

Developments in Emerging East Asia Bond Markets

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Overview

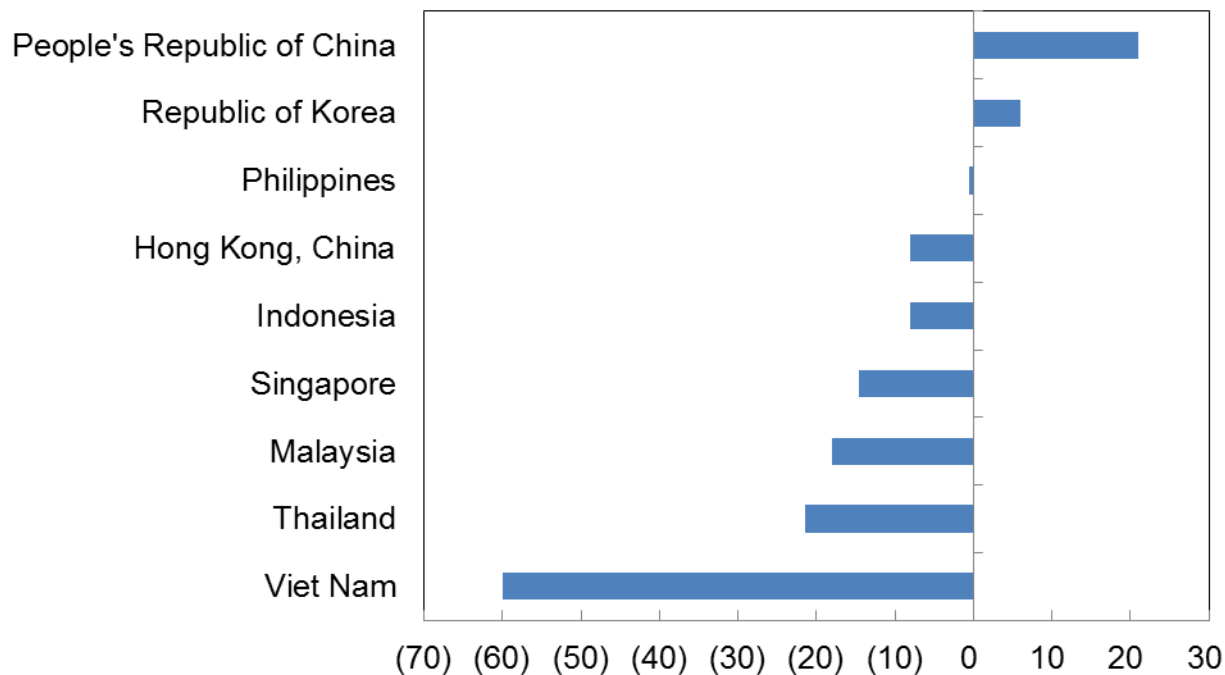
- The outlook for economic growth still remains positive
- In the US, unemployment rate has reached multi-year lows.
- Consistent with the improving US economy, the Federal Reserve raised its key policy rate in March and June.
- GDP forecasts for the Eurozone have increased
- Japan's GDP growth for 2017 is expected to remain above its long-term potential
- This has led to a positive investor sentiment

Overview

- With the US economic expansion on track, there is an increase likelihood of an unwinding of the Federal Reserve balance sheet this year.
- During the 26 July FOMC meeting, the Federal Reserve said that it expects to implement in its balance sheet normalization “relatively soon”.
- However, while forecasts indicate that the global economy continues to expand, inflation continues to lag.
- The Federal Reserve indicated that inflation continues to run below target and that they will continue to monitor inflation closely.
- The ECB and BOJ have also indicated that inflation remains soft.

Government Bond Yields Fell for Nearly all Markets

Changes in 10-Year LCY Government Bond Yields

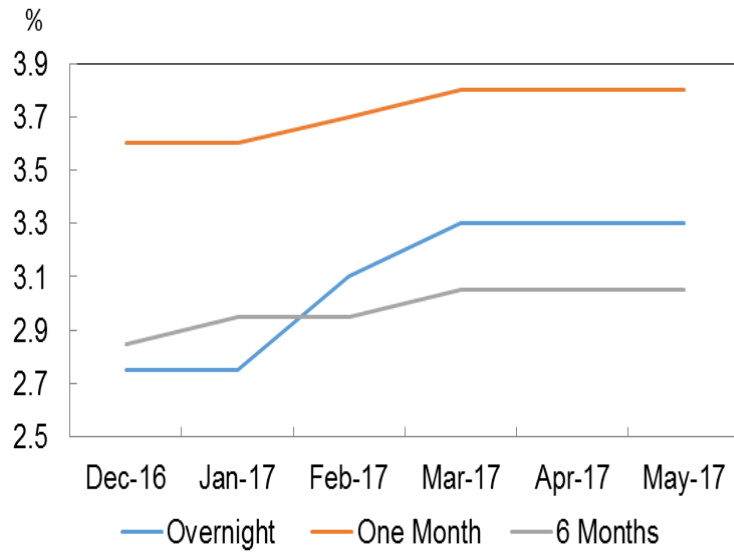


Note. Data reflect changes between 1 April 2017 and 15 July 2017.

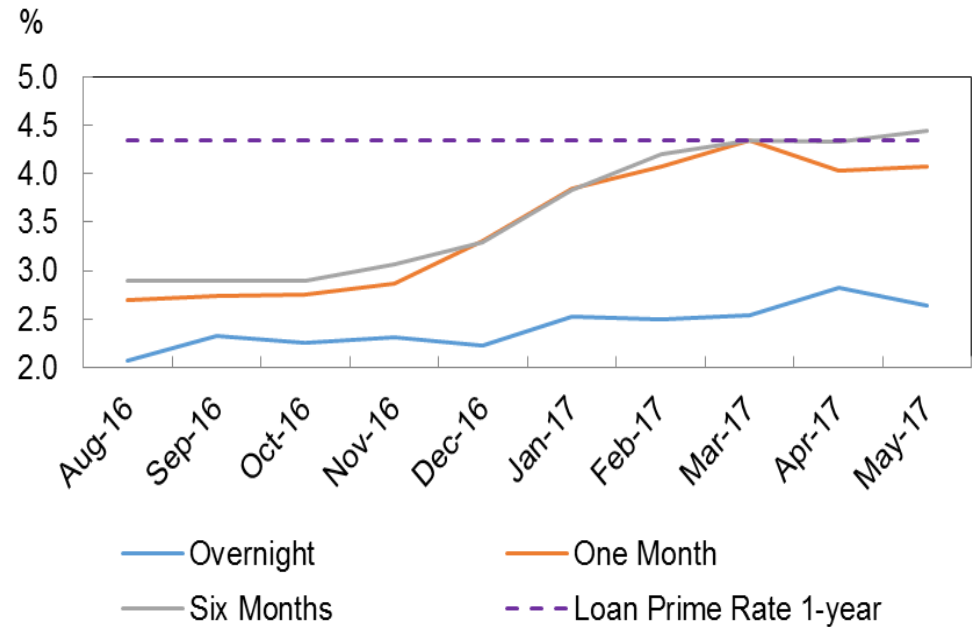
Source: Based on data from Bloomberg LP.

China Rates

Short /medium-term Lending Facility[S/MLF] Rates

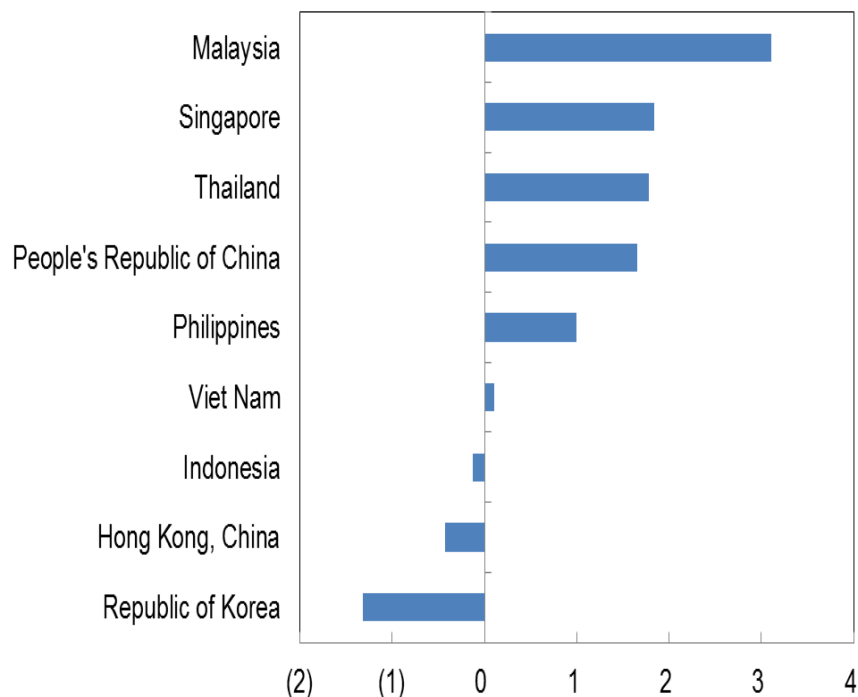


SHIBOR Rates

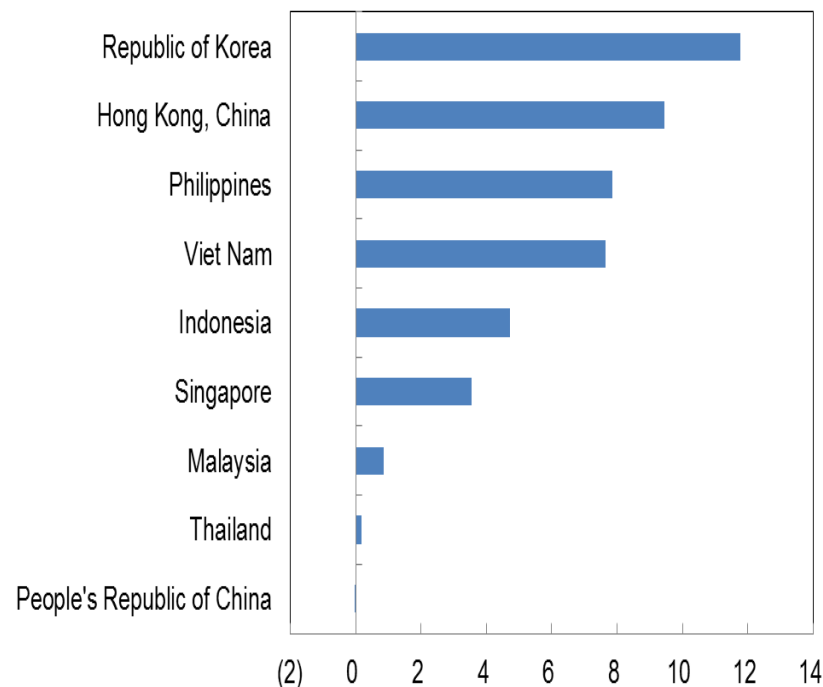


Currency, Equity Gains in Emerging East Asian Markets

Changes in FX Rates (%)



Changes in Equity Indices (%)

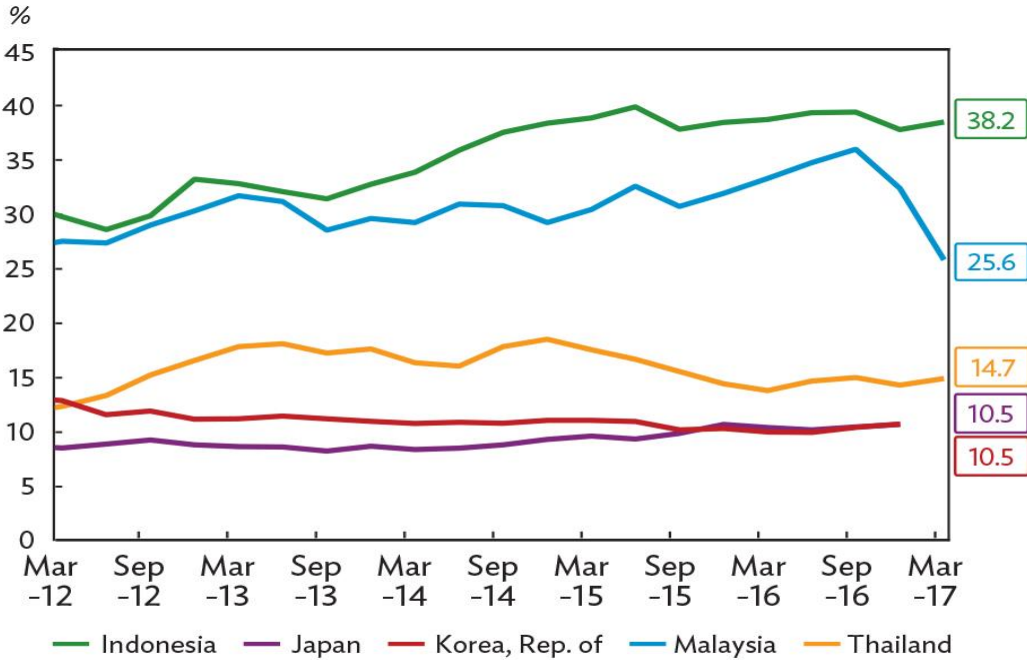


Note. Data reflect changes between 1 April 2017 and 15 July 2017.

Source: Based on data from Bloomberg LP.

Positive Investor Sentiment Drove Gains in the Share of Foreign Holdings of Government Bonds

Foreign Holdings in LCY Government Bonds



Note: Data as of end-March 2017 except for Japan and the Republic of Korea (end-December 2016).

Source: AsianBondsOnline.

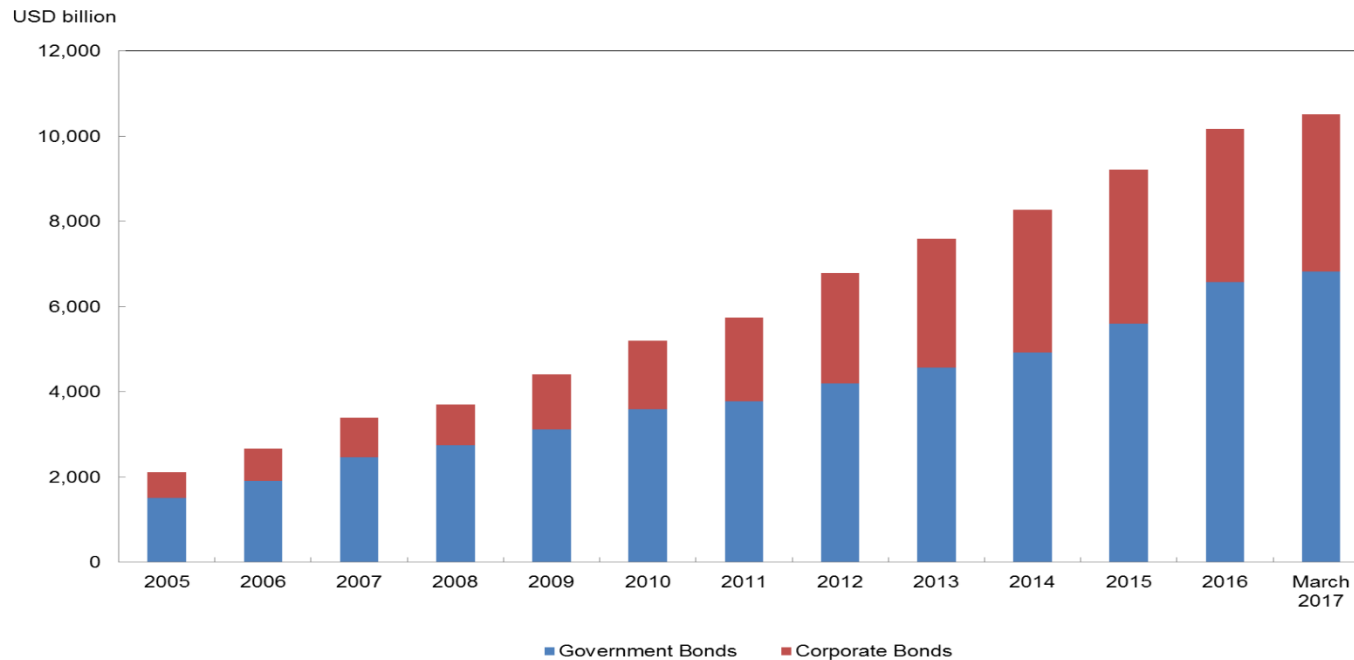


Bond Market Developments

- LCY bonds outstanding expanded to a size of USD10.5 trillion at the end of March
 - Growth was slower at 1.1% q-o-q and 13.3% y-o-y dragged down by a slowdown in the PRC's bond market growth
 - Government bonds continued to dominate the region's bond market accounting for a 64.9% share of total bonds in Q1 2017
- The People's Republic of China remained the largest bond market in the region
- The Republic of Korea had the highest bonds to GDP share
- LCY bond issuance was lower at USD852 billion in Q1 2017

LCY Bond Markets Continue to Grow

Size of Emerging East Asia's LCY Bond Market



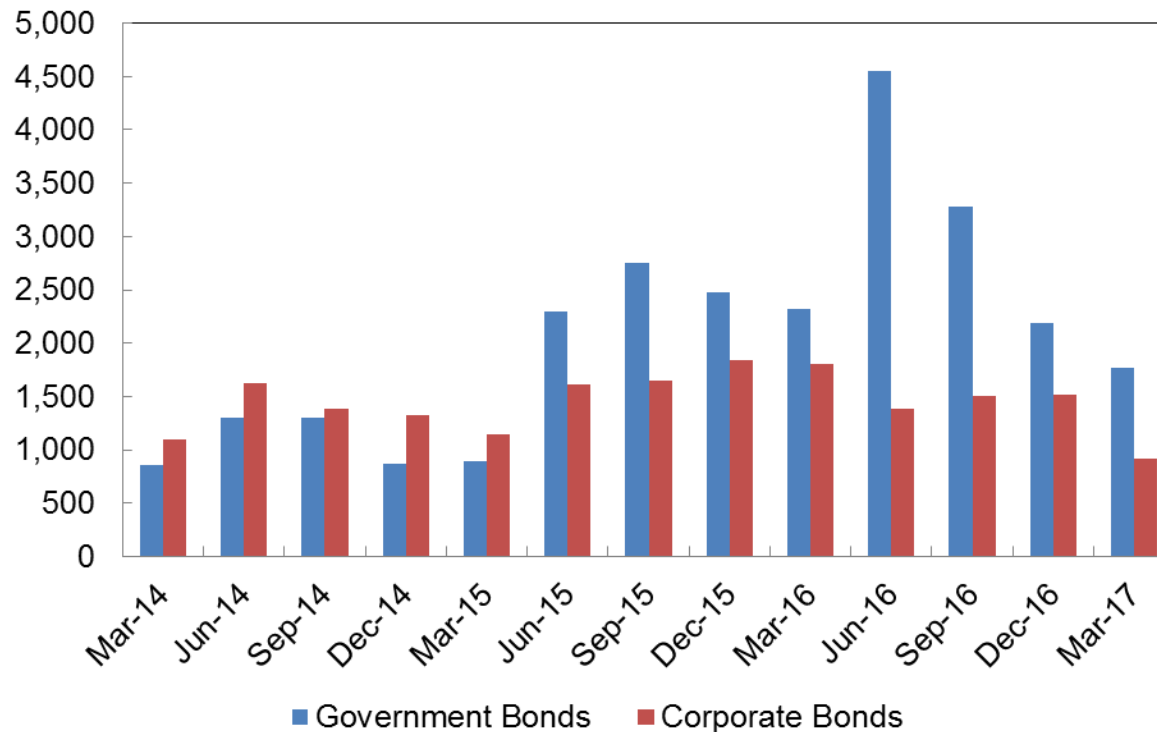
Note: Emerging East Asia comprises the People's Republic of China; Hong Kong, China; Indonesia; the Republic of Korea; Malaysia; the Philippines; Singapore; Thailand; and Viet Nam. Data as of end-March 2017.

Source: AsianBondsOnline.

Government and Corporate Bond Issuance is Decreasing in the PRC

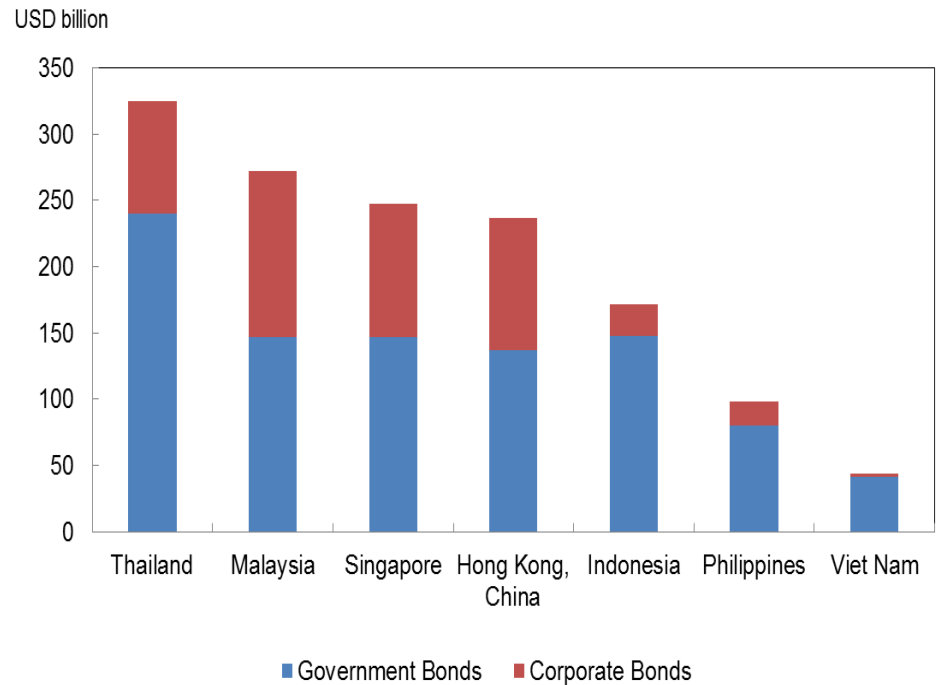
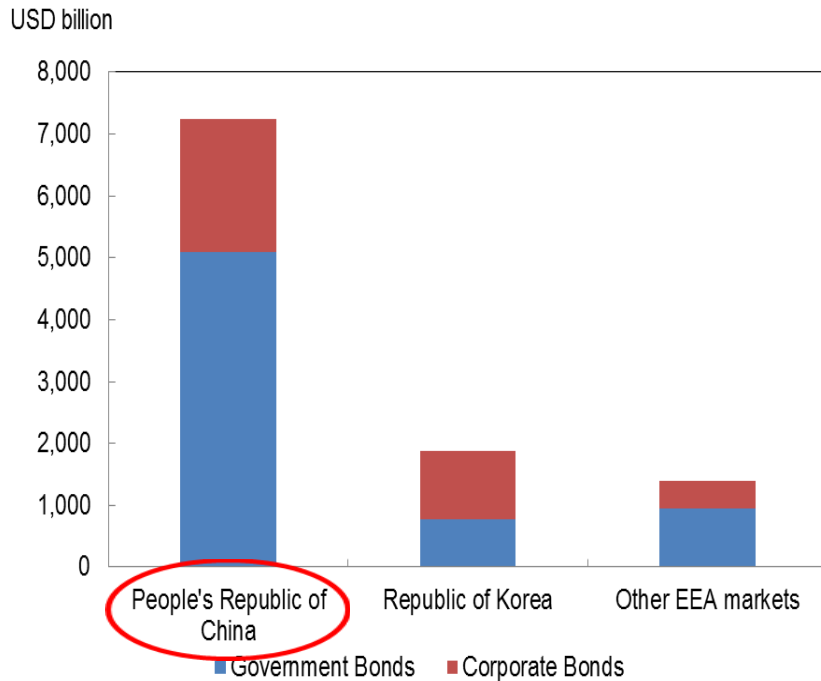
LCY Bond Issuance in the People's Republic of China

CNY billion



PRC Remains the Largest Bond Market in the Region

LCY Bond Outstanding

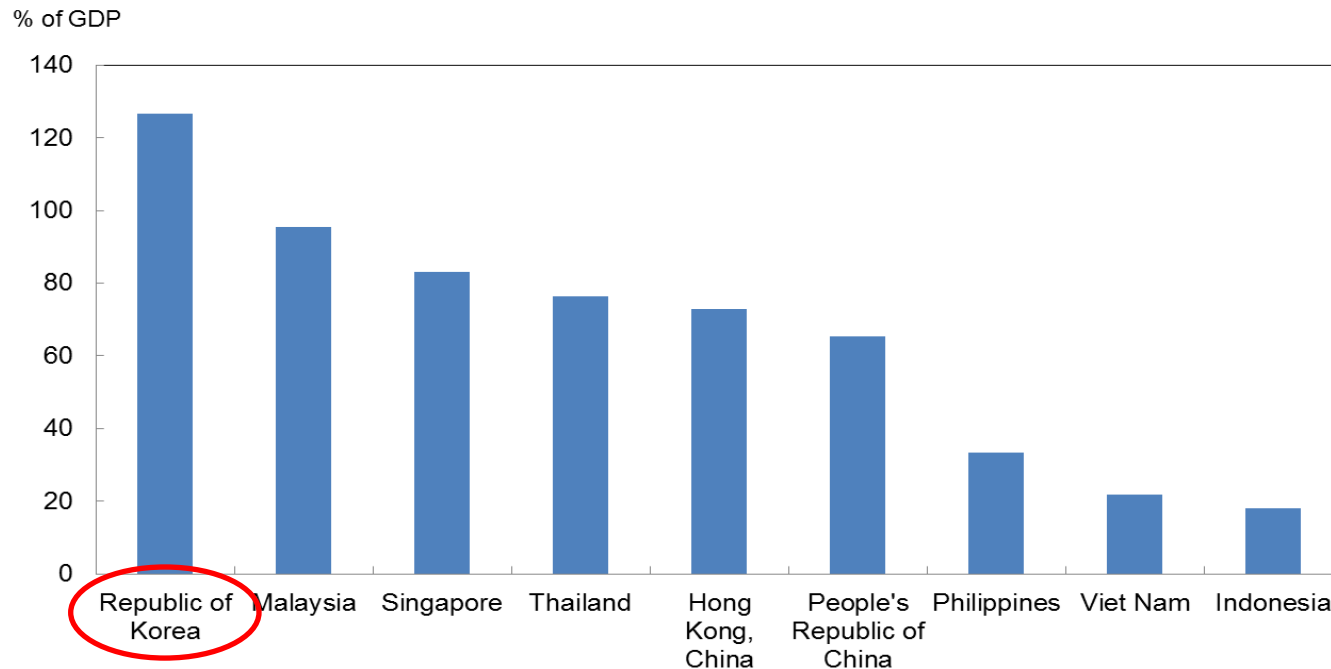


Note: Data as of end-March 2017.

Source: AsianBondsOnline.

Share of Bonds to GDP is the Largest in the Republic of Korea

LCY Bonds Outstanding as a Share of GDP



Note: Data as of end-March 2017. GDP is calculated based on quarterly GDP for Q1 2016 to Q1 2017.

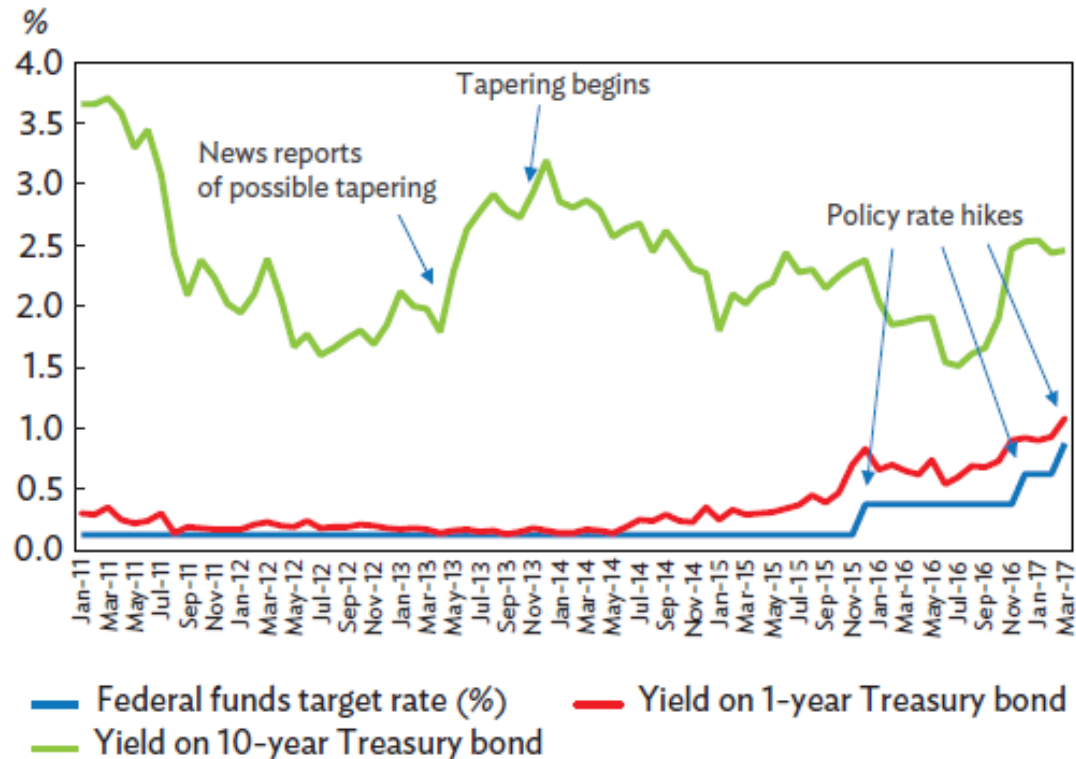
Source: AsianBondsOnline.

Nonetheless, Risks to the Bond Market Remain

- Liquidity conditions may tighten as the Federal Reserve continues its plan of gradually raising interest rates and unwind its asset purchases
- The May 2017 cyberattack highlights how the lack of cybersecurity threatens financial markets

Tightening Global Liquidity

Bond Yield Reactions to Policy Rate Hikes and Asset Purchase Tapering

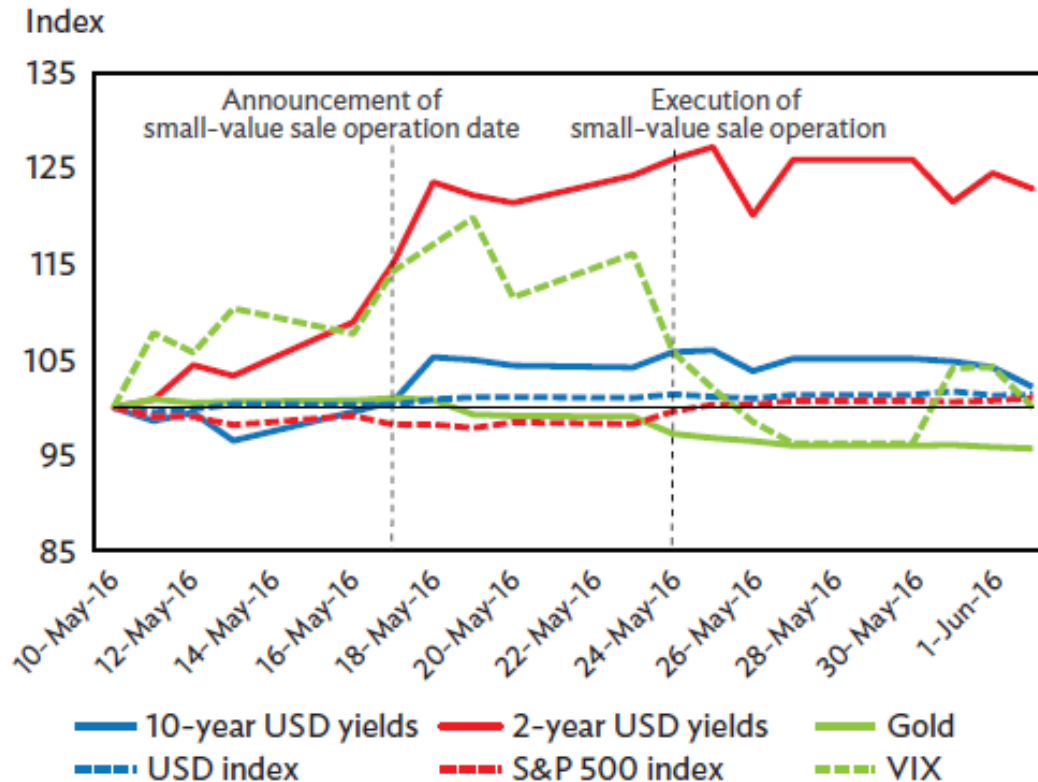


Note: Policy rate and Treasury nominal coupon spot yield are in a percentage and recorded at the end of each month.

Source: Haver Analytics.

Tightening Global Liquidity

Market Reaction to the Federal Reserve's Small-Value Sale Operation



S&P = Standard & Poor's, USD = United States dollar, VIX = Chicago Board Options Exchange Volatility Index.

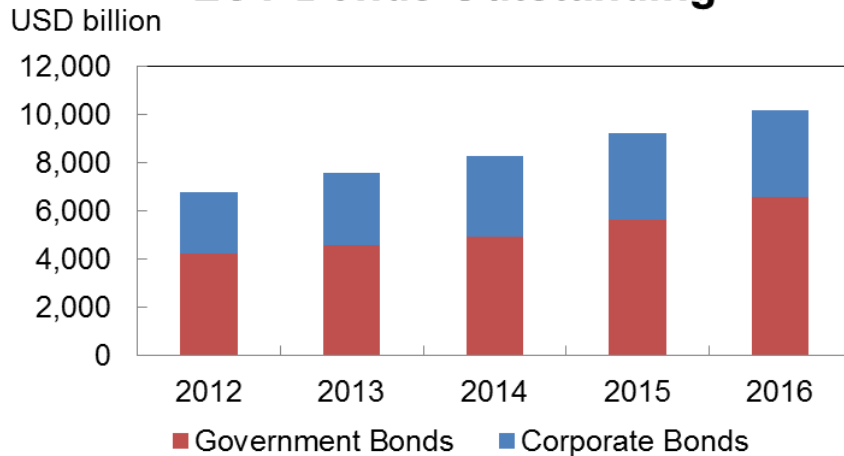
Note: 10 May 2016 = 100.

Source: Bloomberg LP.

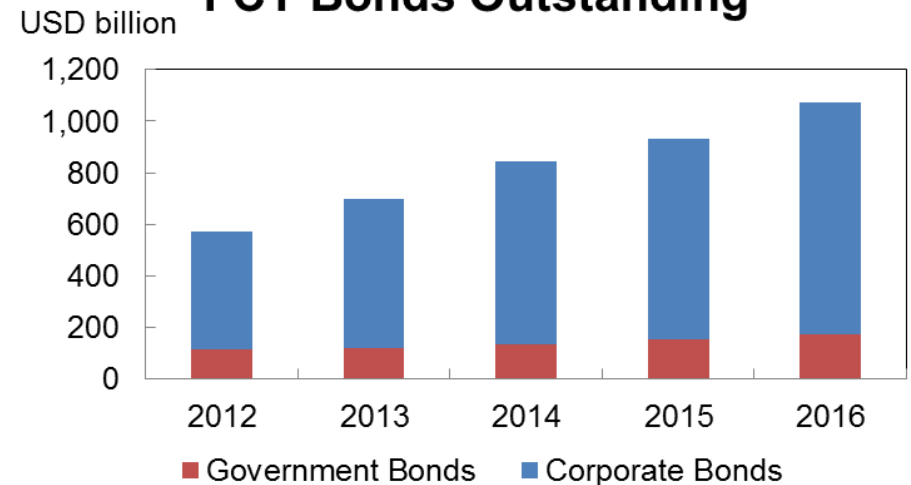
Challenges to Asia

- Expansion of non-financial corporate debt

LCY Bonds Outstanding



FCY Bonds Outstanding



- Rising real estate asset prices
 - Real estate index

Note: Data as of end-March 2017. Data covers emerging East Asia.

Source: AsianBondsOnline.

Conclusion

- Financial markets have been stable given the positive outlooks
- Caution should still be made due to possible risks that still remain
- Emerging East Asia should prepare for potential liquidity tightening stemming from the Federal Reserve's normalization of its monetary policy