

The rising importance of APAC bond markets

From China and Korea to India and Indonesia, local bond markets are playing an increasingly strategic role in global portfolios

Investors in Asia's local currency bond markets have long had to contend with liquidity, execution and transparency challenges. These frictions are taking on greater significance as foreign participation grows and allocation decisions become more complex.

"Three or four years ago the picture was very clear. You had low-yielding markets like Singapore and Hong Kong, and high-yielding markets like Indonesia and India, so investors knew exactly what to do – where to pick up yield and how to structure carry trades. That segmentation has now changed and become more dynamic," says Belinda Liao, a portfolio manager for Fidelity.

Interest in APAC's local currency bond markets has been growing strongly for the past few years. Whereas investors previously saw US Treasuries as a reliable hedge against volatility, some investors are now seeking exposure elsewhere. Local markets may not be a direct substitute for the greenback, but they can offer attractive opportunities for yield and strategic portfolio construction.

That shift is also visible at the trading desk level. Brokers who have spent decades facilitating local currency government bond trading across the region report a marked pickup in demand for pricing information over the past year.

"In the last 12 months, we've seen a material uptick in request for pre-trade bond pricing information across all local currency bond markets. This demand for market pricing has come from global and regional banks, but also from buy side investment businesses and macro funds," says James Ient, APAC CFO and Global Market Data CFO, Tradition.

China remains a key destination for global fixed-income investors and one of the largest recipients of foreign interest in the region's local currency bond markets.

According to Jerome Tay, a senior investment manager at Aberdeen Investments, Beijing's focus on sustaining growth has reinforced expectations that monetary policy will remain accommodative, helping to underpin demand for Chinese bonds. Two other factors are also bolstering investor interest: abundant liquidity and a deep domestic investor base, which help reduce the risk of abrupt capital outflows.

Alicia Garcia-Herrero, APAC Chief Economist for Natixis, says investor demand across the region has been "resilient", supported by attractive valuations in markets such as Indonesia, India and the Philippines. However, liquidity considerations mean appetite for corporate bonds has been moving more slowly than government paper.

Garcia-Herrero adds that structural inflows are also being driven by inclusion in global indices, especially Korea's entry into the FTSE World Government Bond Index in April 2026.



■ Deeper markets, uneven liquidity

Despite rising appetite, lingering geopolitical uncertainty is prompting caution among investors.

"It feels as though the risks have not been properly addressed in many of the markets, and so there could be a bit of near-term weakness, even though valuations may look attractive," says Kheng Siang Ng, Asia Pacific Head of Fixed Income at State Street Investment Management. Conflict in the Middle East is a particular concern.

"The longer this drags on, the more developing economies are affected," says Ng.

Some investors have already pulled back from certain high-yielding markets, according to Ng.

Rising volatility has left many dealers unwilling to warehouse risk, reducing market depth in some segments. That has made execution more sensitive, with larger trades often requiring greater fragmentation and more careful counterparty selection.

“Even as regulation changes and markets open to foreign investors, liquidity can still be tight — many domestic investors tend to hold bonds to maturity, which leads to less transparent pricing and inconsistent execution, with wider bid–ask spreads and liquidity concentrated in recently issued securities,” says Dan Farrell, head of international fixed income for Northern Trust Asset Management.

Liquidity conditions vary considerably across the region. While China’s bond market benefits from a large domestic investor base and relatively deep pools of liquidity, trading conditions can be far more uneven in smaller markets. As foreign participation increases, differences in market depth and secondary market activity are becoming a more important factor in allocation decisions.

To counter this, Farrell says that the more sophisticated investors are **“leveraging a variety of market security data to identify and trade the most liquid bonds available, while deepening relationships with local broker–dealers and investing in regional execution capabilities to better navigate these structural frictions”**.

That search for pricing precision is being reinforced by the changing shape of the investor base itself, as real money and macro accounts take on a larger role in these markets.

“The increased activity of real money and macro funds has in turn driven an increased interest in asset swap pricing in Asian local currency markets,” lent adds.

FX dynamics are also influencing allocation decisions, particularly where interest rate differentials have narrowed or become less predictable.

This broadening of the investor base is also reshaping the FX landscape that sits alongside local bond markets. **“The increase in cross border non–dollar asset trading has also driven a broader pool of FX market participants,”** says lent.

“Even if they initially invest on an unhedged basis, investors should think about whether they may need to hedge further down the line, and ensure they understand what tools are available. The cost and availability of hedging forms an important part of the initial assessment,” says Ng.

In thinner hedging markets – such as those found in Indonesia and India – investors may need to adjust their bond positions more frequently to manage overall risk, increasing transaction costs and reducing execution efficiency. By contrast, China’s larger and more developed onshore markets offer investors a broader range of currency management tools, although access and operational requirements can still be more complex than in developed markets.

■ Structural shift

Liquidity constraints, execution frictions and FX-related challenges are nothing new for investors into Asia’s local currency bond markets. However, policymakers across the region are increasingly taking steps to address them, reflecting a broader effort to deepen market infrastructure, improve accessibility and attract a wider base of international investors.

Korea is a very good example of how some of these frictions are being ironed out. In July, the country will open its markets to 24-hour trading, Monday to Friday. That shift reduces the timing mismatch that foreign investors used to face when managing currency exposure, making it far simpler to hedge positions without having to align trading activity to local market hours. This is likely to support greater participation in the market.

Other markets are pursuing similar goals through initiatives designed to attract foreign capital and deepen local bond markets. In Indonesia, for example, authorities have introduced steps aimed at improving market liquidity and encouraging foreign participation, including the expansion of market instruments and efforts to deepen domestic funding and hedging markets.

At the same time, central banks across the region are showing a greater willingness to support currencies and maintain orderly market conditions during periods of volatility, helping to reinforce investor confidence. In May, the central banks of Indonesia and Sri Lanka both raised interest rates as an effort to support their respective currencies against the US dollar.

“These problems have been around for decades, but things are improving and policymakers are trying to make things more accessible to foreign investors,” says Tay.



■ Local knowledge

Despite attractive valuations and a more supportive policy environment, some investors still remain cautious about increasing allocations.

“We are getting to a place where valuations are beginning to look attractive, and authorities are now more vocal in terms of stepping in to provide support to the market,” says Ng. “But whether investors are ready to put a lot more money to work... well, I still think there’s a big question mark around this.”

That uncertainty places a premium on local knowledge, with investors increasingly focused on understanding the specific dynamics that drive each market.

“Local market expertise has become a genuine competitive advantage rather than a secondary consideration,” says Farrell from Northern Trust Asset Management. “Institutions with established relationships with local dealers tend to have better visibility into real trading flows and can access liquidity that may not be visible through global banks. Arming portfolio managers with a broader and better-quality selection of bonds directly improves execution outcomes.”

He adds that, beyond execution, having a local presence also provides more effective management of FX timing and pricing, giving investors greater control over total trade outcomes.

Local bond ratings are another specific problem that investors have to contend with. In USD markets, most issuers are covered by the three major global rating agencies, which makes credit assessment and portfolio construction relatively straightforward. But in many local markets – such as China and Japan – domestic rating agencies play more of a prominent role.

“For international investors, the lack of a consistent mapping between local and global ratings creates a practical challenge, as a significant portion of the market can effectively appear unrated if only global ratings are used,” says Liao.

“That complicates portfolio construction, risk aggregation and benchmarking, because you need a way to normalise ratings across different systems.”

It’s not just about access, but about how effectively you can operate within each local market structure, says Liao.

“That’s where the relationships, liquidity access and execution efficiency sit,” she adds.



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