AMRO
ASEAN +3 MACROECONOMIC RESEARCH OFFICE

ASEAN+3 Financial Stability Report 2023

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I. MARKET CONJUNCTURAL – LOW VISIBILITY OF CHALLENGES AHEAD

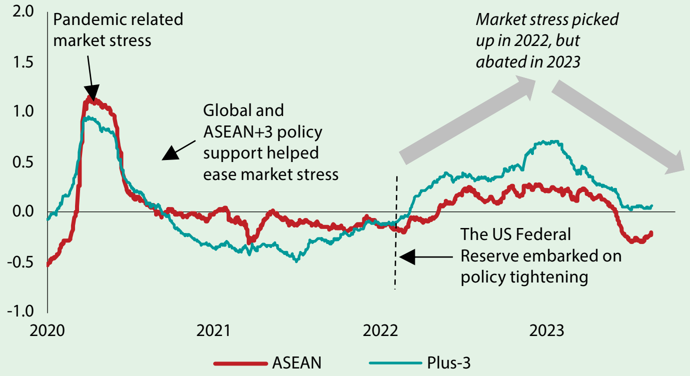
ASEAN+3 markets have calmed after weathering the storm from global markets for the past two years

Global financial conditions have eased since last year and authorities have been proactive in curbing spillovers from stress episodes

Selected Advanced Economies: Financial Conditions Indices
(Index)

Financial conditions have eased after November 2022 amid market perception that the Fed was becoming less hawkish

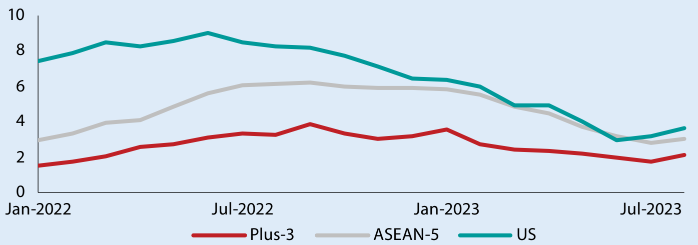
ASEAN+3: Market Stress Indices[1]
(Index)



However, the easier conditions may mask some of the risks to the region such as....

Potential resurgence of inflation, which can force further tightening of the monetary policy;

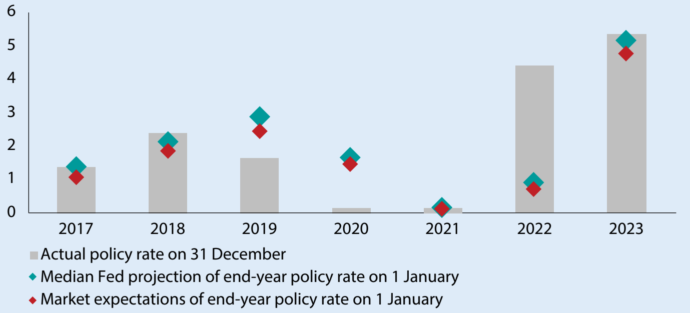
Selected ASEAN+3: Headline Consumer Price Inflation
(Percent)



Note: Plus-3 = China (including Hong Kong, China), Japan and Korea. ASEAN-5 = Indonesia, Malaysia, the Philippines, Singapore and Thailand. US = United States

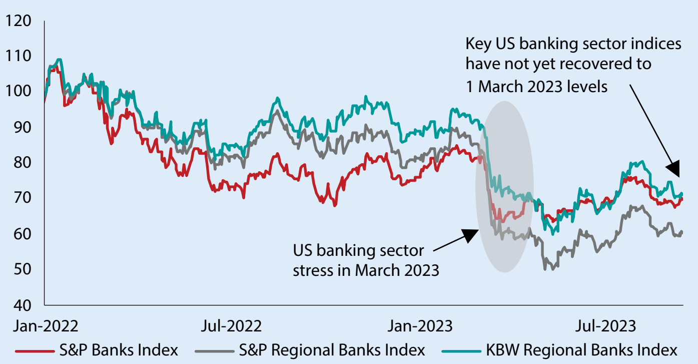
Market volatility as the markets are still adjusting to the new "higher-for-longer" normal;

United States: Projected and Actual Policy Rates
(Percent)



Potential spillovers to regional economies during stress episodes due to the existing vulnerabilities in the US banking sector;

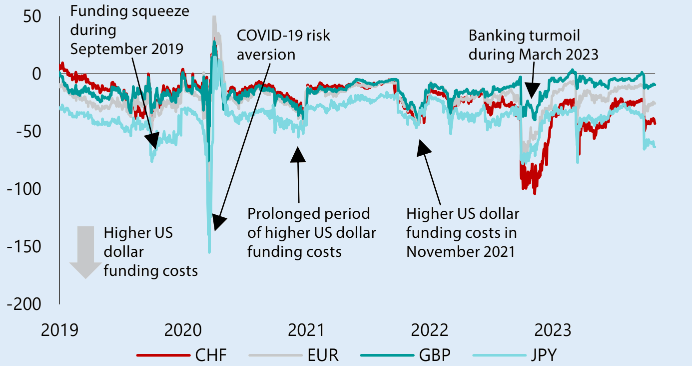
United States: Banking Sector Stock Indices
(Index, 1 January 2022 = 100)



Note: KBW = Keefe, Bruyette, and Woods; S&P = Standard & Poor's

Increasing likelihood of a US dollar funding squeeze despite ample dollar liquidity in global markets

Selected Major Currencies: Cross Currency Swap
(Basis points)



Note: CHF = Swiss franc; EUR = euro; GBP = Pound sterling; JPY = Japanese yen

Source for above charts: Bloomberg Finance L.P.; national authorities; Haver Analytics; AMRO staff calculations.

[1] The Market Stress Index is based on the Mispricing Risk (Refined) proposed in Hennig, Iossifov, and Varghese (2023) which attempts to capture the slack in financial conditions. The Mispricing Risk (Refined) is constructed using a simple average of indicators of price growth and volatility transformed into within-country percentiles. The measure of risk uses real equity market returns, equity market volatility, domestic sovereign bond yield volatility, sovereign FX risk spreads, FX market volatility and real house price growth. We introduce two additional parameters, real domestic government bond yield and growth of real effective exchange rate (REER), which are included in the construction of Mispricing Risk (Unrefined) as high frequency data is available. We also flip the sign of the resultant index so that higher values of the index indicate less slack in financial conditions to create the Market Stress Index.

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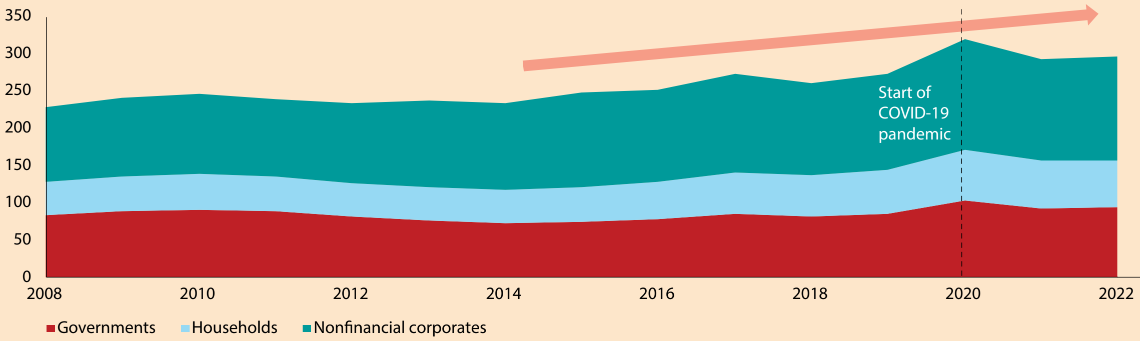
II. THEMATIC CHAPTERS – NAVIGATING HIGH DEBT AMID HIGH INTEREST RATES

Low interest rates and ample liquidity in the post-GFC era have led to a build-up in debt across nonfinancial sectors in ASEAN+3 region

ASEAN+3 corporate, household, and government debt-to-GDP are notably higher than a decade ago

ASEAN+3: Debt-to-GDP by Nonfinancial Sector
(Percent)



The increased debt stocks and rising debt servicing costs in the high interest rate environment could threaten financial stability

Some of the key risks in different sectors are:

Households
House price correction and rising debt burdens from higher interest rates or a recession could increase the risk of default, especially for highly leveraged households

Corporates
Corporates with weaker balance sheets could face greater difficulty refinancing and paying interest expenses

Governments
Governments with elevated debt-to-GDP ratios could face increased refinancing costs and rollover risk on maturing debt

Banks and Nonbank Financial Institutions (NBFIs)

- While the broader ASEAN+3 banking sectors are sound, the resilience of some ASEAN+3 banks could be tested in a high interest rate environment, combined with the exit from pandemic relief measures
- Reliance of banks and NBFIs on market financing, especially US dollar funding, could expose them to more liquidity risks
- NBFIs activities that involve maturity and currency transformations are a source of risk to financial stability

Policy implications

Authorities need to strengthen defenses against financial stability risks amid high debts and elevated interest rates

Policy mix requires a careful balance among monetary, fiscal and macroprudential policy objectives, as well as good cooperation among authorities