International Commentary — July 2, 2025

Keep Calm, Carry On: EM Central Banks Still Set to Ease

Emerging Market Central Bank Monetary Policy Space: Q3-2025

Summary

A geopolitical shock in the Middle East, steady Fed monetary policy and more resilient global growth are unlikely to disrupt central bank easing cycles across the emerging markets. Our Monetary Policy Space framework continues to suggest rate cuts will be delivered over the second half of this year, and in many cases, financial markets may be underpriced for the amount of easing central banks can deliver.

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Key Takeaways: Q3-2025

- On balance, central banks across the emerging markets have maintained policy space to further lower interest rates
    I. Middle East geopolitical events and oil price volatility have not raised inflation expectations nor disrupted central bank policy space for interest rate cuts

    II. Despite the Fed staying on hold, local economic and financial market conditions are still consistent with easier monetary policy across the emerging markets over the second half of this year

    III. Global growth is likely to be more resilient, although still below potential in most emerging economies. Restrained activity should still be a source of easing for policymakers

- According to our framework:
    I. Institutions with “Adequate Monetary Policy Space” are associated with restrictive monetary policy settings, stronger local currencies and inflation well within target CPI ranges

    II. Central banks with “Limited Monetary Policy Space” are restrained from easing more aggressively by elevated inflation, and in certain countries, inflation that is above the upper bound of the CPI target

    III. The Central Bank of Argentina is the only institution our framework identifies as having “No Monetary Policy Space”; however, policymakers may still deliver rate cuts (and other forms of easing) before the end of this year

- Financial market pricing may be misaligned with underlying fundamentals in select cases
    I. Markets may be underpricing easing cycles from central banks our framework deems having “Adequate Monetary Policy Space.” The Philippines, Peru and South Korea particularly stand out

    II. National Bank of Poland is likely to pursue less easing relative to financial market pricing

    III. Reserve Bank of India is likely to deliver at least one more 25 bps cut that markets are not fully priced for

Despite lingering uncertainties emerging market central banks can still pursue monetary easing

Indicators remain consistent with lower interest rates in H2-2025. Markets may be underpricing easing cycles from central banks with "adequate space" for rate cuts as well as in India, while Poland's central bank could ease less than market pricing

	Central Bank Policy Rate	Perceived Policy Rate Cuts (bps)	Market Implied Rate Change (bps)	Q3-2025 Monetary Policy Space [1,2]	Real Interest Rate (%)	Inflation From CB Target (%)	Economic Growth Momentum	FX Performance vs. USD (Last 3 months)
Philippines	5.25%	>50	-13	Green	Green	Green	Green	Green
South Africa	7.25%	>50	-35	Green	Green	Green	Red	Green
Indonesia	5.5%	>50	-45	Green	Green	Green	Green	Orange
Thailand	1.75%	>50	-44	Green	Orange	Green	Red	Green
China [3]	1.4%	>50	-41	Green	Orange	Green	Red	Green
Peru	4.5%	>50	-20	Green	Green	Orange	Green	Green
South Korea	2.5%	>50	-13	Green	Orange	Green	Red	Green
Mexico	8%	25-50	-34	Orange	Green	Orange	Red	Green
Chile	5%	25-50	-49	Orange	Orange	Orange	Green	Green
Russia	20%	25-50	-200	Orange	Green	Red	Green	Green
Colombia	9.25%	25-50	-39	Orange	Green	Red	Green	Green
Poland	5.25%	25-50	-79	Orange	Green	Red	Green	Green
Hungary	6.5%	25-50	-35	Orange	Green	Red	Green	Green
India	5.5%	25-50	-14	Orange	Orange	Orange	Red	Green
Brazil	15%	25-50	-3	Orange	Green	Red	Green	Green
Israel	4.5%	25-50	-42	Orange	Green	Orange	Red	Orange
Turkey	46%	25-50	-1126	Orange	Green	Red	Orange	Orange
Argentina	29%	0	-425	Red	Green	Red	Red	Red

[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

[3] People's Bank of China 7 Day Reverse Repurchase Rate

Source: Bloomberg Finance L.P. and Wells Fargo Economics

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)
    IV. No major economic distortions (i.e., geopolitical conflict)

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