

Chapter 1. Market Conjunctural – Strengthening Resilience to Challenges Ahead

Since the inaugural *ASEAN+3 Financial Stability Report* in late 2023, global financial conditions continued to ease in the first half of 2024, but fluctuated with increased volatilities in the third quarter of 2024. Expectations around the Federal Reserve’s policy together with uncertainties around the US growth outlook and technology stock valuations have been the key drivers for the markets, while geopolitical risks have also played an important role.

ASEAN+3 markets had benefited from the improved financial conditions in late 2023 but the markets have diverged in 2024 as they responded to idiosyncratic developments. Portfolio flows in the region were also relatively muted during the first half of 2024 as ASEAN+3 asset valuations have been relatively modest.

Inflation remains the primary risk for macro-financial stability in ASEAN+3, but policy responses are expected to vary due to differing domestic conditions such as growth outlook, exchange rate developments, stress faced by property sector firms, and household debt leverage. If inflation resurges, central banks’ actions will depend on available non-monetary measures and the spillovers from global monetary tightening. If the emerging concerns around the US growth materialize amid high inflation, it could complicate policy responses and tighten financial conditions. The banking system remains sound and well capitalized, albeit with pockets of vulnerability. The importance of nonbank financial institutions in the region continues to rise, but they are still small relative to banks.

Spillovers from both within and outside the region pose risks to financial stability, necessitating close monitoring. The authorities should continue to build policy space and address structural issues such as property sector weakness and high household debt. They may need to step in to support certain segments of the financial system in periods of stress, while avoiding moral hazard. Going forward, the authorities must also monitor rapid changes in green financing and financial digitalization, ensuring regulatory updates to keep pace with the evolving landscape and minimize related risks.

Feature Analysis. ASEAN+3 Financial Interconnectedness and Potential for Spillovers

Intraregional interconnectedness among ASEAN+3 economies is growing, although the region remains susceptible to macro-financial shocks from major advanced economies and other exogenous shocks.

Singapore and Hong Kong’s extensive external ties expose their financial systems to cross-border spillovers, transmitting shocks across the region. Japan’s financial system is closely linked with developed economies, and China’s is more connected with Hong Kong. Individual ASEAN+3 economies are not only recipients of inward spillovers but also sources of outward spillovers to advanced and emerging market economies within and outside ASEAN+3.

The increasing interconnectedness among ASEAN+3 financial systems warrants stronger regional surveillance and closer cooperation. Strengthening cross-border surveillance and data sharing, conducting regional stress testing, enhancing home-host supervision, and ensuring liquidity support are critical measures.

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Chapter 2. Vulnerabilities and Potential Spillovers Stemming from Property Developer Financing

The outlook for the real estate market in the ASEAN+3 region has generally deteriorated since the COVID-19 pandemic, with reduced prices and transaction volumes seen in several economies.

The downturn, combined with higher interest rates in certain economies, has increased vulnerabilities among property developers. Potential spillover risks from the property market to the financial market appear to be mitigated by robust capital buffers in the banking sector.

Nonetheless, hidden and/or less visible risks from smaller and local banks, along with shadow banking activities related to the property sector, warrant careful monitoring by the authorities.

The authorities should establish a resilient framework to support viable property projects facing temporary liquidity shortages while improving fundamentals for overall soundness.

Chapter 3. Implications of US Dollar Reliance in ASEAN+3

The US dollar has a significant role in the ASEAN+3 macro-financial system as a vehicle currency for trade invoicing and the preferred currency for cross-border financial transactions.

The ASEAN+3 US dollar supply chain is complex as a variety of players interact and perform different roles. Exporters of goods and services and bond issuers are the main sources of US dollar foreign exchange while imports and debt repayments are the main uses of the foreign exchange. Banks and a wide range of nonbank financial institutions (such as securities companies, asset managers, and other market intermediaries) facilitate the flow of funds and risk management. However, this supply chain also results in some currency and maturity mismatches which could pose risks during adverse market conditions.

The region's reliance on the US dollar creates two important risks for the ASEAN+3 financial system. First, a shortage in availability of the US dollars can increase stability risks for financial markets and intermediaries. Second, it acts as a transmission channel for shocks arising from US monetary policy, geopolitical tensions and other global developments.

Authorities may adopt a two-pronged approach to deal with the risks. In the near term, they can build economic resilience against global spillovers while strengthening the surveillance and risk management strategies of the financial sector. In the long term, they can diversify away from the use of US dollars with a meaningful representation of other currencies in the ASEAN+3 financial system and adopting technological solutions. Regional cooperation and strengthening of the regional financial safety net are also of utmost importance to enhance the financial stability of the region.