on-quarter, Q1 = first quarter, Q2 = second quarter, USD = United States dollar, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Bloomberg LP end-of-period local currency–USD rate is used.
3. Growth rates are calculated from local currency base and do not include currency effects.
4. Sukuk Perumahan Kerajaan are Islamic bonds issued by the Government of Malaysia to refinance funding for housing loans to government employees and to extend new housing loans.

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

Government Bonds. LCY government bonds outstanding increased 2.5% q-o-q to MYR644 billion at the end of June, led by increases in the outstanding stock of Malaysian Government Securities and Government Investment Issues. Meanwhile, the outstanding stock of central bank bills continued to decline. On a y-o-y basis, government bonds outstanding rose 5.9% in Q2 2016.

Government bond issuance in Q2 2016 was almost on par with the previous quarter as the higher issuance of Malaysian Government Securities was offset by lower issuance of Government Investment Issues and Treasury bills.

Corporate Bonds. LCY corporate bonds slightly increased 1.4% q-o-q to MYR519 billion at the end of June from MYR512 billion at the end of March. *Sukuk* continued to dominate the Malaysian LCY corporate bond market with their share of the total rising to 72.2% in Q2 2016 from 71.4% in Q1 2016.

At the end of June, the aggregate bonds outstanding of the top 32 LCY corporate bond issuers in Malaysia amounted to MYR295.3 billion, or 56.8% of the total LCY corporate bond market **(Table 2)**. Financial firms, including banks, comprised the majority of the 32 largest corporate bond issuers with total bonds outstanding worth MYR163.6 billion. Highway operator Project Lebuhraya Usahasama remained the largest issuer with outstanding bonds valued at MYR30.6 billion, followed by state-owned mortgage firm Cagamas with MYR26.3 billion.

Issuance of corporate bonds increased slightly to MYR34.1 billion in Q2 2016 from MYR33.5 billion in Q1 2016. *Sukuk* issuance continued to exceed that of conventional bonds, with their share of total issuance rising to 58.9% at the end of June from 55.4% at the end of March. By type of instrument, Islamic medium-term notes had the highest share of total issuance at 43.2%, followed by conventional commercial paper with a share of 25.7%. **Table 3** lists the notable corporate bond issuances in Q2 2016.

The largest corporate bond issuers in Q2 2016 were from government-owned entities, mostly in the utilities sector. Sarawak Energy, an electricity generator and transmitter company, issued Islamic medium-term notes comprising an MYR800 million 15-year tranche and a MYR700 million 20-year tranche with coupon rates of 5.04% and 5.18%, respectively. Pengurusan Air SPV, a water services company, also issued Islamic medium-term notes comprising a MYR400 million 5-year tranche, an MYR800 million 7-year tranche, and a MYR250 million 10-year tranche with coupon rates of 4.04%, 4.23%, and 4.40%, respectively.

Table 2: Top 32 Issuers of Local Currency Corporate Bonds in Malaysia

	Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
		LCY Bonds (MYR billion)	LCY Bonds (USD billion)			
1.	Project Lebuhraya Usahasama	30.6	7.6	No	No	Transport, Storage, and Communications
2.	Cagamas	26.3	6.5	Yes	No	Finance
3.	Danainfra Nasional	25.2	6.3	Yes	No	Finance
4.	Prasarana	20.6	5.1	Yes	No	Transport, Storage, and Communications
5.	Khazanah	20.0	5.0	Yes	No	Finance
6.	Maybank	14.9	3.7	No	Yes	Banking
7.	Pengurusan Air	13.8	3.4	Yes	No	Energy, Gas, and Water
8.	Perbadanan Tabung Pendidikan Tinggi Nasional	11.0	2.7	Yes	No	Finance
9.	CIMB Bank	10.1	2.5	No	No	Banking
10.	Sarawak Energy	9.5	2.4	Yes	No	Energy, Gas, and Water
11.	Jimah East Power	9.0	2.2	Yes	No	Energy, Gas, and Water
12.	Public Bank	8.6	2.1	No	No	Banking
13.	Aman Sukuk	6.3	1.6	Yes	No	Construction
14.	Rantau Abang Capital	6.0	1.5	Yes	No	Finance
15.	RHB Bank	5.4	1.3	No	No	Banking
16.	Turus Pesawat	5.3	1.3	Yes	No	Transport, Storage, and Communications
17.	CIMB Group Holdings	5.2	1.3	Yes	No	Finance
18.	BGSM Management	5.1	1.3	No	No	Transport, Storage, and Communications
19.	1Malaysia Development	5.0	1.2	Yes	No	Finance
20.	Danga Capital	5.0	1.2	Yes	No	Finance
21.	Putrajaya Holdings	4.9	1.2	Yes	No	Property and Real Estate
22.	Manjung Island Energy	4.9	1.2	No	No	Energy, Gas, and Water
23.	YTL Power International	4.8	1.2	No	Yes	Energy, Gas, and Water
24.	Celcom Networks	4.5	1.1	No	No	Transport, Storage, and Communications
25.	Malakoff Power	4.4	1.1	No	No	Energy, Gas, and Water
26.	Bank Pembangunan Malaysia	4.4	1.1	Yes	No	Banking
27.	GOVCO Holdings	4.3	1.1	Yes	No	Finance
28.	AM Bank	4.2	1.0	No	Yes	Banking
29.	Cagamas MBS	4.2	1.0	Yes	No	Finance
30.	Tanjung Bin Power	4.0	1.0	No	No	Energy, Gas, and Water
31.	Telekom Malaysia	4.0	1.0	Yes	Yes	Transport, Storage, and Communications
32.	Valuecap	4.0	1.0	Yes	No	Finance
Total Top 32 LCY Corporate Issuers		**295.3**	**73.3**			
Total LCY Corporate Bonds		**519.4**	**128.9**			
Top 32 as % of Total LCY Corporate Bonds		**56.8%**	**56.8%**			

LCY = local currency, MYR = Malaysian ringgit, USD = United States dollar.
Notes:
1. Data as of end-June 2016.
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on Bank Negara Malaysia Fully Automated System for Issuing/Tendering (FAST) data.

Table 3 : Notable Local Currency Corporate Bond Issuance in Q2 2016

Corporate Issuers	Coupon Rate (%)	Issued Amount (MYR million)
Sarawak Energy		
15-year Islamic MTN	5.04	800
20-year Islamic MTN	5.18	700
Pengurusan Air		
5-year Islamic MTN	4.04	400
7-year Islamic MTN	4.23	800
10-year Islamic MTN	4.40	250
GOVCO Holdings Berhad		
7-year Islamic MTN	4.27	300
10-year Islamic MTN	4.40	400
15-year Islamic MTN	4.73	550
CIMB Bank		
Perpetual Capital Securities - Tier 1	5.80	1,000

MTN = medium-term note, MYR = Malaysian ringgit, Q2 = second quarter.
Source: Bank Negara Malaysia Bond Info Hub.

Investor Profile

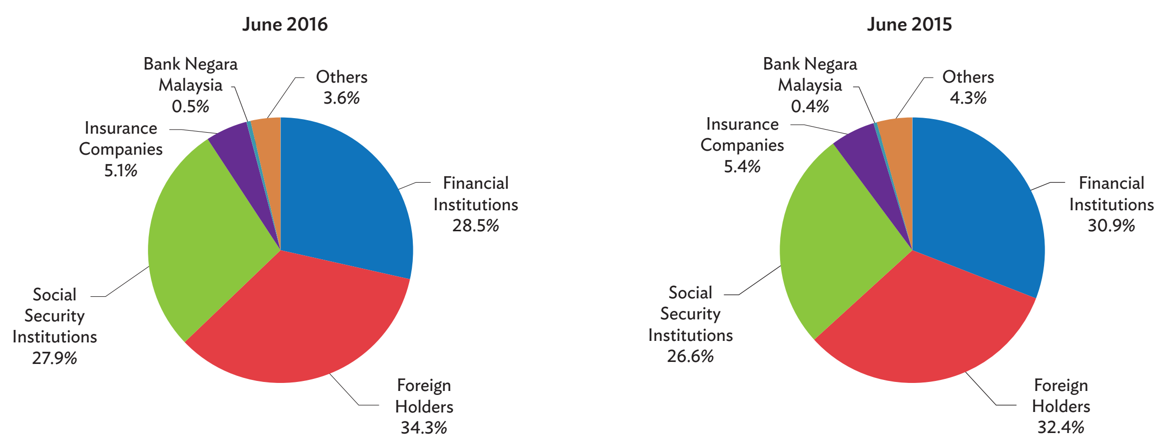
Foreign investors' holdings of LCY government bonds were up in June from a year earlier, both in nominal terms and as a share of the total. In a change from a year earlier, foreign holdings accounted for the largest investor share at the end of June at 34.3%, surpassing financial institutions' share of 28.5%. Social security institutions remained the third largest holders of government bonds at the end of June with a share of 27.9%, down from 26.6% a year earlier.

Malaysia's corporate bond market investor profile was barely changed in June compared with a year earlier **(Figure 3)**. Domestic banks, both commercial and Islamic, continued to account for the largest share of LCY corporate bonds at 46.5%, followed by life insurance companies with a share of 31.5%.

Ratings Update

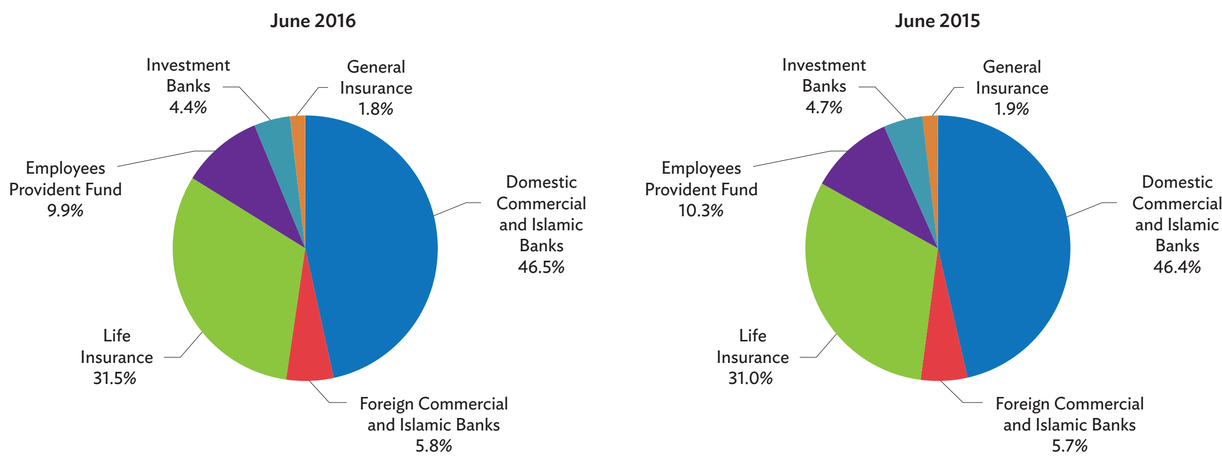
In August, Fitch Ratings (Fitch) affirmed its long-term foreign currency and local currency issuer default ratings of A– for Malaysia, with a stable outlook. Fitch cited as reasons for its decision Malaysia's strong net external creditor position and current account surplus, and strong (despite slower) economic growth relative to its A– rated peers. However, Fitch also noted weakness in Malaysia's governance standards, citing ongoing issues with state-owned 1Malaysia Development Berhad as well as concerns over its federal government debt and deficit levels.

Figure 2: Local Currency Government Bonds Investor Profile



Notes:
1. "Others" include statutory bodies, nominees and trustee companies, and cooperatives and unclassified items.
2. Data are based on the Bank Negara Malaysia Monthly Statistical Bulletin Table 3.1.5: Federal Government Debt Issued Domestically, Classification by Holder.
Source: Bank Negara Malaysia.

Figure 3: Local Currency Corporate Bonds Investor Profile



Note: The Employees Provident Fund's bond holdings data are as of end-December 2015 since data are based on EPF's annual report.
Source: Bank Negara Malaysia and the EPF.

Policy, Institutional, and Regulatory Developments

Bank Negara Malaysia and Financial Markets Association of Malaysia Announce Kuala Lumpur USD–MYR Reference Rate

In June, BNM and the Financial Markets Association of Malaysia announced the adoption of a new methodology for the computation of the Malaysian ringgit's exchange rate. The new rate shall be known as the Kuala Lumpur USD–MYR Reference Rate. Effective 18 July, the new reference rate will be based on the daily weighted average volume of the interbank USD–MYR foreign exchange spot rate transactions of domestic financial institutions between 8 a.m. and 3 p.m. BNM stated that the new methodology promotes transparency and is based on underlying trades, while the previous methodology was based on the submission of quotations by selected banks.

In addition, the official closing time for the onshore ringgit foreign exchange market will be extended from 5 p.m. to 6 p.m.

Bank Negara Malaysia and Otoritas Jasa Keuangan Sign Bilateral Agreement

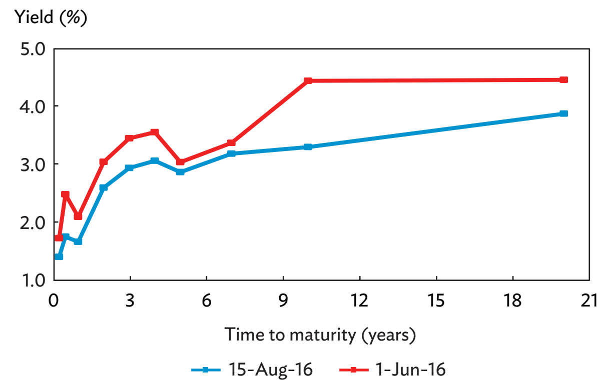
In August, BNM and Otoritas Jasa Keuangan signed a bilateral agreement under the Association of Southeast Asian Nations Banking Integration Framework to further promote banking and financial integration between Malaysia and Indonesia. The implementation of the agreement will involve BNM allowing Qualified Association of Southeast Asian Nations Banks from Indonesia to operate in Malaysia. The agreement envisions a greater role for Malaysian and Indonesian banks in facilitating cross-border trade and investment between the two markets.

Philippines

Yield Movements

Local currency (LCY) government bond yields fell for all maturities between 1 June and 15 August. The yield drop ranged from 17 basis points (bps) for the 5-year tenor to 114 bps for the 10-year tenor **(Figure 1)**. The drop in yields during this period was driven by strong demand for LCY government securities—especially the Treasury bills that were auctioned in July—as well as the United States Federal Reserves' delay in raising interest rates and the United Kingdom's vote to exit from the European Union. Meanwhile, the yield spread between the 2-year and 10-year tenors narrowed 69 bps during the review period.

Figure 1: Philippines' Benchmark Yield Curve—Local Currency Government Bonds



Source: Based on data from Bloomberg LP.

The Monetary Board of the Bangko Sentral ng Pilipinas (BSP) decided during its meetings on 23 June and 11 August to keep the interest rate on the overnight reverse repurchase facility at 3.0%. Interest rates on the overnight lending and deposit facilities were also left unchanged. The BSP noted that inflation in the Philippines continued to be "manageable."

The headline inflation rate, based on the Consumer Price Index, stood at 1.9% year-on-year (y-o-y) in July, unchanged from the previous month. In the second quarter (Q2) of 2016, consumer price inflation averaged 1.5% y-o-y, up from 1.1% y-o-y in the previous quarter. In the first half of 2016, the headline inflation rate averaged 1.3% y-o-y. Consumer price inflation has continued to remain below the Government of the Philippines' 2016–2018 inflation target range of 3.0%±1.0 percentage point.

Real gross domestic product growth was robust at 6.9% y-o-y in the first half of 2016, buoyed by relatively strong growth in household expenditure, government spending, and domestic investment on the demand side; and in the industrial and services sectors on the supply side. On a quarterly basis, real gross domestic product growth accelerated to 7.0% y-o-y in Q2 2016 from 6.8% y-o-y in the previous quarter on the back of faster growth in household spending, government expenditure, and domestic investment; as well as an expansion in the services sector.

Size and Composition

The LCY bond market exhibited mixed trends in Q2 2016, falling 0.4% q-o-q but rising 0.9% y-o-y to reach PHP4,688 billion (USD99 billion) at the end of June **(Table 1)**. The q-o-q decline was induced by a quarterly contraction in Treasury bonds and corporate bonds, while the y-o-y growth stemmed from annual increases in Treasury bills and corporate bonds. At the end of June, government bonds accounted for more than 80% of total bonds outstanding.

Banks remained the largest issuer group in the LCY corporate bond market, with the value of their issued bonds comprising 28.3% of the total LCY corporate bond market at the end of June, followed by property firms with a 24.4% share **(Figure 2)**. Compared to June of the previous year, the share of banks registered the biggest drop among all issuer groups, while property firms posted the largest increase.

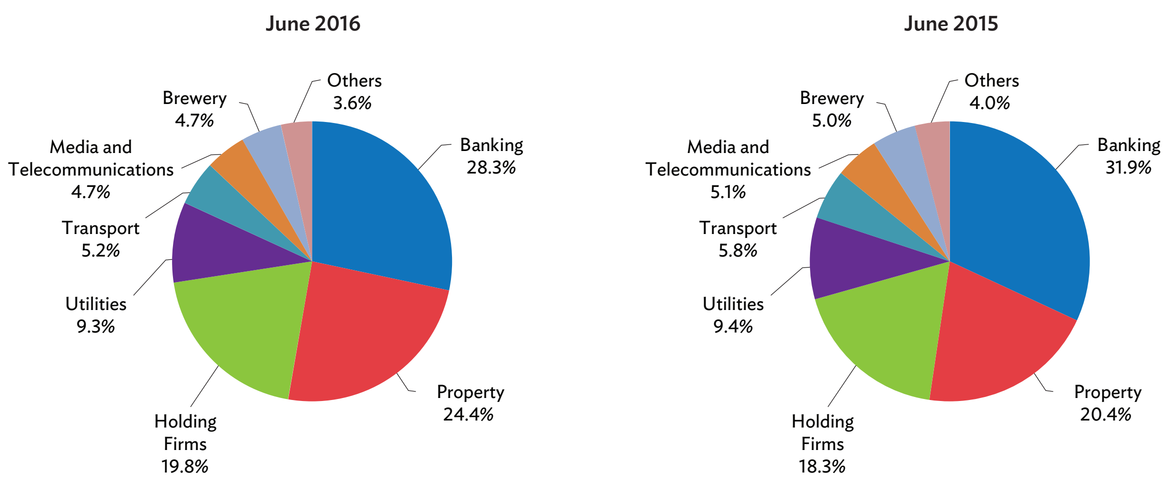
The top 30 corporate bond issuers accounted for a combined PHP722.9 billion worth of outstanding LCY bonds at the end of June, representing 89.5% of the LCY corporate bond market **(Table 2)**.

Table 1: Size and Composition of the Local Currency Bond Market in the Philippines

	Outstanding Amount (billion)						Growth Rate (%)			
	Q2 2015		Q1 2016		Q2 2016		Q2 2015		Q2 2016	
	PHP	USD	PHP	USD	PHP	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**4,645**	**103**	**4,706**	**102**	**4,688**	**99**	**(0.8)**	**3.3**	**(0.4)**	**0.9**
Government	3,896	86	3,893	85	3,880	82	(0.5)	2.0	(0.3)	(0.4)
Treasury Bills	275	6	279	6	288	6	(1.1)	(4.6)	3.2	4.6
Treasury Bonds	3,541	79	3,539	77	3,517	75	(0.2)	3.7	(0.6)	(0.7)
Others	80	2	76	2	76	2	(12.4)	(30.9)	0.0	(5.6)
Corporate	749	17	813	18	808	17	(2.0)	10.5	(0.6)	7.9

( ) = negative, PHP = Philippine peso, q-o-q = quarter-on-quarter, Q1 = first quarter, Q2 = second quarter, USD = United States dollar, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Bloomberg end-of-period local currency–USD rates are used.
3. Growth rates are calculated from a local currency base and do not include currency effects.
4. "Others" comprise bonds issued by government agencies, entities, and corporations for which repayment is guaranteed by the Government of the Philippines. These include bonds issued by Power Sector Assets and Liabilities Management (PSALM) and the National Food Authority, among others.
5. Peso Global Bonds (PHP-denominated bonds payable in US dollars) are not included.
Sources: Bloomberg LP and Bureau of the Treasury.

Figure 2: Local Currency Corporate Bonds Outstanding by Sector



Source: Based on data from Bloomberg LP.

LCY bond issuance in Q2 2016 stood at PHP182.2 billion, down 4.0% q-o-q but up 62.3% y-o-y. Government bond issues, comprising mainly Treasury bills and bonds, were valued at PHP175.2 billion, were down 1.1% q-o-q but up 93.8% y-o-y. Only one corporate bond was sold in Q2 2016—Ayala Land's 9.5-year bond worth PHP7 billion and carrying a 4.75% fixed interest rate—resulting in total corporate bond issuance declining 44.0% q-o-q and 67.9% y-o-y.

Investor Profile

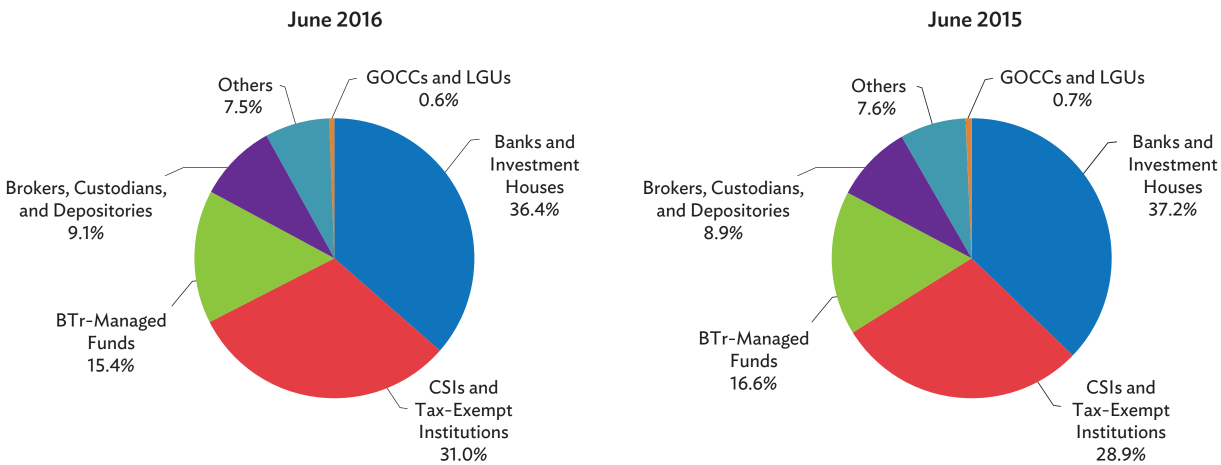
The largest investor group in the LCY government bond market comprises banks and investment houses, which had holdings equivalent to 36.4% of the total LCY government bond market at the end of June **(Figure 3)**. This share of the market was down from a year earlier. The shares of all other investor groups declined as well on a y-o-y basis except for contractual savings and tax exempt institutions, as well as brokers, custodians, and depositories.

Table 2: Top 30 Issuers of Local Currency Corporate Bonds in the Philippines

	Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
		LCY Bonds (PHP billion)	LCY Bonds (USD billion)			
1.	Ayala Land	71.2	1.5	No	Yes	Property
2.	Metrobank	46.8	1.0	No	Yes	Banking
3.	SM Prime	45.0	1.0	No	Yes	Property
4.	Ayala Corporation	40.0	0.8	No	Yes	Holding Firms
5.	San Miguel Brewery	37.8	0.8	No	No	Brewing
6.	BDO Unibank	37.5	0.8	No	Yes	Banking
7.	Philippine National Bank	34.6	0.7	No	Yes	Banking
8.	Aboitiz Equity Ventures	32.0	0.7	No	Yes	Holding Firms
9.	Filinvest Land	32.0	0.7	No	Yes	Property
10.	JG Summit	30.0	0.6	No	Yes	Holding Firms
11.	SM Investments	27.3	0.6	No	Yes	Holding Firms
12.	Meralco	23.5	0.5	No	Yes	Electricity, Energy, and Power
13.	Security Bank	23.0	0.5	No	Yes	Banking
14.	Rizal Commercial Banking Corporation	22.1	0.5	No	Yes	Banking
15.	GT Capital	22.0	0.5	No	Yes	Holding Firms
16.	South Luzon Tollway	18.3	0.4	No	No	Transport
17.	Globe Telecom	17.0	0.4	No	Yes	Telecommunications
18.	East West Bank	16.8	0.4	No	Yes	Banking
19.	Maynilad Water Services	16.3	0.3	No	No	Water and Wastewater Services
20.	MCE Leisure (Philippines)	15.0	0.3	No	No	Casinos and Gaming
21.	Philippine Long Distance Telephone Company	15.0	0.3	No	Yes	Telecommunications
22.	Union Bank of the Philippines	14.0	0.3	No	Yes	Banking
23.	First Metro Investment Corporation	12.0	0.3	No	No	Banking
24.	Robinsons Land	12.0	0.3	No	Yes	Property
25.	Manila North Tollways	11.9	0.3	No	No	Transport
26.	MTD Manila Expressway	11.5	0.2	No	No	Transport
27.	Energy Development Corporation	10.5	0.2	No	Yes	Electricity, Energy, and Power
28.	Aboitiz Power	10.0	0.2	No	Yes	Electricity, Energy, and Power
29.	8990 Holdings	9.0	0.2	No	Yes	Property
30	Filinvest Development	8.8	0.2	No	Yes	Holding Firms
Total Top 30 LCY Corporate Issuers		**722.9**	**15.3**			
Total LCY Corporate Bonds		**807.9**	**17.1**			
Top 30 as % of Total LCY Corporate Bonds		**89.5%**	**89.5%**			

LCY = local currency, PHP = Philippine peso, USD = United States dollar.
Notes:
1. Data as of end-June 2016.
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on Bloomberg LP data.

Figure 3: Local Currency Government Bonds Investor Profile



BTr = Bureau of the Treasury, CSIs = contractual savings institutions, GOCCs = government-owned or -controlled corporations, LGUs = local government units.
Source: Bureau of the Treasury.

Policy, Institutional, and Regulatory Developments

Bangko Sentral ng Pilipinas Further Liberalizes Foreign Exchange Rules

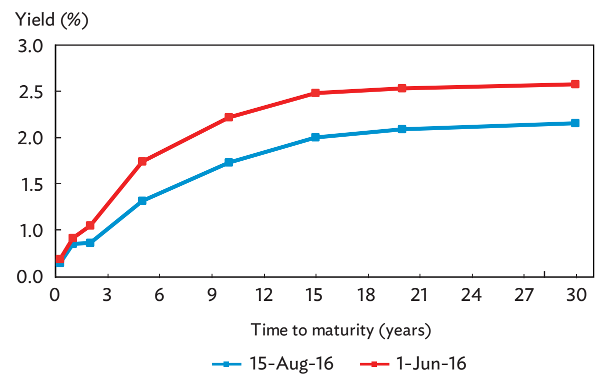
The BSP announced in August that its Monetary Board approved further liberalization of its foreign exchange rules and regulations in line with the Philippine economy's increasing integration with the global economy. The new measures include, among others, increasing the amount of foreign exchange that local residents, both individuals and corporations, can purchase from the banking system, as well as allowing the sale of foreign exchange by banks and their foreign exchange entities for resident-to-resident transactions.

Singapore

Yield Movements

Local currency (LCY) government bond yields in Singapore fell for all tenors between 1 June and 15 August **(Figure 1)**. The yield curve for Singapore Government Securities (SGS) flattened as yields continued to decline, with yields falling more sharply at the longer-end than the shorter-end of the curve. During the review period, yields for bonds with 1-year maturities and below declined an average of 5 basis points (bps). Yields for bonds with 2-year maturities dropped 19 bps, while yields fell an average of 45 bps for the 5-year through 30-year maturities. The spread between the 2-year and 10-year tenors narrowed to 87 bps on 15 August from 117 bps on 1 June.

Figure 1: Singapore's Benchmark Yield Curve–Local Currency Government Bonds



Source: Based on data from Bloomberg LP.

The yields for SGS bonds declined on increased demand, especially as the United States (US) Federal Reserve has continued to delay its much-anticipated interest rate hike, while the fallout from the United Kingdom's vote to exit the European Union has sent jitters through financial markets, causing investors to seek safe havens. The yield spread between 10-year Singapore bonds and 10-year US Treasuries declined from 38 bps on 1 June to 18 bps on 15 August. Continued weakness in global demand, which negatively affects export-oriented economies such as Singapore, and the persistence of deflation also contributed to the drop in bond yields.

Singapore's gross domestic product (GDP) grew 2.1% year-on-year (y-o-y) during the second quarter (Q2) of 2016, a rate of expansion that was unchanged from the first quarter (Q1). The manufacturing sector recorded positive growth of 1.1% y-o-y in Q2 2016, a reversal from the 0.5% y-o-y decline in Q1 2016, while construction sector growth moderated to 3.3% y-o-y in Q2 2016 from 4.0% y-o-y in Q1 2016. The services sector registered growth of 1.4% y-o-y in Q2 2016, down from 1.7% y-o-y in the previous quarter. On a quarter-on-quarter (q-o-q) and seasonally adjusted annualized basis, GDP expanded 0.3% in Q2 2016, a slight improvement from 0.1% growth in Q1 2016.

The Ministry of Trade and Industry has narrowed Singapore's 2016 GDP growth forecast range to 1%–2% from 1%–3%, mainly due to external factors such as a weaker global outlook following the British referendum to leave the European Union, weaker growth momentum in the US, and a continued slowdown in investments and economic restructuring in the People's Republic of China.

Consumer prices fell 0.7% y-o-y in July, which was unchanged from June and also the 21st consecutive month of deflation. The continued contraction in transportation costs and housing and utilities costs accounted for most of the decline. The Monetary Authority of Singapore (MAS) noted the slowdown in housing rentals stemming from the large supply of new residential units available this year, the likelihood that low global oil prices will persist given ample supply and low global demand, and expectations of a lower wage-growth trajectory as the domestic labor market eases. These factors will continue to contribute to deflation in Singapore, which MAS is forecasting at between –1.0% and 0.0% for full-year 2016.

Size and Composition

Singapore's LCY bonds outstanding were SGD314 billion (USD233 billion) at the end of June **(Table 1)**. Growth remained sluggish in Q2 2016, inching up a mere 0.2% q-o-q. On a y-o-y basis, the LCY bond market contracted 4.9%.

Table 1: Size and Composition of the Local Currency Bond Market in Singapore

	Outstanding Amount (billion)						Growth Rate (%)			
	Q2 2015		Q1 2016		Q2 2016		Q2 2015		Q2 2016	
	SGD	USD	SGD	USD	SGD	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**330**	**245**	**314**	**233**	**314**	**233**	**3.0**	**5.5**	**0.2**	**(4.9)**
Government	197	147	184	136	182	135	2.8	4.2	(1.1)	(8.0)
SGS Bills and Bonds	105	78	110	81	109	81	5.3	5.1	(0.5)	3.7
MAS Bills	92	68	74	55	73	54	0.0	3.3	(1.9)	(21.3)
Corporate	133	99	130	96	133	98	3.4	7.4	2.0	(0.3)

( ) = negative, MAS = Monetary Authority of Singapore, q-o-q = quarter-on-quarter, Q1 = first quarter, Q2 = second quarter, SGD = Singapore dollar, SGS = Singapore Government Securities, USD = United States dollar, y-o-y = year-on-year.
Notes:
1. Government bonds are calculated using data from national sources. Corporate bonds are based on *AsianBondsOnline* estimates.
2. SGS bills and bonds do not include the special issue of Singapore Government Securities held by the Singapore Central Provident Fund.
3. Bloomberg LP end-of-period local currency–USD rates are used.
4. Growth rates are calculated from local currency base and do not include currency effects.
Sources: Bloomberg LP, Monetary Authority of Singapore, and Singapore Government Securities.

Government Bonds. LCY government bonds outstanding decreased 1.1% q-o-q to SGD182 billion at the end of June as the outstanding stocks of SGS bills and bonds and MAS bills posted q-o-q decreases. In Q2 2016, SGS bond issuance amounted to SGD6.4 billion, mainly due to a reopening of a 7-year SGS bond and new issuances of 10-year SGS bonds. SGD4.2 billion of SGS bills were redeemed in Q2 2016, which nearly balanced out the SGD4.5 billion worth of SGS bills that were issued during the quarter.

The outstanding stock of MAS bills declined 1.9% q-o-q in Q2 2016 to SGD73 billion. In y-o-y terms, the stock of MAS bills declined 21.3% from SGD92 billion in Q2 2015. New issuance of MAS bills amounted to SGD69.7 billion, reflecting a drop of 2.5% q-o-q and 21.3% y-o-y.

Corporate Bonds. Based on *AsianBondsOnline* estimates, the outstanding stock of LCY corporate bonds reached SGD133 billion at the end of June, up 2.0% q-o-q but down 0.3% y-o-y.

At the end of June, the top 30 largest LCY corporate bond issuers accounted for a combined SGD68 billion worth of notes, or a 51.3% share of the total corporate bond stock **(Table 2)**. Singapore's Housing and Development Board topped the list with outstanding bonds worth SGD20.4 billion. United Overseas Bank was a distant second with total bonds valued at SGD4.7 billion. Temasek Financial I, a wholly owned financing subsidiary of state-owned investment company Temasek Holdings, had total bonds outstanding of SGD3.6 billion.

Among the 30 largest corporate bond issuers, 4 were state-owned agencies, while the rest comprised a diverse set of issuers from the banking, consumer goods, education, finance, real estate, transportation, and utilities sectors.

A downside development in the LCY bond market in Q2 2016 concerns Swiber Holdings, a large Singapore oil services company, which in August defaulted on its coupon payments for SGD150 million worth of notes maturing in August 2018 and with a coupon rate of 6.5%. Despite being able to redeem bonds worth SGD130 million due in June and SGD75 million worth of bonds due in July, Swiber Holdings applied to be placed under judicial management review. Four SGD-denominated notes worth SGD460 million and one renminbi-denominated note worth CNY450 million remain to be paid. The global downturn in the oil and gas industry since 2014 has led to a shortage of projects for energy services firms, which in turn puts strain on their coupon and loan payments. With more notes from Swiber Holdings and other oil and gas industry firms due to mature in 2016–2017, it remains to be seen how the bond market and banking industry will accommodate this stress.

In Q2 2016, a total of 22 companies issued new LCY corporate debt amounting to SGD4.6 billion, reflecting a 41.3% q-o-q rise but a decline of 18.4% y-o-y. The largest issuance in Q2 2016 was United Overseas Bank's perpetual bond worth SGD750 million. It was followed by the Housing and Development Board's 5-year bond sale worth SGD675 million. **Table 3** presents the notable corporate bond issues in Q2 2016.

Table 2: Top 30 Issuers of Local Currency Corporate Bonds in Singapore

	Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
		LCY Bonds (SGD billion)	LCY Bonds (USD billion)			
1.	Housing and Development Board	20.4	15.2	Yes	No	Real Estate
2.	United Overseas Bank	4.7	3.5	No	Yes	Banking
3.	Temasek Financial I	3.6	2.7	Yes	No	Finance
4.	Land Transport Authority	3.5	2.6	Yes	No	Transportation
5.	Capitaland	3.0	2.2	No	Yes	Real Estate
6.	DBS Bank	2.7	2.0	No	Yes	Banking
7.	FCL Treasury	2.4	1.8	No	No	Finance
8.	SP Powerassets	1.9	1.4	No	No	Utilities
9.	Hyflux	1.7	1.3	No	Yes	Utilities
10.	Olam International	1.7	1.3	No	Yes	Consumer Goods
11.	Keppel Corporation	1.7	1.3	No	Yes	Diversified
12.	Public Utilities Board	1.7	1.2	Yes	No	Utilities
13.	City Developments Limited	1.6	1.2	No	Yes	Real Estate
14.	DBS Group Holdings	1.5	1.1	No	Yes	Banking
15.	Oversea-Chinese Banking Corporation	1.5	1.1	No	Yes	Banking
16.	Neptune Orient Lines	1.3	1.0	No	Yes	Transportation
17.	Capitaland Treasury	1.2	0.9	No	No	Finance
18.	Singtel Group Treasury	1.2	0.9	No	No	Finance
19.	Mapletree Treasury Services	1.1	0.8	No	No	Finance
20.	Capitamalls Asia Treasury	1.0	0.7	No	No	Finance
21.	Singapore Airlines	1.0	0.7	No	Yes	Transportation
22.	Ascendas REIT	1.0	0.7	No	Yes	Finance
23.	Sembcorp Financial Services	1.0	0.7	No	No	Engineering
24.	GLL IHT	0.9	0.7	No	No	Real Estate
25.	CMT MTN	0.9	0.7	No	No	Finance
26.	National University of Singapore	0.9	0.7	No	No	Education
27.	Overseas Union Enterprise	0.8	0.6	No	Yes	Real Estate
28.	Sembcorp Industries	0.8	0.6	No	Yes	Shipbuilding
29.	Global Logistic Properties	0.8	0.6	No	Yes	Real Estate
30.	SMRT Capital	0.8	0.6	No	No	Transportation
Total Top 30 LCY Corporate Issuers		**68.0**	**50.5**			
Total LCY Corporate Bonds		**132.6**	**98.4**			
Top 30 as % of Total LCY Corporate Bonds		**51.3%**	**51.3%**			

LCY = local currency, SGD = Singapore dollar, USD = United States dollar.
Notes:
1. Data as of end-June 2016.
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on Bloomberg LP data.

Table 3: Notable Local Currency Corporate Bond Issuance in Q2 2016

Corporate Issuers	Coupon Rate (%)	Issued Amount (SGD million)
United Overseas Bank		
Perpetual bond	4.00	750
Housing and Development Board		
5-year bond	1.75	675
Hyflux		
Perpetual bond	6.00	500
Starhub		
10-year bond	3.55	300
Perennial Real Estate Holdings		
4-year bond	4.55	280
Mapletree Logistics Trust		
Perpetual bond	4.18	250
FCL Treasury		
10-year bond	4.25	250

Q2 = second quarter, SGD = Singapore dollar.
Source: Bloomberg LP.

Ratings Update

On 29 August, RAM Ratings affirmed Singapore's global- and Association of Southeast Asian Nations-scale sovereign ratings of $_{g}AAA_{(pi)}$ and $_{sea}AAA_{(pi)}$, respectively. Both ratings were given a stable outlook. RAM Ratings cited Singapore's strong external position, robust financial profile, sound institutional framework, and stable political governance as the main reasons for the affirmation. The rating comes amid a backdrop of slower economic growth due to a weak external environment and domestic structural challenges posed by labor shortages and an aging population.

Policy, Institutional, and Regulatory Developments

Monetary Authority of Singapore's Renminbi Investments Included in Official Foreign Reserves

MAS announced that it would include renminbi financial investments as part of its Official Foreign Reserves beginning in June. MAS cited the following reasons for this move: (i) the People's Republic of China having taken significant steps to liberalize foreign institutional investors' access to its foreign exchange and securities markets, and (ii) the International Monetary Fund's announcement that it will include the renminbi in the Special Drawing Rights basket of currencies beginning in October.

Singapore Launches First Listed Private Equity Bonds

Astrea III, which is ultimately backed by Singapore's state-owned Temasek Holdings, successfully launched a series of private equity bonds in June. The bonds are backed by 34 private equity funds with interests in more than 590 companies, the first-of-its-kind bond series to be listed in Singapore. The issued bonds are designed to make private equity more accessible to a wider range of institutional and individual investors. The issuance amounted to USD510 million and comprised four classes of 10-year bonds—A-1 (SGD228 million), A-2 (USD170 million), B (USD100 million), and C (USD70 million)—ordered according to seniority and maturity, and with interest rates of 3.90%, 4.65%, 6.50%, and 9.25%, respectively. Class A-1 bonds are redeemable starting in year 3, while Class A-2 bonds can be redeemed starting in year 5.

Singapore Exchange in SGD153 Million Deal to Buy Baltic Exchange

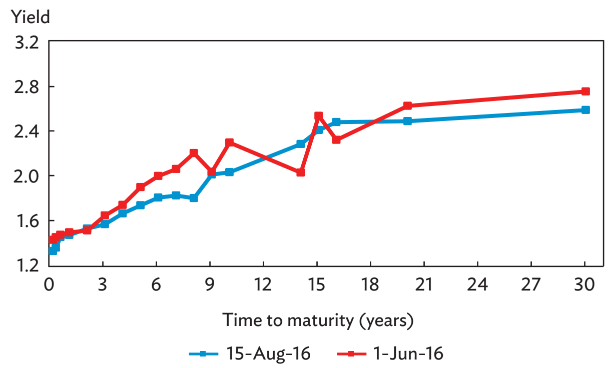
Singapore Exchange (SGX) and the Baltic Exchange Limited (Baltic Exchange) announced on 22 August a SGD153 million deal for SGX to acquire Baltic Exchange. The deal is expected to be completed by November. The acquisition will enable SGX to diversify into the commodities and shipping finance markets; allow SGX to develop new products, benchmarks, and services; and strengthen Singapore's role as a preferred location for the trading and settlement of shipping contracts.

Thailand

Yield Movements

Thailand's local currency (LCY) government bond yields fell for most tenors between 1 June and 15 August **(Figure 1)**. Yields for bonds with maturities of 1 month to 1 year declined 2–10 basis points (bps). Yields for tenors of between 3 years and 7 years fell between 8–24 bps. Yields for tenors of between 8 years and 30 years fell between 13–40 bps, except for the 9-year bond which fell marginally by 2 bps. Only yields for bonds with 2-year, 14-year, and 16-year maturities rose during the review period. The 2-year versus 10-year yield spread narrowed from 79 bps to 50 bps between 1 June and 15 August, leading to a flattening of the yield curve.

Figure 1: Thailand's Benchmark Yield Curve—Local Currency Government Bonds



Source: Based on data from Bloomberg LP.

The decline in government LCY bond yields was due to the sudden increase in capital flows induced by increased investor appetite for emerging market assets resulting from the United Kingdom's referendum to leave the European Union on 23 June as well as the United States (US) Federal Reserve refraining from a policy rate increase at its mid-June and end-July meetings.

Bond yields temporarily rose in the days leading up to Thailand's referendum on 7 August in which more than 60% of Thai voters approved the military-backed constitution. The result boosted investor confidence that Thailand's economy, which had suffered due to political uncertainty, is poised to improve. As an example of increased confidence, the Thai baht appreciated to a year-to-date high of THB34.6 to the US dollar on 15 August.

The Bank of Thailand's (BOT) Monetary Policy Committee voted unanimously to maintain the policy rate at 1.50% in its 3 August meeting. The central bank maintained its accommodative monetary policy stance as it assessed that the economy would continue recovering at a gradual pace despite a perceived increase in downside risks generated by the results of the British referendum, weakness in the European financial sector, and financial stability risks in the People's Republic of China.

Consumer price inflation was positive for the fifth consecutive month in August, albeit at a pace of only 0.3% year-on-year (y-o-y), since Thailand exited from deflation in April. The slight uptick in the Consumer Price Index in August came mainly from rising prices for food and nonalcoholic beverages, which account for 33.5% of the index. Prices of nonfood items and beverages, which account for 66.5% of the index, continued to fall, led by housing and furnishings, and transportation and communications. Inflation is expected to gradually rise but the timing will depend on global oil price movements.

Thailand's gross domestic product growth rose to 3.5% y-o-y in the second quarter (Q2) of 2016 from 3.2% y-o-y in the first quarter (Q1) of 2016, buoyed by a rise in private consumption and continued growth in government spending, gross fixed capital formation, tourism, and the manufacturing sector. Exports of services remained strong on growth of 12.1% y-o-y, though this was down from 18.2% y-o-y growth in Q1 2016. Exports of goods remained weak, contracting 2.5% y-o-y in Q2 2016 after tepid growth of 1.0% in Q1 2016. According to the Office of the National Economic and Social Development Board, Thailand's economy is projected to surpass the 2.8% annual growth it achieved in 2015 by expanding 3.0%–3.5% in 2016.

Size and Composition

Thailand's LCY bond market expanded 1.6% quarter-on-quarter (q-o-q) to THB10,372 billion (USD295 billion)

Table 1: Size and Composition of the Local Currency Bond Market in Thailand

	Outstanding Amount (billion)						Growth Rate (%)			
	Q2 2015		Q1 2016		Q2 2016		Q2 2015		Q2 2016	
	THB	USD	THB	USD	THB	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**9,606**	**284**	**10,206**	**291**	**10,372**	**295**	**3.1**	**4.6**	**1.6**	**8.0**
Government	7,299	216	7,607	217	7,720	220	3.1	4.2	1.5	5.8
Government Bonds and Treasury Bills	3,602	107	3,964	113	3,884	111	0.7	5.2	(2.0)	7.8
Central Bank Bonds	2,910	86	2,869	82	3,030	86	8.5	3.0	5.6	4.1
State-Owned Enterprise and Other Bonds	787	23	774	22	807	23	(3.8)	3.7	4.3	2.5
Corporate	2,307	68	2,599	74	2,652	75	3.2	6.2	2.0	14.9

( ) = negative, q-o-q = quarter-on-quarter, Q1 = first quarter, Q2 = second quarter, THB = Thai baht, USD = United States dollar, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Bloomberg end-of-period LCY–USD rates are used.
3. Growth rates are calculated from an LCY base and do not include currency effects.
Sources: Bank of Thailand and Bloomberg LP.

at the end of June **(Table 1)**. On a y-o-y basis, the LCY bond market grew 8.0% in Q2 2016. Of the total amount, government bonds account for THB7,720 billion and corporate bonds for the remaining THB2,652 billion.

Government Bonds. LCY government bonds outstanding rose 1.5% q-o-q to THB7,720 billion at the end of June. The increase came mainly from the 5.6% q-o-q increase in central bank bonds outstanding and the 4.3% q-o-q increase in outstanding state-owned enterprise and other bonds. At the end of June, the outstanding stock of central government bonds stood at THB3,884 billion, a slight decrease of 2.0% q-o-q. Central bank bonds rose to THB3,030 billion, leading the overall rise in bonds outstanding.

In Q2 2016, newly issued government bonds totaled THB2,216 billion, up from THB2,103 billion in Q1 2016. Most of the new issuance comprised central bank bonds worth THB1,908 billion, which was roughly on par with the previous quarter's issuance and up 36.9% on an annual basis. New issuance of central government bonds rose 42.0% q-o-q to THB251 billion in Q2 2016 but declined 37.8% y-o-y.

Corporate Bonds. Total LCY corporate bonds outstanding rose to THB2,652 billion at the end of June on growth of 2.0% q-o-q and 14.9% y-o-y. LCY corporate bond issuance amounted to THB380 billion in Q2 2016.

At the end of June, the top 30 LCY corporate bond issuers in Thailand had combined outstanding LCY bonds amounting to THB1,465 billion. The top 30 issuers accounted for 55.3% of total LCY corporate bonds outstanding **(Table 2)**. CP All remained the largest corporate issuer in Thailand with THB180 billion of LCY bonds outstanding. Siam Cement, on the back of recent issuances, overtook PTT to become the second largest borrower with THB166.5 billion in outstanding bonds. PTT was in third spot with THB145.4 billion of LCY bonds outstanding.

In Q2 2016, the largest corporate issuance was Siam Cement's 4-year bond sale worth THB25 billion and with a coupon rate of 3.0%. This was followed by Advanced Wireless with a dual-tranche bond sale comprising 7-year and 10-year maturities totaling THB15 billion, and Bangkok Expressway and Metro's issuance of a multitranche bond with maturities ranging from 3 years to 12 years totaling THB15 billion. **Table 3** lists notable corporate bond issuances in Q2 2016.

Investor Profile

Contractual savings funds remained the largest holder of LCY government bonds in Thailand with a share of 28.8% of the total at the end of June, up slightly from 27.9% in Q2 2015 **(Figure 2)**. Insurance companies accounted for the second largest share at 26.3%, which was little changed from 25.8% in Q2 2015. Meanwhile, the share of foreign investors fell to 14.5% at the end of June from 16.5% a year earlier.

Net foreign flows into Thailand's LCY bond market were positive in January–July. In Q1 2016, foreign investors showed renewed interest in the region after

Table 2: Top 30 Issuers of Local Currency Corporate Bonds in Thailand

	Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
		LCY Bonds (THB billion)	LCY Bonds (USD billion)			
1.	CP All	180.0	5.1	No	Yes	Commerce
2.	Siam cement	166.5	4.7	Yes	Yes	Construction Materials
3.	PTT	145.4	4.1	Yes	Yes	Energy and Utilities
4.	Charoen Pokphand Foods	80.0	2.3	No	Yes	Food and Beverage
5.	Bank of Ayudhya	67.3	1.9	No	Yes	Banking
6.	Thai Airways International	54.3	1.5	Yes	Yes	Transportation and Logistics
7.	Indorama Ventures	45.3	1.3	No	Yes	Petrochemicals and Chemicals
8.	Kasikorn Bank	42.5	1.2	No	Yes	Banking
9.	Tisco Bank	40.8	1.2	No	No	Banking
10.	The Siam Commercial Bank	40.0	1.1	No	Yes	Banking
11.	Toyota Leasing Thailand	39.1	1.1	No	No	Finance and Securities
12.	Mitr Phol Sugar	37.8	1.1	No	No	Food and Beverage
13.	Banpu	37.3	1.1	No	Yes	Energy and Utilities
14.	True Corp	37.1	1.1	No	Yes	Communications
15.	True Move H Universal Communication	34.0	1.0	No	No	Communications
16.	Krungthai Card	32.8	0.9	Yes	Yes	Banking
17.	Thanachart Bank	32.5	0.9	No	No	Banking
18.	Land & Houses	32.5	0.9	No	Yes	Property and Construction
19.	PTT Exploration and Production Company	32.1	0.9	Yes	Yes	Energy and Utilities
20.	TPI Polene	32.0	0.9	No	Yes	Property and Construction
21.	Advanced Wireless	31.6	0.9	No	Yes	Communications
22.	Thai Oil	28.0	0.8	Yes	Yes	Energy and Utilities
23.	Minor International	25.8	0.7	No	Yes	Food and Beverage
24.	Quality Houses	25.4	0.7	No	Yes	Property and Construction
25.	TMB Bank	25.4	0.7	No	Yes	Banking
26.	ICBC Thai Leasing	24.9	0.7	No	No	Finance and Securities
27.	Glow Energy	24.6	0.7	No	Yes	Energy and Utilities
28.	CH. Karnchang	24.5	0.7	No	Yes	Property and Construction
29.	IRPC	23.0	0.7	Yes	Yes	Energy and Utilities
30.	Bangkok Dusit Medical Services	22.6	0.6	No	Yes	Medical
Total Top 30 LCY Corporate Issuers		**1,465.1**	**41.7**			
Total LCY Corporate Bonds		**2,651.5**	**75.5**			
Top 30 as % of Total LCY Corporate Bonds		**55.3%**	**55.3%**			

LCY = local currency, THB = Thai baht, USD = United States dollar.
Notes:
1. Data as of end-June 2016.
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on Bloomberg LP data.

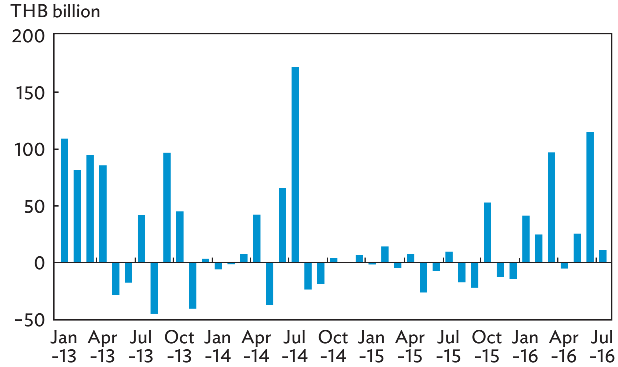
the US Federal Reserve announced it would delay further increases in its policy rate. Toward the end of Q2 2016, the United Kingdom's referendum on leaving the European Union caused uncertainty in global financial markets and directed funds toward the region. In addition, there was a further delay in the next rate hike by the US Federal Reserve. Aggregate net fund inflows in Q2 2016 amounted to THB133 billion. On a monthly basis, the decline in net inflows from THB113 billion in June to THB11 billion in July was the result of political uncertainty ahead of Thailand's referendum on 7 August **(Figure 3)**.

Table 3: Notable Local Currency Corporate Bond Issuance in Q2 2016

Corporate Issuers	Coupon Rate (%)	Issued Amount (THB million)
Siam Cement		
4-year bond	3.00	25,000
Advanced Wireless		
7-year bond	2.51	7,820
10-year bond	2.78	7,180
Bangkok Expressway and Metro		
3-year bond	2.22	5,000
5-year bond	2.52	1,915
7-year bond	3.00	2,000
10-year bond	3.30	3,335
12-year bond	3.61	2,750
Bank of Ayudhya		
2-year bond	1.89	5,000
3-year bond	1.96	7,000
Charoen Pokphand Foods		
4-year bond	2.28	3,060
8-year bond	3.11	3,500
15-year bond	3.73	2,500

Q2 = second quarter, THB = Thai baht.
Source: Bloomberg LP.

Figure 3: Foreign Investor Net Trading of Local Currency Bonds in Thailand

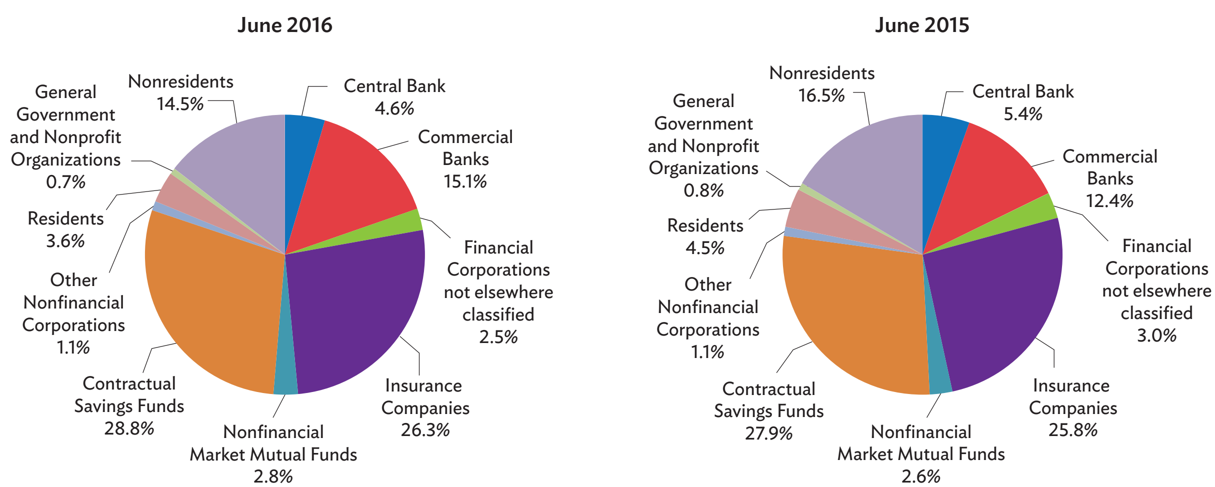


THB = Thai baht.
Source: ThaiBMA.

Ratings Update

On 22 July, Fitch Ratings (Fitch) downgraded Thailand's long-term local currency issuer default rating (IDR) to BBB+ from A–, while it affirmed the long-term foreign currency IDR at BBB+. Both ratings were given a stable outlook. Thailand's country ceiling was affirmed at A–, while its short-term local and foreign currency IDRs were assigned a rating of F2. The downgrade was in accordance with the revised sovereign rating criteria set forth on 18 July. Among other factors, Fitch stated that Thailand's key rating drivers are its strong and robust external and public finances amid multiple domestic and external economic shocks. However, these positives are tempered by weak growth prospects and the uncertain political environment.

Figure 2: Local Currency Government Bonds Investor Profile



Note: Government bonds exclude central bank bonds and state-owned enterprise bonds.
Sources: *AsianBondsOnline* and Bank of Thailand.

On 25 July, RAM Ratings reaffirmed Thailand's global scale rating of $_{g}$BBB1$_{(pi)}$ with a stable outlook. It cited Thailand's robust external finances, strong fiscal position, and well-diversified economy as the primary basis for the reaffirmation. It notes, however, political instability, weak private demand, and structural challenges as key concerns for the economy.

Policy, Institutional, and Regulatory Developments

Bank of Thailand Releases Plan for Bond Issuance Program for the Second Half of 2016

In June, the BOT announced its plan to increase the maximum issuance sizes of all bills and fixed-coupon bonds, except for the 3-year floating-rate bond, as a response to potentially rapid changes in market liquidity conditions and large swings in the appetite for bonds amid heightened volatility in the global financial markets. Auction days and issuance frequencies for all types of BOT bonds will remain the same. Depending on liquidity conditions and the issuance calendar for Treasury bills, the central bank will also consider issuing 1-month BOT bills on an occasional basis.

Bank of Thailand Eases Rules for Ownership of Foreign Securities

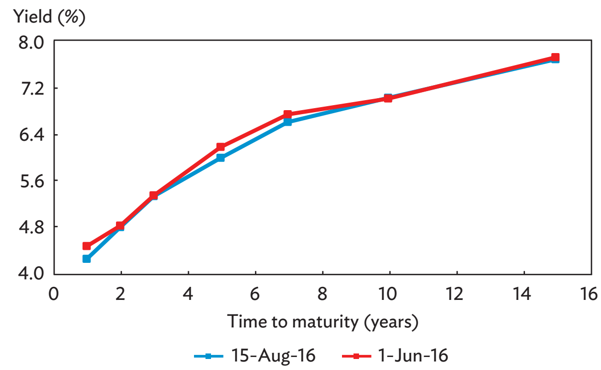
On 5 July, the BOT issued a memorandum allowing Thailand's citizens direct investment access to foreign securities, effective 20 July. Individuals and corporations with deposits or securities of at least THB100 million can directly invest a maximum amount each year of USD5 million in foreign securities. Corporate treasuries will also be allowed to both issue and invest in onshore and offshore foreign-currency-denominated debt beginning 28 July. Previously, stricter rules only allowed for firms to borrow foreign currency from financial institutions and invest in foreign-currency-denominated securities that were issued offshore. This comes as part of the central bank's effort to dampen the strengthening of the Thai baht vis-à-vis the US dollar.

Viet Nam

Yield Movements

Local currency (LCY) government bond yields in Viet Nam fell for all tenors between 1 June and 15 August except for the 10-year maturity **(Figure 1)**. Yields fell the most at the very short-end of the curve, with the 1-year maturity shedding 22 basis points (bps), while yields declined 19 bps for the 5-year maturity and 13 bps for the 7-year tenor. All other maturities across the curve fell by an average of 2 bps during the review period except for the 10-year maturity, which gained 1 bp. The spread between the 2-year and the 10-year maturities widened to 221 bps on 15 August from 217 bps on 1 June.

Figure 1: Viet Nam's Benchmark Yield Curve—Local Currency Government Bonds



Source: Based on data from Bloomberg LP.

The decline in yields can be partly attributed to new regulations passed by the State Bank of Vietnam easing investment restrictions on government bonds by banking institutions and foreign banks (see Policy and Regulatory Developments). Efforts by the State Bank of Vietnam to lower interest rates and maintain a more stable Vietnamese dong vis-à-vis the United States dollar also led to increased demand for government bonds. Further contributing to the decline in yields was the delay in the anticipated United States Federal Reserve rate hike, which has resulted in increased demand for higher-yielding assets.

Real gross domestic product (GDP) growth stood at 5.5% y-o-y in the first half of the year, roughly unchanged from the first 3 months of the year. Growth was buoyed by a 7.1% y-o-y expansion in the industrial and construction sector and a 6.4% y-o-y increase in the services sector.

Size and Composition

The size of Viet Nam's LCY bond market stood at VND969.9 trillion (USD43 billion) at the end of June on growth of 10.8% quarter-on-quarter (q-o-q) and 0.7% y-o-y **(Table 1)**. Growth was led by an increase in the stock of government bonds, particularly Treasury bonds and central bank bills. The corporate bond segment also contributed to growth, though this segment is still small relative to the aggregate bond stock.

Table 1: Size and Composition of the Local Currency Bond Market in Viet Nam

	Outstanding Amount (billion)						Growth Rate (%)			
	Q2 2015		Q1 2016		Q2 2016		Q2 2015		Q2 2016	
	VND	USD	VND	USD	VND	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**963,522**	**44**	**875,076**	**39**	**969,903**	**43**	**(0.8)**	**7.1**	**10.8**	**0.7**
Government	939,049	43	838,284	38	931,111	42	(1.7)	6.3	11.1	(0.8)
Treasury Bonds	546,192	25	627,691	28	717,149	32	(6.3)	7.0	14.3	31.3
Central Bank Bonds	200,308	9	4,905	0.2	9,999	0.4	26.5	23.5	103.9	(95.0)
State-Owned Enterprise Bonds	192,549	9	205,688	9	203,963	9	(9.8)	(8.7)	(0.8)	5.9
Corporate	24,473	1	36,792	2	38,792	2	52.7	48.9	5.4	58.5

( ) = negative, q-o-q = quarter-on-quarter, Q1 = first quarter, Q2 = second quarter, USD = United States dollar, VND = Vietnamese dong, y-o-y = year-on-year.
Notes:
1. Bloomberg LP end-of-period local currency–USD rates are used.
2. Growth rates are calculated from local currency base and do not include currency effects.
Source: Bloomberg LP and Vietnam Bond Market Association.

Government Bonds. At the end of June, LCY government bonds in Viet Nam reached VND931.1 trillion, up 11.1% q-o-q but marginally lower by 0.8% y-o-y. Much of the growth came from increases in the stock of Treasury bonds, which rose 14.3% q-o-q and 31.3% y-o-y. Central bank bills also contributed to the growth, albeit from a low base. The stock of state-owned enterprise bonds marginally declined 0.8% q-o-q during the review period.

Corporate Bonds. At the end of June, the outstanding stock of corporate bonds reached VND38.8 trillion on growth of 5.4% q-o-q and 58.5% y-o-y. The entire corporate bond market of Viet Nam comprised 19 corporate firms at the end of June **(Table 2)**. The largest corporate bond issuer was Masan Consumer Holdings with bonds outstanding amounting to VND11.1 trillion, representing 28.6% of the aggregate corporate bond stock. In the second spot was real estate firm Vingroup with VND8.0 trillion of outstanding bonds. Asia Commercial Joint Stock moved up to the third spot with bonds valued at VND4.6 trillion.

In Q2 2016, three corporate firms in Viet Nam raised capital from the bond market. The largest new corporate debt issuance was Asia Commercial Joint Stock, which raised a total of VND1,600 billion from an issuance of 5-year bonds **(Table 3)**. Saigon–Hanoi Securities issued VND300 billion in 2-year bonds, while Dongnai Plastic issued VND100 billion in 3-year bonds.

Table 3: Notable Local Currency Corporate Bond Issuance in Q2 2016

Corporate Issuers	Coupon Rate (%)	Issued Amount (VND billion)
Asia Commercial Joint Stock		
5-year bond	8.50	800
5-year bond	8.20	800
Saigon-Hanoi Securities		
2-year bond	9.50	300
Dongnai Plastic		
3-year bond	9.75	100

Q2 = second quarter, VND = Vietnamese dong.
Source: Bloomberg LP.

Table 2: Corporate Issuers of Local Currency Corporate Bonds in Viet Nam

Issuers	Outstanding Amount LCY Bonds (VND billion)	Outstanding Amount LCY Bonds (USD billion)	State-Owned	Listed Company	Type of Industry
1. Masan Consumer Holdings	11,100	0.50	No	No	Diversified Operations
2. Vingroup JSC	8,000	0.36	No	Yes	Real Estate
3. Asia Commercial Joint Stock	4,600	0.21	No	Yes	Finance
4. Hoang Anh Gia Lai	4,000	0.18	No	Yes	Real Estate
5. Techcom Bank	3,000	0.13	No	No	Banking
6. Ho Chi Minh City Infrastructure	2,102	0.09	No	Yes	Infrastructure
7. DIC	1,000	0.04	Yes	No	Chemicals
8. Ocean Group	980	0.04	No	Yes	Consulting Services
9. Saigon-Hanoi Securities	950	0.04	No	Yes	Finance
10. Tasco	500	0.02	No	Yes	Engineering and Construction
11. Vietinbank Securities	500	0.02	Yes	Yes	Finance
12. Sotrans	400	0.02	No	No	Logistics
13. Vietnam Investment Construction and Trading	350	0.02	No	Yes	Building and Construction
14. Anphat Plastic & Green Environment	300	0.01	No	Yes	Industrial
15. Hung Vuong	300	0.01	No	Yes	Food
16. Saigon Securities	300	0.01	No	Yes	Finance
17. Ha Do	200	0.01	No	Yes	Construction
18. Ho Chi Minh City Securities	110	0.005	No	No	Finance
19. Dongnai Plastic	100	0.004	No	Yes	Industrial
Total LCY Corporate Issuers	**38,792**	**1.73**			

LCY = local currency, USD = United States dollar, VND = Vietnamese dong.
Notes:
1. Data as of end-June 2016.
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on Bloomberg LP and Vietnam Bond Market Association data.

Policy, Institutional, and Regulatory Developments

State Bank of Vietnam Raises Prudential Ratios for Credit Institutions and Foreign Banks

In May, the State Bank of Viet Nam revised its regulation on prudential ratios for credit institutions and foreign banks. The revision included increasing the ceiling limits on the purchase or investment of government bonds by banking institutions from 15% to 25% of their short-term funding source. The investment cap for foreign banks was also raised to 35% of their short-term funding source.

State Bank of Vietnam Allows Foreign Currency Loans for Exporters

Effective 1 June, the State Bank of Vietnam began allowing commercial banks to provide short-term foreign currency loans for the short-term capital requirements of exporters. Under the new regulation, exporters are required to exchange borrowed foreign currency into Vietnamese dong, unless the loan will be used for a foreign currency payment. This new regulation will be in effect through 31 December. The State Bank of Vietnam had previously tightened regulations on foreign currency lending in March.

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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.

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