Chapter 1

Market Conjunctural: Stay on Guard Against External Uncertainties

Highlights

- Since publication of the 2024 *ASEAN+3 Financial Stability Report*, volatility in global financial markets has increased because of high US policy uncertainty and sporadic spikes in geopolitical tension. Global financial conditions are expected to evolve with US trade policies and geopolitical developments—and their spillovers to global economy.

- Sustained weakness in the US dollar and the increased sensitivity of bond markets to fiscal sustainability concerns have been major developments in global financial markets since early 2025. The US dollar has weakened as markets reevaluated its safe asset status since the US announced tariffs on major trading partners along with changes to immigration and fiscal policies, and regulatory frameworks. The bond markets in some advanced economies saw a significant rise in yields because of either actual or expected increases in fiscal expenditure.

- ASEAN+3 markets were predominantly driven by trade uncertainties. Economies with higher trade exposure to the US or those subject to higher tariffs experienced more stress than others. The impact of US tariffs on corporate profits could be severe for smaller firms which may have concentrated exposure to US demand, either directly or through global supply chains. Nevertheless, the banking system remains sound and well-capitalized, thus underpinning financial stability in the region.

- Uncertainties in US trade policies will remain critical for the outlook for individual economies in the ASEAN+3 region, even as intra-regional trade and domestic demand have become more important drivers of growth. The downside risks to growth along with the US dollar weakness has reduced inflationary pressures and should allow policy makers to focus on supporting growth. However, providing policy support should be done prudently to preserve policy space and promote market stability.

- While managing the near-term uncertainties, policymakers should continue to strive toward strengthening policy frameworks and bolster domestic and regional resilience to mitigate spillover risks from global shocks. Over the medium term, with the US dollar's safe haven status under market scrutiny, deeper regional financial integration could help reduce the vulnerabilities associated with heavy reliance on the dollar.

This chapter is authored by Prashant Pande, under the guidance of Runchana Pongsaparn, with contributions from Benyaporn Chantana, Chiang Yong (Edmond) Choo, Chenxu Fu, Yang Jiao, Wen Yan Ivan Lim, Leilei Lu, Yoki Okawa, Eunmi Park, and research assistance from Ming Hui Tan.

I. Recent Developments

US policy uncertainty and geopolitical tensions cause heightened volatility in global markets

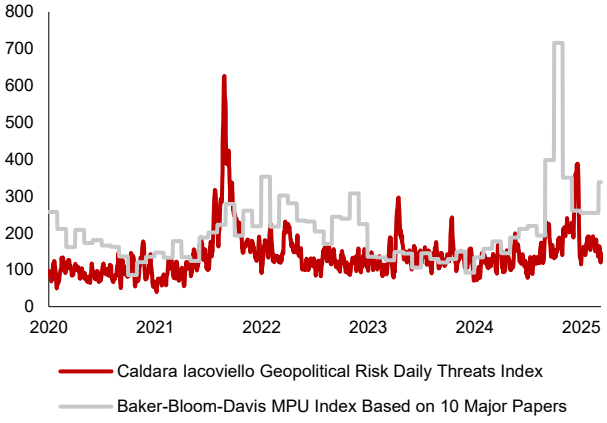
The 2024 *ASEAN+3 Financial Stability Report* was published when global markets were heading into the US presidential elections amid simmering geopolitical tensions. Since then, global markets have seen increased US policy uncertainty from elevated trade tensions and geopolitical conflicts (Figure 1.1). Global financial conditions remained largely accommodative during the last quarter of 2024 but deteriorated significantly during the first quarter of 2025 (Figure 1.2). In the days after the 2 April announcement of US reciprocal tariffs, financial conditions were at their tightest since March 2020 (market stress related to the COVID-19 pandemic) before gradually easing since then.

Trade tensions started rising after the first round of tariffs was announced by the US in early February on Canada, Mexico, and China. Negotiations and threats followed these announcements leading to the ebbs and flows of market stress in February and March. Market turbulence escalated significantly on 2 April, the so-called Liberation Day when President Trump extended reciprocal tariffs ranging from 10 percent to 50 percent on 185 countries (Financial Times 2025). A subsequent 90-day pause on most tariffs and a restart to US-China trade talks offered some relief. The tariffs were eventually imposed on 1 August after some trade deals were struck and negotiations for others continued. Multiple US shifts in its stance on tariffs since February have increased policy uncertainty. In addition, US policy uncertainty has also increased because of changes in immigration, fiscal and regulatory policies (Figure 1.3; Watson and Zars 2025).

The tariff and immigration policies in the US have raised the upside risks to inflation, downside risks to growth and have muddled the outlook for monetary policy. Overall, though the markets still expect the Fed to continue cutting rates (Figure 1.4), the timing, pace and extent of policy easing remain uncertain. In addition, public criticism of Fed Chair Powell by President Trump have raised concerns of a premature exit of Powell before his term ends in May 2026 and if materialized, will raise severe concerns around the independence of the Fed. Separately, US fiscal policy also came under market scrutiny following government proposals for a tax reduction without offsetting spending reductions, along with rising government debt and Moody's' downgrade of US ratings.

Figure 1.1. Selected Advanced Economies: Economic Uncertainty and Geopolitical Stress Indices
(Index)

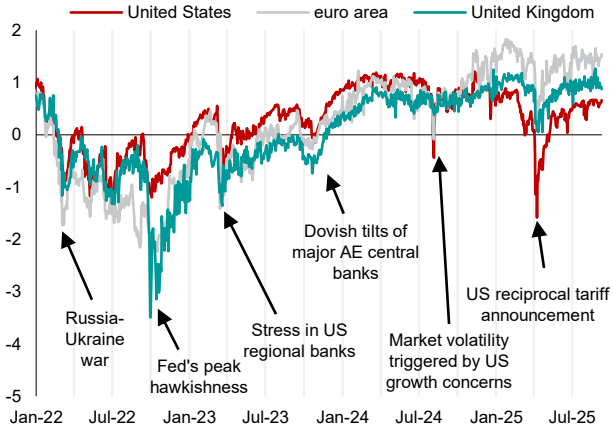
Economic and trade policy uncertainty remained elevated while geopolitical stress escalated sporadically.



Source: Bloomberg Finance L.P.; Baker-Bloom-Davis Economic Policy Uncertainty Indices; AMRO staff compilation.
Note: The seven-day moving average of the Caldara Iacoviello Geopolitical Risk Daily Threats Index is used. MPU = Monetary Policy Uncertainty. Data as of 8 September 2025.

Figure 1.2. Selected Advanced Economies: Financial Conditions Indices
(Index)

Global financial conditions tightened in early April.

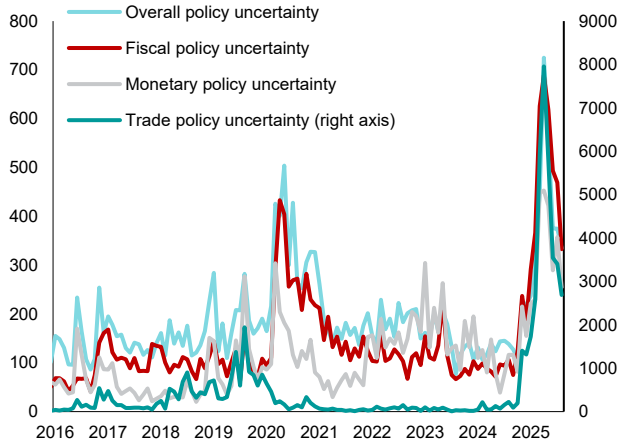


Source: Bloomberg Finance L.P.; AMRO staff compilation.
Note: Higher values of the index indicate easier financial conditions. AE = advanced economy. Data as of 8 September 2025.

Global geopolitical risks have also increased. These risks included wars and border tensions in different parts of the world. Notably, these included the flare up of tensions between Israel and Iran during the Twelve-Day War from 13 June, in which the US became involved. A ceasefire between the three countries helped calm markets soon after (Box 1.1). Separately, tensions between Ukraine and Russia intensified at the margin as Ukraine received permission from its key allies to attack targets deep into Russian territory in late May, while the efforts around a ceasefire have yielded limited results. There were also localized tensions in other parts of the world, including those between India and Pakistan, and Thailand and Cambodia.

Figure 1.3. US Policy Uncertainty Index
(Index)

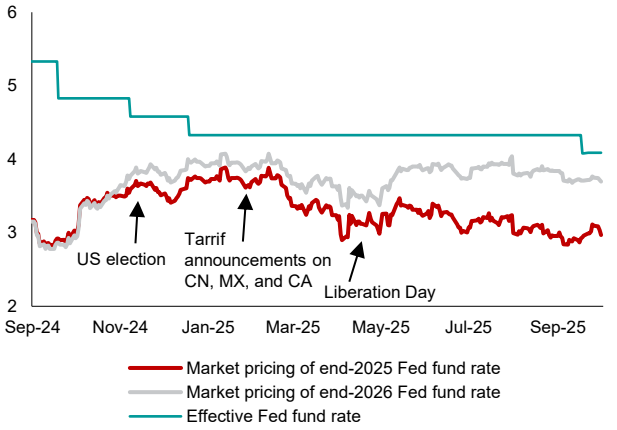
US policy uncertainty increased across the board.



Source: Bloomberg Finance L.P.; AMRO staff calculations.
Note: Data as of 31 August 2025.

Figure 1.4. Fed Rate Expectations
(Percent)

The Fed is widely expected to continue cutting interest rates.



Source: Bloomberg Finance L.P.
Note: CN = China, MX = Mexico, CA = Canada. Data as of 1 October 2025.

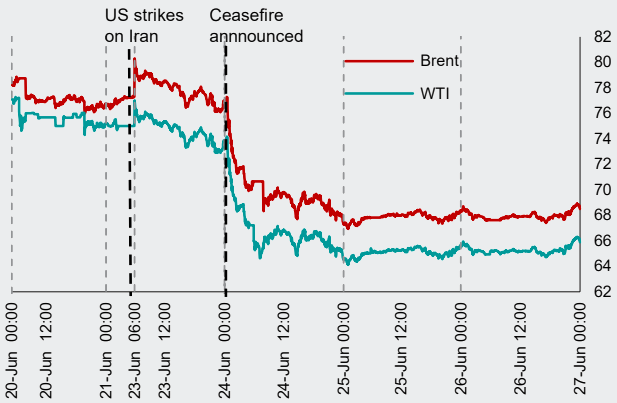
Box 1.1:

Global Market Reactions to Israel, Iran and US Conflict

Tensions between Israel and Iran in June 2025 trace back to October 2023, when Hamas and Hezbollah—allegedly funded by Iran—attacked Israel. The conflict escalated with Iran's direct involvement in April 2024, and culminated more than a year later with Israel's preemptive strikes on Iran's nuclear and military sites on 13 June 2025. A week of attacks followed, escalating when US President Donald Trump launched "Operation Midnight Hammer" on June 22, targeting three key Iranian nuclear facilities.[1] Iran attacked a US military base in Qatar on June 23, but hours later, Trump announced an immediate ceasefire between the US, Israel, and Iran. As of September, the ceasefire remains fragile, with both sides periodically testing the boundaries of the truce and external powers maintaining a critical role in stabilizing the region.

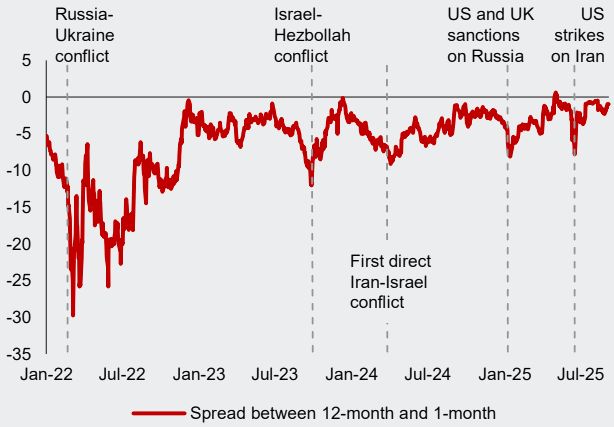
The escalation in conflict, particularly when Iran's parliament voted to close the Straits of Hormuz (Lee 2025; Parry 2025), led to a rise in oil prices as Brent crude rose from about USD 66 per barrel in early June to USD 80 per barrel after US attacked Iran (Figure 1.1.1). In the forward market, the price spread between the 12-month and 1-month contracts widened, confirming rising market concerns on tighter short-term supply. Nonetheless, the magnitude of the spread remained smaller than in past major geopolitical events in recent years (Figure 1.1.2). Both Brent crude prices and the spread normalized quickly after the ceasefire was announced.

Figure 1.1.1. Global Crude Oil Prices
(US dollars per barrel)



Source: Bloomberg Finance L.P.
Note: The timeline is based on GMT +8:00 hours. Gray dotted lines separate trading sessions. The x-axis is not to scale due to the difference in timing reported for each commodity. WTI = Western Texas Intermediate crude oil.

Figure 1.1.2. Brent Forward Spread Between 12-month and 1-month Contracts
(US dollars per barrel)



Source: Bloomberg Finance L.P.

The conflict had spillovers to global markets, including ASEAN+3. Between 12 June and 20 June, most major global equity indices weakened while the US dollar strengthened against major currencies on safe haven demand. US Treasury yields were range-bound but the breakdown of the yield components shows that the effect of rising breakeven yield (indicating domestic inflationary pressures) was offset by the fall in real yields that resulted from the safe-haven demand of Treasuries (Figure 1.1.3). Other perceived safe havens showed divergent behavior.

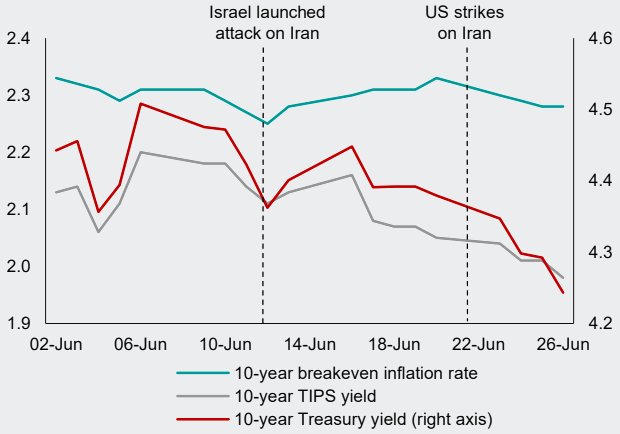
Gold spiked on 13 June following Israel attacks but gave up the gains in the following weeks. Swiss franc initially weakened against the US dollar but appreciated after the US attacks and ceasefire announcement (Figure 1.1.4).

The easing of geopolitical tensions after the ceasefire has calmed market jitters, leading to a stabilization in oil prices and Treasury yields tracking lower after June 24. The US dollar also depreciated against Swiss franc and gold rebounded.

The author of this box is Chiang Yong (Edmond) Choo.

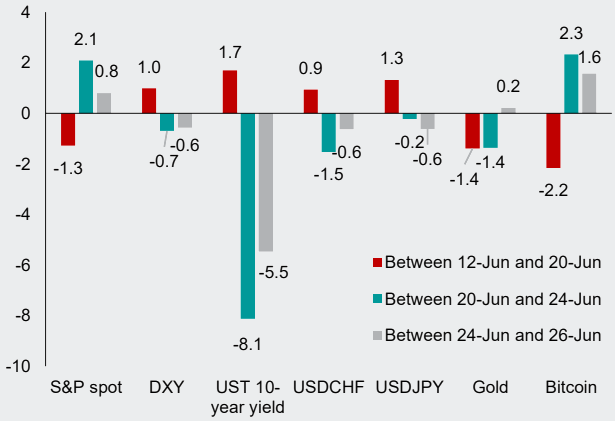
[1] The action was particularly unexpected given President Trump's longstanding position of keeping the US out of foreign conflicts. Just a day before the strikes, he had given Iran a two-week window to initiate negotiations (Liptak and others 2025, Gardner and others 2025).

Figure 1.1.3. The US 10-Year Treasury Yield and Its Components
(Percent)



Source: Bloomberg Finance L.P.; Federal Reserve Bank of St Louis FRED.
Note: TIPS = Treasury inflation-protected securities. Data until 26 June 2025.

Figure 1.1.4. Recent Change in US Asset and Commodity Price
(Change in percentage/basis points)



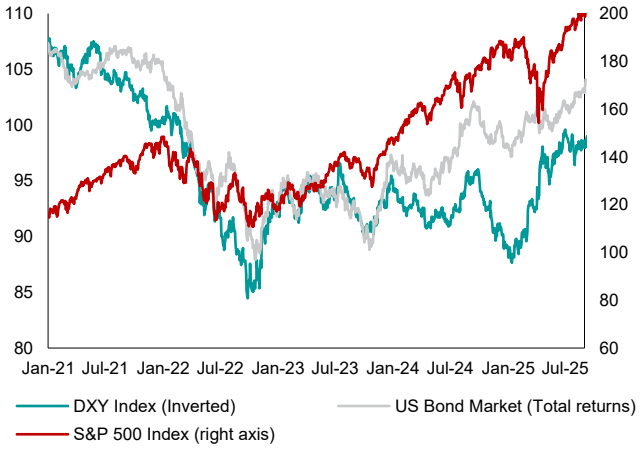
Source: Haver Analytics; AMRO staff calculations.
Note: The change for 10-year United States Treasury (UST) yield is in basis points, while the rest are in percentage change. DXY = broad dollar index; S&P spot = Standard & Poor's 500 index; USDCHF = price of one US dollar in Swiss franc; USDJPY = price of one US dollar in Japanese yen.

Global financial markets remained hostage to the policy uncertainty emerging from the US and the geopolitical tensions, leading to periods of weakness in various assets and heightened volatility (Figures 1.5 and 1.6). US equity markets reacted largely to tariff developments, reaching a trough in early April after Liberation Day before recovering to historical highs by mid-July as tariff implementations were delayed and eased for some countries.

US Treasury yields remained elevated because of expectations of delayed Fed monetary easing and concerns around mounting US debt. Fiscal concerns were not limited to the US alone. A potential rise in Europe's fiscal deficit affected European markets, causing a rise in bond yields. However, European equities and the euro gained around periods when Germany announced a potential expansion of fiscal spending (Box 1.2). The most significant market movements were in the foreign exchange space, where the US dollar depreciated sharply against major currencies and assets since mid-January (Figure 1.7). Markets grew cautious about the safe haven status of the dollar amid policy uncertainty and rising fiscal burdens.

Figure 1.5. US: Equity, Bond Market, and Foreign Exchange Indices
(Index, 1 January 2021 = 100)

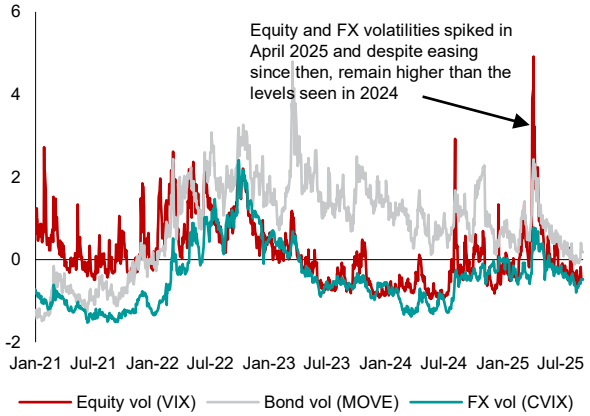
US policy uncertainty and geopolitical tensions led to periods of weakness in the US financial market...



Source: Bloomberg Finance L.P.; AMRO staff calculations.
Note: DXY index refers to the broad US dollar index. The Bloomberg US Aggregate Index is used for US bond market (total returns). The S&P 500 index refers to the Standard & Poor's 500 index. Data as of 8 September 2025.

Figure 1.6. Volatility in Key Assets
(z-score, based on data since 1 January 2010)

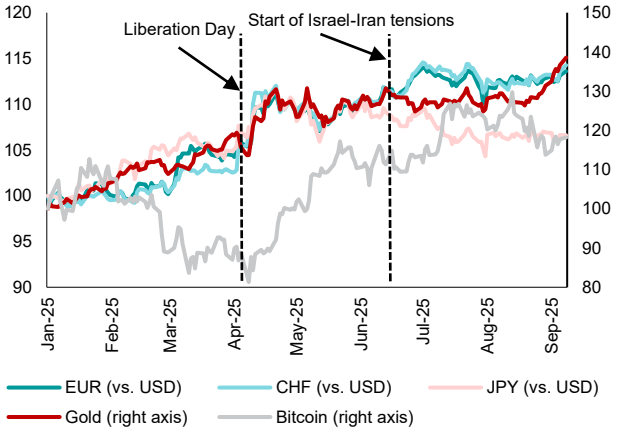
...and heightened volatility.



Source: Bloomberg Finance L.P.; AMRO staff calculations.
Note: VIX refers to Chicago Board Options Exchange's Volatility Index. MOVE refers to Merrill Lynch Options Volatility Estimate Index. CVIX refers to the Deutsche Bank Currency Volatility Index. FX = Foreign exchange. Vol = volatility. Data as of 8 September 2025.

Figure 1.7. Movements in Selected Global Currencies and Assets
(Index, 1 January 2025 = 100)

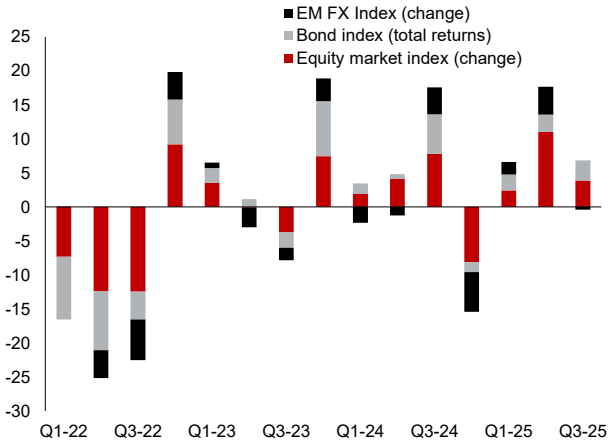
The US dollar depreciated sharply against major currencies and assets.



Source: Bloomberg Finance L.P.; AMRO staff calculations.
Note: Data as of 8 September 2025.

Figure 1.8. Emerging Markets: Equity, Bonds, and Foreign Exchange Indices
(Percent, quarter-on-quarter)

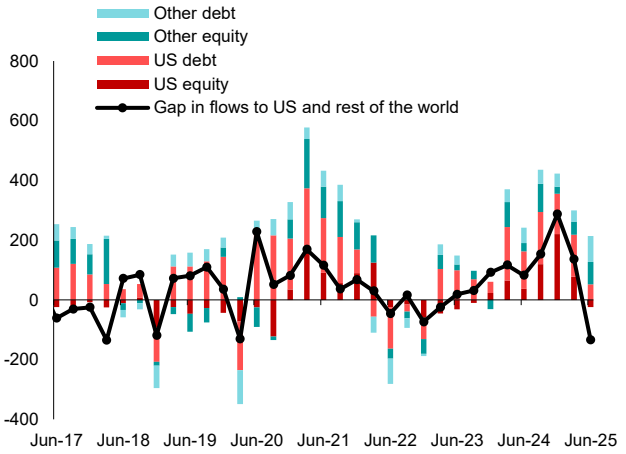
Emerging market assets rebounded in the first half of 2025.



Source: Bloomberg Finance L.P.; AMRO staff calculations.
Note: EM: Emerging markets; FX = Foreign exchange. Data for the third quarter of 2025 as of 8 September 2025.

Figure 1.9. US and Global (ex-US): Bond and Equity Flows
(Millions of US dollars)

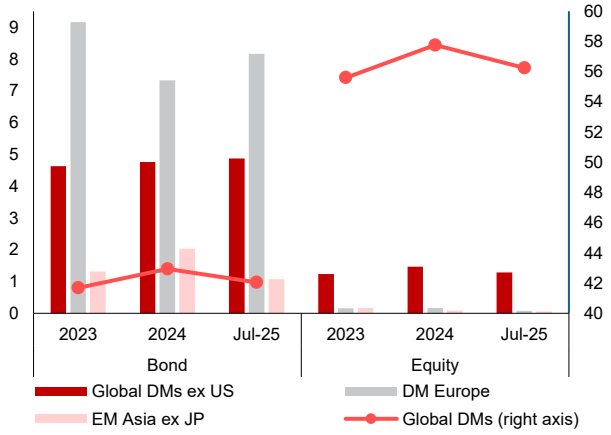
US assets attracted a larger share of funds around the US presidential election.



Source: Emerging Portfolio Fund Research; AMRO staff calculations.
Note: Total flows refer to flows of bond and equity. Data as of the second quarter of 2025.

Figure 1.10. World: Share of US Allocations in Equity and Bond Portfolio by Funds Mandated for Respective Region, Year-to-date 2025
(Percent of total portfolio)

Bond allocations were stable, but equity allocations have reduced.

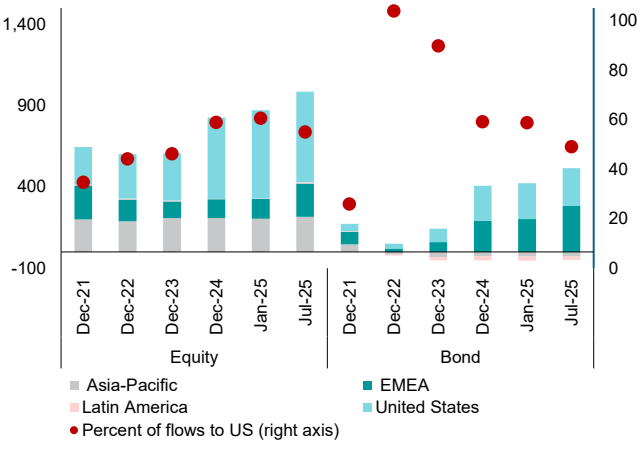


Source: Emerging Portfolio Fund Research; AMRO staff calculations.
Note: Data track funds' exposure to specific countries based on their weights in the provided funds' portfolios. DM = developed market; EM = emerging market; ex = excluding; JP = Japan; US = United States. Data as at July 2025.

Emerging market assets weakened in the fourth quarter of 2024 (Figure 1.8) as US assets attracted a larger share of funds around and after the US presidential elections (Figure 1.9) but the fund allocations to US equities have reduced in 2025 (Figures 1.10 and 1.11). Nevertheless, emerging assets have gained in 2025 despite the increased turbulence in global markets. The MSCI emerging markets index strengthened in the first and second quarters of 2025, driven by gains in equities of China, Korea, and Brazil. A weaker US dollar helped many emerging market currencies strengthen while the limited bond market spillover from advanced economies to emerging market bond markets ensured that the total returns for these markets remain positive. Emerging markets continued receiving inflows, but they were driven primarily by debt flows while equity markets saw aggregate outflows in the first two quarters of 2025 (Figure 1.12). The perceived erosion of the dollar's safe haven status may have supported the demand for emerging market debt sporadically, but the flows could see a material rise if the erosion continues amid US policy and fiscal concerns.

Figure 1.11. World and US: Cumulative Equity and Bond Inflows and Share of Inflows to the US by Foreign Domiciles
(Billions of US dollars; Percent)

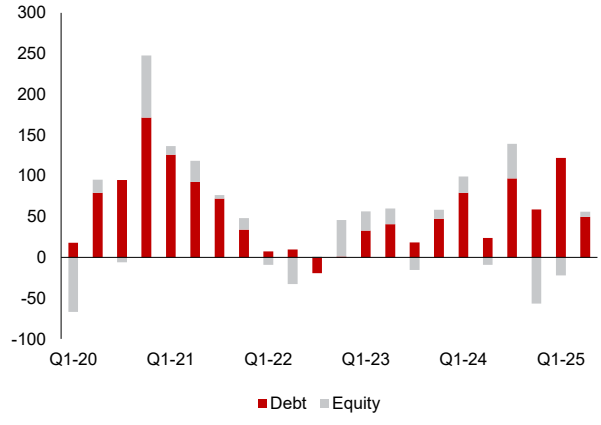
The share of US assets in global flows declined marginally in 2025.



Source: Emerging Portfolio Fund Research; AMRO staff calculations.
Note: Data for total flows refer to cumulative inflows to respective economy by foreign domicile investors since December 2020. The data cover only fund flows from exchange-traded funds and mutual funds. The percentage of inflows to the US is calculated by dividing cumulative inflows to the US by cumulative inflows to the world, including the US. EMEA = Europe, Middle East and Africa.

Figure 1.12. Emerging Markets: Portfolio Investment Flows
(Billions of US dollars)

Portfolio inflows continued in emerging markets in 2025.

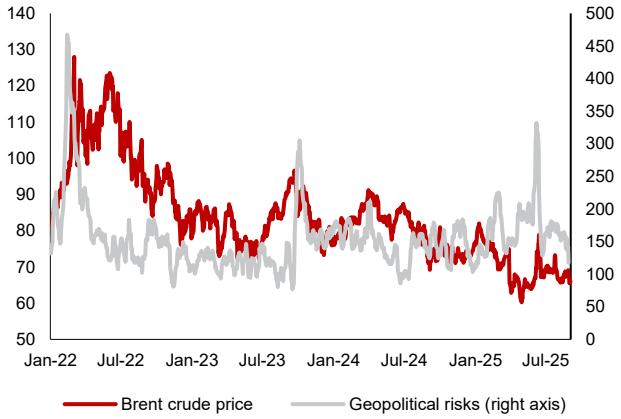


Source: Institute of International Finance via Haver Analytics; AMRO staff calculations.
Note: Data as of the second quarter of 2025.

Oil prices strengthened in periods of geopolitical stress (Figure 1.13) but otherwise have trended lower because of the outlook for supply to outstrip demand. The markets believe that the tariffs will eventually affect growth negatively leading to lower oil demand, while OPEC+ has started increasing its production, fueling expectations of a supply surplus in oil markets (Figure 1.14) (Agnolucci and Makarenko 2025).

Figure 1.13. Brent Crude Oil Price and Geopolitical Risk
(Thousands of US dollars, 7-day moving average; Index, 1985–2019 = 100)

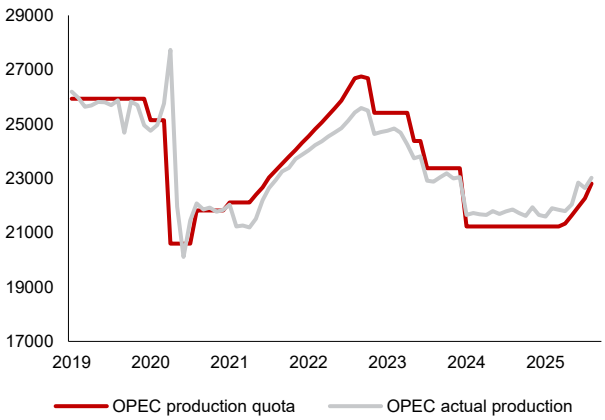
Oil prices trended downward barring geopolitical stress.



Source: Bloomberg Finance L.P.; AMRO staff calculations.
Note: The index used to gauge geopolitical risk refers to the Caldara Iacoviello Geopolitical Uncertainty Index. Data as of 8 September 2025.

Figure 1.14. OPEC Oil Production Quotas and Actual Production
(Thousands of barrels per day)

OPEC started raising its production quotas.



Source: Bloomberg Finance L.P.; AMRO staff calculations.
Note: Iran, Libya and Venezuela are exempted from production quota and excluded from Organization of the Petroleum Exporting Countries (OPEC) actual production. Data as of 8 September 2025.

Box 1.2:

Rising Fiscal Concerns in Major Economies

Bond markets reacted to developments in the fiscal stance of major global economies in 2025. The fiscal developments first came under market scrutiny in mid-December when US President Donald Trump called for abolishing the debt ceiling. The debt ceiling, which was suspended since 2023 was reinstated on 1 January 2025 (Figure 1.2.1), but the US Treasury soon started using "extraordinary efforts" to avoid an immediate default. The Treasury projected it would exhaust its resources sometime between July and October 2025 if a new deal on debt limit was not reached. Concerns around US debt flared up again when Moody downgraded US credit rating from Aaa to Aa1 on 16 May. Finally, President Trump's 'Big Beautiful Bill' raised the debt limit by USD 5 trillion, mitigating default risks in the near term but creating fiscal uncertainty in the long-term with substantial new borrowing, higher public debt, and higher interest payments.

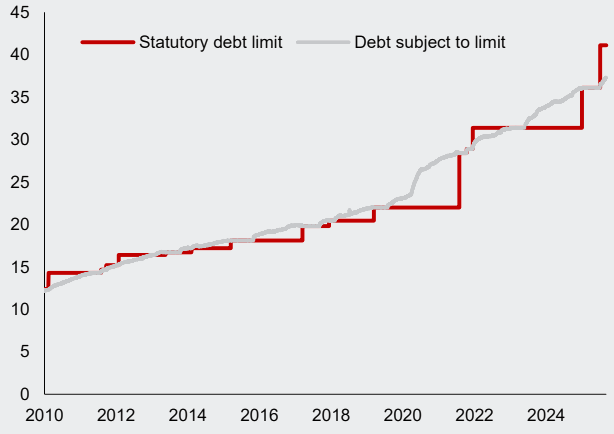
The German government bond (bund) markets saw a sharp rise in yields in early March when the newly elected coalition government proposed an overhaul of the debt brake, which restricted the federal government's structural deficit to 0.35 percent while the state governments were required to maintain a structurally balanced budget. The rule was amended to (1) exempt defense spending above 1 percent of GDP, (2) allow states to run structural deficits of up to 0.35 percent of own GDP, and (3) create a EUR 500 billion fund for infrastructure and climate investment. The proposal was seen as pro-growth and helped European equities and the euro to strengthen. In addition, some EU members invoked the National Escape Clause in March 2025 to allow greater fiscal leeway in the event of urgent security and defense spending needs.

In Japan, domestic factors were limited to market dynamics and speculations. In May, the markets believed that supply-demand dynamics were skewed toward higher long-term yields as the demand of Japanese Government Bonds from insurance companies had receded. The concerns were mitigated by strong buying by foreign investors and adjustments to issuance plans by the Ministry of Finance. In July, heading into the Upper House elections on 20 July, market participants expected economic stimulus measures if the ruling coalition loses. The uncertainty prevailed after the ruling coalition lost its majority in the election, causing the yields to stay elevated.

Bond market reactions to all these events were varied but were more prominent in the longer tenor bond yields. Most of the developments led to gradual rise in bond yields over days and weeks, such as the US debt ceiling concerns in December 2024 and Moody's downgrade of US debt in May 2025 (Figure 1.2.2). But Germany's debt brake proposal caused the sharpest single day rise in German government bond yields in almost 30 years (Figure 1.2.3). While many of these events were idiosyncratic, there were spillovers to other bond markets (Figure 1.2.4). Poor investor sentiment was also seen in bond auctions in these markets during May, June, and July, when most of the bonds for which demand was poor were longer-tenor (typically 20-year or 30-year maturity bonds).

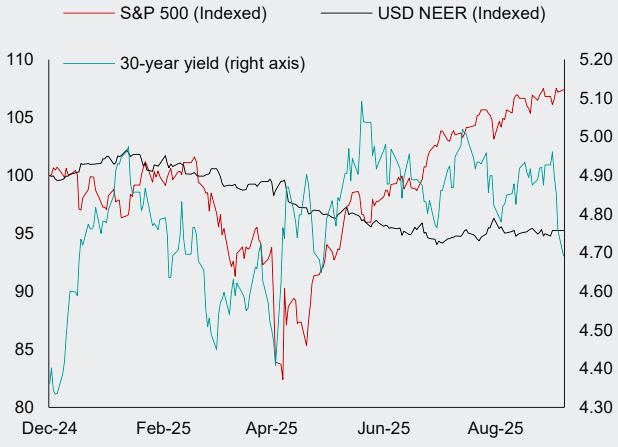
Overall, the market reactions show that investors have grown increasingly sensitive of the fiscal situation and tend to punish the bond markets in events leading to fiscal expansions. Also, reactions can also spillover to other bond markets and cause undue stress, especially if the fiscal outlook is not clear.

Figure 1.2.1. US: Statutory Debt Limit and Outstanding Debt Subject to Limit
(Trillions of US dollars)



Source: Bloomberg Finance L.P.
Note: The periods when the outstanding debt is greater than the debt limit are those when the debt limit was suspended and later reinstated at a higher level.

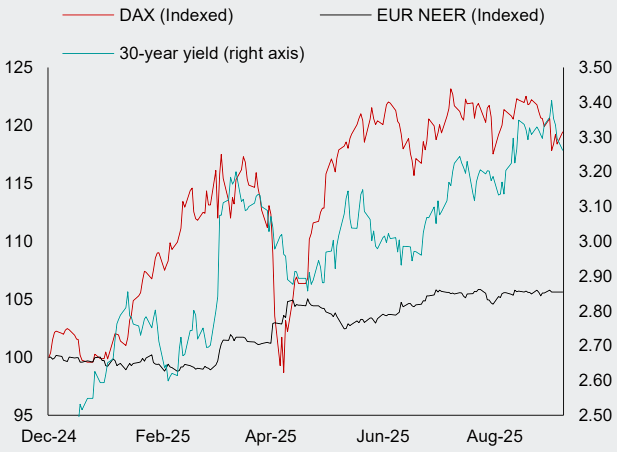
Figure 1.2.2. US: Equity, FX, and Bond Yields
(Index, 1 January 2025 = 100; percent)



Source: Bloomberg Finance L.P.
Note: S&P = Standard & Poor's; USD = US dollar; NEER = nominal effective exchange rate.

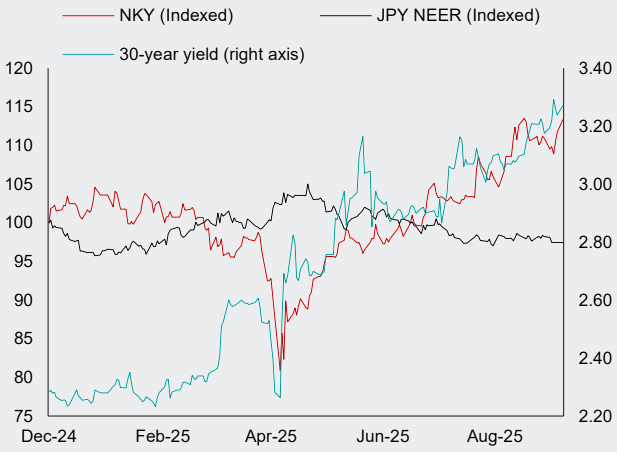
The author of this box is Prashant Pande.

Figure 1.2.3. Germany: Equity, FX, and Bond Yields
(Index, 1 January 2025 = 100; percent)



Source: Bloomberg Finance L.P.
Note: DAX = Deutscher Aktienindex; EUR = euro; NEER = nominal effective exchange rate.

Figure 1.2.4. Japan: Equity, FX, and Bond Yields
(Index, 1 January 2025 = 100; percent)



Source: Bloomberg Finance L.P.
Note: NKY = Nikkei 225 Index; JPY = Japanese yen; NEER = nominal effective exchange rate.

The evolving relationship between the US dollar and dollar-denominated assets

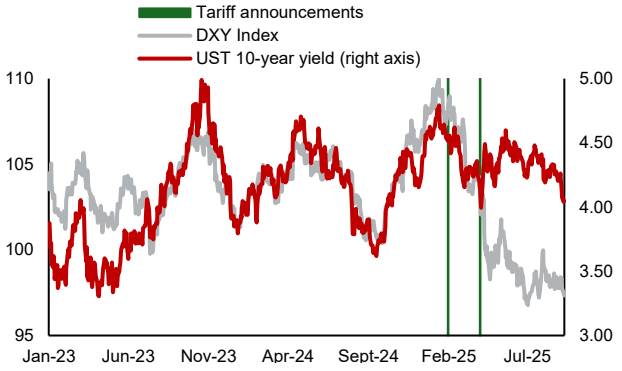
The US dollar has seen a significant shift in its behavior since the US announced tariffs on its trading partners on 1 February 2025. Unlike historical precedents (Box 1.3), the dollar fell despite a notable rise in financial market stress. The US dollar declined until the Liberation Day (April 2) along with the US Treasury yields and US equities. The lower yields and weaker equities reflected market concerns on economic growth and the Fed's response (Atkins and Mackenzie 2025). The weakness in the US dollar could be justified as it has been sensitive to interest rates for the past two years (Figure 1.15).

After the Liberation Day market reaction—which led to a sharp drop in US Treasury yields, equities, and the US dollar—yields and equities recovered in the next few sessions (Figures 1.15 and 1.16). However, the dollar continued to weaken. The subsequently announced 90-day pause was able to support equity markets but did not help the dollar. The dollar also lost its co-movement with the US Treasury yields. While US policy uncertainty, including tariffs and fiscal, led to US dollar weakness, it was probably exacerbated by micro market issues such as the increased foreign exchange (FX) hedging by non-US institutional investors (Shin, Wooldridge, and Xia 2025).

A deeper look into the foreign net purchases of US assets revealed that the markets may have differentiated between US assets and the US dollar. Though the dollar weakened in February, March and May, the buying of US assets by foreign investors remained robust (Figure 1.17), with US Treasuries constituting a large part of the inflows, despite the concerns about the US fiscal situation. Other non-US currencies and assets (perceived to be either safe assets or uncorrelated to the broader context of risk) also largely appreciated from February to June (Figure 1.18), despite elevated uncertainty because of tariffs and geopolitics.

Figure 1.15. US Dollar and US Treasury Yield
(Index; Percent)

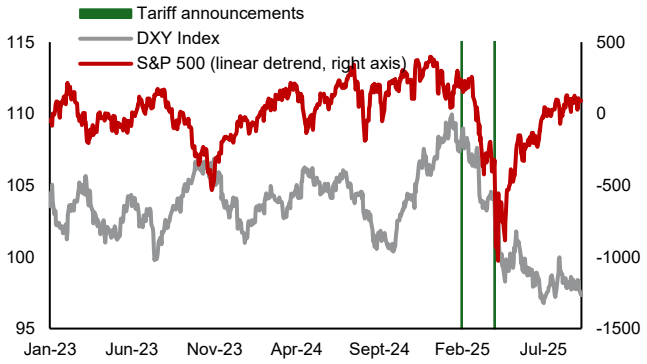
The US dollar-US Treasury yield co-movement broke after Liberation Day.



Source: Bloomberg Finance L.P.; AMRO staff calculations.
Note: DXY = broad dollar index; UST = US Treasury. Data as of 8 September 2025.

Figure 1.16. US Dollar and US Equity Index
(Index; index detrended)

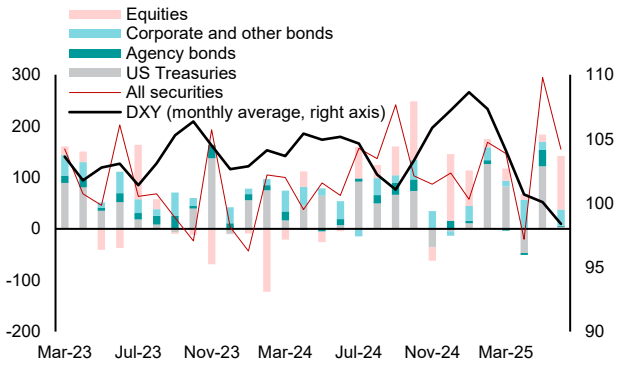
Equities recovered after Liberation Day, but the US dollar continued to slide.



Source: Bloomberg Finance L.P.; AMRO staff calculations.
Note: DXY = broad dollar index; S&P = Standard & Poor's. Data as of 8 September 2025.

Figure 1.17. Net Purchases of US Assets by Foreign Private Investors
(Billions of US dollars; Index)

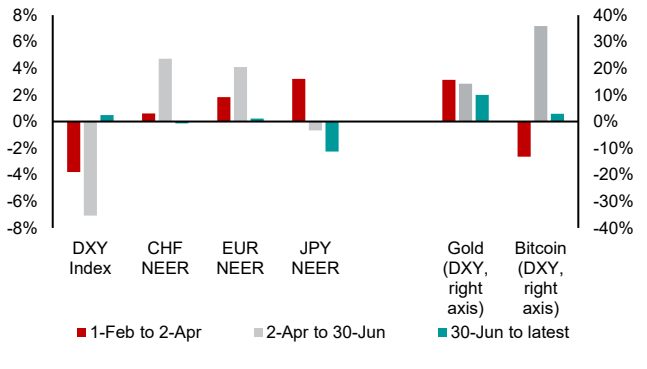
Despite the US dollar's weakness, foreign private investors bought US assets at a brisk pace.



Source: Bloomberg Finance L.P.; AMRO staff calculations.
Note: DXY = broad US dollar. Data as of June 2025.

Figure 1.18. US Dollar and Other Asset's Price Changes
(Percent; Percent)

While the US dollar weakened, other safe assets appreciated.



Source: Bloomberg Finance L.P.; AMRO staff calculations.
Note: CHF = Swiss franc; DXY = broad dollar index; EUR = euro; JPY = Japanese yen. Data as of 8 September 2025.

Box 1.3:

Is the US Dollar Still a Safe Haven Currency?

Since February 2025, the US dollar has shown signs of divergence from its traditional safe haven behavior amid rising stagflation concerns, driven by new tariffs and deep cuts in the federal workforce.[1] The divergence was exacerbated by concerns over further US protectionist trade policies and fiscal sustainability. In April, President Donald Trump's announcement of "Liberation Day" tariffs intensified the decline, fueling recession fears. Uncertainty over the budget resolution further raised concerns about US fiscal sustainability, contributing to a sharp rise in Treasury yields. On 16 May, Moody's downgraded the US credit rating from AAA to Aa1—following similar moves by Standard & Poor's (S&P) in 2011 and Fitch in 2023—deepening investor unease over US safe asset status.[2] This box examines the recent change in the dollar's behavior.

The US dollar is widely regarded as a safe-haven asset during financial turmoil. Historically, the dollar nominal effective exchange rate (NEER) has shown strong correlations with heightened stock market volatility and tightened financial conditions (Figure 1.3.1). In such conditions, investor sentiment often shifts toward a flight to safety, driving demand for perceived risk-free assets like US Treasuries. This further reinforces the strength of the dollar. For example, during the COVID-19 pandemic's "dash-for-cash", the sharp rise in risk aversion led to a stronger dollar compared to other traditional safe assets (like gold) and major reserve currencies as investors rushed to secure dollar-denominated assets, tightening liquidity conditions in that process (Figure 1.3.2).

We examine the correlation between US Financial Conditions Index (FCI),[3] the US dollar NEER and its reserve currency counterparts, gold, and selected ASEAN+3 currencies across several major crisis periods, including post-Liberation Day.

The US dollar has strengthened during all stress episodes since 2008 until the post-Liberation Day, that is, it has a negative correlation with tighter US financial conditions (Figure 1.3.3). Many other reserve, major, and ASEAN+3 currencies did not demonstrate such a consistent correlation. However, during the market stress around the Liberation Day, the correlation of the dollar and US financial conditions index turned positive as the dollar depreciated. Other currencies—notably the euro and Swiss franc—and gold exhibited stronger safe-haven properties.

Correlation patterns observed during the tariff turmoil period suggest that investors may have turned to US dollar alternatives. This shift, if sustained, may reflect increased US policy uncertainty and diminishing influence of US exceptionalism. In the euro area and Switzerland, the willingness of central banks to cut rates to stimulate growth has enhanced their attractiveness. Non-monetary assets like gold have also recently gained favor as a store of value. Bitcoin does not show a sharp tendency to appreciate when financial stress increases but tends to be less correlated with the broader market movements, acting as a diversification tool for market participants. Finally, it might be too early to conclude that the US dollar's safe haven status is eroding. As seen during the Iran-Israel conflict, the US dollar may still exhibit safe haven characteristics if the source of market stress is outside the US.

Despite these shifts, the US dollar remains dominant across economic and financial systems (AMRO 2024a). Over the longer term, if other currencies evolve to gain global recognition and usage, the dollar's traditional safe-haven role is likely to face stronger headwinds in the years ahead (Business Times 2025; Xinhua 2025)

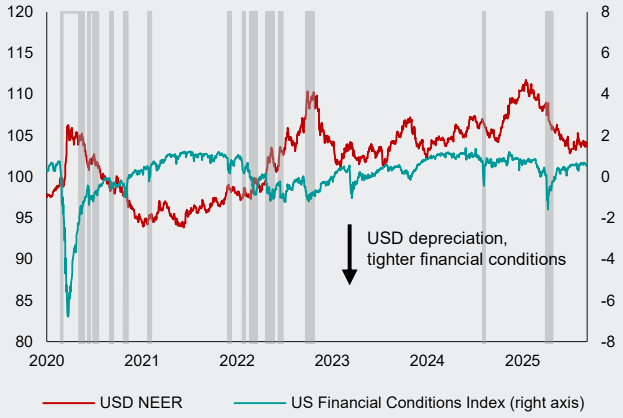
The author of this box is Chiang Yong (Edmond) Choo.

[1] A safe haven asset is one whose nominal value does not decrease during periods of stress in financial markets, and is highly liquid and carries minimal credit risk (Habib and others 2020). Common examples include the US dollar, Swiss franc, highly rated sovereign bonds, defensive stocks, and precious metals.

[2] According to Ohnsorge, Woliski, and Zhang (2014), another definition of a safe haven currency is when that country has a triple AAA credit rating from at least two of the three major rating agencies (Fitch, S&P, and Moody's).

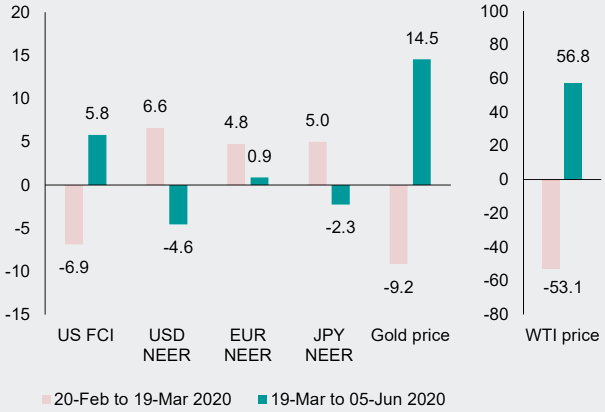
[3] The Financial Conditions Index, provided by Bloomberg Finance L.P., tracks the overall level of financial stress in the US money, bond, and equity markets to assess the availability and cost of credit. There are various weighted money market, bond market, and equity market components of the index, such as commercial paper–T-bill spread, high-yield treasury spread, VIX index, and S&P 500 stock index.

Figure 1.3.1. US Dollar NEER, 10-Year Treasury Yield and Financial Conditions
(Index; Percent/index)



Source: Haver Analytics; Bloomberg Finance L.P.
Note: Gray bars denote periods when the VIX is equal or more than 30 index points. NEER = nominal effective exchange rate; VIX = Chicago Board Options Exchange Volatility Index.

Figure 1.3.2. US FCI, Dollar NEER, Other Reserve Currencies, Gold and Oil Prices During COVID-19
(Percent)



Source: Haver Analytics; Bloomberg Finance L.P.; AMRO staff calculations.
Note: The selected period of 20 February to 19 March 2020 corresponds to the period when CBOE VIX rose from low levels to its peak, while the period between 19 March to 4 June 2020 refers to the time when VIX fell from the peak to lower than 25. EUR = euro; FCI = Financial Conditions Index; JPY = Japanese yen; NEER = nominal effective exchange rate; US = United States; USD = US dollar; WTI = Western Texas Intermediate crude oil.

Figure 1.3.3. Correlation of US Financial Conditions with Selected NEERs, Gold and Bitcoin
(Correlation, +1 = perfect correlation)

Crisis	Sample period	USD	EUR	GBP	AUD	CAD	CHF	JPY	CNY	KRW	SGD	Gold	Bitcoin
Global financial crisis	17-Jun-08 to 10-Oct-08	-0.80	0.60	0.35	0.79	0.44	-0.50	-0.92	-0.78	0.91	0.30	0.03	
2010 flash crash	23-Apr-10 to 30-Jun-10	-0.93	0.86	-0.28	0.89	0.72	-0.18	-0.93	-0.95	0.86	-0.13	-0.66	
US downgrade by S&P	22-Jul-11 to 03-Oct-11	-0.75	0.09	-0.34	0.83	0.90	0.37	-0.76	-0.76	0.72	0.54	-0.44	0.01
2015 Renminbi deval	14-Aug-15 to 24-Aug-15	-0.32	-0.95	0.71	0.95	0.83	-0.99	-0.97	0.62	0.98	0.68	-0.84	0.28
2015-2016 EM sell-off	25-Nov-15 to 11-Feb-16	-0.83	-0.92	0.92	0.83	0.77	-0.34	-0.95	0.88	0.89	0.28	-0.73	0.24
2018 Fed rate hike	03-Oct-18 to 24-Dec-18	-0.64	0.55	0.77	-0.20	0.93	-0.53	-0.44	-0.28	-0.20	-0.66	-0.81	-0.08
Covid-19 pandemic	19-Feb-20 to 24-Mar-20	-0.89	-0.89	0.95	0.96	0.97	-0.85	-0.68	-0.79	0.66	0.92	0.68	-0.11
2022 Fed hikes	04-Jan-22 to 05-Jul-22	-0.82	0.59	0.75	-0.37	-0.09	-0.15	0.61	-0.03	0.71	-0.73	-0.14	0.06
Tariff announcements	19-Feb-25 to 08-Apr-25	0.40	-0.76	0.39	0.90	-0.06	-0.87	-0.78	0.84	0.53	0.87	-0.28	0.20

Source: Bloomberg Finance L.P.; AMRO staff calculations.
Note: The data represents the correlation coefficients of each NEER and gold with US Financial Conditions Index (FCI). The index, NEERs, and prices are in level terms. The redder the color the stronger the negative correlation with US FCI, where a higher index means easier financial condition and vice versa. A greener color denotes a stronger positive correlation. The periods are selected based on the changes in US FCI. The periods capture the steepest phase of financial conditions climbing to the tightest levels seen during the episodes, with a minimum time frame of 10 days.

The ebbs and flows of market stress in ASEAN+3 markets

US trade policy shocks caused the market stress in ASEAN+3 to rise sharply, but the stress normalized as markets stabilized after the events. The magnitude of stress varied across the economies as ASEAN markets saw a relatively larger rise during the 2 April Liberation Day market stress (Figures 1.19 and 1.20).

The average market stress in 2025 (as of 8 September 2025) in ASEAN+3 markets is broadly stable but there has been divergence between the economies and the components (Figure 1.21). Market stress in China (driven by lower stock market and FX volatility) eased while Malaysia (lower real housing prices) saw market stress rise compared to the end of 2024. Notably, market stress rose in most ASEAN+3 economies around Liberation Day (Figure 1.22) amid higher volatility in stocks, FX, and bond yields. However, once the tariff pause was announced, the market stress declined gradually.[1]

Figure 1.19. Plus-3: Market Stress Indicators
(Index)

Plus-3 witnessed a notable rise in market stress in August 2024 driven by heightened market volatility.

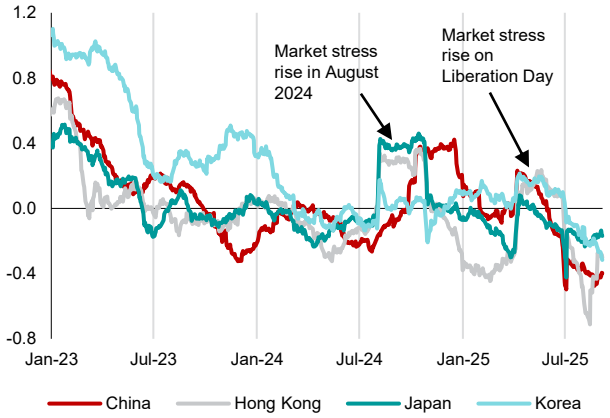
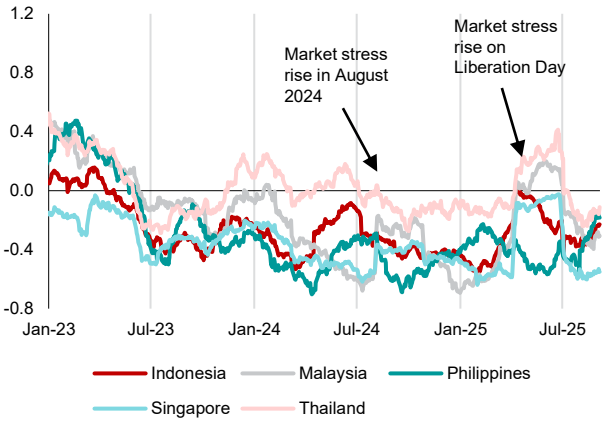


Figure 1.20. ASEAN: Market Stress Indicators
(Index)

ASEAN saw a larger rise in market stress on Liberation Day.



Source: Bloomberg Finance L.P.; Haver Analytics; AMRO staff calculations.
Note: 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-economy percentiles. The measure of risk uses real equity market returns, equity market volatility, domestic sovereign bond yield volatility, sovereign foreign exchange risk spreads, foreign exchange 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 are 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. Data as of 8 September 2025.

Figure 1.21. Selected ASEAN+3: Contributors to Change in Market Stress from January 2025 to September 2025
(Index)

Market stress levels differed across economies.

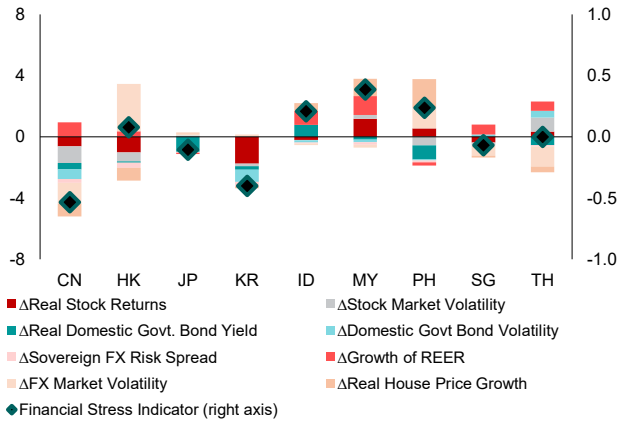
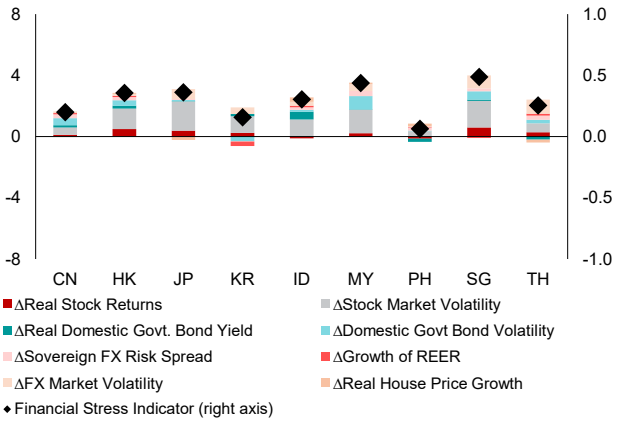


Figure 1.22. Selected ASEAN+3: Contributors to Change in Market Stress from 25 March 2025 to 14 April 2025
(Index)

Market stress rose around Liberation Day in most regional economies because of higher market volatility.



Source: Bloomberg Finance L.P.; Haver Analytics; AMRO staff calculations.
Note: A rise in stock market volatility, real domestic government yields, domestic government bond yield volatility, sovereign foreign exchange risk spread, and foreign exchange market volatility; and a fall in real stock market returns, growth of REER and real house prices contribute to higher market stress. FX = foreign exchange; govt. = government; REER = real effective exchange rate; Δ = change in; CN = China; HK = Hong Kong; ID = Indonesia; JP = Japan; KR = Korea; MY = Malaysia; PH = Philippines; SG = Singapore; TH = Thailand; 25 March 2025 is the trough of market stress closer to the Liberation Day, while 14 Apr 2025 is the peak post Liberation Day. Data as of 8 September 2025.

[1] The market stress is calculated based on a three-month rolling window. Therefore, the stress indicator declined notably after three months from the Liberation Day.

Tariffs, politics, and fiscal policy create differentiation among ASEAN+3 assets

ASEAN+3 markets showed divergence in 2025 (Figures 1.23 to 1.26). While some domestic developments were responsible, the divergence also reflected the variety of structures of the economy and markets, which led markets to react differently to the global developments. Notably, the impact of Liberation Day tariff announcements on regional financial assets was a function of the tariff rates and the trade exposure of an economy (AMRO 2025). Higher tariffs and higher exposure to global trade led to weaker stock markets and exchange rates.

Overall, in 2025 (year to date), there was a distinction between the stock markets of Plus-3 and ASEAN economies. Plus-3 stock markets strengthened (except Japan) while those in ASEAN weakened (except Singapore). Government bond yields remained less sensitive to changes in US yields and fell in most of the regional markets. Expectations of monetary easing in response to the negative growth implications of the tariffs were among the driving factors. US dollar weakness was evident against most regional currencies as the bilateral exchange rate became insensitive to yield differentials. That said, some divergence was seen between nominal effective exchange rates, largely reflecting relative spillovers from the tariffs and idiosyncratic factors such as political developments and tariffs. Some of the important idiosyncratic factors relevant for ASEAN+3 asset price movements are:

- After a subdued start to the year, Korean stocks strengthened as the elections in early June provided political stability, fueling market hopes of swift economic stimulus and market reforms. The new government also passed the Commercial Reform Act with the aim to improve valuations of Korean companies (Lee and Lee 2025).[2]

- Expectations of monetary easing pushed bond yields lower in most of the economies except Japan, where rate hikes were expected, and Vietnam, because of expectations for heavier bond supplies (Vu and Guarascio 2025).

- The Indonesian rupiah depreciated on a nominal effective exchange rate basis. The Indonesian rupiah came under pressure as markets evaluated the policy signals and priorities of the new administration inaugurated in October 2024. It also led to a rise in bond yields early in the year; subsequently yields eased as foreign investor demand returned in the second quarter but persistent sale of equities by foreigners limited any positive spillovers to the rupiah.

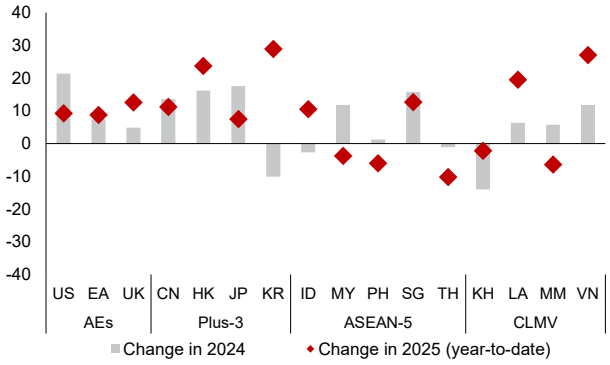
- Thai stock markets also weakened as political uncertainty remained high in 2025 amid a weaker growth outlook (NESDC 2025).

Most regional bond yields have eased more than those of US Treasuries in 2025, which makes their valuations less attractive at the margin as compared to those in 2024 (Figure 1.27). The bond valuations reflect the higher premium demanded by investors from US Treasuries amid fiscal concerns and the expectations of monetary easing by most ASEAN+3 central banks, which pushes domestic bond yields lower. Rising price-to-earnings ratios for most regional equities has also reduced attractiveness from a valuation standpoint. Whereas many regional equity markets have risen in 2025, the earnings outlook has weakened (Figure 1.28). Overall, as compared to 2024, global uncertainties have led to less attractive valuations of regional assets.

[2] The Commercial Act reform aims at modernizing corporate governance, strengthening minority shareholders and tackling the so-called "Korea discount". The discount refers to the lower valuations of Korean companies have been attributed to inferior governance practices as compared to major advanced economies and dominance of conglomerates.

Figure 1.23. Selected ASEAN+3: Changes in Equity Markets
(Percent, log changes)

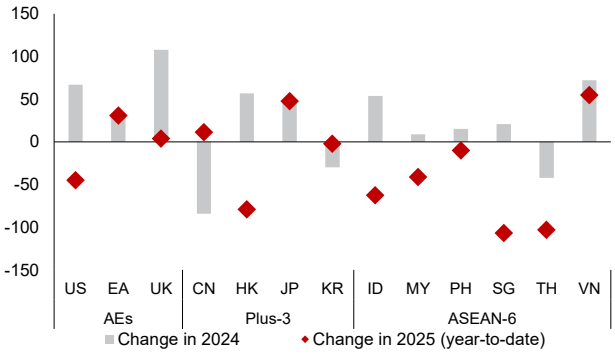
Plus-3 equity markets strengthened while most ASEAN markets weakened.



Source: National authorities via Bloomberg Finance L.P.; Bank for International Settlements; Haver Analytics; AMRO staff calculations.
Note: The DXY Index is used to determine the change in the US dollar. AEs = advanced economies; CN = China; EA = euro area; HK = Hong Kong; ID = Indonesia; JP = Japan; KH = Cambodia; KR = Korea; LA = Lao PDR; MM = Myanmar; MY = Malaysia; PH = Philippines; SG = Singapore; TH = Thailand; UK = United Kingdom; US = United States. VN = Vietnam. Data for 2025 (year to date) as of 8 September 2025.

Figure 1.24. Selected ASEAN+3: Changes in 10-Year Government Bond Yields
(Basis points)

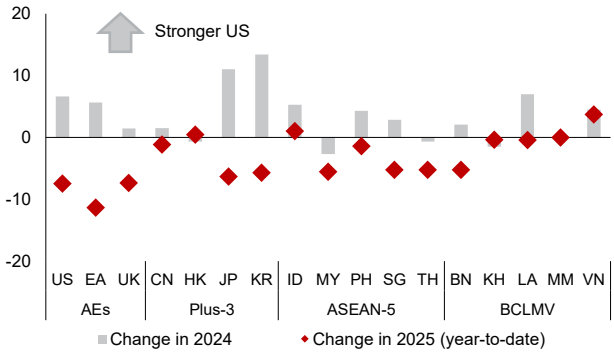
Government bond yields fell in most regional markets.



Source: National authorities via Bloomberg Finance L.P.; Bank for International Settlements; Haver Analytics; AMRO staff calculations.
Note: The DXY Index is used to determine the change in the US dollar. AEs = advanced economies; CN = China; EA = euro area; HK = Hong Kong; ID = Indonesia; JP = Japan; KR = Korea; MY = Malaysia; PH = Philippines; SG = Singapore; TH = Thailand; UK = United Kingdom; US = United States. VN = Vietnam. Data for 2025 (year to date) as of 8 September 2025.

Figure 1.25. Selected ASEAN+3: Exchange Rates Against the US Dollar
(Percent, log changes)

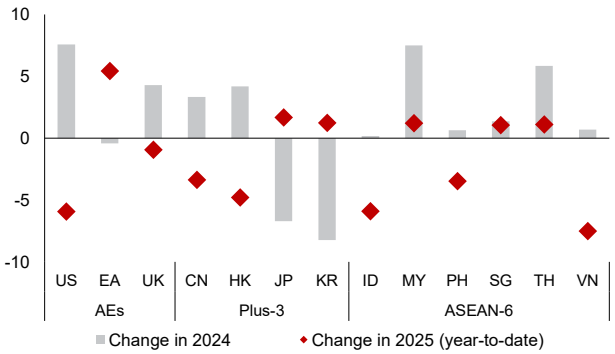
Most ASEAN+3 currencies strengthened against the US dollar.



Source: National authorities via Bloomberg Finance L.P.; Bank for International Settlements; Haver Analytics; AMRO staff calculations.
Note: The DXY Index is used to determine the change in the US dollar. AEs = advanced economies; BN = Brunei; CN = China; EA = euro area; HK = Hong Kong; ID = Indonesia; JP = Japan; KH = Cambodia; KR = Korea; LA = Lao PDR; MM = Myanmar; MY = Malaysia; H = Philippines; SG = Singapore; TH = Thailand; UK = United Kingdom; US = United States. VN = Vietnam. Data for 2025 (year to date) as of 8 September 2025.

Figure 1.26. Selected ASEAN+3: Nominal Effective Exchange Rates
(Percent, log changes)

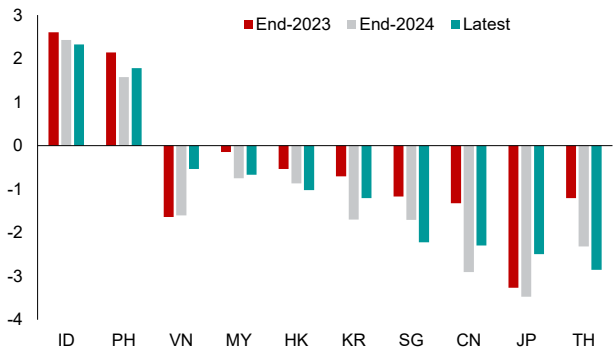
The performance of NEERs in the region diverged.



Source: National authorities via Bloomberg Finance L.P.; Bank for International Settlements; Haver Analytics; AMRO staff calculations.
Note: The DXY Index is used to determine the change in the US dollar. AEs = advanced economies; CN = China; EA = euro area; HK = Hong Kong; ID = Indonesia; JP = Japan; KR = Korea; MY = Malaysia; PH = Philippines; SG = Singapore; TH = Thailand; UK = United Kingdom; US = United States. VN = Vietnam. Data for 2025 (year to date) as of 8 September 2025.

Figure 1.27. Selected ASEAN+3: 10-Year Yield Spread versus US Treasury Yields
(Percentage points)

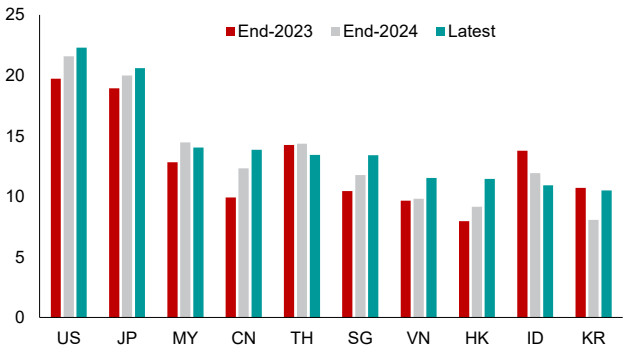
The yield spread over US Treasury for most ASEAN+3 bonds has narrowed.



Source: Bloomberg Finance L.P.; Haver Analytics; AMRO staff calculations.
Note: CN = China; HK = Hong Kong; ID = Indonesia; JP = Japan; KR = Korea; MY = Malaysia; PH = Philippines; SG = Singapore; TH = Thailand; VN = Vietnam. Data as of 8 September 2025.

Figure 1.28. US and Selected ASEAN+3: 12-Month Forward Price-to-Earnings Ratio
(Index)

Change in price-to-earnings ratios for most ASEAN+3 stock markets reflect a weaker earnings outlook because of tariffs.



Source: Bloomberg Finance L.P.; Haver Analytics; AMRO staff calculations.
Note: CN = China; HK = Hong Kong; ID = Indonesia; JP = Japan; KR = Korea; MY = Malaysia; SG = Singapore; TH = Thailand; US = United States; VN = Vietnam. Data as of 8 September 2025.

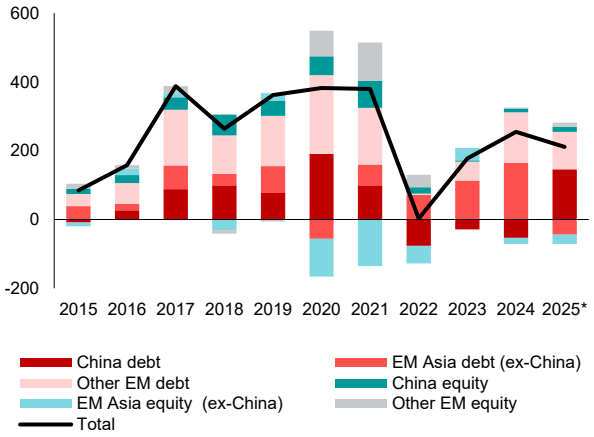
Foreign portfolio investors prefer debt investments over equity

Emerging market portfolio inflows continue to be dominated by debt flows in 2025 (Figures 1.29 to 1.32). Emerging markets outside Asia continued to receive robust inflows but within Asian emerging markets, the inflows were dominated by China. The inflows into China's debt markets resumed in the first half of 2025. The relative stability and lower volatility of Chinese bonds may have been important factors (Yue 2025), attracting foreign investors as fiscal concerns rose in other major economies. China also received modest inflows into its equity markets amid a stock market recovery in 2025.

Equity markets in emerging-market Asia (excluding China) saw outflows in 2025 (year to date). Outflows from equity markets were consistent throughout the first half across countries with growth prospects broadly worsening amid the tariff uncertainty. Korean equity markets were able to garner foreign interest after the June elections as political stability and market reforms provided confidence to international investors. On the other hand, debt markets received inflows across markets during the first half. The debt instruments in most of Asian emerging markets appeared attractive in the context of slowing growth and subdued inflation which can lead to monetary easing and lower rates. Some of these markets acted as an ideal destination for investors to move away from major bond markets on fiscal concerns.

Figure 1.29. Emerging Markets: Annual Portfolio Flows
(Billions of US dollars)

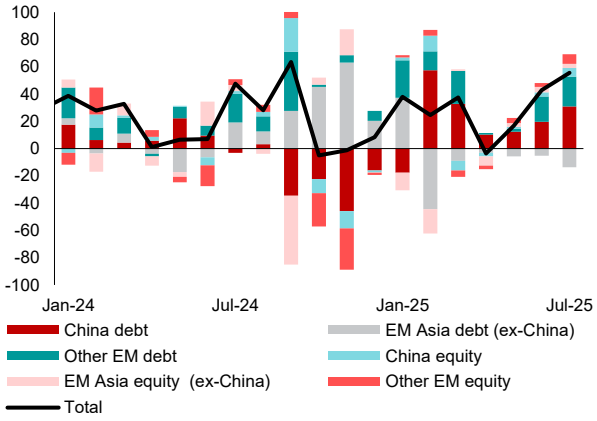
EM portfolio inflows dominated by debt flows in 2025.



Source: The Institute of International Finance via Haver Analytics; AMRO staff calculations.
Note: EM = emerging market. Data as of July 2025.

Figure 1.30. Emerging Markets: Monthly Portfolio Flows
(Billions of US dollars)

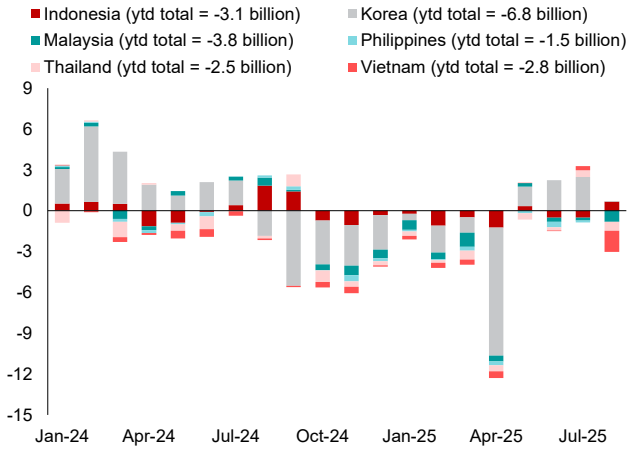
EM outside Asia and China attracted portfolio inflows while EM Asia (ex-China) saw outflow.



Source: The Institute of International Finance via Haver Analytics; AMRO staff calculations.
Note: EM = emerging market. Data as of July 2025.

Figure 1.31. Selected ASEAN+3: Monthly Equity Flows
(Billions of US dollars)

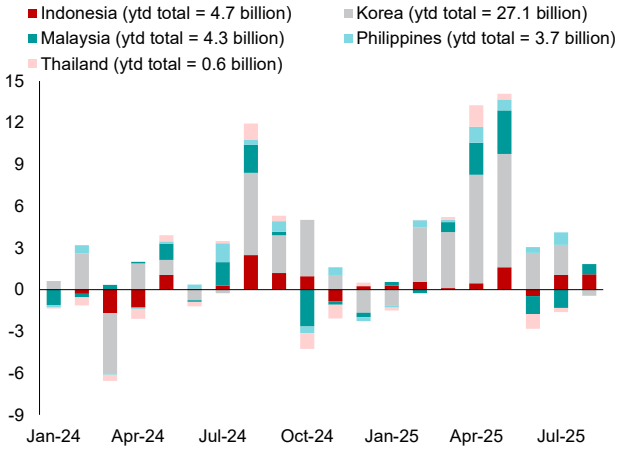
Regional equity markets saw outflows in the first half of 2025 amid worsening growth prospects.



Source: National authorities; Bloomberg Finance L.P; Haver Analytics; AMRO staff calculations
Note: ytd = year-to-date. Data as of August 2025.

Figure 1.32. Selected ASEAN+3: Monthly Debt Flows
(Billions of US dollars)

Regional debt markets received inflows in the first half of 2025 buoyed by monetary easing expectation.



Source: National authorities; Bloomberg Finance L.P; Haver Analytics; AMRO staff calculations.
Note: The debt flows data includes foreign investments in local currency debt only. The data consists only of government bonds for Indonesia and the Philippines, and government and corporate bonds for other markets. ytd = year-to-date. Data as of July 2025 for Philippines and Vietnam, and August 2025 otherwise.

Monetary policy in ASEAN+3 stays on track for gradual interest rate reductions

Many regional central banks are on a path of easing monetary policy to support growth, facing heightened uncertainties from the tariff and geopolitical events while inflationary pressure remains low.

The overarching themes for ASEAN+3 central banks over the past three quarters have been subdued or moderate inflationary pressures and downside risks to growth from US tariffs and potentially weaker global growth and demand (Figure 1.34). This has paved the way for the regional central banks to reduce their policy rates (Figure 1.35). However, the pace has been gradual as central banks exercise caution because of global trade and geopolitical uncertainties. The gradual pace of lowering rates helps the central banks to preserve policy space, ensure currency stability, and limit imported inflation (amid episodes of geopolitical stress leading to rise in commodity prices), while allowing them to monitor the economic effects of the previous rate cuts and providing due consideration to other financial stability risks such as household debt.

However, some central banks are at a different stage of monetary policy.

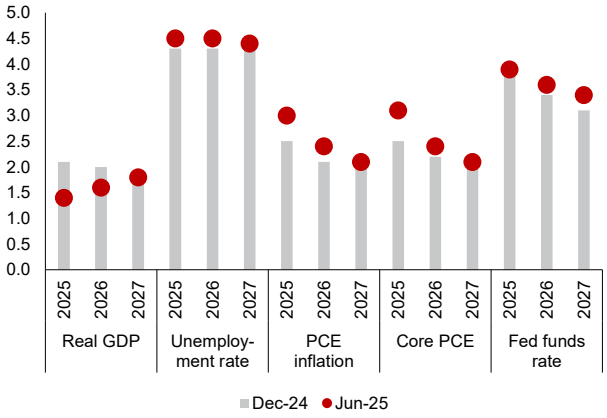
- **Japan:** The Bank of Japan (BOJ) stays on the path of gradual rate hikes. It started raising interest rates in 2024 as it found evidence of a recovery of inflation and strong wage growth, which can help reinforce expectations of self-sustaining inflation. However, global and domestic uncertainties and economic conditions, and the need to avoid premature tightening has led to the BOJ leaving its policy rates unchanged since January 2025.

- **China:** The People's Bank of China (PBC) had embarked on monetary easing in 2023, much earlier than most other regional central banks to provide financial support to the economy and maintained the support through 2024. It delivered another round of monetary easing in May 2025 to maintain a moderately loose monetary policy and strengthen support for the real economy.

- **Vietnam:** The State Bank of Vietnam also eased monetary policy in 2023 but has stayed on hold in 2024 and 2025. However, it maintains an accommodative monetary policy to support growth while restricting inflation below the government's ceiling of 4.5 percent to 5 percent and aims to achieve a credit growth of 16 percent in 2025 (Vu and Hue 2025).

Figure 1.33. Federal Reserve: Change in Summary of Economic Projections from December 2024 to Latest
(Percent)

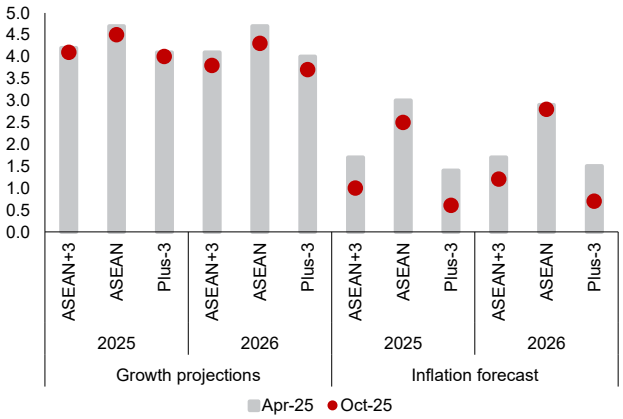
Fed expects lower growth, higher unemployment, and higher inflation.



Source: Federal Open Market Committee projection materials; AMRO staff calculations
Note: PCE = Personal Consumption Expenditures Price. Data as of 8 September 2025.

Figure 1.34. ASEAN+3: Change in AMRO's Growth and Inflation Forecast from April 2025 to October 2025
(Percent)

AMRO lowered growth and inflation forecast for the region.

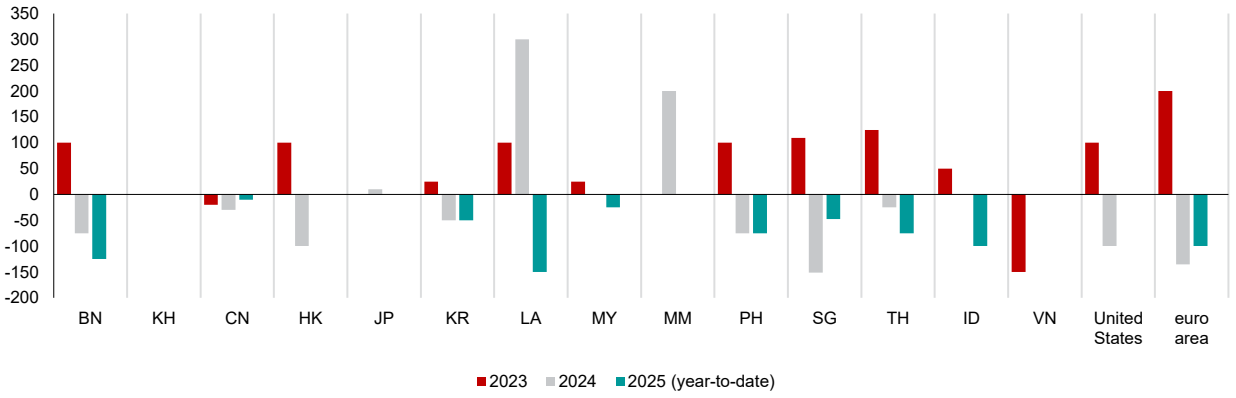


Source: April 2025, October 2025 *ASEAN+3 Regional Economic Outlook (AREO)*; AMRO staff calculations.
Note: Data as of 15 September 2025.

The broad weakness in the US dollar exchange rates has allowed ASEAN+3 central banks to scale back their FX interventions. That said, central banks intervened when exchange rate volatility was high in February and April. The ASEAN+3 currencies have been stable otherwise and ample foreign exchange reserves (Figure 1.36) have further underpinned the currency markets. Most central banks have accumulated FX reserves during the year (Figure 1.37), though some of the rise could be attributed to the valuation effects of a weaker US dollar (which inflates the value of non-dollar assets) and a strong rally in gold prices. Holdings of gold have increased in terms of value but after adjusting for the price, the ASEAN+3 central banks have held their gold holdings stable (Figure 1.38).

Figure 1.35. US, euro area, and ASEAN+3: Change in Monetary Policy Rates
(Percent)

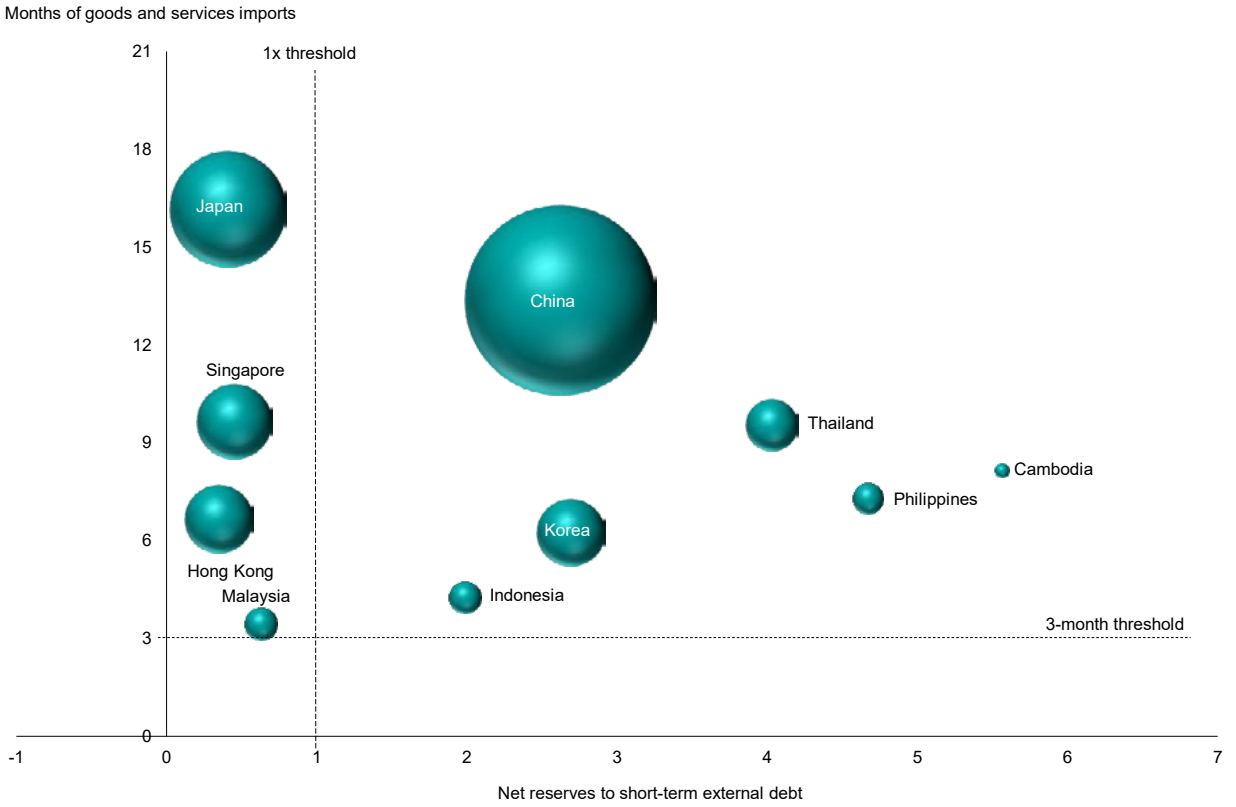
Most central banks in the region cut rates in 2025.



Source: National authorities via Haver Analytics; AMRO staff calculations.
Note: H1 = first half of the year; H2 = second half of the year; BN = Brunei, KH = Cambodia; CN = China; HK = Hong Kong; JP = Japan; KR = Korea; MY = Malaysia; MM = Myanmar; PH = Philippines; SG = Singapore; TH = Thailand; ID = Indonesia; VN = Vietnam; For Brunei, we use the standing facility lending rate. For China, we use the People's Bank of China 7-day reverse repurchase yield. For Hong Kong, we use the Base Rate. Data for 2025 as of 8 September 2025.

Figure 1.36. ASEAN+3: Reserve Adequacy

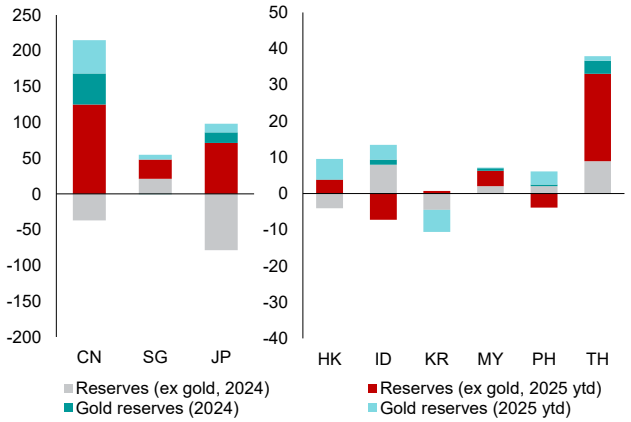
ASEAN+3 maintains solid foreign exchange reserves.



Source: National authorities; International Monetary Fund; World Bank; AMRO staff calculations.
Note: Data for reserves are sourced from either national authorities or IMF IFS database and are as of April 2025, except Cambodia (March 2025). Data for short-term external debt are sourced from IMF Quarterly External Debt Statistics database and are as of the fourth quarter of 2024, except Lao PDR, Myanmar (end of 2021) and Vietnam (end of 2023). Data for goods and services imports are sourced from either national authorities or IMF IFS database and are as of Q4 2024. The size of the bubble denotes the relative amount of each economy's net international reserves in US dollars. Lao PDR and Myanmar are excluded due to lack of short-term external debt data..

Figure 1.37. Selected ASEAN+3: Changes in Foreign Reserves, 2024 and 2025
(Billions of US dollars)

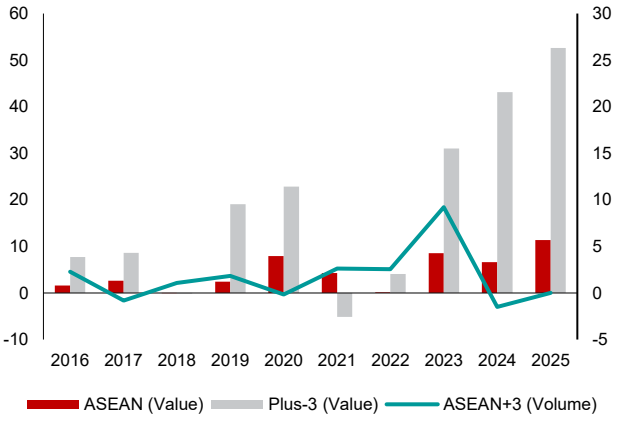
Most central banks in the region have accumulated FX reserves during 2025.



Source: National authorities via Haver Analytics; AMRO staff calculations.
Note: ytd = year-to-date. Data as of August 2025.

Figure 1.38. Selected ASEAN+3: Annual Net Purchases of Gold for Reserves
(Percent, both scales)

The dollar value of ASEAN+3 central bank's gold holdings rose in 2025 as a result of valuation effects.



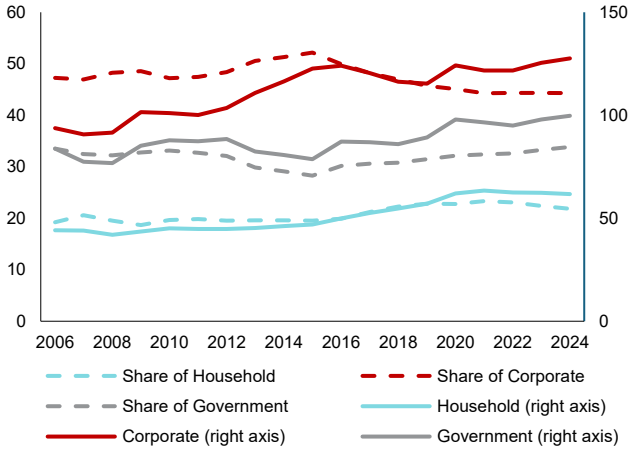
Source: Bloomberg Finance L.P.; National authorities via Haver Analytics; AMRO staff calculations.
Note: Data as of June 2025.

The debt overhang in ASEAN+3 economies persist

The weighted average debt-to-GDP ratio across ASEAN+3 economies rose slightly in 2024 as an uptick in corporate and government debt was partially offset by a reduction in household debt (Figure 1.39). Rising interest rates amid still robust growth outlook may have helped stabilize the debt at elevated levels. Monetary easing in many economies will reduce the debt burden in coming years if debt build-up is restrained. That said, the debt overhang may amplify spillovers from global developments.

Figure 1.39. Selected ASEAN+3: Corporate, Government, and Household Debt
(Percent; Percent of GDP)

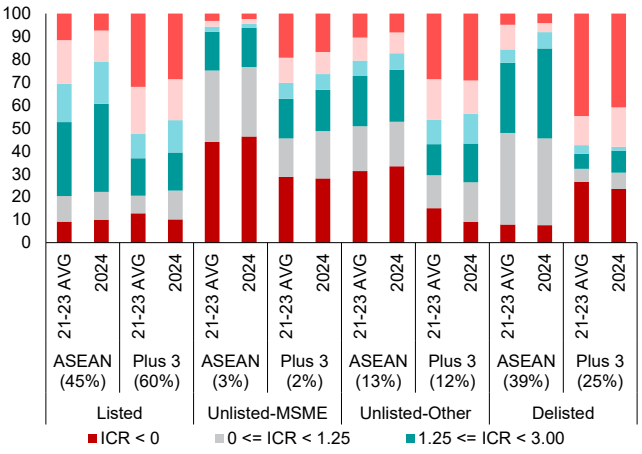
ASEAN+3's total debt-to-GDP ratio rose by 4 percentage points in 2024, driven by corporate and government debt.



Source: Bank for International Settlements (BIS); AMRO staff calculations.
Note: Data covers all economies reporting nonfinancial debt data to the BIS. Selected ASEAN+3 includes China, Hong Kong, Indonesia, Japan, Korea, Malaysia, Singapore, and Thailand. Government debt data for these economies in nominal value, except for Korea, which reports market value.

Figure 1.40. ASEAN+3: Share of Corporate Debt by Interest Coverage Ratio (ICR) Range
(Percent of total debt)

Many unlisted MSMEs may face difficulties in meeting their debt obligations.



Source: Orbis and ARTEMIS[3]; AMRO staff calculations.
Note: Unlisted-Others refers to other subgroups than MSMEs in the "unlisted" category. The number in parenthesis denotes the share of debt by each firm category in ASEAN or Plus 3 in 2024. 21-23 AVG refers to the average level of 2021 to 2023. MSME = micro, small, and medium-sized enterprise.

[3] AMRO members can access corporate debt information compiled by AMRO at https://amro-asia-org.domo.com/page/130520604.

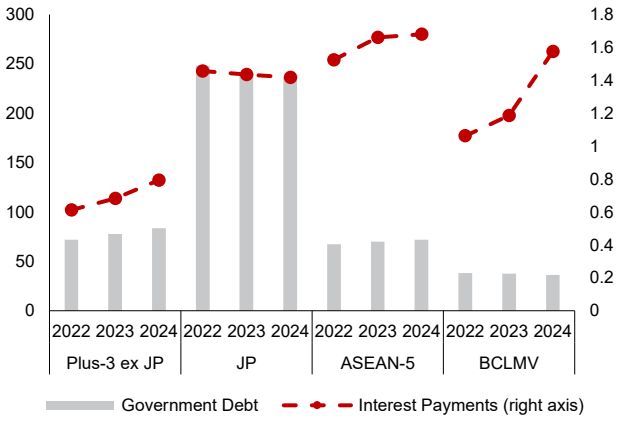
Vulnerabilities in corporate debt remained concentrated among unlisted firms, especially micro, small, and medium-sized enterprises (MSMEs) (Figure 1.40). As of end 2024, roughly half of MSME debt in Plus-3 and about 77 percent of MSME debt in ASEAN carried an ICR below 1.25 at the end of 2024, both marginally higher than in 2023. Among the sectors, property and construction remain the most vulnerable with Debt-at-Risk (DAR)[4] around 3.4 percent of GDP, followed by raw materials at 2 percent and manufacturing at 1.9 percent. A slowdown in global demand, either because of tariffs or other growth shocks, can cause further stress in export-oriented sectors such as manufacturing and raw materials.

The ASEAN+3 government debt to GDP ratio inched higher in 2024 with a more noticeable rise in the Plus-3 economies (excluding Japan) than ASEAN economies. The interest burden remained stable for Japan but rose for other Plus-3 and ASEAN-5 economies due to the elevated debt and higher interest rates. The BCLMV economies saw a steeper rise in debt service burden mainly driven by substantial external public debt interest payments due from Lao PDR in 2024, which were nearly double the amount in 2023 (Figure 1.41). The composition of debt, which generally has a well spread-out maturity profile, and most bonds, being fixed-rate and denominated in local currencies, should limit any near-term rollover and interest rate risks.

Investor composition also matters. Multiple studies[5] have shown that foreign investors—particularly foreign nonbank investors—tend to have higher demand elasticity than other investor groups, making them more prone to sudden and large-scale withdrawals during periods of stress. However, the share of foreign holdings in ASEAN+3 government debt is generally lower than the global average (Figure 1.42). In an environment where global investors are becoming increasingly sensitive to the fiscal situation of major economies, fiscally prudent emerging markets with lower foreign positioning could attract more foreign demand.

Figure 1.41. Selected Economies: Government Debt and Interest Payments
(Percent of GDP)

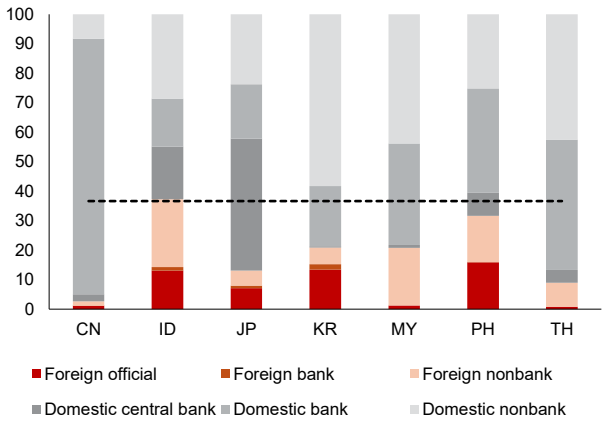
Rising government debt and higher interest rates drove up interest payments.



Source: National authorities via CEIC and Haver Analytics, IMF WEO April 2024 and AMRO staff calculations.
Note: Government debt-to-GDP is GDP-weighted, and interest payments-to-GDP is the simple average, both based on fiscal-year data for economies in each group. Plus-3 ex-JP = China, Hong Kong, and Korea; JP = Japan; ASEAN-5 = Indonesia, Malaysia, Philippines, Singapore, and Thailand; BCLMV = Brunei, Cambodia, Lao PDR, Myanmar, and Vietnam.

Figure 1.42. Selected ASEAN+3: Investor Composition of Government Debt
(Percent)

Most ASEAN+3 markets' foreign positioning were lower than the global average.



Source: International Monetary Fund; AMRO staff calculations.
Note: The dotted line represents a global average of the foreign investor holding ratio. CN = China; ID = Indonesia; JP = Japan; KR = Korea; MY = Malaysia; PH = Philippines; TH = Thailand. Data are as of the second quarter of 2024.

ASEAN+3 financial institutions remain sound

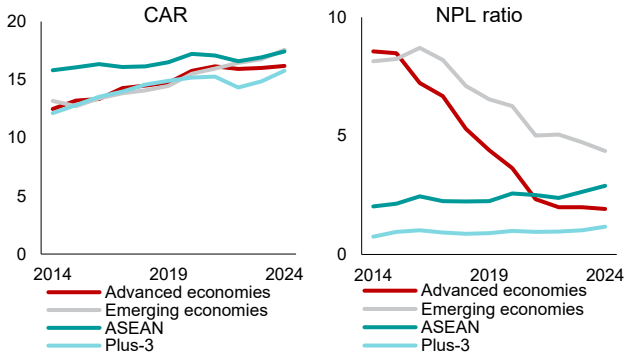
Adequate capital levels and stable asset quality have continued to underpin the resilience of the ASEAN+3 banking system (Figure 1.43). In 2024, banks in the region further strengthened their capital buffers and stayed well above regulatory thresholds. While nonperforming loan (NPL) ratios rose slightly in some economies, Plus-3 banks still recorded some of the lowest levels globally, and ASEAN banks' NPL ratios remained broadly in line with the global average.[6]

Profitability improved in recent years, supported by policy rate increases that widened lending spreads and increased net interest margins, especially in ASEAN, where banks remain more reliant on interest income. Both net interest margins and returns on assets have risen steadily in ASEAN over the past few years, whereas gains have been more modest in Plus-3 economies (Figure 1.44), where margin compression continues to weigh on profitability.

[4] DAR is defined as ICR below 1.25.
[5] Saito and Hogen (2014), Park, Taniguchi, and Tian (2018), Fang, Hardy, and Lewis (2023), Eren, Schrimpf, and Xia (2023), IMF (2023).
[6] That said, in some economies, the COVID-related regulatory forbearance measures may not have been fully normalized, which could mask the true underlying conditions or financial soundness of the banking system.

Figure 1.43. Selected Regions: Total Capital Adequacy Ratio (CAR) and Nonperforming Loan (NPL) Ratio
(Percent)

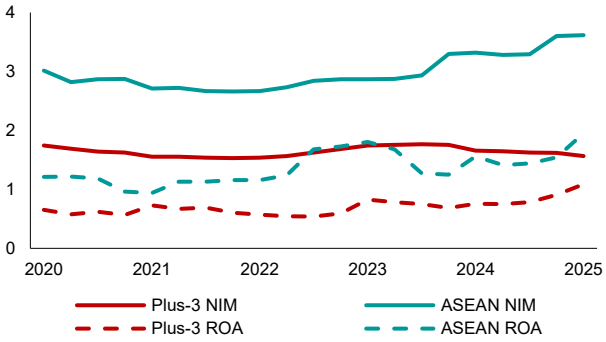
ASEAN+3 banks maintained high asset quality and showed resilience with robust capital buffers, mitigating credit risks.



Source: National authorities; International Monetary Fund via Haver Analytics; AMRO staff calculations.
Note: Simple averages of economies in each group. Due to data availability, 'ASEAN' does not cover Lao PDR, Myanmar, and Vietnam. Advanced economies refer to selected economies in North America and Western Europe. Emerging economies refer to selected economies in Latin America and Eastern Europe. For countries that have not released end-2024 data, the latest available quarter data was used.

Figure 1.44. ASEAN+3: Return on Assets (ROA) and Net Interest Margin (NIM)
(Percent)

ROA and NIM trended upward for ASEAN, supported by increased interest rates.



Source: CEIC, AMRO staff calculations.
Note: Simple average of economies in each group. Data as of the first quarter of 2025.

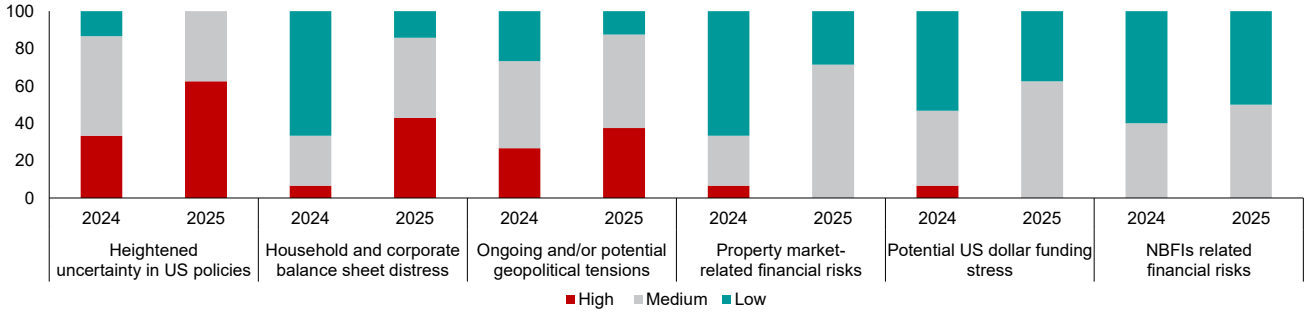
Despite pockets of vulnerability—such as deteriorating asset quality in property-related exposures and an increasing reliance on non-deposit market-based funding highlighted in Chapter 2 of the 2024 *ASEAN+3 Financial Stability Report*—banks have generally managed well in absorbing monetary policy shocks and promoting financial digitalization. First, as discussed in Chapter 2 of this report, the banking sector has demonstrated resilience to monetary tightening: a 1 percentage point increase in global policy rates would, on average, raise NPL ratios in the region by just 0.1 percentage point and have minimal impact on CARs. Second, as noted in Chapter 3, banks have played a crucial role in advancing digitalization while balancing innovation with financial stability through the modernization of banking services driven by technological advancements, evolving structures, and proactive risk management.

II. Risks

The primary risks to financial stability in ASEAN+3 emerge from external developments, but some idiosyncratic issues could be a source of fragility. The external risks are concentrated around the US policy uncertainty, especially corporate credit risks associated with US trade policies, and potential market risks associated with continued worries about the safe haven status of the US dollar and assets. At the same time, geopolitical risks persist, and their escalation could have significant impact on financial systems in ASEAN+3. AMRO survey of member authorities indicates increased concerns around spillovers from US policy uncertainty and household and corporate balance sheet stress compared to last year. At the same time, the perceived likelihood of property market related financial risks and US dollar funding stress have reduced (Figure 1.45).

Figure 1.45. AMRO Member Survey: Perceived Likelihood of Key Risks in 2025
(Share of respondents)

The survey results show increased concerns about US policy spillovers, and household and corporate balance sheet stress.



Source: AMRO's survey of member authorities.
Note: For "Heightened uncertainty in US policies", the 2024 survey referred specifically to monetary policy spillovers, while the 2025 survey referred to trade policy. Note: Simple average of economies in each group. Data as of the first quarter of 2025.

Spillovers from US policy uncertainty

The growth impact of US tariffs can have a material spillover on the health of the export-oriented companies in some of the ASEAN+3 economies. The impact of tariffs will largely depend on the pricing power of these companies in the US. Anecdotal evidence exists on either side of the spectrum. Whereas some exporters may not raise their prices for the US consumer and will absorb the tariff impact (Reuters 2025), others are passing the tariff costs to the consumers (Tewari 2025). However, in either case, it is likely that the profitability of these firms is impacted.

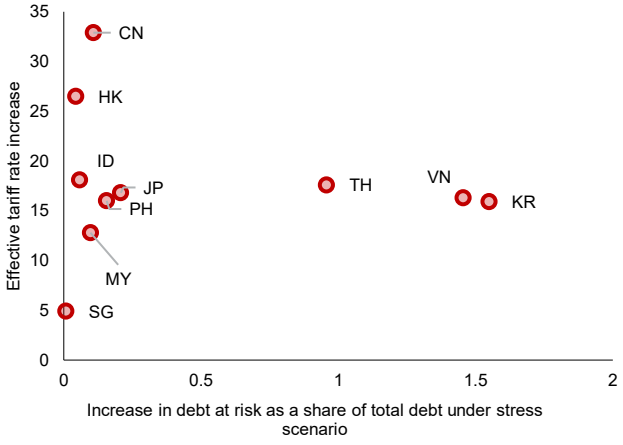
The impact could be particularly severe for smaller companies which may have concentrated exposure to US demand, either directly or through global supply chains. Indeed, companies directly exposed to US markets would be more vulnerable to the shocks and though the data about US share in corporate revenues in ASEAN+3 is not available, we look at the sensitivity of debt-at-risk to a 10 percent shock in revenues. We find that most countries in the region, on aggregate, are resilient to a blanket revenue shock but the concentration of risks in certain sectors and types of firms could be exposed in adverse scenarios. Companies in countries facing higher tariffs (Figure 1.46) could be more vulnerable to spillovers from US tariffs.

Unlisted MSMEs in raw materials and manufacturing have relatively higher levels of debt-at-risk and these firms exporting to the US may need closer monitoring. The health of MSMEs is especially important because they employ almost 60 percent of the working population in developing Asia (ADB 2024). Though export-oriented MSMEs are still fewer in number, any stress in the sector could have widespread consequences for the economy.

The growing uncertainties could also prompt banks in many ASEAN+3 economies to shift further toward lower-risk assets. Banks in most of the region's economies have reduced their risk-weighted asset intensity[7] since 2020, indicating a broad move toward safer exposure (Figure 1.47). The growth impact of US trade policies could cause central banks to lower policy rates to support domestic industries and could reverse some recent gains in bank profitability. Lower interest rates could compress net interest margins, particularly for banks in economies that remain heavily reliant on lending income. Notably, Vietnam and Cambodia have reduced risk-weighted asset intensity since 2020 but still maintain relatively high exposure to riskier segments, while Lao PDR has recorded a notable increase in intensity, suggesting a shift toward higher-risk assets, partly from increased lending to households and infrastructure projects, as well as regulatory tightening. However, this shift has been accompanied by sufficient capital levels, with CARs above regulatory requirements, indicating that banks in these economies continue to maintain adequate buffers to absorb potential losses.

Figure 1.46. US Effective Tariff Increase and Corporate Debt at Risk Sensitivity
(Percent)

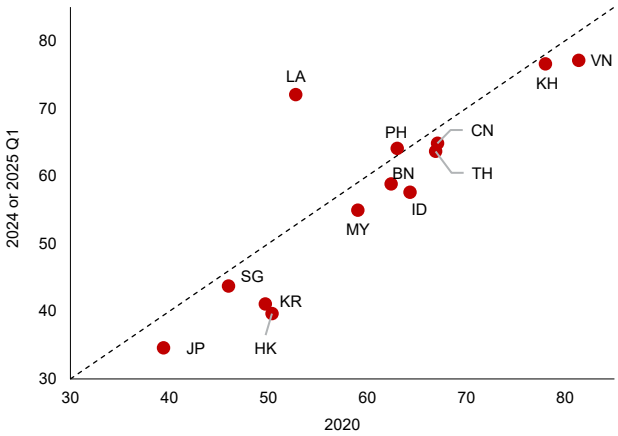
Revenue shock has a marginal impact on overall debt-at-risk, but some sectors and firms may face greater stress.



Source: Orbis and AMRO staff calculations.
Note: Effective tariff rate increase is calculated as the August 7 effective tariff rate (as described in AMRO 2025b) less the end-2024 effective tariff rate (calculated as actual US customs tax collected as percentage of import from the trading partner). Increase in Debt at Risk (DAR) as Share of Total Debt under Stress Scenario denotes the rise in DAR following a 10 percent revenue shock, after accounting for firms' cash buffers. CN = China, ID = Indonesia, JP = Japan, KR = Korea, MY = Malaysia, SG = Singapore, TH = Thailand, VN = Vietnam.

Figure 1.47. ASEAN+3: Five-Year Change in Risk-Weighted Asset Intensity
(Percent)

Most economies show declining risk-weighted asset intensity, indicating a move toward safer asset profiles.



Source: Moody's BankFocus, AMRO staff calculations.
Note: BN = Brunei; CN = China; HK = Hong Kong, ID = Indonesia; JP = Japan; KH = Cambodia; KR = Korea; LA = Lao PDR; MY = Malaysia; PH = Philippines; SG = Singapore; TH = Thailand; VN = Vietnam

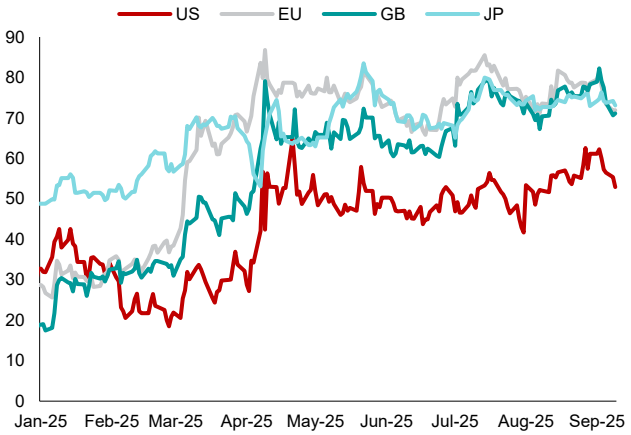
[7] Risk-weighted asset intensity is defined as the ratio of risk-weighted assets to total assets, reflecting the average riskiness of a bank's asset portfolio.

Markets have become more sensitive to fiscal risks

Finally, the fiscal policy uncertainty that emerged from the US has quickly spread to other major advanced and emerging markets. Markets may have become less tolerant of fiscal indiscipline. Bond yields have reacted significantly to inflationary fiscal policies in the US and other developed markets as reflected in the rise of the 10-year versus 2-year yield spreads— i.e., yield curves have steepened (Figure 1.48). The steepening pressures on most ASEAN+3 markets have been limited so far. Even as about half of the emerging market ASEAN+3 yield curves have steepened in 2025 (Figure 1.49), the steepness can partly be attributed to spillovers from global developments as term premiums have risen in global bond markets. However, the emergence of fiscal concerns in any of the ASEAN+3 economies could force investors to demand higher term premiums and reduce demand of domestic bonds.

Figure 1.48. Selected Advanced Economies: 10-Year versus 2-Year Yield Spread
(Basis points)

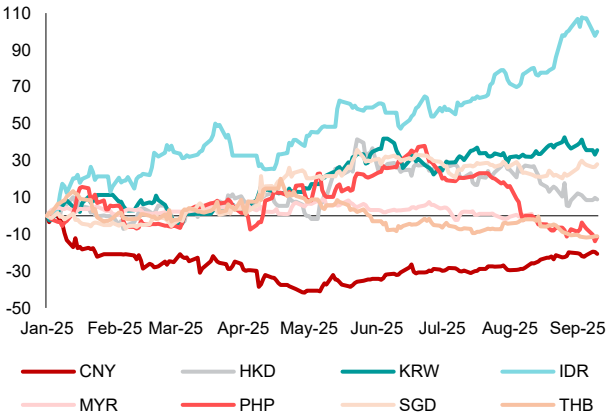
Major advanced economy yield curves steepened in 2025.



Source: Bloomberg Finance L.P.; AMRO staff calculations.
Note: GB = Great Britain. Data as of 9 September 2025.

Figure 1.49. Selected ASEAN+3: 10-Year versus 2-Year Yield Spread
(Basis points, indexed on 1 January 2025)

The steepening in most ASEAN markets has been limited.



Source: Haver Analytics; AMRO staff compilation.
Note: Data as of 9 September 2025.

Revaluation of US dollar's safe status

Market scrutiny of the US dollar's safe haven status can have positive implications for the region but could also create other vulnerabilities for the financial system. Concerns around the status could reduce the attractiveness of the dollar in financial and real transactions, which will—at the margin—reduce the reliance of ASEAN+3 financial institutions on dollar funding and so reduce one of the important risks to financial stability in the region (Chapter 3 of the 2024 *ASEAN+3 Financial Stability Report*). Diversification away from the dollar (and probably dollar assets) could stimulate capital inflows into regional economies. The absence of a single comparable alternative to the dollar could act as a catalyst for the use of regional currencies for cross-border transactions in ASEAN+3, further strengthening the momentum of regional integration.

That said, the diminishing safe haven status of the US dollar could create some risks:

- Absence of a comparable alternative to the US dollar risks creating a fragmented international financial system. The reliance of regional financial institutions on external financing may not be reduced but may shift from the dollar to a basket of other currencies, thus making it more expensive and inefficient to procure liquidity from international markets and manage their FX exposures. Such fragmented markets would be susceptive to more information asymmetries which will further complicate liquidity management.

- Assets denominated in US dollars account for about half of global equity markets and about 40 percent of global bond markets. If the dollar loses its safe haven status, that could create valuation pressures or even bubbles in other assets perceived to be safer. In such a scenario, the volatility of these assets could rise.

- US Treasury yields have long served the international financial system as a risk-free anchor. However, as the safe haven status erodes, US Treasuries would no longer be risk-free assets and the markets would be dependent on private signals and relative valuations, which could increase volatility and a structurally higher risk premium (Landau 2025).

Geopolitical risks continue to linger

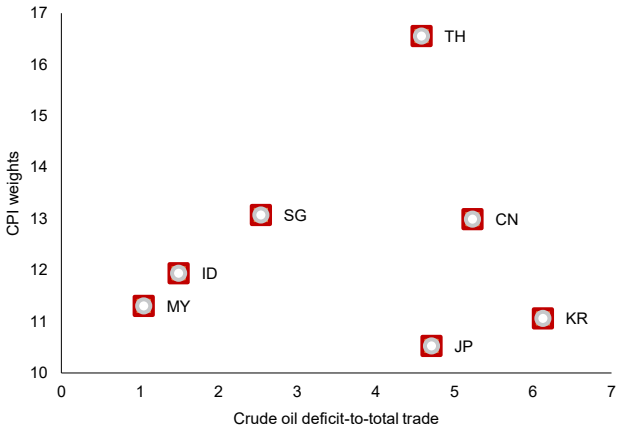
Geopolitical tensions and escalations were highlighted as a financial stability risk in Chapter 1 of the *ASEAN+3 Financial Stability Report 2024*, and the risks continue to linger in the background. The tensions in the Middle East and Russia-Ukraine war have failed to subside while geopolitical tensions have increased in other parts of the world. That said, conflicts in the Middle East pose a greater risk to ASEAN+3 economies. These could cause oil prices and shipping costs to rise, thus adding to supply-side inflationary pressure and market volatility. Notably, since many ASEAN+3 economies are net oil importers, rising oil prices lead to currency depreciation as terms of trade worsen. In addition, inflationary pressures could be higher in economies with a higher weight of energy-dependent transport sector in CPI basket (Figure 1.50). Our analysis shows that regional currencies face depreciation pressures when supply-side factors lead to higher oil prices (Figure 1.51). An escalation of geopolitical tensions also hurts market sentiment. As seen in the Israel-Iran conflict in June, these events can cause risk aversion and, in an extreme scenario, trigger capital outflows from the region.

Property market weakness has eased but still warrants monitoring

The property market in some ASEAN+3 economies saw a significant downturn after the pandemic (Figure 1.52). There were concerns that the decline, in an environment of high interest rates and financially vulnerable developers, could pose a risk to financial stability (Chapter 2 of the *ASEAN+3 Financial Stability Report 2024*). However, authorities have managed to ringfence the stress emerging from the property sector. For instance, China's government has implemented real estate stimulus policies over the past two years to stabilize market expectations and support reasonable housing demand. However, the situation may still require continued monitoring, policy support, and structural reforms to ensure the long-term stability and health of the property market (Box 1.4). On the other hand, in a few regional property markets prices have risen sharply in the past couple of years and, in some cases, authorities have intervened. For example, price growth in Singapore moderated after the implementation of measures such as higher stamp duty for buyers, tighter loan-to-value ratios, and stimulating supply by increasing government land sales.

Figure 1.50. Selected ASEAN+3: Transportation Weights in the CPI Basket and Crude Oil Deficit
(Percent; Percent)

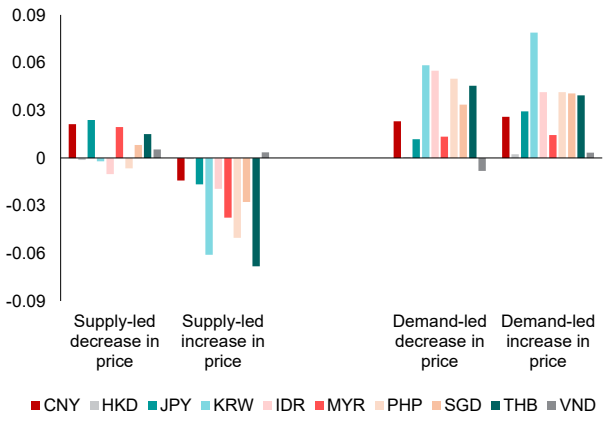
Larger crude oil deficits and energy-intensive CPI baskets could raise inflationary pressures.



Sources: Haver Analytics; AMRO staff calculations.
Note: CPI = Consumer Price Index. The y-axis contains the weightage of transportation in the CPI basket in 2024 for all economies other than China. For China, the weightage of transportation and communication in the CPI basket in 2024 is displayed. The x-axis lists the crude oil deficits (total crude oil imports – exports) scaled by total trade (goods exports + goods imports) for 2024. CN = China; JP = Japan; KR = Korea; ID = Indonesia; MY = Malaysia; SG = Singapore; TH = Thailand.

Figure 1.51. Beta of Supply and Demand-side Oil Price Changes to ASEAN+3 Currency Changes
(Coefficient)

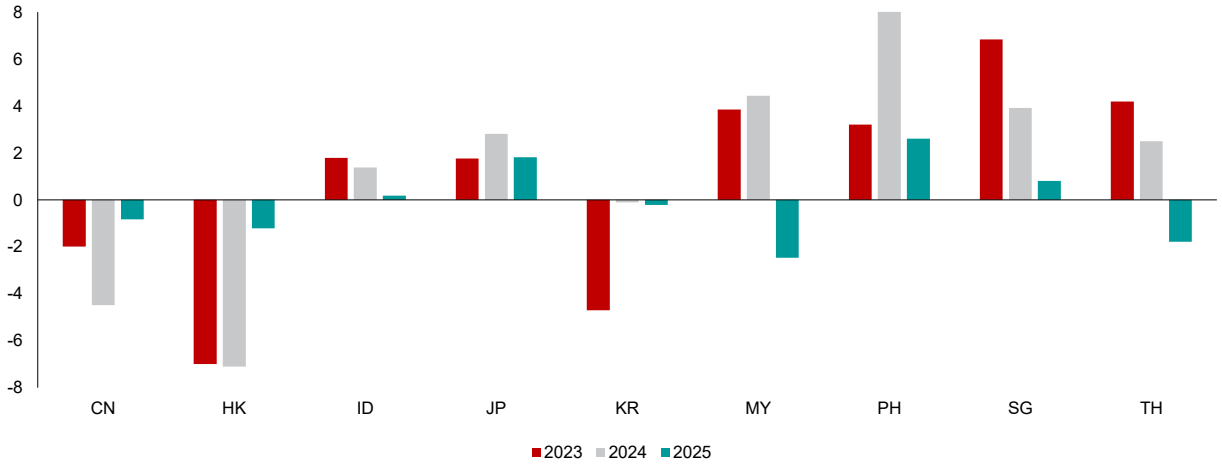
Supply-led increases in oil prices can lead to currency depreciation pressures.



Sources: Bloomberg Finance L.P.; AMRO staff calculations.
Note: Daily supply- and demand-side oil price changes are first sorted into price decreases and increases. Betas between daily individual currency changes and the corresponding price changes for decreases and increases are then calculated. CNY = Chinese yuan; HKD = Hong Kong dollar; JPY = Japanese yen; KRW = Korean won; IDR = Indonesian rupiah; MYR = Malaysian ringgit; PHP = Philippine peso; SGD = Singapore dollar; THB = Thai baht; VND = Vietnamese dong. Data are from 1 April 2021 to 15 August 2025.

Figure 1. 52. Selected ASEAN+3: Residential Property Price Indices
(Percent, year-on-year)

The property market downturn is easing in China, Hong Kong, and Korea; meanwhile, property prices are rising in some ASEAN economies.



Source: Bank for international Settlements (BIS) residential property price database.
Note: CN = China; HK = Hong Kong; ID = Indonesia; JP = Japan; KR = Korea; MY = Malaysia; PH = The Philippines; SG = Singapore; TH = Thailand. For CN, HK, KR, and TH, monthly data as of April 2025 (except China, where May 2025 data is available) are used, whereas for ID, JP, MY, PH, and SG, quarterly data as of Q1 2025 are employed.

Box 1.4:

Implications of Stress in China's Property Sector for Financial Stability

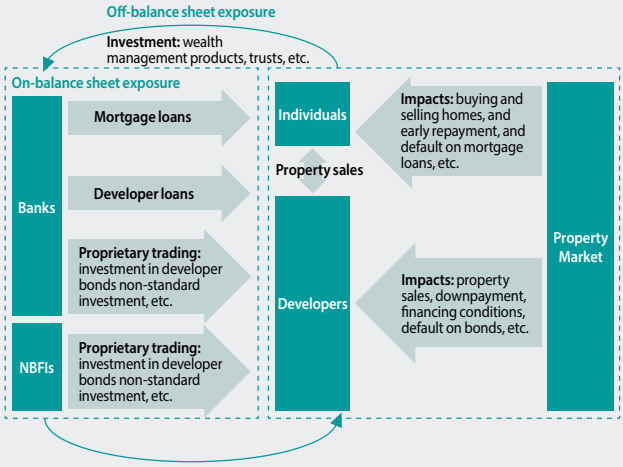
The adjustment of the Chinese real estate market has evolved into a long-term challenge for financial stability. The market has been in a prolonged downturn since May 2022, worsened by the COVID-19 pandemic. Residential property prices have dropped (Figure 1.4.1), leading to a devaluation of collateral and potential asset quality deterioration for banks, which could increase nonperforming loans (NPLs). The reduced sales constrained developers' cash flows, heightening the risk of defaults. More than 50 Chinese developers have defaulted on more than USD 60 billion of dollar-denominated bonds, causing market volatility and downgrades in credit ratings.

Figure 1.4.1. Residential Property Prices and Sales Volumes

(Millions of square meters; Index, 2020 = 100)

Source: National Bureau of Statistics.

Figure 1.4.2. Interconnectedness of the Financial system and Real Estate Sector



Source: AMRO staff compilation.

The Chinese financial system's exposure to real estate is concentrated in bank loans. Developers, individuals, banks, and nonbank financial institutions (NBFIs) collectively form a comprehensive investment and financing system in the real estate market (Figure 1.4.2). The sector's link to financial institutions, especially commercial banks, is significant, as their on-balance sheet exposure includes mortgage loans, developer loans, and property-related investments. NBFIs have limited exposure, primarily through proprietary investments. In addition, off-balance-sheet risks exist through wealth management products and trust investments, presenting further credit risks despite indirect exposure.

The proportion of real estate exposure of financial institutions has been continuously decreasing in recent years. On-balance-sheet exposures peaked in 2022 but has stabilized since then with the proportion of total assets declining steadily from 2021 to 2024 (Figure 1.4.3). This decrease is due to stricter regulations, such as lending caps and increased risk management, along with financial institutions reducing exposure to mitigate risks amid the market downturn. NBFI exposure is much smaller, and off-balance-sheet exposure, particularly in real estate trusts, is now half of its peak (Figure 1.4.4).

The real estate-related risks faced by financial institutions can be channeled through asset quality and profitability. Due to the real estate downturn and stagnant income growth, the nonperforming loan ratio of mortgages rose to 0.7 percent in 2024, twice the rate in 2015. Developer loans have seen a significant decline in asset quality, with the nonperforming loan ratio rising materially from 2021 to 2023 before a slight decrease in 2024 (Figure 1.4.5). Banks face growing profitability pressures as accommodative monetary policy has driven down the weighted average mortgage lending rate from 5.63 percent in 2023 to 3.1 percent in 2024. This, along with negative growth in mortgage loan balances, has shrank banks' net interest margins.[1]

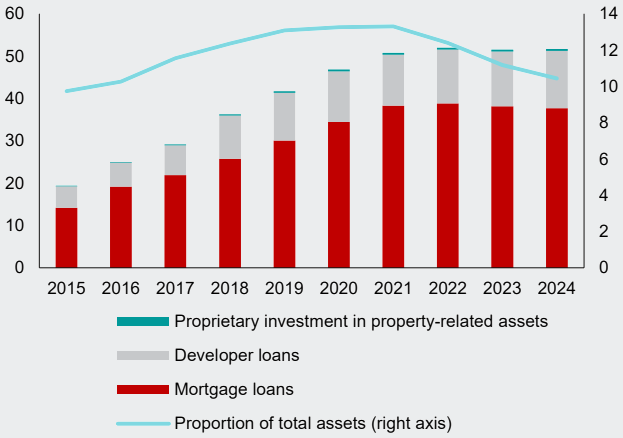
The author of this box is Yang Jiao.

[1] The NIM of China's banking sector has narrowed from 2.18 percent in 2018 to 1.52 percent in 2024.

The reduction in mortgage loan outstandings and interest income accounts for about 11 percent of the banking sector's overall profitability.[2] Despite Proprietary investments and WMPs' smaller scale, these are still highly exposed to risks. In 2024, 27 defaults occurred in RMB 34.2 billion of real estate bonds, representing 27 percent of all defaults in the bond market. Real estate bond markets have also been volatile (Figure 1.4.6).

China needs to further enhance the supervision and disposal mechanisms for the financial sector's real estate-related businesses. Banks could diversify their asset allocation in low-risk, high-liquidity instruments and reduce their exposure to real estate assets. For nonperforming assets tied to real estate, asset securitization and the transfer of asset income rights are viable solutions. Since August 2023, the Chinese government has implemented a series of real estate stimulus policies, including reducing the downpayment ratio and mortgage interest rates, relaxing purchase restrictions, supporting developer financing, and promoting the "guaranteeing the delivery of buildings" policy. These measures have stabilized market expectations and support reasonable housing demand, but their long-term effectiveness will depend on a sustained recovery in consumer confidence and the broader economy. Continued policy support, coupled with structural reforms to address systemic risks, will be essential to ensure the stability and healthy development of the real estate market.

Figure 1.4.3. Financial system on-balance sheet exposure to real estate sector
(Trillions of Chinese renminbi; Percent)

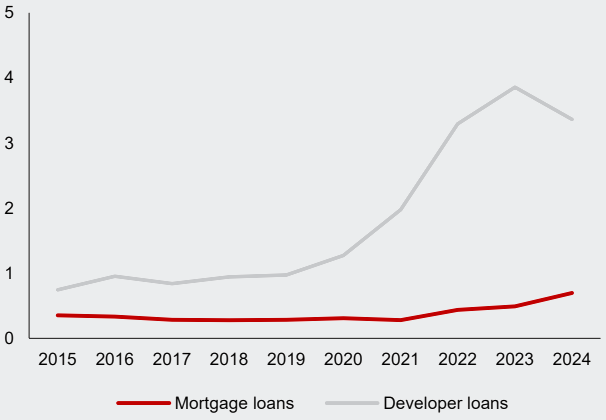


Source: People's Bank of China; China Central Depository and Clearing Company; Shanghai Clearing House; Shanghai Stock Exchange.

Figure 1.4.4. Real estate trust
(Billions of Chinese renminbi)

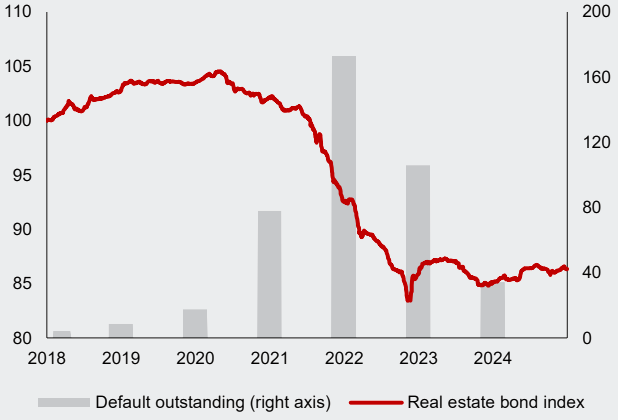
Source: China Trustee Association.

Figure 1.4.5. NPL ratios
(Percent)



Source: Wind.
Note: The weighted average NPL ratios for mortgage and developer loans are calculated from annual financial reports of 42 listed banks.

Figure 1.4.6. Real estate bonds index and defaults
(Index, 2018 = 100; Billions of Chinese renminbi)



Source: Wind.

[2] Assuming the mortgage loan balance continues to grow at the average rate of the past five years, the expected mortgage loan balance in 2024 would be RMB 42.86 trillion. However, the actual mortgage loan balance in 2024 was RMB 37.56 trillion. Whereas the NIM was expected to be 2.09 percent in 2024, assuming its grew at the average rate over the past five years, the actual NIM in 2024 was 1.53 percent. The decrease in this loan balance, combined with the impact of declining interest rates on NIM, is factored in to assess the effect on the banking sector's profitability, which is reduced by RMB 320 billion. This accounts for about 11 percent of banking sector profits in 2024, which totaled RMB 2.89 trillion.

III. Policy Discussion

Heightened US policy uncertainty and geopolitical tensions are major risks to growth and financial stability in the ASEAN+3 region. While the tariff announcements and geopolitical issues created market volatility, the appreciation of regional currencies against the US dollar helped to cushion spillovers to regional financial markets and reduced the risks of supply-side inflationary pressures. Risks to the outlook remain, with pockets of vulnerability especially evident in export-oriented MSME sectors. Continued monitoring and identification of vulnerabilities is essential to help devise preemptive policy actions. Such monitoring should span across all types of firms and industries to the extent possible in order to safeguard against potential financial stability risks arising from sectors that could be beyond regulatory reach.[8]

The ASEAN+3 policy mix, therefore, needs to focus on mitigating risks to financial stability from external uncertainty while supporting domestic growth and keeping inflationary pressure in check. As discussed in Chapter 2, ASEAN+3 authorities will need to strengthen their domestic policy frameworks and bolster regional resilience to mitigate spillover risks from monetary policies and market volatility in advanced economies.

Compared to the US, regional economies face a less complicated challenge in the absence of significant upside risks to inflation. This will allow ASEAN+3 monetary and fiscal policies to focus on supporting growth, while remaining aware of the uncertain outlook. Monetary and fiscal policies could have different roles, based on domestic economic and market conditions and the available policy space. Monetary policy can support the economy in a broad-based slowdown, while fiscal policy can be more targeted to vulnerable sections. If needed, macroprudential measures can also be activated to complement monetary and fiscal policies, should financial stability issues, such as a build-up in debt, arise.

That said, policy support should be provided prudently. With heightened external uncertainty, careful calibration of fiscal and monetary policies to strike a balance between timely policy actions and preserving policy space for future shocks would be essential. Preserving monetary policy space can help limit further spillovers from global market stress. Many regional central banks have moderated the pace of rate cuts to promote exchange rate stability and discourage volatile capital outflows. Moderating monetary easing can also help manage the risk of imported inflation, especially since geopolitical tensions persist. In fact, in an extreme scenario, volatility in commodity prices and supply chain disruptions could create upside risks to inflations, which may require a shift towards monetary tightening. However, elevated policy rates alone may not ensure exchange rate stability during heightened global market stress and may require authorities to intervene in the markets to curb volatility. Finally, while monetary policy can play an important role in managing the external shock, it also needs to account for domestic vulnerabilities.

Fiscal policy can also be used effectively to build resilience to external shocks. The uncertain outlook makes it important for fiscal policy to remain agile and flexible to respond swiftly and, if needed, preemptively to emerging shocks. ASEAN+3 economies have used fiscal policy in close coordination with monetary policy to mitigate supply-side inflation risks and support growth. However, weakened fiscal position and narrowed fiscal buffers may limit the effectiveness of fiscal support (AMRO 2024b). Fiscal discipline can also prevent bond market volatility. As seen in the first half of 2025, deepening fiscal concerns led government bond yields and volatility to rise in many advanced economies, indicating increased sensitivity of bond investors to fiscal risks. The risk of severe bond market reactions can be mitigated with well-targeted fiscal policies while staying committed to medium-term fiscal consolidation.

The risks around the US fiscal situation and growth outlook amid concerns about the consequences of the US dollar losing its safe haven status could also repel investors from US bonds and equities. These flows could be partially reallocated to ASEAN+3 assets. Even as such foreign portfolio inflows could be supportive of domestic financial stability in the near term, authorities need to stay vigilant on potential asset price misalignments and excessive credit growth.

[8] This includes large conglomerates. Structurally, some economies suffer from the opaque relationships between banks and conglomerates. These linkages could cause systemic risks to arise not only from direct linkages but also from market sentiment, which tends to deteriorate in the event of global shocks. The primary issue is the difficulty in quantifying these linkages and the spillovers due to lack of data, differences in institutional frameworks, and the high-level of interagency coordination required to address these issues.

The diminishing attractiveness of the US dollar as a safe asset could help reduce vulnerabilities to dollar financing risks. The ASEAN+3 region has been vulnerable to dollar funding shortages during adverse market conditions but when the US dollar is weak, these risks are typically lower (Chapter 3 of the *ASEAN+3 Financial Stability Report 2024*). The current environment provides an opportune time for ASEAN+3 authorities to encourage a diversification in the use of currencies, which can improve funding resiliency (AMRO 2024a). That said, it may be too early to conclude that the US dollar's safe haven status has diminished, and a scenario of a US dollar resurgence should not be ignored. Though the region remained resilient during the previous episode of US dollar strength driven by the Fed's tightening cycle, the situation could be more challenging if the dollar rises while growth prospects dwindle due to US tariffs. The current backdrop of weak US dollar provides a window of opportunity to accumulate and diversify reserves, which could be deployed to manage FX volatility, should the need arise.

In addition, authorities may need to closely monitor the US dollar alternatives used by their financial systems and establish appropriate safety nets through swap lines and reserves denominated in the alternative currencies. Existing safety nets, such as the Chiang Mai Initiative Multilateralization, have also evolved to facilitate local currency usage. Finally, authorities may need to deepen domestic bond markets so that in absence of a global risk-free benchmark, there is a reliable domestic benchmark yield curve which can be used to price domestic assets while reducing the dependence on global benchmarks for pricing.

Over the medium term, further regional financial integration can help strengthen resilience to global shocks. In this regard, the efforts put in by the smaller ASEAN economies—Brunei, Cambodia, Lao PDR, and Myanmar will be crucial in narrowing the gap between the ASEAN+3 financial systems. These developments include active effort in deepening the financial markets (with a focus on interbank market development), using technology to consolidate exchange rate markets, and strengthening regulations for nonbank financial institutions (Box 1.5).

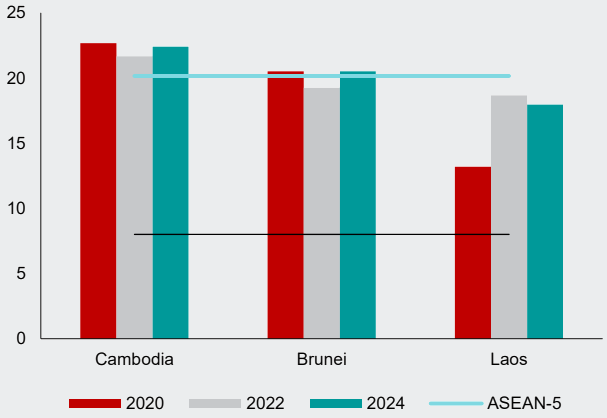
Box 1.5:

Recent Developments in BCLM Financial Sector

Banking systems remain the primary financial intermediaries across Brunei, Cambodia, Lao PDR, and Myanmar (known collectively as the BCLM countries), though performance has diverged significantly. Brunei's banks remain well capitalized, and asset quality has improved, with the nonperforming loan (NPL) ratio falling below 2 percent (Figures 1.5.1 and 1.5.2). However, the other countries face more pressing challenges. Cambodia's banking sector has experienced a notable rise in nonperforming loans from below 2 percent in 2020 to over 7 percent by 2024. This increase partially reflects weakening real estate conditions and a slower-than-expected recovery in tourism. Lao PDR's capital adequacy ratio has stayed below regional peers, and the capital buffer of the largest state-owned bank fell well below the minimum ratio, leaving the system more exposed to shocks despite a modest decline in reported NPLs.[1]

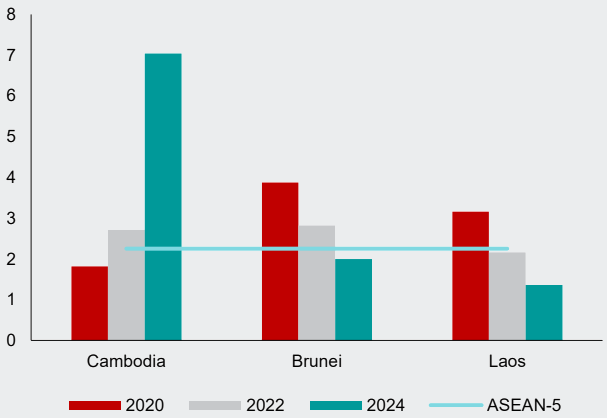
Real credit growth (Figure 1.5.3) has moderated, though for different reasons. In Cambodia, weaker loan demand and tighter underwriting standards have slowed annual credit expansion to low single digits. Lao PDR has seen credit expansion slow as banks respond to monetary policy tightening and the stabilization of currency depreciation.

Figure 1.5.1. Capital Adequacy Ratio
(Percent)



Sources: Haver Analytics; IMF; Bank of the Lao People's Democratic Republic.
Note: Regulatory capital to Risk weighted asset. ASEAN-5 is a simple average of ASEAN-5 countries as of end 2024. Black horizontal line is 8 percent, Basel III regulatory minimum without considering countercyclical buffer of 0-2.5 percent.

Figure 1.5.2. Nonperforming Loan to Gross Loan
(Percent)



Sources: Haver Analytics; IMF; Bank of the Lao People's Democratic Republic.
Note: End of year. ASEAN-5 is a simple average of ASEAN-5 countries as of end 2024.

BCLM countries are working to deepen their domestic financial markets, with particular focus on interbank market development. Brunei has made significant progress by completing four high-priority reforms in 2024 aimed at improving interbank market depth and functionality.[2] These reforms encompass improvements to market infrastructure, trading mechanisms, and liquidity management frameworks. The authorities are currently implementing additional measures, including enhanced legal frameworks for interbank transactions and increased central bank bill issuance to provide more liquid benchmark instruments.

Lao PDR has also made strides in this area by establishing the Interbank 2018 platform.[3] This initiative is designed to facilitate interbank lending activities and improve the efficiency of monetary policy operations by providing a centralized and regulated platform for financial institutions to manage their short-term liquidity.

Cambodia has been developing its sovereign bond market to facilitate the construction of a domestic yield curve.[4] Following the successful issuance of its first sovereign bond in 2022 with a 1-year maturity, the authorities expanded the maturity profile in 2023 to include 2, 3, and 5-year tenors. This progressive lengthening of maturities is crucial for establishing benchmark rates across different horizons, thereby aiding price discovery and the development of other fixed-income instruments.

The author of this box is Yoki Okawa.

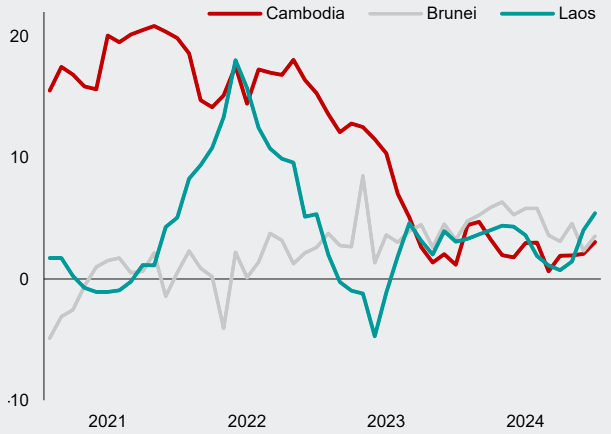
1 AMRO Annual Consultation Report Lao PDR, 2024.
2 IMF Brunei Darussalam 2024 Staff report for Article IV Consultation.
3 AMRO Annual Consultation Report Lao PDR, 2024.
4 ADB Completion Report Cambodia: Inclusive Financial Sector Development Program, 2023.

Exchange rate developments have varied considerably across the region (Figure 1.5.4). Cambodia and Brunei have maintained relative currency stability through their monetary arrangements. Cambodia continues to operate an effective crawling peg against the US dollar, which has provided exchange rate predictability while allowing for gradual adjustments. Brunei's currency board arrangement with the Singapore dollar has similarly ensured exchange rate stability.

In contrast, Myanmar and Lao PDR experienced significant currency pressures, with sharp depreciations from 2023 through mid-2024. Both currencies have since stabilized. Lao PDR's exchange rate stabilization could be attributed to the tighter regulation and the launch of the Lao Forex Exchange platform.[5]

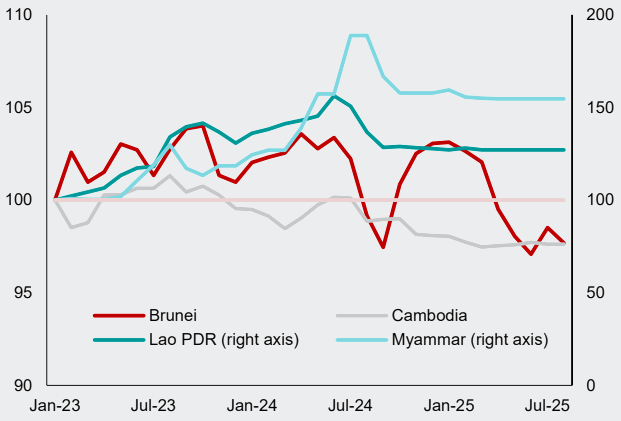
While the banking sector retains a dominant role, the nonbank financial sector in BCLM countries is gradually increasing in importance.[6] Countries are enhancing regulatory frameworks to ensure stability and foster growth in this segment. In Cambodia, for example, the Non-Bank Financial Services Authority (NBFSA) was established to strengthen regulatory oversight and enhance supervisory capacity across all nonbank subsectors. A key initiative involves collaborative efforts between the Credit Bureau of Cambodia and the NBFSA. They are jointly assessing the quality of real estate sector loans with a focus on obtaining more granular insights into the financial health of developers.

Figure 1.5.3. Real Credit Growth
(Percent)



Sources: Haver Analytics; IMF.
Note: Annual growth of total credit to private sector divided by consumer price index. Negative numbers suggest credit growth is outpaced by growth in consumer prices.

Figure 1.5.4. Foreign Exchange Rates
(Index)



Source: Haver Analytics; IMF; Bank of the Lao People's Democratic Republic; AMRO staff calculations.
Note: Exchange rate of LCU/USD, normalized with 100 in 1 January 2023. Higher number denotes depreciation against the US dollar. Lao PDR exchange rates are parallel rates from the Bank of the Lao People's Democratic Republic. Myanmar exchange rate is AMRO staff estimates of effective exchange rate.

[5] Ng, Poh Lynn, and Thai Yangsingkham. 2025. "Lao PDR's Bold Foreign Exchange Measures: A Step Toward Macroeconomic Stability." AMRO, *Blog*, 13 March.
[6] AMRO Annual Consultation Report Cambodia, 2024.

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