Developments in Regional Financial Conditions

Emerging East Asian financial conditions improved between 2 June and 29 August over continued monetary easing in the region.[1] Increased expectations of a United States (US) Federal Reserve (Fed) pivot added further impetus. Progress on several trade deals in the region as well as a truce in trade negotiations between the People's Republic of China (PRC) and the US helped mollify investor concerns. During the review period, narrowed risk premiums, gains in equity markets, net portfolio equity inflows, and lower local currency (LCY) bond yields were seen in most emerging East Asian markets (**Table A**). Regional currencies were largely stable, recording a marginal appreciation on a gross domestic product (GDP)-weighted average basis. Risks to regional financial conditions are balanced. While regional central banks signaled their scope for further monetary easing to support growth amid a clouded global outlook, downside risks remain over continued uncertainty related to trade policies, the US monetary policy path, and geopolitical factors.

Bond yield movements diverged in major advanced economies during the review period. In the US, both 2-year and 10-year bond yields declined over rising expectations of a Fed rate cut following weak labor market data released in early August. On the other hand, bond yields rose in the euro area over the "wait-and-watch" stance adopted by the European Central Bank (ECB) and in Japan over improving economic performance and still-elevated inflation.

The 2-year and 10-year US yields declined during the review period as weaker labor market data raised the prospect of faster-than-expected Fed easing. The US

Table A: Changes in Financial Conditions in Major Advanced Economies and Select Emerging East Asian Markets from 2 June to 29 August 2025

	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	15	20	–	(0.1)	2.1
Japan	10	9	(2.7)	9.9	(3.0)
United States	(32)	(21)	–	8.8	–
Select Emerging East Asian Markets					
People's Republic of China	(6)	8	(8.0)	15.2	1.0
Hong Kong, China	47	(5)	–	8.3	0.6
Indonesia	(85)	(44)	(9.1)	10.8	(1.5)
Republic of Korea	2	2	(8.9)	18.0	(0.8)
Malaysia	(14)	(14)	(9.8)	4.4	0.8
Philippines	(9)	(26)	(2.4)	(3.1)	(2.5)
Singapore	(52)	(59)	–	9.7	0.1
Thailand	(41)	(49)	(10.6)	7.6	1.3
Viet Nam	51	44	(16.8)	25.9	(1.2)

( ) = 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.

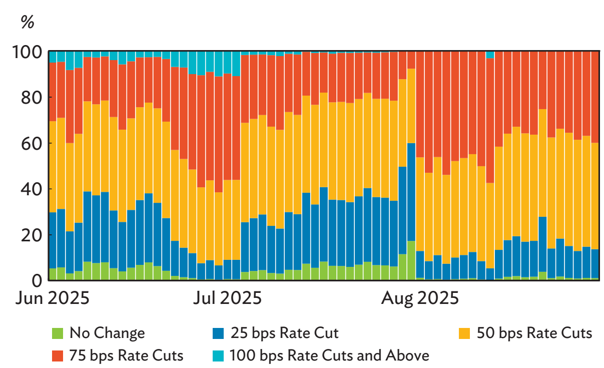
economy showed some improvement during the review period, albeit with emerging signs of weakness. While annualized GDP growth rebounded to an upwardly revised 3.3% in the second quarter (Q2) of 2025 from a contraction of 0.5% in the prior quarter, annualized GDP growth in the first half of 2025 averaged only 1.4% versus 2.3% in the same period a year earlier. In June, the Fed revised its 2025 GDP growth forecast downward to 1.4% from an estimate of 1.7% in March and reduced its 2026 projection to 1.6% from 1.8%. Retail sales growth rebounded to 0.5% month-on-month (m-o-m) in July and 0.9% m-o-m in June from a 0.8% m-o-m contraction in May. The S&P Global US Manufacturing Purchasing Managers Index (PMI) strengthened to 53.0 in August from 49.8 in July and 52.9 in June. However, industrial production posted a marginal contraction of 0.1% m-o-m in July after gaining 0.4% m-o-m in June and 0.1% m-o-m in May. Moreover, recent data on nonfarm payroll employment suggest that labor market growth was weaker than previously understood. Nonfarm payroll employment posted additions of 22,000 in August, well below the expected gain of 75,000 and July's revised figure of 79,000. The July nonfarm payroll employment additions were also well below the expected 105,000. More significantly, the new jobs figure for June was revised downward in July to 14,000 from 147,000; in August it was further revised to reflect a net loss of 13,000 jobs in June. The unemployment rate also ticked up during the review period, reaching 4.3% in August from 4.2% in July and 4.1% in June. The weakened employment figures prompted a reassessment of the current state of the US economy, raising expectations of a rate cut at the Fed's September meeting. On 2 June, CME FedWatch's probability of a 25 basis points (bps) rate cut in September stood at 54.2%, rising to 86.4% on 29 August and 91.1% on 10 September.

Inflation in the US rose during the review period and remained above the 2.0% target. Consumer price inflation ticked up to 2.9% year-on-year (y-o-y) in August and 2.7% y-o-y in July and June, compared to 2.4% y-o-y in May and 2.3% y-o-y in April. Core inflation rose to 3.1% y-o-y in August and July, and 2.9% y-o-y in June, up from 2.8% y-o-y in May. Personal Consumption Expenditures (PCE) inflation also climbed to 2.6% y-o-y in July and June from 2.4% y-o-y in May. Core PCE inflation inched up to 2.9% y-o-y in July from 2.8% y-o-y in June and May. In its June forecasts, the Fed revised upward its PCE forecasts for 2025 and 2026 to 3.0% y-o-y and 2.4% y-o-y, respectively, from forecasts of 2.7% y-o-y and 2.2% y-o-y made in March. Core PCE inflation projections for 2025 and 2026 were also revised upward to 3.1% y-o-y and 2.4% y-o-y, respectively, from 2.8% y-o-y and 2.2% y-o-y. The Fed believes that the full effects of tariffs have yet to be reflected in consumer prices.[2] Meanwhile, the impacts of tariffs were being seen in producer prices in July, with producer price inflation rising to 3.3% y-o-y from 2.4% y-o-y in June. Core producer price inflation rose to 3.7% y-o-y in July from 2.6% y-o-y in June. On a m-o-m basis, producer prices rose 0.9% in July, the fastest increase since March 2022. Also reflecting tariff pressures, import prices rose 0.4% m-o-m in July following declines of 0.1% m-o-m in June and 0.4% m-o-m in May.

Market expectations of the future US monetary policy stance reversed several times during the review period, ending with a more dovish outlook by 29 August. The shifts were mirrored in the data from CME FedWatch (**Figure A**).

- **Phase A:** Amid concerns over the impacts of tariffs on inflation and growth, the Fed left unchanged the federal funds target rate range at 4.25%–4.50% during its 17–18 June Federal Open Market Committee (FOMC) meeting, noting that while the economy continues to expand, inflation remains elevated.[3] The June FOMC meeting affirmed the March projection of two rate cuts (totaling 50 bps)

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



bps = basis points.
Note: Data are as of 29 August 2025.
Source: CME FedWatch Tool.

[2] US Federal Reserve, Federal Open Market Committee. 2025. Minutes of the Federal Open Market Committee of 29–30 July 2025.
[3] US Federal Reserve. 2025. Federal Reserve Issues FOMC Statement. Press release. 18 June.

in 2025. On 20 June, the likelihood of a cumulative 75 bps rate cut in 2025 was 27.3% per CME FedWatch.

- **Phase B:** Despite the wait-and-see stance exhibited at the June FOMC meeting, there were some investor expectations of a rate cut at the subsequent July FOMC meeting. On 20 June, Fed Governor Christopher Waller expressed his view that the impact of tariffs on inflation would be minimal and that the Fed should cut rates in July. On 23 June, Fed Vice Chair for Supervision Michelle Bowman stated that she also favored a rate cut in July if inflationary pressures were low. During the Semiannual Banking Committee Testimony on 24 June, Fed Chair Jerome Powell said that it would be possible for the Fed to cut rates in July if inflation fell. On 30 June, the likelihood of a cumulative 75 bps rate cut in 2025 rose to 50.5%.
- **Phase C:** Expectations of a July rate cut were dampened in early July. On 1 July, Fed Chair Jerome Powell highlighted that they were largely in a wait-and-see mode over the imposition of US tariffs. He indicated that the Fed would have already cut rates if not for the uncertainty brought about by tariff policies. In addition, the stronger-than-expected June nonfarm payroll data released on 3 July—147,000 additions compared to an expected 106,000—further bolstered the likelihood of the Fed holding rates steady at its July meeting. The likelihood of a cumulative 75 bps rate cut in 2025 fell to 29.6% on 3 July, with a hawkish stance being backed by several Fed members throughout July.[4] As widely expected, the federal funds target rate range was held unchanged during the 29–30 July FOMC meeting as the Fed considered the impact of economic growth moderation in the first half of 2025.[5]
- **Phase D:** Following the weak July nonfarm payroll data released on 1 August, a few Fed officials turned dovish.[6] The probability of a cumulative 75 bps rate cut in 2025 rose to 53.1% on 4 August. However, the release of rising Producer Price Index data on 15 August reignited inflationary concerns, pushing down the probability of a cumulative 75 bps rate in 2025 to 36.0% on the same day.[7] This probability dipped all the way to 25.4% on 21 August after the release of the Fed's July minutes showing that members judged inflationary risks to be more serious than labor market concerns. However, the probability rose again to 40.1% on 29 August, following the Jackson Hole symposium on 21–23 August when Fed Chair Jerome Powell acknowledged a challenging situation with risks to both labor markets and inflation, indicating that an adjustment in policy was warranted given the shifting balance of risks.

The euro area witnessed rising bond yields during the review period amid the ECB's wait-and-see policy stance and stable economic growth. GDP growth eased slightly to 1.5% y-o-y in Q2 2025 from 1.6% y-o-y in the first quarter (Q1) of 2025, while still exceeding the 1.3% y-o-y growth recorded in the fourth quarter of 2024. In August, the euro area's manufacturing PMI continued to trend upward and into expansionary territory (i.e., above the 50-point threshold) to 50.7 after reaching 49.8 in July, 49.5 in June, and 49.4 in May. The unemployment rate fell slightly to 6.2% in July from 6.3% in June and 6.4% in May. Inflation remained largely in line with the ECB's expectations and target, with some upward pressure amid global trade uncertainty. The y-o-y inflation rate inched up to 2.1% in August from 2.0% in July and June. With inflation hovering around the 2.0% target, the ECB held its policy rates steady at its 24 July meeting, noting that economic growth and inflation were evolving as expected.[8] ECB officials highlighted that the inflation outlook is related to the external trade environment.[9] Some ECB officials consistently reiterated the ECB's wait-and-watch stance after the meeting.[10]

[4] On 2 July, Fed Bank of Richmond President Thomas Barkin noted there was no urgency to lower rates. On 3 July, Fed Bank of Atlanta President Raphael Bostic cited that a wait-and-see approach could help given uncertainty. On 15 July, Fed Bank of Dallas President Lorrie Logan indicated that it was necessary to hold rates steady to help cool inflation but the Fed might also need to pivot if inflation and the labor market softened.

[5] US Federal Reserve. 2025. Decisions Regarding Monetary Policy Implementation. Press release. 30 July.

[6] For example, on 4 August, Fed Bank of San Francisco President Mary Daly noted that an imminent rate cut was possible given the labor data. On 6 August, Fed Bank of Minneapolis President Neel Kashkari indicated that the Fed might cut interest rates soon. On the same day, Fed Governor Lisa Cook highlighted that the labor data were consistent with turning points in the economy. On 10 August, Fed Vice Chair for Supervision Michelle Bowman announced she expected three rate cuts in 2025 given the weak labor data.

[7] Fed Bank of Chicago President Austan Goolsbee indicated that recent inflation data and uncertainties over tariffs made him hesitant to lower rates.

[8] ECB. 2025. Monetary Policy Statement of Christine Lagarde, President of the ECB. Press release. 24 July.

[9] ECB. 2025. Monetary Policy Press Conference, President of the ECB. Press release. 24 July.

[10] On 25 July, Bank of Latvia Governor Martins Kazaks and Deutsche Bundesbank President Joachim Nagel both indicated that there is value in holding current rates steady. On 26 July, ECB Governing Member Piero Cipollone explained that in September (and afterward) they would have more information to better make their assessment. On 29 July, Central Bank of Ireland Governor Gabriel Makhlouf mentioned that they have reached a point where they can "wait and see." On 6 August, Oesterreichische Nationalbank Governor Robert Holzmann expressed that the ECB should "wait and see" what economic developments arise.

In Japan, both 2-year and 10-year bond yields rose during the review period, driven by strengthened economic performance and still-elevated inflation. Government bond yields fell in June, as the government reduced the amount of government bonds to be auctioned, and rose in July and August on uncertainty over the results of the House of Councilors election on 20 July and the release of stronger-than-expected economic data in the first half of August. Japan's GDP grew 2.2% y-o-y in Q2 2025 versus an expected 1.0% y-o-y and compared with 0.6% y-o-y in Q1 2025. However, y-o-y growth in both quarters was down from the economy's 2.4% y-o-y expansion in Q4 2024. Industrial production contracted 0.9% y-o-y in July after gaining 4.4% y-o-y in June, but this was still better than May's 2.4% y-o-y decline. Manufacturing PMI stood at 49.7 in August and 48.9 in July yet remained below June's 50.1. At its 30–31 July meeting, the Bank of Japan (BOJ) revised upward its 2025 GDP growth forecast to 0.6% y-o-y from its 0.5% y-o-y estimate in April. Japan's inflation has been trending down but remains above the BOJ's target. Consumer price inflation fell slightly to 3.1% y-o-y in July from 3.3% y-o-y in June and 3.5% y-o-y in May. The BOJ revised its 2025 inflation forecast to 2.7% in July from 2.2% in April. Despite upgrading its economic forecasts, the BOJ kept the policy rate unchanged at its 16–17 June and 30–31 July monetary policy meetings, noting the uncertain impact of global trade policies on the economy.

Both 2-year and 10-year bond yields fell in most emerging East Asian markets between 2 June and 29 August amid continued disinflationary progress and monetary easing by some regional central banks, as well as increased expectations of a Fed rate cut in September (**Table B**). Most regional markets witnessed either lower or stable inflation during the review period (**Figure B**). For example, in Indonesia, although inflation rose to 2.3% y-o-y in August and 2.4% y-o-y in July from 1.9% y-o-y in June, it remained well within the target range of 1.5%–3.5%. Four central banks in Southeast Asia eased monetary policy to support growth during the review period, while other regional central banks pursued a wait-and-see stance. Bangko Sentral ng Pilipinas cut its policy rate by 25 bps on 19 June and again on 28 August, citing moderating inflation, global uncertainties, and the need to support growth. On 9 July, Bank Negara Malaysia cut its policy rate by 25 bps as a preemptive action in anticipation of the potential impact of external uncertainties. Bank Indonesia conducted successive 25 bps rate cuts during its 15–16 July and 19–20 August meetings, marking its third and fourth rate cuts for the year, respectively. On 13 August, the

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

Economy	Policy Rate 1-Aug-2024 (%)	Rate Change (%)													Policy Rate 29-Aug-2025 (%)	Change in Policy Rates (basis points)
		Aug-2024	Sep-2024	Oct-2024	Nov-2024	Dec-2024	Jan-2025	Feb-2025	Mar-2025	Apr-2025	May-2025	Jun-2025	Jul-2025	Aug-2025		
Euro Area	3.75		↓0.25	↓0.25		↓0.25		↓0.25	↓0.25	↓0.25		↓0.25			2.00	↓ 175
Japan	0.25						↑0.25								0.50	↑ 25
United Kingdom	5.00				↓0.25			↓0.25			↓0.25			↓0.25	4.00	↓ 100
United States	5.50		↓0.50		↓0.25	↓0.25									4.50	↓ 100
People's Republic of China	1.70		↓0.20								↓0.10				1.40	↓ 30
Indonesia	6.25		↓0.25				↓0.25				↓0.25		↓0.25	↓0.25	5.00	↓ 125
Republic of Korea	3.50			↓0.25	↓0.25			↓0.25			↓0.25				2.50	↓ 100
Malaysia	3.00												↓0.25		2.75	↓ 25
Philippines	6.50	↓0.25		↓0.25		↓0.25				↓0.25		↓0.25		↓0.25	5.00	↓ 150
Singapore	–						↓			↓					–	↓ –
Thailand	2.50			↓0.25				↓0.25		↓0.25				↓0.25	1.50	↓ 100
Viet Nam	4.50														4.50	◆ 0

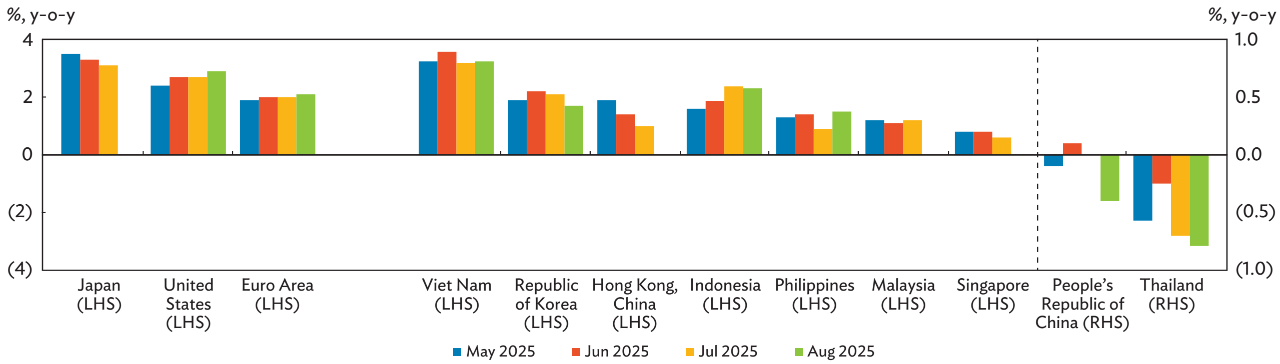
( ) = negative, – = no data.

Notes:

1. Data coverage is from 1 August 2024 to 29 August 2025.
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. 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, LHS = left-hand side, RHS = right-hand side, y-o-y = year-on-year.

Notes:

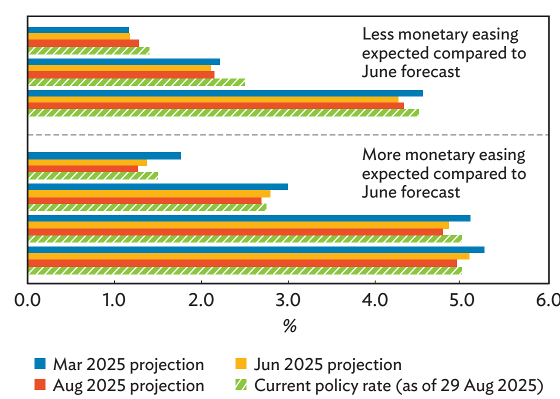
1. For Hong Kong, China; Japan; Malaysia; and Singapore, data are up to July 2025.
2. For the People's Republic of China, July 2025 inflation was at 0.0% year-on-year. For the euro area, August 2025 data is based on preliminary estimate.

Sources: Various local sources.

Bank of Thailand reduced its policy rate by 25 bps over subdued inflation and to support the economy amid the impact of tariffs. Focus Economics' August forecast showed that moderating inflation and tariff uncertainties led to increased expectations of further easing by most Southeast Asian central banks before the end of the year, compared with June's forecast (**Figure C**). For example, in July, Bank Indonesia indicated that it would consider cutting interest rates further amid a tame inflation outlook and a weak global economy. On 11 August, Bangko Sentral ng Pilipinas Governor Eli Remolona mentioned that two more rate cuts within the year were likely.

Amid ongoing monetary easing and disinflation during the review period, emerging East Asian bond markets witnessed an average decline of 12 bps and 16 bps in 2-year and 10-year bond yields, respectively. Across the region, Viet Nam saw increases of 51 bps and 44 bps in its respective 2-year and 10-year yields, driven by strong domestic economic growth (the highest in the region) and relatively high inflation (also the highest in the region) despite a decline in inflation in July. To reach its 2025 growth target of 8.3%–8.5%, the Government of Viet Nam implemented several fiscal measures such as implementing a 2 percentage point reduction in the value-added tax, which is expected to raise the fiscal deficit and increase government bond issuance. In the Republic of Korea, 2-year and 10-year bond yields rose marginally by 2 bps each as the Bank of Korea held its base rate steady at its 28 August and 10 July meetings amid uncertainty in the domestic outlook. On 28 August,

Figure C: Current Policy Rates and End-2025 Projections in Select Emerging East Asian Economies



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

Sources: Various central banks and Focus Economics projections.

the Bank of Korea noted that while domestic growth has improved, uncertainty remains high over tariffs. As a result of the Bank of Korea's cautious comments, investors expected less easing, as reflected in Figure C. During the review period, the PRC's 10-year yield saw an increase of 8 bps as the People's Bank of China signaled in its August monetary report that there was no urgency to cut rates.

Despite lingering trade policy uncertainty, many regional economies recorded faster GDP growth in Q2 2025 than in Q1 2025 (**Table C**). Viet Nam remained the fastest-growing economy in the region with GDP growth

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

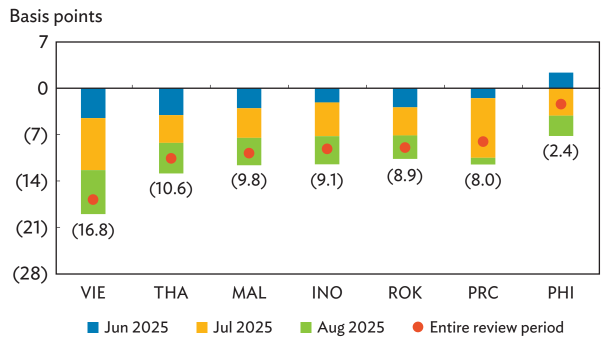
Economy	2025 Q1	2025 Q2	Forecast for 2025
PRC	5.40	5.20	4.70
HKG	3.00	3.10	2.00
INO	4.87	5.12	5.00
ROK	0.00	0.60	0.80
MAL	4.40	4.40	4.30
PHI	5.40	5.50	5.60
SIN	4.10	4.40	1.60
THA	3.20	2.80	1.80
VIE	6.93	7.96	6.30

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; SIN = Singapore; THA = Thailand; VIE = Viet Nam; y-o-y = year-on-year.

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

Sources: Various local sources.

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 2 June 2025 and 29 August 2025.

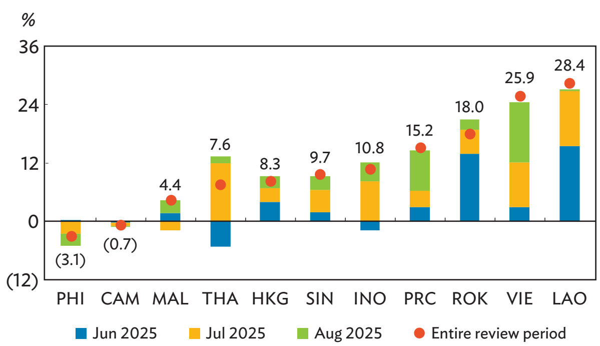
Source: *AsianBondsOnline* calculations based on Bloomberg LP data.

accelerating to 8.0% y-o-y in Q2 2025 from 6.9% y-o-y in the previous quarter, supported by growth across all major sectors, led by manufacturing and construction and services. GDP growth also ticked up during the review period in the Republic of Korea to 0.6% y-o-y from 0.0% y-o-y due to improvements in domestic consumption (1.4% y-o-y versus 1.0% y-o-y) and export growth (4.5% y-o-y versus 1.5% y-o-y). In Indonesia, GDP growth accelerated to 5.1% y-o-y in Q2 2025 from 4.9% y-o-y in Q1 2025, with expansions recorded across all expenditure components except government spending. GDP growth in Singapore reached 4.4% y-o-y in Q2 2025, exceeding both the advance estimate of 4.3% y-o-y and the 4.1% y-o-y growth in Q1 2025, with faster growth recorded in both the goods and services sectors. With strong growth in the first half of the year, the government revised Singapore's 2025 growth forecast upward to 1.5%–2.5% from an earlier estimate of 0.0%–2.0%. Economic growth in the PRC reached 5.2% y-o-y in Q2 2025, compared with expected growth of 5.1% y-o-y and Q1 2025's expansion of 5.4% y-o-y, which was partly boosted by government support measures amid tariff policy uncertainties. Meanwhile, Thailand's GDP growth slowed to 2.8% y-o-y in Q2 2025 from 3.2% y-o-y in Q1 2025 due to a deceleration in the growth of exports and investments.

Despite uncertainty in the external environment, financial conditions improved in the region during the review period. Besides continued monetary easing, the improvement was supported by progress in tariff negotiations and the expectations of a US rate cut in September. Risk premiums, as measured by credit default swap (CDS) spreads, collectively narrowed during the review period across regional markets. From 2 June to 29 August, the region's average CDS spread narrowed by 9.4 bps from 59.7 bps to 50.3 bps (simple average) and by 8.3 bps from 52.9 bps to 44.6 bps (GDP-weighted). As shown in **Figure D**, in June, risk premiums declined due to the Israel–Iran ceasefire, while in July and August, investor sentiment was buoyed by a slew of tariff agreements and an extension on the tariff pause between the PRC and the US. During the review period, the CDS spread fell the most in Viet Nam (–16.8 bps) as it was the first market in the region that closed a trade agreement with the US in early July. On the other hand, there was a rise in the CDS spread in the Philippines in June amid political concerns surrounding the vice-president's impeachment as well as rising debt levels.

Improved investor sentiment was also evident in strong equity market performances in regional markets. Most regional equity markets recorded gains in July, as various trade deals eased tariff tensions, and in August on expectations of a September Fed rate cut (**Figure E**). During the review period, the region's equity markets gained 10.8% (simple-average) and 13.0% (market-weighted). The largest equity gains occurred in Viet Nam where investor optimism over strong GDP growth and stock market reforms contributed to a 25.9% increase. This was followed by the Republic of Korea with a gain of 18.0% on easing political concerns and optimism over

Figure E: Changes in Equity Indexes in Select Emerging East Asian Markets

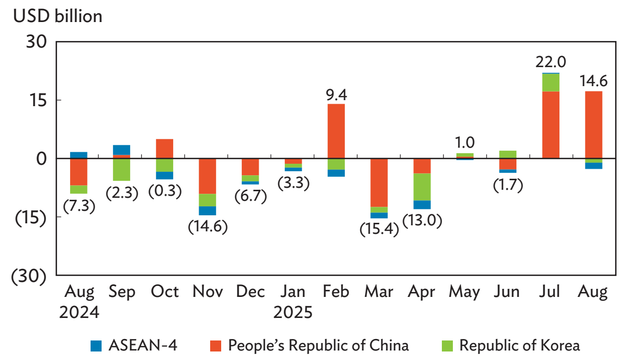


( ) = negative; CAM = Cambodia; PRC = People's Republic of China; HKG = Hong Kong, China; INO = Indonesia; ROK = Republic of Korea; LAO = Lao People's Democratic Republic; MAL = Malaysia; PHI = Philippines; SIN = Singapore; THA = Thailand; VIE = Viet Nam.

Note: The numbers above (below) each bar refer to the percentage change between 2 June 2025 and 29 August 2025.

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

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



( ) = outflows, USD = United States dollar.

Notes:
1. Data coverage is from 1 August 2024 to 29 August 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 (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.

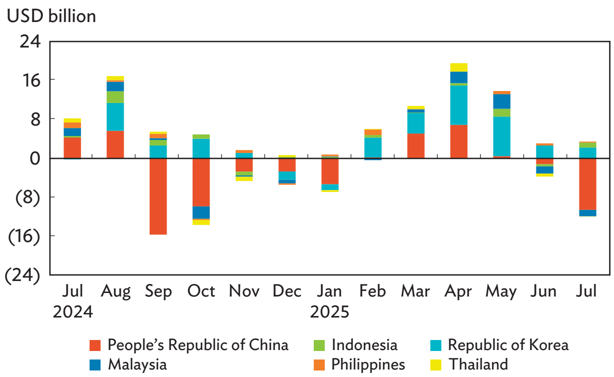
Source: Institute of International Finance.

corporate governance reforms. Similarly, the PRC's equity market gained 15.2% during the review period amid higher-than-expected GDP growth in Q2 2025, stock market reforms, and monetary easing measures. In April and May, the People's Bank of China released CNY600 billion (USD82.3 billion) via the medium-term lending facility and cut the reserve requirement ratio and 7-day reverse repo rate. In addition, stock market reforms were announced on 7 May to (i) encourage listed companies to improve corporate governance, (ii) consolidate an existing market stabilization fund, (iii) expand a pilot investment program for insurance companies, (iv) release an action plan to strengthen the mutual fund industry, and (v) reduce risk weightings for stock market investments by insurance companies. Only the Philippines posted equity market losses (–3.1%) during the review period; investor sentiment was dampened by the weakening growth outlook as the government lowered its growth forecast for the year and amid concerns over rising debt levels.

Emerging East Asia's strong equity market performance was partly supported by net equity capital inflows. Between 2 June and 29 August, the region posted net portfolio inflows into equity markets of USD35.0 billion, supported by easing tariff concerns and market-specific factors (**Figure F**). In June, there were net portfolio equity outflows of USD1.7 billion as the US' initial tariff pause ended and uncertainty over the wider conflict in the Midde East escalated. Emerging East Asia recorded large inflows of USD22.0 billion in July on the signing of several trade agreements as well as on progress in trade talks between the US and other trading partners. The PRC posted net portfolio inflows of USD17.3 billion in July over better-than-expected GDP figures. In August, the region posted net inflows of USD14.6 billion, largely driven by the PRC (USD17.3 billion) following the extension of the PRC–US tariff pause and news benefiting its technology sector. Specifically, DeepSeek updated its artificial intelligence model, further boosting market sentiment. In addition, the government asked local technology firms to focus on buying from local chipmakers instead of from foreign companies. Viet Nam posted the region's largest outflows (USD1.5 billion) in August, largely driven by the portfolio rebalancing of some international investors. At the same time, the equity market was well supported by domestic investors amid ongoing stock market reforms, such as the establishment of a central counterparty clearing system, and strong economic growth in the first half of 2025, which led to solid gains in Viet Nam's equity market during the review period.

During June–July, the region's bond markets recorded net portfolio outflows of USD9.4 billion, driven by market-specific factors (**Figure G**). The largest bond outflows came from the PRC (USD11.9 billion), largely due to a shift in investments from bonds to equities amid a domestic stock market boom. On the other hand, the Republic of Korea witnessed net bond inflows of

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



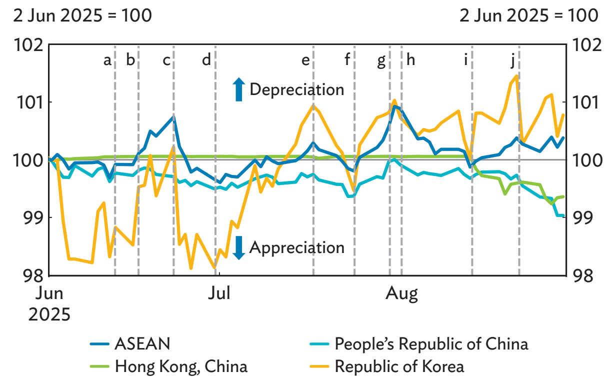
( ) = negative, USD = United States dollar.

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 July 2025.
3. Figures were computed based on 31 July 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).

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



ASEAN = Association of Southeast Asian Nations, US = United States.

Notes:

1. Corresponding dates of the following events:
   - a Israel attacks Iran's nuclear facilities.
   - b The Fed maintains the federal funds rate at a range of 4.25%–4.50% at the June FOMC meeting.
   - c Israel–Iran ceasefire announced.
   - d US consumer spending fell in May, dampening global growth prospects.
   - e Fed Governor Christopher Waller advocates for a rate cut.
   - f Fed Chair Jerome Powell advocates a wait-and-see stance on the federal fund target rate.
   - g The Fed keeps the federal funds rate unchanged at a range of 4.25%–4.50% at the July FOMC meeting.
   - h Announcement of weaker-than-expected nonfarm payroll additions in July.
   - i Some Fed officials express hesitation about cutting rates at the September FOMC meeting.
   - j Start of the Fed's Jackson Hole Symposium.
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 29 August 2025.
4. An increase (decrease) in the value indicates depreciation (appreciation) of the currency against the US dollar.

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

USD4.8 billion due to improved investment sentiment as political concerns eased following the presidential elections and indications that the Bank of Korea would keep rates elevated. The Philippines recorded inflows of USD0.6 billion in June–July amid speculation that its market would be included in JP Morgan's EM bond index. Indonesia also recorded bond inflows of USD0.6 billion during the period as investors shifted from Bank Indonesia Rupiah Securities to Treasury bonds following a reduction in issuance of the former by the central bank.

Emerging East Asian currencies were largely stable during the review period, supported by sound economic growth and improved investment sentiment. The region saw a 0.2% simple-average currency depreciation against the US dollar but an appreciation of 0.6% on a GDP-weighted average basis. The Philippine peso saw the largest depreciation across the region at 2.5%, driven by two rate cuts during the review period and heightened concerns regarding the current account deficit (**Figure H**). On 13 June, the Philippines revealed it had recorded a current account deficit of USD4.2 billion in Q1 2025, doubling the USD2.1 billion tallied in the same period a year earlier. The government also revised downward its 2025 economic growth target to 5.5%–6.5% on 26 June from 6.0%–8.0% in December 2024. The second-largest depreciation was observed in Indonesia (1.5%), following two consecutive 25 bps rate cuts in July and August. The Vietnamese dong also weakened by 1.2% following government directives to keep interest rates low, which led to increased demand for US dollars from financial institutions and domestic investors.

Risks to the outlook for regional financial conditions are balanced. On the upside, regional central banks signaled scope for further monetary easing to support growth. Downside risks mostly come from external sources, including uncertainties over US trade and monetary policies, as well as geopolitical tensions:

- Trade policy uncertainty continues to weigh heavily on investor confidence. Although markets reacted positively to the 90-day extension of the PRC–US trade truce, the potential scale and

timing of tariffs remain unpredictable, which could trigger renewed market volatility. According to the *Asian Development Outlook July 2025*, higher tariffs and/or a re-escalation of PRC–US trade tensions could reduce regional growth, with most of the impact expected in 2026. Meanwhile, an escalation of the PRC–US tariff dispute would push inflation higher in the US and lower in most regional economies (except the PRC) due to weaker global demand. In addition to the overall tariffs imposed on economies, sector-specific tariffs add another layer of uncertainty. Continued uncertainty in trade policies could erode investment sentiment, curtail global and regional investment activity, and slow economic growth. Moreover, growing concerns about a more fragmented global economy may undermine international cooperation, disrupt cross-border capital flows, weaken the global financial safety net, and heighten systemic financial vulnerabilities.
- US monetary policy uncertainty beyond the expected September rate cut also contributes to risks to the region's financial conditions. Tariff-related price pressures could spread beyond a temporary adjustment and become embedded in broader cost structures, particularly through intermediate goods. These higher input costs could ripple through the entire production chain as businesses pass them on to other producers and consumers, sustaining higher inflation over time. In addition, a sustained depreciation of the US dollar could further amplify import-driven inflation, while geopolitical tensions may intensify cost pressures and financial market volatility. Slowing growth among its major trading partners could reduce demand for US exports and tighten global liquidity, raising the likelihood of policy trade-offs in which the Fed must balance supporting growth against maintaining price stability. Such dynamics increase the risk of policy misjudgments and abrupt market repricing.
- Geopolitical risks remain significant. Unexpected wider conflict in the Middle East could disrupt supply chains, push up energy and food prices, and intensify global uncertainty.

Environmental and climate-related risks remain highly relevant and continue to pose significant downside threats to financial conditions. For example, weather disturbances brought about by Typhoon Wipha and monsoon rains affected the Philippines and the PRC during the review period, leading to agricultural and infrastructure losses. Extreme weather events can damage economic infrastructure, reduce output, and increase inflationary pressures, compounding other financial vulnerabilities. Disasters have been shown to raise borrowing costs by increasing expectations for future damages (**Box 1**).

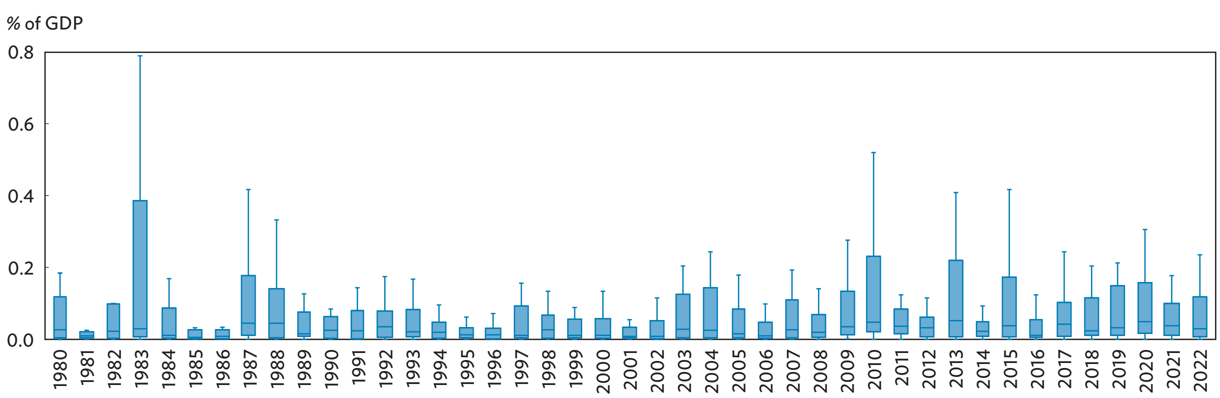
Box 1: Getting the Timing Right—Disasters and Sovereign Debt Issuance

Climate change has supercharged the devastation from disasters triggered by natural hazards, threatening sustainable development. As temperatures and sea levels continue to rise, intense floods, storms, heat waves, and droughts now occur five times more often than in 1980. The economies most vulnerable to climate change account for much of this increase. Despite improvements in disaster risk management, economic losses continue to mount due to increased disaster frequency and the expansion of human settlement in disaster-prone areas. Some of the most damaging disasters in recent decades have been in Asia and the Pacific, which is home to two-thirds of people affected by disasters globally. Climate-change-related disasters threaten to erode the region's progress in poverty reduction and sustainable development.

The fiscal footprint of disasters risks jeopardizing debt sustainability. Disaster damages are sizable relative to gross domestic product (GDP), even if abstracting from indirect effects (e.g., lost tax revenue from declining economic activity) (**Figure B1.1**). The costs associated with damage from disasters have been shown to lower tax revenue and raise expenditures, budget deficits, and debt-to-GDP ratios (Acevedo 2014; Jones, Keen, and Strand 2013; Lis and Nickel 2010; Melecky and Raddatz 2011). Expectations of renewed fiscal pressures after disasters undermine sovereigns' repayment capacity, leading creditors in sovereign debt markets to ask for compensation to bear additional risks, which is known as the disaster premium. This premium adds to sovereign borrowing costs, weakening debt sustainability. Importantly, the uncertain magnitude of disaster-induced economic losses and their unpredictable timing makes self-insurance through fiscal buffers infeasible, with such buffers posing high opportunity costs.

Disasters drive up sovereign borrowing costs, but the effect fades over time. Ficarra and Raabe (forthcoming) assess the impact of disasters on borrowing costs and track the disaster premium over time. Using Bloomberg data on 2 decades of sovereign bond issuances for 112 economies mapped to records of disaster costs from EM-DAT—a disaster events database maintained by the Centre for Research on the Epidemiology of Disasters—the authors identify a significant rise in borrowing costs for post-disaster issuances. Markets attach a larger disaster premium to bonds issued shortly after disasters, with the premium fading over time. Disaster insurance further reduces the premium. Moreover, investors appear to price realized disasters more than climate change vulnerability, with effects most pronounced for floods and storms.

Figure B1.1: Disaster Damages (% of GDP)



GDP = gross domestic product.

Notes: This figure exhibits for each year the cross-economy distribution of annual disaster damages as a share of GDP for economies worldwide for the period 1980–2022. The thick blue bars indicate the interquartile range.

Source: Authors' calculations based on data from EM-DAT.

This box was written by Alexander Raabe (economist) at the Asian Development Bank, Manila.

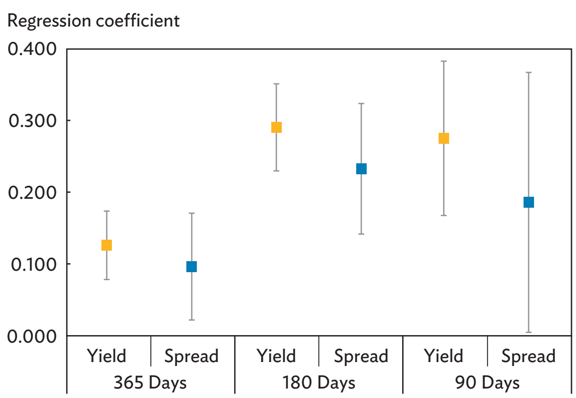
continued on next page

Box 1 *continued*

Sovereigns pay a significant disaster premium. Cumulating disaster damage costs in periods prior to bond issuance ranging from 30 days to 1 year, Ficarra and Raabe (forthcoming) find that disasters significantly raise sovereign yields and spreads (**Figure B1.2**). A 1 percentage point increase in the damages-to-GDP ratio raises borrowing costs by 29 basis points, while spreads over United States Treasuries can widen by as much 61 basis points. Based on Intergovernmental Panel on Climate Change (2021) estimates of average disaster frequency under different global warming scenarios, the disaster premium can increase borrowing costs by as much as 2.9 percentage points, a significant increase from the average 10-year yield of 3.4% prevailing in developing Asia as of July 2025.

Investors' recency bias reduces the disaster premium over time. Recency bias refers to a behavioral predisposition to attach greater importance to recent events compared to those in the past. In sovereign debt markets, this means that the disaster premium for a bond issued shortly after a disaster tends to be higher. That is, the premium declines during the time between a disaster and bond issuance. Specifically, the premium falls 2 basis points every day from the disaster to the bond issuance, translating into an average decline at the date of issuance equal to two-fifths of the initial disaster-induced increase.

Figure B1.2: Regression Coefficients of Disaster Damages on Sovereign Yields and Spreads



Note: This figure shows the regression coefficients of climate-change-related disaster damages on sovereign yields and spreads, controlling for bond and economy characteristics, as well as global financial conditions. Disaster damages are cumulative for 365-, 180-, and 90-day windows prior to the respective bond issuance.

Sources: Authors' calculations based on data from EM-DAT, Bloomberg, and the International Monetary Fund.

These results suggest that delaying a sovereign issuance even a few days can meaningfully reduce financing costs after a disaster.

Disasters raise borrowing costs by increasing expectations for future damages. Ficarra and Raabe (forthcoming) isolate the impact of disaster expectations by controlling for pre-disaster fundamentals affecting vulnerability and the immediate fiscal impact of disasters. This is achieved by comparing the disaster impact on bond yields at issuance to forward yields in the secondary market for bonds with the same tenor issued prior to the disaster. The results confirm an increase in borrowing costs relative to what would have been expected prior to the disaster, and thus the role of a shift in creditors' expectations.

Sovereign bond markers care more about realized disasters than vulnerability to climate change. Vulnerability to climate change has been shown to raise sovereign borrowing costs (Beirne, Renzhi, and Volz 2021; Cevik and Jalles 2022a, 2022b; International Monetary Fund 2020; Painter 2020). Going beyond mere vulnerability, Ficarra and Raabe (forthcoming) focus on realized disasters as they are more informative to expectations of future costs based on observed shifts in the probability distribution of disasters. Results from a horse race between ex ante vulnerability and ex post damage-related costs leave the latter uncontested as a driver of sovereign borrowing costs—that is, information about realized disasters is a more critical determinant of sovereign borrowing costs.

Insurance mechanisms lower the disaster premium. Drawing on EM-DAT data for disaster insurance coverage, the analysis contrasts results for insured and uninsured disasters. Results suggest that the disaster premium is lower for insured disaster damages. In contrast, uninsured damages are associated with rising borrowing costs.

The results call for mitigating elevated sovereign borrowing costs as part of post-disaster relief. Several policy conclusions apply. First, the declining disaster premium over time implies a trade-off. Sovereign debt managers are compelled to choose between elevated short-term borrowing costs for issuance right after a disaster versus waiting to issue at lower yields but at the cost of maintaining higher fiscal buffers required in the interim. Multilateral financial institutions can alleviate this trade-off by upgrading disaster financing facilities to mitigate increased post-disaster borrowing costs as part

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Box 1 *continued*

of a relief package. Second, with climate change fueling more severe and frequent disasters, accelerating climate mitigation and adaptation is imperative to keep borrowing costs in line with debt sustainability. Finally, the results support the expansion of disaster insurance coverage—for example, by leveraging multilateral insurance facilities (e.g., catastrophe bonds).

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