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The *Asia Bond Monitor* (ABM) reviews recent developments in East Asian local currency bond markets along with the outlook, risks, and policy challenges. It covers the 10 Association of Southeast Asian Nations member countries plus the People's Republic of China; Hong Kong, China; and the Republic of Korea (ASEAN+3).

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Emerging East Asian Local Currency Bond Markets:

A Regional Update

Highlights

- Concerns have been mounting that the global economic recovery and stabilization of world financial markets, which has been underway since the last half of 2009, may stutter as vulnerabilities persist in the mature economies.

- Emerging East Asian[1] economies have thus far not been significantly impacted by the sovereign debt crisis in Europe or concerns about the pace of recovery in the United States. Flush liquidity in global markets and higher returns in emerging East Asia's local markets is attracting capital inflows.

- Emerging East Asia's local currency (LCY) bond market in 2Q10 grew at a rapid rate of 18.8% year-on-year (y-o-y) in 2Q10 and 5.1% quarter-on-quarter (q-o-q).

- The government bond market grew by 16.7% y-o-y in 2Q10, while the corporate bond market grew at a more rapid rate of 24.4% y-o-y. The q-o-q growth rates of the government and corporate bond markets were almost identical at 5.1% and 5.0%, respectively.

- Emerging East Asia's most rapidly growing LCY corporate bond markets in 2Q10 were in Viet Nam, the People's Republic of China (PRC), the Philippines, and Indonesia.

- New issuance in the emerging East Asian LCY bond market in 2Q10 grew 6.5% y-o-y, but declined 11.7% q-o-q, mainly driven by a q-o-q decline in central bank issuance due to a reduction in sterilization activities, as most regional currencies—with the exceptions of the Korean won and Philippine peso—remained stable in 2Q10 compared with 1Q10.

- The region's most active corporate bond issuers in 2Q10—both publicly-owned companies and private corporations—were found in the financial and infrastructure sectors.

- Foreign currency bond issuance from the region remained on track to equal—or even exceed—the USD63.2 billion of new issuance in 2009. The strong appetite for new G3 currency issuance reflected sustained investor interest in the bonds of major Asian governments, corporations, and financial institutions.

- Yield curves on LCY government bonds in emerging East Asia have flattened since the end of 2009—and, in some cases, shifted downward—as flush global liquidity and low interest rates in mature markets spurred foreign investment in local markets.

- Foreign participation in local bond markets has accelerated as investors hunt for yields and extend duration.

- Higher-grade corporate bond credit spreads have declined since end-December 2009, while credit spreads for lower-rated corporates have generally declined only at the short-end of their respective curves—and, in some cases, have risen.

- Risks to the market outlook in the region, which are now tilted to the downside, include (i) a sharp slowdown in mature economies, (ii) destabilizing capital flows, and (iii) a rise in inflationary pressures.

- At the end of 1Q10, emerging East Asia's share of the global bond market stood at 7.4%, compared with 2.1% before the onset of the 1997/98 Asian financial crisis. The region's two largest bond markets—the PRC and Korea—accounted for 4.2% and 1.7% of the global total, respectively.

- Emerging East Asia's corporate bond market increased its share of the global corporate bond market to 4.9% at end-March 2010 from 4.4% at end-December 2009. The region's government bond market increased its share of the global government bond market to 9.4% at end-March from 9.2% at end-December.

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

Introduction: **Global and Regional Market Developments**

Concerns have been mounting that the global economic recovery and stabilization of world financial markets, which has been underway since the last half of 2009, may stutter as vulnerabilities persist in mature economies. Financial markets have been gripped by fear that growth in advanced economies may stay low for longer periods.

While global and regional growth forecasts for 2010 still remain robust, largely driven by a strong performance in the first half of the year, the downside risks to the outlook for the second half of 2010 and 2011 have increased. Large fiscal deficits and burgeoning public debt in developed economies, particularly the euro area, may impact the banking system and sovereign debt. Markets are pricing in these risks amid moves by credit rating agencies to downgrade European sovereigns and financial institutions. These developments, as well as signals from policymakers that interest rates in developed economies may remain low and expectations that the United States (US) Federal Reserve may resume quantitative easing, have pushed Treasury bond yields lower as investors seek refuge in safe-haven government bonds.

While key global financial markets have recovered dramatically from the worst days of 2008, the outlook remains uncertain and subject to further volatility. These trends can be seen in (i) the continued decline of 10-year government bond yields since the beginning of this year as investors have sought the safe haven of government paper **(Figure A)**; (ii) a renewed widening of corporate bond spreads in the US and Japan, following a recovery between end-2009 and end-April 2010 **(Figure B)**; (iii) a recovery of major MSCI indices in the first half of 2010, followed by a new round of weakness in early August **(Figure C)**; (iv) a renewed decline in JP Morgan's EMBI sovereign stripped spreads **(Figure D)**; and (v) a decline in credit default swap spreads for emerging East Asia **(Figure E)**, with a more mixed picture for European countries **(Figure F)** since the beginning of July.

Emerging East Asian[2] economies have thus far not been significantly impacted by the sovereign debt crisis in Europe. The region's financial systems have remained stable, with banks holding ample capital cushions and showing strong profitability. The economies of emerging East Asia are reporting impressive growth performances, as can be seen in the year-on-year (y-o-y) gross domestic product (GDP) growth rates for 2Q10. Not only did the People's Republic of China (PRC) grow 10.3%, Malaysia also grew 8.9%, Thailand 9.1%, and the Philippines 7.9%, while the Republic of Korea (Korea) reported GDP growth of 8.1% in 1Q01 and 7.2% in 2Q10.

Some economies in the region began to unwind policy stimulus in the first half of the year. However, many Asian central banks, while generally tightening monetary policy, have adopted a cautious outlook with respect to the growth outlook for the second half of 2010 and 2011. As a result, policy normalization appears to have been put on hold for now.

Flush liquidity in global markets, investors' hunt for yields, the appreciation of regional currencies, and the region's strong growth performance have spurred foreign portfolio capital inflows into Asian markets. Foreign holdings of local currency (LCY) government bonds **(Figure 4 on page 17)** have surged; investors have also pumped funds into local stock markets **(Figure G)**. LCY bonds in most markets have rallied in line with US Treasuries as the correlation between them has increased in recent months **(Figure H)**. Foreign fund inflows and the rally in US Treasuries continue to underpin support for LCY bonds despite the strong regional growth outlook. This has led to a flattening of

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

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

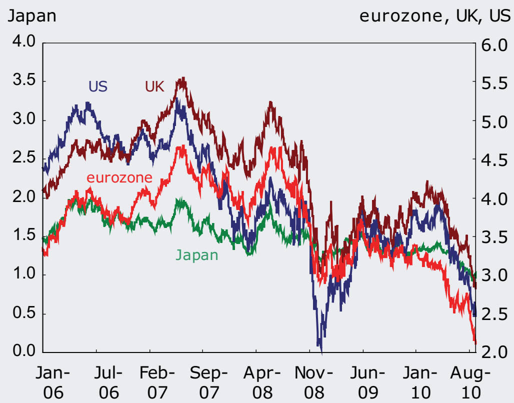


Figure D: JPMorgan EMBI Sovereign Stripped Spreads[3]

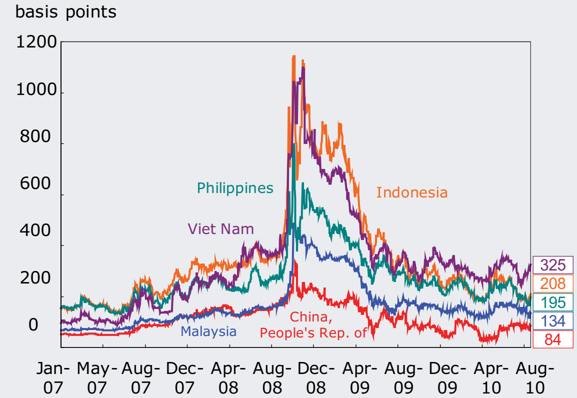


Figure B: Corporate Bond Spreads[1]

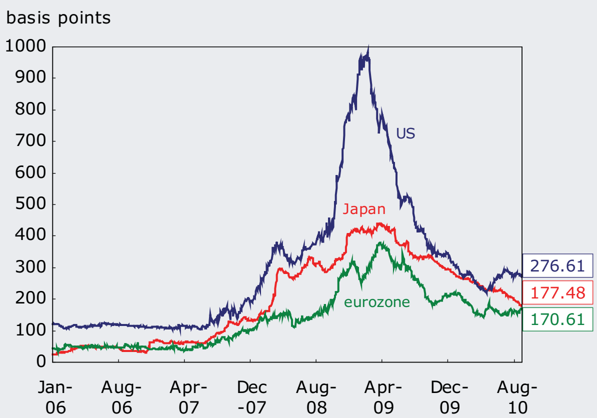


Figure E: Credit Default Swap Spreads
(senior 5-year)[3]

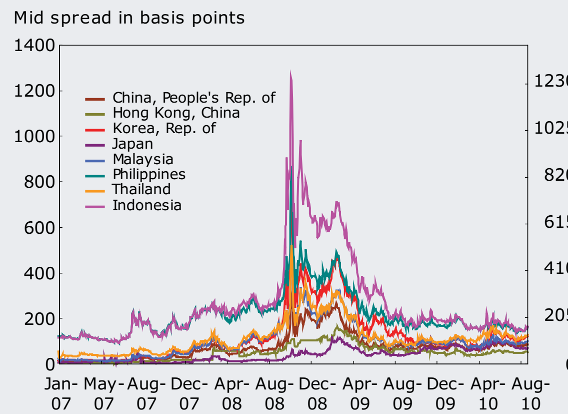


Figure C: MSCI Indexes[2]
(January 2007 = 100)

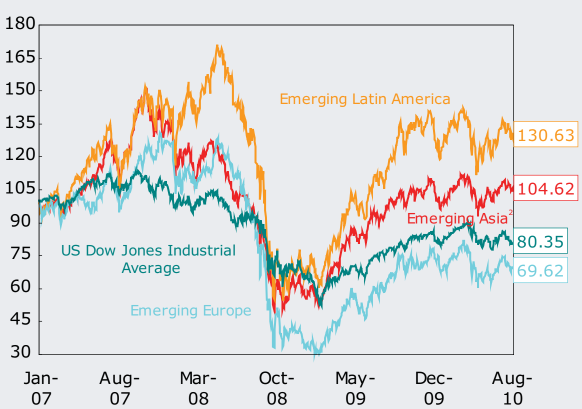
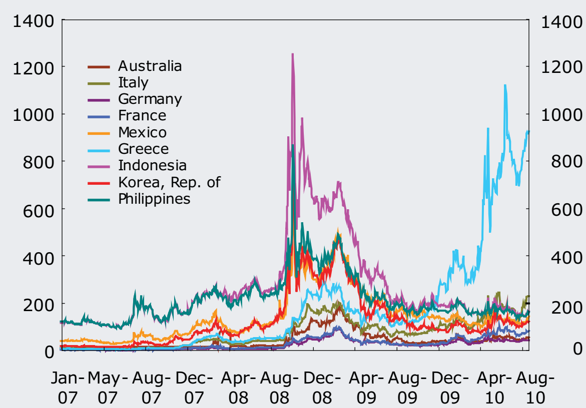
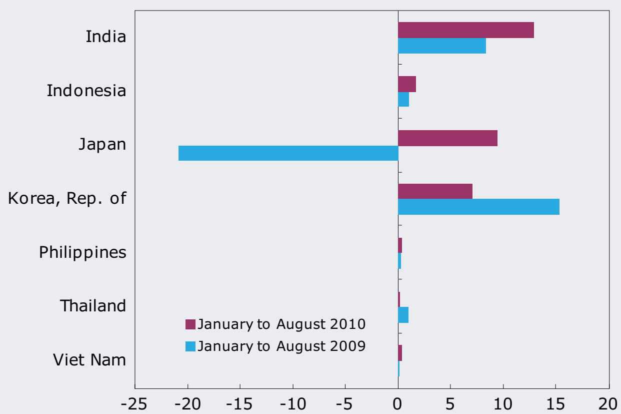


Figure F: Credit Default Swap Spreads for Select OECD and Asian Economies



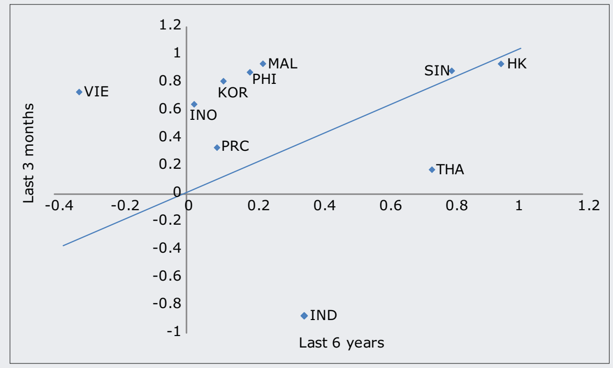
US = United States, UK = United Kingdom, EMBI = Emerging Markets Bond Index, OECD = Organisation for Economic Co-operation and Development.
Notes:
1 Bond spread refers to the difference between yields of 5-year bonds issued by BBB-rated finance companies and yields of sovereign benchmark bonds of the same tenor.
2 Includes People's Rep. of China; India; Indonesia; Republic of Korea; Malaysia; Pakistan; Philippines; Taipei,China; and Thailand.
3 USD based on sovereign bonds.
Source: Thomson DataStream, Morgan Stanley Capital International (MSCI) Barra and Bloomberg LP.

Figure G: Net Foreign Portfolio Investment in Equities (USD billion)



Source: Bloomberg LP.

Figure H: Correlation between Yields on 10-yr US Treasury Bonds and 10-yr LCY Government Bonds



LCY = local currency, US = United States.
Note: PRC = China, People's Rep. of; HK= Hong Kong, China; IND= India; INO = Indonesia; KOR= Rep. of Korea; MAL = Malaysia; PHI= Philippines; SIN= Singapore; THA= Thailand; and VIE= Viet Nam.
Source: Bloomberg LP and Standard Chartered.

government bond yield curves in most emerging East Asian markets, especially at the long-end.

Risks to the market outlook in the region, which are now tilted to the downside, include (i) a sharp slowdown in mature economies, (ii) destabilizing capital flows, and (iii) a rise in inflationary pressures.

Emerging East Asian LCY bonds showed strong growth in the first half of 2010. The y-o-y growth rate in 2Q10 rose slightly to 18.8% from 17.1% in 1Q10, and was driven primarily by 24.4% y-o-y growth in the corporate sector. Meanwhile, the government bond market grew by 16.7% y-o-y in 2Q10. Given that the region's corporate bond markets are emerging as an important source of funding for private sector investment, the growth of these fledgling markets in emerging East Asia will be an important point to watch in coming years.

At the end of March, emerging East Asia's share of the global bond market stood at 7.4%, compared with 2.1% before the onset of the 1997/98 Asian financial crisis. The two largest markets in the region at the end of 1Q10 were the PRC (4.2% of the global bond market) and Korea (1.7%) **(Table A)**.

Table A: Bonds Outstanding in Major Markets (USD billion)

	Mar-10		Dec-96	
	LCY Bonds Outstanding	% of World Total	LCY Bonds Outstanding	% of World Total
United States	24,978	39.8	10,926	42.9
Japan	9,754	15.5	4,456	17.5
France	3,094	4.9	1,261	4.9
Germany	2,632	4.2	1,888	7.4
United Kingdom	1,525	2.4	678	2.7
Emerging East Asia	4,633	7.4	527	2.1
of which: PRC	2,648	4.2	62	0.2
Emerging East Asia excl. PRC	1,985	3.2	465	1.8
of which: Korea, Rep. of	1,095	1.7	283	1.1
of which: ASEAN-6	735	1.2	148	0.6
Indonesia	108	0.2	7	0.0
Malaysia	199	0.3	71	0.3
Philippines	66	0.1	28	0.1
Singapore	159	0.3	25	0.1
Thailand	191	0.3	18	0.1
Viet Nam	12	0.0	—	—
Memo Items:				
Brazil	1,218	1.9	299	1.2
PRC (excl. policy bank bonds)	1,971	3.1	—	—
India	652	1.0	81	0.3
Russia	51	0.1	43	0.2

— = not applicable, ASEAN = Association of Southeast Asian Nations, LCY = local currency, PRC = People's Republic of China.
Note:
Emerging East Asia comprises the People's Republic of China; Hong Kong, China; Indonesia: Republic of Korea; Malaysia; Philippines; Singapore; Thailand; and Viet Nam.
Source: Bank for International Settlements and *AsianBondsOnline*.

Bond Market Developments in the Second Quarter of 2010

Size and Composition

Total LCY bonds outstanding in emerging East Asia[3] in 2Q10 rose by 5.1% q-o-q to USD4.8 trillion, driven by strong growth in both government and corporate bonds.

Growth in emerging East Asia's local currency (LCY) bond market in 2Q10, which exceeded 1Q10's growth rate of 3.8% quarter-on-quarter (q-o-q), was backed across the region by significant policy measures and strong innovation in both government and corporate bond markets. However, excluding the People's Republic of China (PRC), the q-o-q growth rate in 2Q10 was only 2.6%. Total bonds outstanding in the PRC, the region's dominant LCY bond market, grew by 6.9% q-o-q to USD2.85 trillion. Meanwhile, Viet Nam registered the region's highest growth rate at 29.0% q-o-q, followed by Malaysia at 7.4%. Bonds outstanding in the Republic of Korea (Korea), the second largest bond market in the region, grew by just 1.5% q-o-q, while growth was almost flat in Indonesia.

Total bonds outstanding grew by 18.8% year-on-year (y-o-y) in 2Q10 **(Table 1)**. However, y-o-y growth excluding the PRC was significantly lower at 13.8%. This was mainly due to a lower growth rate of 9.6% y-o-y in Korea **(Figure 1)**.

Total government bonds outstanding grew by 5.1% q-o-q in 2Q10, led by Viet Nam; Malaysia; Hong Kong, China; and the PRC.

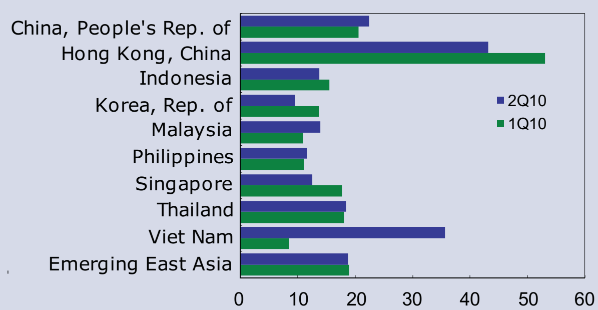
The strong growth in government bond markets was driven in some cases—including Viet Nam, the PRC, and Philippines—by the need to finance budget deficits. Perhaps the most significant feature of government bond markets in 2Q10 has been the innovative policy reforms ushered in to deepen domestic bond markets, expand cross-border transactions, and lengthen maturity profiles.

The PRC announced in mid-August that it will permit non-resident financial institutions greater access to its interbank bond market to promote use of the yuan in cross-border trade. In addition, the State Administration of Foreign Exchange (SAFE) has been investing in Asian debt, including the purchase of JPY1.73 billion of Japanese debt during the first half of the year. According to Korea's Financial Supervisory Service, the PRC's holdings of Korean Treasury bonds (KTBs) surged 111% to KRW4.0 trillion in June from KRW1.9 trillion in December.

In May, Hong Kong, China sold HKD3.0 billion worth of 10-year government bonds under the government's Institutional Bond Issuance

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

Figure 1: Growth of Emerging East Asian LCY Bond Markets in 1Q10 and 2Q10 (y-o-y %)



LCY = local currency, y-o-y = year on year.
Notes:
1. Calculated using data from national sources.
2. Growth rates are calculated from local currency (LCY) base and do not include currency effects.
3. Emerging East Asia growth figure is based on end-June 2010 currency exchange rates and do not include currency effects.
Source: People's Republic of China (*ChinaBond*); Hong Kong, China (Hong Kong Monetary Authority); Indonesia (Indonesia Stock Exchange and Bank Indonesia); Republic of Korea (Bank of Korea and *KoreaBondWeb*); Malaysia (Bank Negara Malaysia); Philippines (Bureau of the Treasury and Bloomberg LP); Singapore (Singapore Government Securities, Monetary Authority of Singapore, and Bloomberg LP); Thailand (Bank of Thailand); and Viet Nam (Bloomberg LP).

Table 1: Size and Composition of Emerging East Asian LCY Bond Markets

	2Q09		1Q10		2Q10		Growth Rate (LCY-base %)				Growth Rate (USD-base %)			
							2Q09		2Q10		2Q09		2Q10	
	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 (PRC)														
Total	2,309	100.0	2,648	100.0	2,848	100.0	5.3	14.8	6.9	22.5	5.3	15.2	7.6	23.4
Government	1,954	84.6	2,157	81.4	2,302	80.8	2.9	7.0	6.0	17.0	2.9	7.4	6.7	17.8
Corporate	355	15.4	492	18.6	546	19.2	21.1	90.9	10.4	52.7	21.1	91.6	11.1	53.8
Hong Kong, China														
Total	111	100.0	155	100.0	159	100.0	9.8	19.4	2.7	43.3	9.8	20.2	2.4	42.7
Government	37	33.4	80	51.8	86	54.0	31.8	99.9	6.9	131.4	31.8	101.1	6.6	130.3
Corporate	74	66.6	75	48.2	73	46.0	1.3	(0.6)	(1.9)	(0.9)	1.3	(0.03)	(2.2)	(1.3)
Indonesia														
Total	85	100.0	108	100.0	109	100.0	1.5	12.8	(0.03)	13.8	16.4	1.9	0.4	28.3
Government	77	90.8	98	90.6	99	90.6	0.8	14.7	(0.1)	13.5	15.6	3.6	0.3	28.0
Corporate	8	9.2	10	9.4	10	9.4	9.0	(3.2)	0.9	16.5	24.9	(12.5)	1.4	31.3
Korea, Rep. of														
Total	901	100.0	1,095	100.0	1,029	100.0	5.3	13.1	1.5	9.6	13.2	(6.9)	(6.1)	14.2
Government	415	46.0	490	44.8	458	44.5	5.9	10.7	0.8	5.9	13.8	(8.9)	(6.7)	10.3
Corporate	486	54.0	605	55.2	571	55.5	4.8	15.2	2.0	12.7	12.6	(5.2)	(5.6)	17.4
Malaysia														
Total	174	100.0	199	100.0	216	100.0	4.6	0.3	7.4	14.0	8.5	(6.7)	8.6	24.2
Government	96	55.6	111	55.9	124	57.7	5.5	(4.2)	10.8	18.3	9.4	(11.0)	12.0	28.9
Corporate	77	44.4	88	44.1	91	42.3	3.5	6.8	3.1	8.6	7.3	(0.8)	4.3	18.4
Philippines														
Total	57	100.0	66	100.0	66	100.0	2.1	8.2	2.5	11.6	2.4	0.9	(0.1)	15.7
Government	51	89.2	58	88.1	58	87.8	(0.2)	4.0	2.1	9.8	0.1	(3.0)	(0.5)	13.8
Corporate	6	10.8	8	11.9	8	12.2	25.6	62.4	5.5	26.8	26.0	51.5	2.8	31.5
Singapore														
Total	139	100.0	159	100.0	162	100.0	6.5	6.3	1.8	12.6	12.0	(0.1)	1.9	16.7
Government	80	57.7	90	57.0	92	56.7	6.9	7.1	1.2	10.7	12.4	0.7	1.3	14.8
Corporate	59	42.3	68	43.0	70	43.3	6.0	5.2	2.6	15.1	11.4	(1.1)	2.7	19.4
Thailand														
Total	159	100.0	191	100.0	198	100.0	3.6	7.8	3.9	18.4	7.9	5.8	3.7	24.5
Government	126	79.0	153	80.4	160	80.7	1.6	5.6	4.3	21.0	5.8	3.6	4.1	27.2
Corporate	33	21.0	38	19.6	38	19.3	11.8	17.1	2.3	9.0	16.4	15.0	2.1	14.6
Viet Nam														
Total	12	100.0	12	100.0	15	100.0	3.0	6.4	29.0	35.8	3.0	0.7	29.1	26.8
Government	12	95.1	11	89.9	14	90.1	2.7	6.2	29.4	28.8	2.7	0.5	29.5	20.2
Corporate	0.6	4.9	1	10.1	2	9.9	10.3	10.3	25.3	170.9	10.3	4.4	25.5	152.9
Total Emerging East Asia														
Total	3,947	100.0	4,633	100.0	4,802	100.0	5.2	13.0	5.1	18.8	7.8	6.9	3.6	21.7
Government	2,847	72.1	3,250	70.1	3,392	70.6	3.6	7.8	5.1	16.7	5.5	3.9	4.4	19.1
Corporate	1,100	27.9	1,384	29.9	1,410	29.4	9.5	28.6	5.0	24.4	14.1	15.5	1.9	28.3
Less PRC:														
Total	1,638	100.0	1,985	100.0	1,954	100.0	5.1	10.6	2.6	13.8	11.4	(3.0)	(1.6)	19.3
Government	893	54.6	1,093	55.1	1,090	55.8	5.2	9.5	3.1	16.0	11.7	(3.0)	(0.3)	22.0
Corporate	744	45.4	892	44.9	864	44.2	4.9	11.8	1.9	11.3	11.1	(2.9)	(3.2)	16.1
Japan														
Total	9,038	100.0	9,754	100.0	10,465	100.0	0.7	0.7	1.7	6.5	3.9	11.0	7.3	15.8
Government	8,116	89.8	8,797	90.2	9,452	90.3	0.7	0.6	1.9	7.1	3.9	10.9	7.4	16.5
Corporate	922	10.2	957	9.8	1,013	9.7	0.5	1.6	0.4	1.1	3.7	12.0	5.9	9.9

LCY = local currency, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. For Singapore, corporate bonds outstanding quarterly figues are 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, total emerging East Asia growth figures are based on end-June 2010 currency exchange rates and do not include currency effects.
5. Emerging East Asia comprises the People's Republic of China; Hong Kong, China; Indonesia; Republic of Korea; Malaysia; Philippines; Singapore; Thailand; and Viet Nam.
Source: People's Republic of China (*ChinaBond*); Hong Kong, China (Hong Kong Monetary Authority); Indonesia (Indonesia Stock Exchange and Bank Indonesia); Republic of Korea (Bank of Korea and *KoreaBondWeb*); Malaysia (Bank Negara Malaysia); Philippines (Bureau of the Treasury and Bloomberg LP); Singapore (Singapore Government Securities, Monetary Authority of Singapore and Bloomberg LP); Thailand (Bank of Thailand); Viet Nam (Bloomberg LP); and Japan (Japan Securities Dealers Association).

Programme (SAR bonds). This issue was followed by another HKD1.5 billion sale of 5-year SAR bonds in June, bringing Hong Kong, China's SAR bonds outstanding to HKD16.0 billion. The SAR bonds are direct obligations of Hong Kong, China's government, while Exchange Fund Bills and Notes (EFBN) are obligations of the Hong Kong Monetary Authority (HKMA).

Beginning in June, Bank Indonesia (BI) reduced the frequency of its *Sertifikat* Bank Indonesia (SBI) auctions to a monthly basis from a weekly basis. BI has also pushed for longer-tenor maturities, with recent and planned issuances to focus on 3- and 6-month tenors, instead of 1-month tenors. This new policy aims to support more active transactions in the interbank money market and encourage banks to manage liquidity over a longer period.

In September, the Financial Supervisory Commission of Korea approved the Korea Exchange's amended version of its Derivatives Market Business Regulation that will enhance the trading of 10-year KTB futures. Korea plans to issue KTBs with maturities of less than 1 year in order to help establish a short-term benchmark bond rate.

The Singapore Exchange launched a series of initiatives in August to promote the listing, trading, and distribution of fixed-income products in Singapore.

Interest in retail bonds increased in 2Q10.

Following several months of delay due to political tensions, the Thai government sold THB80 billion in savings bonds in June out of a planned total of THB100 billion.

The Philippine government's retail bonds have continued to attract domestic investor interest. The Philippines sold a total of PHP97.5 billion of retail treasury bonds in August. One of the most liquid peso bonds at present is a PHP50 billion retail treasury bonds issued in September 2009.

The Indonesian government sold its seventh series of retail treasury bonds in August, raising IDR8.0 trillion. The government initially planned to sell IDR5.0 trillion, but increased its target to IDR8.0 trillion amid strong demand from investors.

The corporate bond market in emerging East Asia expanded 5.0% q-o-q in 2Q10, compared with 4.6% in the previous quarter, led by Viet Nam, the PRC, the Philippines, and Malaysia.

Viet Nam's tiny corporate bond market was helped by a key policy announcement from the Ministry of Finance that it will begin allowing limited liability companies to issue corporate bonds in domestic and global capital markets. This measure will provide domestic enterprises more options to raise funds and restructure capital bases.

The fast-growing PRC corporate bond market expanded by 10.4% q-o-q in 2Q10 on the back of a resurgence in the medium-term note (MTN) and commercial paper markets. The MTN market, which has helped spur massive growth in domestic corporate bonds over the past 2 years, posted growth of 17.9% q-o-q in 2Q10, up from 13.2% in the previous quarter. Similarly, total bonds outstanding in the commercial paper market rose 21.0% q-o-q in 2Q10 against 11.5% in 1Q10.

The rise in q-o-q growth for MTNs and commercial paper reflected strong corporate demand in the PRC for short- to medium-term funds, access to which has been facilitated by the relatively fast approval processes for the MTN and commercial paper issuance windows.

Ratio of Bonds Outstanding to Gross Domestic Product

The ratio of LCY bonds outstanding to GDP for emerging East Asia was essentially unchanged in 2Q10 from 1Q10.

The ratio of LCY bonds outstanding to gross domestic product (GDP) in 2Q10 stood at 58.7%, which was nearly unchanged from 58.3% in 1Q10 **(Table 2)**. This reflected a slight rise in the ratio of government bonds to GDP from 40.9% in 1Q10 to 41.5% in 2Q10. The two markets that saw the greatest increase in their respective ratios of total bonds outstanding to GDP were Malaysia and Viet Nam, while the market that saw the largest decline in this ratio was Korea. However, the PRC also experienced a substantial increase in its ratio of government and corporate bonds outstanding to GDP, reflecting the growing role of debt markets in domestic financing.

Issuance

LCY bond issuance in emerging East Asia in 2Q10 totaled USD938 billion, which was a 6.5% y-o-y increase, but an 11.7% q-o-q decline.

Total issuance of USD938 billion in 2Q10 represented a decline of 11.7% from USD1.07 trillion in 1Q10 **(Table 3)**. This decline was led by a dip in central bank issuance. Total central bank bill and bond sales, which accounted for about 61% of total issuance, fell by 25.7% q-o-q in 2Q10. The decline may have been caused by monetary authorities in a number of markets scaling back sterilization, as most regional currencies—with the exception of the Korean won and Philippine peso—have remained stable in 2Q10 compared with 1Q10. In Indonesia, BI's issuance dropped by 59.2% q-o-q in 2Q10, as the central bank reduced the frequency of SBI auctions to a monthly basis beginning in June 2010. Furthermore, BI launched efforts in August to reform its SBI note structure away from 1-month notes towards maturities of 3- , 6-, and 9-months.

Table 2: Size and Composition of Emerging East Asian LCY Bond Markets (% of GDP)

	2Q09	1Q10	2Q10
China, People's Rep. of			
Total	49.0	51.3	52.9
Government	41.5	41.8	42.7
Corporate	7.5	9.5	10.1
Hong Kong, China			
Total	52.8	72.1	73.0
Government	17.6	37.3	39.4
Corporate	35.1	34.7	33.6
Indonesia			
Total	16.3	17.0	16.5
Government	14.8	15.4	14.9
Corporate	1.5	1.6	1.6
Korea, Rep. of			
Total	111.7	113.5	112.5
Government	51.4	50.8	50.0
Corporate	60.3	62.7	62.4
Malaysia			
Total	87.8	91.7	95.3
Government	48.8	51.3	55.0
Corporate	39.0	40.4	40.4
Philippines			
Total	36.6	38.0	37.9
Government	32.6	33.5	33.2
Corporate	3.9	4.5	4.6
Singapore			
Total	76.1	80.9	79.2
Government	43.9	46.1	44.9
Corporate	32.2	34.7	34.3
Thailand			
Total	60.8	65.6	66.1
Government	48.0	52.7	53.3
Corporate	12.8	12.9	12.8
Viet Nam			
Total	13.6	13.3	16.5
Government	12.9	12.0	14.9
Corporate	0.7	1.4	1.6
Total Emerging East Asia			
Total	55.3	58.3	58.7
Government	39.9	40.9	41.5
Corporate	15.4	17.4	17.2
Japan			
Total	179.0	191.3	194.5
Government	160.8	172.6	175.7
Corporate	18.3	18.8	18.8

LCY = local currency.
Note:
1. Data for GDP is from CEIC.
Source: People's Republic of China (*ChinaBond*), Hong Kong, China (Hong Kong Monetary Authority), Indonesia (Indonesia Stock Exchange and Bank Indonesia), Republic of Korea (Bank of Korea and *KoreaBondWeb*), Malaysia (Bank Negara Malaysia), Philippines (Bureau of the Treasury and Bloomberg LP); Singapore (Singapore Government Securities, Monetary Authority of Singapore and Bloomberg LP); Thailand (Bank of Thailand); Viet Nam (Bloomberg LP); and Japan (Japan Securities Dealers Association).

Table 3: LCY-Denominated Bond Issuance (Gross)

	LCY billion		USD billion		Growth Rate (LCY-base %)		Growth Rate (USD-base %)	
	2Q10	% share	2Q10	% share	2Q10		2Q10	
					q-o-q	y-o-y	q-o-q	y-o-y
China, People's Rep. of (PRC)								
Total	2,820	100.0	416	100.0	23.3	23.3	24.1	24.2
Government	2,378	84.3	351	84.3	26.1	34.3	26.9	35.2
Central Bank	1,558	55.3	230	55.3	9.2	68.4	9.9	69.7
Treasury and Other Govt	820	29.1	121	29.1	78.6	(3.1)	79.8	(2.4)
Corporate	442	15.7	65	15.7	10.2	(14.3)	10.9	(13.7)
Hong Kong, China								
Total	1,353	100.0	174	100.0	(49.8)	12.1	(49.9)	11.6
Government	1,315	97.2	169	97.2	(50.3)	14.4	(50.4)	13.9
Central Bank	1,310	96.8	168	96.8	(50.4)	14.0	(50.5)	13.5
Treasury and Other Govt	5	0.3	1	0.3	(25.0)	—	(25.2)	—
Corporate	38	2.8	5	2.8	(19.5)	(34.0)	(19.8)	(34.3)
Indonesia								
Total	331,023	100.0	37	100.0	(55.5)	(9.1)	(55.3)	2.5
Government	323,720	97.8	36	97.8	(56.2)	(8.0)	(56.0)	3.7
Central Bank	281,026	84.9	31	84.9	(59.2)	(13.5)	(59.1)	(2.4)
Treasury and Other Govt	42,694	12.9	5	12.9	(12.5)	57.5	(12.1)	77.6
Corporate	7,303	2.2	0.8	2.2	35.7	(40.1)	36.3	(32.4)
Korea, Rep. of								
Total	185,619	100.0	152	100.0	(0.6)	(18.8)	(8.0)	(15.4)
Government	101,285	54.6	83	54.6	(12.1)	(32.2)	(18.6)	(29.4)
Central Bank	74,350	40.1	61	40.1	(11.3)	(37.0)	(17.9)	(34.3)
Treasury and Other Govt	26,935	14.5	22	14.5	(14.3)	(14.4)	(20.6)	(10.8)
Corporate	84,334	45.4	69	45.4	17.8	6.5	9.1	10.9
Malaysia								
Total	107	100.0	33	100.0	56.6	7.1	58.3	16.7
Government	84	78.5	26	78.5	49.3	16.9	51.0	27.4
Central Bank	68	64.0	21	64.0	92.4	44.8	94.6	57.8
Treasury and Other Govt	16	14.5	5	14.5	(24.8)	(36.7)	(23.9)	(31.0)
Corporate	23	21.5	7	21.5	90.4	(18.0)	92.5	(10.6)
Philippines								
Total	146	100.0	3	100.0	(51.0)	5.1	(52.3)	8.9
Government	128	87.7	3	87.7	(56.3)	62.9	(57.5)	68.8
Central Bank	0	0.0	0	0.0	—	—	—	—
Treasury and Other Govt	128	87.7	3	87.7	(56.3)	62.9	(57.5)	68.8
Corporate	18	12.3	0.4	12.3	260.0	(70.1)	250.8	(69.1)

continued on next page

Table 3 continued

	LCY billion		USD billion		Growth Rate (LCY-base %)		Growth Rate (USD-base %)	
	2Q10	% share	2Q10	% share	2Q10		2Q10	
					q-o-q	y-o-y	q-o-q	y-o-y
Singapore								
Total	57	100.0	41	100.0	14.5	18.3	14.7	22.7
Government	54	93.9	39	93.9	19.8	17.0	20.0	21.2
Central Bank	0	0.0	0	0.0	—	—	—	—
Treasury and Other Govt	54	93.9	39	93.9	19.8	17.0	20.0	21.2
Corporate	4	6.1	3	6.1	(31.6)	43.9	(31.5)	49.2
Thailand								
Total	2,568	100.0	79	100.0	(0.8)	(14.3)	(1.0)	(9.8)
Government	2,293	89.3	71	89.3	(4.0)	(15.2)	(4.2)	(10.9)
Central Bank	1,953	76.0	60	76.0	(6.2)	(17.2)	(6.4)	(13.0)
Treasury and Other Govt	340	13.2	10	13.2	10.7	(1.5)	10.5	3.6
Corporate	275	10.7	8	10.7	37.1	(5.2)	36.8	(0.3)
Viet Nam								
Total	69,172	100.0	3.6	100.0	138.4	722.5	138.6	667.8
Government	63,322	91.5	3.3	91.5	135.2	754.6	135.4	697.8
Central Bank	0	0.0	0.0	0.0	—	—	—	—
Treasury and Other Govt	63,322	91.5	3.3	91.5	135.2	754.6	135.4	697.8
Corporate	5,850	8.5	0.3	8.5	179.9	485.0	180.2	446.1
Total Emerging East Asia								
Total	—	—	938	100.0	(11.7)	6.5	(12.6)	9.2
Government	—	—	779	83.1	(15.7)	9.7	(16.3)	12.5
Central Bank	—	—	571	60.9	(25.7)	13.4	(26.2)	16.4
Treasury and Other Govt	—	—	208	22.2	34.0	0.7	32.6	3.0
Corporate	—	—	159	16.9	14.8	(6.9)	11.3	(4.3)
Less PRC:								
Total	—	—	522	100.0	(28.0)	(3.9)	(29.3)	(0.3)
Government	—	—	429	82.1	(33.7)	(4.6)	(34.5)	(1.1)
Central Bank	—	—	342	65.4	(38.9)	(7.0)	(39.6)	(3.9)
Treasury and Other Govt	—	—	87	16.7	(0.4)	6.4	(2.8)	11.4
Corporate	—	—	94	17.9	18.3	(0.8)	11.6	3.5
Japan								
Total	49,225	100.0	556	100.0	(3.9)	17.3	1.4	27.6
Government	45,264	92.0	511	92.0	(5.9)	21.2	(0.7)	31.8
Central Bank	0	0.0	0	0.0	—	—	—	—
Treasury and Other Govt	45,264	92.0	511	92.0	(5.9)	21.2	(0.7)	31.8
Corporate	3,961	8.0	45	8.0	27.7	(14.2)	34.7	(6.7)

— = not applicable, LCY = local currency, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Corporate bonds include issues by financial institutions.
2. Bloomberg LP end-of-period LCY—USD rates are used.
3. For LCY-base, total emerging East Asia growth figures are based on end-June 2010 currency exchange rates and do not include currency effects.
Source: People's Republic of China (*ChinaBond*); Hong Kong, China (Hong Kong Monetary Authority); Indonesia (Indonesia Debt Management Office, Bank Indonesia, Indonesia Stock Exchange and Bloomberg LP); Republic of Korea (Bank of Korea); Malaysia (Bank Negara Malaysia); Philippines (Bloomberg LP); Singapore (Singapore Government Securities and Bloomberg LP); Thailand (Bank of Thailand); Viet Nam (Bloomberg LP); and Japan (Japan Securities Dealers Association).

Figure 2a: Government and Central Bank Bond Issuance[1]

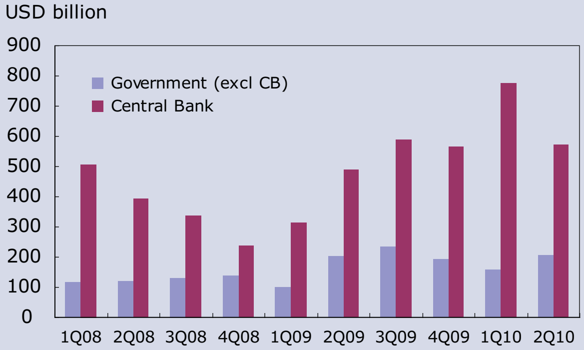


Figure 2b: Government (excluding Central Bank) **and Corporate Bond Issuance**[1]

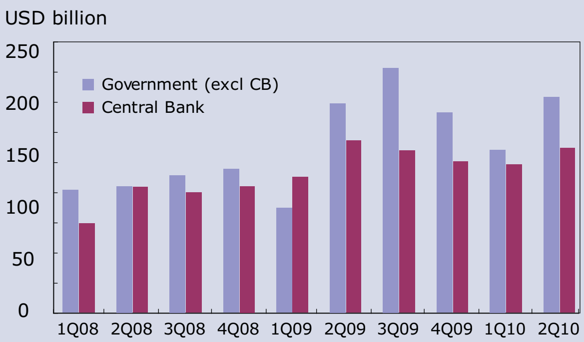
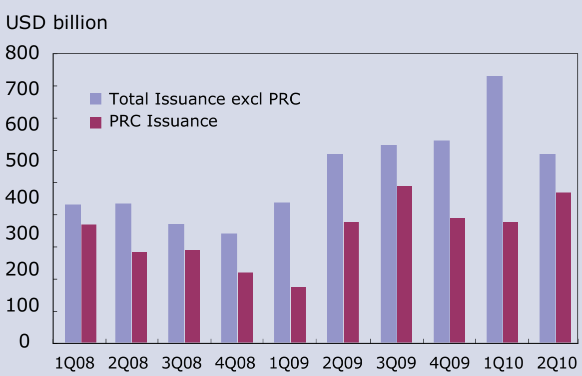


Figure 2c: Total LCY Bond Issuance



CB = Central Bank, LCY = local currency, PRC = People's Republic of China.

[1]These data include both bonds and bills issued by governments and central banks as well as commercial paper issued by corporate entities.

Source: People's Republic of China (*ChinaBond*); Hong Kong, China (Hong Kong Monetary Authority); Indonesia (Indonesia Debt Management Office, Bank Indonesia, and Bloomberg LP); Republic of Korea (Bank of Korea and *KoreaBondWeb*); Malaysia (Bloomberg LP); Philippines (Bloomberg LP); Singapore (Bloomberg LP); Thailand (Bank of Thailand); and Viet Nam (Bloomberg LP).

Bank Negara Malaysia (BNM) was the most active issuer among central banks in 2Q10. The issuance of BNM bills increased as the central bank mopped up excess liquidity in the market amid rising consumer price inflation. Issuance of BNM bills reached MYR68.2 billion in 2Q10 from MYR35.5 billion in 1Q09. Issuance by the People's Bank of China (PBOC), which accounted for 55.3% of total government bond issuance in the PRC, rose by 9.2% q-o-q in 2Q10.

Issuance by government entities (excluding central banks and monetary authorities) in 2Q10 was largely unchanged on a y-o-y basis, but rose significantly by 34% on a q-o-q basis, mainly due to a large increase in issuance from government entities in the PRC and—to a lesser extent—in Singapore and Viet Nam.

Corporate issuance in the region fell by 6.9% y-o-y, but rose by 14.8% on a q-o-q basis. The q-o-q rise in issuance was especially large in Korea, Malaysia, the Philippines, Thailand, and Indonesia. The trend of domestic companies borrowing more from local markets is a significant development that began during the recent global crisis and has continued as liquidity remains ample and the interest rate environment in the region remains benign.

Many of the trends described above are summarized in **Figure 2a**, which compares annual issuance by central banks and government entities (excluding central banks); **Figure 2b**, which compares issuance by governments (excluding central banks) and corporates; and **Figure 2c**, which compares total issuance in the region with issuance by entities in the PRC.

Money Market Trends and Bills-To-Bonds Ratios

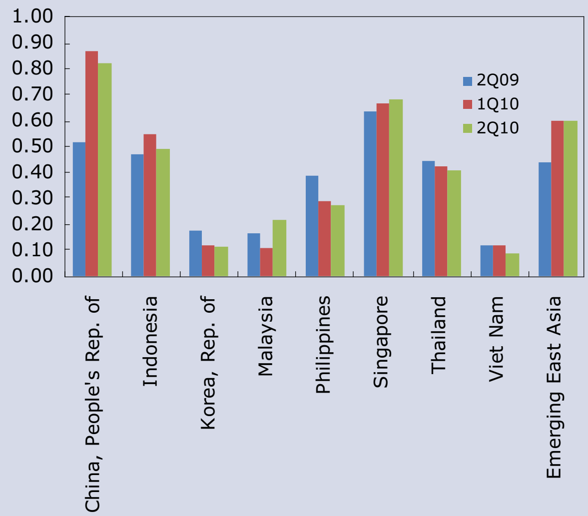
The bills-to-bonds ratio for most emerging East Asian markets fell in 2Q10, mainly due to a fall in the ratio of central bank bills to bonds rather than the ratio of treasury bills to bonds, which remained broadly unchanged.

The total bills-to-bonds ratio, a key indicator of a government's funding structure, fell on a q-o-q basis in five out of the nine emerging East Asian markets in 2Q10 **(Figure 3)**. This trend reflected a slight decline in the bills-to-bonds ratios for treasury bonds and bills in some markets. Most importantly, it reflected a sudden drop in the PRC's ratio of central bank bills to bonds—from 9.88 in 1Q10 to 6.37 in 2Q10—after this ratio had risen sharply from only 1.53 in 2Q09 **(Table 4)**. The PRC's central bank bills-to-bonds ratio rose in 1Q10 due to a sudden increase in the issuance of central bank bills, while the PRC's stock of central bank bonds fell 50% from 2Q09 levels. In 2Q10, the PRC's stock of central bank bills rose by 3.0% q-o-q, while its stock of central bank bonds rose by almost 60%, albeit from a very small base. Both of these developments contributed to total central bank issuance from the PRC rising by 9.2% q-o-q in 2Q10 (Table 3).

The PBOC's stock of bonds outstanding in 1Q10 was only 10.1% of its stock of bills outstanding. In 2Q10, this increased to 15.7%. In 1Q09, the PBOC's ratio of bonds to bills had been nearly 80%. The PBOC's monetary policy over the last year has involved large increases in the issuance of bills, while its stock of bonds has generally fallen from early 2009 levels.

The PBOC's ratio of bills to bonds rose rapidly until 2Q10, in large part because it had ceased to issue new bonds (securities paying coupons) from the end of 2Q08 until the beginning of 2Q10. The PBOC resumed issuing bonds again in 2Q10, and the bills-to-bonds ratio fell somewhat, as described above. However, the PRC domestic money market looks upon the PBOC's bills and bonds as roughly equivalent instruments with almost the same bid–ask spread, even though many of the PBOC bonds have a 3-year maturity and pay a coupon. In fact, the 3-year PBOC bond is referred to by many market participants as the 3-year PBOC bill. Thus, in the PRC market, the bills-to-bonds ratio for PBOC securities has less practical relevance than it does in other emerging East Asian markets.

Figure 3: Total Bills-To-Bonds Ratios



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

The ratio of central bank bills to bonds fell slightly in Korea and Thailand in 2Q10 from 1Q10. In Korea, this was due to a 2.7% q-o-q reduction in the stock of central bank bills, while the stock of central bank bonds rose by 8.4%. In Thailand, the central bank bills-to-bonds ratio fell in 2Q10 due to an 8.3% q-o-q rise in central bank bonds outstanding, while central bank bills rose by only 4.8%.

The region's overall ratio of treasury bills to treasury bonds was virtually unchanged in 2Q10 at 0.12, compared with 0.11 in 1Q10. The stabilization of this ratio has been a consequence of the reduction in growth rates for both treasury bonds and bills in recent quarters, as governments appear to be

Table 4: Government Bills-to-Bonds Ratios of Emerging East Asian LCY Bond Markets

	2Q09		1Q10		2Q10		Government Bills to Bonds Ratio			Growth Rate (LCY-base %)		Growth Rate (USD-base %)	
	Amount (USD billion)	% share	Amount (USD billion)	% share	Amount (USD billion)	% share	2Q09	1Q10	2Q10	2Q10 q-o-q	2Q10 y-o-y	2Q10 q-o-q	2Q10 y-o-y
China, People's Rep. of (PRC)													
Total	1,351.5	100.0	1,418.6	100.0	1,516.6	100.0				6.2	11.4	6.9	12.2
Total Bills	471.6	34.9	670.5	47.3	695.8	45.9	0.54	0.90	0.85	3.1	46.5	3.8	47.5
Treasury Bills	103.4	7.6	88.6	6.2	92.1	6.1	0.16	0.13	0.13	3.3	(11.5)	3.9	(10.9)
Central Bank Bills	368.3	27.2	581.9	41.0	603.7	39.8	1.53	9.88	6.37	3.0	62.7	3.7	63.9
Total Bonds	879.9	65.1	748.0	52.7	820.8	54.1				9.0	(7.4)	9.7	(6.7)
Treasury Bonds	639.9	47.3	689.1	48.6	726.0	47.9				4.7	12.6	5.3	13.5
Central Bank Bonds	240.0	17.8	58.9	4.2	94.8	6.3				59.9	(60.8)	61.0	(60.5)
Hong Kong, China													
Total	37.2	100.0	80.4	100.0	85.7	100.0				6.9	131.4	6.6	130.3
Total Bills	28.4	76.2	69.9	86.9	74.6	87.1	3.20	6.65	6.74	7.1	164.4	6.8	163.2
Treasury Bills	0.0	0.0	0.0	0.0	0.0	0.0	—	—	—	—	—	—	—
Central Bank Bills	28.4	76.2	69.9	86.9	74.6	87.1	3.20	7.74	8.28	7.1	164.4	6.8	163.2
Total Bonds	8.9	23.8	10.5	13.1	11.1	12.9				5.6	25.7	5.3	25.1
Treasury Bonds	0.0	0.0	1.5	1.8	2.1	2.4				39.1	—	38.7	—
Central Bank Bonds	8.9	23.8	9.0	11.2	9.0	10.5				0.1	2.3	(0.1)	1.9
Indonesia													
Total	77.0	100.0	98.2	100.0	98.6	100.0				(0.1)	13.5	0.3	28.0
Total Bills	25.2	32.8	35.6	36.3	33.1	33.6	0.49	0.57	0.51	(7.5)	16.4	(7.1)	31.2
Treasury Bills	2.4	3.2	2.6	2.7	3.2	3.2	0.05	0.04	0.05	20.4	15.2	21.0	30.0
Central Bank Bills	22.8	29.6	33.0	33.6	29.9	30.4	—	—	—	(9.7)	16.5	(9.3)	31.3
Total Bonds	51.8	67.2	62.6	63.7	65.5	66.4				4.1	12.2	4.6	26.5
Treasury Bonds	51.8	67.2	62.6	63.7	65.5	66.4				4.1	12.2	4.6	26.5
Central Bank Bonds	0.0	0.0	0.0	0.0	0.0	0.0				—	—	—	—
Korea, Rep. of													
Total	348.9	100.0	418.6	100.0	393.0	100.0				1.4	8.1	(6.1)	12.7
Total Bills	53.8	15.4	46.2	11.0	41.6	10.6	0.18	0.12	0.12	(2.7)	(25.8)	(9.9)	(22.7)
Treasury Bills	0.0	0.0	0.0	0.0	0.0	0.0	—	—	—	—	—	—	—
Central Bank Bills	53.8	15.4	46.2	11.0	41.6	10.6	0.66	0.48	0.43	(2.7)	(25.8)	(9.9)	(22.7)
Total Bonds	295.0	84.6	372.3	89.0	351.4	89.4				2.0	14.3	(5.6)	19.1
Treasury Bonds	213.8	61.3	275.1	65.7	253.8	64.6				(0.3)	13.9	(7.7)	18.7
Central Bank Bonds	81.3	23.3	97.3	23.2	97.6	24.8				8.4	15.4	0.4	20.2
Malaysia													
Total	94.4	100.0	110.5	100.0	124.1	100.0				11.0	20.7	12.3	31.5
Total Bills	13.7	14.5	11.3	10.2	22.7	18.3	0.17	0.11	0.22	99.5	52.8	101.8	66.5
Treasury Bills	1.2	1.3	1.3	1.2	1.3	1.1	0.02	0.01	0.01	0.0	0.0	1.1	9.0
Central Bank Bills	12.4	13.2	9.9	9.0	21.4	17.3	—	—	—	112.8	58.0	115.2	72.2
Total Bonds	80.7	85.5	99.3	89.8	101.3	81.7				1.0	15.2	2.1	25.6
Treasury Bonds	80.7	85.5	99.3	89.8	101.3	81.7				1.0	15.2	2.1	25.6
Central Bank Bonds	0.0	0.0	0.0	0.0	0.0	0.0				—	—	—	—
Philippines													
Total	49.2	100.0	55.9	100.0	55.3	100.0				1.4	8.3	(1.1)	12.3
Total Bills	14.1	28.7	12.8	22.9	12.2	22.1	0.40	0.30	0.28	(2.0)	(16.5)	(4.5)	(13.5)
Treasury Bills	14.1	28.7	12.8	22.9	12.2	22.1	0.40	0.30	0.28	(2.0)	(16.5)	(4.5)	(13.5)
Central Bank Bills	0.0	0.0	0.0	0.0	0.0	0.0	—	—	—	—	—	—	—
Total Bonds	35.1	71.3	43.1	77.1	43.0	77.9				2.5	18.3	(0.1)	22.7
Treasury Bonds	35.1	71.3	43.1	77.1	43.0	77.9				2.5	18.3	(0.1)	22.7
Central Bank Bonds	0.0	0.0	0.0	0.0	0.0	0.0				—	—	—	—

continued on next page

Table 4 continued

	2Q09		1Q10		2Q10		Government Bills to Bonds Ratio			Growth Rate (LCY-base %)		Growth Rate (USD-base %)	
	Amount (USD billion)	% share	Amount (USD billion)	% share	Amount (USD billion)	% share	2Q09	1Q10	2Q10	2Q10 q-o-q	2Q10 y-o-y	2Q10 q-o-q	2Q10 y-o-y
Singapore													
Total	79.9	100.0	90.5	100.0	91.7	100.0				1.2	10.7	1.3	14.8
Total Bills	31.8	39.8	37.0	40.8	38.0	41.5	0.66	0.69	0.71	2.7	15.4	2.8	19.7
Treasury Bills	31.8	39.8	37.0	40.8	38.0	41.5	0.66	0.69	0.71	2.7	15.4	2.8	19.7
Central Bank Bills	0.0	0.0	0.0	0.0	0.0	0.0	—	—	—	—	—	—	—
Total Bonds	48.1	60.2	53.5	59.2	53.7	58.5				0.1	7.6	0.2	11.5
Treasury Bonds	48.1	60.2	53.5	59.2	53.7	58.5				0.1	7.6	0.2	11.5
Central Bank Bonds	0.0	0.0	0.0	0.0	0.0	0.0				—	—	—	—
Thailand													
Total	110.4	100.0	137.4	100.0	143.8	100.0				4.9	23.9	4.7	30.3
Total Bills	34.9	31.6	41.9	30.5	42.9	29.8	0.46	0.44	0.43	2.5	16.9	2.3	22.9
Treasury Bills	8.3	7.5	6.4	4.7	5.8	4.0	0.15	0.09	0.08	(10.1)	(34.2)	(10.3)	(30.8)
Central Bank Bills	26.6	24.1	35.5	25.8	37.1	25.8	1.47	1.39	1.35	4.8	32.9	4.6	39.8
Total Bonds	75.5	68.4	95.4	69.5	100.9	70.2				6.0	27.1	5.8	33.7
Treasury Bonds	57.4	52.0	70.0	50.9	73.4	51.0				5.2	21.5	4.9	27.8
Central Bank Bonds	18.1	16.4	25.5	18.6	27.5	19.1				8.3	45.0	8.1	52.4
Viet Nam													
Total	5.8	100.0	4.9	100.0	6.3	100.0				30.1	16.1	30.2	8.4
Total Bills	0.6	11.0	0.5	10.9	0.5	8.3	0.12	0.12	0.09	(0.1)	(11.9)	0.0	(17.7)
Treasury Bills	0.6	11.0	0.5	10.6	0.5	8.2	0.12	0.12	0.09	(0.1)	(13.6)	0.0	(19.4)
Central Bank Bills	0.0	0.0	0.0	0.2	0.0	0.2	—	—	—	0.0	—	0.1	—
Total Bonds	5.2	89.0	4.3	89.1	5.8	91.7				33.8	19.6	33.9	11.6
Treasury Bonds	5.2	89.0	4.3	89.1	5.8	91.7				33.8	19.6	33.9	11.6
Central Bank Bonds	0.0	0.0	0.0	0.0	0.0	0.0				—	—	—	—
Total Emerging East Asia													
Total	2,154.3	100.0	2,414.9	100.0	2,515.1	100.0				5.1	14.0	4.1	16.7
Total Bills	674.1	31.3	925.7	38.3	961.6	38.2	0.46	0.62	0.62	3.8	39.8	3.9	42.6
Treasury Bills	161.9	7.5	149.3	6.2	153.1	6.1	0.14	0.11	0.12	2.4	(7.3)	2.6	(5.4)
Central Bank Bills	512.3	23.8	776.5	32.2	808.4	32.1	1.47	4.07	3.53	4.1	54.7	4.1	57.8
Total Bonds	1,480.2	68.7	1,489.2	61.7	1,553.5	61.8				5.9	2.3	4.3	5.0
Treasury Bonds	1,131.9	52.5	1,298.5	53.8	1,324.5	52.7				3.2	13.7	2.0	17.0
Central Bank Bonds	348.2	16.2	190.7	7.9	229.0	9.1				24.6	(35.3)	20.1	(34.2)
Less PRC:													
Total	802.8	100.0	996.3	100.0	998.5	100.0				3.5	18.1	0.2	24.4
Total Bills	202.5	25.2	255.2	25.6	265.8	26.6	0.34	0.34	0.36	5.7	25.1	4.1	31.2
Treasury Bills	58.5	7.3	60.7	6.1	61.0	6.1	0.12	0.10	0.10	1.1	0.0	0.6	4.3
Central Bank Bills	144.0	17.9	194.6	19.5	204.8	20.5	1.33	1.48	1.53	7.1	35.2	5.3	42.2
Total Bonds	600.3	74.8	741.1	74.4	732.7	73.4				2.7	15.8	(1.1)	22.1
Treasury Bonds	492.1	61.3	609.3	61.2	598.5	59.9				1.6	15.0	(1.8)	21.6
Central Bank Bonds	108.2	13.5	131.8	13.2	134.2	13.4				7.8	19.3	1.8	24.1
Japan													
Total	7,074.5	100.0	7,665.2	100.0	8,236.8	100.0				1.9	7.1	7.5	16.4
Total Bills	233.6	3.3	352.1	4.6	386.6	4.7	0.03	0.05	0.05	4.1	52.2	9.8	65.5
Treasury Bills	233.6	3.3	352.1	4.6	386.6	4.7	0.03	0.05	0.05	4.1	52.2	9.8	65.5
Central Bank Bills	0.0	0.0	0.0	0.0	0.0	0.0	—	—	—	—	—	—	—
Total Bonds	6,840.9	96.7	7,313.1	95.4	7,850.1	95.3				1.8	5.5	7.3	14.8
Treasury Bonds	6,840.9	96.7	7,313.1	95.4	7,850.1	95.3				1.8	5.5	7.3	14.8
Central Bank Bonds	0.0	0.0	0.0	0.0	0.0	0.0				—	—	—	—

— = not applicable, LCY = local currency, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Bloomberg LP end-of-period LCY—USD rates are used.
2. For LCY-base, total emerging East Asia growth figures are based on end-June 2010 currency exchange rates and do not include currency effects.
3. Total figures per market refer to bills and bonds issued by the central government and the central bank. It excludes bonds issued by policy banks and state-owned enterprises. Bills are defined as securities with original maturities of less than one year.

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

easing up on their respective economic stimulus programs. The overall modest decline of the region's central bank bills-to-bonds ratio in 2Q10 indicates that central banks and monetary authorities in the region may have cut back on sterilization.

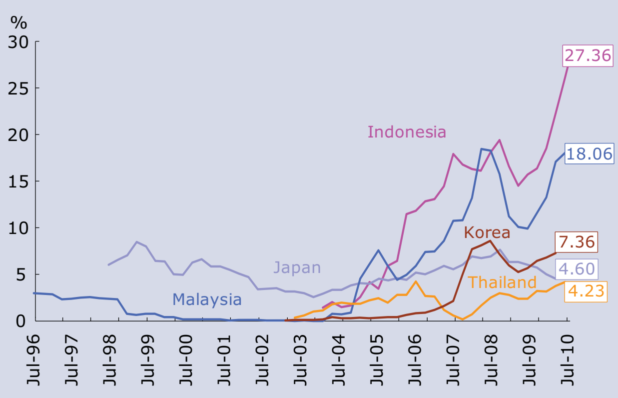
Foreign Holdings

Foreign holdings of local domestic bonds continue to soar as investors chase yields, seek to participate in the region's economic recovery, and make additional gains from the anticipated appreciation of regional currencies.

At the end of July, foreigners held 27.4% of Indonesian government debt **(Figure 4)**. High yields and better economic prospects continued to attract foreign investors to Indonesian government bonds. Meanwhile, the portion of foreign holdings was 18.1% in Malaysia, 7.4% in Korea, and 4.2% in Thailand. Malaysian government securities are seeing increased attention from foreign investors due to expectations of further appreciation of the Malaysian ringgit.

Korea has seen a substantial rise in its foreign holdings this year, reflecting the (i) removal of the withholding tax on government bonds in May of last year; (ii) improving performance of the KTB futures market, which makes it easier for market participants to hedge their investment positions; and (iii) PRC government seeking to diversify its foreign exchange holdings. The PRC's holdings of KTBs surged 111% to KRW4.0 trillion in June from KRW1.9 trillion in December. The PRC's share at the end of 2Q10 accounted for about 10% of total foreign holdings of KTBs.

Figure 4: Foreign Holdings of LCY Government Bonds (% of Total)



LCY = local currency.
Note: Data for the Republic of Korea and Japan as of March 2010; Data for Malaysia and Thailand as of June 2010; Data for Indonesia as of July 2010.
Source: *AsianBondsOnline.*

Maturity Profiles

The maturity profile for most emerging East Asian government markets has changed little since 4Q09.

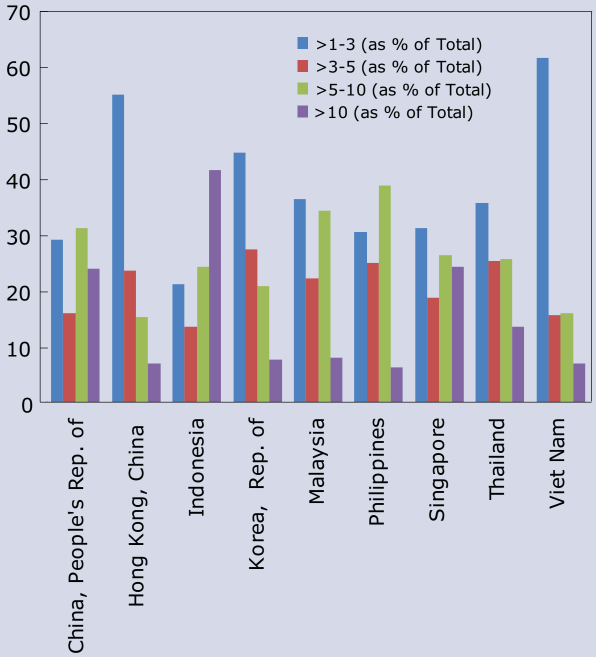
Maturities are concentrated at the shorter-end of the yield curve in Hong Kong, China; Korea; and Viet Nam. These three markets, as well as markets in Malaysia and the Philippines, have 10% or less of their bonds outstanding in maturities of more than 10 years. The PRC, Thailand, and Singapore have a proportionately larger share of their bonds outstanding in maturities greater than 10 years. Indonesia, however, has structured its debt so that maturities of more than 10 years are the largest segment of its market **(Figure 5)**. It remains to be seen whether the region's governments will take advantage of lower bond yields to reduce the magnitude of their respective shorter-term maturities in the remaining months of 2010.

Bond Turnover Ratios

The increase in government bond turnover ratios for Hong Kong, China; Korea; Thailand; and the Philippines reflected specific economic and political developments in each of these markets in 2Q10.

In keeping with the experience from most quarters over the last several years, turnover ratios for government bonds **(Figure 6a)** in 2Q10 were much higher than for corporate bonds **(Figure 6b)** in all of the region's markets, except the PRC. However, turnover among government bonds varied greatly.

Figure 5: Maturity Profiles
(individual maturities as % of total)



Source: *AsianBondsOnline.*

Quarterly government bond turnover ratios in 2Q10 fell in four markets—Hong Kong, China; Korea; the Philippines; and Thailand—but rose in the other four markets surveyed—the PRC, Indonesia, Malaysia, and Singapore. As has been the case in the past, the turnover ratio for government bonds in Hong Kong, China was higher than all other markets by a factor of 10 or more. Most of Hong Kong, China's government debt consists of EFBNs issued by the HKMA for monetary policy purposes. EFBNs are important for bank liquidity management purposes since they can be used as collateral when borrowing from the HKMA through repurchase agreements. Another factor contributing to the high liquidity of EFBNs is that they can be used as margin collateral for stock options and futures trading.

Recent changes in Hong Kong, China's market, especially the PRC's efforts to expand the role of the yuan in currency trading and bond purchases, also seem to be benefiting liquidity in this market.

Traditional patterns reasserted themselves once again in the turnover ratios for the region's corporate bonds. The quarterly turnover ratio for the PRC's corporate bonds was larger than most other markets by a factor of four or more. In fact, the PRC's corporate bond turnover ratio in 2Q10 was slightly higher than that for most other emerging East Asian governments. Furthermore, the PRC's corporate bond turnover ratio rose slightly in 2Q10, as did the turnover ratio in most other markets. Only the quarterly turnover ratios for Korea and Thailand declined.

Figure 6a: Quarterly Government Bond Turnover Ratios[1]

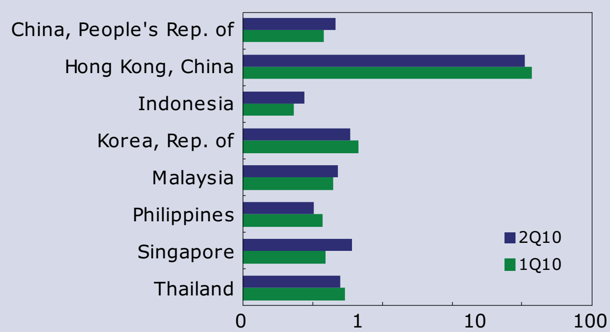
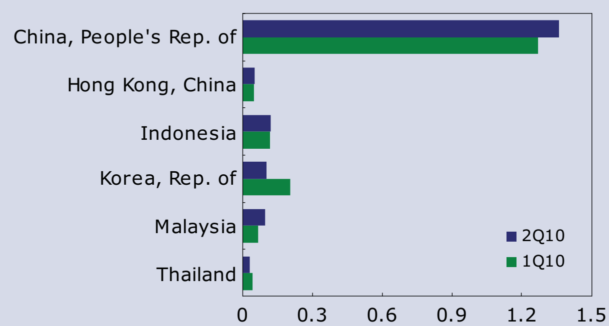


Figure 6b: Quarterly Corporate Bond Turnover Ratios[1]



[1]Calculated as local currency (LCY) trading volume (sales amount only) divided by average LCY value of outstanding bonds during each 3-month period.
Figure 6a is based on a logarithmic scale.
Source: People's Republic of China (*ChinaBond*); Hong Kong, China (Hong Kong Monetary Authority); Indonesia (Indonesia Stock Exchange); Republic of Korea (Bloomberg, LP and *KoreaBondWeb*); Malaysia (Bank Negara Malaysia); Philippines (Bureau of the Treasury); Singapore (Monetary Authority of Singapore and Singapore Government Securities); and Thailand (Bank of Thailand and Thai Bond Market Association).

Bond Yield Curves

Yield curves for LCY government bonds in emerging East Asia have continued to flatten since the end of 2009—and, in some cases, have shifted downward.

The uncertain global economic outlook, low interest rates in developed markets, and flush global liquidity have combined to benefit LCY bonds in emerging East Asia. Foreign fund flows into local markets have accelerated as investors extend duration in search for yields.

Most LCY yield curves have flattened, especially at the long-end, in the past few months as demand for government bonds emerged stronger in recent quarters on a combination of factors, including (i) attractive yields and a strong regional growth trajectory in the face of simmering uncertainty over the global economic outlook, (ii) reserve diversification demand from central banks, (iii) anticipation of appreciation of regional currencies, and (iv) availability of improved hedging and risk management products **(Figure 7)**.

These factors have led to a bullish flattening of yield curves in most markets. However, the exact path of yield compression since end-December 2009 differs from market to market:

(i) Government bond yield curves for the PRC, Philippines, Malaysia, Singapore, and Thailand have flattened from the belly to the long-end of the curve.

(ii) In the Philippines, yields beyond 5 years have fallen since the conclusion of the May presidential election, which resolved earlier concerns over political uncertainty.

(iii) The Indonesian yield curve flattened from the short-end through the very long-end of the curve.

(iv) The yield curves for Hong Kong, China and Korea have simply shifted downward over most of their respective lengths, except at their very short-ends.

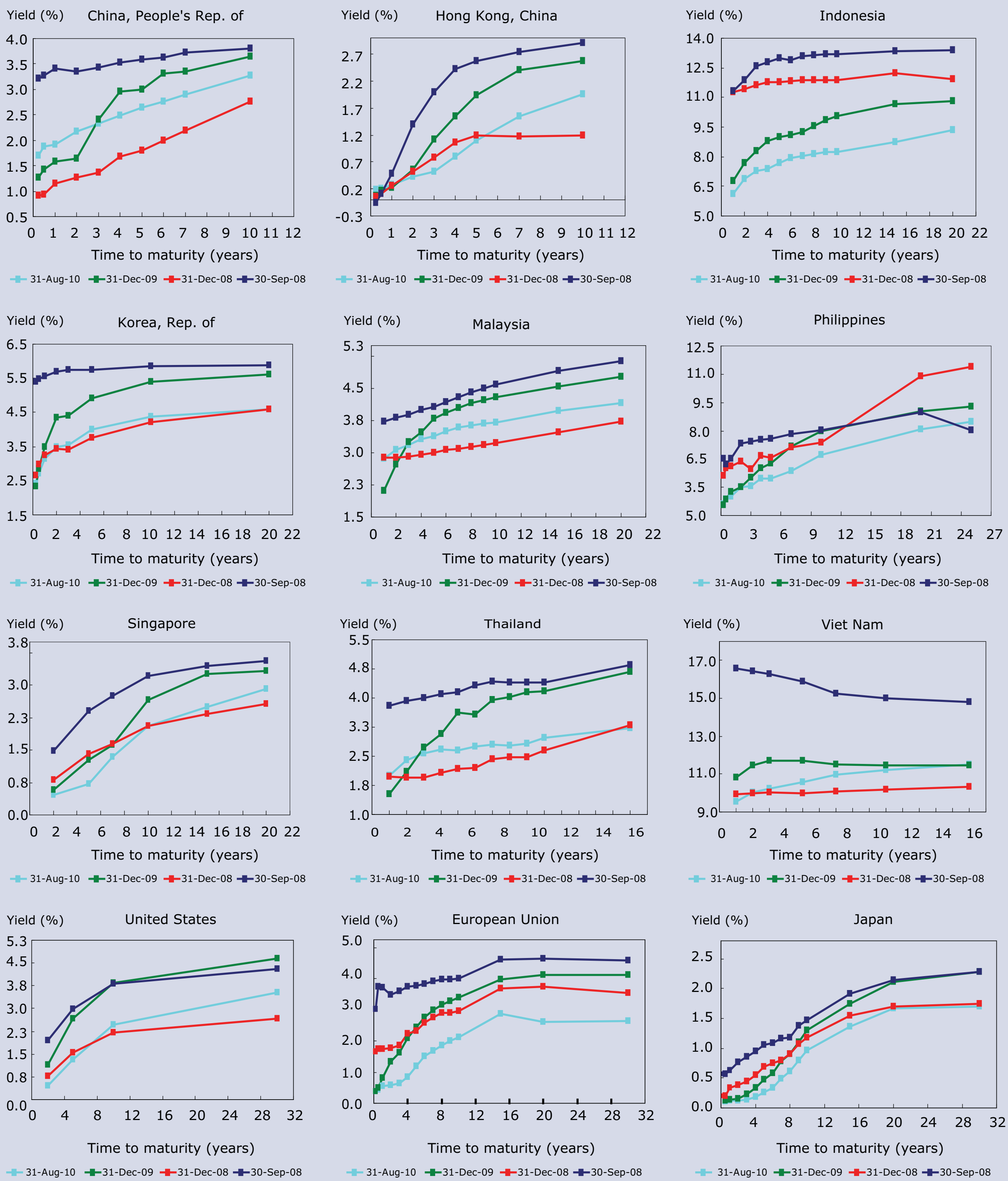
(v) The Vietnamese yield curve steepened along most of its curve, with the steepening being most dramatic for maturities under 5 years.

This underlying trend of declining long-term yields since the end of 2009, while short-term yields have risen in some markets—including the PRC, Malaysia, and Thailand—has resulted in a decline of the spread between 2- and 10-year government bonds in most emerging East Asian bond markets **(Figure 8)**. The only market to experience a rise in its spread since the end of 2009 was Viet Nam.

The near-term outlook for government bond yields is that they may flatten further out along the curve as Asian central banks, while generally tightening monetary policy, have adopted a cautious growth outlook for the second half of 2010 and 2011. Most central banks in the region seem to have concluded their normalization phase. BNM raised its policy rate by 25 basis points in February, May, and July for a total increase of 75 basis points. The central banks of Korea and Thailand have each raised their policy rate once by 25 basis points. Most central banks and monetary authorities in the region, however, are likely to wait before making further adjustments to their monetary policy stance. Although economic growth in the region has held up well this year, and price levels are beginning to rise in some markets (largely due to rising food prices), the economic outlook for Europe and the United States (US) remains uncertain, and Asian policymakers are concerned about the possible impact on their respective export sectors.

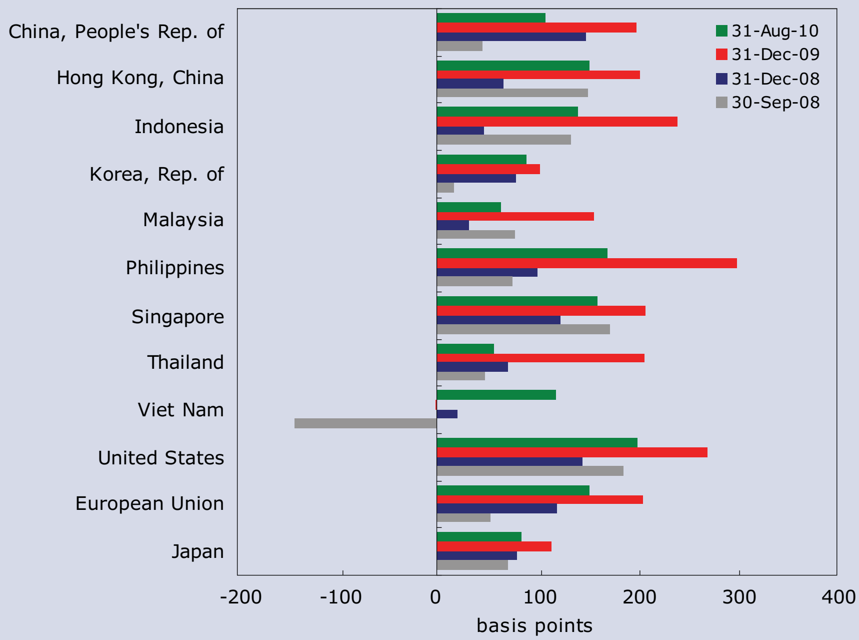
Current inflation trends in the region are more or less stable **(Figure 9)**. Some countries are either allowing their currencies to appreciate modestly, or are at least managing their exchange rate as an effective anti-inflationary tool. However a snapback in inflation rate might push yields higher in some markets **(Figure 10)**.

Figure 7: Benchmark Yield Curves—LCY Bonds



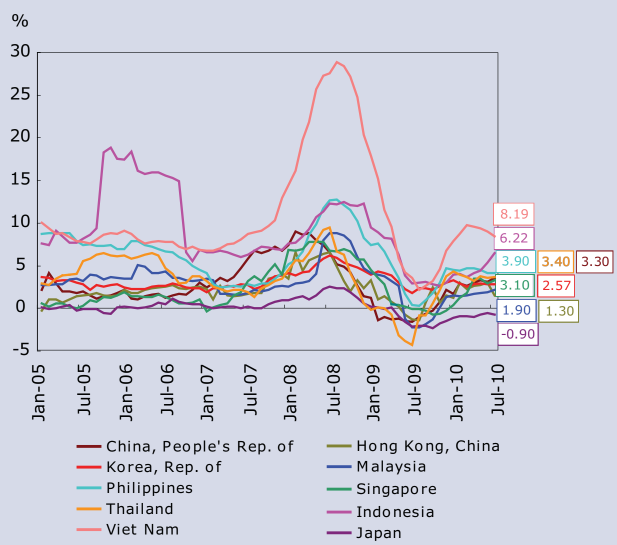
LCY = local currency.
Source: Based on data from Bloomberg LP.

Figure 8: Yield Spreads Between 2- and 10-Year Government Bonds



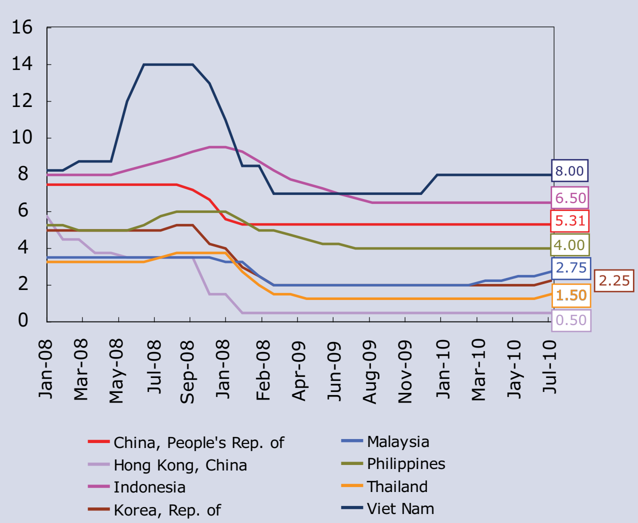
Source: Based on data from Bloomberg LP.

Figure 9: Headline Inflation Rates (July 2010)



Source: Bloomberg LP.

Figure 10: Policy Rates (July 2010)



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

G3 Currency Issuance

G3 currency issuance remains on track this year in emerging East Asia compared with 2009, having reached USD46.3 billion in August.

New issuance of bonds in G3 currencies in 2010 remains broadly on track to equal—if not exceed—the record USD63.2 billion of new G3 currency issuance in 2009. New issuance in G3 currencies reached USD31.8 billion in the first half of the year and added an additional USD14.5 billion between 1 July and 20 August **(Table 5)**. This upsurge in G3 currency issuance reflected the return of investor appetite for the bonds of major Asian governments, corporations, and financial institutions; a renewed search for yield; and low US interest rates. For example, low US interest rates have allowed many banks and corporations in Korea to issue bonds at lower coupons.

Korea accounted for the largest amount of new G3 currency issuance between the beginning of the year and August at USD15.95 billion. The largest group of issuers in Korea were banks; the Export–Import Bank of Korea issued two bonds for a total of USD2.25 billion in the first half of the year, while the Korea Development Bank and Shinhan Bank issued bonds of USD750 million and USD700 million, respectively. In July and August, Woori Bank issued a bond for USD600 million, while Korea Exchange Bank, Korea Housing Finance Corp., and the National Agricultural Cooperative Federation each issued bonds of USD500 million.

The next largest issuers of G3 currency bonds through mid-August were the PRC and Hong Kong, China. The PRC's total G3 issuance amounted to USD7.9 billion and contained a number of prominent real estate developers. Issuance out of Hong Kong, China amounted to USD7.4 billion, including two issues from Bank of China (Hong Kong) totaling USD2.5 billion. Meanwhile, the Viet Nam sovereign issued a USD1.0 billion bond. And finally, the Philippine government issued two bonds, one of which was a *samurai* issue, totaling USD1.7 billion.

Bond Market Returns

Returns on LCY bonds for most markets have been buoyant in 2010, with Indonesia, the Philippines, and Thailand posting the largest gains.

The Asian Bond Fund (ABF) Pan Asian Bond Index has gained 7.9% to date in 2010, compared with 5.0% for all of 2009 **(Table 6)**. Indonesian bonds were the best performers, gaining 15.0%, followed by the Philippines (9.3%) and Thailand (7.5%).

The year-to-date returns for emerging East Asia's bond market have in many cases been overtaken by returns in individual equity markets **(Table 7)**. The equity markets of Indonesia, Malaysia, the Philippines, and Thailand have all delivered double-digit returns. The only negative performance in the equity markets was from the PRC and Singapore, while Hong Kong, China and Korea delivered low single-digit returns.

The appreciation of the region's currencies in 2010 has helped to push up returns on LCY bonds **(Table 8)**. The Indonesian rupiah and Malaysian ringgit both gained slightly more than 10% against the US dollar between end-December and end-August. This appreciation contributed to Indonesia's status as the best performing segment of the ABF iBoxx index in 2010, and also helped the Malaysian segment of the index perform well on a USD-unhedged basis. Almost all currencies in emerging East Asia have performed well versus the US dollar in 2010. The Philippine peso and the Singapore dollar have appreciated 6%–7% to date, while the Thai baht has appreciated 8.4%. Currency appreciation would also seem to be a factor in the individual equity markets that have performed better than the region as a whole in 2010, especially Indonesia, the Philippines, and Thailand.

Table 5: G3 Currency Bond Issuance (1H10 and 1 July—20 August 2010)

Issued in 1H10		
Issuer	**USD million**	**Issue Date**
China, People's Rep. of	**4,770**	
Evergrande 13% 2015	1,350	27-Jan-10
Agile Property 8.875% 2017	650	28-Apr-10
MCE Finance 10.25% 2017	600	17-May-10
Country Garden 11.25% 2017	550	22-Apr-10
Citic Bank 6.875% 2020	500	24-Jun-10
Others	1,120	
Hong Kong, China	**5,405**	
Bank of China (Hong Kong) 5.55% 2020	1,600	11-Feb-10
Bank of China (Hong Kong) 5.55% 2020	900	19-Apr-10
Li & Fung 5.25% 2020	750	13-May-10
Fita International 7.0% 2020	750	10-Feb-10
CLP Power 4.75% 2020	500	19-Mar-10
Others	905	
Indonesia	**4,004**	
Indonesia Sovereign 5.875% 2020	2,000	19-Jan-10
Star Energy 11.5% 2015	350	12-Feb-10
Listrindo Capital 9.25% 2015	300	29-Jan-10
Others	1,354	
Korea, Rep. of	**10,833**	
Export-Import Bank of Korea 5.125% 2020	1,250	29-Jun-10
Export-Import Bank of Korea 4.125% 2015	1,000	9-Mar-10
Korea Development Bank 4.375% 2015	750	10-Feb-10
Shinhan Bank 4.375% 2015	700	15-Mar-10
Hana Bank 4.5% 2015	500	30-Apr-10
Woori Bank 4.5% 2015	500	7-Apr-10
Hynix Semiconductor 2.65% 2015	500	14-May-10
Hyundai Motors 4.5% 2015	500	15-Apr-10
Others	5,133	
Malaysia	**1,950**	
1Malaysia *Sukuk* 3.928% 2015	1,250	4-Jun-10
Others	700	
Philippines	**2,829**	
Philippines Sovereign (*Samurai*) 2.32% 2020	1,070	2-Mar-10
Philippines Sovereign 6.5% 2020	650	13-Jan-10
International Container Terminal 7.375% 2020	450	17-Mar-10
Others	658	
Singapore	**845**	
CMT MTN 4.321% 2015	500	8-Apr-10
Others	345	
Thailand	**200**	
Export-Import Bank 0.9% 2015	200	14-Jan-10
Viet Nam	**1,000**	
Viet Nam Sovereign 6.75% 2020	1,000	29-Jan-10
Emerging East Asia Grand Total	**31,835**	
Memo Item:		
India	**3,579**	
Vedanta Resources 4.0% 2017	883	30-Mar-10
Bank of India (London) 4.75% 2015	500	31-Mar-10
IndianOil 4.75% 2015	500	22-Jan-10
Others	1,696	

Issued in 1 July–20 August 2010		
Issuer	**USD million**	**Issue Date**
China, People's Rep. of	**3,100**	
Sino-Ocean Land Capital 8.0% Perpetual	900	27-Jul-10
China Resources Power 3.75% 2015	500	3-Aug-10
Shimao Property 9.65% 2017	500	3-Aug-10
China Development Bank 1.6331% 2013	400	15-Jul-10
Country Garden 10.5% 2015	400	11-Aug-10
Others	400	
Hong Kong, China	**2,002**	
Bank of East Asia 6.125% 2020	600	16-Jul-10
China Oriental 8.0% 2015	550	18-Aug-10
Noble Group 4.875% 2015	500	5-Aug-10
Others	352	
Indonesia	**1,100**	
Indosat 7.375% 2020	650	29-Jul-10
Berau Capital Resources 12.5% 2015	450	8-Jul-10
Korea, Rep. of	**5,118**	
Woori Bank 4.75% 2016	600	20-Jul-10
Korea Exchange Bank 4.875% 2016	500	14-Jul-10
Korea Housing Finance Corp. 4.125% 2015	500	15-Jul-10
Korea National Oil Corp. 1.72469% 2013	500	19-Jul-10
NACF 4.25% 2016	500	28-Jul-10
Industrial Bank of Korea (*Samurai*) 1.7% 2012	361	23-Jul-10
Korea Development Bank (*Samurai*) 1.48% 2012	261	1-Jul-10
Others	1,896	
Malaysia	**0**	
Philippines	**800**	
Alliance Global 6.5% 2017	500	18-Aug-10
FPMH Finance 7.375% 2017	300	23-Jul-10
Singapore	**1,646**	
STATS ChipPAC 7.5% 2015	600	12-Aug-10
PSA International 3.875% 2021	500	11-Aug-10
Olam International 7.5% 2020	250	12-Aug-10
Others	296	
Thailand	**700**	
PTTEP Australia International Finance 4.152% 2015	500	19-Jul-10
PTTEP Australia International Finance 4.152% 2015	200	4-Aug-10
Viet Nam	**0**	
Emerging East Asia Grand Total	**14,466**	
Memo Item:		
India	**2,330**	
State Bank of India (London) 4.5% 2015	1,000	27-Jul-10
ICICI Bank 5.0% 2016	500	15-Jul-10
Union Bank of India 4.625% 2016	400	11-Aug-10
Others	430	

Sources: Compilation from newspaper and wire reports.

Table 6: iBoxx Asia Bond Fund Index Family Returns

Market	Modified Duration (years)	2009 Returns (%)		2Q10 Returns (%)		2010 YTD Returns (%)	
		LCY Total Return Index	USD Unhedged Total Return Index	LCY Total Return Index	USD Unhedged Total Return Index	LCY Total Return Index	USD Unhedged Total Return Index
China, People's Republic of	6.00	(0.64)	(0.69)	3.18	3.73	4.39	4.65
Hong Kong, China	3.75	(0.76)	(0.82)	2.17	1.79	3.79	3.45
Indonesia	5.40	20.22	35.61	11.80	15.50	15.03	18.90
Korea, Rep. of	3.68	1.94	9.73	4.36	(0.40)	6.77	3.91
Malaysia	4.67	0.48	1.64	2.87	8.15	4.47	13.20
Philippines	4.28	9.00	11.88	4.54	4.27	9.27	11.08
Singapore	5.57	0.48	3.06	3.52	3.68	5.17	8.29
Thailand	5.05	(3.47)	0.73	5.85	8.60	7.48	13.76
Pan-Asian Index	4.81	—	5.00	—	4.44	—	7.85
HSBC ALBI	8.18	—	6.13	—	4.61	—	7.74
US Govt 1-10 years	3.91	—	(1.38)	—	4.76	—	6.74

— = not applicable, ALBI = Asian Local Bond Index, LCY = local currency, US = United States.
Notes:
1. The Asian Bond Fund (ABF) indices contain only government debt and government-guaranteed debt obligations.
2. Market bond indices are from iBoxx Index Family. 2010 returns are year-to-date as of 31 August 2010.
3. Annual return is computed for each year using natural logarithm of end-of-year index value/beginning year index value.
4. Duration is as of 31 August 2010
Source: *AsianBondsOnline* and Bloomberg LP.

Table 7: MSCI Index Returns

Market	2008 Returns (%)		2009 Returns (%)		2010 YTD Returns (%)	
	LCY terms	USD terms	LCY terms	USD terms	LCY terms	USD terms
China, People's Rep. of	(52.23)	(51.94)	58.89	58.80	(6.04)	(6.34)
Hong Kong, China	(53.16)	(52.88)	55.28	55.20	1.34	1.02
Indonesia	(50.76)	(57.57)	90.27	120.75	11.92	16.38
Korea, Republic of	(40.62)	(55.87)	56.63	69.42	2.23	(0.71)
Malaysia	(40.77)	(43.39)	46.25	47.78	10.57	20.64
Philippines	(46.77)	(53.79)	55.79	60.24	11.42	13.56
Singapore	(49.50)	(49.55)	63.02	67.29	(0.29)	3.33
Thailand	(48.72)	(50.34)	63.00	70.04	17.99	25.70
Far East ex-Japan Index	(48.14)	(51.96)	60.32	65.01	(1.48)	(1.34)
MSCI USA	—	(38.58)	—	24.20	—	(5.92)

—= not applicable, LCY= local currency.
Notes:
1. Market indices are from MSCI country indexes. 2010 returns are year-to-date as of 31 August 2010.
2. Far East ex Japan includes: PRC; Hong Kong, China; Indonesia; Korea, Rep. of; Malaysia; Philippines; Singapore; Taipei,China; and Thailand.
Source: *AsianBondsOnline* and Bloomberg LP.

Table 8: Appreciation (Depreciation) of Emerging East Asian Currencies (%)

Currency	2008	2009	2Q10		as of 31 Aug 2010	
	y-o-y	y-o-y	y-o-y	q-o-q	y-o-y	q-o-q
CNY	6.7	(0.02)	0.7	0.7	0.3	(0.4)
HKD	0.6	(0.04)	(0.5)	(0.3)	(0.4)	0.1
IDR	(18.7)	17.8	12.0	0.5	10.8	0.1
KRW	(29.7)	8.4	4.1	(7.7)	4.3	2.0
MYR	(4.5)	0.6	8.6	1.1	11.2	2.4
PHP	(13.9)	2.7	3.6	(2.6)	7.4	2.3
SGD	0.1	2.2	3.6	0.1	6.2	3.1
THB	(3.1)	3.9	5.0	(0.2)	8.4	3.6
VND	(8.8)	(5.5)	(6.9)	0.1	(8.9)	(2.2)
JPY	20.8	(2.6)	8.4	5.3	9.9	5.2

q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Note: Appreciation (depreciation) is computed as follows: -ln (end-of-period rate/start-of-period rate) x 100.
Source: Bloomberg LP.

Policy and Regulatory Developments

People's Republic of China (PRC)

PBOC Signals Greater Yuan Flexibility

On 20 June, the People's Bank of China (PBOC) announced that the yuan's exchange rate would be allowed to adjust based on floating bands. The announcement signaled a move towards a more flexible exchange rate regime. The PBOC, however, ruled out a one-time revaluation of the currency and no timeframe was announced for the shift in policy.

Yuan Settlement Pilot Program Expanded

The PBOC announced on 22 June that it would expand coverage of its pilot yuan settlement program to include the rest of the world. Previously, the program, which allows for use of the yuan for trade settlement, had been limited to members of the Association of Southeast Asian Nations (ASEAN); Macao, China; and Hong Kong, China. The PBOC also expanded the number of provinces and municipalities participating in the pilot program by eighteen. The pilot program was introduced in July 2009. Shanghai and four cities in Guangdong province were the first cities in the PRC to be allowed to settle external trade using the yuan.

Insurance Regulator Sets Rules on Insurers' Investments

The PRC's insurance regulator, the China Insurance Regulatory Commission, issued a detailed set of rules on insurers' investments on 5 August. According to the Provisional Measures on Insurance Capital Uses, insurance companies will not be permitted to invest more than 10% of their assets (as of the most recent quarter) in the property market. The rules also set ceilings on investments in different asset classes. Insurance companies can invest up to 20% of their assets in equities and up to 5% in stakes in unlisted enterprises. Insurers will also be allowed to invest up to 20% of their assets in unsecured corporate bonds and the debt of non-financial firms, and up to 5% in debt associated with infrastructure projects. PRC insurance companies' assets totaled CNY4.5 trillion at the end of 2Q10, with equity investments accounting for 10% of these assets.

Mini-QFII Program Under Consideration

In July, the PRC was reported to be considering the establishment of a "mini-Qualified Foreign Institutional Investor (QFII)" scheme on a pilot basis. Under the scheme, the Hong Kong, China subsidiaries of PRC-based brokerages and fund managers would be permitted to channel offshore yuan back into the PRC's domestic capital markets, providing them with an expanded range of CNY-denominated investment opportunities. The scheme is reportedly set to be implemented in late 2010 or early 2011. The program, along with the opening up of the PRC's interbank bond market to overseas investors (see below), is part of the PRC's efforts to promote international use of the yuan.

PRC Begins to Open Interbank Bond Market to Overseas Investors

On 17 August, the PBOC announced that it would permit non-resident financial institutions greater access to the PRC's interbank bond market as part of a pilot program to promote cross-border yuan trade settlement and broaden investment channels for yuan to flow back to the PRC. Foreign investment in the PRC's capital markets had previously been limited to QFII program participants.

Under the measures announced by the PBOC, central banks, yuan-clearing banks, and banks based in Hong Kong, China and Macao, China that are participating in the PRC's yuan trade settlement program will be allowed to invest their yuan holdings in the PRC's interbank bond market. Institutions approved to participate in the program will be subject to the approval of investment quotas set by the PBOC.

Hong Kong, China

HKMA and PBOC Signs Supplementary Memorandum of Cooperation on Yuan Transactions

On 19 July, the Hong Kong Monetory Authority (HKMA) and PBOC signed a supplementary memorandum of cooperation regarding the expansion of the existing yuan trade settlement scheme. The HKMA and PBOC have agreed to strengthen cooperation and further promote Hong Kong, China's status as a yuan market platform in an effort to develop more CNY-denominated business outside of the PRC.

Also, the PBOC and Bank of China (Hong Kong) signed a revised settlement agreement on yuan clearing. According to the HKMA, following the revision of the settlement agreement, there will no longer be restrictions on banks in Hong Kong, China in establishing yuan accounts for and providing related services to financial institutions. In addition, individuals and corporations will be able to conduct yuan payments and transfers through banks. As a result, many types of CNY-denominated financial intermediation are expected to be introduced in Hong Kong, China.

Indonesia

Policy Package to Strengthen Monetary Management and Develop Financial Markets

In June, Bank Indonesia (BI) announced a policy package that aimed to boost the effectiveness of monetary policy transmission, shore up financial system stability, and encourage financial market deepening. The package includes the following measures:

(i) Effective 17 June, BI widened the range of its overnight interbank money market rate from 6.0%–7.0% to 5.5%–7.5%.

(ii) Effective 1 July, the net open position holding limit of foreign exchange by banks was capped at 20% of capital.

(iii) Effective 7 July, a minimum 1-month holding period is required for investors of *Sertifikat* Bank Indonesia (SBI) with 1-month maturities. Also, new monetary instruments in the form of term deposits were introduced.

(iv) BI began issuing longer-tenor SBI with maturities of 9-months, effective the second week of August, and 12-months, effective the second week of September.

(v) By 2011, BI will introduce three-party repurchases of government bonds.

According to BI, these policies are not being instituted to control the foreign exchange market, but rather to support sustainable macroeconomic stability and strengthen the momentum of economic recovery.

Debt Issuance to be Trimmed

In late July, the Ministry of Finance reported that government spending was sluggish in the first half of the year, resulting in a lower-than-projected budget deficit for 2010. The government managed to spend only IDR395.8 trillion, or 35.1% of the target set in the 2010 revised state budget, in the first half of the year. Revenue collection reached 44.7% of the target. This resulted in a budget surplus amounting to IDR47.9 trillion in the first half of 2010. As a result, the Ministry of Finance estimates a deficit equivalent to only 1.5% of GDP for the year as a whole, compared with its earlier forecast of 2.1%.

In line with this development, the government will trim its remaining debt issuance by 26%. The debt issuance target will be reduced by IDR15 trillion out of the IDR58 trillion worth of debt still to be issued.

Treasury Bill Issuance to be Reduced

In mid-August, Rahmat Waluyanto, Director General of Debt Management announced that the Ministry of Finance will reduce treasury bill issuance to control refinancing risks. He explained that the value of short-term treasury bonds with tenures of less than 5 years (including treasury bills) accounts for 18% of total IDR-denominated treasury notes. In the future, this percentage will be cut to less than 10% to attract more capital into the long-term treasury bond market to lessen the market's vulnerability to the risk of capital flight.

BI Announces New Regulations on Reserve Requirements and Bank Lending

In September, BI announced new regulations on reserve requirements and bank lending to help contain inflation and boost economic growth. Beginning in November, the primary reserve requirement will be raised to 8.0% of deposits—from 5.0%—while the secondary reserve requirement will remain at 2.5%. Banks that are able to comply with the new primary reserve requirement will earn 2.5% interest on the amount covering the 3 percentage points increase in primary reserves. On the other hand, those banks that fail to meet the new 8.0% primary reserve requirement will be fined the equivalent of 125% of the average 1-day overnight Jakarta Interbank Offered Rate (JIBOR). BI also announced a new regulation designed to give banks incentives for maintaining their loan-to-deposit ratio within a range of 78%–100%, effective 1 March 2011.

Republic of Korea (Korea)

Korea To Introduce Short-Term KTBs

In July, Korea publicized its plan to issue Korean Treasury Bonds (KTBs) with maturities of less than 1 year in order to form a short-term benchmark bond rate. The issuance of short-term KTBs will take place following revisions in the National Finance Act to be made in 2011/12.

FSC Approves Regulation to Promote Trading of Long-Term KTB Futures

In September, the Financial Supervisory Commission (FSC) of Korea approved the Korea Exchange's amendments to the Derivatives Market Business Regulation, which aims to enhance the trading of long-term KTB futures. The revised version calls for harmonizing regulations on short-term and long-term KTB futures to improve the accessibility of KTB futures and facilitate the trading of these derivative instruments. The amended regulation, which is expected to be implemented in October, aims to stabilize price movements and enhance market-making functions in the KTB futures market.

Malaysia

BNM Further Liberalizes FX Rules

In August, Bank Negara Malaysia (BNM) announced the further liberalization of foreign exchange (FX) administrative rules to promote efficiency in trade. The new rules provide for the following:

(i) the use of the ringgit as a settlement currency for international trade of goods and services between residents and non-residents;

(ii) the borrowing of any amount of foreign currency by a resident company from its respective non-resident, non-bank related company (thus abolishing all limits on cross-boarder foreign currency inter-company borrowings); and

(iii) the lifting of the limit on residents' anticipatory hedging of current account transactions with licensed onshore banks.

To promote bilateral trade between the PRC and Malaysia, the China Foreign Exchange Trading System (CFETS) has issued a separate statement that allows trading of the PRC yuan against the ringgit. Aside from the ringgit, other currencies that are traded on the CFETS are the US dollar, euro, pound sterling, yen, and Hong Kong dollar.

Philippines

Bond Exchange Program Planned

In August, the Philippine Bureau of the Treasury revealed its plan to allow the exchange of shorter- and longer-term bonds in order to lengthen the maturity profile of the Philippine government's debt. In particular, 5-year government bonds can be exchanged for 10-year bonds, while 10-year bonds can be exchanged for 20- or 25-year bonds. This bond exchange program is expected to be launched by the end of the year.

Singapore

PBOC and the MAS Agree to a Bilateral Currency Swap

On 23 July, the PBOC and the Monetary Authority of Singapore (MAS) agreed to a bilateral currency swap arrangement to promote bilateral trade and direct investment. The swap arrangement will provide PRC yuan liquidity of up to CNY150 billion and Singapore dollar liquidity of up to SGD30 billion. The initial term of the arrangement is 3 years with the possibility for extension.

SGX Launches Initiatives to Boost Bond Listing and Trading

In August, the Singapore Exchange (SGX) launched initiatives to promote the listing, trading, and distribution of fixed-income instruments in Singapore. Among the initiatives are measures to attract companies listed in Singapore to issue bonds that can be listed and traded on the SGX. The SGX plans to streamline the approval process for bond listings and cut the time required for approval in half.

In addition to attracting bond listings, the SGX plans to encourage the listing and trading of preference shares and convertible bonds. By 1Q11, the SGX expects to put in place an on-exchange secondary market allowing for the trading of Singapore Government Securities both by individual and institutional investors.

Thailand

Thai Cabinet Approves Draft Securities Bill

In May, the Thai Council of Ministers approved a draft securities bill that allows the demutualization of the Stock Exchange of Thailand (SET). The bill will pass through the National Economic and Social Development Board and the Commerce Ministry for scrutiny. The SET will be the trading center and the SEC will be in charge of capital market development and rule formulation. The Finance Ministry proposed the amendment to better connect Thailand's financial markets with the global economy and improve management of the free flow of investments.

SEC Approval and Credit Rating Required for State-Owned Enterprises and Government Agencies to Issue Bonds

The SEC announced a regulation that requires state-owned enterprises and government agencies to obtain SEC approval and a credit rating before issuing bonds. This rule has previously only applied to private companies issuing debt instruments. The Thai Finance Ministry has been reducing the financial dependency of state-owned enterprises and state agencies on the central government by decreasing the amount of guaranteed debts and signaling that such enterprises and agencies need to rely less on the government for financing.

Viet Nam

SBV to Base Policy Rate on Market Rates

In June, the Vietnamese National Assembly passed legislative amendments requesting the State Bank of Vietnam (SBV) to use market interest rates as a basis of monetary policy. The SBV usually publishes a base rate every month, but with the amendment, the SBV will publish monthly market rates as reported by credit institutions. The changes will take effect on 1 January 2011.

Limited Liability Companies to Issue Bonds

In July, the Ministry of Finance issued a draft decree that allows limited liability companies to issue corporate bonds in the domestic and international capital markets. The draft decree identifies which limited liability companies are allowed to issue bonds and provides a legal framework to enterprises on international bond issuance.

Corporate Bond Market Developments

Recent Trends

Emerging East Asia's LCY corporate bond market continued to act as an important driver of overall bond market growth in the region in the first half of 2010.

The emerging East Asian[4] local currency (LCY) corporate bond market grew 24.4% year-on-year (y-o-y) in 2Q10, compared with 16.7% for the government bond market. On a quarter-on-quarter (q-o-q) basis, however, the growth rates for the government and corporate bond sectors were almost identical: 5.1% and 5.0%, respectively. Emerging East Asia's most rapidly growing LCY corporate bond markets in 2Q10 were those of Viet Nam, the People's Republic of China (PRC), the Philippines, and Indonesia **(Table 9)**. These markets recorded y-o-y growth rates of 170.9%, 52.7%, 26.8%, and 16.5%, respectively. The PRC's corporate bond market is the second largest in emerging East Asia, comprising 38.7% of the region's total corporate bonds, and is exceeded only by that of the Republic of Korea (Korea) at 40.5%. The high growth rates in 2Q10 of corporate bond markets in Viet Nam, the Philippines, and Indonesia reflected the fact that these markets were growing rapidly from a relatively small base. The y-o-y growth rates of the more developed and mature corporate bond markets of Singapore, Korea, Thailand, and Malaysia were lower at 15.1%, 12.7%, 9.0%, and 8.6%, respectively. Growth in the corporate bond market of Hong Kong, China was essentially flat in 2Q10 on a y-o-y basis.

Table 9: Corporate Bonds Outstanding

	Amount (USD billion)			**Growth Rate** (y-o-y %)		
	2Q09	**1Q10**	**2Q10**	**2Q09**	**1Q10**	**2Q10**
China, People's Republic of	355	492	546	90.93	67.45	52.71
Hong Kong, China	74	75	73	(0.64)	2.35	(0.88)
Indonesia	8	10	10	(3.21)	25.77	16.46
Korea, Republic of	486	605	571	15.19	15.83	12.73
Malaysia	77	88	91	6.75	8.99	8.62
Philippines	6	8	8	62.39	50.97	26.82
Singapore	59	68	70	5.23	18.95	15.14
Thailand	33	38	38	17.13	19.05	8.96
Viet Nam	1	1	2	10.33	138.50	170.94
Emerging East Asia	1,100	1,384	1,410	28.63	29.66	24.35

y-o-y = year-on-year.
Notes:
1. For Singapore, corporate bonds outstanding quarterly figues are based on *AsianBondsOnline* estimates.
2. Corporate bonds include issues by financial institutions.
3. Bloomberg LP end-of-period LCY—USD rates are used.
4. Total emerging East Asia growth figures are based on end-June 2010 currency exchange rates and do not include currency effects.
5. Emerging East Asia comprises the People's Republic of China; Hong Kong, China; Indonesia; Republic of Korea; Malaysia; Philippines; Singapore; Thailand; and Viet Nam.
Source: People's Republic of China (*ChinaBond*); Hong Kong, China (Hong Kong Monetary Authority); Indonesia (Indonesia Stock Exchange and Bank Indonesia); Republic of Korea (Bank of Korea and *KoreaBondWeb*); Malaysia (Bank Negara Malaysia); Philippines (Bureau of the Treasury and Bloomberg LP); Singapore (Singapore Government Securities, Monetary Authority of Singapore and Bloomberg LP); Thailand (Bank of Thailand); Viet Nam (Bloomberg LP); and Japan (Japan Securities Dealers Association).

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

Korea's corporate bond market growth rate is explained by the fact that y-o-y growth in Korea's commercial bank sector was negative (–1.4%), while growth rates for bonds outstanding of public sector companies and private sector corporates (excluding bank debentures) were 36.7% and 12.7%, respectively.

In the case of Malaysia, Islamic corporate bonds expanded by 4.6% y-o-y in 2Q10, while conventional corporate bonds grew at a faster rate of 14.6% y-o-y. The most rapidly growing part of the Malaysian corporate bond market was the medium-term note (MTN) sector. In 2Q10, conventional MTNs grew 44.7% y-o-y, while Islamic MTNs grew 13.0%. The growth of both the Islamic and non-Islamic MTN sector in 2Q10 was driven primarily by the large amount of MTN issuance by financial institutions, including Danga Capital (a subsidiary of Khazanah), Cagamas (the national mortgage corporation), and major commercial banks.

The rapid growth of the emerging East Asian corporate bond market in 1Q10 resulted in an increase of its share of the global corporate bond market to 4.9% from 4.4% at the end of 4Q09.

East Asia's corporate bond market increased its share of the global bond market to 4.9% at end-March 2010 from 4.4% at end-December 2009 **(Table 10)**. The 0.5 percentage point increase in global corporate bond market share compares well

Table 10: Breakdown of Bonds Outstanding in Major Markets

	All		Government		Corporates	
	Mar-10	Mar-10	Mar-10	Dec-09	Mar-10	Dec-09
	LCY Bonds Outstanding (USD billion)	% of World Total	% of World Total	% of World Total	% of World Total	% of World Total
United States	24,978	39.8	29.0	28.0	52.9	52.7
Japan	9,754	15.5	25.5	25.5	3.4	3.3
France	3,094	4.9	4.7	5.0	5.2	5.0
Germany	2,632	4.2	4.3	4.6	4.1	4.3
United Kingdom	1,525	2.4	3.5	3.5	1.2	1.2
Emerging East Asia	**4,633**	**7.4**	**9.4**	**9.2**	**4.9**	**4.4**
of which: PRC	2,648	4.2	6.3	6.2	1.7	1.5
Emerging East Asia excl. PRC	1,985	3.2	3.2	3.0	3.1	2.9
of which: Korea, Rep. of	1,095	1.7	1.4	1.3	2.1	2.0
of which: ASEAN-6	735	1.2	1.5	1.4	0.7	0.7
Indonesia	108	0.2	0.3	0.3	0.0	0.0
Malaysia	199	0.3	0.3	0.3	0.3	0.3
Philippines	66	0.1	0.2	0.2	0.0	0.0
Singapore	159	0.3	0.3	0.3	0.2	0.2
Thailand	191	0.3	0.4	0.4	0.1	0.1
Viet Nam	12	0.0	0.0	0.0	0.0	0.0
Memo Items:						
Brazil	1,218	1.9	2.3	2.4	1.5	1.5
PRC (excl. policy bank bonds)	1,971	3.1	4.3	4.3	1.7	1.5
India	652	1.0	1.6	1.6	0.3	0.2
Russia	51	0.1	0.1	0.1	—	—

— = data not available, ASEAN = Association of Southeast Asian Nations, LCY = local currency, PRC = People's Republic of China.
Note:
Emerging East Asia comprises the People's Republic of China; Hong Kong, China; Indonesia: Republic of Korea; Malaysia; Philippines; Singapore; Thailand; and Viet Nam.
Source: Bank for International Settlements and *AsianBondsOnline*.

with the larger emerging East Asian government bond market, which increased its share of the global government bond market to 9.4% in 1Q10 from 9.2% in 4Q09. These trends resulted in the emerging East Asian bond market as a whole increasing its share of the global bond market to 7.4% at the end of 1Q10 from 7.0% at the end of 4Q09.

Structure of the Emerging East Asian Corporate Bond Market

The emerging East Asian bond market is still a relatively small component of the region's domestic financing structure.

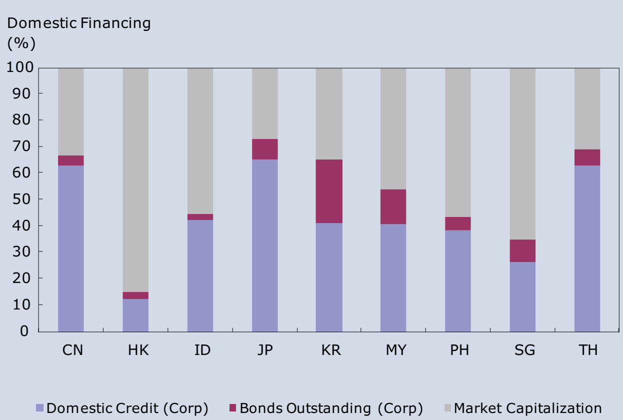
The composition of domestic finance in emerging East Asia can be seen in **Figure 11**, which compares the levels of bank lending, corporate bonds outstanding, and market capitalization of individual equity markets to demonstrate that corporate bonds outstanding comprise the smallest element of domestic financing in almost every market. **Figure 12** provides a ratio of equity market capitalization to corporate bonds outstanding in each market. These ratios fell during the 2008/09 economic and financial crisis, but have generally been recovering since then. These ratios remain very large, even after the decline of equity market capitalization in 2008/09. The only instances where equity market capitalization and corporate bonds outstanding are in relative balance are Korea and—to a lesser degree—Malaysia.

SOEs and financial institutions remain the dominant players in many of the region's LCY corporate bond markets, particularly in Korea and the PRC.

Korea: Korea's LCY bond market comprised 1.7% of the total global bond market at the end of 1Q10, up from 1.5% at the end of 2009. Korea's government bond market accounted for 1.4% of the global government bond market, while its corporate bond market accounted for 2.1% of the global corporate bond market. Official corporate bond market data in Korea breaks down the market into three major categories as shown in **Table 11:**

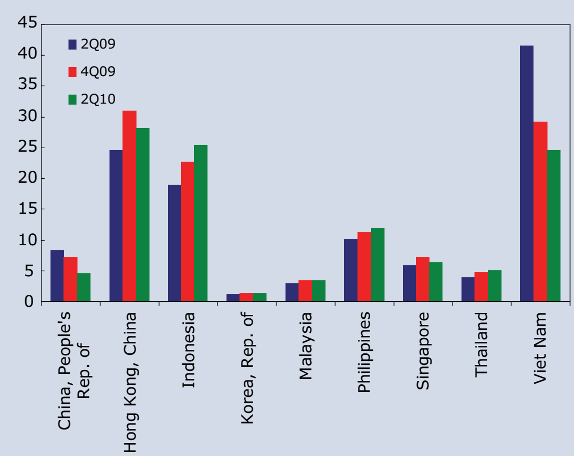
(i) state-owned enterprises (SOEs)—primarily engaged in energy, infrastructure, and transport—and various special purpose financial entities that support housing, infrastructure, and other public sector activities;

Figure 11: Composition of Domestic Investment



Source: International Financial Statistics, World Federation of Exchanges, Bank Negara Malaysia, and *AsianBondsOnline* calculations.

Figure 12: Ratio of Equity Market Capitalization to Corporate Bonds Outstanding



Source: Bloomberg LP and *AsianBondsOnline* calculations.

(ii) commercia bank subsidiaries of Korea's financial holding companies (bank debentures); and

(iii) private sector companies, including some holding companies of the major financial groups and major securities companies, which are the largest entities in the private sector category of the official corporate bond data.[5]

PRC: Table 12 presents data on bonds outstanding for the largest corporate issuers in the PRC, which are still considered to be part of the state-owned sector of the economy. The table allocates corporate bonds outstanding into one of three categories: (i) SOE bonds, (ii) MTNs, and (iii) commercial bank bonds. Commercial bank bond issuance in the PRC, which does not include bonds of the China Development Bank (CDB), mostly consists of subordinated debt bonds, which can be counted as Tier II capital under the rules of the Bank for International Settlements (BIS). Until very recently, banks in the PRC had been reluctant to issue new equity and instead relied mainly on the issuance of subordinated debt bonds to build-up their capital as they have increased the pace of loan growth over the last several years.

Subordinated debt bonds are typically issued with tenors of at least 10 years, and sometimes up to 15 years. Under BIS guidelines, subordinated

Table 11: Structure of the Korean LCY Corporate Bond Market (KRW billion)

Total Corporate Bonds	**697,705**
Special Public Corporations	**235,082**
of which:	
Korea Land & Housing Corporation	51,385
Korea Housing Finance Corporation (KHFC)	31,001
Korea Deposit Insurance Corporation (KDIC)	27,381
Korea Finance Corporation	20,780
Korea Electric Power Corporation (KEPCO)	20,150
Financial Debentures	**210,476**
of which:	
Industrial Bank of Korea (IBK)	38,056
Kookmin Bank	35,484
Woori Bank	22,322
Shinhan Bank	19,817
Nonghyup	15,924
Private Corporations	**252,147**
of which:	
Daewoo Securities	20,869
Woori Investment & Securities	16,148
Korea Investment & Securities	10,102
Hyundai Securities	8,812
Mirae Asset Securities	6,719

LCY = local currency.
Source: *AsianBondsOnline* and *KoreaBondWeb.*

Table 12: PRC's Top Corporate Bond Issuers
(CNY Billion)

	Total	SOE Bonds	MTNs	Bank Bonds
Ministry of Railways	343.4	293.4	50.0	-
State Grid Corp.	209.5	119.5	90.0	-
Bank of China	124.9	-	-	124.9
China Construction Bank	120.0	-	-	120.0
Industrial Bank	85.0	-	-	85.0
China Natl Petroleum Corp.	80.0	-	80.0	-
ICBC	75.0	-	-	75.0
China Petrol & Chemical Corp.	58.5	28.5	30.0	-
Petrochina	56.0	-	56.0	-
Agricultural Bank of China	50.0	-	-	50.0
China Telecom	50.0	-	50.0	-
China Mobile	10.0	10	-	-
Total-Top Issuers	**1,262.3**	**451.4**	**356.0**	**454.9**
Total SOE, MTN, & Bank Bonds Outstanding	**2,540.8**	**781.059**	**1151.2**	**608.52**
Total-Top Issuers/Total Corporate Bonds Outstanding	**49.7%**	**57.8%**	**30.9%**	**74.8%**
Memo Items:				
Local Corporate Bonds	461.66			
Commercial Papers	615.39			
Other	60.86			
Asset/Mortgage-backed Securities	26.46			
Subtotal	1,164.4			
Grand Total	**3,705.1**			

MTN = Medium Term Notes, SOE = State-Owned Corporate Bonds, PRC = People's Republic of China.
Source: *ChinaBond.*

[5] The household-name industrial corporates of Korea are relatively modest issuers of bonds, instead relying on the equity market and banks as their more important sources of finance.

debt bonds must amortize for the last 5 years of their life to be counted as Tier II capital. Most of the subordinated debt bonds issued by PRC banks are ordinary subordinated debt. According to the capital adequacy guidelines of the BIS, such bonds can only be issued in an amount equal to 50% of total equity, and for this reason are known as Lower Tier II subdebt. If a bank wishes to issue additional amounts of subdebt, such instruments must be able to temporarily miss coupon payments under certain defined conditions without constituting an event of default. Thus, they are known as cumulative hybrid securities, or Upper Tier II securities. At the present time, the overall stock of the PRC's subordinated bonds only contains 11 of these cumulative hybrid securities. These have not been issued by the "big four" commercial banks—Industrial and Commercial Bank of China, Bank of China, Agricultural Bank of China, and China Construction Bank—but rather by somewhat smaller mid-level institutions —Industrial Bank, Minsheng Bank, Huaxia Bank, and Shenzhen Development Bank.

These cumulative hybrid securities have maturities of 15 years and amortize over the last 5 years of their life, as explained above. In addition, they are rated one notch below the issuer rating of the issuing institution. All of the cumulative hybrid securities are rated AA, except for the security issued by Shenzhen Development Bank, which is rated AA-.

The companies and financial institutions listed in Table 12 are considered a core component of the PRC's public sector and, thus, they present a minimum bound estimate of the magnitude of bonds outstanding issued by SOEs. However, the bonds issued by banks are subordinated debt bonds, and are less traded. Thus, the seven non-financial companies comprise the more liquid part of the corporate bond sector. These seven non-financial companies are all rated AAA, and in the PRC bond market are known as the Super AAAs. Given the decline of yields and bid–ask spreads on PRC treasury bonds this year, the Super AAAs have become more attractive to investors due to their AAA credit rating, as well as the increase in yields and bid-ask spreads compared with government bonds. Table 12 also provides total data on commercial paper and other types of corporate bonds outstanding. Commercial paper represents a large market in the PRC, but it is issued in relatively small sizes compared with MTNs, SOE bonds, and commercial bank bonds.

Other coporate bond markets: Private companies account for a larger share of the corporate bond market elsewhere in emerging East Asia. (Individual companies are discussed in more detail in the Market Summaries presented at the end of this report.) However, in almost every emerging East Asian market, an SOE tends to be the largest or second-largest commercial bond issuer. The type of SOE activities range from public housing in Hong Kong, China (HK Mortgage Co. and Kowloon–Canton Railway) and Singapore (Housing and Development Board), to oil refining and petrochemicals (PTT) in Thailand, and electric power in Indonesia (PLN) and the Philippines (PSALM).

One of the more interesting and developed LCY bond market structures in the region is that of Malaysia **(Table 13)**. The Malaysian corporate bond market is divided into two sectors: conventional and Islamic. Both of these sectors issues asset-backed securities, regular bonds, and MTNs. While public sector companies such as Kazanah, Cagamas, and Tenaga Nasional are important issuers in the Malaysian bond market, they are not dominant. Furthermore, the bonds currently being issued by Kazanah and Cagamas—MTNs and Islamic bonds—are commercial in character. Both of these institutions issued conventional bonds for the purpose of establishing a sovereign benchmark when they were first created over a decade ago. Most of these bonds have either matured or are about to do so and have since been replaced by Malaysia Government Securities and Government Islamic Issues as the new sovereign benchmarks. As mentioned earlier, the Malaysian Islamic bond sector grew at an overall rate of 4.6% in 2Q10, while the total corporate bond sector's growth rate was 8.6%.

Table 13: Malaysia's Top 20 Corporate Issuers (MYR billion)

Issuer	Industry	Conventional Bonds	Islamic Bonds	Conventional MTN	Islamic MTN	Total
Cagamas	Finance	—	—	9.30	8.85	18.15
Khazanah	Quasi-Govt. and Other	—	13.20	—	—	13.20
Binariang GSM	Transport, Storage & Comm.	—	3.17	—	8.28	11.45
Project Lebuhraya	Transport, Storage & Comm.	—	6.57	—	3.68	10.25
Prasarana	Finance	5.11	2.00	—	2.00	9.11
Maybank	Finance	6.10	2.50	—		8.60
Rantau Abang Capital Bhd	Quasi-Govt. and Other	—	—	—	8.00	8.00
Malakoff Corp	Finance	—	1.70	—	5.60	7.30
KL International Airport	Transport, Storage & Comm.	1.60	4.76	—	—	6.36
AM Bank	Finance	1.60	—	4.33	—	5.93
Value Cap	Finance	5.10	—	—	—	5.10
1 Malaysia Development Bhd.	Finance	—	—	—	5.00	5.00
Jimah Energy Ventures	Utilities	—	—	—	4.77	4.77
Tanjung Bin	Utilities	—	—	—	4.59	4.59
Bank Pembangunan Malaysia	Finance	1.00	—	2.60	0.90	4.50
Putrajaya Holdings	Finance	—	1.70	—	3.65	5.35
YTL Power International	Utilities	2.20	—	1.70	—	3.90
Tenaga Nasional	Utilities	1.50	2.15	—	—	3.65
Danga Capital	Finance	—	—	—	3.60	3.60
RHB Bank	Finance	0.60	—	3.00	—	3.60
Total		**24.81**	**37.75**	**20.93**	**58.91**	**142.40**
Total Outstanding		**63.48**	**70.47**	**45.48**	**89.40**	**294.65**
Top 20 as % of Outstanding		**39.1%**	**53.6%**	**46.0%**	**65.9%**	**48.3%**

— = not applicable, MTN = medium-term notes.
Source: Bank Negara Malaysia Fully Automated System for Issuing/Tendering (FAST).

The most active corporate bond issuers—both publicly-owned companies and private corporations—were found in the financial, infrastructure, transport, and energy sectors in 2Q10.

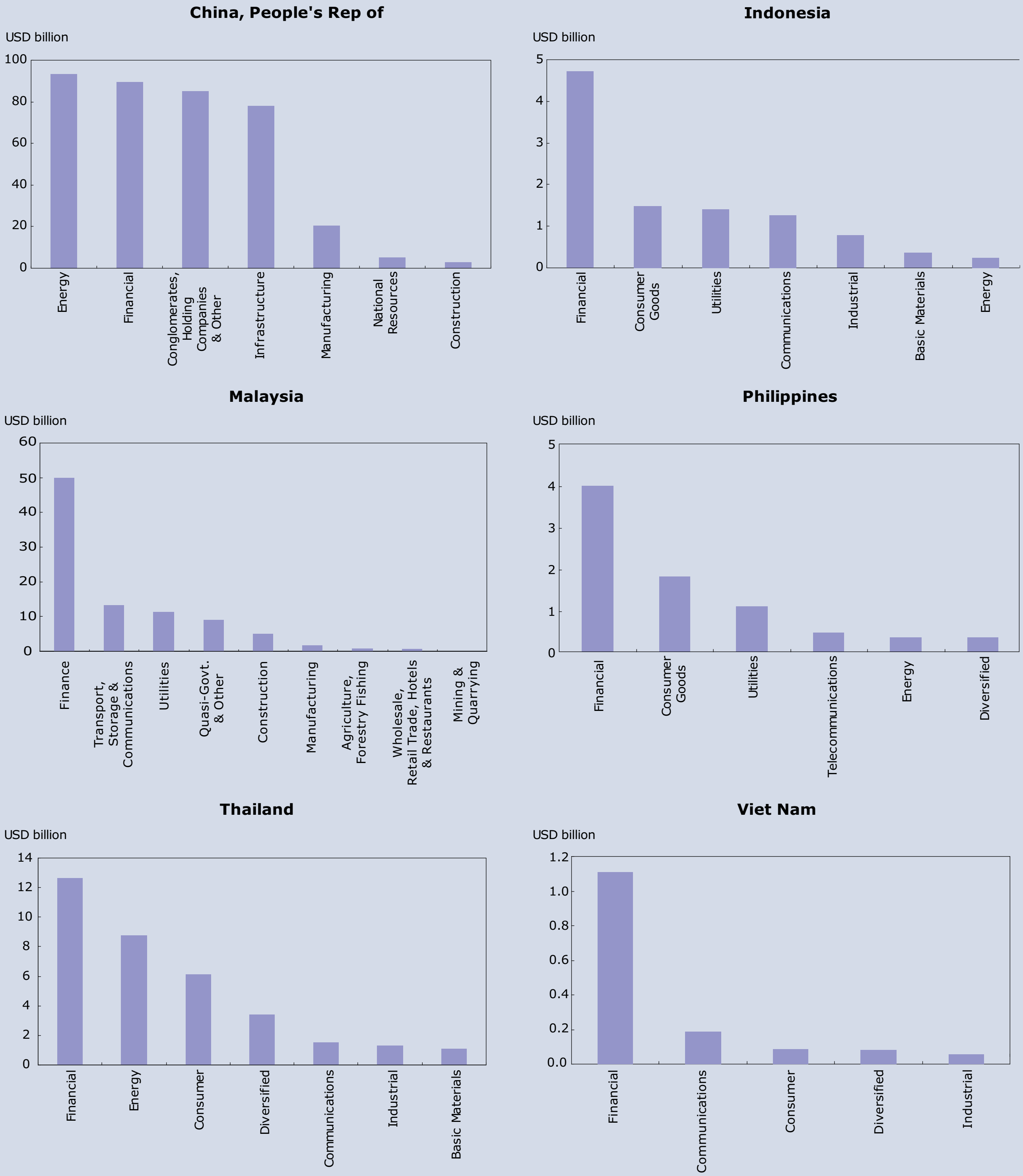
The most common type of activity for which corporate bonds are issued in Indonesia, Malaysia, Philippines, Thailand, and Viet Nam is finance **(Figure 13)**. Financial sector issuers include commercial banks, securities companies, and specialized finance companies. Other sectors with companies active in bond issuance across the region include infrastructure, transport, and energy.

Figure 14a reveals these patterns within the Korean LCY corporate bond market. The largest categories of issuance in the Korean market include bank debentures—bonds issued by commercial banks, many of which are subsidiaries of bank holding companies—and bonds issued by specialized finance companies. A number of these banks and finance companies reside within the public sector. Infrastructure, transport, and energy are the next most active sectors in Korea's corporate bond market.

This trend is broadly repeated in the case of public sector companies issuing special public bonds **(Figure 14b)**. The largest sector is once again finance, with issuance led by special purpose finance companies. The next largest categories of issuers in the Korean public sector are real estate, infrastructure and telecoms, energy, and transport.

Private sector issuance in the Korean LCY market is dominated by private sector securities companies, which account for nearly half of all bonds issued by private sector companies, followed by manufacturing, energy, and transport **(Figure 14c)**. The "other" category for the private sector bond segment is quite large because it encompasses bonds issued by holding companies and diversified conglomerates, and a number of small, highly-specialized private companies.

Figure 13: LCY Corporate Bonds by Sector



LCY = local currency.
Notes:
1. For China, People's Rep. of, data excludes local corporate bonds, asset/mortgage-backed securities, commercial paper, securities company bonds and commercial paper, non-bank financial institution bonds, and SME collective bonds
2. For Thailand, data includes state-owned enterprises.
Source: China, People's Republic of (*ChinaBond*); Indonesia (Indonesia Stock Exchange and Bloomberg LP); Malaysia (Fully Automated System for Issuing/Tendering); Philippines (Bloomberg LP); Thailand (Bloomberg LP); and Viet Nam (Bloomberg LP).

Figure 14a: Total Korean Corporate Bonds by Sector, June 2010

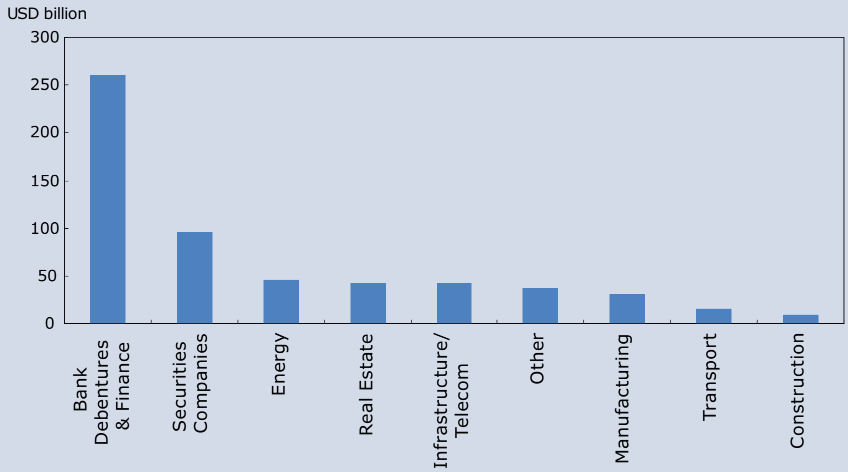


Figure 14b: Special Public Bonds (excluding Bank Debentures)

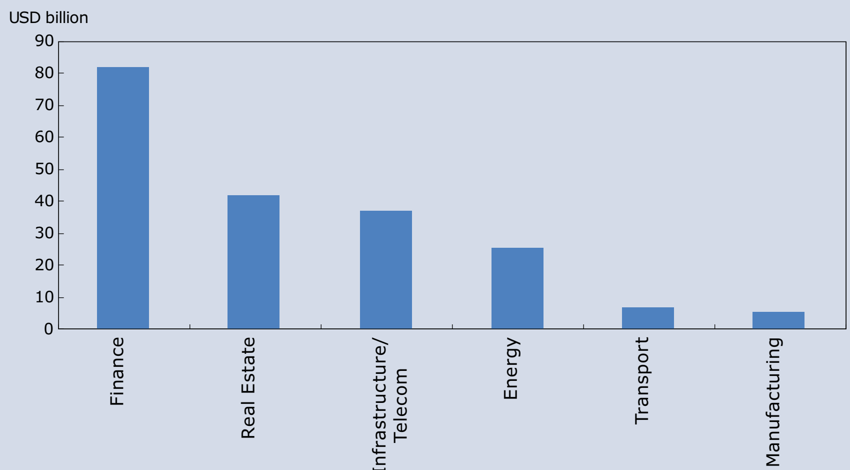
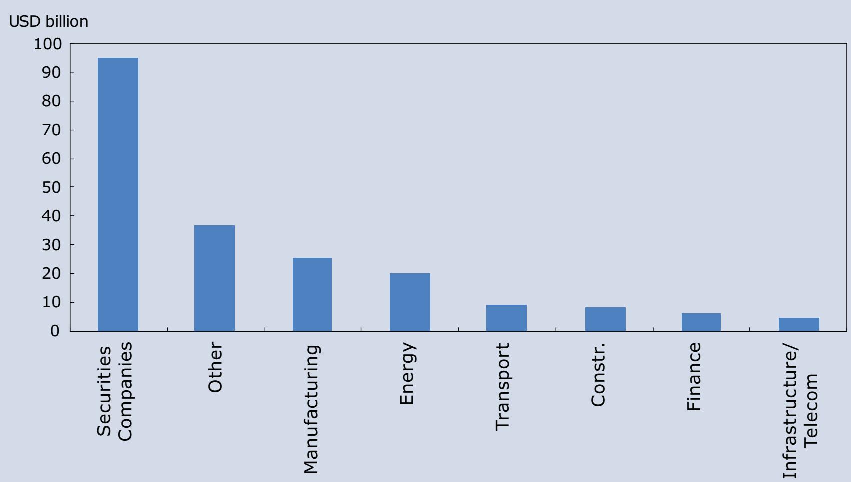


Figure 14c: Private Sector Bonds (excluding Bank Debentures)



Note: Bank debentures are bonds issued by commercial banks. Finance includes bonds issued by bank holding companies and non-bank finance companies, including special purpose publicly owned non-bank financial entities.
Source: *KoreaBondWeb.*

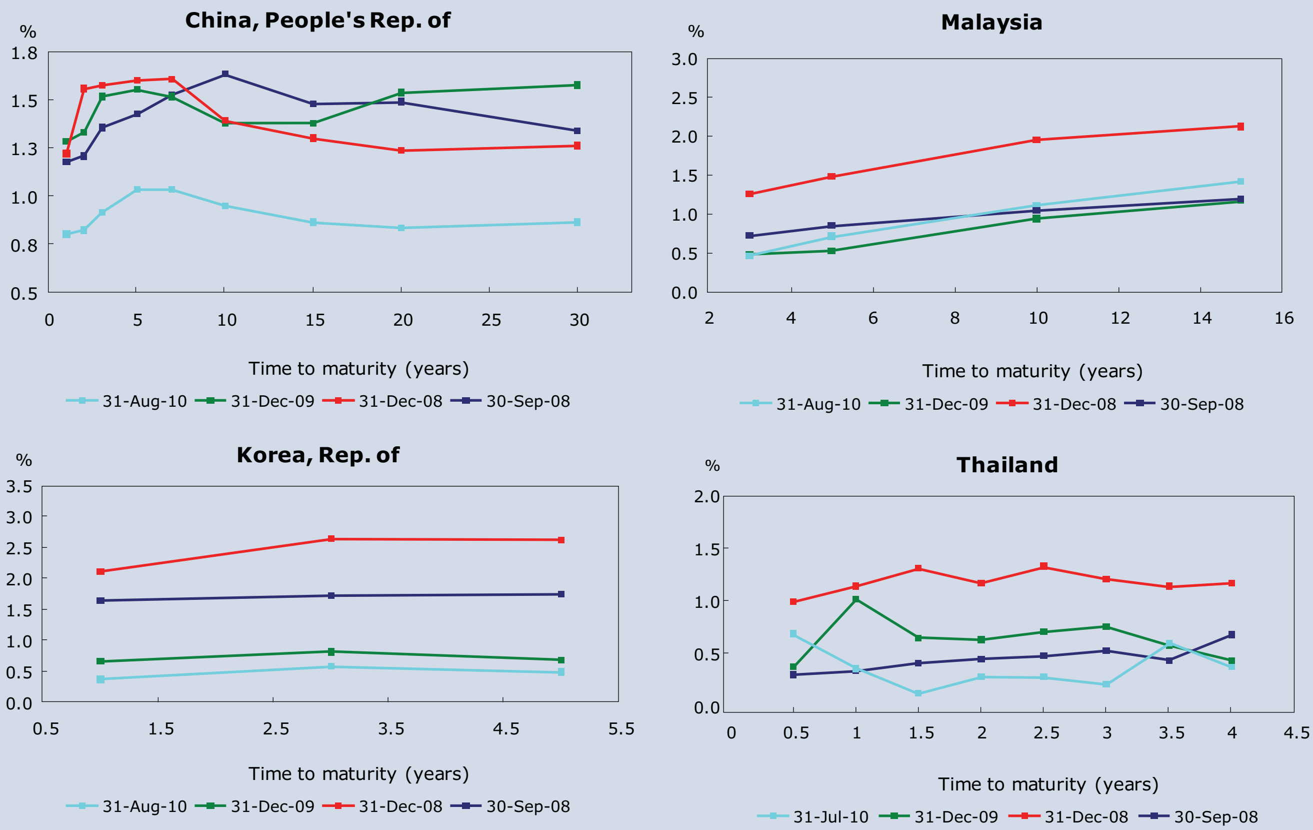
Corporate Bond Credit Spreads

Higher-grade corporate credit spreads have narrowed since end-December 2009, while those for lower-rated corporates have tightened only at the short-end of their respective curves—and, in some cases, have widened.

Credit spreads on higher-grade corporate bonds—rated AAA—tightened between end-December 2009 and end-August 2010 along the entire length of corporate bond credit curves in the PRC and Korea **(Figure 15a)**. The Malaysian curve steepened, with credit spreads widening above end-December 2009 levels for all maturities, except at the very short-end of the curve.

The behavior of the Thai yield curve was more complex. Thai credit spreads tightened along most parts of the curve compared with end-December 2009 levels, but Thai credit spreads narrowed much more for maturities of 1–3 years than for maturities of less than 1 year or more than 3 years. Thai credit spreads at both the short- and long-end of the Thai credit curve, which only extends up to maturities of 4 years, were slightly above their levels of September 2008 in the immediate aftermath of the collapse of Lehman Brothers. Furthermore, credit spreads in the belly of the curve were extremely low, ranging between 0.2% and 0.3%.

Figure 15a: Credit Spreads—LCY Corporates Rated AAA vs. Government Bonds



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

Trends for lower-rated corporate bonds **(Figure 15b)** were unique for each of the four markets in which data were available:

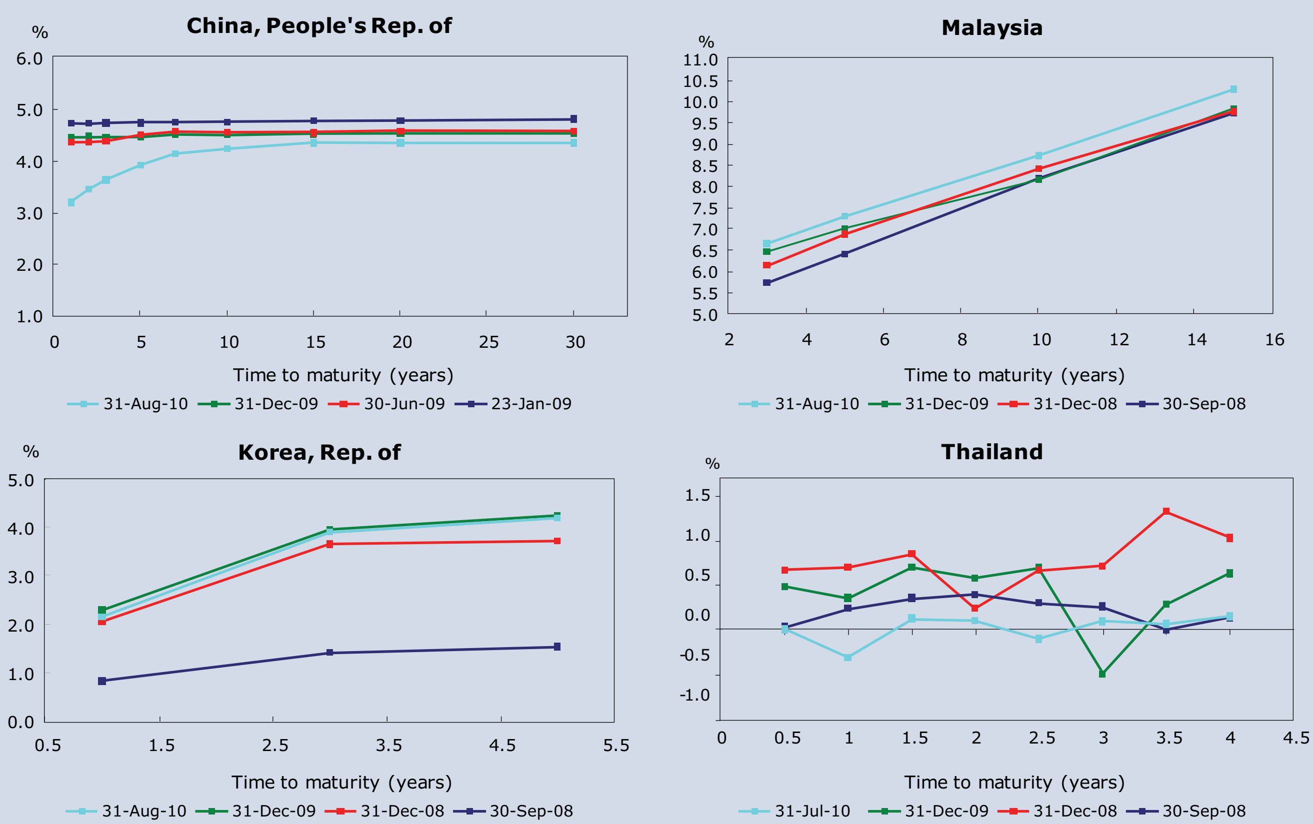
(i) In the PRC, credit spreads with tenors of 15 years or more declined slightly, while credit spreads under 15 years tightened significantly, especially for maturities under 5 years.

(ii) In Korea, credit spreads tightened modestly between end-December 2009 and end-August 2010. But this did not signal a steepening of the curve, rather credit spreads simply tightened below end-December 2009 levels along the entire length of the curve.

(iii) In Malaysia, the credit curve steepened along its entire length relative to its position at end-December 2009.

(iv) The trend for the lower-rated Thai credit curve was similar to that of the higher-rated curve, except that spreads on the lower-rated curve were roughly zero and therefore even lower than the 0.2%–0.3% spreads of the higher-rated curve. The short- and long-end of the lower-rated Thai credit curve also approached levels similar to those of end-September 2008.

Figure 15b: Credit Spreads—Lower-Rated LCY Corporates vs. AAA



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

Investor Profiles for Corporate Bonds

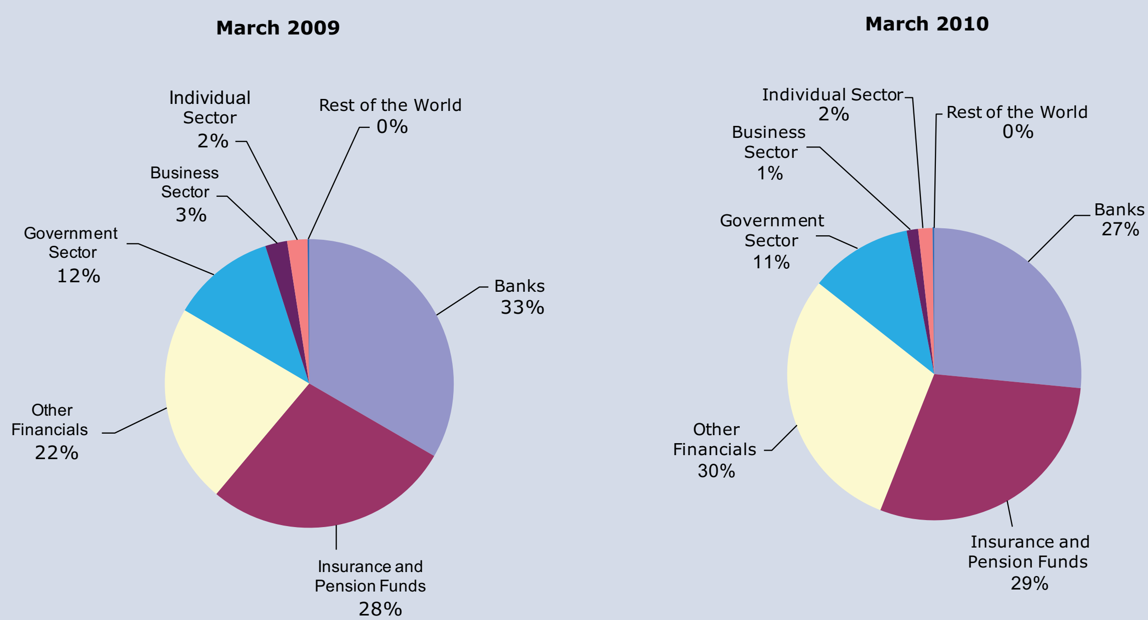
Investor profile data for corporate bond markets in emerging East Asia is limited to Korea, the PRC, and Thailand.

Investor profile data for the Korean LCY corporate bond market shows that that as of end-March the holdings of banks fell slightly to 27% of the total from 34% at end-March 2009, while the holdings of non-financial entities rose slightly **(Figure 16a)**. Holdings of commercial paper in Korea remain overwhelmingly dominated by financial institutions. In both cases, foreign participation was minimal **(Figure 16b)**.

In the PRC, the investor profile of SOE corporate bonds was largely unchanged in June from end-December 2009 **(Figure 17)**. Insurance companies —with 39% of total holdings—remained the single largest investor class in SOE bonds. National commercial banks held 24.1% of SOE bonds, and other types of banks held 16.6%.

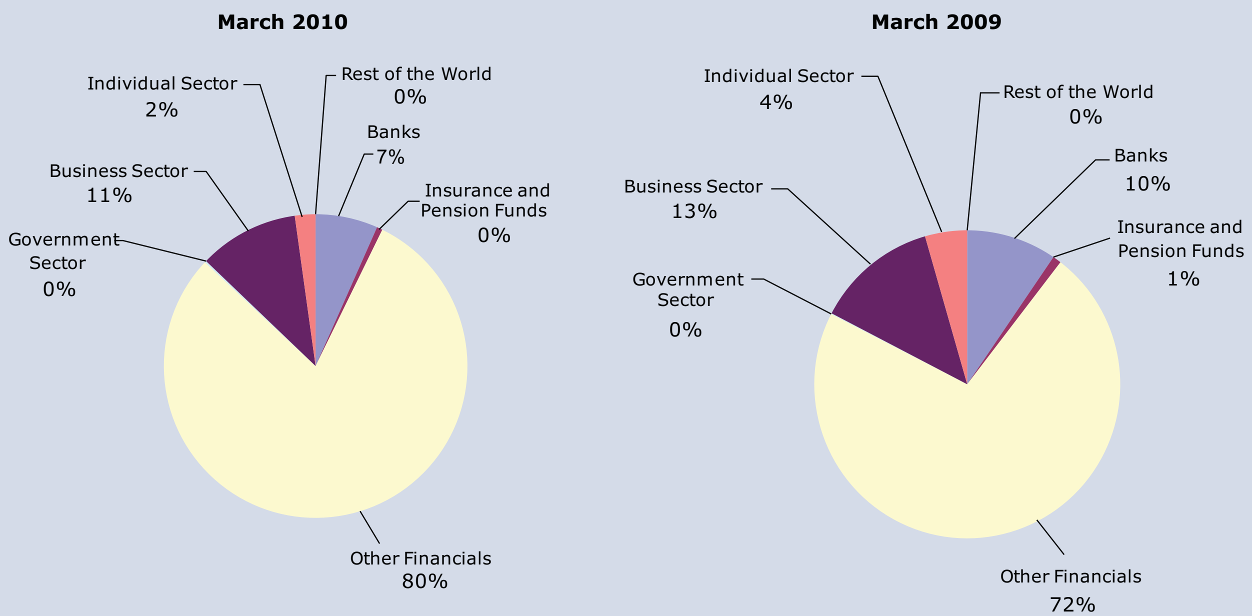
The investor profile for Thai corporate bonds is distinguished by the fact that retail investors are the largest investor class **(Figure 18)**. At end-March 2010, retail investors held about 51% of all corporate bonds, followed by institutional investors with about 37%. Retail investors include individual investors—with a 44.7% share of total corporate bonds—while corporate investors held 6.2%. Institutional investors include contractual savings funds—government pension funds, provident funds, and social security funds—which held 13.5% of the total corporate bonds, followed by insurance companies (8.8%), mutual funds (8.0%), and commercial banks (5.9%).

Figure 16a: Korea's Investor Profile for LCY Corporate Bonds



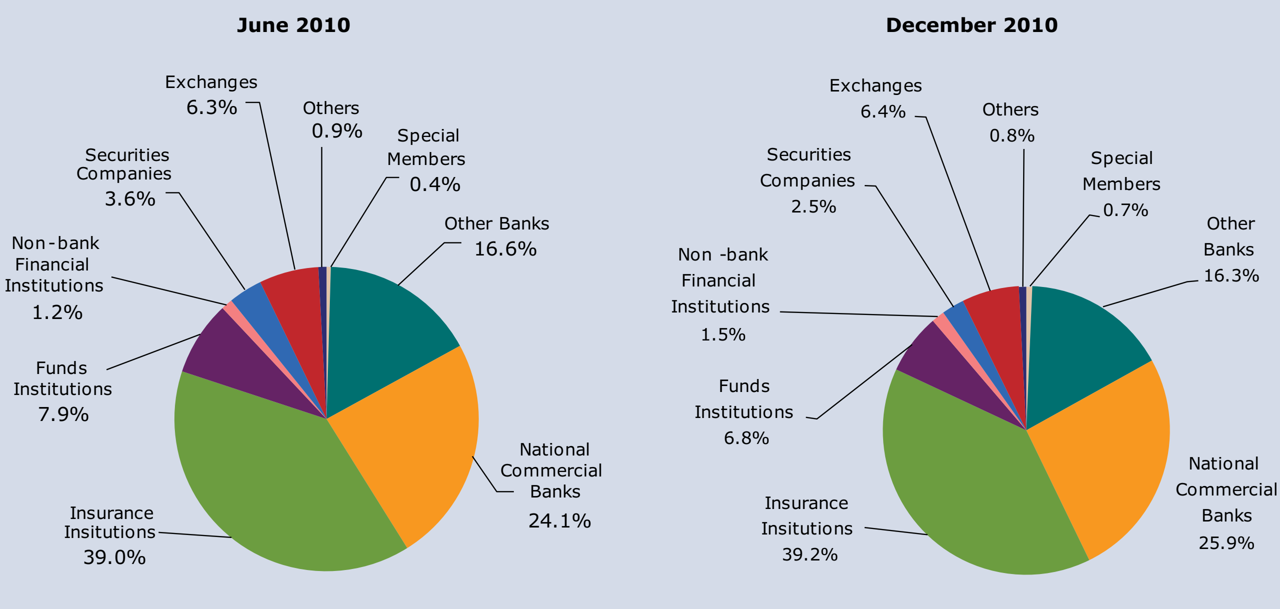
LCY = local currency.
Source: Bank of Korea.

Figure 16b: Korea's Investor Profile for Commercial Paper



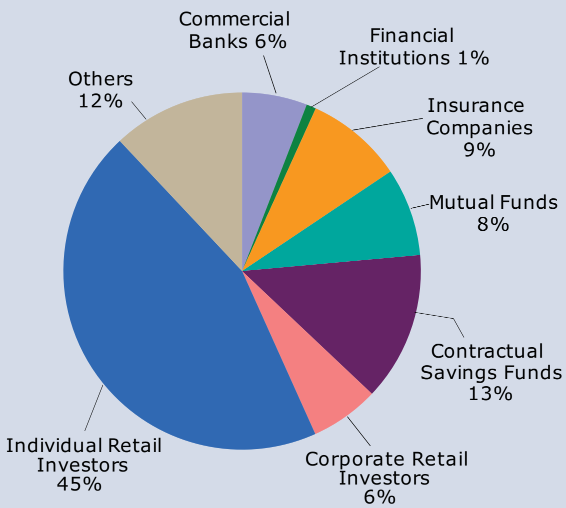
Source: Bank of Korea.

Figure 17: PRC's Investor Profile for Corporate Bonds



Source: *ChinaBond.*

Figure 18: Thailand's Investor Profile for Corporate Bonds, March 2010



Source: Thai Bond Market Association (ThaiBMA).

Market Summaries

People's Republic of China—Update

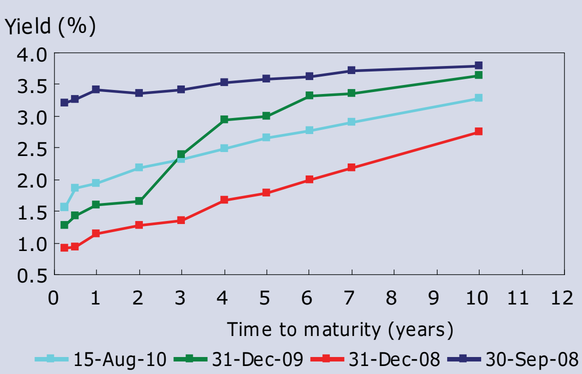
Yield Movements

The government bond yield curve for the People's Republic of China (PRC) flattened between end-December 2009 and mid-August 2010. Yields for maturities ranging from 3 months to 2 years rose significantly, while yields fell for maturities further out along the curve. At the short-end of the curve, yield increases ranged from a low of 29 basis points for the 3-month tenor to a high of 54 basis points for the 2-year tenor. Meanwhile, the yield on the 3-year tenor declined slightly by 8 basis points, while yields posted hefty declines at the longer-end of the curve, ranging from 34 basis points for 5-year bonds to 55 basis points for 6-year bonds **(Figure 1)**.

Due to the rise in short-term yields and a decline in yields for longer-term bonds, the spread between 2- and 10-year government bonds decreased to 110 basis points in mid-August from 199 basis points at end-December.

In 2Q10, the PRC's gross domestic product (GDP) growth rate moderated to 10.3% year-on-year (y-o-y) after having surged to 11.9% in 1Q10. Economic data releases in July pointed towards a continuing moderation of economic growth. Industrial output grew at 13.4% y-o-y in July, down from 13.7% in June. Cumulative (year-to-date) urban fixed-asset investment through July rose 24.9% compared with the same period in 2009. However, for the first 6 months of the year, cumulative urban fixed-asset investment grew 25.5% y-o-y. Finally, new loans extended in July amounted to CNY532.8 billion, compared with CNY603.4 billion in June.

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



LCY = local currency.
Source: Bloomberg LP.

Consumer price inflation stood at 3.1% y-o-y in May, fell to 2.9% in June, and rose to 3.3% in July. The July spike in inflation was expected to be temporary, as it was largely driven by rising food prices brought on by crop destruction due to recent floods. Despite this, inflationary pressures remain due to wage increases earlier in the year and the large amounts of liquidity still in the financial system. The People's Bank of China (PBOC), which in the first half of the year increased requirements for banks' reserve ratios three times in an effort to curb loan growth and asset price inflation, maintained its 1-year lending and deposit rates at 5.31% and 2.25%, respectively.

Size and Composition

The outstanding amount of local currency (LCY) bonds in the PRC reached CNY19.3 trillion at the end of June, representing a y-o-y increase of 22.5% and a quarter-on-quarter (q-o-q) rise of 6.9% **(Table 1)**.

Government bonds outstanding increased 17.0% y-o-y and 6.0% q-o-q in 2Q10, while corporate bonds rose 52.7% y-o-y and 10.4% q-o-q. In the government sector, policy bank bonds posted the highest y-o-y increase, growing 25.1%, followed by central bank and treasury bonds, which posted growth rates of

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

	Amount (billion)								**Growth Rates** (%)						
	Mar-10		**Apr-10**		**May-10**		**Jun-10**		**Mar-10**		**Apr-10**	**May-10**	**Jun-10**		
	CNY	**USD**	**CNY**	**USD**	**CNY**	**USD**	**CNY**	**USD**	**y-o-y**	**q-o-q**	**m-o-m**	**m-o-m**	**y-o-y**	**q-o-q**	**m-o-m**
Total	18,077	2,648	18,504	2,711	18,883	2,765	19,316	2,848	20.7	3.1	2.4	2.0	22.5	6.9	2.3
Government	14,721	2,157	15,016	2,200	15,237	2,232	15,611	2,302	13.5	2.1	2.0	1.5	17.0	6.0	2.5
Treasury Bonds	5,717	837	5,769	845	5,855	858	6,069	895	16.7	(0.4)	0.9	1.5	13.5	6.1	3.6
Central Bank Bonds	4,381	642	4,602	674	4,648	681	4,743	699	0.8	3.5	5.0	1.0	14.0	8.3	2.0
Policy Bank Bonds	4,624	677	4,646	681	4,734	693	4,800	708	24.0	3.9	0.5	1.9	25.1	3.8	1.4
Corporate	3,356	492	3,488	511	3,646	534	3,705	546	67.5	8.2	3.9	4.5	52.7	10.4	1.6
Policy Bank Bonds															
China Development Bank	3,351	491	3,383	496	3,456	506	3,462	510	24.4	4.7	1.0	2.2	25.0	3.3	0.2
Export-Import Bank of China	443	65	433	63	448	66	481	71	37.7	1.1	(2.3)	3.5	42.1	8.4	7.2
Agricultural Dvt. Bank of China	830	122	830	122	830	122	857	126	16.3	2.3	0.0	0.0	17.3	3.3	3.3

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

14.0% and 13.5% respectively. On a q-o-q basis, however, the growth rates of central bank bonds and treasury bonds in 2Q10 outpaced the growth of policy bank bonds. Central bank and treasury bonds expanded 6.1% and 6.0% q-o-q, respectively, while policy bank bonds grew 3.8%, approximating their 1Q10 q-o-q growth rate.

Treasury Investor Profile

Banks remained the largest category of treasury bond investors in the PRC in 2Q10, holding a larger share of these bonds at the end of June 2010 compared with end-June 2009 **(Figure 2)**. In June 2010, banks held 60.4% of treasury bonds outstanding, compared with 56.3% in June 2009. The share held by PRC Special Members dropped to 28.3% in June from 31.7% a year earlier. Special Members comprise the PBOC, Ministry of Finance, policy banks, China Government Securities Depository Trust and Clearing Co., and China Securities Depository and Clearing Corporation.

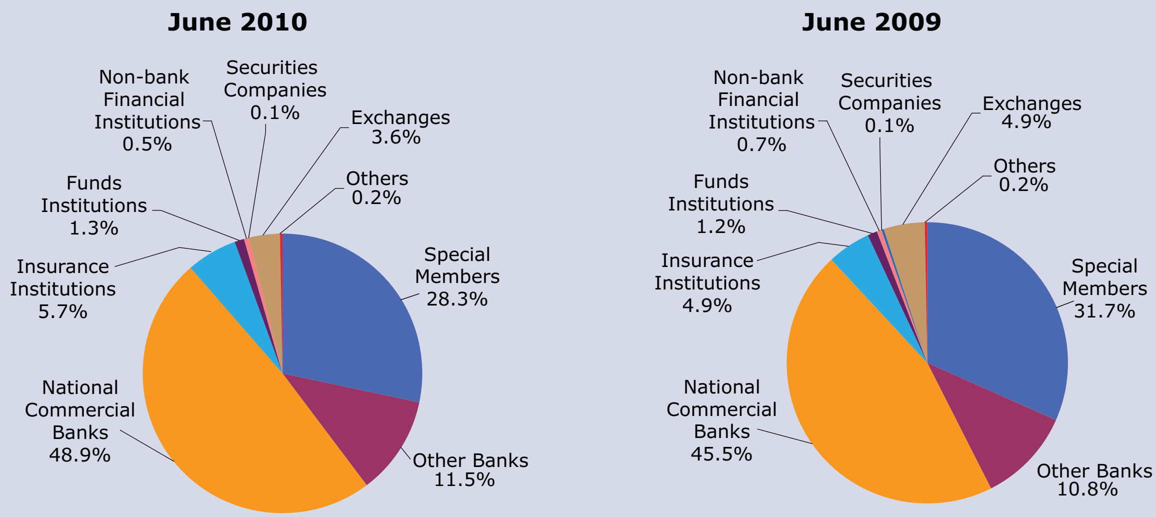
Corporate Bonds

With the exception of asset- and mortgage-backed securities, which have been declining since 2Q09, key sectors of the corporate bond market experienced double-digit y-o-y growth in 2Q10. Medium-term notes (MTNs) grew by 94.4% y-o-y, while commercial paper and local corporate bonds posted growth rates of 60.1% and 56.1%, respectively. Meanwhile, state-owned corporate bonds (or state-owned enterprises [SOE] bonds) grew by 38.2% y-o-y and commercial bank bonds grew 25.1%.

On a q-o-q basis, MTNs, commercial paper, and commercial bank bonds posted higher growth rates in 2Q10 compared with the previous quarter **(Table 2)**. MTNs increased 17.9% q-o-q, compared with 13.2% in the previous quarter. Commercial paper grew 21.0% q-o-q, compared with 11.5% in 1Q10. Meanwhile, commercial bank bonds grew at a more subdued pace of 3.2% q-o-q in 2Q10, up from 0.2% in 1Q10.

In contrast to MTNs and commercial paper, the

Figure 2: Treasury Bonds Investor Profile



Source: *ChinaBond.*

Table 2: Corporate Bonds Outstanding in Key Sectors (CNY billion)

	Amount						Growth Rates (%)						
							q-o-q						y-o-y
	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	2Q10
Commercial Bank Bonds	437.7	486.4	589.2	588.4	589.6	608.5	12.6	11.1	21.1	(0.1)	0.2	3.2	25.1
State-Owned Corporate Bonds (SOE)	526.5	565.3	619.3	720.2	771.1	781.1	0.9	7.4	9.6	16.3	7.1	1.3	38.2
Local Corporate Bonds	196.9	295.7	328.8	376.9	420.0	461.7	24.3	50.1	11.2	14.6	11.4	9.9	56.1
Commercial Papers	409.4	384.3	353.1	456.1	508.8	615.4	(2.6)	(6.1)	(8.1)	29.2	11.5	21.0	60.1
Asset/Mortgage-Backed Securities	56.6	55.4	46.0	39.9	31.1	26.5	2.7	(2.1)	(16.9)	(13.4)	(22.1)	(14.8)	(52.2)
Medium Term Notes	340.8	592.1	742.1	862.2	976.4	1,151.2	103.8	73.7	25.3	16.2	13.2	17.9	94.4

q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Source: *ChinaBond.*

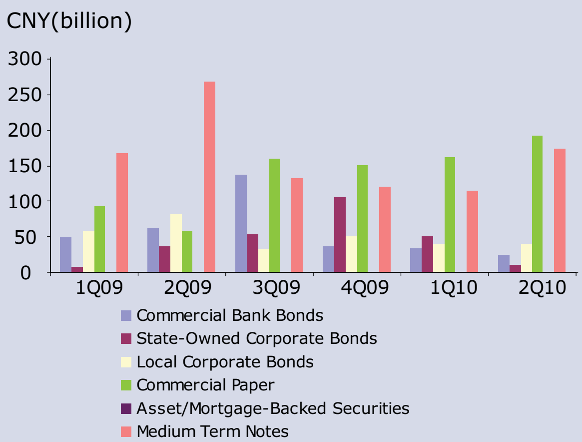
growth rates of SOE bonds and local corporate bonds in 2Q10 declined from the previous quarter. As can be seen in Table 2, the q-o-q growth rate of local corporate bonds declined from 14.6% in 4Q09 to 9.9% in 2Q10, while the growth rate of SOE bonds fell more dramatically, from 16.3% in 4Q09 to 1.3% in 2Q10.

The rise in q-o-q growth figures for MTNs and commercial paper in 2Q10 reflected continued strong corporate sector demand for medium- to short-term funds, access to which has been facilitated by the relatively quick issuance approval processes for these issuance windows.

Consistent with growth in the outstanding amount of MTNs in 2Q10, MTN issuance rebounded from CNY114.9 billion in 1Q10 to CNY174.1 billion in 2Q10, for a q-o-q increase of 51.5%. Issuance of MTNs had been on a downward trend since peaking at CNY268.6 billion in 2Q09 **(Figure 3).** Notable MTN issuers in 2Q10 were China National Petroleum Corporation, Petrochina, and State Grid Corporation of China.

Also in line with the q-o-q increase in commercial paper outstanding, issuance of commercial paper rose 18.2% from CNY162.1 billion in 1Q10 to CNY191.5 billion in 2Q10.

Figure 3: Corporate Bond Issuance in Key Sectors



Source: *ChinaBond.*

Policy, Institutional, and Regulatory Developments

PBOC Signals Greater Yuan Flexibility

On 20 June, the PBOC announced that the yuan's exchange rate would be allowed to adjust based on floating bands. The announcement signaled a move towards a more flexible exchange rate regime. The PBOC, however, ruled out a one-time revaluation of the currency and no timeframe was announced for the shift in policy.

Yuan Settlement Pilot Program Expanded

The PBOC announced on 22 June that it would expand coverage of its pilot yuan settlement program to include the rest of the world. Previously, the program, which allows for use of the yuan for trade settlement, had been limited to members of the Association of Southeast Asian Nations (ASEAN); Macao, China; and Hong Kong, China. The PBOC also expanded the number of provinces and municipalities participating in the pilot program by eighteen. The pilot program was introduced in July 2009. Shanghai and four cities in Guangdong province were the first cities in the PRC to be allowed to settle external trade using the yuan.

Insurance Regulator Sets Rules on Insurers' Investments

The PRC's insurance regulator, the China Insurance Regulatory Commission, issued a detailed set of rules on insurers' investments on 5 August. According to the Provisional Measures on Insurance Capital Uses, insurance companies will not be permitted to invest more than 10% of their assets (as of the most recent quarter) in the property market. The rules also set ceilings on investments in different asset classes. Insurance companies can invest up to 20% of their assets in equities and up to 5% in stakes in unlisted enterprises. Insurers will also be allowed to invest up to 20% of their assets in unsecured corporate bonds and the debt of non-financial firms, and up to 5% in debt associated with infrastructure projects. PRC insurance companies' assets totaled CNY4.5 trillion at the end of 2Q10, with equity investments accounting for 10% of these assets.

Mini-QFII Program Under Consideration

In July, the PRC was reported to be considering the establishment of a "mini-Qualified Foreign Institutional Investor (QFII)" scheme on a pilot basis. Under the scheme, the Hong Kong, China subsidiaries of PRC-based brokerages and fund managers would be permitted to channel offshore yuan back into the PRC's domestic capital markets, providing them with an expanded range of CNY-denominated investment opportunities. The scheme is reportedly set to be implemented in late 2010 or early 2011. The program, along with the opening up of the PRC's interbank bond market to overseas investors (see below), is part of the PRC's efforts to promote international use of the yuan.

PRC Begins to Open Interbank Bond Market to Overseas Investors

On 17 August, the PBOC announced that it would permit non-resident financial institutions greater access to the PRC's interbank bond market as part of a pilot program to promote cross-border yuan trade settlement and broaden investment channels for yuan to flow back to the PRC. Foreign investment in the PRC's capital markets had previously been limited to QFII program participants.

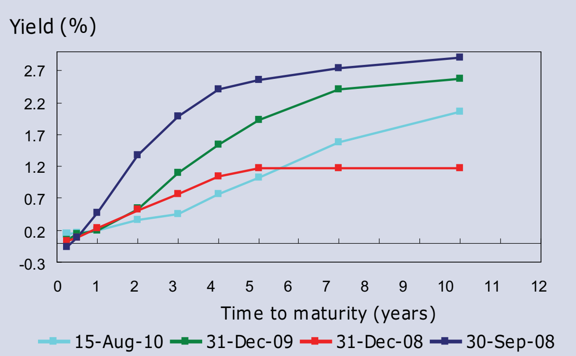
Under the measures announced by the PBOC, central banks, yuan-clearing banks, and banks based in Hong Kong, China and Macao, China that are participating in the PRC's yuan trade settlement program will be allowed to invest their yuan holdings in the PRC's interbank bond market. Institutions approved to participate in the program will be subject to the approval of investment quotas set by the PBOC.

Hong Kong, China—Update

Yield Movements

The yield curve for Hong Kong, China's Exchange Fund Bills and Notes (EFBN) shifted downward between end-December 2009 and mid-August 2010 for maturities of 1-year through 10-years **(Figure 1)**. On the other hand, yields at the short-end of the curve rose slightly by 1–8 basis points. Yields fell the most for the 5-year tenor, shedding 89 basis points. The yield spread between 2-year and 10-year maturities narrowed to 170 basis points in mid-August from 203 basis points at end-December.

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



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

The Hong Kong Monetary Authority (HKMA) has kept its base rate steady at a record-low level of 0.5% since December 2008. Consumer price inflation in Hong Kong, China eased to 1.3% year-on-year (y-o-y) in July from 2.8% in June. The slowdown in the inflation rate was largely due to the government's decision to make rental payments for 2 months on behalf of all public housing tenants. All components of the consumer price index recorded y-o-y increases in July, except for housing and durable goods. In the first 7 months of the year, consumer price inflation reached 2.1% y-o-y.

Hong Kong, China recorded gross domestic product (GDP) growth of 6.5% y-o-y in 2Q10, following revised growth of 8.0% in 1Q10. Domestic demand remained resilient as private consumption increased by 4.6% y-o-y in 2Q10 on account of the improving economic situation and rising incomes. Also, investment spending surged 15.2% y-o-y from 8.2% in 1Q10. Merchandise exports remained strong, expanding by 20.1% y-o-y in 2Q10, boosted by growth in many Asian markets and further recovery in import demand.

Size and Composition

At the end of June, Hong Kong, China's local currency (LCY) bonds outstanding reached HKD1.2 trillion (USD159 billion) for y-o-y growth of 43.3% **(Table 1)**. On a quarter-on-quarter (q-o-q) basis, LCY bonds outstanding grew by 2.7% in 2Q10.

Total government bonds outstanding—comprising exchange fund bills (EFB), exchange fund notes (EFN), and Hong Kong Special Administrative Region (HKSAR) bonds—grew by a notable 131.4% to HKD667 billion (USD86 billion) in 2Q10. The growth in government bonds is largely attributed to the 164.4% y-o-y increase in EFBs to HKD581 billion (USD75 billion). EFBs account for 87% of Hong Kong, China's government bonds. On the other hand, the stock of EFNs only grew by 2.3% y-o-y to HKD70 billion (USD9 billion) in 2Q10.

Meanwhile, the stock of HKSAR bonds rose to HKD16 billion (USD2 billion) at the end of June. In May, HKD3 billion of 10-year government bonds were sold under the Institutional Bond Issuance Programme. The bonds were well received by institutional investors, with tenders reaching HKD8 billion, and carried an annualized yield of 2.955%. This was followed by another HKD1.5 billion issue of 5-year government bonds in June. The bonds were oversubscribed with demand reaching HKD4.8 billion. The 5-year bonds carried an annualized yield of 1.658%.

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

	Amount (billion)								Growth Rate (%)						
	Mar-10		Apr-10		May-10		Jun-10		Mar-10		Apr-10	May-10	Jun-10		
	HKD	USD	HKD	USD	HKD	USD	HKD	USD	y-o-y	q-o-q	m-o-m	m-o-m	y-o-y	q-o-q	m-o-m
Total	1,204	155	1,220	157	1,238	159	1,237	159	53.3	8.4	1.3	1.5	43.3	2.7	(0.1)
Government	624	80	643	83	665	85	667	86	185.1	16.8	3.1	3.4	131.4	6.9	0.3
Exchange Fund Bills	542	70	561	72	581	75	581	75	259.2	16.8	3.5	3.5	164.4	7.1	0.0
Exchange Fund Notes	70	9	70	9	70	9	70	9	3.2	0.6	0.0	(0.9)	2.3	0.1	1.0
HKSAR Bonds	12	1.5	12	1.5	15	2	16	2	—	—	0.0	26.1	—	39.1	10.3
Corporate	580	75	577	74	573	74	569	73	2.4	0.5	(0.6)	(0.6)	(0.9)	(1.9)	(0.6)

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

Corporate bonds outstanding in Hong Kong, China in 2Q10 fell by 0.9% y-o-y and 1.9% q-o-q to HKD569 billion (USD73 billion). The top 20 non-bank corporate issuers in Hong Kong, China accounted for almost 15% of total corporate bonds outstanding in 2Q10 **(Table 2)**. The Hong Kong Mortgage Corporation was Hong Kong, China's top corporate issuer of LCY bonds with bonds outstanding reaching HKD26.4 billion at the end of June, followed by Sun Hung Kai Properties (Capital Market) Limited with bonds outstanding of HKD9.1 billion, and CLP Power Hong Kong Financing Limited with bonds of HKD8.5 billion.

At the end of June, corporate bond issuance had declined 34.0% y-o-y to reach HKD38.2 billion (USD4.9 billion).

Table 2: Top 20 Non-Bank Corporate Issuers, June 2010

Top 20 Non-Bank Corporate Issuers	Outstanding Amount	
	LCY Bonds (HKD billion)	LCY Bonds (USD billion)
The Hong Kong Mortgage Corporate Limited	26.39	3.39
Sun Hung Kai Properties (Capital Market) Ltd.	9.13	1.17
CLP Power Hong Kong Financing Limited	8.52	1.09
Kowloon-Canton Railway Corporation	6.60	0.85
MTR Corporation (C.I.) Ltd.	5.35	0.69
Swire Pacific MTN Financing Limited	4.10	0.53
Hongkong Electric Finance Ltd.	3.50	0.45
Airport Authority Hong Kong	3.10	0.40
Cheung Kong Bond Finance Limited	2.95	0.38
HKCG (Finance) Limited	2.76	0.35
Bauhinia MBS Limited	2.66	0.34
The Link Finance (Cayman) 2009 Limited	2.10	0.27
Urban Renewal Authority	1.50	0.19
Hysan (MTN) Ltd.	1.20	0.15
Wharf Finance (No. 1) Ltd.	1.03	0.13
Wharf Finance Ltd.	1.01	0.13
Cheung Kong Finance (MTN) Ltd.	0.80	0.10
Hong Kong Link 2004 Limited	0.79	0.10
Wharf Finance (BVI)	0.65	0.08
The Hong Kong Land Notes Company Limited	0.20	0.03
Swire Pacific Finance Int'l Limited	0.20	0.03
Total	**84.53**	**10.86**

LCY = local currency.
Note:
Based on Central Money Markets Unit (CMU) data on tradeable non-bank debt securities issued and still outstanding as of 29 June 2010.
Source: Hong Kong Monetary Authority.

Policy, Institutional, and Regulatory Developments

HKMA and PBOC Signs Supplementary Memorandum of Cooperation on Yuan Transactions

On 19 July, the HKMA and People's Bank of China (PBOC) signed a supplementary memorandum of cooperation regarding the expansion of the existing yuan trade settlement scheme. The HKMA and PBOC have agreed to strengthen cooperation and further promote Hong Kong, China's status as a yuan market platform in an effort to develop more CNY-denominated business outside of the PRC.

Also, the PBOC and Bank of China (Hong Kong) signed a revised settlement agreement on yuan clearing. According to the HKMA, following the revision of the settlement agreement, there will no longer be restrictions on banks in Hong Kong, China on establishing yuan accounts for and providing related services to financial institutions. In addition, individuals and corporations will be able to conduct yuan payments and transfers through banks. As a result, many types of CNY-denominated financial intermediation are expected to be introduced in Hong Kong, China.

Indonesia—Update

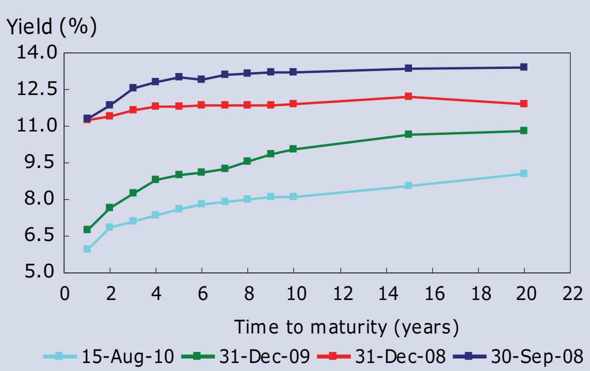
Yield Movements

Indonesia's government bond yield curve shifted downward between end-December 2009 and mid-August 2010 as yields fell for all maturities **(Figure 1)**. The government bond yield curve flattened from the short-end to the long-end of the curve. Yields fell the most for the 15-year tenor, shedding 209 basis points. The yield spread between 2-year and 10-year maturities narrowed to 124 basis points in mid-August from 241 basis points at end-December.

Yields for treasury bills have fallen below the Bank Indonesia (BI) rate. The new regulation requiring a 1-month holding period for *Sertifikat* Bank Indonesia (SBI) has led investors to switch funds and invest in treasury bills. This has bolstered the demand for treasury bills and resulted in a much lower yield rate. As of mid-August, 1-year bills returned a yield of only 5.968%.

BI has kept its benchmark interest rate at a record-low level of 6.5% since August 2009. According to BI, it is closely monitoring the recent rise in inflation and the current BI rate remains adequate to safeguard against expectations of future inflation. Consumer price inflation rose sharply to 6.22% year-on-year (y-o-y) in July, compared with 5.05% y-o-y in June, mainly due to rising food prices and an electricity price hike that took effect on 1 July. For the first 7 months of the year, inflation stood at 4.02%, which was still within the central bank's annual inflation target of 4.0%–6.0%.

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



LCY = local currency.
Source: Bloomberg LP.

Gross domestic product (GDP) grew 6.2% y-o-y in 2Q10 on account of strong household consumption and domestic investment, as well as continued recovery in exports. GDP growth in 2Q10 was up from the 5.7% y-o-y growth recorded in 1Q10. Household consumption expanded 5.0% y-o-y, while exports and investments grew 14.6% and 8.0% y-o-y, respectively. Most major sectors recorded higher annual growth in 2Q10, compared with the previous quarter, led by manufacturing which expanded 4.3% y-o-y. On a quarter-on-quarter (q-o-q) basis, Indonesia's GDP expanded 2.8% in 2Q10, following a 1.9% expansion in 1Q10. For the full year 2010, the Ministry of Finance estimated a growth target of 5.8% based on the 2010 revised state budget.

Size and Composition

The size of Indonesia's local currency (LCY) bond market expanded 13.8% y-o-y as of end-June, with the total volume of LCY bonds outstanding reaching IDR985.4 trillion (USD109 billion) **(Table 1)**. On a q-o-q basis, however, growth in LCY bonds outstanding remained flat from 1Q10.

Total government bonds outstanding climbed 13.5% y-o-y to IDR892.3 trillion (USD99 billion), with both central government bonds (issued by the Ministry of Finance) and central bank bonds (issued by BI in the form of SBI) posting double-digit growth. The stock of central government bonds increased 12.3% y-o-y in 2Q10, higher than the 8.5% y-o-y growth in 1Q10. On a q-o-q basis, central government bonds rose 4.7% in 2Q10, following a 2.0% q-o-q rise in 1Q10.

The government continued to implement a strategy of frontloading its financing requirements

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

	Amount (billion)								**Growth Rate** (%)						
	Mar-10		**Apr-10**		**May-10**		**Jun-10**		**Mar-10**		**Apr-10**	**May-10**	**Jun-10**		
	IDR	**USD**	**IDR**	**USD**	**IDR**	**USD**	**IDR**	**USD**	**y-o-y**	**q-o-q**	**m-o-m**	**m-o-m**	**y-o-y**	**q-o-q**	**m-o-m**
Total	985,619	108	1,042,418	116	1,002,121	109	985,359	109	15.6	6.0	5.8	(3.9)	13.8	(0.03)	(1.7)
Government	893,420	98	949,945	105	910,185	99	892,328	99	14.6	6.2	6.3	(4.2)	13.5	(0.1)	(2.0)
Central Govt Bonds	593,165	65	603,280	67	609,677	66	621,226	69	8.5	2.0	1.7	1.1	12.3	4.7	1.9
Central Bank Bills	300,255	33	346,666	38	300,509	33	271,103	30	29.0	15.5	15.5	(13.3)	16.5	(9.7)	(9.8)
Corporate	92,199	10	92,473	10	91,936	10	93,030	10	25.8	4.2	0.3	(0.6)	16.5	0.9	1.2

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

through the issuance of bonds in the domestic and global markets. In 2010, the government had raised about IDR128.3 trillion worth of bonds as of 3 August, which was equivalent to about 72.1% of its original target (gross) of IDR178.0 trillion. The Ministry of Finance also announced that it will reduce its issuance of debt securities as the budget deficit is now expected to be equivalent to only 1.5% of GDP, compared with an original estimate of 2.5% of GDP in the 2010 revised state budget. Since the beginning of the year, the government has issued various types of debt securities, including conventional and Islamic (*sukuk*) debt instruments.

In June, the Ministry of Finance conducted a buy-back of short-dated government debt in exchange for longer-tenor paper. The swap allowed investors to exchange bonds maturing between 2011 and 2013 for 10-year bonds maturing in 2020. The debt exchange was valued at IDR80 billion.

In August, the government raised IDR8.0 trillion from the sale of its seventh series of retail bonds. The government initially planned to raise IDR5.0 trillion, but increased its target to IDR8.0 trillion amid strong demand from investors. The retail bonds carried a maturity of 3 years with a coupon of 7.95%.

The growth in central bank bills, while remaining positive, eased to 16.5% y-o-y in 2Q10, compared with 29.0% in 1Q10. On a q-o-q basis, the growth of central bank bills fell by 9.7% q-o-q, following growth of 15.5% in 1Q10. The lower growth rate in 2Q10 can be attributed to new regulations imposed by BI that seek to encourage banks to manage liquidity over a longer period and support more active transactions in the interbank market. In addition, the auction of SBI was changed from a weekly basis to a monthly basis in June. BI has pushed for longer-tenor maturities with issuance to include more 3-month and 6-month tenors as a replacement for 1-month tenors. BI also announced a policy package to strengthen monetary management and develop financial markets, which is discussed in detail in the Policy, Institutional, and Regulatory Developments section.

Table 2: Top 30 Corporate Issuers, June 2010

Top 30 Corporate Issuers	Outstanding Amount		
	LCY Bonds (IDR billion)	**LCY Bonds** (USD billion)	**FCY Bonds** (USD billion)
PLN	12,100	1.34	4.00
Indosat	8,090	0.89	0.34
Bank Tabungan Negara	4,900	0.54	—
Jasa Marga	4,150	0.46	—
Bank Panin	3,900	0.43	—
Indofood Sukses Makmur	3,610	0.40	—
Bank Mandiri	3,500	0.39	—
Perum Pegadaian	3,000	0.33	—
Astra Sedaya Finance	2,862	0.32	—
Federal International Finance	2,845	0.31	—
Bank Ekspor Indonesia	2,541	0.28	—
Oto Multiartha	2,500	0.28	—
Bank Tabungan Pensiunan Nasional	2,050	0.23	—
Bank Rakyat Indonesia	2,000	0.22	—
Bank Jabar	1,750	0.19	—
Excelcom	1,500	0.17	0.25
Medco Energi Internasional	1,500	0.17	0.28
Bentoel	1,350	0.15	—
Berlian Laju Tanker	1,340	0.15	0.13
Bank Danamon	1,250	0.14	—
Danareksa	1,080	0.12	—
Bank Negara Indonesia	1,000	0.11	0.10
Bank Mega	1,000	0.11	—
Bank OCBC NISP	880	0.10	—
BCA Finance	850	0.09	—
Pupuk Kaltim	791	0.09	—
WOM Finance	775	0.09	—
Bank DKI	750	0.08	—
Salim Ivomas Pratama	730	0.08	—
Lontar Papyrus	725	0.08	—
Total Top 30 Corporate Issuers	**75,319**	**8.32**	
Total Corporate Bonds Outstanding	**93,030**	**10.28**	
Top 30 as % of Total Corporate	**80.96%**	**80.96%**	

FCY = foreign currency, LCY = local currency.
Source: Indonesia Stock Exchange.

Following these new regulations, BI issued SBI with 9-month maturities for the first time in August. At present, investors no longer hold 1-month SBI.

Meanwhile, corporate bonds outstanding rose to IDR93.0 trillion (USD10 billion) in 2Q10, expanding 16.5% y-o-y, compared with 25.8% in 1Q10. On a q-o-q basis, corporate bonds grew by only 0.9% in 2Q10.

As of end-June, the top 30 corporate issuers in Indonesia accounted for about 81% of total corporate bonds outstanding **(Table 2)**. State-power firm PLN remained Indonesia's top corporate issuer of LCY bonds, with total outstanding bonds valued at IDR12.1 trillion. Telecommunications firm PT Indosat ranked second with IDR8.1 trillion in outstanding LCY bonds, while Bank Tabungan Negara was third with outstanding LCY bonds of IDR4.9 trillion. About half of the top 30 LCY bond issuers were from the financial sector. Most were banks that were raising funds to help boost their capital adequacy ratios and fund lending activities.

Among Indonesia's top 30 corporate issuers, only six companies have issued foreign currency (FCY)-denominated bonds. Indonesia's top LCY issuer, PLN, has issued FCY bonds that are the equivalent of nearly three times its outstanding LCY bonds. PLN also issues both conventional bonds and *sukuk*. In contrast, Indosat has issued FCY bonds that are the equivalent of about one-third of its outstanding LCY bonds.

In 2Q10, corporate bond issuance reached IDR7.3 trillion (USD0.8 billion), primarily comprising issuance from financial sector firms. Most of the bonds issued in 2Q10 had coupons of 10% or more and were consistently over-subscribed. Notable issues in 2Q10 are listed in **Table 3**.

State-owned lender Bank Tabungan Negara raised nearly IDR1.7 trillion worth of bonds in June. The bonds carried a maturity of 10 years and a coupon of 10.25%. The bonds were oversubscribed with total order book reaching IDR3.4 trillion.

Table 3: Notable Corporate Issuance in 2Q10

Corporate Issuers	Amount Issued (IDR billion)
Bank Tabungan Negara	1,650
Federal International Finance	1,500
Bank Tabungan Pensiun Nasional	1,300
Bank OCBC NISP	1,000
Bank Sulut	500
Titan Petrokimia Nusantara	273
Reliance Securities	40
Total	**6,263**

Source: Indonesia Stock Exchange.

Motorcycle-financing firm Federal International Finance issued bonds worth IDR1.5 trillion in four tranches in April. The bonds consisted of the following tranches:

(i) 1-year bonds worth IDR300 billion, coupon of 8.10%;

(ii) 2-year bonds worth IDR200 billion, coupon of 8.75%;

(iii) 3-year bonds worth IDR400 billion, coupon of 10.15%; and

(iv) 4-year bonds worth IDR600 billion, coupon of 10.55%.

Mid-sized lender Bank Tabungan Pensiun Nasional sold IDR1.3 trillion in bonds in May with maturities of 3–5 years. The bonds consisted of the following tranches:

(i) 3-year bonds worth IDR715 billion, coupon of 9.90%; and

(ii) 5-year bonds worth IDR585 billion, coupon of 10.6%.

Leasing company Oto Multiartha issued IDR1.3 trillion in bonds in a four-tranche deal in June, which was an increase from its initial plan of only IDR1.0 trillion. The bonds consisted of the following tranches:

(i) 370-day bonds worth IDR300 billion, coupon of 7.90%;

(ii) 2-year bonds worth IDR225 billion, coupon of 8.70%;

(iii) 3-year bonds worth IDR575 billion, coupon of 10.05%; and

(iv) 4-year bonds worth IDR200 billion, coupon of 10.65%.

Also in June, Bank OCBC NISP raised IDR880 billion from a 7-year subordinated bond issue. The subdebt issue carried a coupon of 11.35%.

Foreign Currency Bonds

In August, the government cancelled its planned issue of FCY-denominated *sukuk*. The global *sukuk* issuance has been re-scheduled for early next year.

Rating Changes

In June, Moody's Investor Service (Moody's) revised the outlook for Indonesia's sovereign credit rating to positive. The revised outlook applies to the Ba2 level for Indonesia's LCY and FCY sovereign ratings, as well as to the Ba1 FCY bond ceiling and Ba3 FCY deposit ceiling. According to Moody's, the positive outlook reflects the country's capacity for sustained strong growth, the overall stability and effectiveness of the government's fiscal and monetary policies, and expectations of further improvements in the government's financial and debt positions.

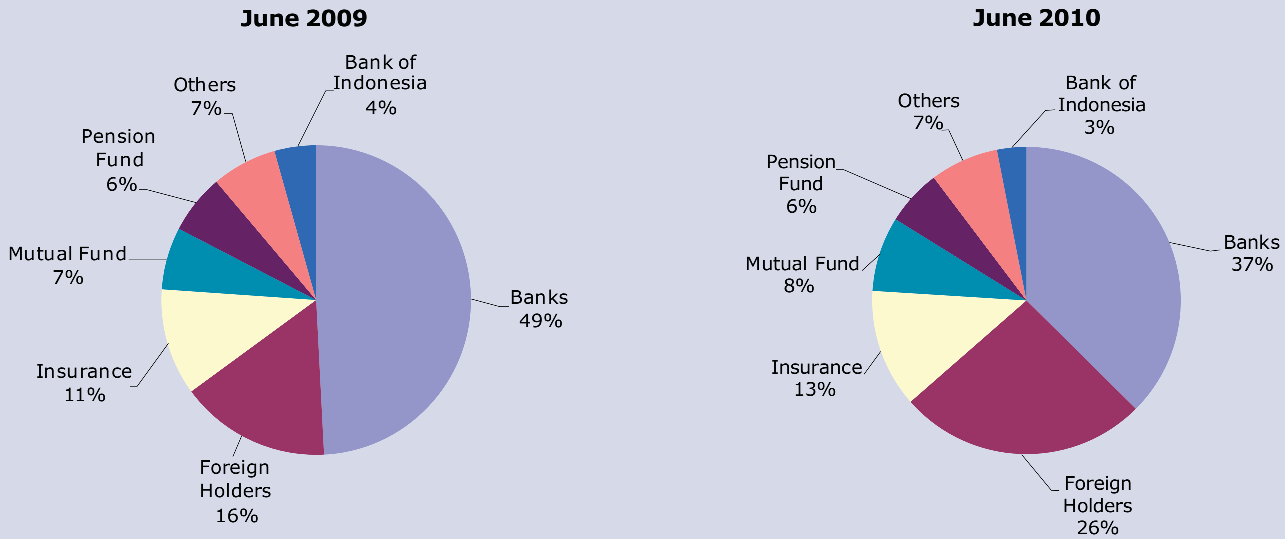
Indonesia's sovereign rating was also raised to investment grade by Japan Credit Rating Agency (JCR) on 13 July. Specifically, Indonesia's FCY long-term debt and LCY long-term debt were upgraded by JCR to BBB- from BB+ and BBB from

Table 4: Selected Sovereign Ratings and Outlook for Indonesia

	Moody's	S&P	Fitch
Sovereign FCY LT Ratings	Ba2	BB	BB+
Outlook	positive	positive	stable

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

Figure 2: LCY Government Bonds Investor Profile



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

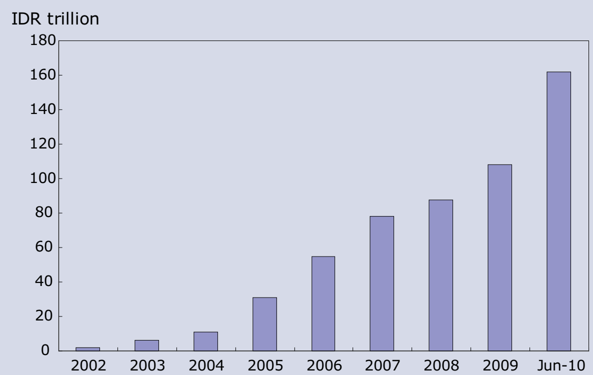
BBB-, respectively, while the ratings outlook for both was stable. According to JCR, the upgrade reflects the country's sustained growth, which is being accompanied by strong domestic demand, a reduced public debt burden, increased resilience to external shocks, improved political and social stability, as well as government efforts to deal with structural issues.

Investor Profile

As of end-June, banking institutions remained the biggest holders of Indonesian LCY government bonds, with holdings equivalent to 38% of total central government bonds outstanding **(Figure 2)**. However, the banks' share of total holdings has declined significantly in recent years. In 2002, banks were holding as much as 82% of total government bonds outstanding.

Foreign investors were the second biggest holder of Indonesian central government bonds as of end-June. Foreign investors' share in LCY bonds has exhibited an upward trend from less than 1% in 2002 to 26% in 2Q10. As of end-June, bonds held by foreign investors reached IDR162.1 trillion **(Figure 3)**.

Figure 3: Foreign Holdings of Government Bonds



Source: Indonesian Debt Management Office.

As of end-June, about 72% of bonds held by foreigners were invested in long-dated tenors, or those with maturities of 5 years and above. On the other hand, only 10% of bonds held by foreigners carried maturities of 2 years and below.

Meanwhile, the share in LCY bond holdings of insurance companies (12%) and mutual funds (8%) also increased as of end-June compared to their levels 1 year ago.

Policy, Institutional, and Regulatory Developments

Policy Package to Strengthen Monetary Management and Develop Financial Markets

In June, BI announced a policy package that aimed to boost the effectiveness of monetary policy transmission, shore up financial system stability, and encourage financial market deepening. The package includes the following measures:

(i) Effective 17 June, BI widened the range of its overnight interbank money market rate from 6.0%–7.0% to 5.5%–7.5%.

(ii) Effective 1 July, the net open position holding limit of foreign exchange by banks was capped at 20% of capital.

(iii) Effective 7 July, a minimum 1-month holding period is required for investors of SBI with 1-month maturities. Also, new monetary instruments in the form of term deposits were introduced.

(iv) BI began issuing longer-tenor SBI with maturities of 9-months, effective the second week of August, and 12-months, effective the second week of September.

(v) By 2011, BI will introduce three-party repurchases of government bonds.

According to BI, these policies are not being instituted to control the foreign exchange market, but rather to support sustainable macroeconomic stability and strengthen the momentum of economic recovery.

Debt Issuance to be Trimmed

In late July, the Ministry of Finance reported that government spending was sluggish in the first half of the year, resulting in a lower-than-projected budget deficit for 2010. The government managed to spend only IDR395.8 trillion, or 35.1% of the target set in the 2010 revised state budget, in the first half of the year. Revenue collection reached 44.7% of the annual target. This resulted in a budget surplus amounting to IDR47.9 trillion in the first half of 2010. The Ministry of Finance now estimates a deficit equivalent to only 1.5% of GDP for the year as a whole, compared with its earlier forecast of 2.1%.

In line with this development, the government will trim its remaining debt issuance by 26%. The debt issuance target will be reduced by IDR15 trillion out of the IDR58 trillion worth of debt still to be issued in 2010.

Treasury Bill Issuance to be Reduced

The government is considering a plan to reduce treasury bill issuance due to strong foreign capital flows into various commercial paper, especially short-term bonds. To curb hot money flows, the government may try to align its policies with the BI policy of channeling foreign capital towards long-term investments.

In mid-August, Rahmat Waluyanto, Director General of Debt Management announced that the Ministry of Finance will reduce treasury bill issuance to control refinancing risks. He explained that the value of short-term treasury bonds with tenures of less than 5 years (including treasury bills) accounts for 18% of total IDR-denominated treasury notes. In the future, this percentage will be cut to less than 10% to attract more capital into the long-term treasury bond market to lessen the market's vulnerability to the risk of capital flight.

BI Announces New Regulations on Reserve Requirements and Bank Lending

In September, BI announced new regulations on reserve requirements and bank lending to help contain inflation and boost economic growth. Beginning in November, the primary reserve requirement will be raised to 8.0% of deposits—from 5.0%—while the secondary reserve requirement will remain at 2.5%. Banks that are able to comply with the new primary reserve requirement will earn 2.5% interest on the amount covering the

3 percentage points increase in primary reserves. On the other hand, those banks that fail to meet the new 8.0% primary reserve requirement will be fined the equivalent of 125% of the average 1-day overnight Jakarta Interbank Offered Rate (JIBOR). BI also announced a new regulation designed to give banks incentives for maintaining their loan-to-deposit ratio within a range of 78%–100%, effective 1 March 2011.

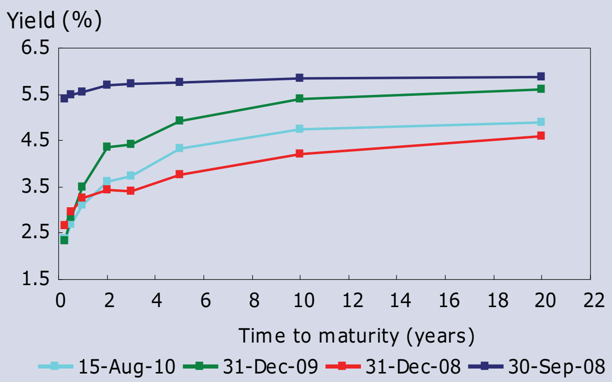
Republic of Korea—Update

Yield Movements

Government bond yields for the Republic of Korea (Korea) for most maturities were down as of mid-August 2010 from their end-December 2009 levels **(Figure 1)**. Yield movements were marginal and mixed for tenors of less than 1 year, while yields for 1-, 2-, 3-, and 5-year maturities dropped 36, 75, 68, and 60 basis points, respectively. Yields for longer-term tenors also fell, by 64 basis points for 10-year maturities and 71 basis points for 20-year maturities. Meanwhile, Korea's yield spreads between 2- and 10-year tenors widened 11 basis points between end-December and mid-August.

The accommodative monetary policy stance of the Bank of Korea (BOK), relatively low interest rates, and increasing foreign investor interest in Korean bonds have all contributed to the decline in government bond yields. Based on Financial Supervisory Service (FSS) data, as of August, foreigners held KRW44.0 trillion of Korean Treasury bonds (KTBs), compared with KRW27.5 trillion in December, and KRW30.0 trillion of monetary stabilization bonds (MSBs), compared with KRW28.2 trillion in December. There was a huge increase in the People's Republic of China's (PRC) holdings of KTBs in 1H10, with holdings surging 111% to KRW4.0 trillion in June from KRW1.9 trillion in December.

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



LCY = local currency.
Source: Bloomberg LP.

In September, the BOK kept its base rate—the 7-day repurchase rate—steady at 2.25%. The BOK noted that it continues to maintain an accommodative monetary policy to ensure price stability and sustain Korea's sound growth. In 2Q10, Korea's gross domestic product (GDP) expanded 7.2% year-on-year (y-o-y) and 1.4% quarter-on-quarter (q-o-q) on the back of buoyant export growth, rising domestic demand, and a solid performance in the manufacturing sector. Consumer price inflation in August remained the same as in the previous 2 months at 2.6% y-o-y.

Size and Composition

Korea's total local currency (LCY) bonds outstanding rose 9.6% y-o-y and 1.5% q-o-q to KRW1,256.6 trillion (USD1,029 billion) in June **(Table 1)**. The expansion in the size of Korea's LCY bond market was led by positive growth in both government bonds and corporate bonds.

The total amount of LCY government bonds in Korea reached KRW558.9 trillion (USD458 billion) at the end of June, a 5.9% increase from June 2009. This increase was driven by central government bonds, which climbed 14.8% y-o-y to KRW357.5 trillion (USD293 billion), mainly led by a 16.5% y-o-y increase in KTBs. MSBs, which are issued by the BOK, rose 1.2% y-o-y and 3.4% q-o-q to KRW167.6 trillion (USD137 billion). The largest government bond issues in 2Q10 included KRW12.0 trillion of 2-year MSBs with a coupon of 3.62%, and KRW3.5 trillion of 10-year KTBs with a 5.0% coupon.

Korea's LCY corporate bonds outstanding expanded 12.7% y-o-y and 2.0% q-o-q to KRW697.7 trillion (USD571 billion) in June. This expansion stemmed from 36.7% y-o-y growth in special public bonds as well as 8.0% y-o-y growth in private corporate bonds, more than offsetting the 1.4% y-o-y decline in financial debentures. As of June, private corporate bonds remained the largest type of

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

	Amount (billion)								Growth Rate (%)						
	Mar-10		Apr-10		May-10		Jun-10		Mar-10		Apr-10	May-10	Jun-10		
	KRW	USD	KRW	USD	KRW	USD	KRW	USD	y-o-y	q-o-q	m-o-m	m-o-m	y-o-y	q-o-q	m-o-m
Total	1,238,390	1,095	1,243,126	1,119	1,255,894	1,043	1,256,605	1,029	13.7	4.7	0.4	1.0	9.6	1.5	0.1
Total Government	554,368	490	559,651	504	562,349	467	558,900	458	11.2	7.2	1.0	0.5	5.9	0.8	(0.6)
Central Bank Bonds	162,120	143	165,050	149	162,440	135	167,610	137	12.1	8.6	1.8	(1.6)	1.2	3.4	3.2
Central Government Bonds	356,875	316	361,785	326	367,118	305	357,475	293	17.6	7.3	1.4	1.5	14.8	0.2	(2.6)
Industrial Finance Debentures	35,372	31	32,816	30	32,791	27	33,815	28	(29.8)	0.9	(7.2)	(0.1)	(33.2)	(4.4)	3.1
Corporate	684,022	605	683,475	615	693,545	576	697,705	571	15.8	2.7	(0.1)	1.5	12.7	2.0	0.6

LCY = local currency, m-o-m = month-on-month, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Note:
1. Calculated using data from national sources.
2. Central government bonds include Treasury bonds, National Housing bonds, and Seoul Metropolitan Subway bonds.
3. Bloomberg end-of-period LCY–USD rates are used.
4. Growth rates are calculated from LCY base and do not include currency effects.
Source: Bank of Korea and *KoreaBondWeb*.

Table 2: Top 10 Issuers of LCY Special Public Bonds in Korea, June 2010

Issuer	Outstanding Amount		
	LCY Bonds (KRW billion)	**LCY Bonds** (USD billion)	**FCY Bonds** (USD billion)
1. Korea Land & Housing Corp.	51,385	42.1	2.4
2. Korea Housing Finance Corp.	31,001	25.4	0.0
3. Korea Deposit Insurance Corp.	27,381	22.4	0.0
4. Korea Finance Corp.	20,780	17.0	0.1
5. Korea Electric Power Corp.	20,150	16.5	3.2
6. Korea Highway	16,440	13.5	0.8
7. Small & Medium Business Corp.	14,723	12.1	0.4
8. Korea Gas Corp.	10,220	8.4	2.0
9. Korea Rail Network Authority	9,905	8.1	0.3
10. Korea Railroad Corp.	6,560	5.4	0.8
Total Top 10	**208,545**	**170.7**	
Total LCY Special Public Bonds	**235,082**	**192.5**	
Top 10 as % of Total LCY Special Public Bonds	**88.7%**	**88.7%**	

FCY = foreign currency, LCY = local currency.
Source: *AsianBondsOnline*, Bloomberg LP, and *KoreaBondWeb*.

corporate bonds in Korea at KRW252.1 trillion (USD206 billion), followed by special public bonds at KRW235.1 trillion (USD193 billion), and financial debentures at KRW210.5 trillion (USD172 billion).

The top 10 issuers of LCY special public bonds as of end-June had a combined KRW208.5 trillion (USD171 billion) of bonds outstanding and accounted for about 89% of total LCY special public bonds outstanding **(Table 2)**. Among the largest issuers of LCY special public bonds were Korea Land Housing Corp., Korea Housing Finance Corp., and Korea Deposit Insurance Corp. Eight of the top 10 LCY special public bond issuers also had foreign currency (FCY) bonds outstanding, with the largest amount of FCY bonds being issued by Korea Electric Power Corp.

The outstanding amount of LCY financial debentures of the top 10 Korean issuers (excluding Korea Development Bank) as of June amounted to KRW174.7 trillion (USD143 billion), which comprised 83% of the country's total financial debentures **(Table 3)**. The largest three issuers of LCY financial

Table 3: Top 10 Issuers of LCY Financial Debentures in Korea (as of June 2010)

Issuer	Outstanding Amount		
	LCY Bonds (KRW billion)	**LCY Bonds** (USD billion)	**FCY Bonds** (USD billion)
1. Industrial Bank of Korea	38,056	31.2	5.3
2. Kookmin Bank	35,484	29.1	3.2
3. Woori Bank	22,322	18.3	6.1
4. Shinhan Bank	19,817	16.2	2.8
5. Nonghyup	15,924	13.0	2.9
6. Hana Bank	15,486	12.7	2.8
7. Shinhan Card	9,019	7.4	0.7
8. Export-Import Bank of Korea	6,270	5.1	92.3
9. Hyundai Capital Services	6,190	5.1	3.1
10. Korea Exchange Bank	6,140	5.0	0.6
Total Top 10	**174,708**	**143.0**	
Total LCY Financial Debentures	**210,476**	**172.3**	
Top 10 as % of Total LCY Financial Debentures	**83.0%**	**83.0%**	

FCY = foreign currency, LCY = local currency.
Note: Financial debentures exclude Korea Development Bank.
Source: *AsianBondsOnline*, Bloomberg LP, and *KoreaBondWeb*.

Table 4: Top 10 Issuers of LCY Private Corporate Bonds in Korea (as of June 2010)

Issuer	Outstanding Amount		
	LCY Bonds (KRW billion)	**LCY Bonds** (USD billion)	**FCY Bonds** (USD billion)
1. Daewoo Securities	20,869	17.1	0.0
2. Woori Investment and Securities	16,148	13.2	0.0
3. Korea Investment and Securities	10,102	8.3	0.2
4. Hyundai Securities	8,812	7.2	0.0
5. Mirae Asset Securities	6,719	5.5	0.0
6. Tong Yang Securities	6,303	5.2	0.0
7. Shinhan Financial Group	5,680	4.7	0.2
8. Samsung Securities	5,260	4.3	0.0
9. KT Corporation	5,020	4.1	2.4
10. Hana Daetoo Securities	4,404	3.6	0.0
Total Top 10	**89,315**	**73.1**	
Total LCY Private Corporate Bonds	**252,147**	**206.4**	
Top 10 as % of Total LCY Private Corporate Bonds	**35.4%**	**35.4%**	

FCY = foreign currency, LCY = local currency.
Source: *AsianBondsOnline*, Bloomberg LP, and *KoreaBondWeb.*

debentures were the Industrial Bank of Korea, Kookmin Bank, and Woori Bank. Each of the top 10 issuers of LCY financial debentures also had FCY bonds outstanding, with the largest amount issued by the Export–Import Bank of Korea.

The combined amount of bonds outstanding of the top 10 issuers of LCY private corporate bonds in Korea as of June totaled KRW89.3 trillion (USD73.1 billion), which represented about 35% of the total LCY private corporate bonds in the country **(Table 4)**. Eight out of the top 10 issuers were securities companies, with the largest being Daewoo Securities, Woori Investment and Securities, and Korea Investment and Securities. Only three of the top 10 issuers had FCY bonds outstanding, with the largest being issued by KT Corporation.

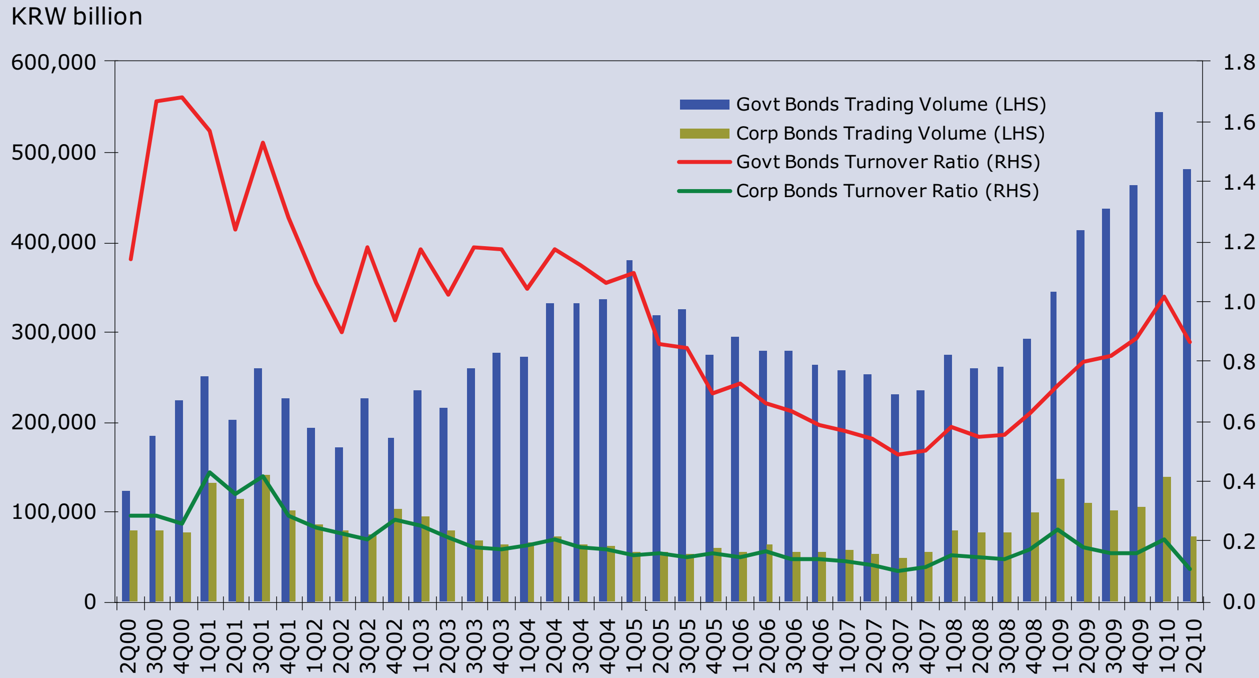
Liquidity

Trading volumes and turnover ratios fell on a quarterly basis in 2Q10 for both Korean government and corporate LCY bonds **(Figure 2)**. Trading volume in 2Q10 for government bonds fell 11.8% q-o-q to KRW479.3 billion. For corporate bonds, trading volume decreased 47.9% q-o-q to KRW71.9 trillion. Similarly, the turnover ratio for government bonds declined to 0.86 in 2Q10 from 1.02 in 1Q10. For corporate bonds, the turnover ratio dropped to 0.10 in 2Q10 from 0.20 in 1Q10. On a y-o-y basis, however, trading volume for government bonds rose 16.6% in 2Q10, while the turnover ratio of government bonds also increased to 0.86 from 0.80 in 2Q09. Trading volume for corporate bonds plunged 34.7% y-o-y in 2Q10, while the turnover ratio also decreased to 0.10 from 0.18 in 2Q09.

KTBs were the most traded type of government bonds in Korea as of June 2010 , with the top 30 traded KTBs amounting to KRW299.4 trillion, which comprised 98% of total KTBs **(Figure 3)**. In terms of tenor, the top 30 traded KTBs consisted of four 20-year KTBs, ten 10-year KTBs, ten 5-year KTBs, and six 3-year KTBs **(Figure 4)**.

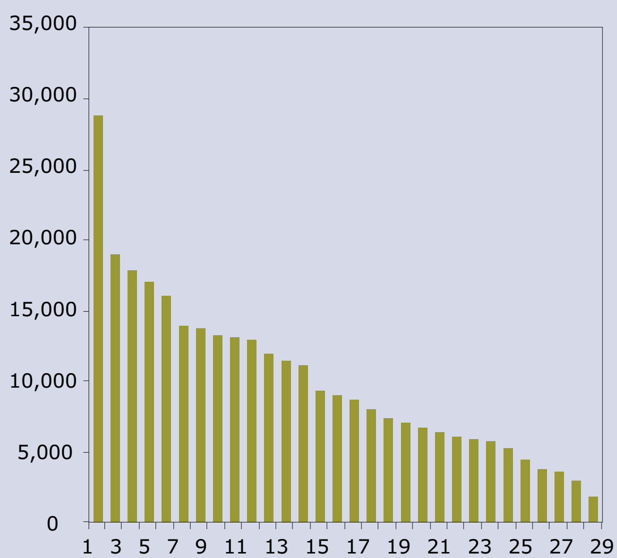
The KTB futures market includes 3-, 5-, and 10-year KTB futures contracts, but only 3-year

Figure 2: Trading Volumes and Turnover Ratios of Korean Government and Corporate Bonds, 2Q00–2Q10



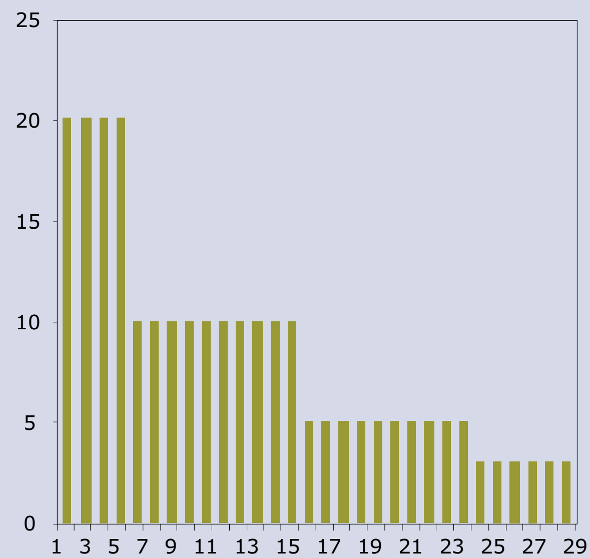
LHS = Left-hand side, RHS = Right-hand side.
Source: *AsianBondsOnline*, Bloomberg LP, and *KoreaBondWeb*.

Figure 3: Top 30 KTBs by Size, June 2010
(KRW billion)



Source: Bloomberg LP.

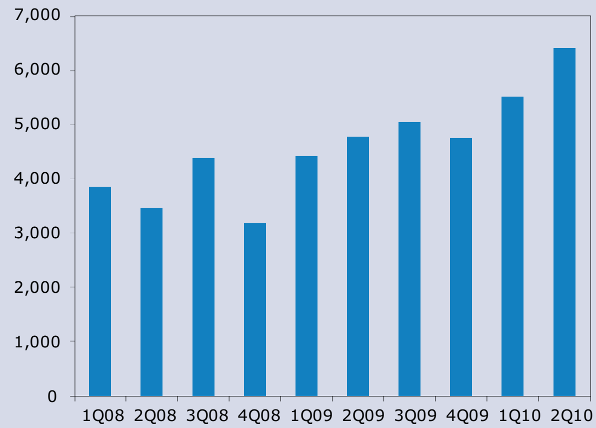
Figure 4: Top 30 KTBs by Tenor, June 2010
(Years)



Source: Bloomberg LP.

KTB futures are widely traded. Recently, there has been an increase in the trading volume of 3-year KTB futures. In 2Q10, the number of 3-year KTB futures contracts traded reached 6.4 million, up 15.9% q-o-q and 33.9% y-o-y **(Figure 5)**.

Figure 5: Trading Volume of 3-Year KTB Futures, 1Q08–2Q10 (number of contracts traded, in thousands)



KTB = Korea Treasury bonds.
Source: Korea Exchange.

Policy, Institutional, and Regulatory Developments

FSC Approves Regulation to Improve Trading of Long-Term KTB Futures

In September, the Financial Supervisory Commission (FSC) of Korea approved the Korea Exchange's amended version of its Derivatives Market Business Regulation, which aims to enhance the trading of long-term KTB futures. The revised version calls for harmonizing regulations on short-term and long-term KTB futures to improve the accessibility of KTB futures and facilitate the trading of these derivative instruments. Part of this provision is to change the final settlement method for 10-year KTB futures to cash settlement (from physical delivery) in order for primary dealers to actively trade 10-year KTB futures. The amended version, which is expected to be implemented in October, aims to stabilize price movements and enhance market-making functions in the KTB futures market.

Korea To Introduce Short-Term KTBs

In July, Korea publicized its plan to issue KTBs with maturities of less than 1 year in order to form a short-term benchmark bond rate. The issuance of short-term KTBs will take place following revisions in the National Finance Act to be made in 2011/12.

Korea Sets Ceiling on Call Money Borrowings

The Korean government revealed in July that it will establish a cap in call money borrowings equivalent to 100% of a securities firm's equity capital in order to reduce the potential systemic risk associated with firms' heavy reliance on call money loans. The new rule is intended to be implemented in the third quarter of this year.

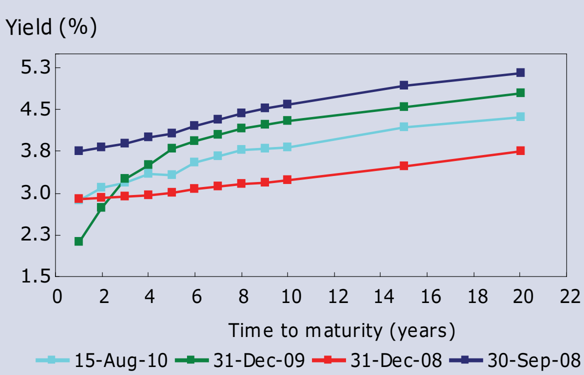
Malaysia—Update

Yield Movements

An increase in the overnight policy rate (OPR), an uptick in consumer price inflation, and robust growth in the first half of the year resulted in the flattening of Malaysia's government bond yield curve. Between end-2009 and mid-August, yields rose at the short-end and dropped in the belly and at the long-end of the curve **(Figure 1)**. Bank Negara Malaysia (BNM) has already raised its key rate three times this year, increasing the OPR by a total of 75 basis points to 2.75%. Before an initial increase in February, the OPR had been kept at a historic low of 2.0% since February 2009.

Driven by sustained growth in domestic and external demand, Malaysia's economy expanded 8.9% year-on-year (y-o-y) in 2Q10, which brought the country's gross domestic product (GDP) growth to 9.5% in the first half of the year. Domestic demand grew 9.0% y-o-y in 2Q10, higher than growth of 5.3% recorded in 1Q10, mainly due to higher levels of private consumption as well as increased business and public sector spending. Relatively low inflation coupled with favorable labor market conditions and improved consumer confidence led to 7.9% y-o-y growth in private consumption. Meanwhile, public sector spending increased 6.9% y-o-y in 2Q10 and gross fixed capital formation grew 9.4% y-o-y.

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



LCY = local currency.
Source: Bloomberg LP.

Prices in Malaysia continued to rise as domestic demand and public sector spending fueled economic growth. In July, consumer price inflation rose slightly to 1.9% y-o-y from 1.7% in June and 1.6% in May. For January–July, consumer price inflation was reported at 1.5% y-o-y.

Size and Composition

At the end of June, total outstanding local currency (LCY) bonds in Malaysia stood at MYR695.9 billion, up 14.0% y-o-y. Outstanding government LCY bonds expanded 18.3% y-o-y to MYR401.2 billion. Excluding central bank bills, outstanding government LCY bonds rose 12.5% y-o-y **(Table1)**.

Issuance of government LCY bonds (excluding central bank bills) was lower in 1H10 compared with 1H09, as the government had issued more bonds in 2009 to fund its MYR60.0 billion stimulus program. The government issued a total of MYR21.0 billion of Malaysian Government Securities (MGS) in the first 6 months of 2010 compared with MYR32.0 billion in the same period last year. Issuance of Government Investment Issues (GII) likewise fell, from MYR16.5 billion in 1H09 to MYR12.0 billion in 1H10.

The issuance of central bank bills increased as the central bank mopped up excess liquidity in the market amid rising consumer price inflation. Issuance of central bank bills reached MYR68.2 billion in 2Q10 from MYR35.5 billion in 1Q09.

In 2Q10, total corporate LCY bonds outstanding grew 8.6% y-o-y, and 3.1% on a quarter-on-quarter (q-o-q) basis, to reach MYR294.7 billion.

After a slow start in 1Q10, the issuance of corporate LCY bonds picked up in 2Q10. Malaysia's corporate LCY bond issuance totaled

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

	Amount (billion)								Growth Rate (%)						
	Mar-10		Apr-10		May-10		Jun-10		Mar-10		Apr-10	May-10	Jun-10		
	MYR	USD	MYR	USD	MYR	USD	MYR	USD	y-o-y	q-o-q	m-o-m	m-o-m	y-o-y	q-o-q	m-o-m
Total	648.0	198.6	674.3	211.8	686.2	210.3	695.9	215.7	11.0	(98.4)	4.1	1.8	14.0	7.4	1.4
Government	362.2	111.1	381.7	119.9	392.8	120.4	401.2	124.4	12.7	4.4	5.4	2.9	18.3	10.8	2.1
Central Government Bonds	328.1	100.6	322.7	101.3	322.7	98.9	331.2	102.7	22.2	5.0	(1.6)	-	15.0	0.9	2.6
Central Bank Bills	32.5	9.9	57.6	18.1	69.2	21.2	69.1	21.4	(27.1)	8.2	77.3	20.2	58.0	112.8	(0.1)
Others	1.7	0.5	1.5	0.5	1.0	0.3	1.0	0.3	(79.9)	(60.1)	(14.4)	(34.2)	(87.1)	(43.7)	-
Corporate	285.7	87.6	292.6	91.9	293.4	89.9	294.7	91.4	9.0	(0.9)	2.4	0.3	8.6	3.1	0.4

LCY = local currency, m-o-m = month-on-month, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Bloomberg end-of-period LCY—USD rate is used.
3. Growth rates are calculated from LCY base and do not include currency effects.
4. "Others" refer to Khazanah Bonds issued by Khazanah Nasional Berhad and Cagamas, Bonds and Notes, Bithaman Ajil Islamic Securities, Sanadat ABBA Cagamas and Sanadat Mudharabah Cagamas issued by Cagamas Berhad.

Source: Bank Negara Malaysia, and Bloomberg LP.

MYR22.9 billion in 2Q10, 90.4% higher than the MYR12.0 billion posted in 1Q10, but 18.0% lower compared with the MYR28.0 billion issued in 2Q09. Among the biggest issuances during the period were Bank Pembangunan Malaysia (MYR2.5 billion), Khazanah Nasional subsidiary Danga Capital (MYR2.0 billion), national mortgage corporation Cagamas Berhard (MYR1.8 billion), AmBank (MYR1.3 billion), RHB Bank (MYR1.0 billion), and CIMB Group (MYR750 million).

The top 20 corporate issuers in Malaysia comprised 48.3% of total corporate bonds outstanding in 2Q10 **(Table 2)**. Cagamas Berhad remained the top issuer of corporate bonds with MYR18.2 billion outstanding in conventional and Islamic *(sukuk)* medium-term notes, followed by the government's investment-holding arm, Khazanah Nasional, and the investment holding company, Binariang GSM, with MYR13.2 billion and MYR11.5 billion, respectively.

Investor Profile

At the end of June, financial institutions were the largest holders of government bonds, with 43.7% of total outstanding MGS and GII, followed by social security institutions, which held 30.2%. Foreign holders and insurance companies held 18.1% and 6.0%, respectively, of total outstanding MGS and GII **(Figure 2)**.

Meanwhile, foreign holdings of MGS increased from 16.9% at end-December to 23.4% at end-June **(Figure 3)**.With the relaxation of foreign exchange rules (see **Policy, Institutional, and Regulatory Developments**), the Malaysian ringgit gained against the US dollar in 2Q10 and government bonds rallied on expectations of the ringgit's further appreciation, which has already gained 9.4% against the US dollar since the beginning of the year.

Turnover Ratio

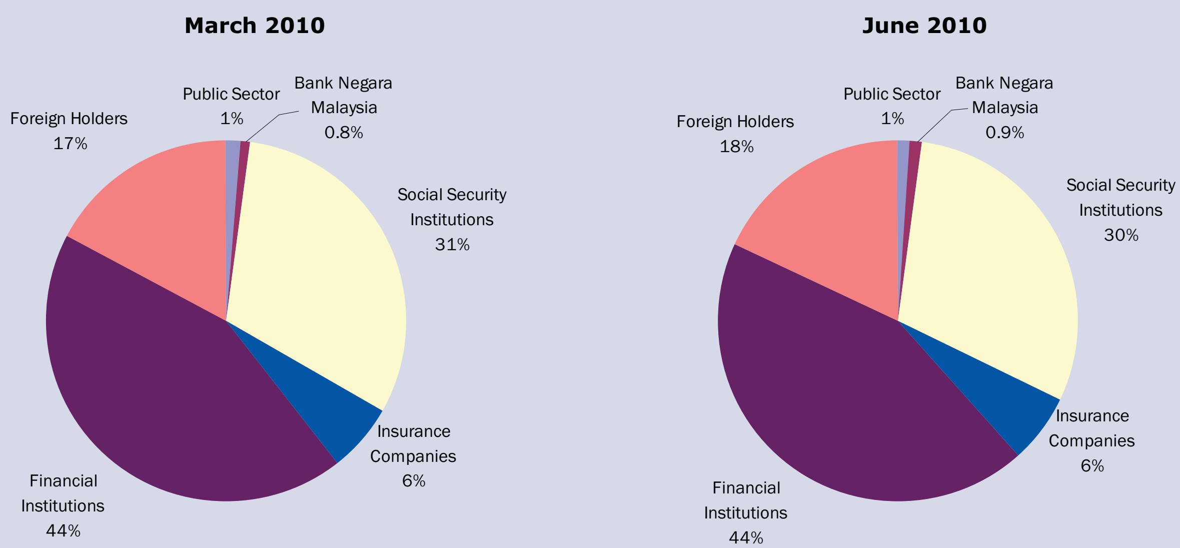
Monthly data showed government bond trading volume rose to MYR71.5 billion in January after having fallen in 4Q09, when trading volume

Table 2: Top 20 Corporate Issuers, June 2010 (MYR billion)

Issuer	Industry	Conventional Bonds	Islamic Bonds	Conventional MTN	Islamic MTN	Total
Cagamas	Finance	—	—	9.30	8.85	18.15
Khazanah	Quasi-Govt. and Other	—	13.20	—	—	13.20
Binariang GSM	Transport, Storage & Comm.	—	3.17	—	8.28	11.45
Project Lebuhraya	Transport, Storage & Comm.	—	6.57	—	3.68	10.25
Prasarana	Finance	5.11	2.00	—	2.00	9.11
Maybank	Finance	6.10	2.50	—		8.60
Rantau Abang Capital Bhd	Quasi-Govt. and Other	—	—	—	8.00	8.00
Malakoff Corp	Finance	—	1.70	—	5.60	7.30
KL International Airport	Transport, Storage & Comm.	1.60	4.76	—	—	6.36
AM Bank	Finance	1.60	—	4.33	—	5.93
Value Cap	Finance	5.10	—	—	—	5.10
1 Malaysia Development Bhd.	Finance	—	—	—	5.00	5.00
Jimah Energy Ventures	Utilities	—	—	—	4.77	4.77
Tanjung Bin	Utilities	—	—	—	4.59	4.59
Bank Pembangunan Malaysia	Finance	1.00	—	2.60	0.90	4.50
Putrajaya Holdings	Finance	—	1.70	—	3.65	5.35
YTL Power International	Utilities	2.20	—	1.70	—	3.90
Tenaga Nasional	Utilities	1.50	2.15	—	—	3.65
Danga Capital	Finance	—	—	—	3.60	3.60
RHB Bank	Finance	0.60	—	3.00	—	3.60
Total		**24.81**	**37.75**	**20.93**	**58.91**	**142.40**
Total Outstanding		**63.48**	**70.47**	**45.48**	**89.40**	**294.65**
Top 20 as % of Outstanding		**39.1%**	**53.6%**	**46.0%**	**65.9%**	**48.3%**

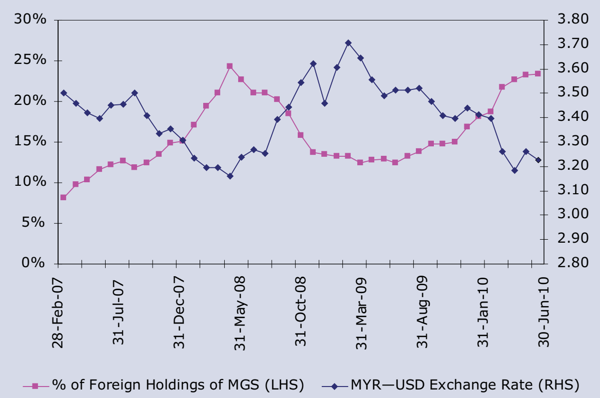
— = not applicable, MTN = medium-term notes.
Source: Bank Negara Malaysia Fully Automated System for Issuing/Tendering (FAST).

Figure 2. LCY Government Bonds Investor Profile



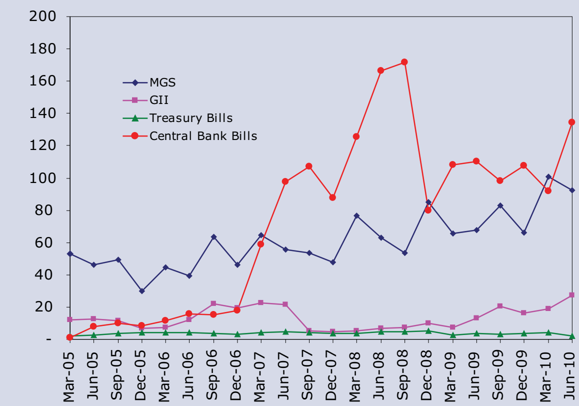
LCY = local currency.
Source: Bank Negara Malaysia.

Figure 3. Foreign Holdings of MGS vs. the MYR—USD Exchange Rate



MGS = Malaysian Government Securities.
Source: Bank Negara Malaysia.

Figure 4. Quarterly Trading Volume for LCY Government Bonds (MYR billion)



LCY = local currency, MGS = Malaysian Government Securities, GII = Government Investment Issues.
Source: Bank Negara Malaysia.

averaged MYR65.5 billion per month. Trading volume fell again to MYR54.9 billion in February before rising to MYR89.4 billion in March **(Figure 4)**. The quarterly turnover ratio was 0.61 in 1Q10, compared with 0.56 in 4Q09.

In April, government bond trading volume surged to MYR104.0 billion due to an increase in trading of central bank bills, which reached MYR53.6 billion in the month as their issuance was increased to mop up excess liquidity. Government bond trading volume fell to MYR80.5 billion and MYR71.9 billion in May and June, respectively. The turnover ratio for government bonds stood at 0.67 in 2Q10.

For January–June, the bulk of the trading of government bonds and central bank bills were interbank transactions **(Table 3)**. Of the MYR232.8 billion in government bonds traded in 1H10, MYR184.0 billion of these bonds were traded in the interbank market. About 70% of the trading volume of central bank bills was in the interbank market.

Corporate bond trading volume reached MYR19.2 billion in 1Q10 from MYR16.2 billion in 4Q09. The trading volume increased further in 2Q10 to MYR28.3 billion. As a result, the turnover

Table 3: Securities Turnover by Participant for January–June 2010 (MYR million)

	Interbank	Non-Interbank	Total
Government Bonds	184,018	48,812	232,830
MGS	143,279	45,594	188,872
GII	40,740	3,218	43,958
Treasury Bills	4,311	2,342	6,653
Central Bank Bills	156,150	65,388	221,538

MGS = Malaysian Government Securities, GII = Government Investment Issues.
Note:
Interbank—both buyers and sellers are financial institutions.
Non-Interbank—either the buyer or seller is a financial institution.
Source: Bank Negara Malaysia.

ratio for corporate bonds increased to 0.10 in 2Q10 from 0.06 and 0.07 in 4Q09 and 1Q10, respectively.

Policy, Institutional, and Regulatory Developments

Corporate Debt Restructuring Committee Revises Eligibility Criteria

The Corporate Debt Restructuring Committee (CDRC) has revised its eligibility criteria to allow more companies to seek assistance from the CDRC in restructuring their debt obligations. Under the revised eligibility criteria, companies seeking to resolve their debt obligations under the CDRC must fulfill the following:

(i) aggregate indebtedness of MYR30 million or more;

(ii) at least two financial creditors;

(iii) not in receivership or liquidation, except in cases where receivers have been appointed over certain specified assets and the directors remain in control over the companies' overall operations; and

(iv) difficulties in servicing debt obligations, which may not include having already defaulted, provided criteria (i) and (ii) are met.

The revised criteria extends eligibility to any company listed on Bursa Malaysia that has been classified as either PN17 (Main Market—the merged main board and second board of Bursa Malaysia) or GN3 (ACE market—the revamp of the Malaysian Exchange Securities Dealing and Automated Quotation [MESDAQ]), irrespective of the amount of debt outstanding.

BNM Further Liberalizes FX Rules

In August, BNM announced the further liberalization of foreign exchange (FX) administrative rules to promote efficiency in trade. The new rules provide for the following:

(i) the use of the ringgit as a settlement currency for international trade of goods and services between residents and non-residents;

(ii) the borrowing of any amount of foreign currency by a resident company from its respective non-resident, non-bank related company (thus abolishing all limits on cross-border foreign currency inter-company borrowings); and

(iii) the lifting of the limit on residents' anticipatory hedging of current account transactions with licensed onshore banks.

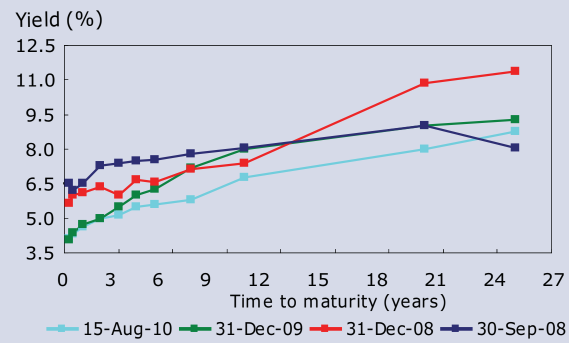
To promote bilateral trade between the People's Republic of China (PRC) and Malaysia, the China Foreign Exchange Trading System (CFETS) has issued a separate statement that allows trading of the PRC yuan against the ringgit. Aside from the ringgit, other currencies that are traded on the CFETS are the US dollar, euro, pound sterling, yen, and Hong Kong dollar.

Philippines—Update

Yield Movements

Yields of Philippine government bonds fell for most maturities between end-December 2009 and mid-August 2010 **(Figure 1)**. Yields dropped for most maturities at the shorter-end of the curve. But the decline was relatively larger from the belly through the longer-end of the curve, falling by 65, 135, 121, 103, and 53 basis points for 5-, 7-, 10-, 20-, and 25-year maturities, respectively. Meanwhile, yield spreads between 2- and 10-year tenors narrowed by 121 basis points between end-December and mid-August.

Figure 1: Philippines' Benchmark Yield Curve–LCY Government Bonds



LCY = local currency.
Source: Bloomberg LP.

In August, the central bank—Bangko Sentral ng Pilipinas—held the overnight borrowing (reverse repurchase) and overnight lending (repurchase) rates steady at 4.0% and 6.0%, respectively. Consumer price inflation in the Philippines stood at 4.0% year-on-year (y-o-y) in August, compared with 3.9% in July. The Philippines registered gross domestic product (GDP) growth of 7.9% y-o-y in 2Q10, following revised 7.8% growth in 1Q10, on the back of double-digit growth in domestic investment, total exports, and industrial activity.

Size and Composition

The size of the Philippine local currency (LCY) bond market had expanded 11.6% y-o-y, and 2.5% quarter-on-quarter (q-o-q), to PHP3.1 trillion (USD66.2 billion) as of end-June **(Table 1)**. This growth stemmed from increases in both government bonds and corporate bonds outstanding.

The size of the Philippine LCY government bond market amounted to PHP2.7 trillion (USD58.1 billion) at the end of June, a 9.8% y-o-y increase. Treasury bonds, which comprised 74% of total government bonds, expanded 18.3% y-o-y to PHP2.0 trillion (USD43 billion). In contrast, treasury bills plunged 16.5% y-o-y to PHP567.4 billion (USD12.2 billion). Other bonds, which include government-guaranteed bonds and bonds owned by government-owned-and-controlled corporations (GOCCs) totaled PHP131.7 billion (USD2.8 billion), which represented increases of 47.9% y-o-y and 18.1% q-o-q.

In 2Q10, the Philippine government issued a total of PHP127.8 billion (USD2.7 billion) in government bonds, of which 63.2% were treasury bills and 13.3% were treasury bonds. The remaining 23.5% were issued by a Philippine GOCC, the Power Sector Assets and Liabilities Management Corp. (PSALM).

In September, the Philippines issued PHP44.1 billion (USD1.0 billion) of 10-year bonds in international capital markets; this served as the first LCY bonds sold offshore by an Asian country. The bonds have a coupon rate of 4.95%, a yield of 5.0%, and were priced at 99.607%. About 37% of the bond purchases came from Asian investors, 33% from US investors, and 30% from European investors. The bonds are exempted from the Philippines' 20% tax on interest income.

Philippine LCY corporate bonds outstanding soared 26.8% y-o-y to PHP376.2 billion (USD8.1 billion) in June. On a q-o-q basis, corporate bonds outstanding climbed 5.5%. During 2Q10, four LCY corporates issued a total of PHP18.0 billion (USD388.1 million) in bonds: Ayala Corporation (PHP10.0 billion), Rizal Commercial Banking Corporation (PHP5.0 billion), Metrobank Card Corporation (PHP2.0 billion), and SM Prime Holdings (PHP1.0 billion).

The top 20 LCY corporate issuers in the Philippines, as of June 2010, had combined LCY bonds outstanding of PHP301.1 billion, which represented 80% of the overall LCY corporate bond market **(Table 2)**. San Miguel Brewery, the largest beer producer in the country, had LCY bonds outstanding of PHP38.8 billion, followed by three commercial banks—Banco de Oro Unibank (PHP30.9 billion), Rizal Commercial Banking Corporation (PHP21.0 billion), and Metrobank (PHP18.5 billion).

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

	Amount (billion)								**Growth Rate** (%)						
	Mar-10		**Apr-10**		**May-10**		**Jun-10**		**Mar-10**		**Apr-10**	**May-10**	**Jun-10**		
	PHP	**USD**	**PHP**	**USD**	**PHP**	**USD**	**PHP**	**USD**	**y-o-y**	**q-o-q**	**m-o-m**	**m-o-m**	**y-o-y**	**q-o-q**	**m-o-m**
Total	2,996	66	3,029	68	3,060	66	3,072	66.2	11.1	2.9	1.1	1.0	11.6	2.5	0.4
Government	2,639	58	2,670	60	2,684	58	2,696	58	7.3	3.1	1.2	0.5	9.8	2.1	0.4
Treasury Bills	579	13	579	13	575	12	567	12	(24.6)	(6.9)	0.0	(0.7)	(16.5)	(2.0)	(1.3)
Treasury Bonds	1,948	43	1,938	44	1,977	43	1,996	43	21.0	6.0	(0.6)	2.0	18.3	2.5	1.0
Others	112	2	153	3	132	3	132	3	35.2	12.0	37.0	(13.8)	47.9	18.1	0.0
Corporate	357	8	359	8	376	8	376	8	51.0	1.5	0.8	4.7	26.8	5.5	0.0

LCY = local currency, m-o-m = month-on-month, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Note:
1. Calculated using data from national sources.
2. Bloomberg end-of-period LCY—USD rates are used.
3. Growth rates are calculated from LCY base and do not include currency effects.
4. "Others" includes government-guaranteed bonds such as Land Bank of the Philippines and National Power Corporation (Napocor).
Source: Philippine Bureau of the Treasury and Bloomberg LP.

Table 2: Top 20 Issuers of LCY Corporate Bonds in the Philippines, June 2010

Rank	Issuer	Amount Outstanding (PHP billion)
1	San Miguel Brewery	38.80
2	Banco de Oro Unibank	30.90
3	Rizal Commercial Banking Corporation	21.00
4	Metropolitan Bank & Trust Company	18.50
5	Manila Electric Company	18.30
6	Philippine National Bank	17.75
7	Globe Telecom	16.80
8	Petron Corporation	16.30
9	Ayala Corporation	16.00
10	Robinsons Land Corporation	15.00
11	JG Summit Holdings	13.31
12	SM Prime Holdings	12.49
13	Energy Development Corporation	12.00
14	Bank of Philippine Islands	10.00
15	SM Investments Corporation	9.40
16	Allied Banking Corporation	8.00
17	Ayala Land	7.00
18	Aboitiz Power Corporation	6.88
19	Megaworld Corporation	6.40
20	Metrobank Card Corporation	6.30
Total Top 20		**301.13**
Total LCY Corporate Bonds		**376.17**
Top 20 as % of Total LCY Corporate Bonds		**80%**

LCY = local currency.
Source: Bloomberg LP.

Rating Changes

In August, Fitch Ratings affirmed the sovereign credit ratings of the Philippines at BB for its foreign currency (FCY) long-term issuer default rating, BB+ for its LCY long-term issuer default rating and country ceiling, and B for its short-term issuer default rating **(Table 3)**. Fitch Ratings also affirmed its stable outlook on the country.

Table 3: Selected Sovereign Ratings and Outlook for the Philippines

	Moody's	Standard & Poor's	Fitch
FCY Long-Term Rating	Ba3	BB–	BB
Outlook	stable	stable	stable

FCY = foreign currency.
Source: Rating agencies.

Policy, Institutional, and Regulatory Developments

Bond Exchange Program Planned

In August, the Philippine Bureau of the Treasury revealed its plan to allow the exchange of shorter- and longer-term bonds in order to lengthen the maturity profile of the Philippine government's debt. In particular, 5-year government bonds can be exchanged for 10-year bonds, while 10-year bonds can be exchanged for 20- or 25-year bonds. This bond exchange program is expected to be launched by the end of the year.

PDEx Revises Rules on Failed Trades and Delayed Settlements of Fixed-Income Securities

In May, the Philippine Dealing and Exchange Corporation (PDEx) amended its rules for the Philippine fixed-income securities market. PDEx revised certain provisions on the definition, reporting, handling, and penalties of failed trades and delayed settlements of fixed-income securities.

Singapore—Update

Yield Movements

Singapore government bond yields fell throughout the length of the curve between end-December 2009 and mid-August 2010 **(Figure 1)**. The yield on the 2-year tenor declined 9 basis points from its December 2009 level. Yields fell by larger amounts along the rest of the curve, with the most pronounced yield declines being those for the 10- and 15- year tenors, which fell by 75 and 74 basis points, respectively. The decline in yields, particularly at the short-end, was mirrored by the Singapore Interbank Offered Rate (SIBOR), which has been declining since January 2010 **(Figure 2)**.

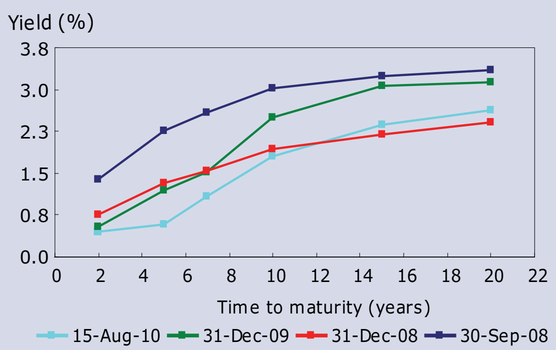
Singapore's gross domestic product (GDP) in 2Q10 surged 18.8% year-on-year (y-o-y), compared with a 16.9% expansion in 1Q10. The economic growth in 2Q10 was underpinned by manufacturing output, which rose 44.5% y-o-y on the back of increased production of active pharmaceutical ingredients and semiconductor chips. The wholesale and retail trade sectors grew 18.9% y-o-y due to high global trade flows, while several other sectors of the economy—construction, financial services, and other service industries such as tourism—posted y-o-y growth rates above 10%.

Citing the slowdown of economic conditions in the United States and European Union, as well as moderating growth in the People's Republic of China (PRC), the Ministry of Trade and Industry (MTI) said Singapore's remarkable first half economic performance was not likely to be sustained. The MTI did project, however, that Singapore's growth would remain healthy for the rest of 2010, and maintained its forecast of 13%–15% economic growth for the full year.

In April, the Monetary Authority of Singapore (MAS) announced that it would re-center its exchange rate policy band to the prevailing level of the Singapore dollar's nominal effective exchange rate, and that it would shift its policy from zero percent appreciation to "modest and gradual appreciation," with the width of the policy band remaining unchanged. As of mid-August, Singapore was continuing to maintain this exchange rate policy.

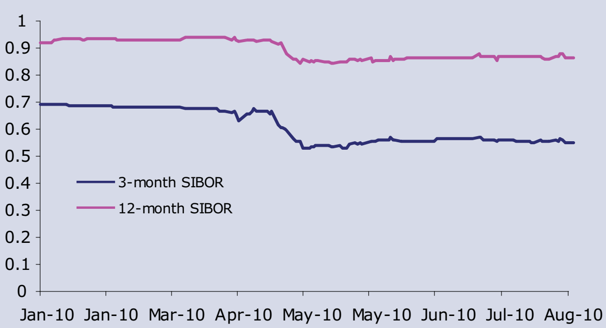
Singapore's consumer price inflation stood at 3.1% y-o-y in July due to higher transportation, housing, and food costs. The July inflation figure compares with 2.7% in June and 3.2% in May. The MAS expects inflation to range between 2.5% and 3.5% for the full year, driven by higher commodity prices and private road transport costs.

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



LCY = local currency.
Source: Bloomberg LP.

Figure 2: SIBOR Rates



SIBOR = Singapore Interbank Offered Rate.
Source: Bloomberg LP.

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

	Amount (billion)								Growth Rate (%)						
	Mar-10		Apr-10		May-10		Jun-10		Mar-10		Apr-10	May-10	Jun-10		
	SGD	USD	SGD	USD	SGD	USD	SGD	USD	y-o-y	q-o-q	m-o-m	m-o-m	y-o-y	q-o-q	m-o-m
Total	222	159	222	162	225	160	226	162	17.8	5.2	(0.1)	1.3	12.6	1.8	0.6
Government	127	90	125	91	126	90	128	92	17.0	2.3	(1.1)	0.6	10.7	1.2	1.7
Bills	52	37	52	38	53	38	53	38	25.2	(0.8)	0.6	1.3	15.4	2.7	0.8
Bonds	75	54	73	53	73	52	75	54	12.0	4.6	(2.3)	—	7.6	0.1	2.5
Corporate	95	68	97	70	99	70	98	70	18.9	9.3	1.2	2.3	15.1	2.6	(0.9)

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

Size and Composition

The amount of local currency (LCY) bonds outstanding in Singapore at the end of June totaled SGD226 billion, up 12.6% y-o-y **(Table 1)**. Government bonds outstanding rose 10.7% y-o-y to SGD128 billion, while corporate bonds outstanding grew 15.2%. As of end-June, the top 30 corporate issuers accounted for 40.8% of total corporate bonds outstanding **(Table 2)**. Notable issuance in 2Q10 included those by the Land Transport Authority (SGD575 million), SP Power Assets (SGD500 million), and HK Land Treasury (SGD150 million).

Rating Changes

On 27 August, Standard & Poor's (S&P) affirmed Singapore's long-term and short-term sovereign credit ratings at AAA and A-1+, respectively, with a stable outlook. S&P said that the ratings were supported by Singapore's "extensive fiscal and external strengths" and "solid record of prudent macroeconomic management." In particular, S&P cited Singapore's significant foreign exchange reserves and sound fiscal position that allowed the government to introduce a SGD20.5 billion stimulus package in 2009 in response to the global financial crisis. According to S&P, the package helped the economy weather the crisis as the economy contracted at a slower rate.

Table3: Selected Sovereign Ratings and Outlook for Singapore

	Moody's	Standard & Poor's	Fitch
Sovereign FCY LT Ratings	Aaa	AAA	AAA
Outlook	stable	stable	stable

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

Policy, Institutional, and Regulatory Developments

PBOC and the MAS Agree to a Bilateral Currency Swap

On 23 July, the People's Bank of China (PBOC) and the MAS agreed to a bilateral currency swap arrangement to promote bilateral trade and direct investment. The swap arrangement will provide PRC yuan liquidity of up to CNY150 billion and Singapore dollar liquidity of up to SGD30 billion. The initial term of the arrangement is 3 years with the possibility for extension.

SGX Launches Initiatives to Boost Bond Listing and Trading

In August, the Singapore Exchange (SGX) launched initiatives to promote the listing, trading, and distribution of fixed-income instruments in Singapore. Among the initiatives are measures to attract companies listed in Singapore to issue

Table 2: Bonds Outstanding of Top 30 Corporate Issuers, June 2010

Issuer	**Outstanding Amount LCY Bonds** (SGD billion)
Housing and Development Board (Public Housing Authority)	5.55
Capitaland (Real Estate)	4.87
United Overseas Bank (Banking)	3.62
SP Power Assets (Electricity Transmission and Distribution)	2.91
Temasek Financial I (Investment Company)	2.60
Oversea-Chinese Banking (Banking)	2.20
Public Utilities Board (National Water Authority)	2.10
Land Transport Authority (Building and Construction)	1.88
DBS Bank Singapore (Banking)	1.61
PSA Corp. (Container Transhipment Hub)	1.60
F&N Treasury (Food Service, Property, Pub & Printing)	1.32
Singapore Airlines (Airlines)	0.90
Capitaland Treasury (Real Estate)	0.70
HK Land Treasury Service (Property Investment Management)	0.70
Capitamall Trust (REITS-Shopping Centers)	0.65
City Developments (Hotels and Motels)	0.60
Singapore Press Holdings (Publishing-Newspapers)	0.60
Singtel Group Treasury (Telecoms)	0.60
Keppel Land (Real Estate)	0.59
Mapletree Treasury Services (Special Purpose Entity)	0.53
Ascott Capital (Real Estate)	0.50
Sembcorp Financial Services (Engineering/R&D Services)	0.50
Singapore Post (Postal Services)	0.50
ST Treasury Services (Finance)	0.48
Yanlord Land Group (Real Estate, PRC-based)	0.42
Capitacommercial Trust (REITS-Diversified)	0.41
Hotel Properties (Hotels and Motels)	0.40
Guocoland (Property Development and Investment)	0.39
Asia Pacific Breweries (Breweries)	0.36
Fraser & Neave (Food Service, Property, Pub & Printing)	0.35
Total Top 30 Corporate Issuers	**40.4**
Total Corporate Bonds Outstanding	**99.1**
Top 30 as % of Total Corporate	**40.79%**

Note: Total corporate bonds outstanding based on *AsianBondsOnline* estimates.
Source: Bloomberg LP.

bonds that can be listed and traded on the SGX. The SGX plans to streamline the approval process for bond listings and cut the time required for approval in half.

In addition to attracting bond listings, the SGX plans to encourage the listing and trading of preference shares and convertible bonds. By 1Q11, the SGX expects to put in place an on-exchange secondary market allowing for the trading of Singapore Government Securities by both individual and institutional investors.

Thailand—Update

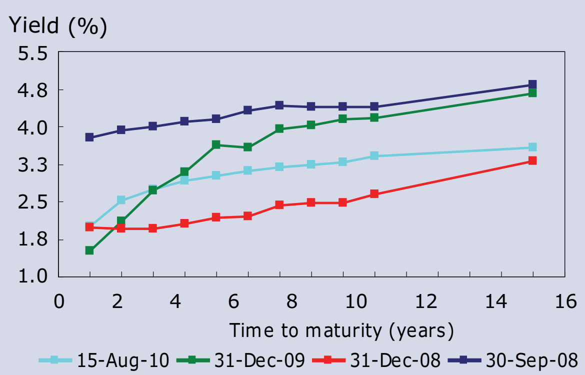
Yield Movements

The Thai government bond yield curve flattened from the belly to the long-end of the curve between end-December 2009 and mid-August 2010 **(Figure 1)**. Yields rose by as much as 48 basis points at the short-end of the curve, while yields declined by as much as 108 basis points from the belly to the long-end. The yield spread between 2- and 10-year bonds narrowed to 88 basis points in mid-August from 207 basis points at end-December.

The flattening of the yield curve reflected recent policy rate hikes from the Bank of Thailand (BOT), as investors demanded safer assets due to concerns over the slowing global economic recovery. The BOT raised its 1-day repurchase rate by 25 basis points to 1.75% at its meeting on 25 August. The August increase followed the first rate hike in 2 years on 14 July.

Inflation remains modest at present, although an increase is expected next year in line with economic expansion and increasing production costs. Consumer price inflation stood at 3.4% year-on-year (y-o-y) in July, compared with 3.3% in June, as food and energy prices continued to climb. Inflation is expected to slow in the coming months as the supply of agricultural products increases, oil prices stabilize, and interest rates rise.

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



LCY = local currency.
Source: Bloomberg LP.

Thailand's economy expanded 9.1% y-o-y in 2Q10, compared with 12.0% in 1Q10. The dramatic turnaround from the first half of 2009 was driven by strong export growth despite political uncertainties in April and May. Thailand's gross domestic product (GDP) is expected to grow 6.5%–7.5% in 2010 and 3.0%–5.0% in 2011.

Size and Composition

At the end of June, the size of Thailand's total local currency (LCY) bond market had expanded 18.4% y-o-y, with the volume of bonds outstanding amounting to THB6.4 trillion (USD198 billion) **(Table 1)**. Total bonds outstanding grew 3.9% quarter-on-quarter (q-o-q) in 2Q10.

Thai government bonds were up 21.0% y-o-y at the end of June for a total outstanding amount of THB5.2 trillion (USD160 billion). BOT bonds recorded the highest growth rate of 37.8% y-o-y as of end-June, with total bonds outstanding of THB2.1 trillion, followed by treasury bonds, which posted a 14.5% y-o-y growth rate with total bonds outstanding of THB2.6 trillion. State-owned enterprise and other bonds, however, declined 0.4% over the same period to THB514 billion.

The Public Debt Management Office (PDMO) announced in June that a planned THB104 billion bond issuance, which is aimed at deepening the bond market, would push through in the fourth quarter of fiscal year 2009/10. The planned issue will bring the full year issuance of government bonds to THB434 billion from an initial target of THB386 billion.

The Thai government plans to issue more types of bonds in 2010, including public savings bonds and Islamic bonds (*sukuk*). Following several

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

	Amount (billion)								**Growth Rate** (%)						
	Mar-10		**Apr-10**		**May-10**		**Jun-10**		**Mar-10**		**Apr-10**	**May-10**	**Jun-10**		
	THB	**USD**	**THB**	**USD**	**THB**	**USD**	**THB**	**USD**	**y-o-y**	**q-o-q**	**m-o-m**	**m-o-m**	**y-o-y**	**q-o-q**	**m-o-m**
Total	6,178.1	191.0	6,191.7	191.5	6,185.9	190.3	6,419.0	198.0	18.1	4.7	0.2	(0.1)	18.4	3.9	3.8
Government	4,964.7	153.5	4,950.4	153.1	4,934.5	151.8	5,177.5	159.7	17.9	5.4	(0.3)	(0.3)	21.0	4.3	4.9
Treasury Bonds	2,471.0	76.4	2,456.0	75.9	2,462.6	75.7	2,566.7	79.2	13.0	4.6	(0.6)	0.3	14.5	3.9	4.2
Central Bank Bonds	1,972.8	61.0	1,975.8	61.1	1,954.9	60.1	2,096.8	64.7	29.6	8.4	0.2	(1.1)	37.8	6.3	7.3
State-owned Enterprise & Other Bonds	520.9	16.1	518.5	16.0	517.0	15.9	514.0	15.9	3.8	(1.7)	(0.5)	(0.3)	(0.4)	(1.3)	(0.6)
Corporate	1,213.4	37.5	1,241.3	38.4	1,251.4	38.5	1,241.4	38.3	19.0	2.0	2.3	0.8	9.0	2.3	(0.8)

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

months of delay due to political tensions, the Thai government sold THB80 billion in savings bonds in June out of a planned total of THB100 billion. The 6-year bonds pay an average annual yield of 4.17%. Proceeds from the issue will be used to finance infrastructure projects under the Thai Khem Khaeng economic stimulus program. Also, the Islamic Bank of Thailand is planning to issue THB5 billion worth of *sukuk* in 4Q10. Target buyers are domestic and international institutional investors, including Malaysian firms doing business in Thailand. Proceeds from the bond issue will finance lending expansion and capital base restructuring.

Thai corporate bonds outstanding at the end of June stood at THB1.2 trillion (USD38.3 billion), up 9.0% y-o-y and 2.3% q-o-q. New issuance in 2Q10 declined 5.2% y-o-y to THB275 billion, but increased 37.1% on a q-o-q basis. Notable THB-denominated corporate bond issues in 2Q10 included Bank of Ayudhya's THB20 billion of 10-year subordinated bonds, Siam Cement's THB10 billion of 4-year bonds, and Thai Military Bank's THB8 billion worth of 10-year bonds. Thanachart Bank also issued 10-year subordinated bonds worth THB6 billion to the general public and institutional investors.

In April, the Thai Ministry of Finance granted approval to five international financial institutions (IFIs) to issue THB-denominated bonds worth up to THB4 billion each and with tenors of more than 3 years. The IFIs include Australia and New Zealand Banking Group Limited, Deutsche Bank, International Finance Corporation, Export–Import Bank of Korea, and the Bank of Nova Scotia.

In August, the Thai Finance Ministry granted approval to three Korean firms to issue a total of THB14 billion in bonds in the Thai bond market before the end of 2010. Industrial Bank of Korea and Korea Development Bank have each been granted permission to issue THB5 billion in bonds, while Korea Water Resources Corp. has been permitted to issue THB4 billion in bonds.

Table 2: Top 30 Corporate Issuer, June 2010

Top 30 Corporate Issuers	Outstanding Amount		
	LCY Bonds (THB billion)	LCY Bonds (USD billion)	FCY Bonds (USD billion)
PTT PCL	181.2	5.6	1.16
Siam Cement PCL	110.0	3.4	—
Krung Thai Bank PCL	73.7	2.3	0.22
Bank Ayudhya Public Ltd	63.2	1.9	—
PTT Exporation and Product PCL	49.0	1.5	—
Kasikorn Bank PCL	37.1	1.1	0.18
Thai Airways International PCL	36.8	1.1	—
Toyota Leasing Thailand	28.7	0.9	—
Charoen Pokphand Foods	26.2	0.8	—
TMB Bank PCL	25.3	0.8	0.02
Dad SPV Company Ltd	24.0	0.7	—
Thai Oil PCL	20.8	0.6	0.35
PTT Chemical PCL	20.6	0.6	0.30
Siam Commercial Bank Co	20.0	0.6	—
Krung Thai Card PCL	19.5	0.6	—
Advanced Info Service	19.5	0.6	—
Bangkok Expressway PCL	19.0	0.6	—
Thanachart Bank PCL	18.0	0.6	—
Ayudhya Capital Auto Lease	15.5	0.5	—
Glow Energy PCL	15.0	0.5	—
PTT Aromatics and Refining	15.0	0.5	—
True Corporation PCL	14.0	0.4	—
Thanachart Capital PCL	13.5	0.4	—
Quality Houses Public Co	13.0	0.4	—
Bangkok Mass Transit System	12.0	0.4	—
Central Pattana Public	11.7	0.4	—
CH. Karnchang Public Co	10.9	0.3	—
Minor International PCL	10.4	0.3	—
Land & Houses Public Co	10.0	0.3	—
Siam City Bank PCL	10.0	0.3	—
Total Top 30 Corporate Issuers	**944**	**29**	
Total Corporate Bonds Outstanding	**1,241**	**38**	
Top 30 as % of Total Corporate	**76%**	**76%**	

— = not applicable, FCY = foreign currency, LCY = local currency.
Source: Bloomberg LP.

The following corporations have bond issues in the pipeline for the second half of 2010:

(i) True Corporation plans to sell THB30 billion of bonds with tenors of up to 20 years.

(ii) Thailand's largest energy firm PTT will sell THB20 billion worth of bonds.

(iii) Leading coal miner Banpu PCL plans to raise up to THB20 billion to be able to compete with Australia's Centennial Coal.

(iv) Siam Cement plans to sell THB5 billion of 4-year bonds.

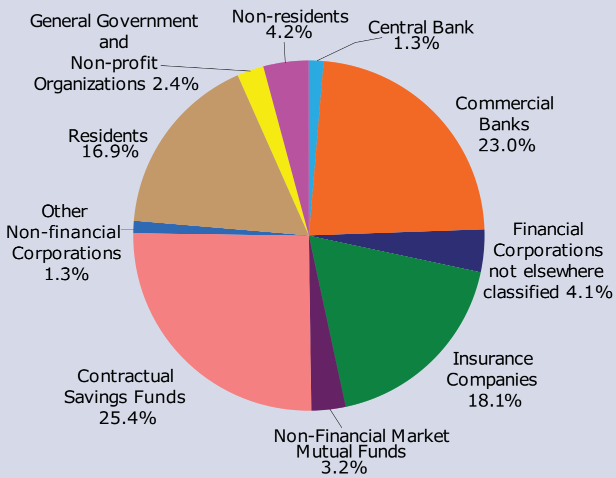
(v) The second-largest Thai property developer Pruksa Real Estate plans to sell THB5 billion of 3- to 5-year bonds in November.

(vi) PTT Chemical plans to raise THB3 billion to repay project investments.

At the end of June, the top 30 corporate issuers in Thailand were mainly from the industrial and financial sectors, and together represented 76% of total LCY corporate bonds outstanding **(Table 2)**. PTT ranked first as the top LCY and foreign currency (FCY) corporate issuer, with total bonds outstanding of THB181.2 billion and USD1.2 billion, respectively.

In July, PTT Exploration and Production became the first Thai issuer to sell bonds in the international market in 3 years. The firm issued USD500 million worth of 5-year bonds with a coupon of 4.152%. Asian investors bought 69% of the bonds, Europeans took 11%, and offshore investors from the United States purchased 20%. The last Thai corporate bond issuance in the international market—USD350 million of 7-year bonds—was conducted by True Move in July 2007.

Figure 2: LCY Government Bonds Investor Profile, June 2010



LCY = local currency.
Source: Bank of Thailand.

Investor Profile

At the end of June, contractual savings funds were the largest holder of Thai government bonds (25.4%), with a total amount of THB651.2 billion **(Figure 2)**. Commercial banks were the second-largest holder of government bonds with a 23.0% share, followed by insurance companies (18.1%), residents (16.9%), and nonresidents (4.2%). Financial corporations "not elsewhere classified" held 4.1% of all Thai government bonds, non-financial market mutual funds had a 3.2% share, and general government and non-profit organizations had a 2.4% share. Meanwhile, other non-financial corporations and the BOT both held shares of 1.3%.

Rating Changes

Moody's and Standard & Poor's (S&P) affirmed Thailand's sovereign ratings in spite of the political turmoil in 2Q10 **(Table 3)**. Moody's kept Thailand's long-term FCY rating at Baa1 and maintained its negative outlook, while S&P affirmed Thailand's long-term FCY rating of BBB+ and also retained its negative outlook.

Table 3: Selected Sovereign Ratings and Outlook for Thailand

	Moody's	Standard & Poor's	Fitch
Sovereign FCY LT Ratings	Baa1	BBB+	BBB
Outlook	negative	negative	stable

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

Policy, Institutional, and Regulatory Developments

SEC Allows Thai Firms to Issue USD-Denominated Bonds

In April, the Securities and Exchange Commission (SEC) of Thailand approved, in principle, the issuance of FCY-denominated bonds to domestic investors by both Thai and foreign issuers. Previously, only foreign firms were allowed to issue FCY-denominated bonds to Thai commercial banks. Thai issuers—including PTT Exploration and Production, Bangkok Bank, and Siam Commercial Bank—are keen on issuing USD-denominated bonds domestically to help lower their cost of funding.

Thai Cabinet Approves Draft Securities Bill

In May, the Thai Council of Ministers approved a draft securities bill that allows the demutualization of the Stock Exchange of Thailand (SET). The bill will pass through the National Economic and Social Development Board and the Commerce Ministry for scrutiny. The SET will be the trading center and the SEC will be in charge of capital market development and rule formulation. The Finance Ministry proposed the amendment to better connect Thailand's financial markets with the global economy and improve the management of investment flows.

SEC Approval and Credit Rating Required for State-Owned Enterprises and Government Agencies to Issue Bonds

The SEC announced a regulation that requires state-owned enterprises and government agencies to obtain SEC approval and a credit rating before issuing bonds. This rule has previously only applied to private companies issuing debt instruments. The Thai Finance Ministry has been reducing the financial dependency of state-owned enterprises and state agencies on the central government by decreasing the amount of guaranteed debts and signaling that such enterprises and agencies need to rely less on the government for financing.

Viet Nam—Update

Yield Movements

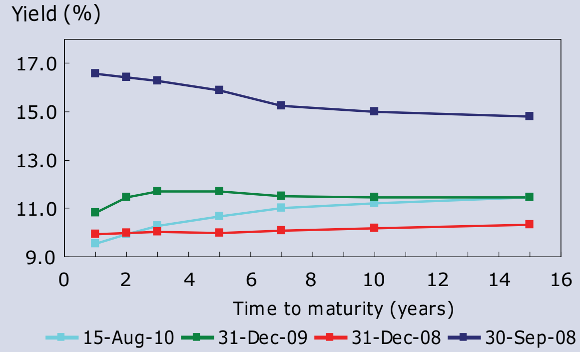
The Vietnamese government bond yield curve steepened between end-December 2009 and mid-August 2010 as yields fell from the short-end to the belly of the curve **(Figure 1)**. Yields on 1-, 2-, 3- and 5-year maturities fell up to 150 basis points through mid-August, while the yield spread between 2- and 10-year maturities widened to 126 basis points compared with a spread of –2 basis points at the end-December.

The State Bank of Viet Nam (SBV) has kept its policy rate unchanged for 9 consecutive months as the government is seeking to boost lending. The base rate is being maintained at 8.0%, while the refinancing and discount rates are being kept unchanged at 8.0% and 6.0%, respectively.

Viet Nam's economic growth accelerated to 6.4% year-on-year (y-o-y) in 2Q10 as revived bank lending helped boost manufacturing and consumer spending. Gross domestic product (GDP) in 1Q10 expanded 5.83% y-o-y. Viet Nam's GDP is expected to expand 6.5% in 2010, higher than the 5.32% growth recorded in 2009. Consumer price inflation eased to 8.19% y-o-y in July, compared with 8.69% in June, as banks lowered interest rates and input costs stabilized.

The SBV devalued the Vietnamese dong by 2.1%, effective 18 August, in an effort to control Viet Nam's widening trade deficit. The trade deficit for the first 6 months of the year stood at USD6.7 billion, compared with USD2.1 billion in the same period last year. This was the third devaluation of the dong since November; the dong was devalued by 5.4% in November 2009 and by 3.4% in February 2010. The new reference rate was set at VND18,932 per USD1, from the previous average interbank rate of VND18,544 per USD1. The daily trading band was maintained at 3.0%.

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



LCY = local currency.
Source: Bloomberg LP.

Size and Composition

As of June 2010, total local currency (LCY) bonds outstanding in Viet Nam stood at VND293.6 trillion (USD15.4 billion), representing a 35.8% y-o-y increase from VND227.6 trillion (USD12.0 billion) in March 2010 **(Table 1)**. Compared with 1Q10, total bonds outstanding increased 29.0% in 2Q10.

Viet Nam's total government bonds outstanding rose 28.8% y-o-y, and 29.4% on a quarter-on-quarter (q-o-q) basis, to VND264.6 trillion (USD14.0 billion). The quarterly increase in government bonds was driven by 30.2% growth in treasury bonds to VND120.4 trillion as well as a 28.8% growth in Viet Nam Development Bank and state-owned enterprise bonds. Meanwhile, the amount of central bank bonds remained unchanged in 2Q10 at VND200 billion.

Government bonds represented 90% of total bonds outstanding in the Vietnamese bond market in 2Q10. Major issuers—measured by the amount of bonds outstanding as of end-June—included the national government (VND30.0 trillion), Viet Nam Bank for Social Policies (VND8.4 trillion),

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

	Amount (billion)								Growth Rate (%)						
	Mar-10		Apr-10		May-10		Jun-10		Mar-10		Apr-10	May-10	Jun-10		
	VND	USD	VND	USD	VND	USD	VND	USD	y-o-y	q-o-q	m-o-m	m-o-m	y-o-y	q-o-q	m-o-m
Total	227,596.9	11.9	256,867.2	13.5	277,029.2	14.6	293,569.2	15.4	8.5	2.3	12.9	7.8	35.8	29.0	6.0
Government	204,507.0	10.7	232,077.3	12.2	251,189.3	13.2	264,629.3	13.9	2.7	1.5	13.5	8.2	28.8	29.4	5.4
Treasury Bonds	92,490.2	4.8	98,095.2	5.2	108,950.2	5.7	120,390.2	6.3	(11.3)	2.4	6.1	11.1	15.9	30.2	10.5
Central Bank Bonds	200.0	0.0	200.0	0.0	200.0	0.0	200.0	0.0	—	88.5)	—	—	—	—	—
Viet Nam Development Bank Bonds, State-Owned Enterprise Bonds and Other Bonds	111,816.8	5.9	133,782.1	7.0	142,039.1	7.5	144,039.1	7.6	17.9	2.2	19.6	6.2	41.8	28.8	1.4
Corporate	23,089.9	1.2	24,789.9	1.3	25,839.9	1.4	28,939.9	1.5	116.2	10.0	7.4	4.2	170.9	25.3	12.0

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

Notes:

1. Bloomberg end-of-period LCY—USD rates are used.
2. Growth rates are calculated from LCY base and do not include currency effects.

Source: Bloomberg LP.

Viet Nam Development Bank (VND21.8 trillion), and Viet Nam Electricity (VND3.0 trillion). The Vietnamese government has issued bonds to repay maturing bonds and to cover the budget deficit, which is expected to reach 6% of GDP this year. The government plans to issue VND100 billion for the whole of 2010, but only VND40 billion had been raised as of July.

Vietnamese state-owned conglomerates Petrovietnam, the Viet Nam Coal and Mineral Industries Group (Vinacomin), and Viet Nam Electricity each plan to issue foreign currency (FCY) bonds worth USD1.0 billion in 4Q10, with the goal of using the raised funds for their respective capital mobilization efforts.

VND-denominated corporate bonds increased 170.9% y-o-y, and 25.3% q-o-q, to VND29.0 trillion (USD1.5 billion) in 2Q10. The top issues for the quarter included VND3.0 trillion in bonds from Vietnam JSC Commercial Bank and VND1.5 trillion in bonds from Song Da Holdings. In May, property developer Vincom Joint Stock Company (Vincom JSC) issued VND1.0 trillion worth of 5-year bonds with a 16.0% coupon. Proceeds from the Vincom JSC bond issue will fund construction projects.

As of end-June, LCY corporate issuers' total bonds outstanding stood at VND28.9 trillion (USD1.5 billion) **(Table 2)**. Most of the LCY corporate issuers were from the financial and industrial sectors. Vincom JSC ranked first with outstanding bonds totaling VND5.0 trillion, followed by the FPT Corporation and Asia Commercial Bank, which both had VND3.6 trillion in total bonds outstanding. Vincom JSC is the only major Vietnamese corporation that has issued an FCY bond to date (USD100 million).

Rating Changes

In June 2010, Standard and Poor's affirmed Viet Nam's long-term FCY rating of BB with a negative outlook, reflecting the increased vulnerability of the economy to severe shocks as well as risks to financial stability **(Table 3)**. Standard & Poor's

Table 2: Corporate Issuers, June 2010

Corporate Issuers	Outstanding Amount		
	LCY Bonds (VND billion)	LCY Bonds (USD billion)	FCY Bonds (USD billion)
Vincom JSC	5,000	0.26	0.1
FPT Corporation	3,600	0.19	—
Asia Commercial Joint Stock Bank	3,600	0.19	—
Vietnam JSC Commercial Bank	3,000	0.16	—
Techcombank	3,850	0.2	—
Saigon Securities Inc	2,000	0.1	—
Saigon Thuong Tin Commercial	2,000	0.1	—
Song Da Holdings	1,500	0.08	—
Military Commercial Bank	1,000	0.05	—
Vinpearl Land Tourism JSC	1,000	0.05	—
Kinh Bac City Development	500	0.03	—
Songda Urban & Industrial	500	0.03	—
HCMC General Import Export	450	0.02	—
Binh Chanh Construction	300	0.02	—
Long Hau Corp	200	0.01	—
Minh Phu Seafood JSC	200	0.01	—
Transforwarding Warehouse	100	0.01	—
Khang Dien House Trading	90	0	—
Son Ha International	50	0	—
TOTAL	**28,940**	**1.52**	**0.1**

— = not applicable, FCY = foreign currency, LCY = local currency.
Source: Bloomberg LP.

also affirmed Viet Nam's long-term LCY rating of BB+.

In July, Fitch Ratings announced that it had downgraded both its long-term FCY and LCY issuer default ratings for Viet Nam to B+ from BB-. Fitch placed Viet Nam on a stable outlook, replacing the negative outlook announced in March 2010. Fitch also downgraded Viet Nam's country ceiling from BB- to B+, and affirmed its short-term FCY issuer default rating at B.

Table 3: Selected Sovereign Ratings and Outlook for Viet Nam

	Moody's	S&P	Fitch
Sovereign FCY LT Ratings	Ba3	BB	B+
Outlook	negative	negative	stable

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

Policy, Institutional, and Regulatory Developments

Tax on Foreign Investors Hiked in June 2010

In May, the Finance Ministry amended Circular No. 134/2008/TT-BTC, which had been issued on 31 December 2008. The circular guides the implementation of taxes on foreign institutions and individuals doing business or earning income in Viet Nam. Effective 7 June 2010, foreign investors were made subject to a 10% income tax on interest derived from certificates of deposit and bonds, with the exception of government bonds.

SBV to Base Policy Rate on Market Rates

In June, the Vietnamese National Assembly passed legislative amendments requesting the SBV to use market interest rates as a basis of monetary policy. The SBV usually publishes a base rate every month, but with the amendment, the SBV will publish monthly market rates as reported by credit institutions. The changes will take effect on 1 January 2011.

Limited Liability Companies to Issue Bonds

In July, the Ministry of Finance issued a draft decree that allows limited liability companies to issue corporate bonds in the domestic and international capital markets. The draft decree identifies which limited liability companies are allowed to issue bonds and provides a legal framework to enterprises on international bond issuance.

Fees on Corporate Bonds to be Cut by 50%

In August, the prime minister's working group proposed that the Finance Ministry reduce corporate bond issuance acceptance fees by 50% in an effort to harmonize such fees with those on other licenses such as investment registration and construction licenses. The proposed changes would adjust fees to the following levels: (i) VND 5million for bond issues of less than VND50 billion, (ii) VND10 million for issues of less than VND150 billion, (iii) VND17.5 million for issues of less than VND250 billion, and (iv) VND25 million for issues larger than VND250 billion.

Asia Bond Monitor October 2010

The Asia Bond Monitor (ABM) reviews recent developments in East Asian local currency bond markets along with the outlook, risks, and policy options. The ABM covers the 10 Association of Southeast Asian Nations member countries plus the People's Republic of China; Hong Kong, China; and the Republic of Korea.

About the Asian Development Bank

ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries substantially reduce poverty and improve the quality of life of their people. Despite the region's many successes, it remains home to two-thirds of the world's poor: 1.8 billion people who live on less than $2 a day, with 903 million struggling on less than $1.25 a day. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

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