Allianz Global Investors

SEPTEMBER 2024 | OUTLOOK & COMMENTARY

How will US policy rate cuts affect Asia?

Christiaan Tuntono, Senior Economist for Asia Pacific at Allianz Global Investors, shares his insights on the impact of the US Fed's rate cuts on Asian economies.

Softening US labour conditions and disinflation have shifted the Fed's policy focus to growth from inflation. As such, the market is currently pricing in the Federal Reserve (Fed) to start cutting in September, lowering the Fed Funds Target Rate from the current 5.5% to 4.25% by end-2024 and 3% by end-2025.

Lower US interest rates favour Asia as narrower US Dollar (USD)-Asian currency rate differentials help stabilise Asian currencies and enable Asian central banks to ease domestic monetary conditions. The table shows our forecast of the US's and Asia's policy rates till end-2025. We expect 6 of our covered Asian central banks to cut (blue zone), 4 to hold (amber zone), and 1 to hike (red zone).

Policy rate forecasts

Narrowing policy room to cut rate

	Current	3Q24F	4Q24F	1Q25F	.....	4Q25F
US	5.50	5.25	4.75	4.25		3.50
CN	1.70	1.60	1.60	1.50		1.40
PH	6.50	6.25	5.75	5.50		5.00
ID	6.25	6.00	5.75	5.25		5.00
KR	3.50	3.50	3.25	3.00		2.75
TH	2.50	2.50	2.25	2.25		2.00
IN	6.50	6.50	6.00	5.75		5.75
TW	2.00	2.00	2.00	2.00		2.00
AU	4.35	4.35	4.35	4.35		4.35
MY	3.00	3.00	3.00	3.00		3.00
VN	4.50	4.50	4.50	4.50		4.50
JP	0.25	0.25	0.50	0.50		0.75

Note: US=Fed Funds Target Rate, CN=7D Reverse Repo Rate, PH=O/N Borrowing Rate, ID=7D Reverse Repo Rate, KR=Policy Base Rate, TH=Policy Rate, IN=Policy Repo Rate, TW=Discount Rate, AU=Policy Cash Rate, MY=O/N Policy Rate, VN=Refinancing Rate, JP=Uncollateralised O/N Call Rate

Source: Bloomberg, AllianzGI Global Economics & Strategy, as at September 2024.

That said, the reaction functions of Asian central banks vary on the following four key conditions: (1) neutral rate level#; (2) currency stability risk; (3) domestic demand conditions; (4) financial stability concern.

We think China requires easier monetary conditions the most within Asia. Not only its current policy rate level is above neutral (amidst muted price pressure), but China also has a closed capital account to help stabilize its currency and poor domestic demand conditions that favour lower interest rates. Financial stability risks in the real estate and local government debt sectors have been addressed through administrative means; hence, it is not an up-front concern for now. The PBoC has just made another round of policy rate cuts in July as the market's expectation on the Fed's policy rate trajectory pivoted.

The Philippines and Indonesia are the next in line. Policy rates were driven up in the past to maintain FX stability, but recent USD weakness and moderate inflations open the door for easing. Domestic demands are being pressured by high real rates but there are limited financial stability concerns. The Philippines has already started cutting in August, ahead of the Fed, and we expect Indonesia to follow soon.

Next, we have economies with higher-than-neutral policy rates but are constrained from swift easing due to cost-push inflation and/or financial stability concerns. These economies include Korea, Thailand, India, Taiwan and Australia. The nuance within this group is that Korea is more susceptible to currency stability risk and, hence, more likely to ease following the Fed in the 4th quarter of 2024. At the same time, Taiwan's and Australia's domestic demands remain resilient, pushing back the timing of easing to 2025 or after.

Malaysia and Vietnam may stay on hold for longer as their policy rates are around/below neutral while domestic demand conditions are still holding up. Upside risk on inflation may prompt their central banks to delay potential policy rate cuts till 2025 or after. Japan's policy rate is below neutral, suggesting that the Fed's easing may delay the Bank of Japan's next policy rate hike to the 4th quarter of 2024 or later.

In sum, we think US policy rate cuts would be positive for Asia's growth, currency stability and asset market performances. We stay constructive on India and turn positive on the Malaysian, Filipino and Indonesian equity markets, anticipating support from resilient domestic demand (India, Malaysia), currency stability and easier domestic monetary conditions (Philippines and Indonesia).

We stay neutral on the Chinese, Taiwanese, and Korean equity markets, continue expecting drags from sluggish domestic demand (for China) and weakening tech export momentum (for Taiwan and Korea). We have also turned neutral on the Japanese equity markets, concerning that the Japanese Yen's strength may increase market volatility, and remain neutral on other regional equity markets.

We stayed constructive on Asia's fixed-income markets as lower US policy rates and long-term bond yields prompt policy rate cuts and easier monetary conditions in the region. We have also stayed constructive on Asian currencies in anticipation of weaker USD.

The policy rate level (real or nominal) at which it is neither stimulatory nor contractionary and is consistent with output at potential and stable inflation.

To view more market insights from Christiaan Tuntono, visit **Market & Model QuickUpdate** at **ap.allianzgi.com**

The document is for use by qualified Institutional Investors (or Professional/Sophisticated/Qualified Investors as such term may apply in local jurisdictions).

This document or information contained or incorporated in this document have been prepared for informational purposes only without regard to the investment objectives, financial situation, or means of any particular person or entity. The details are not to be construed as a recommendation or an offer or invitation to trade any securities or collective investment schemes nor should any details form the basis of, or be relied upon in connection with, any contract or commitment on the part of any person to proceed with any transaction.

Any form of publication, duplication, extraction, transmission and passing on of the contents of this document is impermissible and unauthorised. No account has been taken of any person's investment objectives, financial situation or particular needs when preparing this content of this document. The content of this document does not constitute an offer to buy or sell, or a solicitation or incitement of offer to buy or sell, any particular security, strategy, investment product or services nor does this constitute investment advice or recommendation.

The views and opinions expressed in this document or information contained or incorporated in this document, which are subject to change without notice, are those of Allianz Global Investors at the time of publication. While we believe that the information is correct at the date of this material, no warranty of representation is given to this effect and no responsibility can be accepted by us to any intermediaries or end users for any action taken on the basis of this information. Some of the information contained herein including any expression of opinion or forecast has been obtained from or is based on sources believed by us to be reliable as at the date it is made, but is not guaranteed and we do not warrant nor do we accept liability as to adequacy, accuracy, reliability or completeness of such information. The information is given on the understanding that any person who acts upon it or otherwise changes his or her position in reliance thereon does so entirely at his or her own risk without liability on our part. There is no guarantee that any investment strategies and processes discussed herein will be effective under all market conditions and investors should evaluate their ability to invest for a long-term based on their individual risk profile especially during periods of downturn in the market.

Investment involves risks, in particular, risks associated with investment in emerging and less developed markets. Any past performance, prediction, projection or forecast is not indicative of future performance. Investors should not make any assumptions on the future on the basis of performance information in this document. The value of an investment and the income from it can fall as well as rise as a result of market and currency fluctuations and you may not get back the amount originally invested.

Investing in fixed income instruments (if applicable) may expose investors to various risks, including but not limited to creditworthiness, interest rate, liquidity and restricted flexibility risks. Changes to the economic environment and market conditions may affect these risks, resulting in an adverse effect to the value of the investment. During periods of rising nominal interest rates, the values of fixed income instruments (including short positions with respect to fixed income instruments) are generally expected to decline. Conversely, during periods of declining interest rates, the values are generally expected to rise. Liquidity risk may possibly delay or prevent account withdrawals or redemptions.

September 2024

ADM-W3846924