International Commentary — May 7, 2025

Easier to Ease. Emerging Market Central Banks Can Loosen The Policy Reins

Emerging Market Central Bank Monetary Policy Space: Q2-2025

Summary

In the background of a more contentious tariff environment policymakers at emerging market central banks have mostly communicated caution in regard to easing monetary policy. However, local currency strength combined with softer growth and inflation expectations now provide central banks with more space to deliver interest rate cuts. Our Monetary Policy Space framework suggests central banks across all regions, but particularly in Emerging Asia, have accumulated space to deliver aggressive easing before the end of this year.

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Emerging Market Central Bank Monetary Policy Space Overview

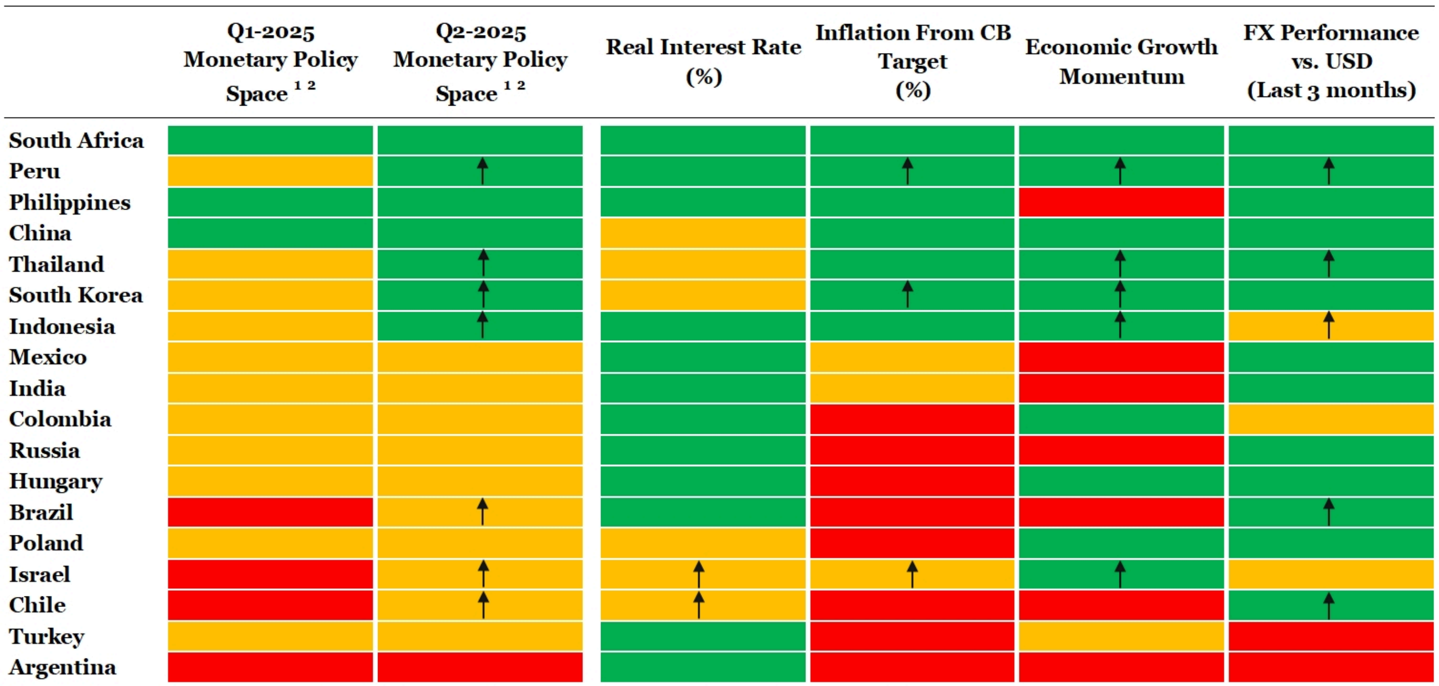
- Monetary policy space analyzes emerging market central banks' capacity to lower interest rates in the current calendar year.
- Monetary policy space assesses capacity for interest rate cuts arising from:
    - I. Current monetary policy settings: measured by real interest rate
    - II. Inflation expectations: measured by a forward-looking assessment of inflation relative to central bank CPI targets
    - III. Economic activity: measured by proxy indicators for GDP growth
    - IV. Financial stability & imported inflation risk: measured by FX performance vs. U.S. dollar
- Our framework aggregates indicators to determine overall space for central bank interest rate cuts (Adequate, Limited or No Space)
- Our framework also assigns a basis point adjustment (greater than 50 bps, between 25-50 bps, or 0 bps) that each central bank can pursue based on overall monetary policy space
- The framework is designed to act as a starting point for the direction and magnitude of policy rate changes, but are not necessarily forecasts nor an expression of directional bias
- Should the combination of our framework and empirical judgment suggest a greater or lesser degree of easing relative to financial market pricing, opportunities in rates as well as FX may be present
- For our framework to be most effective, monetary policy space relies on:
    - I. Independent and credible central bank (i.e., no real or perceived political influence)
    - II. Orthodox monetary policy theory (i.e., higher policy rates leads to lower inflation)
    - III. Coordinated fiscal and monetary policy (i.e., no overwhelming fiscal dominance)

Key Takeaways: Q2-2025

- Relative to Q1-2025, central banks have accumulated increased policy space to lower interest rates. According to our framework:
    I. Seven central banks now have “Adequate Monetary Policy Space” for more than 50 bps of rate cuts (3 in Q1-2025)
    II. Ten institutions have “Limited Monetary Policy Space” for between 25-50 bps of easing (11 in Q1-2025)
    III. One central bank has “No Monetary Policy Space” (4 in Q1-2025)
- Monetary policy space accumulation materialized across Emerging Asia, Latin America and EMEA
    I. Bank of Thailand, Bank of Korea & Bank Indonesia are all now associated with “Adequate Monetary Policy Space”
    II. Central Bank of Peru now has adequate space; Brazilian Central Bank & Chilean Central Bank may now be able to cut rates
    III. Bank of Israel may now have capacity to initiate an easing cycle
- Emerging Asia central banks, in aggregate, have the most space to cut rates. Policy space in EMEA & Latin America is more mixed
    I. Of the seven central banks with “Adequate Monetary Policy Space”, five are in Asia
    II. South African Reserve Bank has the most space and is the only EMEA institution that can cut aggressively by year-end
    III. Rates divergence can still materialize in Latin America; however, region-wide easing has now become more likely
- Central bank rate decisions through the end of this year might still be misaligned from underlying fundamentals
    I. Central Bank of Mexico is likely to lower interest rates at a quicker pace than our framework suggests
    II. Reserve Bank of India is likely to pursue more easing relative to underlying fundamentals assessed by our framework
    III. Argentina’s central bank (BCRA) lacks policy space, but we expect forceful BCRA rate cuts over the next few quarters

Which Emerging Market Central Banks Can Ease Monetary Policy, and by How Much?

FX strength, softer growth and inflation expectations, and overly restrictive monetary policy settings are now sources of monetary policy space for multiple central banks. Thematically, rate cuts are now more likely across all regions



[1] Green indicates "Adequate Monetary Policy Space", Orange indicates "Limited Monetary Policy Space", Red indicates "No Monetary Policy Space"

[2] Adequate Monetary Policy Space represents scope for >50 bps rate cuts, Limited Monetary Policy Space represents scope for 25-50 bps rate cuts, No Monetary Policy Space represents scope for 0 rate cuts

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