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Globalization of the Asian Bond Markets: Foreign Investors Indispensable for Further Development

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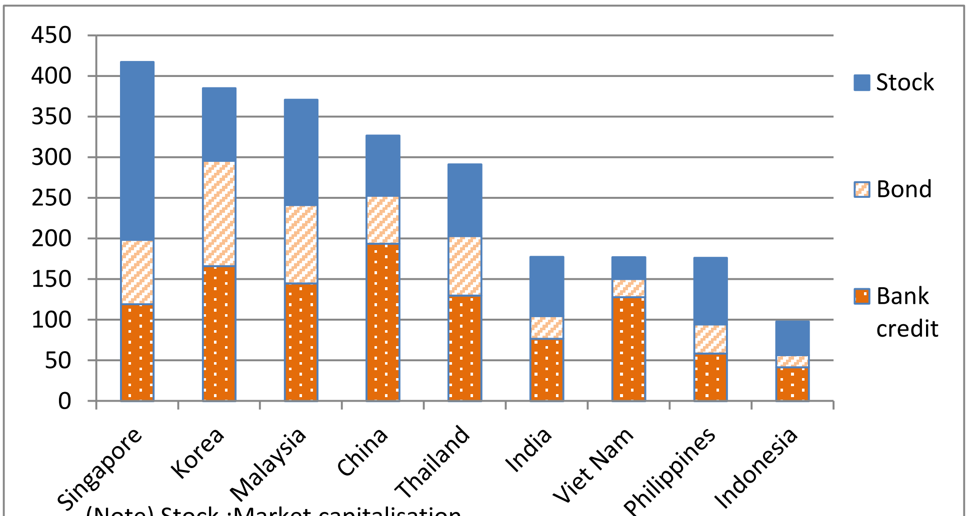
Fostering Bond Markets to Prevent Recurrence of an Asian Financial Crisis

In the Asian emerging and developing countries, indirect finance mainly conducted by commercial banks accounts for a larger part of their domestic finance.

In the 1990s, the governments in Asian countries rapidly promoted liberalization and internationalization of their financial system despite in an environment having still underdeveloped domestic financial sectors, and this largely prompted the outflow of domestic savings for external investments through the intermediation of U.S. and European financial institutions. On the other hand the domestic financial sectors tended to heavily rely on foreign short term capital to raise their funds. This caused a mismatch of currency and term in the form of “long-term domestic assets denominated in domestic currency coupled with short-term debts denominated in foreign currency” in their domestic financial sectors. Inflow of foreign short-term capital was also spurred by an institutional factor that many Asian countries had maintained a fixed exchange rate regime pegged to the U.S. dollar. In 1997, Thailand was attacked by a heavy and rapid capital outflow and was forced to make a transition from the fixed exchange rate regime to a floating rate system. Triggered by the rapid capital outflow in Thailand, the neighboring countries got an immediate contagion of capital outflow which developed into an Asian financial crisis. Reflecting on the lessons from the crisis, Asian countries started to accumulate foreign exchange reserves and at the same time, trying to divert regional savings toward regional investment, began to make efforts, as a pressing issue, to foster their domestic bond markets where more local-currency-denominated bonds could be dealt with. These efforts included the Asian Bond Market Initiative (ABMI) that was promoted as part of ASEAN+3 (Japan, China and Korea) financial cooperation.

Figure1: Financial Markets of Asian Countries (As % of GDP, end of 2015)



(Note) Stock :Market capitalisation
(Sources) ADB, IMF and each country'S data

Thanks to the efforts under the ABMI as well as of the national authorities, the local currency bond markets have been institutionally improved, slowly and in differing degrees. Yet, many of these countries shared the same problems like insufficient participation of institutional investors, lack of variety of investors, lack of liquidity (in many Asian countries domestic investors often took a "buy and hold" strategy on their portfolio investment), and lack of diversity of bond issuers. In this regard, foreign investors had drawn an increased attention as a way to address the problems noted above.

Globalization of Asian Bond Markets Progressed, But Still Only Half Way Through

With the progress of financial globalization, participation of foreign investors in the local bond markets in the Asian countries has been gradually increasing. Their participation is highly expected to contribute to the improved efficiency of their markets in the form of enhanced transparency and increased amount of information that they will bring about together with increased variation of investors and invigorated bond transactions.

Among the global cross-border bond investment, those directed to Asia amounted to $302.4 billion in 2001, which increased to $1,035.8 billion in 2010 and to $1,613.8 billion in 2016, increasing by 5.3 fold in the past 15 years. However, its share in the world total, which increased by 3.7 fold in the same period, only rose from 4% to 6% (Table 1). The predominant part of the world bond investment has been directed to the U.S. (a share of 47% in 2016) and the U.K. (14%). Although Japan is the top recipient among the bond investment targeted to Asia, Japan's share in the world accounted for only 3% in 2016.

During the same period, however, the intra-regional bond investment increased by 8.7 fold from $53.1 billion to $461.1 billion. The share of the intra-Asian bond investment in the total bond investment directed to Asia steadily increased from 4% in 2001 to 7% in 2010, and 12% in 2016. Excluding China, which was not included as an investor in the statistics of prior to 2015, the adjusted share increased to 11% in 2016. Especially in Asia, Hong Kong and Singapore play a big role as an investment hub. Hong Kong plays a role of a window for investment not only to ASEAN but also to South Asia including India.

To Attract Foreign Investors

According to a study by the Asian Development Bank (ADB) economists on international bond investment[1], foreign investors have a tendency to give a higher weight to investment in advanced countries and a lower weight in emerging countries. Especially they have a strong tendency to be cautious to invest in emerging countries in Latin America and Asia. Specifically, China has been given a substantially low weight due to its capital controls. On the other hand, emerging countries in Europe have been less underweighted as they have been deepening their economic integration with the Euro area.

Also in every market, there remains a strong home-bias (preference of domestic securities), especially in emerging countries. During the 5 years from 2010 to 2015, preference of foreign bonds is observed to have increased to some extent in both emerging and advanced countries, indicating the progress in the globalization of bond investment. In fact, after the global financial crisis of 2007-2008, preference of bonds in emerging countries has grown seeking for higher

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1 Park et al. (2018)

yields.

Among such movements, however, foreign investors have still given a relatively lower weight to the bonds of emerging Asian countries as compared to their market size. The ADB study explains that this is due to the capital controls remaining in some of the Asian markets. The study cites, as factors to attract foreign investors, high yields, low volatility, fewer regulations, good performance of macro economy, and stability in exchange rates. It also points out that the larger is the home market, the stronger is the tendency that the investors prefer foreign securities.

Conclusion

It goes without saying that to expand the investor base in the bond market it is important to increase domestic investors, especially in view of their tenacity to external shocks. However, when there is a limited variety in domestic investors, as is often seen in emerging and developing countries, the existence of foreign investors cannot be ignored. In order to expand the participation of investors in the bond markets which are still underdeveloped, it will be fastest way for the Asian emerging and developing countries to promote regional economic integration and attract foreign (especially intra-regional) investors who are familiar to the region. In this sense, it will be indispensable for these countries to continue to make efforts to promote regional financial cooperation, especially through the ASEAN+3 and others. On the side of individual countries, it is also important for them to make efforts to increase the trust of foreign investors by enhancing their market transparency and strengthening their economic fundamentals.

Table 1：Cross-border Bond Investment Outstanding in Asia

＜2001＞ Unit：millions of dollars

Investment from / in	China, P.R.: Hong Kong	China, P.R.: Macao	China, P.R.: Mainland	India	Indonesia	Japan	Korea, Republic of	Malaysia	Philippines	Singapore	Thailand	Total Asia (c)	United Kingdom	United States	World Total (d)	(c)/(d)
Hong Kong		445			96	1,268	306	28	25	1,684	119	3,972	8,597	1,893	16,872	24%
Macao															23	
China,Mainland	2,967	114				880	142			561		4,664	828	634	7,178	65%
India		8				166	66	6		382		627	625	301	2,125	30%
Indonesia						108	63	8	3	476		657	319	315	1,873	35%
Japan	7,103	44			1		75	15	5	7,299		14,542	41,480	27,125	208,238	7%
Korea	3,789	44				5,454		3	7	2,659		11,954	3,877	4,938	25,397	47%
Malaysia	1,817	10			2	2,200	329		9	2,180		6,546	1,017	1,680	10,294	64%
Philippines	1,179					1,347	106	41		954		3,628	712	2,671	9,497	38%
Singapore	1,282	28			38	1,209	151	10	59		98	2,875	7,741	1,442	14,508	20%
Taiwan	609	27				82	8	15	13	431		1,184	287	253	2,165	55%
Thailand	659					748	159	21		888		2,476	425	782	4,265	58%
Vietnam															3	
Total Asia (a)	19,405	719			137	13,462	1,404	147	121	17,514	217	53,126	65,908	42,034	302,440	18%
World Total(b)	110,985	2,298			701	1,062,403	6,735	947	2,024	78,669	743	1,265,504	745,665	690,936	7,520,680	17%
(a)/(b)	17%	31%			20%	1%	21%	16%	6%	22%	29%	4%	9%	6%	4%	

＜2010＞ Unit：millions of dollars

Investment from / in	China, P.R.: Hong Kong	China, P.R.: Macao	China, P.R.: Mainland	India	Indonesia	Japan	Korea, Republic of	Malaysia	Philippines	Singapore	Thailand	Total Asia (c)	United Kingdom	United States	World Total (d)	(c)/(d)
Hong Kong		1,198			147	1,484	450	234	217	6,581	331	10,642	6,995	2,297	23,369	46%
Macao	286				0	0	0				0	286	24	56	366	78%
China,Mainland	50,550	468			108	494	197	9	0	1,506	1	53,333	2,548	1,602	62,040	86%
India	8,796	35			10	1,057	124	235	0	14,519	446	25,222	14,491	5,009	64,341	39%
Indonesia	393	0				2,649	80	253	697	16,272	43	20,389	1,760	9,622	45,736	45%
Japan	18,715	28		4	14		1,134	65	64	C	112	20,135	71,071	52,700	533,140	4%
Korea	18,460	187			130	12,200		2,540	250	18,173	11,238	63,177	22,497	25,772	152,571	41%
Malaysia	5,367	127			51	2,774	211		21	7,691	133	16,375	3,643	11,940	50,689	32%
Philippines	1,146	0		0	1	2,937	195	512		2,555	46	7,393	1,020	7,506	26,509	28%
Singapore	5,225	123		7	739	4,998	155	1,991	139		176	13,553	5,270	7,552	41,851	32%
Taiwan	1,712	2			5	25	15	0		6,051	0	7,810	6,070	377	17,640	44%
Thailand	749	24			2	886	112	165	0	4,607		6,545	656	2,035	14,676	45%
Vietnam	281				1	38	25	0	0	139	1	485	1,117	674	2,895	17%
Total Asia (a)	111,680	2,192		12	1,207	29,542	2,698	6,003	1,387	78,095	12,527	245,343	137,164	127,142	1,035,822	24%
World Total(b)	347,709	7,000		527	5,881	2,667,349	30,301	10,843	5,745	292,875	17,997	3,386,228	2,065,895	2,091,098	25,018,498	14%
(a)/(b)	32%	31%		2%	21%	1%	9%	55%	24%	27%	70%	7%	7%	6%	4%	

＜2016＞ Unit：millions of dollars

Investment from / in	China, P.R.: Hong Kong	China, P.R.: Macao	China, P.R.: Mainland	India	Indonesia	Japan	Korea, Republic of	Malaysia	Philippines	Singapore	Thailand	Total Asia (c)	United Kingdom	United States	World Total (d)	(c)/(d)
Hong Kong		3,141	33,434	0	38	6,979	2,842	793	740	11,904	1,555	61,426	13,304	5,852	105,537	58%
Macao	248		94	0		0	0	13	C	22	107	484	287		845	57%
China,Mainland	110,622	17,017		0	295	5,245	4,118	405	408	21,180	1,702	160,991	6,686	4,200	202,771	79%
India	6,017	13	294		41	3,384	309	69	287	19,238	151	29,804	6,840	9,743	70,567	42%
Indonesia	1,198	4	752	0		6,000	460	867	1,973	9,984	326	21,565	4,357	26,026	92,784	23%
Japan	42,923	517	3,187	0	8		3,881	391	389	C	3,099	54,395	138,581	167,340	773,952	7%
Korea	13,665	439	1,154	0	2	14,127		444	235	14,135	1,161	45,363	9,584	22,748	125,920	36%
Malaysia	4,157	428	181	0	13	6,305	539		57	11,739	378	23,797	3,936	11,012	65,007	37%
Philippines	1,102	2	37	0	1	1,743	555	122		2,612	12	6,187	2,276	6,782	28,567	22%
Singapore	10,033	484	4,486	6	2,141	12,406	2,589	9,578	92		399	42,211	7,145	15,086	106,043	40%
Taiwan	2,414		343	0	6	1,118	12	3	C	276	3	4,175	4,648	84	10,923	38%
Thailand	1,206	27	73	0	23	5,324	29	504	104	2,707		9,996	4,504	3,052	27,794	36%
Vietnam	325		47	0	10	25	52	2	C	209	1	671	791	546	3,058	22%
Total Asia (a)	193,909	22,071	44,082	6	2,577	62,656	15,386	13,193	4,285	94,008	8,893	461,066	202,940	272,471	1,613,768	29%
World Total(b)	491,746	37,664	153,980	996	9,210	2,483,194	125,956	23,534	10,845	506,961	21,848	3,865,935	1,875,941	2,756,649	27,533,018	14%
(a)/(b)	39%	59%	29%	1%	28%	3%	12%	56%	40%	19%	41%	12%	11%	10%	6%	

（Notes）Blank means zero or not available. 0 means less than US$500,000 or reported as 0. Total Asia means the sum of available data of 13 Asian economies in this table. C means confidential.

(Source) IMF

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