

# **How Might Sovereign Bond Yields in Asia Pacific React to US Monetary Normalisation under Turbulent Market Conditions?**

**Tom Fong**

Hong Kong Monetary Authority

and

**Ceara Hui**

Hong Kong Monetary Authority

and

**Alfred Wong**

Hong Kong Monetary Authority

May 2015

## **Summary**

This paper examines the potential impact of US monetary normalisation on sovereign bond yields in Asia Pacific. We apply the quantile vector autoregressive model with principal component analysis to the assessment of tail risk of sovereign debt, which may not be detectable using traditional OLS-based analysis. Our empirical evidence suggests that US Treasury bond yields can have a significant impact on sovereign bond yields in the region, an important channel through which monetary normalisation by the Fed can affect Asia-Pacific economies. Increases in sovereign bond yields will not only compromise the ability of the sovereigns in the region to service their debt but also translate into higher costs of borrowing for the rest of the economy. The results show how much the outsized impact could potentially be if US monetary normalisation somehow turns out to be much more disorderly than expected.