Real economies are solid due to firm domestic demand, while risks to financial instability to be monitored

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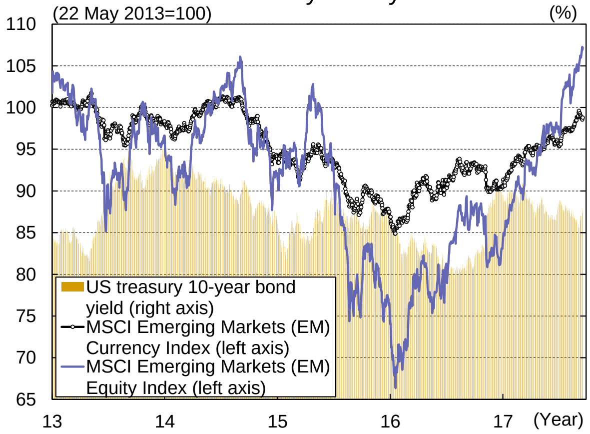
Financial markets in emerging countries including Asia as a whole remain stable after the US Federal Reserve Bank has decided at Federal Open Market Committee (FOMC) in September to initiate the balance sheet normalization program starting from October (see chart 1). The markets have already factored in the Fed's decision this time, unlike when then-Federal Reserve Chairman Ben Bernanke commented in May 2013 that the Fed's quantitative easing (QE) program could be unwound or after the US presidential election in November 2016. The US interest rate increase staying within a narrow range and the ongoing capital inflows from overseas backed by favorable fundamentals in emerging countries seem to have been supporting the markets.

Looking at the real economies in ASEAN countries, they maintained a solid expansion on the back of firm domestic demand and strong exports. Main economic indicators in June showed some softening in automobile sales and exports partially due to slippage of Lebaran (the festival after fasting month of Ramadan) holidays, however many shifted to acceleration after July. Going forward, domestic demand will remain firm driven by private consumption on the back of stable employment/income environment and the ongoing growth-friendly fiscal and monetary policies.

ASEAN major currencies have shown contrasting movements with Philippine Peso softened while Thai baht strengthen (see chart 2). In Philippines, the current account balance has been deteriorating due to increase in imports buoyed by domestic demand, and fiscal balance turned to deficit in 2016 for the first time in four years on the back of rise in infrastructure spending. In Thailand, on the other hand, current account surplus has remained high due to export expansion, while the pace of recovery in domestic demand stayed moderate. Such contrast between improvement/deterioration in current account balance and fiscal balance is closely monitored in foreign exchange market.

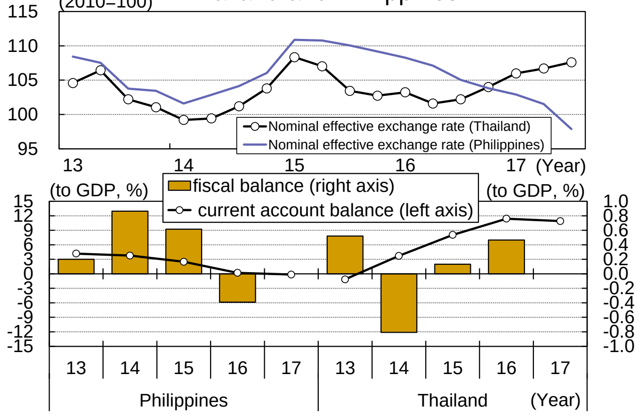
While gradual US rate hike is expected, most ASEAN countries have managed to maintain currency/price stability which enabled them to continue accommodative monetary policy. However, currency depreciation could incur an increase in inflation, make it difficult to continue accommodative monetary policy, and discourage increasing private consumption and expanding business activities. The countries with current account deficit and/or fiscal deficit could potentially face risks such as rapid capital outflow and currency depreciation, therefore it is advisable to continue monitoring such risks to instability of financial markets.

Chart 1：Emerging Currency/Equity Indices and US treasury bond yields



Source: Bloomberg, FRB, BTMU Economic Research Office

Chart 2：Exchange rates, current/fiscal balance in Thailand and Philippines



Note: Fiscal balance until 2016, current account balance until first half of 2017.
Source: BIS, individual country statistics, BTMU Economic Research Office

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