Developments in Regional Financial Conditions

Emerging East Asian financial markets remained resilient amid global headwinds between 3 November 2025 and 6 February 2026, supported by sound economic fundamentals and accommodative monetary stances across the region.[1] There was a brief spike in market volatility in November 2025 on concerns over artificial intelligence (AI) valuations, which eased the following month and intensified again in January 2026 over geopolitical and trade tensions. Better-than-expected economic growth performance in the fourth quarter (Q4) of 2025 in most regional economies and improved sentiment on tech stocks bolstered regional financial markets amid lingering global uncertainty. During the review period, emerging East Asian equity markets gained, supported by net portfolio inflows, and regional currencies appreciated against the United States (US) dollar (**Table A**). Risk premiums diverged over market-specific factors. Regional 10-year government bond yields rose, broadly tracking movements in advanced economies and responding to priced-in domestic conditions.

Market volatility rose amid heightened global uncertainties in January 2026. Following progress on trade agreements between the US and several Asian economies in October 2025, global uncertainty—as measured by trade policy uncertainty and geopolitical risk indicators, and market volatility captured by the Chicago Board Options Exchange Volatility Index (VIX)—eased in November–December 2025. (**Figure A**). The VIX index spiked briefly in the third week of November amid AI-valuation fears and concerns that the Federal Reserve (Fed) might not cut interest rates in December.[2] Volatility ebbed following the Fed's rate cut at its December meeting and as AI concerns eased. January saw renewed volatility amid

Table A: Changes in Financial Conditions in Major Advanced Economies and Select Emerging East Asian Markets from 3 November 2025 to 6 February 2026

	2-Year Government Bond Yield (bps)	10-Year Government Bond Yield (bps)	5-Year Credit Default Swap Spread (bps)	Equity Index (%)	FX Rate (%)
Major Advanced Economies					
Euro Area	9	18	–	5.6	2.6
Japan	36	56	5.9	10.3	(1.9)
United States	(11)	10	–	1.2	–
Select Emerging East Asian Markets					
People's Republic of China	(5)	2	3.2	2.2	2.7
Hong Kong, China	(30)	15	–	1.5	(0.5)
Indonesia	15	25	4.4	(4.1)	(1.2)
Republic of Korea	33	62	0.1	20.5	(2.2)
Malaysia	(10)	7	(1.1)	6.8	6.4
Philippines	(22)	2	2.8	9.7	0.4
Singapore	(3)	12	–	11.0	2.6
Thailand	(16)	13	(1.9)	3.4	2.6
Viet Nam	29	27	(7.3)	8.6	1.3

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

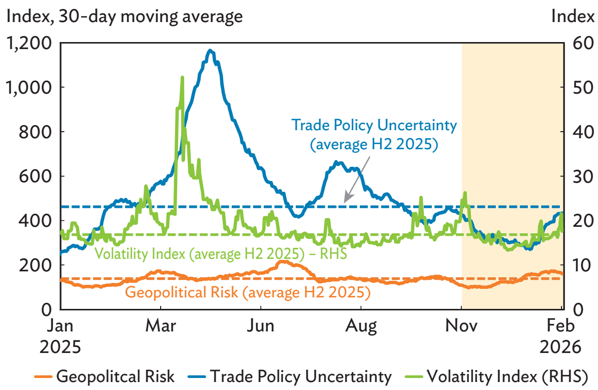
Note: FX rates are presented against the United States dollar. A positive (negative) value for the FX rate indicates the appreciation (depreciation) of the local currency against the United States dollar.

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

1 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.

2 Per CME FedWatch, on 19 November, there was a 30.1% probability that the Fed would not cut the federal funds rate at its December meeting.

Figure A: Trade Policy Uncertainty, Geopolitical Risk, and Chicago Board Options Exchange Volatility—Daily Indexes



H2 = second half, RHS = right-hand side.

Note: Data as of 6 February 2026.

Source: Bloomberg LP, Geopolitical Risk Index, and Trade Policy Uncertainty Index (accessed 18 February 2026); Caldara, D. et al. 2020. The Economic Effects of Trade Policy Uncertainty. *Journal of Monetary Economics*. 109. pp. 38–59; Caldara, D., and M. Iacoviello. 2022. Measuring Geopolitical Risk. *American Economic Review*. April. 112 (4). pp. 1194–1225.

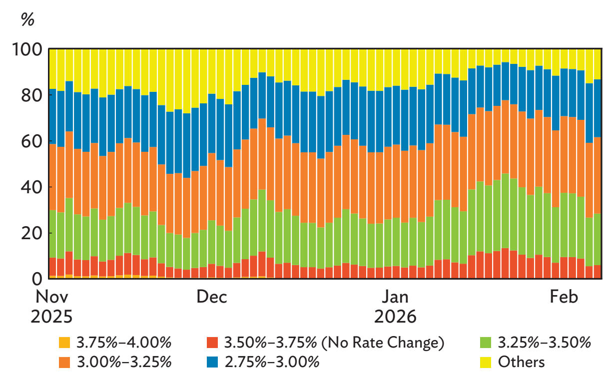
friction between the US and European Union economies, which receded after a reversal in the US tariff stance was announced on 21 January in Davos, Switzerland. Afterward, a series of negative events—including a market rout fueled by AI and technology-sector valuation concerns and the possibility of the Fed restarting quantitative tightening—generated risk-off sentiment among investors, leading to another spike in volatility.

Bond yields in advanced economies climbed during the review period. Yields in the euro area rose largely due to the European Central Bank's (ECB) wait-and-see stance. In Japan, yields inched up on rising expectations of rate hikes and expansionary fiscal policy. Bond yields in the US rose amid concerns that the Fed might revert to quantitative tightening.

United States

The US saw its 10-year yield rise between 3 November 2025 and 6 February 2026 over the Fed's more hawkish-than-expected stance. The 2-year yield declined during the review period, mostly driven by an expected December rate cut and supportive financial conditions following the end of the Fed's quantitative tightening on 1 December, which was announced during the October meeting. The Fed gradually shifted toward a cautious stance, as evidenced by the December Federal Open Market Committee (FOMC) meeting's statement about "considering the extent and timing of additional adjustments." The December FOMC meeting minutes showed that some members who voted for a rate cut could have also supported keeping rates unchanged. At the 28–29 January FOMC meeting, the Fed held the policy rate steady and noted that unemployment had stabilized. On 30 January, Kevin Warsh was nominated to be the next Fed chair, which briefly sparked market expectations that the Fed might resume quantitative tightening. During the review period, the market was still expecting a cumulative 50 basis points (bps) rate cut by the end of 2026, as measured by the CME FedWatch tool (**Figure B**).

Figure B: Daily Probability of Year-End Federal Reserve Target Rate Range



Notes:
1. Data are as of 6 February 2026.
2. Others reflect probabilities of four rate cuts or more.

Source: CME FedWatch Tool.

US economic performance rebounded during the review period, with softening yet still above-target inflation and a stabilizing job market. US final third quarter (Q3) annualized gross domestic product (GDP) growth was revised up to 4.4% from 4.3% (second estimate), an improvement from the previous quarter's 3.8%. However, Q4 2025 GDP growth slowed to 1.4%, dragged by the government shutdown, which ended on 12 November. Industrial production posted consecutive gains of 0.7% month-on-month (m-o-m) in January, 0.3% m-o-m in December and 0.1% m-o-m in November, following a decline of 0.3% m-o-m in October. The S&P Global Manufacturing Purchasing Managers' Index (PMI) remained in expansionary territory at 51.2 in February, 52.4 in January, 51.8 in December, and 52.2 in November. The Fed noted that growth could strengthen in the first quarter of 2026 following the reopening of government operations after the shutdown. In December, the Fed revised upward its GDP forecasts for 2026 and 2027 to 2.3% and 2.0%, respectively, from projections of 1.8% and 1.9% made in September.

Inflation softened but remained above the Fed's 2.0% target. Inflation fell steadily to 2.4% year-on-year (y-o-y) in January and 2.7% y-o-y in December and November from 3.0% y-o-y in September. However, Personal Consumption Expenditures inflation, which lags consumer price data, remained persistent at 2.9% y-o-y in December, 2.8% y-o-y in November, and 2.7% y-o-y in October, compared to 2.8% in September. In December, the Fed projected that inflation would continue to soften, revising downward its forecasts for 2025 and 2026 to 2.9% and 2.4%, respectively, from forecasts of 3.0% and 2.6% made in September.

The US job market remained weak with signs of stabilization during the review period. Nonfarm payroll additions recorded a higher-than-expected 130,000 in January, up from a revised 48,000 in December and 41,000 in November. The unemployment rate inched down slightly to 4.3% in January from 4.4% in December and 4.5% in November. Nevertheless, downward revisions to 2025 nonfarm payroll data showed that the labor market was weaker than previously thought as total nonfarm payrolls additions in 2025 were revised down to 181,000 from 584,000. Moreover, the December Job Openings and Labor Turnover Survey number of 6.5 million, released on 5 February, was lower than both the expected 7.3 million job openings and November's reading of 6.9 million, which was previously the lowest level since October 2020. The Fed kept its unemployment forecast for 2026 at 4.4% in December, the same as its September projection, and revised downward the 2027 forecast to 4.2% from September's 4.3%.

Euro Area

The 2-year and 10-year bond yields in the euro area—proxied by Bloomberg's Euro Generic Government Bond Yields—rose strongly during the review period, driven by the ECB's wait-and-see monetary stance, a stabilized and resilient economic outlook, and the planned increase in Germany's federal spending in 2026.[3] The ECB maintained its wait-and-see stance and left policy rates unchanged at its December 2025 and February 2026 meetings over resilient GDP growth in the euro area. While growth fell slightly to 1.3% y-o-y in Q4 2025 from 1.4% y-o-y in Q3 2025, q-o-q growth remained unchanged at 0.3% and exceeded the ECB's forecast for Q4 2025 of 0.2% q-o-q. Inflation in the euro area eased to 1.7% y-o-y in January and 2.0% y-o-y in December from 2.1% y-o-y in October and November. The unemployment rate also declined, with December unemployment coming in at 6.2% versus 6.3% in November and October. The HCOB Manufacturing PMI stabilized at around the 50.0 threshold during the review period, with readings of 50.8 in February, 49.5 in January, 48.8 in December, and 49.6 in November—compared with 50.0 in October.

The ECB acknowledged that economic growth was resilient and inflation was stabilizing around its target, while also noting greater uncertainty regarding the inflation outlook due to global headwinds, largely around trade. At the December meeting, the ECB revised its GDP forecasts for 2026 and 2027 upward to 1.2% and 1.4%, respectively, from September's projections of 1.0% and 1.3%. The ECB raised its inflation forecast for 2026 to 1.9% from 1.7% in September and lowered the forecast for 2027 to 1.8% from 1.9% in September. At the February meeting, the ECB announced that it expected inflation to settle around the central bank's target over the medium-term.

Japan

The 2-year and 10-year yields in Japan rose during the review period amid increased hawkishness from the Bank of Japan (BOJ) as well as expectations of an expansionary fiscal policy. The BOJ raised the policy rate by 25 bps at its 18–19 December meeting, as it expected that wages and prices would continue to rise. The BOJ also implied additional rate hikes would follow on the condition that its October 2025 forecasts for the economic outlook were met. The hawkish tone was affirmed in the BOJ's Summary of Opinions released on 29 December. In the summary, the BOJ noted that (i) current market conditions were a partial reflection of its policy rate being too low relative to inflation, and (ii) further interest rate hikes could help reduce future inflationary pressure. The BOJ left its policy rate on hold at its 22–23 January

[3] On 14 November, the German Bundestag's Budget Committee revealed its 2026 budget plan, showing an increase in net debt of EUR98 billion, up from EUR90 billion in a previous proposal. If funding for defense and infrastructure is included, net debt is expected to increase by EUR180 billion. The budget plan was later signed into law on 28 November.

meeting, with its updated forecasts showing that the economy is expected to grow as external demand improves and prices remain elevated.

Japan's economic performance rebounded but remained subdued, while inflation continued to decline but remained above target. Though weaker than expected, Japan's GDP growth recovered to an annualized 0.2% in Q4 2025 after declining 2.3% in Q3 2025, driven by domestic consumption and investment. Industrial production contracted in December (–0.1% m-o-m) and November (–2.7% m-o-m). Consumer price inflation continued to decelerate, moderating to 1.5% y-o-y in January from 2.1% y-o-y in December, 2.9% y-o-y in November, and 3.0% y-o-y in October. When excluding fresh food and energy, consumer price inflation stood at 2.6% y-o-y in January, 2.9% y-o-y in December, and 3.0% y-o-y in November, down from 3.1% y-o-y in October.

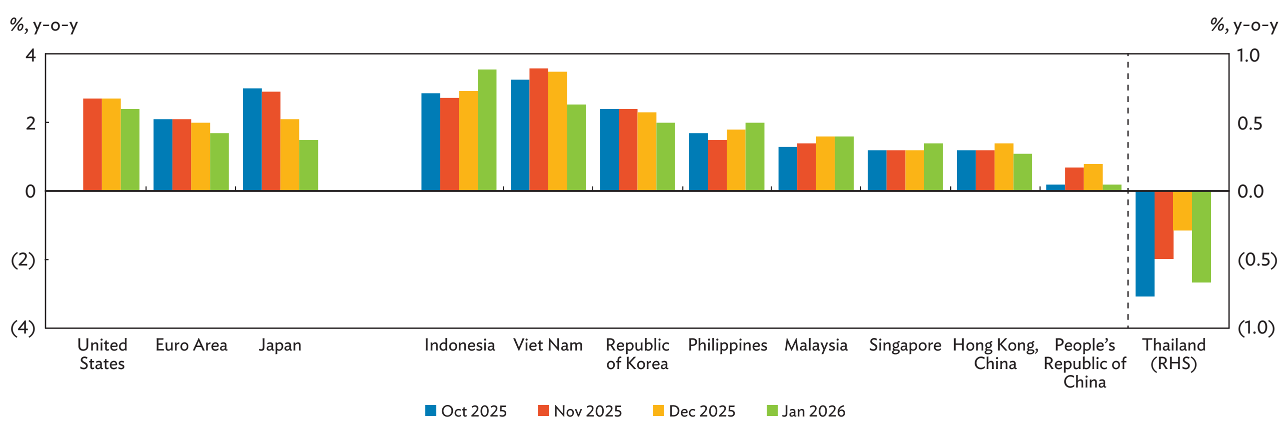
To support economic performance, Prime Minister Sanae Takaichi announced plans for tax cuts, including a 2-year temporary suspension of the consumption tax on food. In December, the Japanese National Diet passed a JPY18.3 trillion supplementary budget for fiscal year 2025. The victory of the Prime Minister's party in the 8 February elections reinforced market expectations of an expansionary fiscal stance. Japan's business sentiment improved, with the Manufacturing PMI reaching 53.0 in February—its highest level since May 2022—and 51.5 in January, up from 50.0 in December and 48.7 in November. In January, the BOJ upgraded its GDP growth forecasts to 0.9% for fiscal year 2025 and 1.0% for fiscal year 2026, from 0.7% for both in October. The BOJ also raised its consumer price inflation forecast for fiscal year 2026 to 1.9% from 1.8% in October. For consumer price inflation excluding fresh food and energy, the forecast for fiscal year 2026 was raised to 2.2% from 2.0% in October.

Emerging East Asia

In emerging East Asian bond markets, 10-year yields collectively rose during the review period on yield upticks in major advanced economies and market-specific factors. Some regional economies witnessed a modest increase in inflation—but still within their respective central bank targets (**Figure C**). This allowed regional central banks to maintain accommodative monetary stances, with the Philippines and Thailand cutting interest rates in December 2025 (**Table B**). The Bangko Sentral ng Pilipinas, as expected, again cut its policy rate by 25 bps on 19 February to support the weakening economy. The 2-year yield declined in most emerging East Asian bond markets—tracking the 2-year yield's movement in the US—amid accommodative monetary policies from regional central banks. Bucking regional trends, 2-year bond yields rose in the Republic of Korea, Viet Nam, and Indonesia on market-specific factors:

- Bond yields rose in the Republic of Korea over a hawkish shift by the Bank of Korea (BOK) and the possibility of an increase in government spending. At its 27 November meeting, the BOK left its policy

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



( ) = negative, RHS = right-hand side, y-o-y = year-on-year.
Note: For the United States, inflation data were not available for October 2025.
Sources: Various local sources.

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

Economy	Policy Rate 1-Feb-2025 (%)	Rate Change (%) Feb-2025	Mar-2025	Apr-2025	May-2025	Jun-2025	Jul-2025	Aug-2025	Sep-2025	Oct-2025	Nov-2025	Dec-2025	Jan-2026	Feb-2026	Policy Rate 6-Feb-2026 (%)	Change in Policy Rates (basis points)
Euro Area	3.00	↓0.25	↓0.25	↓0.25		↓0.25									2.00	↓ 100
Japan	0.50											↑0.25			0.75	↑ 25
United Kingdom	4.75	↓0.25			↓0.25			↓0.25				↓0.25			3.75	↓ 100
United States	4.50								↓0.25	↓0.25		↓0.25			3.75	↓ 75
People's Republic of China	1.50				↓0.10										1.40	↓ 10
Indonesia	5.75				↓0.25		↓0.25	↓0.25	↓0.25						4.75	↓ 100
Republic of Korea	3.00	↓0.25			↓0.25										2.50	↓ 50
Malaysia	3.00						↓0.25								2.75	↓ 25
Philippines	5.75			↓0.25		↓0.25		↓0.25		↓0.25		↓0.25			4.50	↓ 125
Singapore	–			↓											–	↓ –
Thailand	2.25	↓0.25		↓0.25				↓0.25				↓0.25			1.25	↓ 100
Viet Nam	4.50														4.50	◆ 0

– = no data.

Notes:
1. Data coverage is from 1 February 2025 to 6 February 2026.
2. For the People's Republic of China, the data used in the chart are 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. An arrow up (down) indicates a policy rate hike (cut). A diamond indicates no change in the policy rate.
5. For Singapore, the up (down) arrow 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.

rate unchanged and removed previous language about "maintaining a rate cut stance." The BOK also noted that recent inflation has been higher than expected. In both January and February, the government hinted that another supplemental budget might be passed in the first half of 2026.

- Yields in Viet Nam increased over an expanded bond issuance plan in 2026—with scheduled issuances totaling VND500.0 trillion, up from VND371.5 trillion in 2025.
- Indonesian yields rose on market stress in January when MSCI warned of the potential reduction of Indonesian stock weights in its MSCI Emerging Market Index or a possible downgrade of Indonesia's classification to the Frontier Market Index.[4] Investors were also concerned about the government's fiscal stance as the 2025 budget deficit reached 2.9% of GDP, nearly hitting the legal debt limit of 3.0%. In addition, Moody's Ratings downgraded Indonesia's sovereign credit outlook from "stable" to "negative" on 5 February, further pushing up bond yields. On 9 February, FTSE Russell announced that it will delay its March 2026 planned review of Indonesian stocks.

The region saw resilient economic performance in Q4 2025, with growth accelerating in six out of nine markets compared with Q3 2025 (**Table C**). Singapore's Q4 2025 GDP expanded 6.9% y-o-y, up from 4.6% y-o-y in Q3 2025, amid a manufacturing boom led by AI-fueled demand. Thailand recorded Q4 GDP growth of 2.5% y-o-y, accelerating from 1.2% y-o-y in Q3 2025 over strong domestic consumption, investment, and government spending. Malaysia posted Q4 2025 GDP growth of 6.3% y-o-y, up from 5.4% y-o-y in Q3 2025, boosted by expansions in services and manufacturing and rising domestic demand. Viet Nam again had the strongest GDP performance in the region with a Q4 2025 growth rate of 8.5% y-o-y, up from 8.3% y-o-y in the previous quarter, driven by continued government efforts to boost the economy. Meanwhile, the People's Republic of China's (PRC) Q4 2025 growth was within expectations at 4.5% y-o-y, while its full-year 2025 GDP growth of 5.0% met the government's target. The Republic of Korea experienced slower Q4 2025 GDP growth of 1.5% y-o-y, compared with 1.8% y-o-y in Q3 2025, mostly due to weaker domestic demand. The Philippines experienced the region's biggest slowdown, with Q4 2025 growth falling

[4] MSCI flagged transparency issues related to equity share ownership structures and the quality of available free float data in the Indonesian market.

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

Economy	2025 Q1	2025 Q2	2025 Q3	2025 Q4	2025 Full Year	Forecast for Full Year 2025
PRC	5.40	5.20	4.80	4.50	5.00	4.80
HKG	3.10	3.20	3.70	3.80	3.50	3.40
INO	4.87	5.12	5.04	5.39	5.11	5.00
ROK	0.00	0.60	1.80	1.50	1.00	0.90
MAL	4.40	4.40	5.40	6.30	5.20	4.50
PHI	5.40	5.50	3.95	3.00	4.40	5.00
SIN	3.90	4.60	4.60	6.90	5.00	4.10
THA	3.20	2.80	1.20	2.50	2.40	2.00
VIE	7.05	8.16	8.25	8.46	8.02	7.40

PRC = People's Republic of China; HKG = Hong Kong, China; INO = Indonesia; ROK = Republic of Korea; MAL = Malaysia; PHI = Philippines; Q1 = first quarter; Q2 = second quarter; Q3 = third quarter; Q4 = fourth quarter; SIN = Singapore; THA = Thailand; VIE = Viet Nam; y-o-y = year-on-year.

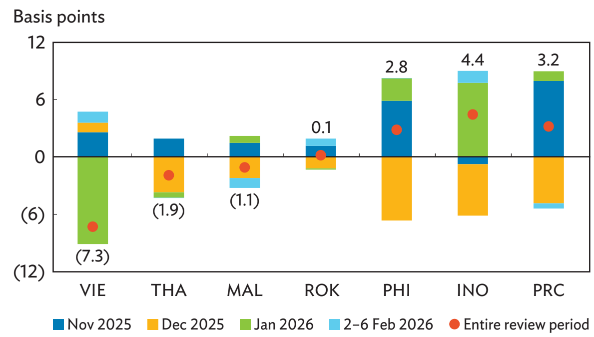
Notes:
1. Forecasts for 2025 are based on the *Asian Development Outlook December 2025*.
2. Q4 2025 and full year data for the Republic of Korea are based on advanced estimates.

Sources: Various local sources.

to 3.0% y-o-y from 4.0% y-o-y in Q3 2025, amid a slump in private consumption growth and reduced government construction spending.

Risk premiums, measured by credit default swap (CDS) spreads, diverged across the region during the review period on market-specific patterns. Risk premiums widened in most regional markets in November 2025 and January 2026, reflecting heightened risk aversion (**Figure D**). In November, CDS spreads rose in nearly all markets on increased volatility due to receding expectations of a December rate cut by the Fed and concerns about the overvaluation of AI technology stocks. CDS spread movements subsequently reversed, narrowing in December following the Fed rate cut and as concerns over a potential AI bubble eased. In January, however, CDS spreads rose again in several markets, most notably in Indonesia (7.7 bps) on market stress related to MSCI's review and in the Philippines (2.4 bps) after it reported weak growth in Q4 2025 GDP. Viet Nam registered the region's largest decline in the CDS spread (–9.1 bps) in January amid strong economic growth and Fitch Ratings' upgrade of its senior secured long-term debt to BB+ from BBB–. In February, regional markets saw their respective CDS spreads diverge. Indonesia's spread widened further following the downgrade from Moody's Ratings, while Viet Nam's rose following the release of January's trade balance data, which showed the largest

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.

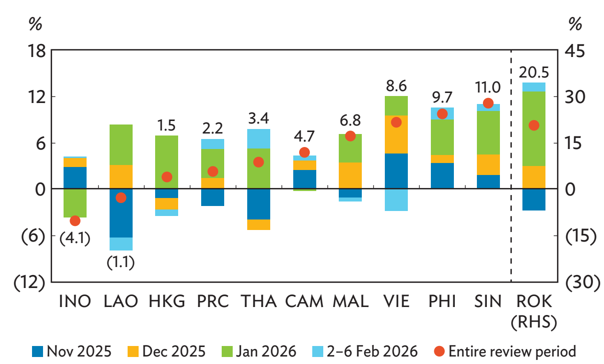
Note: The numbers above (below) each bar refer to the change in spreads between 3 November 2025 and 6 February 2026.

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

deficit since February 2022 despite expectations of a surplus. Meanwhile, Malaysia's CDS spread narrowed over an improving growth outlook.

Equity markets gained in most regional economies during the review period, bolstered by strong economic growth in Q4 2025 and the ongoing AI boom. Regional stocks gained 4.2% (market-weighted average) (**Figure E**). AI stocks lifted equity performances across the region, with the biggest jump recorded in the Republic of Korea (20.5%), driven by its semiconductor industry. Singapore's

Figure E: 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; RHS = right-hand side; SIN = Singapore; THA = Thailand; VIE = Viet Nam.

Note: The numbers above (below) each bar refer to the percentage change between 3 November 2025 and 6 February 2026.

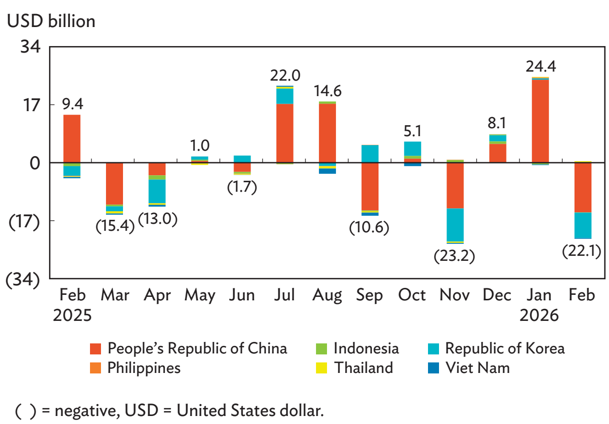
Source: *AsianBondsOnline* calculations based on Bloomberg LP data.

equity market gained 11.0%, supported by strong Q4 2025 GDP growth and demand for semiconductor manufactures. The Philippine market rose 9.7% over news that the government would spend PHP1.4 billion in the first quarter of 2026 to support economic growth. Viet Nam's equity market rose 8.6% on optimism over regulatory reforms to support Viet Nam's inclusion in FTSE Russell's emerging market index by September 2026. Only Indonesia posted equity losses (–4.1%) during the review period, as its gains in earlier months were more than offset by a market rout following MSCI's review in January. Emerging East Asia saw equity losses in November (–2.1%, market-weighted average) over a market sell-off driven by AI valuation concerns. Markets subsequently recovered in December–January, supported by the Fed's December rate cut and an upturn in AI-related sentiment.

Most regional equity markets recorded net inflows during the review period as resilient economic fundamentals helped weather global market volatility. Four out of six regional markets with available data recorded portfolio inflows. The PRC and the Republic of Korea experienced both large inflows and outflows over the course of the review period, tracking the shifts in AI-valuation concerns (**Figure F**). These capital flows were mainly driven by risk sentiment related to tech stocks. The region saw net outflows of USD23.2 billion in November, largely due to a sell-off amid concerns over tech stock valuations, with particularly notable outflows from the PRC (–USD13.6 billion) and the Republic of Korea (–USD9.7 billion). In December, equity flows turned positive on the recovery in investor sentiment surrounding AI and the Fed's rate cut. In January, improved growth sentiment in the region and strong corporate earnings generated additional inflows, with the PRC witnessing inflows of USD24.4 billion. February saw regional outflows of USD22.1 billion, led by the PRC and the Republic of Korea, over more AI related sell-offs. Excluding the Republic of Korea, the region saw net equity inflows of USD2.1 billion during the review period.

Regional bond markets logged net portfolio inflows of USD12.2 billion in November–January, largely due to an improved growth outlook for most markets in the region. Easing inflation in the US led to increased expectations of a rate cut in December, which contributed to bond inflows in emerging East Asia. Among regional bond markets, the Republic of Korea posted the largest net portfolio inflows of USD19.2 billion, as investors ramped up their holdings ahead of the Republic of Korea's inclusion in the FTSE Russell World Government Bond Index in April 2026 (**Figure G**). In contrast, the PRC posted net portfolio

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

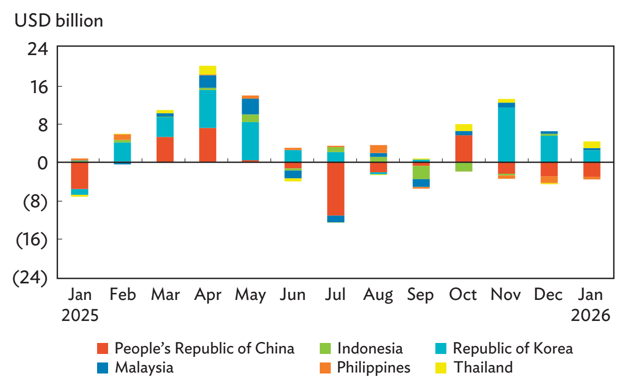


( ) = negative, USD = United States dollar.

Notes:
1. Data coverage is from 1 February 2025 to 6 February 2026.
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 (ASEAN) plus the People's Republic of China; Hong Kong, China; and the Republic of Korea.

Source: Institute of International Finance.

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



( ) = negative, USD = United States dollar.

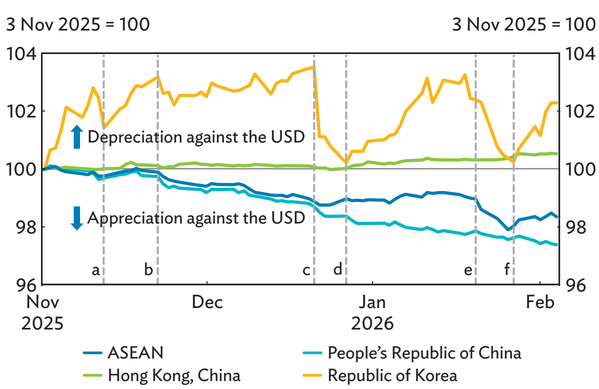
Notes:
1. The Republic of Korea and Thailand provided data on bond flows. For the People's Republic of China, Indonesia, Malaysia, and the Philippines, month-on-month changes in foreign holdings of local currency government bonds were used as a proxy for bond flows.
2. Data are as of 31 January 2026.
3. Figures were computed based on 31 January 2026 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).

outflows of USD8.3 billion in November–January over investor concerns amid slow economic growth. Meanwhile, the Philippines experienced USD2.6 billion of net outflows following successive rate cuts in August, October, December, and February.

Emerging East Asian currencies appreciated against the US dollar by 1.3% (simple average) and 2.0% (GDP-weighted) during the review period due to a rate cut and heightened uncertainty in the US and the region's resilient economic performance (**Figure H**). Regional currencies strengthened in December, following the US rate cut, and again in January, when rising geopolitical tensions led to the depreciation of the US dollar. During the review period, the Malaysian ringgit posted the region's largest gain of 6.4% over improved investor sentiment and the government's fiscal consolidation plan. Meanwhile, the Korean won depreciated 2.2% against the US dollar on strong domestic dollar demand for the US dollar, including the purchasing of US stocks by retail investors. The Indonesian rupiah depreciated 1.2% against the US dollar, largely due to portfolio outflows following a market sell-off in January.

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



ASEAN = Association of Southeast Asian Nations, USD = United States dollar.

Notes:

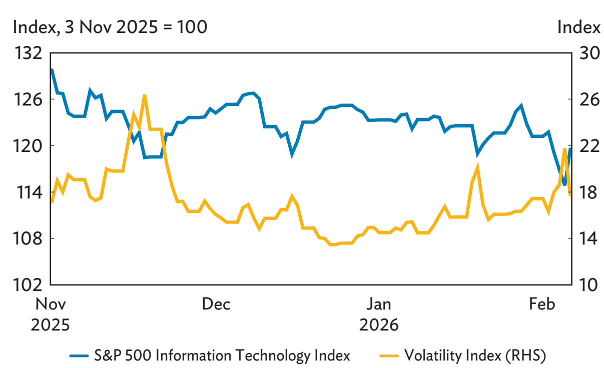
1. Corresponding dates of the following events:
   - a Growing number of Fed officials signal reticence on further easing.
   - b Dovish remark from New York Fed President John Williams about a rate cut at the December Federal Open Market Committee meeting.
   - c Heightened geopolitical tensions drive investors away from the USD.
   - d Korean won depreciates amid strong domestic demand for the USD.
   - e Planned US tariffs for European economies were pulled back.
   - f Kevin Warsh is expected to replace Fed Chair Jerome Powell in May, raising market concerns that the Fed might resume quantitative tightening.
2. ASEAN comprises the markets of Brunei Darussalam, Cambodia, Indonesia, the Lao People's Democratic Republic, Malaysia, the Philippines, Singapore, Thailand, and Viet Nam.
3. Data are as of 6 February 2026.
4. An increase (decrease) in the value indicates depreciation (appreciation) of the currency against the USD.

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

Regional financial markets are expected to remain broadly resilient as upside and downside risks appear balanced. On the upside, the region's generally solid macroeconomic fundamentals and accommodative monetary policies should help cushion external shocks. If the AI-related investment cycle continues to gain momentum and productivity gains materialize, sustained earnings growth in the technology sector could reinforce equity market performance, support capital inflows, and strengthen broader market sentiment across the region.

Meanwhile, several downside risks warrant close monitoring. The prolonged property sector downturn in the PRC remains a significant risk to regional growth and financial stability. New home prices across 70 cities fell 2.7% y-o-y in December 2025, accelerating from a 2.4% y-o-y decline in November. S&P Global Ratings recently downgraded its outlook, projecting property sales to drop by about 10%–14% in 2026, compared with earlier expectations of a 5%–8% decline. Continued weakness could dampen domestic demand, weigh on fiscal finances, and constrain credit expansion. Abrupt changes in investor sentiment, especially AI-related concerns, could lead to spikes in market volatility. The VIX Index and tech stocks' performance have shown a highly negative correlation (**Figure I**). Uncertainty about the US monetary policy path—including the upcoming leadership transition at the Fed, the pace of future interest rate adjustments, and possible quantitative tightening—could contribute to fluctuations in asset prices and global capital flows. **Box 1** highlights how improved policy frameworks and the development of local currency bond markets enhance financial resilience in emerging markets, including in ASEAN markets.

Figure I: Tech Stock Market Performance and Chicago Board Options Exchange Volatility Index



RHS = right-hand side.

Note: Data are as of 6 February 2026.

Source: Bloomberg, LP.

Unexpected trade policy and geopolitical developments could also heighten uncertainty. Rising trade fragmentation poses both risks and opportunities for regional financial markets. On the downside, increased tariffs, export controls, and policy uncertainty can weigh on export-oriented sectors and heighten earnings volatility for firms integrated into global value chains, potentially leading to capital flow volatility and weaker investor sentiment. At the same time, economies that benefit from supply chain diversification and "friend-shoring" trends could attract increased foreign direct investment and portfolio inflows, supporting domestic financial conditions.

Box 1: Building Resilience in Emerging Market Local Currency Bond Markets

Improved policy frameworks and the development of local currency (LCY) bond markets have strengthened financial resilience in emerging markets, including in Asia. Emerging markets historically face higher financial stability risks when they borrow in foreign currency and when nonresident investors hold a large share of domestic debt. Increased LCY debt issuance to domestic investors in recent years has reduced both currency mismatches and the risk of sudden capital outflows.[a]

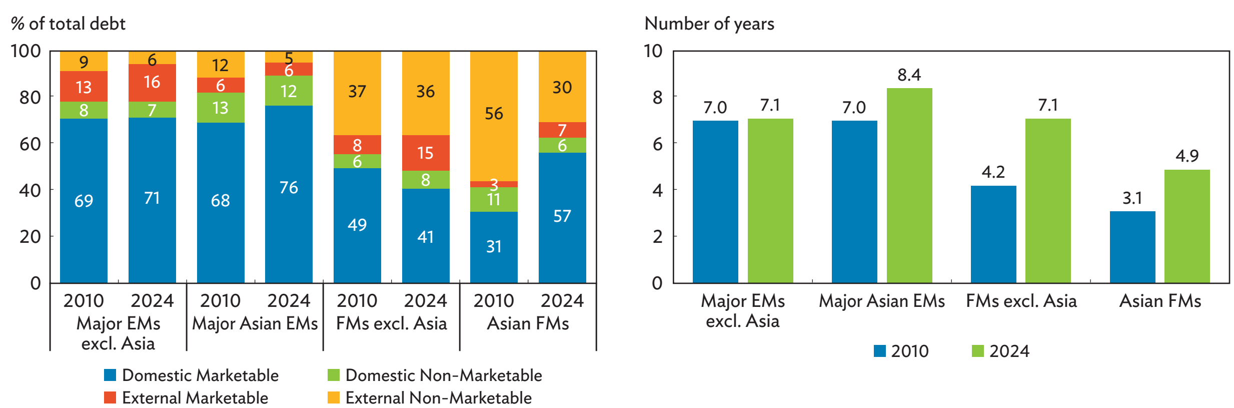
Improvements in financial stability remain uneven across economies, and government debt has increased sharply since 2010. LCY bond market development lags in many developing economies, including in parts of Asia with lingering structural constraints. Strong macroeconomic frameworks and subdued inflation and exchange rate volatility have enabled major Asian emerging markets to primarily issue in local currency, particularly for longer-term fixed-rate bonds, including *sukuk* (Islamic bonds) (**Figure B1.1**). However, many smaller emerging markets and frontier markets still rely significantly on foreign currency issuance, short-term LCY debt, or concessional lending. Among frontier markets, Asian economies rely relatively more on LCY debt but issue at shorter maturities.

Investor Composition

Nonresident investor participation in LCY debt has fallen to multiyear lows across most emerging markets.[b] While a few markets experienced large outflows of LCY debt from 2012 to 2024, nonresident inflows generally stagnated and failed to keep pace with heavy domestic issuance (**Figure B1.2**). Risk-adjusted returns for this asset class were poor for much of the last decade, partially due to the persistent strength of the dollar prior to 2025. Nonresident participation is broadly lower across emerging markets in

Figure B1.1: Local Currency Bond Market Composition in Emerging Markets

Composition of Central Government Debt | **Average Time to Maturity for Domestic Debt**



EM = emerging market, FM = frontier market.

Source: International Monetary Fund. 2025. *Global Financial Stability Report, October 2025.* https://www.imf.org/en/publications/gfsr/issues/2025/10/14/global-financial-stability-report-october-2025.

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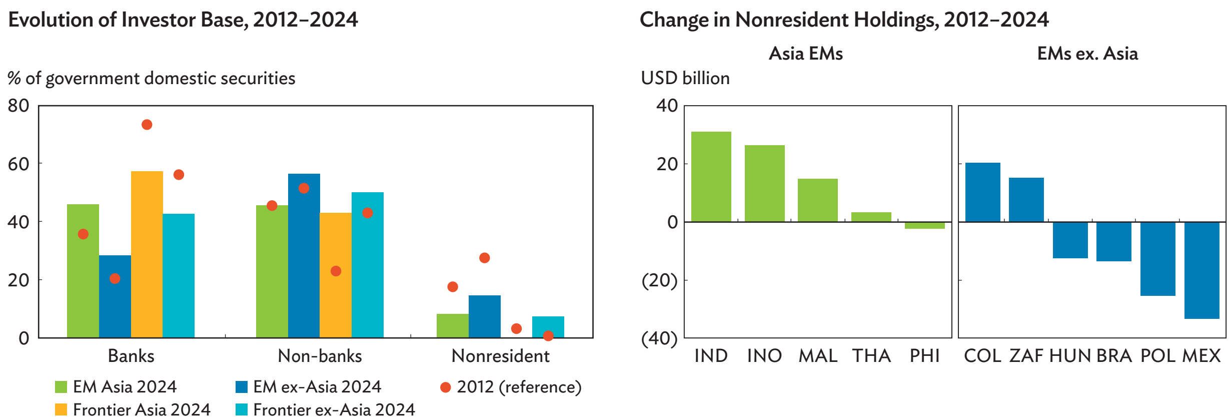
Box 1 *continued*

Figure B1.2: Local Currency Bond Market Investor Composition in Emerging Markets



( ) = negative, BRA = Brazil, COL = Colombia, EM = emerging market, HUN = Hungary, IND = India, INO = Indonesia, MAL = Malaysia, MEX = Mexico, PHI = Philippines, POL = Poland, THA = Thailand, USD = United States dollar, ZAF = South Africa.

Source: International Monetary Fund. 2025. *Global Financial Stability Report*, October 2025. https://www.imf.org/en/publications/gfsr/issues/2025/10/14/global-financial-stability-report-october-2025.

Asia compared to emerging markets in other regions, though nonresidents hold about 20% of LCY debt in Malaysia. Among frontier markets, nonresident ownership varies greatly, with some economies prone to large capital flow cycles (e.g., Egypt, Ghana), while nonresident ownership in others is negligible.

Banks continue to play a dominant role in absorbing domestic issuance, though nonbank financial institutions (NBFIs) are increasing their purchases of LCY debt in some emerging markets. In major Asian emerging markets, the domestic investor composition remains balanced between banks and NBFIs. Elsewhere, NBFIs have generally increased their market share over the last decade, with NBFI ownership exceeding banks in some cases. In contrast, many frontier markets remain highly dependent on banks, particularly across Asia. Several emerging markets outside of Asia have more developed NBFI sectors with sizeable pension and investment fund assets, notably in South Africa, Brazil, and Chile.[c]

Greater domestic ownership reduces the sensitivity of emerging market LCY bond markets to global shocks. Empirical analysis of data covering 2012–2024 shows that a shock of 10 percentage points in the Volatility Index increases LCY bond yields by about 19 basis points (Chen et al. 2025). A higher share of domestic bank ownership—one standard deviation above average—reduces the impact to about 11 basis points. Greater nonresident ownership increases the impact to 23 basis points. For domestic NBFIs, the results are more nuanced, but any positive effect appears more significant for pension funds and insurance companies, which have long-term investment horizons. Model results for liquidity, proxied by bid–ask spreads, show similar patterns. However, higher levels of domestic bond ownership also have drawbacks. LCY bond markets with limited absorption capacity are more prone to risks from the increasing sovereign–bank nexus. Policymakers also may resort to financial repression to place debt at below-market rates.

Market Functioning

Market functioning matters for bond market resilience just as much as investor composition. Government bond market liquidity in emerging markets lags advanced economies, though many markets have improved over time. The picture is mixed for Asian emerging markets. They tend to issue a larger number of smaller bond lines, while repo and hedging markets are less developed, which limits market depth. Bank trading books in major Asian emerging markets are typically smaller than in other major emerging markets, constraining dealers’ ability to intermediate risk and reducing turnover. For pre-trades on benchmark bonds, firm-price availability is universal across emerging markets, and bid–ask spreads in major Asian emerging markets are as tight as in other major emerging markets. In frontier markets, average trade sizes are significantly smaller with shallow liquidity.

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Box 1 *continued*

Policy Framework

LCY bond market development forms part of a broader financial stability agenda. Sovereign issuance is not just a financing tool; it is also about market building. Issuing debt at fair, market-clearing yields strengthens market discipline and helps policymakers act early when needed. A nonmarket approach to issuing government securities—characterized by administratively set yields, ad hoc interventions, price-making behavior, multiple instruments offered at each auction, and irregular auction management—fundamentally undermines price discovery and investor confidence.

The LCY bond market framework of the International Monetary Fund (IMF) and the World Bank prioritizes six core policy areas for reform: (i) money market, (ii) primary market, (iii) secondary market, (iv) investor base, (v) financial market infrastructure, and (vi) legal and regulatory framework. These pillars provide a clear structure for economies aiming to deepen their markets to support stable domestic financing, strengthen policy transmission, and remain functional even under global stress. The IMF and World Bank provide programmatic technical assistance on LCY bond market development to members, supported by capacity building through the IMF's online training module on LCY bond market development.

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This box is based on © International Monetary Fund. 2025. *Global Financial Stability Report, October 2025*. https://www.imf.org/en/publications/gfsr/issues/2025/10/14/global-financial-stability-report-october-2025. It was written by Bryan Gurhy (senior financial sector expert), Arindam Roy (senior financial sector expert), Patrick Schneider (financial sector expert), and Xuege Zhang (economist), all from the Monetary and Capital Markets Department, IMF. The views expressed here are those of the authors and do not reflect the views of the IMF or its board.

[a] In this box, emerging markets comprise 12 economies, including 6 from Asia: the People's Republic of China, India, Indonesia, Malaysia, the Philippines, and Thailand. Frontier markets comprise 13 economies, including 4 from Asia: Armenia, Pakistan, Sri Lanka, and Viet Nam. Classification into major emerging markets and frontier markets is based on the size of the bond market (as a share of gross domestic product) and the size of individual bonds.

[b] Nonresident holdings increased in the People's Republic of China and India after policymakers relaxed foreign investment restrictions and LCY bonds were added to global benchmarks; however, their respective shares in total bonds remained low at the end of 2024.

[c] Among Asian emerging markets, Malaysia has a relatively deep NBFI sector. Pension and insurance allocations to government bonds are generally high in Asian emerging markets, partly reflecting their respective regulatory frameworks.