

# Developments in Regional Financial Conditions

Financial conditions in emerging East Asia improved from 1 June to 30 August over expectations of policy rate cuts in both advanced economies and regional markets amid the continued moderation of inflation.<sup>1</sup> Most of the improvements started in July when the United States (US) Federal Reserve hinted that a policy rate cut was likely in September. Expected policy rate cuts in the US and the euro area drove down bond yields in both advanced and regional markets during the review period (**Table A**). The expectation of rate cuts also contributed to the collective appreciation of regional currencies against the US dollar and a decline in risk premiums. Most regional equity markets posted gains leading to capital inflows during the review period, as investor confidence was restored following the short-lived market turmoil in early August. The market turmoil was largely driven by dampened investor sentiment over the weakening US labor market and related concerns about a possible recession. Risks to the financial conditions outlook are balanced over the next quarter. On the upside, moderating inflation and an end to monetary tightening in the region could contribute to the

further improvement of financial conditions. Downside risks include rising geopolitical risks, recent domestic uncertainty in some Association of Southeast Asian Nations (ASEAN) markets, trade tensions between the US and the People's Republic of China (PRC), a weaker-than-expected economic performance in the PRC, and uncertainty regarding the US election. Regional financial conditions are also exposed to market volatility from negative news, such as the financial turmoil experienced in early August.

Bond yields fell in the US during the review period over a widely expected Federal Reserve rate cut in September amid moderating inflation and some signs of economic weakness. During the 11–12 June Federal Open Market Committee (FOMC) meeting, the Federal Reserve left the federal funds target rate unchanged and acknowledged progress toward its 2.0% inflation goal. During the 30–31 July FOMC meeting, the Federal Reserve left its policy rate unchanged, while confirming further progress toward achieving its inflation goal. The Federal Reserve

**Table A: Changes in Financial Conditions in Major Advanced Economies and Select Emerging East Asian Markets from 1 June to 30 August 2024**

	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	(71)	(37)	-	(0.5)	1.8
Japan	(3)	(17)	(2)	(1.7)	7.6
United States	(96)	(60)	-	7.0	-
<b>Select Emerging East Asian Markets</b>					
People's Republic of China	(24)	(15)	(5)	(7.9)	2.1
Hong Kong, China	(109)	(94)	-	(0.5)	0.3
Indonesia	(26)	(26)	(5)	10.0	5.1
Republic of Korea	(40)	(49)	(4)	1.4	3.5
Malaysia	(23)	(13)	(9)	5.1	8.9
Philippines	(30)	(68)	(9)	7.2	4.3
Singapore	(87)	(65)	-	3.2	3.4
Thailand	(19)	(27)	(7)	1.0	8.6
Viet Nam	(0.4)	(13)	(14)	1.8	2.3

( ) = 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.

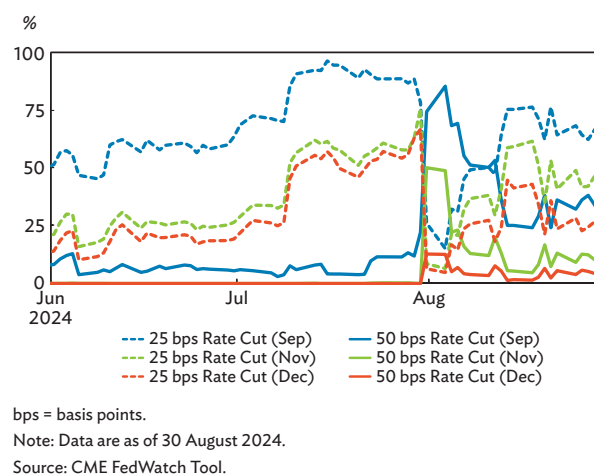
<sup>1</sup> Emerging East Asia is defined to include member states of the Association of Southeast Asian Nations plus the People's Republic of China; Hong Kong, China; and the Republic of Korea.

also noted at the July meeting that unemployment had risen slightly and job gains had moderated. With both inflation and the job market's performance supporting a rate cut, Federal Reserve Chair [Jerome Powell](#) hinted that the Federal Reserve would cut interest rates at its next FOMC meeting in September unless inflation progress stalled. While the weaker labor market performance data released on 2 August triggered a market overreaction on fears that this was a looming sign of recession, this concern has since abated. Based on the CME FedWatch tool, on 31 July, markets were pricing an 11.8% probability of a 50 basis points (bps) rate cut at the September meeting; this probability surged to 85.0% on 5 August following the release of weak labor market data on 2 August. Meanwhile, the probability of a 25 bps rate cut in September fell from 88.1% on 31 July to 15.0% on 5 August.

In August, Federal Reserve officials helped set market expectations. San Francisco Federal Reserve President [Mary Daly](#) said on 5 August that the job market was softening but remained sound and that companies were merely slowing their hiring and not cutting jobs. On the same day, Chicago Federal Reserve President [Austan Goolsbee](#) said that the recent jobs report was not necessarily a recession indicator and that the Federal Reserve was looking at the totality of the data. During the 22–24 August Jackson Hole symposium, Federal Reserve Chair [Jerome Powell](#) indicated that “the time has come for policy to adjust.” In his speech, Jerome Powell noted that the labor market had weakened while inflation was on a sustainable downward trend. By 30 August, the probability of a 50 bps rate cut at the September meeting had plunged to 30.0%, while the probability of a 25 bps rate cut had risen to 70.0%. The probabilities of 25 bps rate cuts at the November and December FOMC meetings also rose to 49.3% and 30.0%, respectively, on 30 August, from 21.1% and 14.0% on 3 June (**Figure A**).

The US economy remained sound but witnessed some signs of weakness during the review period. At the June FOMC meeting, the Federal Reserve kept its 2024 forecasts for annualized gross domestic product (GDP) growth and the unemployment rate unchanged at 2.1% and 4.0%, respectively, the same as its March forecasts. But projected annual Personal Consumption Expenditures (PCE) inflation for 2024 was revised slightly higher to 2.6% from 2.4% in March. Second estimates for second quarter (Q2) US GDP showed annualized growth

**Figure A: Probability of a 25 Basis Points versus a 50 Basis Points Rate Cut at the September, November, and December Federal Open Market Committee Meetings**



of 3.0%, up from 1.4% in the previous quarter, driven by improved consumer spending and business sentiment. Headline inflation continued to trend downward, clocking in at 2.9% year-on-year (y-o-y) in July from 3.0% y-o-y in June and 3.3% y-o-y in May. July's print was the first time since March 2021 that consumer price inflation had fallen below 3.0% y-o-y. PCE inflation also ticked down to 2.5% y-o-y in June and July from 2.6% y-o-y in May, while core PCE inflation (excluding energy and food) was steady at 2.6% y-o-y in May, June, and July. Overall business activity remained in an expansionary regime, as evidenced by composite Purchasing Managers Index (PMI) readings of 54.8, 54.3, and 54.6 in June, July, and August, respectively, as well as services PMI readings of 55.3, 55.0, and 55.7, respectively. However, the manufacturing PMI fell further to 47.9 in August from 49.6 in July and 51.6 in June. The July reading was below the expansionary threshold of 50.0 for the first time this year, indicating softening in the manufacturing sector. Labor market indicators continued showing some weakness. Nonfarm payroll additions read 142,000 in August, higher than 89,000 in July and 118,000 in June, but lower than the expected 160,000. The unemployment rate in the US dropped slightly to 4.2% in August from 4.3% in July, the highest since October 2021, but was still up from 4.1% in June.

In the euro area, government bond yields fell during the review period following the European Central Bank's (ECB) policy rate cut in June. The ECB reduced its key policy rates by 25 bps during its 5–6 June meeting but

stressed that it was not pre-committing to a particular rate path. At its 17–18 July meeting, the ECB kept its key policy rates steady, noting that the June policy rate cut had been transmitted smoothly. After the July meeting, some ECB officials hinted at a possible rate cut in the September meeting. On 22 July, ECB Governing Council member [Peter Kazimir](#) said that market expectations of two rate cuts this year were not “misplaced,” but the ECB would continue to assess incoming data. On 25 July, Deutsche Bundesbank President [Joachim Nagel](#) indicated that the ECB would cut rates if economic data lined up with previous forecasts. Bank of Portugal Vice Governor [Clara Raposo](#) mentioned that the ECB could cut rates twice this year provided that inflation fell within expectations. On 23 August, Bank of Portugal Governor [Mario Centeno](#) said that a September cut was an “easy decision.” However, some members remained cautious. De Nederlandsche Bank President [Klaas Knot](#) indicated on 27 August that he wanted more data before deciding on a September cut. On 29 August, [Joachim Nagel](#) mentioned that while the euro area was close to its inflation target, it was important not to cut rates too quickly.

Meanwhile, the euro area’s economic recovery remained fragile. Economic conditions saw improvements during the review period as the euro area’s GDP growth rose to 0.6% y-o-y in Q2 2024 from 0.5% y-o-y in the previous quarter. The ECB’s June 2024 GDP forecast was raised to 0.9% y-o-y from 0.6% y-o-y in March. The euro area’s composite PMI improved slightly to 51.0 in August from 50.2 in July, and the services PMI rose to 52.9 from 51.9 over the same period. However, some underlying weakness remained. The manufacturing PMI remained below the 50-point expansion threshold in August at 45.8, the same as in both June and July. Meanwhile, euro area inflation eased to 2.2% y-o-y in August from 2.6% y-o-y and 2.5% y-o-y in July and June, respectively. The ECB’s inflation forecast for 2024 was raised to 2.5% y-o-y in June from 2.3% y-o-y in March.

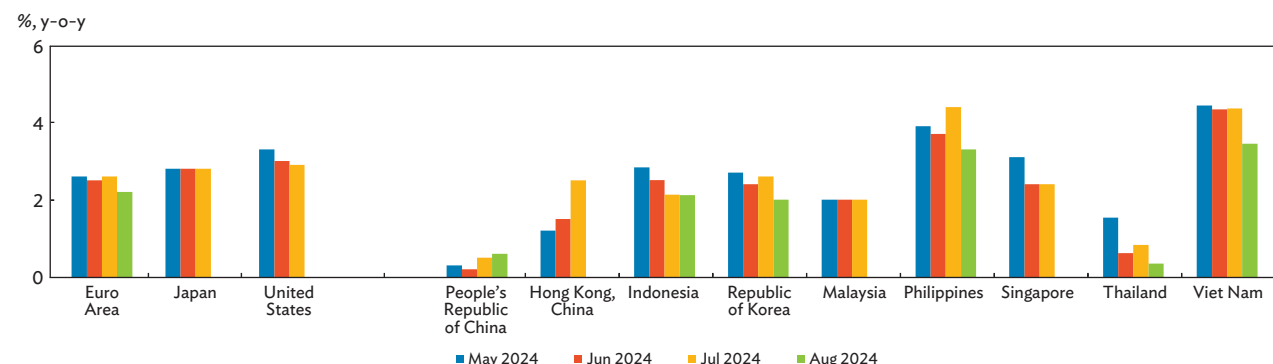
In Japan, 2-year and 10-year bond yields fell during the review period despite the Bank of Japan’s (BOJ) 15 bps rate hike at its 31 July meeting. The decline in bond yields happened mostly during early August’s market turmoil, when losses in Japanese equity markets spurred risk aversion and increased demand for safer Japanese government bonds. Losses in equity markets were driven by asset sales, when investors unwound their Japanese yen carry trade positions on the increased

likelihood of faster-than-expected US rate cuts. At its [31 July meeting](#), the BOJ hiked the policy rate for a second time in 2024, citing that growth and inflation were generally in line with the central bank’s outlook. The BOJ also signaled the possibility of further monetary policy normalization. The central bank announced plans to reduce its Japanese government bond purchases, beginning in August, by about JPY400 billion each quarter until its monthly purchases decline to about JPY2.9 trillion by the first quarter of 2026. On 1 August, [BOJ Governor Kazuo Ueda](#) said that he still deemed real interest rates to be low. Market participants are expecting another rate hike this year as the BOJ reported in its [31 July statement](#) that “if the outlook for economic activity and prices presented in the July Outlook Report will be realized, the BOJ will accordingly continue to raise the policy interest rate and adjust the degree of monetary accommodation.” Also, on 22 August, [Kazuo Ueda](#) reiterated that the BOJ would raise rates if its economic forecasts are met.

During the review period, the Japanese economy improved on a strong performance in Q2 2024. GDP growth (seasonally adjusted annualized rate) rebounded to 2.9% in Q2 2024, buoyed by rising consumption. Inflation remained above the 2.5% y-o-y target in both July and June at 2.8% y-o-y, up from 2.5% y-o-y in April. Consumer sentiment in Japan showed signs of improvement. The composite PMI rose to 52.9 in August (an 8-month high) from 52.5 in July and 49.7 in June, while the services PMI improved to 53.7 in July from 49.4 in June and remained at this level in August. However, the manufacturing PMI remained in a contractionary regime (albeit with some improvement), with an August reading of 49.8, up from 49.1 in July. The Japanese job market remained sound, as the unemployment rate stood at 2.5% and 2.7% in June and July, respectively, a similar level to 2.6% in May. At its July meeting, however, the BOJ revised downward its 2024 inflation forecast to 2.5% y-o-y from the April forecast of 2.8% y-o-y. The BOJ’s fiscal year 2024 growth forecast was revised downward to 0.6% y-o-y in July from 0.8% y-o-y in April.

Local currency bond yields fell for both 2-year and 10-year tenors in all emerging East Asian markets, following continued moderation in domestic inflation and lower bond yields in advanced markets. Inflation continued its moderating trend in most regional markets during the review period ([Figure B](#)). The Philippines and Viet Nam, which posted relatively higher inflation in the region in July, saw their respective inflation

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



y-o-y = year-on-year.

Note: Data coverage is from May to August 2024 except for Hong Kong, China; Japan; Malaysia; Singapore; and the United States (July 2024).

Sources: Various local sources.

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

Economy	Policy Rate 1-Aug-2023 (%)	Rate Change (%)												Policy Rate 30-Aug-2024 (%)	Change in Policy Rates (basis points)
		Aug- 2023	Sep- 2023	Oct- 2023	Nov- 2023	Dec- 2023	Jan- 2024	Feb- 2024	Mar- 2024	Apr- 2024	May- 2024	Jun- 2024	Jul- 2024		
Euro Area	3.50	↑0.25	↑0.25										↓0.25	3.75	↑ 25
Japan	(0.10)							↑0.20					↑0.15	0.25	↑ 35
United Kingdom	5.00	↑0.25											↓0.25	5.00	◆ 0
United States	5.50													5.50	◆ 0
People's Republic of China	2.65	↓0.15											↓0.20	2.30	↓ 35
Indonesia	5.75		↑0.25					↑0.25						6.25	↑ 50
Republic of Korea	3.50													3.50	◆ 0
Malaysia	3.00													3.00	◆ 0
Philippines	6.25		↑0.25										↓0.25	6.25	◆ 0
Singapore	-													-	-
Thailand	2.00	↑0.25	↑0.25											2.50	↑ 50
Viet Nam	4.50													4.50	◆ 0

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

Notes:

1. Data coverage is from 1 August 2023 to 30 August 2024.
2. For the People's Republic of China, the data used in the chart are for the 1-year medium-term lending facility rate. While the 1-year benchmark lending rate is the official policy rate of the People's Bank of China, market players use the 1-year medium-term lending facility rate as a guide for the bank's monetary policy direction.
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.

rates moderating to 3.3% y-o-y (from 4.4% y-o-y) and 3.5% y-o-y (from 4.4% y-o-y) in August due to slower increases in food prices. The decline in yields in the region was also influenced by market expectations of more rate cuts in both advanced economies and the region. During the review period, most central banks in emerging East Asia held their policy rates unchanged (Table B). The exceptions were the PRC and the Philippines; both conducted rate cuts. On 22 July, the People's Bank of China (PBOC) surprisingly reduced by

10 bps each the 7-day repurchase rate, the 1-year loan prime rate, and the 5-year loan prime rate. The PBOC's rate cut was to support economic activities as Q2 2024 GDP fell to 4.7% y-o-y from 5.3% y-o-y in the first quarter. On 25 July, the PBOC lowered the 1-year medium-term lending facility rate by 20 bps to 2.3%. On 15 August, the Bangko Sentral ng Pilipinas lowered its policy rate by 25 bps. The central bank indicated that inflation is expected to fall within its 2024 target range of 2.0%–4.0%. Some central banks have signaled their planned rate

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

Economy	2024		
	Q1	Q2	Forecast
People's Republic of China	5.30	4.70	4.80
Hong Kong, China	2.80	3.30	2.80
Indonesia	5.11	5.05	5.00
Republic of Korea	3.30	2.30	2.50
Malaysia	4.20	5.90	4.50
Philippines	5.80	6.30	6.00
Singapore	3.00	2.90	2.40
Thailand	1.60	2.30	2.60
Viet Nam	5.66	6.93	6.00

Q1 = first quarter, Q2 = second quarter, y-o-y = year-on-year.

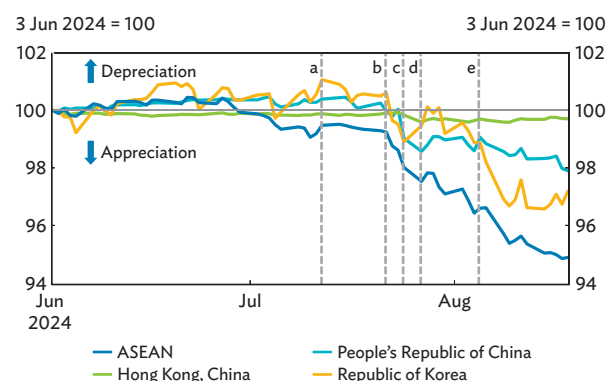
Note: Forecasts for 2024 are based on the *Asian Development Outlook July 2024*.

Sources: Various local sources.

cuts. For example, [Bank Indonesia](#) indicated on 8 July that a cut in the fourth quarter was possible should the rupiah continue to stabilize. Similarly, on 3 September, the [Bank of Korea](#) said that it was now time to consider cutting rates.

Regional economies demonstrated solid growth prospects during the review period. Most regional economies—particularly Hong Kong, China; Malaysia; the Philippines; Thailand; and Viet Nam—witnessed improvements in their Q2 2024 GDP performance compared to the first quarter (**Table C**). In the July edition of the *Asian Development Outlook*, the Asian Development Bank's 2024 growth projection for East Asia was revised slightly upward to 4.6% from the 4.5% forecast made in April, due to strong exports of semiconductors and artificial intelligence products from high-income economies in the region, including the Republic of Korea. The growth forecast for Southeast Asia was maintained at 4.6%, supported by strong domestic and external demand.

Expectations of rate cuts in the US supported the appreciation of emerging East Asian currencies against the US dollar during the review period. Regional currencies strengthened by 3.3% (simple average) and 2.7% (GDP-weighted average) against the US dollar during the review period. Most of the gains were observed starting in July, when the Federal Reserve hinted that a rate cut was likely in September (**Figure C**). In June, regional currencies weakened by a marginal 0.3% (both simple and GDP-weighted averages) against the US dollar due to uncertainties regarding the direction of US monetary policy, which kept the interest differential between the US dollar and local currencies relatively high. In July, the

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


ASEAN = Association of Southeast Asian Nations.

- Some Federal Reserve officials affirm that the timing of a policy rate cut draws near.
- Federal Reserve Chair Jerome Powell indicates at the Federal Open Market Committee meeting that a rate cut is possible in September.
- Market overreaction to the release of weak United States' labor market indicators and concerns of a recession.
- Some Federal Reserve officials sought to calm financial markets.
- More Federal Reserve officials indicated support for a policy rate cut on the release of slowing July inflation.

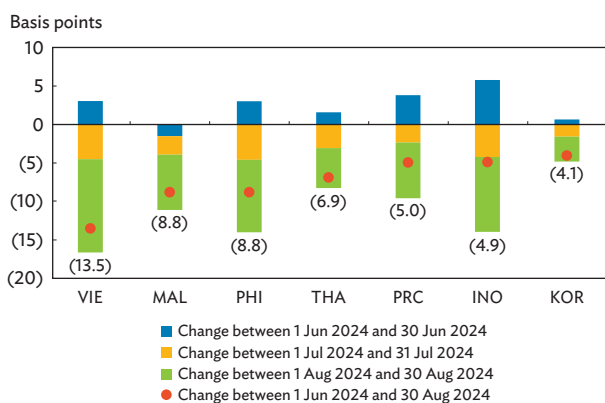
Notes:

- ASEAN comprises the markets of Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Viet Nam.
- Data are as of 30 August 2024.
- A higher level indicates currency depreciation against the United States dollar.

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

region's currencies gained 1.0% (simple average) and 0.7% (GDP-weighted) on hints of a possible rate cut in September by the Federal Reserve. Regional currencies continued to appreciate against the US dollar in August (2.7% simple average and 2.4% GDP-weighted average) as the market expectation of a September US rate cut gained more ground. During the entire review period, the Malaysian ringgit witnessed the largest appreciation versus the US dollar (8.9%), driven by strong capital inflows and positive sentiment over the planned implementation of a consumption tax that is expected to bolster government finances. The Thai baht recorded the region's next largest appreciation at 8.6%, buoyed by increased tourist arrivals and an upgrade in the government's 2024 GDP forecast to 2.7% from a previous forecast of 2.4%.

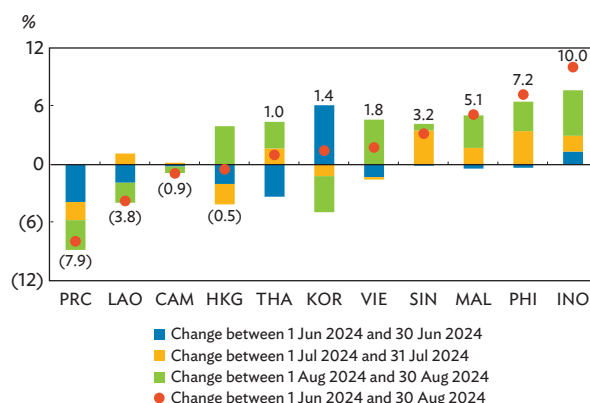
Risk premiums narrowed in all regional markets during the review period. Risk premiums, as measured by the credit default swap (CDS) spread, narrowed by a simple average of 7.4 bps and a GDP-weighted average of 5.2 bps across emerging East Asia during the review period. This was largely driven by the expected ending of monetary tightening worldwide. In June, most regional markets' risk premiums widened on uncertainty regarding US monetary

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

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

Note: The numbers above (below) each bar refer to the change in spreads between 1 June 2024 and 30 August 2024.

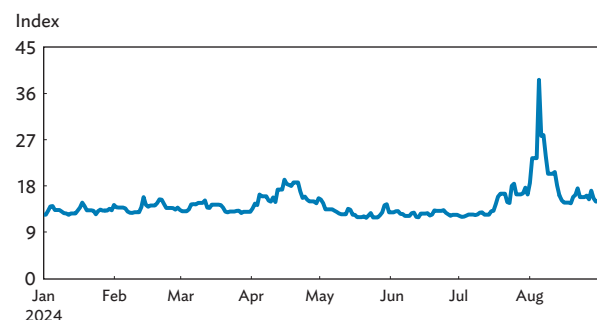
Source: AsianBondsOnline calculations based on Bloomberg LP data.

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

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

Note: The numbers above (below) each bar refer to the change between 1 June 2024 and 30 August 2024.

Source: AsianBondsOnline calculations based on Bloomberg LP data.

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

Note: Data are as of 30 August 2024.

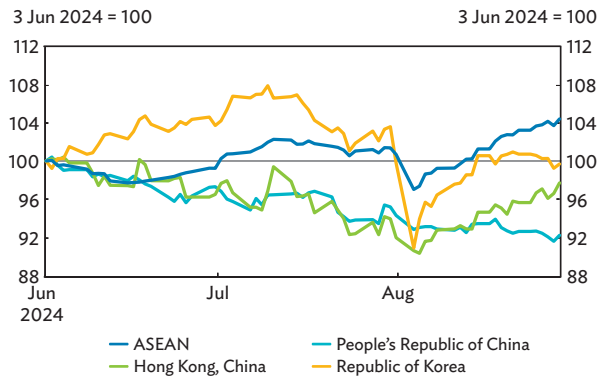
Source: Bloomberg LP.

policy and the prospect of higher-for-longer rates. Since July, the regional CDS spread collectively narrowed as the Federal Reserve indicated it was increasingly confident that inflation was trending downward (**Figure D**). In early August, risk aversion heightened after US labor market data were released. Global risk aversion also rose over concerns of a possible recession in the US, pushing the Chicago Board Options Exchange's Volatility Index up from 16.4 to 38.6 from 31 July to 5 August (**Figure E**). After Federal Reserve officials, such as [Mary Daly](#) and [Austan Goolsbee](#), helped to calm markets on 5 August, the volatility index subsequently recovered to 15.0 on 30 August, and risk premiums in regional markets also receded.

Most regional equity markets gained during the review period, except for the PRC and Hong Kong, China (**Figure F**). Regional equity markets recorded a market-weighted average return of  $-3.7\%$  during the review period, but a market-weighted gain of  $3.6\%$  when excluding the PRC and Hong Kong, China. The weak equity performance in the PRC and Hong Kong, China was driven by continued weakness in the PRC's economy. Similar to risk premiums, most regional equity markets recorded losses in June and gains since July. Regional equity markets collectively fell from 1 August to 5 August due to heightened risk aversion on weak US labor market data (**Figure G**). However, markets subsequently recovered. Among regional markets, Indonesia and the Philippines recorded the largest gains. In Indonesia, gains were fueled by rising expectations of a policy rate cut and increased capital inflows. In the Philippines, the Bangko Sentral ng Pilipinas reduced its policy rate in August and the economy posted the region's second-highest GDP growth in Q2 2024.

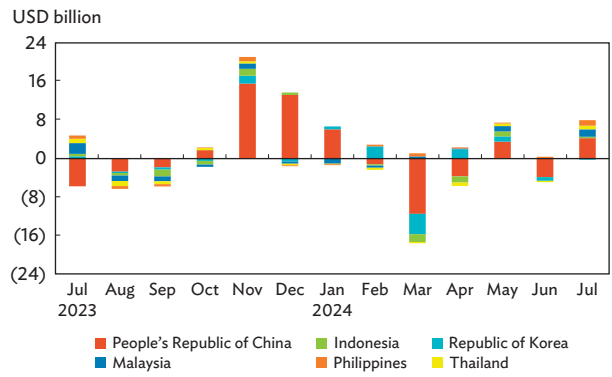
Portfolio inflows were observed in regional equity and bond markets during the review period. The region recorded cumulative equity inflows of USD7.6 billion from 1 June to 30 August (**Figure H**). In June, regional equity markets recorded net portfolio outflows of USD2.1 billion over heightened uncertainty regarding US monetary policy. Beginning in July, sentiments turned positive as the Federal Reserve became confident that the inflation

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



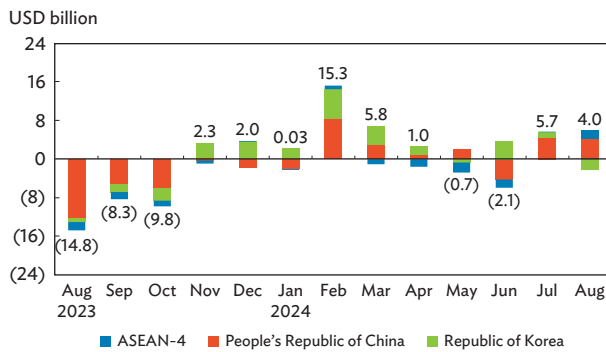
ASEAN = Association of Southeast Asian Nations.  
 Notes:  
 1. ASEAN comprises the markets of Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, the Philippines, Singapore, Thailand, and Viet Nam.  
 2. Data are as of 30 August 2024.  
 Source: AsianBondsOnline calculations based on Bloomberg LP data.

**Figure I: 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 July 2024.  
 3. Figures were computed based on 31 July 2024 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).

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



( ) = outflows, USD = United States dollar.  
 Notes:  
 1. Data coverage is from 1 August 2023 to 30 August 2024.  
 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.  
 4. ASEAN-4 includes Indonesia, the Philippines, Thailand, and Viet Nam.  
 Source: Institute of International Finance.

path supported a rate cut. Between 1 July and 30 August, the region recorded inflows of USD9.7 billion. Similar to the region's equity markets, bond market sentiment also improved in July when inflows of USD7.7 billion were recorded in the region's bond markets. In June, capital outflows of USD4.6 billion were recorded in regional bond markets, much of which came from the PRC's bond market on concerns over its growth outlook and property sector (Figure I).

The risk outlook to regional financial conditions remains balanced. On the upside, the regional economy is strong. Regional price pressures continued to gradually ease due to a slight decrease in global food prices and the lagged effect of tight monetary policy, despite ongoing oil price volatility. Additionally, the anticipated rate cuts in the US may allow many central banks in the region to cut rates during the second half of the year. Expected rate cuts by central banks, both within the region and in advanced economies, are projected to support financial conditions and bolster investor confidence. **Box 1** discusses how macroeconomic factors affect the resilience of emerging markets to changes in US monetary policy cycles.

Despite a still sound regional economy and moderating inflation, several downside factors could undermine these positive trends. First, ongoing trade tensions between the US and the PRC could disrupt global supply chains and weigh upon the region's trade and economic performance. Uncertainty surrounding the US election's outcome, which could potentially lead to broader US tariffs on a wider range of Chinese imports, contributes to the uncertainty surrounding trade tensions. Rising trade tensions may exacerbate market volatility, lead to capital outflows, strain regional currencies, and affect financial stability. Second, the PRC's weaker-than-expected

economic performance could have spillover effects across the region, as declining consumer and investor sentiment in the PRC would reduce demand for regional goods and services, and increase risk aversion in financial markets. Third, escalating geopolitical tensions pose risks to oil prices. Wider conflict in the Middle East might further disrupt shipping routes and push up oil and commodity prices, which could reignite inflationary pressures. In addition, domestic uncertainties in some ASEAN economies could raise investor risk aversion and weaken financial conditions in the region. For instance,

in Thailand, the [prime minister](#) was dismissed following a court ruling on 14 August. Lastly, adverse weather conditions and the impacts of climate change pose risks to food and energy security, and contribute to supply chain disruptions, potentially leading to persistent inflation. This, in turn, would affect central bank decisions regarding interest rates, and thus impact global and regional financial conditions. The outlook to regional financial conditions is also exposed to market volatility in response to negative news, similar to what was observed in early August.

### Box 1: Why Are Some Emerging Markets More Resilient to United States Monetary Policy Cycles Than Others?

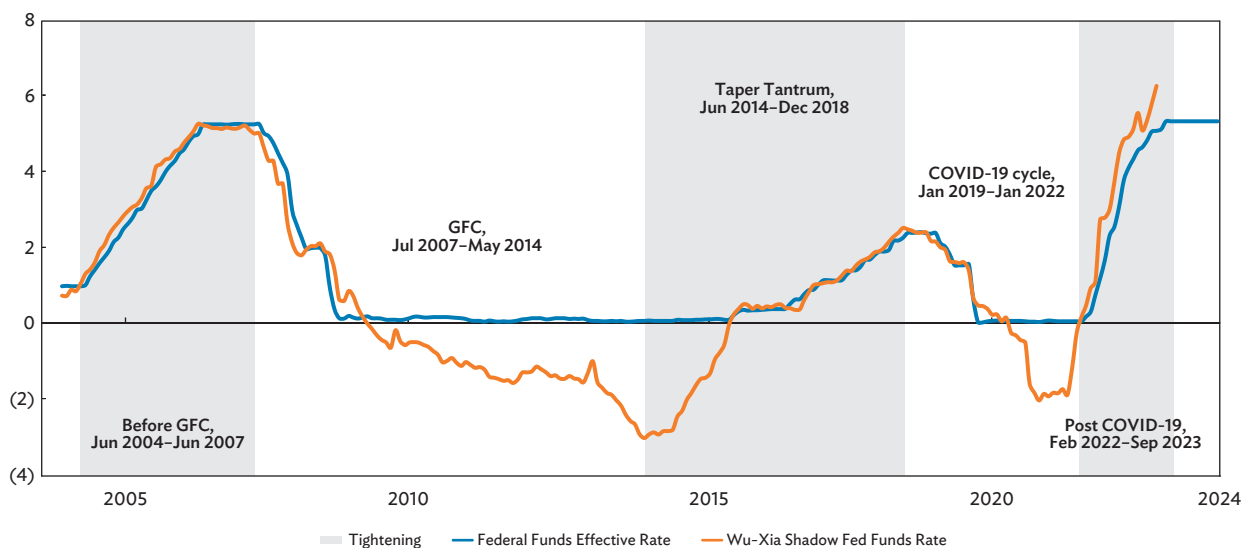
The United States (US) dollar continues to reign supreme. The dollar dominates international trade and financial transactions, and the foreign exchange reserves of central banks. As such, US monetary policy still drives global financial cycles, impacting global capital flows and credit growth. Dollar dominance ultimately limits the policy choices of financially integrated emerging markets.

The global influence of US monetary policy was especially visible during the 7 years of easing (2007–2014) induced by the global financial crisis and its aftermath. This was

followed by 4.5 years of tightening that was kicked off by the 2013 “taper tantrum.” Subsequently, 3 years of easing (2019–2022), largely induced by the COVID-19 pandemic, eventually led to a major tightening beginning in February 2022 as a delayed reaction to rapidly rising inflation in the US (**Figure B1**).

As US monetary policy shifts have global repercussions, capital markets in emerging economies are often vulnerable to destabilizing flight-to-quality outflows during periods of heightened uncertainty. They are also vulnerable to volatile

Figure B1: Monetary Cycles in the United States



COVID-19 = coronavirus disease, GFC = global financial crisis.

Sources: Atlanta Federal Reserve Bank. [Wu-Xia Shadow Federal Funds Rate](#); St. Louis Federal Reserve Bank. [Federal Funds](#).

**Box 1** *continued*

search-for-yield inflows during periods of low returns in the US. Large inflows were observed when the Federal Reserve's massive monetary easing pushed the federal funds rate close to zero in the wake of the global financial crisis.

At a broader level, these episodes placed increasing pressure on the macroeconomic outlook of emerging markets and raised their risk profile. They also impacted emerging market currencies, debt repayments, and capital flows. For instance, 2023 saw many currencies in developing Asia depreciate substantially versus the US dollar due to aggressive tightening by the Federal Reserve (Asian Development Bank 2023).

A natural question that arises is why some emerging markets are more resilient and/or less vulnerable to US monetary policy cycles, an issue examined by Aizenman et al. (2024). They sought to empirically assess whether macroeconomic variables such as debt level and institutional variables such as degree of corruption can explain an emerging market's resilience during each cycle. The three measures of emerging market resilience included in this study are (i) the bilateral exchange rate against the US dollar, (ii) exchange rate market pressure, and (iii) the market-specific Morgan Stanley Capital International Index. In addition, the role of policy factors such as exchange rate regime type and inflation targeting were also examined.

At the broadest level, the existing research finds that macroeconomic and institutional variables are indeed significantly associated with emerging market performance. Furthermore, the determinants of resilience differ during tightening versus easing cycles, and the quality of institutions matters even more during difficult times.

The findings of Aizenman et al. (2024) can be succinctly described as follows. First and foremost, cross-market differences in ex-ante macroeconomic fundamentals and institutional variables can help explain the differences in performance and resilience of a large cross-section of emerging markets during different US monetary cycles. Second, these determinants differ during tightening versus easing cycles. Third, the significance of ex-ante institutional variables increased during the monetary cycles triggered by the global financial crisis and the taper tantrum. This suggests that good institutions matter more during difficult times.

Finally, emerging market policymakers can draw some policy implications from the paper's empirical findings. For instance, the authors find that international reserves, the current account balance, and inflation are all important determinants of an emerging market's resilience to US monetary policy swings. This reinforces the conventional wisdom that strong fundamentals protect emerging markets in the face of large external shocks.

**References**

- J. Aizenman, D. Park, I.A. Qureshi, G.S. Uddin, and J. Saadaoui. 2024. *The Performance of Emerging Markets During the Fed's Easing and Tightening Cycles: A Cross-Country Resilience Analysis*. *Journal of International Money and Finance*.
- Asian Development Bank. 2023. *Asian Development Outlook*. Manila.
- L.S. Goldberg and S. Krogstrup. 2023. International Capital Flow Pressures and Global Factors. *National Bureau of Economic Research Working Paper No. 30887*.