

Foreword from the Chief Economist

Since the release of the inaugural *ASEAN+3 Financial Stability Report (AFSR)* in late 2023, some risks to the ASEAN+3 financial systems have diminished while others have grown. While last year's report concentrated on the effects of rising debt levels on the region's financial stability, this year's AFSR expands its scope to chart a broader array of risks and challenges confronting the region in the period ahead.

Chapter 1 – Market Conjunctural: Strengthening Resilience to Challenges Ahead – explores recent market dynamics and highlights the near-term risks facing ASEAN+3 economies. The first half of 2024 saw an easing in global financial conditions as the US Federal Reserve (Fed) end its policy rate hiking cycle. Market movements have been largely driven by expectations surrounding the Fed's policy, with geopolitical risks also playing a significant role. However, in the third quarter of 2024, uncertainties regarding the US growth outlook, aggravated by the unwinding of yen carry trades, triggered significant market volatility. The Fed commenced its monetary easing in September, which could help stabilize financial conditions but uncertainties around inflation and growth outlook remain. While ASEAN+3 markets generally mirrored global trends, they also responded to local developments such as the Bank of Japan policy rate hike.

The threat of an inflation resurgence remains a significant risk, potentially forcing the Fed and other major central banks to reconsider rate hikes. Furthermore, geopolitical tensions in the Middle East and the upcoming US presidential elections have added layers of complexity to these uncertainties.

Overall, the financial stability risk across ASEAN+3 in 2024 appears lower than in 2023, offering authorities a chance to rebuild policy space while remaining vigilant to emerging risks. The current environment of robust growth and disinflation presents an opportunity for authorities in the region to reduce debt and enhance fiscal capacity to manage potential shocks. Rebuilding foreign exchange reserves during periods of capital inflows can further boost market confidence and provide buffers against extreme market volatility.

This year's report includes three comprehensive thematic studies that delve into the specific risks confronting the region.

- The Feature Analysis in Chapter 1 highlights the risks of financial contagion, showing that ASEAN+3 remains vulnerable to macro-financial shocks from major advanced economies and other external factors. The financial systems of Singapore and Hong Kong, with their extensive global connections, are particularly exposed to cross-border spillovers, acting as conduits for shocks throughout the region.
- Chapter 2 examines the real estate market downturn in the region, where weakened demand from the pandemic lockdown combined with stricter post-pandemic credit access have severely impacted the financial health of property developers, leading to declining profitability, liquidity, and debt servicing capacity. Although robust capital buffers in the banking sector seem to mitigate spillover risks from the property market to the financial system, less visible risks from smaller local banks, as well as shadow banking activities related to the property sector, require close monitoring and may even require regulatory actions.
- Chapter 3 explores the region's heavy reliance on the US dollar for cross-border financial activities, highlighting two primary risks: a potential shortage of US dollar funding, which could destabilize financial markets and intermediaries, and the transmission of global shocks through the US dollar, especially during periods of monetary tightening or geopolitical tension.

In the near term, authorities should stay alert to the risks of inflation resurgence, escalating geopolitical tensions, or a global growth slowdown, all of which could challenge the resilience of the ASEAN+3 financial system. Given the increased interconnectedness of financial systems, continuous monitoring of international spillovers is essential, along with strengthening ASEAN+3-centric surveillance and cooperation. This includes enhancing cross-border surveillance, data sharing, regional stress testing, home-host supervision, and liquidity support to manage and mitigate potential spillover risks effectively.

To stabilize the property sector, authorities should implement measures to prevent commercially sound companies from defaulting due to the tight credit environment, while also enhancing the resilience of financial institutions, particularly smaller banks and nonbank financial intermediaries (NBFIs). To improve resilience against external shocks within the dollar-reliant environment, ASEAN+3 economies should reinforce their economic and financial fundamentals, strengthen surveillance frameworks for monitoring US dollar liquidity conditions, bolster macroprudential frameworks for banks and NBFIs, and provide financing support to member economies facing US dollar liquidity stresses. Additionally, reducing structural dependence on the US dollar in the medium-to-long term by encouraging the use of local currencies and establishing cross-currencies payment systems should be a priority.

In this situation, the region must come together as one and strive for macroeconomic and financial resilience and stability. AMRO holds high hopes that our *ASEAN+3 Financial Stability Report* will play a vital role in our collective efforts, making a substantial contribution toward achieving this objective.

Hoe Ee Khor

Chief Economist