

# Developments in Regional Financial Conditions

Emerging East Asian financial conditions remained resilient amid heightened global uncertainty between 3 March and 30 May.<sup>1</sup> Intensified trade tensions and uncertainty surrounding negotiations between the United States (US) and its trading partners raised investor risk aversion and clouded the global economic outlook, especially in March and April. In May, improvements in financial conditions were observed following trade negotiations between the US and some of its trading partners, particularly the People's Republic of China (PRC). During the review period, mixed patterns were observed in regional financial markets. Risk premiums marginally widened and net equity portfolio outflows were recorded, while optimism over trade negotiations and various domestic factors supported regional equity markets, especially in May. Meanwhile, regional currencies strengthened against the US dollar due to weakened investor confidence in USD-denominated assets over uncertainty in US economic policies, a widening federal budget deficit and elevated debt levels,

and the downgrade of the US' sovereign credit rating. Continued monetary easing and disinflation contributed to the decline in both short- and long-term bond yields in most regional bond markets (**Table A**). Nevertheless, uncertainty still clouds the outlook for regional financial conditions pending the outcome of trade negotiations, especially given that the current pause on US tariff implementation expires in July.

During the review period, 10-year bond yields rose in the US, driven by several factors. First, the Federal Reserve (Fed) maintained its higher-for-longer monetary stance, citing the resilient US economic performance and uncertainty about the possible inflationary impact of tariffs. Moreover, subdued investor confidence in USD-denominated assets led to sales of US Treasuries, pushing up US bond yields. Aside from uncertainty over US economic policies, there were also concerns that the federal budget deficit would worsen. On 16 May, Moody's

**Table A: Changes in Financial Conditions in Major Advanced Economies and Select Emerging East Asian Markets from 3 March 2025 to 30 May 2025**

	2-Year Government Bond Yield (bps)	10-Year Government Bond Yield (bps)	5-Year Credit Default Swap Spread (bps)	Equity Index (%)	FX Rate (%)
<b>Major Advanced Economies</b>					
Euro Area	(29)	0.9	–	(3.1)	8.2
Japan	(9)	9	5.6	3.0	3.8
United States	(5)	25	–	1.1	–
<b>Select Emerging East Asian Markets</b>					
People's Republic of China	8	(6)	4.2	0.9	1.2
Hong Kong, China	(139)	(56)	–	1.2	(0.8)
Indonesia	(25)	(5)	1.6	10.1	1.2
Republic of Korea	(32)	7	(0.1)	6.5	5.6
Malaysia	(31)	(26)	2.8	(4.0)	4.9
Philippines	(11)	15	(7.3)	5.0	3.8
Singapore	(61)	(30)	–	(0.4)	4.3
Thailand	(35)	(36)	5.8	(3.3)	4.1
Viet Nam	5	3	4.2	1.8	(1.6)

( ) = negative, – = not available, bps = basis points, FX = foreign exchange.

Note: FX rates are presented against the United States dollar. A positive (negative) value for the FX rate indicates the appreciation (depreciation) of the local currency against the United States dollar.

Source: *AsianBondsOnline* calculations based on Bloomberg LP data.

<sup>1</sup> Emerging East Asia is defined to include member states of the Association of Southeast Asian Nations plus the People's Republic of China; Hong Kong, China; and the Republic of Korea.

downgraded the US' sovereign credit rating from Aaa to Aa1, citing the worsening fiscal deficit as well as a significant build-up of debt. Following the downgrade, the US has now lost its AAA rating from all three major rating agencies. On 22 May, the US House of Representatives passed a new tax and spending bill. The provisions of the bill expand and extend previous tax cuts and add new tax deductions such as for car loans and tips. Market concerns of higher debt levels and a worsening fiscal position thus led to a surge of 12 basis points (bps) for 10-year US bond yields between 16 May and 21 May. US Treasury yields fell slightly on 23 May, following Treasury Secretary [Scott Bessent's](#) announcement that the government was considering scrapping a regulation that limits banks' ability to hold Treasury bonds. Meanwhile, the 2-year bond yield declined during the review period. The decline mostly occurred in March and April, driven by expectations of a bigger cumulative rate cut in 2025 than the Fed's December 2024 projection of 50 bps (**Figure A**). The 2-year bond yield rose in May after the [Fed](#) reaffirmed the prospect of a higher-for-longer monetary stance.

The US economy remains resilient, but recent economic data show some signs of weakening. Gross domestic product (GDP) in the US contracted an annualized 0.2% in the first quarter (Q1) of 2025 after gaining 2.4% in the fourth quarter (Q4) of 2024, largely due to a surge in imports ahead of the full implementation of tariffs, which widened the trade deficit; a slowdown in domestic consumption to 1.2% in Q1 2025 from 4.0% in Q4 2024; and a 0.7% contraction in government expenditures in Q1 2025 versus an expansion of 3.1% in Q4 2024. Retail sales remained subdued. Growth softened to 0.1% month-on-month (m-o-m) in April from 1.7% m-o-m in March, due to weak consumer demand and a high base effect from front-loaded purchases before the full implementation of tariffs, but was still higher than February's 0.0% growth. The S&P Global US Manufacturing Purchasing Managers Index (PMI) recovered in May, rising to 52.0 from 50.2 in both April and March. Industrial production was unchanged on a monthly basis in April after contracting 0.3% m-o-m in March. Consumer confidence rose to 98.0 in May from 85.7 in April and 93.9 in March, but still lower than that of February (100.1) and January (105.3). Nevertheless, the US labor market remained solid. Nonfarm payroll additions recorded 139,000 in May, slightly down from 147,000 in April, but up from 120,000 in March and 102,000 in February. The

unemployment rate held steady at 4.2% in May, April and March, which was slightly higher than February's 4.1%. The generally weak economic data echoed the Fed's projections in March, when it revised downward its 2025 GDP growth forecast to 1.7% from a December estimate of 2.1% and revised upward its 2025 unemployment rate forecast to 4.4% from a December estimate of 4.3%.

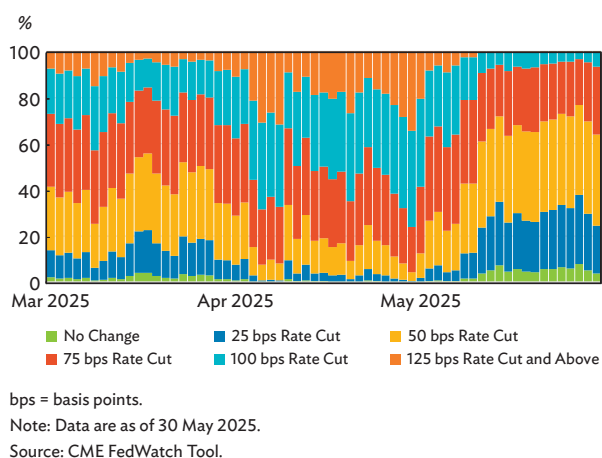
Inflation in the US continued to soften during the review period yet remained above the Fed's 2.0% target. In April, consumer price inflation eased to 2.3% year-on-year (y-o-y) from 2.4% y-o-y in March, 2.8% y-o-y in February, and 3.0% y-o-y in January. Personal Consumption Expenditure (PCE) inflation fell to 2.1% y-o-y in April from 2.3% y-o-y in March and 2.6% y-o-y in February. Core PCE inflation slowed to 2.5% y-o-y in April from 2.7% y-o-y in March and 2.9% y-o-y in February. Nevertheless, the Fed raised the inflation forecast during its March meeting because of the possible inflationary impact of tariffs. The PCE inflation forecast for full-year 2025 was raised to 2.7% from 2.5% in December, while the core PCE inflation forecast for full-year 2025 was raised to 2.8% from 2.5%.

Heightened uncertainty contributed to the higher-for-longer monetary stance in the US. During its March and May Federal Open Market Committee (FOMC) meetings, the Fed left the federal funds target rate range unchanged at 4.25%–4.50% and maintained its December 2024 forecast of a cumulative 50 bps rate cut in 2025. However, in March, the [individual forecasts](#) of Fed members turned slightly hawkish compared to December, while the Fed highlighted that the economy risked higher inflation and unemployment amid rising uncertainty. On 7 May, Fed Chair [Jerome Powell](#) discussed the ongoing uncertainties surrounding tariffs, citing that such policies are still evolving, making their impacts on the economy unclear. Thus, the Fed indicated a wait-and-see attitude, which raised the likelihood of a higher-for-longer monetary stance given the Fed's assessment of a resilient economic outlook.<sup>2</sup> Prior to the 6–7 May FOMC meeting, concerns regarding US tariffs and a possible economic slowdown had driven up the combined probability of a 75 bps (36.4%) or 100 bps (28.9%) cumulative rate cut in 2025 to 65.2%, while the expected chance of either a 25 bps (5.4%) or 50 bps (20.7%) cumulative rate cut had fallen to 26.1% (**Figure A**). However, after the May FOMC meeting, market expectations that the Fed would

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<sup>2</sup> Some Fed officials similarly highlighted the need for caution. For example, on 27 March, Fed Bank of Richmond President [Tom Barkin](#) said that a moderately restrictive monetary policy is appropriate in the face of rapid changes in US economic policy. On 11 April, Fed Bank of New York President [John Williams](#) said that he expects tariffs to raise inflation but that it is also hard to assess the overall impact of policy changes on the economy. On 22 April, Fed Governor [Adriana Kugler](#) said that given the tariffs' inflationary pressures, it was best to maintain the Fed's current policy rate.

**Figure A: Daily Probability of Cumulative Rate Adjustments by the Federal Reserve in 2025**



hold a higher-for-longer policy stance increased, with the combined chance of a 25 bps or 50 bps cumulative rate cut in 2025 immediately rising to 41.1% on 8 May and further to 60.3% by 30 May, with the chance of either a 75 bps or 100 bps cumulative rate cut declining to 35.8%.

In the euro area, the 2-year yield declined between 3 March and 30 May on continued disinflation and monetary easing by the European Central Bank (ECB). However, the 10-year yield rose over expectations of widening [budget deficits](#) driven by increased defense and infrastructure spending following comments from US officials that North Atlantic Treaty Organization members needed to increase defense spending as a percentage of GDP. The euro area's economy has remained resilient. GDP grew 1.5% y-o-y in Q1 2025 from 1.2% y-o-y in Q4 2024, while GDP growth also accelerated on a quarter-on-quarter basis to 0.6% in Q1 2025 from 0.3% in the prior quarter. The manufacturing PMI remained in contraction but continued to trend upward, rising to 49.4 in May from 49.0 in April and 48.6 in March. Nevertheless, heightened global uncertainties also dampened the euro area's growth outlook. In March, the ECB updated its GDP growth forecast by revising downward its projections for full-year 2025 and 2026 to 0.9% and 1.2%, respectively, from December forecasts of 1.1% and 1.4%. Annual inflation in the euro area also continued to trend downward, falling to 1.9% in May from 2.2% each in April and March, and 2.3% in February. However, in its March forecast, the ECB raised its full-year

2025 inflation projection to 2.3% from 2.1% in December and kept its 2026 forecast unchanged at 1.9%. In its June update, the ECB left unchanged the 2025 GDP growth forecast at 0.9% but revised downward the 2026 forecast to 1.1%. In addition, the ECB reduced its 2025 and 2026 inflation projections to 2.0% and 1.6%, respectively.

The ECB continued to ease monetary policy over moderating inflation, while remaining cautious amid rising uncertainty. The ECB reduced its key policy rates by 25 bps each at its 6 March and 17 April meetings. The ECB noted that the disinflation process remained on track. However, during its April meeting, the ECB mentioned that the outlook had deteriorated over rising trade uncertainty. While many ECB members are in favor of further rate cuts, some have expressed caution. For example, on 22 April, ECB President [Christine Lagarde](#) said that the disinflation process was almost done and that they must remain data dependent to properly assess the impact of US trade policies. On 28 April, Bank of Ireland Governor [Gabriel Makhoul](#) advocated for caution, saying he favored a meeting-by-meeting approach due to uncertainty about inflation over the medium-term. On 5 May, Bank of Greece Governor [Yannis Stournaras](#) said that the ECB is set to continue cutting interest rates but also expressed caution. Amid ongoing global uncertainty, the ECB reduced policy rates by 25 bps on 5 June, citing the ongoing disinflation process and need to support growth.

Bond yields in Japan fell at the short-end of the curve between 3 March and 30 May over an expected softening in the Bank of Japan's (BOJ) monetary stance and continued disinflation. However, tariff-related concerns led to speculation that Japan would pass a [supplemental budget](#) to aid the economy. There were also concerns about the government's fiscal position following a proposal for consumption tax cuts ahead of upcoming elections. The Japanese government has since pushed back on the idea of implementing such cuts. In addition, yields faced upward pressure following the reduction of Japanese government bond investments by four major [insurance companies](#) because of [high volatility and low liquidity](#), pushing up long-term bond yields during the review period. In contrast to the easing monetary stances of both the Fed and the ECB, the BOJ previously adopted a tightening stance, raising the policy rate in its January meeting. However, with heightened uncertainty in the

<sup>3</sup> For example, on 24 April, Banque de France Governor [Francois Villeroy de Galhau](#) said that the expected decline in inflation warranted further rate cuts. On 26 April, Bank of Lithuania Governor [Gediminas Simkus](#) said that he saw two more rate cuts this year. On 28 April, Bank of Finland Governor [Olli Rehn](#) said that it was possible for inflation to fall further than expected and that this would allow for further rate cuts.

global trade environment, the BOJ left the policy rate unchanged at its 19 March meeting, noting that the high level of uncertainty surrounding trade policies could affect the paths of inflation and growth. On 16 April, BOJ Governor [Kazuo Ueda](#) said that the central bank may need to take action if US tariffs impact Japan's growth, hinting at a continuation of the pause in rate hikes at the monetary policy meeting in May. As expected, the BOJ held the policy rate steady at its 1 May meeting. The Japanese economy remains largely subdued, with annualized GDP contracting 0.2% in Q1 2025—following annualized growth of 2.2% in Q4 2024 and 0.9% in the third quarter of 2024—over a decline in exports and weak consumption. The manufacturing PMI continued in a contractionary regime, with a May reading of 49.4, slightly higher than April's and March's readings of 48.7 and 48.4, respectively. The unemployment rate remained at 2.5% in March and April, but slightly higher than 2.4% in February. Meanwhile, disinflation continued, with inflation falling to 3.6% y-o-y in April and March from 3.7% y-o-y in February and 4.0% y-o-y in January, although it remained above the BOJ's 2.0% target. In light of heightened trade uncertainty, in May the BOJ revised downward its full-year 2025 and 2026 GDP growth projections to 0.5% and 0.7%, respectively, from projections of 1.1% and 1.0% made in January. The BOJ also reduced its full-year 2025 and 2026 inflation forecasts to 2.2% and 1.7%, respectively, from January projections of 2.4% and 2.0%.

Continued disinflation and monetary easing, combined with the moderated growth outlook over mounting global trade uncertainties, contributed to a decline in LCY government bond yields in most emerging East Asian economies during the review period (**Table B**). Ongoing monetary easing was supported by continued disinflation in the region (**Figure B**). Inflation saw a rise only in Hong Kong, China, over faster increases in housing and transport costs, and in Indonesia, where inflation rose on higher housing and food prices but remained within the central bank's target range. Yields for 2-year and 10-year bonds declined the most in Hong Kong, China as the [Hong Kong Monetary Authority](#) expanded the money supply by selling Hong Kong dollars to maintain the dollar peg following the overall appreciation of regional currencies against the US dollar. The next largest decline in yields during the review period was seen in Singapore, largely driven by two consecutive easing adjustments, in January and April, by the Monetary Authority of Singapore to the Singapore dollar nominal effective exchange rate, in line with a lower inflation forecast and a weakened economic outlook. The Bank of Thailand eased monetary policy via consecutive rate cuts in February and April, as the central bank assessed that the Thai economy was likely to slow and inflation to further moderate. The Bangko Sentral ng Pilipinas reduced its policy rate by 25 bps on 10 April amid lower inflation and noted that

**Table B: Changes in Monetary Stances in Major Advanced Economies and Select Emerging East Asian Markets**

Economy	Policy Rate 1-May-2024 (%)	Rate Change (%)													Policy Rate 30-May-2025 (%)	Change in Policy Rates (basis points)
		May- 2024	Jun- 2024	Jul- 2024	Aug- 2024	Sep- 2024	Oct- 2024	Nov- 2024	Dec- 2024	Jan- 2025	Feb- 2025	Mar- 2025	Apr- 2025	May- 2025		
Euro Area	4.00	↓0.25				↓0.25	↓0.25		↓0.25		↓0.25	↓0.25	↓0.25	↓0.25	2.25	↓ 175
Japan	0.10		↑0.15							↑0.25					0.50	↑ 40
United Kingdom	5.25				↓0.25			↓0.25		↓0.25				↓0.25	4.25	↓ 100
United States	5.50					↓0.50		↓0.25	↓0.25						4.50	↓ 100
People's Republic of China	1.80			↓0.10		↓0.20								↓0.10	1.40	↓ 40
Indonesia	6.25					↓0.25				↓0.25				↓0.25	5.50	↓ 75
Republic of Korea	3.50						↓0.25	↓0.25			↓0.25			↓0.25	2.50	↓ 100
Malaysia	3.00														3.00	◆ 0
Philippines	6.50				↓0.25		↓0.25		↓0.25				↓0.25		5.50	↓ 100
Singapore	-									↓			↓		-	↓ -
Thailand	2.50						↓0.25				↓0.25		↓0.25		1.75	↓ 75
Viet Nam	4.50														4.50	◆ 0

( ) = negative, ◆ = no change, - = no data.

Notes:

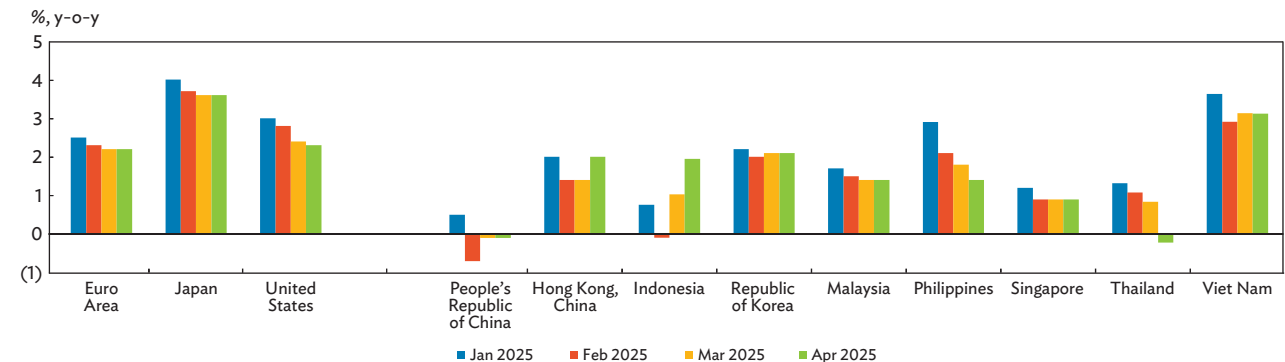
1. Data coverage is from 1 May 2024 to 30 May 2025.

2. For the People's Republic of China, data used in the chart is for the 7-day reverse repurchase rate.

3. For the United States, the upper bound of the policy rate target range is reported on the table.

4. The up (down) arrow for Singapore signifies monetary policy tightening (loosening) by its central bank. The Monetary Authority of Singapore utilizes the Singapore dollar nominal effective exchange rate to guide its monetary policy.

Sources: Various central bank websites.

**Figure B: Inflation in Major Advanced Economies and Select Emerging East Asian Markets**


( ) = negative, y-o-y = year-on-year.

Sources: Various local sources.

the external outlook for the Philippines has become challenging. Bank Indonesia and the Bank of Korea each lowered their policy rate by another 25 bps on 21 May and 29 May, respectively, following their 25 bps rate cuts in January and February, to support economic growth amid heightened uncertainty over trade policies. The People's Bank of China announced easing measures in response to trade uncertainty by cutting the 7-day reverse repo rate by 10 bps on 6 May and the 1-year and 5-year loan prime rates by 10 bps each on 20 May. The People's Bank of China also reduced the reserve requirement ratio by 50 bps on 15 May. Similarly, on 8 May, Bank Negara Malaysia lowered the statutory reserve requirement ratio by 100 bps to 1.0% to support the financial market amid ongoing uncertainties.

Economic performance moderated in Q1 2025 in most regional markets. GDP growth in Singapore decelerated to 3.9% y-o-y from 5.0% y-o-y in Q4 2024 amid a slowdown in the manufacturing, trade, and service sectors (**Table C**). A slower pace of economic expansion was also noted in Malaysia—with growth dragged down by a slowdown in the construction, service, and manufacturing sectors—and in Viet Nam, as growth in the industrial and service sectors decelerated. In the Republic of Korea, GDP was unchanged in Q1 2025, following growth of 1.1% y-o-y in Q4 2024, over lingering political concerns as well as a worsening trade outlook. On the other hand, in Hong Kong, China, economic growth accelerated to 3.1% y-o-y in Q1 2025 from 2.5% y-o-y in Q4 2024, buoyed by strong exports (8.7% y-o-y), imports (7.4% y-o-y), and a recovery in investments (2.8% y-o-y). GDP growth in the Philippines also accelerated to 5.4% y-o-y in Q1 2025, up from 5.3% y-o-y growth in the previous quarter, over increased

**Table C: Gross Domestic Product Growth in Select Emerging East Asian Economies (y-o-y, %)**

Economy	2024		2025	Forecast for 2025
	Q3	Q4	Q1	
PRC	4.60	5.40	5.40	4.70
HKG	1.90	2.50	3.10	2.30
INO	4.95	5.02	4.87	5.00
ROK	1.50	1.10	0.00	1.50
MAL	5.40	4.90	4.40	4.90
PHI	5.24	5.30	5.40	6.00
SIN	5.70	5.00	3.90	2.60
THA	3.00	3.30	3.10	2.80
VIE	7.43	7.55	6.93	6.60

PRC = People's Republic of China; HKG = Hong Kong, China; INO = Indonesia; ROK = Republic of Korea; MAL = Malaysia; PHI = Philippines; Q1 = first quarter; Q3 = third quarter; Q4 = fourth quarter; SIN = Singapore; THA = Thailand; VIE = Viet Nam; y-o-y = year-on-year.

Note: Forecasts for 2025 are based on the *Asian Development Outlook April 2025*.

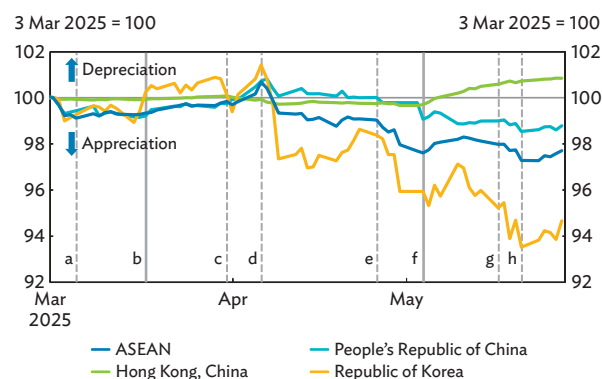
Sources: Various local sources.

consumption and government spending. The April 2025 edition of the *Asian Development Outlook* forecast slightly weaker economic growth in 2025 of 4.4% for East Asia, down from 4.7% in 2024, largely due to continued weakness in the PRC's property sector and increased tariffs. The growth forecast in Southeast Asia also reflected marginal weakening to 4.7% in 2025 from 4.8% in 2024, driven by a slowdown in the oil and gas sector in Brunei Darussalam and slowing export growth in Malaysia, Singapore, and Viet Nam.

Uncertainty over US trade policies and their potential impacts on US economic performance, combined with a high level of debt and large fiscal deficit, have generated investor risk aversion toward USD-denominated assets, contributing to an overall strengthening of emerging East Asian currencies against the US dollar. From 3 March

to 30 May, regional currencies appreciated 2.3% (simple average) and 1.7% (GDP-weighted average) against the US dollar. Among all regional currencies, the Korean won and Malaysian ringgit appreciated the most at 5.6% and 4.9%, respectively (Table A, **Figure C**). The Korean won was aided by a number of favorable factors: news of trade negotiations between the Republic of Korea and the US, improving sentiment in the semiconductor sector following the announcement of a supply deal between Saudi Arabia and Nvidia, as well as the announcement of snap elections that pared ongoing political concerns. The Malaysian ringgit was supported by an influx of foreign funds into its bond market. In contrast, the Vietnamese dong weakened the most among all regional currencies during the review period, dipping 1.6% versus the dollar, largely driven by dampened sentiment in the manufacturing sector, as its manufacturing PMI dropped to 45.6 in April from 50.5 in March amid trade policy uncertainty. In May, the manufacturing PMI rose to 49.8.

**Figure C: Currency Exchange Rates Against the United States Dollar in Select Emerging East Asian Markets**



ASEAN = Association of Southeast Asian Nations.

Notes:

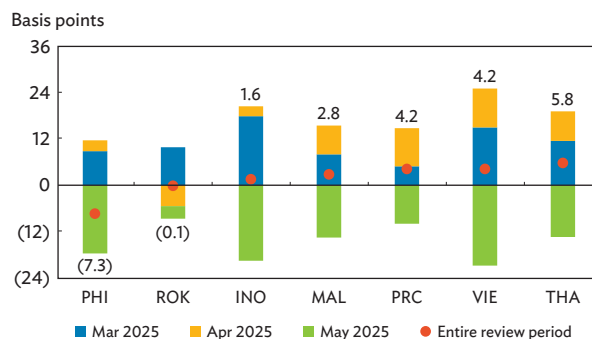
- Corresponding dates of the following events:
  - Fed Chair Jerome Powell signals a slower pace of rate cuts in 2025 amid heightened uncertainty in the United States' (US) economic outlook.
  - The Fed maintains the federal funds rate at a range of 4.25%–4.50% and keeps its projection for two rate cuts in 2025.
  - "Reciprocal tariff" policy of the US with its trading partner economies takes effect.
  - US President Donald Trump announces a 90-day pause on reciprocal tariffs, except for those on the People's Republic of China.
  - US President Donald Trump signs an executive order easing some tariff measures.
  - The Fed maintains the federal funds rate at a range of 4.25%–4.50% amid elevated inflation and increased economic uncertainty.
  - Moody's downgrades the US sovereign credit rating from Aaa to Aa1, adding to investor concerns.
  - US President Donald Trump imposes 50% tariffs on all European Union imports to the US starting 1 June.
- ASEAN comprises the markets of Brunei Darussalam, Cambodia, Indonesia, the Lao People's Democratic Republic, Malaysia, the Philippines, Singapore, Thailand, and Viet Nam.
- Data are as of 30 May 2025.
- An increase (decrease) in the value indicates depreciation (appreciation) of the currency against the US dollar.

Source: AsianBondsOnline calculations based on Bloomberg LP data.

Global uncertainty over trade policies have generated investor risk aversion, leading to the widening of risk premiums across the region. Credit default swap spreads, a proxy of risk premiums, marginally widened by 1.6 bps (simple average) and 3.5 bps (GDP-weighted average) during the review period. Nearly all regional markets recorded a widening of credit default swap spreads in March and April on mounting trade-related uncertainty (**Figure D**). In May, risk premiums collectively narrowed over expectations of progress in trade negotiations between the US and its trading partners, especially the PRC. On 12 May, the PRC and the US jointly announced an agreement based on their meeting in Geneva. Under the terms of the agreement, both governments agreed to reduce additional tariffs on each other to 10% for a 90-day period.

Subdued investor sentiment led to a similar pattern of portfolio outflows from regional equity markets. Between 3 March and 30 May, regional equity markets recorded net portfolio outflows of USD27.1 billion. Outflows were mainly observed in March–April, while net inflows of USD1.3 billion were recorded in regional markets in May over optimism on a deal between the PRC and the US to lower tariffs (**Figure E**). The Republic of Korea recorded large outflows in April over lingering domestic political issues alongside heightened trade uncertainty. ASEAN collectively posted net portfolio outflows of USD3.7 billion during the review period. The PRC recorded large outflows in March on the weakened domestic economic outlook and escalated trade tensions with the US. Outflows from the PRC's equity market continued in April but the outflows were smaller than

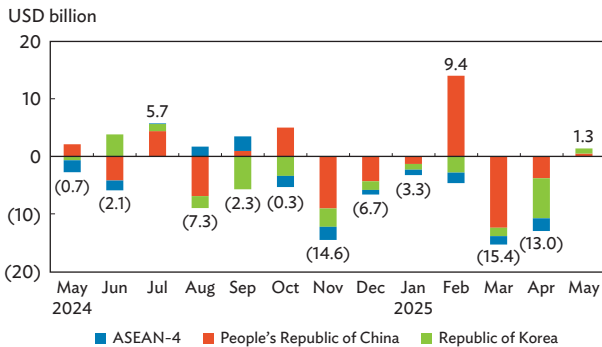
**Figure D: Changes in Credit Default Swap Spreads in Select Emerging East Asian Markets (senior 5-year)**



( ) = negative; PRC = People's Republic of China; INO = Indonesia; ROK = Republic of Korea; MAL = Malaysia; PHI = Philippines; THA = Thailand; VIE = Viet Nam.

Note: The numbers above (below) each bar refer to the change in spreads between 3 March 2025 and 30 May 2025.

Source: AsianBondsOnline calculations based on Bloomberg LP data.

**Figure E: Foreign Capital Flows in Select Emerging East Asian Equity Markets**


( ) = outflows, USD = United States dollar.

Notes:

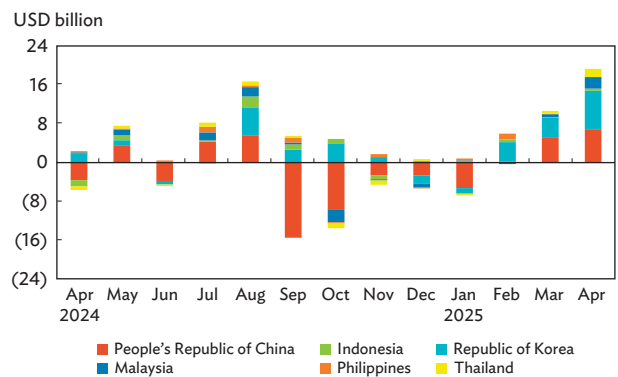
1. Data coverage is from 1 May 2024 to 30 May 2025 except for Thailand (29 May 2025).
2. The numbers above (below) each bar refer to net inflows (net outflows) for each month.
3. Emerging East Asia is defined to include member states of the Association of Southeast Asian Nations plus the People's Republic of China; Hong Kong, China; and the Republic of Korea.
4. ASEAN-4 includes Indonesia, the Philippines, Thailand, and Viet Nam.

Source: Institute of International Finance.

in March due to increased expectations for a trade deal between the PRC and the US. In May, the PRC recorded portfolio inflows of USD0.5 billion.

Expectations of continued monetary easing and rising risk aversion in equity markets supported demand for regional bonds, as evidenced by capital inflows into the region's bond markets. Despite regional central banks expressing caution, expectations of the continuation of accommodative monetary stances in the region, or lower future interest rates, pushed up bond prices and attracted more investment. Most major bond markets in emerging East Asia recorded net capital inflows, driven by monetary easing among the region's central banks, leading to total net inflows of USD29.8 billion in March and April (**Figure F**). During the review period, the largest inflows in the region's LCY bond markets were recorded in the Republic of Korea, with USD12.0 billion in net capital inflows into its bond market following a rate cut in February and expectations of further easing to support economic growth amid rising uncertainty. Similarly, the PRC posted substantial inflows of USD11.8 billion amid the People's Bank of China's [accommodative monetary policy stance](#) in support of growth.

Recent optimism about trade negotiations between the US and its trade partners, as well as domestic factors, supported regional equity markets. The region's equity markets gained 2.0% (simple-average) and 1.6%

**Figure F: Foreign Capital Flows in Select Emerging East Asian Local Currency Bond Markets**


( ) = outflows, USD = United States dollar.

Notes:

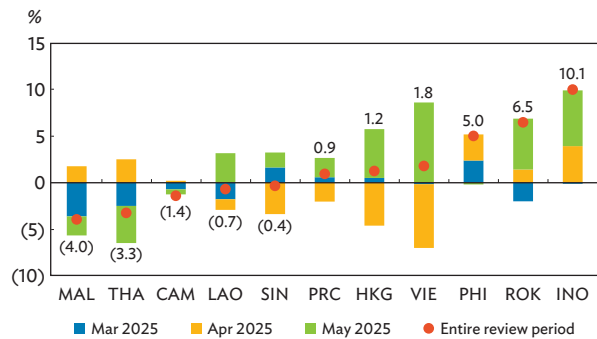
1. The Republic of Korea and Thailand provided data on bond flows. For the People's Republic of China, Indonesia, Malaysia, and the Philippines, month-on-month changes in foreign holdings of local currency government bonds were used as a proxy for bond flows.
2. Data are as of 30 April 2025.
3. Figures were computed based on 30 April 2025 exchange rates and do not include currency effects.

Sources: People's Republic of China (Bloomberg LP); Indonesia (Directorate General of Budget Financing and Risk Management, Ministry of Finance); Republic of Korea (Financial Supervisory Service); Malaysia (Bank Negara Malaysia); Philippines (Bureau of the Treasury); and Thailand (Thai Bond Market Association).

(market-weighted average) from 3 March to 30 May. Five of nine regional equity markets declined in March due to various domestic factors (e.g., equity market losses in Malaysia were partly driven by declining palm oil prices). Most regional equity markets recorded equity losses in April too, due to intensified trade uncertainty, but expectations of progress in trade negotiations, particularly the trade deal between the PRC and the US, supported regional equity markets in May (**Figure G**). Indonesia's equity market gained the most during the review period, rising 10.1% on improved investor sentiment, especially over the news that the state social security fund would increase its equity portfolio allocation to 20% from 10% in the next 3 years. During the review period, equity markets in the Republic of Korea rose 6.5% over expectations of possible stock market reforms and further central bank rate cuts, and the Philippines' market gained 5.0% as it posted one of the highest GDP growth rates in the region as well as on expectations of increased domestic consumption resulting from election spending.

The risks to financial conditions highlighted in the March 2025 edition of the *Asia Bond Monitor* remain relevant, with risks continuing to skew to the downside. This is largely due to heightened uncertainty surrounding US trade policies and the expected higher-for-longer interest

**Figure G: Changes in Equity Indexes in Select Emerging East Asian Markets**



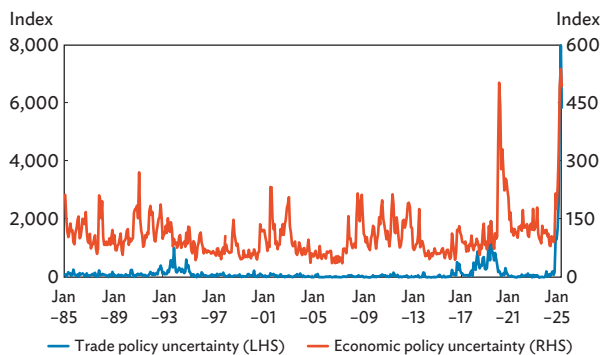
( ) = negative; CAM = Cambodia; PRC = People's Republic of China; HKG = Hong Kong, China; INO = Indonesia; ROK = Republic of Korea; LAO = Lao People's Democratic Republic; MAL = Malaysia; PHI = Philippines; SIN = Singapore; THA = Thailand; VIE = Viet Nam.

Note: The numbers above (below) each bar refer to the percentage change between 3 March 2025 and 30 May 2025.

Source: AsianBondsOnline calculations based on Bloomberg LP data.

rate environment in the US. In April, US trade policy uncertainty surged to a record high over rising trade tensions between major economies, while US economic policy uncertainty surpassed its previous peak seen during the COVID-19 pandemic (Figure H). Financial markets reacted with increased volatility in March–April as investors struggled with the implications of shifting trade dynamics (Figure I), before volatility eased in May with the expected progress of trade negotiation between US and its trade partners, especially after the announcement of a trade deal between the PRC and the US. However, any further uncertainty in trade policies

**Figure H: United States Policy Uncertainty Indexes**

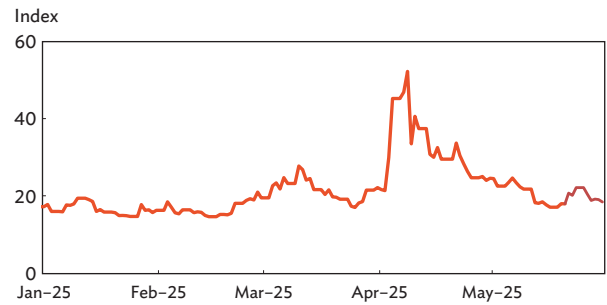


LHS = left-hand side, RHS = right-hand side.

Note: Data are as of May 2025.

Source: [https://www.policyuncertainty.com/trade\\_uncertainty.html](https://www.policyuncertainty.com/trade_uncertainty.html) (accessed 31 May 2025).

**Figure I: Chicago Board Options Exchange Volatility Index**



Note: Data are as of 30 May 2025.

Source: Bloomberg LP.

could erode investment sentiment and weigh down financial conditions, curtailing investments globally and regionally. Such uncertainty may prolong elevated borrowing costs, heighten market volatility, intensify supply chain disruptions, and slow economic growth. Uncertain trade policies can also raise concerns that the global economy is becoming more divided, thus harming international cooperation, disrupting cross-border capital flows, and weakening the global financial safety net. These developments could significantly heighten systemic financial vulnerabilities and reduce the resilience of the global financial system.

Compounding these risks is the higher-for-longer interest rate environment in the US. The Fed's concern about persistent inflation, driven by the impacts of higher tariffs combined with a resilient economic performance and domestic job market, may prolong the easing cycle. After the May FOMC meeting, the expected likelihood of a 25 bps rate cut in June fell to 3.8% on 30 May from 34.0% on 2 May, and the probability of a 25 bps rate cut in July fell from 55.2% to 24.8%. Meanwhile, the chances of there being no rate cut in June and July rose to 96.2% and 74.3%, respectively, on 30 May from 65.1% and 20.7% on 2 May. The prospect of a higher-for-longer interest rate environment in the US might delay the easing of monetary stances in emerging East Asia as regional central banks maintain current policies to support their domestic currencies, keeping global borrowing costs elevated. Borrowers with high levels of USD-denominated debt and weak fundamentals could face prolonged pressure as persistently high interest rates increase the burden of debt servicing. **Box 1** discusses the challenges that central banks face implementing monetary policy in a high-debt environment.

Other possible downside risks include the potential of wider conflict in the Middle East, which could disrupt supply chains, driving up food and energy prices and increasing global uncertainty. Within the region, further deterioration in the PRC's property sector could potentially exacerbate negative spillovers to household wealth and income prospects, weakening consumer and

business sentiment and overall economic activity. This could also lead to lower-than-expected fiscal revenues for local governments and distressed financial positions among property developers and related businesses. In the medium term, extreme weather events could negatively impact growth and inflation.

### Box 1: Why High Debt Makes It Harder for Central Banks to Do Their Job

Fueled by low interest rates, expansionary fiscal policies, and accommodative monetary measures to sustain growth and financial stability, public and private debt have grown significantly worldwide since the global financial crisis. While borrowing has supported economic growth, it also raises an important concern: When economies carry a lot of debt, it can make it harder for central banks to do their job—especially when it comes to controlling inflation and keeping the economy stable.

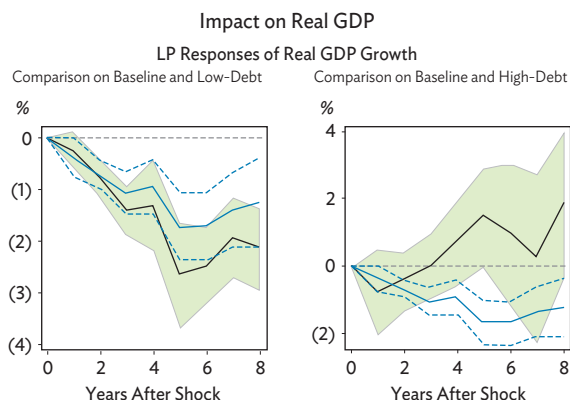
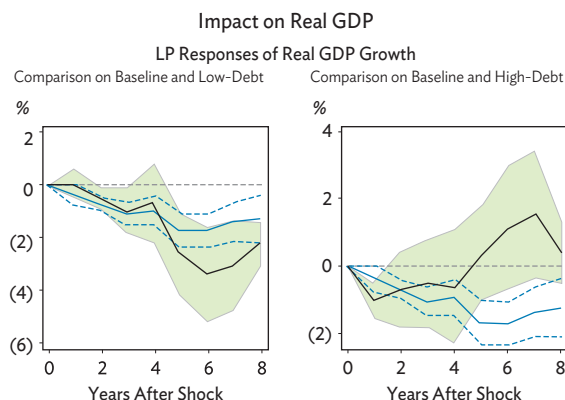
Central banks rely on tools like interest rate changes to influence the economy. For example, if inflation is too high, raising interest rates can help cool things down. But when an economy is carrying a heavy debt load, these tools may not work well. There are several reasons: First, a government may prefer low interest rates to keep borrowing costs down, especially when it has large debts to repay. This can lead to pressure on the central bank to keep rates low, even when inflation is rising. Second, too much public spending can “crowd out” private sector investment, making it more expensive for businesses to borrow and invest—limiting the overall impact of low interest rates. Third, households and firms that are already under a high debt burden may choose to pay down their loans when interest rates are reduced—so the usual boost to the economy is muted. Finally, confidence and debt concerns may make it harder for central banks to keep inflation stable if people and investors start to worry that an economy cannot manage its debt, since they may expect higher inflation in the future and therefore demand higher interest rates.

Qureshi, Jalles, and Tian (forthcoming) look at how well monetary policy—mainly interest rate changes—works in 40 economies, including several in Asia. The paper focuses on how different levels of debt and government spending affect the ability of central banks to influence inflation and economic growth.

To examine these dynamics, a local projection method is employed, which allows for the flexible estimation of impulse response functions without imposing strong assumptions about the data-generating process (Jordà 2005). A smooth transition autoregressive structure is embedded into the local projection framework to capture nonlinear and asymmetric effects of monetary policy across different fiscal regimes (Granger and Teräsvirta 1993). This approach allows monetary transmission to evolve gradually with changing debt levels or fiscal conditions, rather than shifting abruptly at an arbitrary threshold. It also accommodates heterogeneity in institutional frameworks and macro-fiscal structures across economies, making it well-suited to a diverse data sample. The paper identifies a new set of monetary policy shocks for about 40 advanced and emerging economies using the high-frequency forecast error approach based on the methodology of Furceri et al. (2018), which isolates unexpected changes in policy rates from anticipated central bank actions. These shocks are aggregated to an annual frequency to align with macro-fiscal data and estimate dynamic policy effects.

The key findings of Qureshi, Jalles, and Tian (forthcoming) suggest that when debt levels are high, monetary policy becomes less effective (**Figure B1**). When central banks raise interest rates, we typically expect inflation to fall and economic growth to slow. But in economies with high levels of public and private debt, these effects are much weaker. The paper finds output responses to be 30%–50% smaller, and the impact of monetary policy on inflation often disappears completely in high-debt situations. The paper also finds that private debt plays a bigger role in weakening the effects on economic growth, while public debt more directly limits the central bank's ability to lower inflation. The situation gets even more complicated when governments are still spending heavily—that is, when the fiscal stance is expansionary. Under such a scenario, central banks' policies are even less likely to

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Box 1 *continued***Figure B1: Conditional Effects of Monetary Policy Shocks on Growth—Private and Public Debt in Emerging Markets and Developing Economies****A. Private Debt****B. Public Debt**

( ) = negative, GDP = gross domestic product, LP = local projection.

Notes: Monetary policy shocks are based on the high-frequency forecast error approach (Furceri et al. 2018) and applied to Consensus Economics data. Point estimates are normalized by one standard deviation of the shock. The solid black lines in the figure plot the impulse responses of shocks on the dependent variable amid the private and public debt regime indicated above each panel. Year = 1 is the first year after a shock took place at year = 0. For example, the position of the line at year = 8 shows the change in real GDP 8 years after the shock. The solid blue line and corresponding dashed blue lines correspond to the baseline unconditional result for better comparison. The green shaded areas display the 90% spatial-correlation-consistent error bands.

Source: Authors' calculations based on data from CEIC Data Company.

work as intended. Interestingly, economies with stronger institutions—especially independent central banks—tend to manage better. These economies see a stronger response to monetary policy, even in high-debt environments. However, simply having rules about government spending (e.g., fiscal rules) does not help much unless those rules are actually implemented.

The policy implications of the study are clear. First, debt must remain sustainable. Managing debt responsibly helps protect both government finances and the effectiveness of central banks. Aims during economic booms should be to reduce deficits and avoid spending spikes. Central bank independence should also be sustained. Central banks must be free to act in the best interest of the economy—especially when it comes to keeping inflation in check—because political or fiscal interference weakens their ability to effectively conduct monetary policy. In addition, since private debt can also dampen monetary policy effectiveness, governments should use macroprudential tools such as regulations on lending and frequent stress testing to limit risky borrowing and protect financial stability. Finally, fiscal and monetary policies should work in the same direction and coordinate as much as possible. For example, governments should keep spending in check when central banks are trying to cool down the economy.

As economies across Asia and the Pacific and other regions try to rebuild after the COVID-19 pandemic, they face a tricky environment: rising inflation, greater policy uncertainty, a slowing global growth outlook, less room to spend, and tighter global financing conditions. In this context, the ability of central banks to act effectively becomes even more critical. Aligning responsible government spending with strong, independent central banks helps to maintain stability, control inflation, and respond to future economic shocks.

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