ASIAN DEVELOPMENT OUTLOOK

JULY 2025

HIGHLIGHTS

- Developing Asia's growth forecasts have been downgraded from projections in April to 4.7% in 2025 and 4.6% in 2026. Growth in the region accelerated in the first quarter of 2025 thanks to solid domestic demand and pre-tariff front-loading of exports, but higher tariffs and global trade uncertainty are expected to dampen momentum going forward.
- Rising trade uncertainty also weighs on Southeast Asia's growth outlook, prompting the largest downward revisions among subregions to 4.2% for 2025 and 4.3% for 2026.
- The growth forecast for East Asia in 2025 is revised down, to 4.3%, and to 5.9% in South Asia, amid weaker trade prospects due to the US tariff hikes, while the 2026 growth forecasts remain 4.0% and 6.2%, respectively.
- Growth for the Pacific is still forecast at 3.9% for 2025 but revised down to 3.5% for 2026, reflecting expected softening in visitor arrivals.
- The growth forecast for the Caucasus and Central Asia is raised to 5.5% for 2025 and 5.1% for 2026, from 5.4% and 5.0%, reflecting stronger activity in Kazakhstan, supported by robust oil production.
- Disinflation in developing Asia is expected to continue, with headline inflation forecast to ease to 2.0% in 2025 and 2.1% in 2026, amid stronger agricultural output and lower oil prices.
- Higher US tariffs and trade uncertainty are the main risks for the region's outlook. Renewed geopolitical tensions and a faster deterioration in the PRC's property market could also weaken regional growth.

SLOWER GROWTH AMID TARIFFS AND UNCERTAINTY

Developing Asia's outlook has worsened since the *April 2025 Asian Development Outlook (ADO)*, as trade and other risks loom large. Gross domestic product (GDP) growth in the region accelerated in the first quarter (Q1) of 2025, underpinned by resilient consumption and front-loading of exports as firms anticipated tariff hikes in Q2 in the United States (US). Disinflation continued, as food and oil prices declined. Despite these positive developments in Q1, developing Asia's growth projections for both 2025 and 2026 have been downgraded compared with forecasts in the *April 2025 ADO* due to expectations of a more challenging external environment and weaker domestic demand. Downside risks have also intensified. Foremost among these is higher-than-expected US tariffs and trade uncertainty, which could worsen the region's growth prospects. A re-escalation of conflict in the Middle East could disrupt shipping and raise oil prices, curbing growth, and boosting inflation. In addition, a protracted property downturn in the People's Republic of China (PRC) could hamper the growth outlook in developing Asia's largest economy, with adverse spillovers to the rest of the region.

The recent developments section was written by Shiela Camingue-Romance under the guidance of Abdul Abiad, John Beirne, and Matteo Lanzafame of the Economic Research and Development Impact Department (ERDI). The Asian Development Bank Regional Economic Outlook Task Force led the preparation of the revised subregional outlook. The task force is chaired by ERDI and includes representatives of the Central and West Asia Department, East Asia Department, Pacific Department, South Asia Department, and Southeast Asia Department. ADB placed on hold its regular assistance to Afghanistan effective 15 August 2021. Effective 1 February 2021, ADB placed a temporary hold on sovereign project disbursements and new contracts in Myanmar.

ADB

Recent Developments

Growth in major advanced economies diverged in Q1 2025 amid mounting trade tensions and tariff-related disruptions. The US economy contracted at a seasonally adjusted annualized rate (saar) of 0.5%, as trade uncertainty dampened consumer sentiment. Manufacturing and services indexes weakened amid policy uncertainty, while industrial output stalled and job gains slowed. Japan's economy also contracted by 0.2% saar in Q1. Rising housing, healthcare, and rice prices and the waning impact of energy subsidies constrained consumption, while a stronger yen and tariff uncertainty hampered exports, particularly in the automobile sector. Quarterly growth flatlined, indicating a loss of momentum even before US reciprocal tariffs were announced on 2 April. In contrast, the euro area grew by 2.5% saar in Q1 2025, the fastest since Q2 2022. The acceleration was driven by strong domestic demand in France, Italy, and Spain, exports in Germany, and one-off factors related to export front-loading in Ireland. Manufacturing strengthened, while a resilient labor market and stable wage growth supported consumer spending. Oil prices remained around $65 per barrel from May until the Middle East conflict escalated on 13 June, triggering a surge to $78 per barrel by 19 June. The ceasefire announced on 24 June resulted in oil prices declining to $66 per barrel on 25 June.

Developing Asia's growth picked up early this year, fueled by surging exports and resilient consumption. Growth accelerated in the PRC and India in Q1 2025, compared to the second half of 2024, while the performance was mixed in the rest of the region (Figure 1A). Tariff-related front-loading shaped much of the momentum and also contributed to continued growth in tech exports—particularly semiconductors and AI-related equipment. In the PRC, GDP expanded 5.4% in Q1 and 5.3% overall in the first half of 2025, supported by policy stimulus for consumption and industrial activity owing to a surge in exports as firms rushed shipments in anticipation of steep US tariff hikes. Year-on-year export growth rose to a 6-month high at 12.3% in March before moderating to 6.2% in Q2. India's GDP grew 7.4%, boosted by higher net exports and a sharp rise in investment spurred by surging public spending. In contrast, total consumption eased even as rural demand remained firm. Front-loading and global demand for electronics supported activity in some high-income technology exporters, but to a lesser extent in the Republic of Korea amid falling prices and a decline in chip exports to the PRC following tighter US restrictions on high-bandwidth memory sales. In the Association of Southeast Asian Nations (ASEAN) economies, rising exports were partly offset by weaker domestic demand, dented by lower investment in

Figure 1 Contributions to GDP Growth in Developing Asia, H2 2024 and Q1 2025

A. Demand Side

Growth in developing Asia accelerated in Q1 2025, driven largely by exports and consumption.

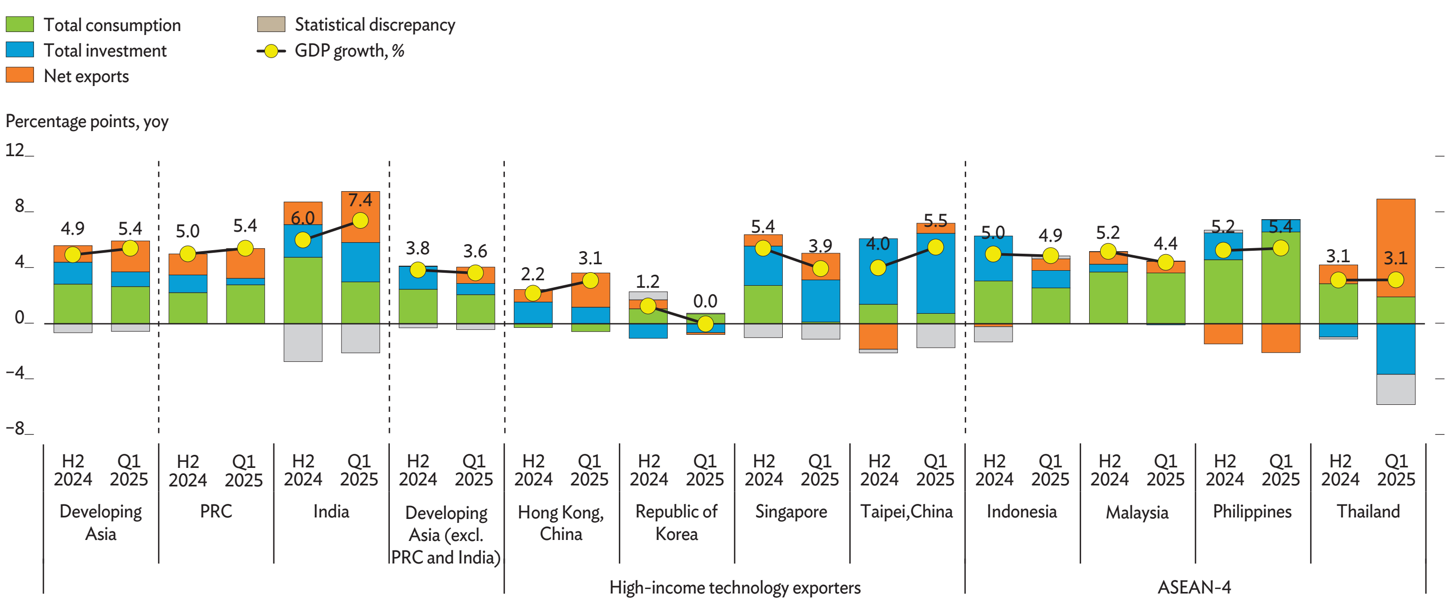

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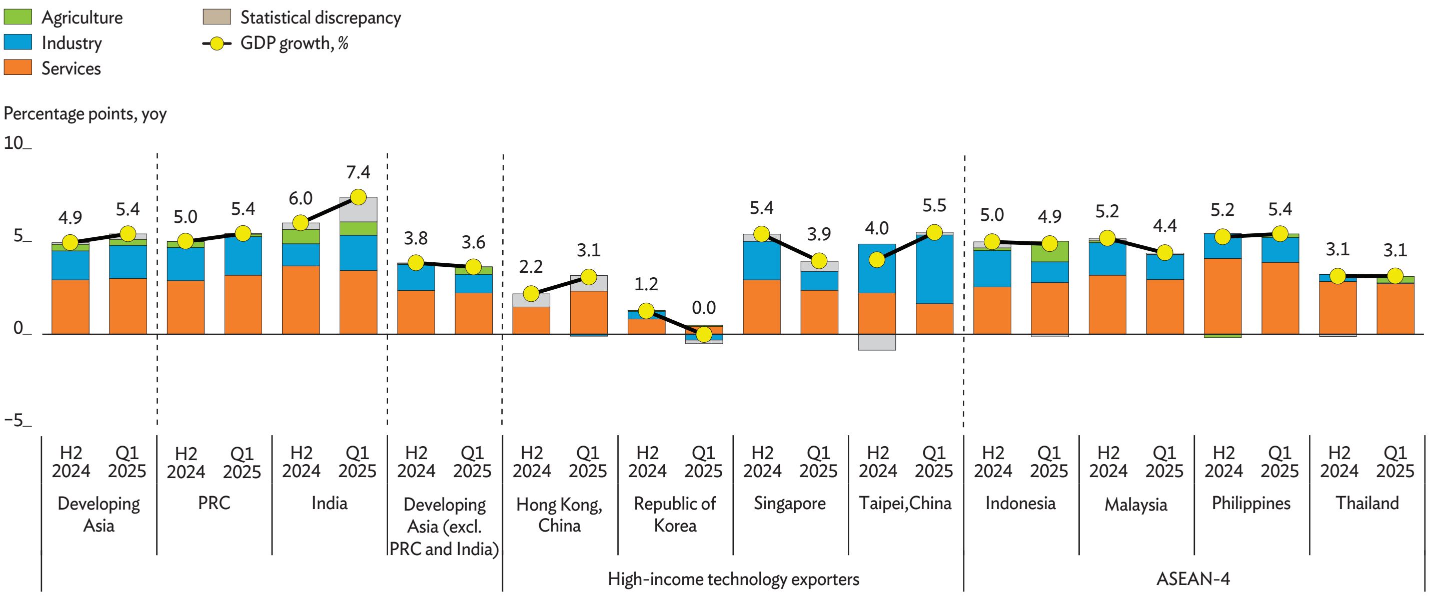
Figure 1 *Continued*

B. Supply Side

Industry performance was mixed, while services growth remained largely robust.



ASEAN = Association of Southeast Asian Nations, PRC = People's Republic of China, GDP = gross domestic product, H = half, Q = quarter, yoy = year-on-year.

Notes: Economies included are those with available quarterly GDP data and demand-side breakdowns, accounting for about 90% of developing Asia. All data are for calendar years. H2 2024 GDP growth is the percentage growth rate of GDP in the last 2 quarters of 2024 over the same period in 2023.

Sources: Haver Analytics; CEIC Data Company.

Indonesia, Malaysia, and Thailand. On the supply side, services remained largely robust, but industrial performance was mixed across the region. Industrial output grew more rapidly in the PRC, India, and Taipei,China, but moderated elsewhere, reflecting a worsening of expectations among manufacturers (Figure 1B).

Leading indicators suggest growth slowed in Q2 and will weaken further. Manufacturing Purchasing Managers' Indexes (PMIs) indicate that activity worsened in June for 5 of the 10 regional economies with available data. The index only picked up in India, Thailand, the Philippines, and the PRC (Table 1). This still represents a marginal upgrade with respect to April and May, when the PMIs for 7 economies were below the threshold of 50 separating improving from worsening conditions. Weaker Q2 manufacturing activity mirrors slower export momentum in the region, as reflected in worsening export orders in the PRC, ASEAN economies, and the high-income technology exporters (Hong Kong, China; Republic of Korea; Singapore; and Taipei,China). This suggests that both domestic and external demand may constrain growth. Meanwhile, PMIs indicate that, in June, activity in services continued to grow strongly in India, while softening in the PRC.

Disinflation continued across the region as global food prices eased and the recent volatility in oil prices proved to be transitory (Figure 2). Headline inflation moderated to 1.1% in May, less than half the pre-pandemic average of 2.6%. The fall was largely driven by the PRC, where inflation turned to deflation from February to May 2025, reflecting subdued domestic demand, oversupply of pork, and intensified price competition among producers and retailers. Excluding the PRC, headline inflation also remained below the pre-pandemic average and decreased gradually. Disinflation was stronger in South Asia and Southeast Asia, whereas inflation rose in the Caucasus and Central Asia, due in part to increases in utility prices aimed at attracting investment to modernize infrastructure in Kazakhstan. Despite a slight increase between March and May, average food inflation in the region stayed below last year's and pre-pandemic levels. Rice prices dropped 20.5% from the start of the year to 24 June, and other agricultural price pressures remained subdued. Brent crude oil prices swung sharply from early April to mid-June 2025, on the renewed conflict in the Middle East. However, the impact on oil prices was short-lived, such that energy prices have remained broadly stable across the region since April. On the other hand, core inflation ticked up slightly in recent months, driven by increases in service prices in the PRC. Excluding the PRC, core inflation has plateaued since mid-2024, reflecting broad-based price moderation for both goods and services.

Table 1 Purchasing Managers' Index, Selected Asian Economies

Leading indicators suggest manufacturing activity is slowing.

Economy	2024						2025					
	Q3			Q4			Q1			Q2		
	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Manufacturing PMI, seasonally adjusted												
India	58.1	57.5	56.5	57.5	56.5	56.4	57.7	56.3	58.1	58.2	57.6	58.4
Thailand	52.8	52.0	50.4	50.0	50.2	51.4	49.6	50.6	49.9	49.5	51.2	51.7
Philippines	51.2	51.2	53.7	52.9	53.8	54.3	52.3	51.0	49.4	53.0	50.1	50.7
PRC	49.8	50.4	49.3	50.3	51.5	50.5	50.1	50.8	51.2	50.4	48.3	50.4
Singapore, *nsa*	50.7	50.9	51.0	50.8	51.0	51.1	50.9	50.7	50.6	49.6	49.7	50.0
Malaysia	49.7	49.7	49.5	49.5	49.2	48.6	48.7	49.7	48.8	48.6	48.8	49.3
Viet Nam	54.7	52.4	47.3	51.2	50.8	49.8	48.9	49.2	50.5	45.6	49.8	48.9
Republic of Korea	51.4	51.9	48.3	48.3	50.6	49.0	50.3	49.9	49.1	47.5	47.7	48.7
Taipei,China	52.9	51.5	50.8	50.2	51.5	52.7	51.1	51.5	49.8	47.8	48.6	47.2
Indonesia	49.3	48.9	49.2	49.2	49.6	51.2	51.9	53.6	52.4	46.7	47.4	46.9
Services PMI, seasonally adjusted												
India	60.3	60.9	57.7	58.5	58.4	59.3	56.5	59.0	58.5	58.7	58.8	60.4
PRC	52.1	51.6	50.3	52.0	51.5	52.2	51.0	51.4	51.9	50.7	51.1	50.6
Philippines, *nsa*	48.5	49.0	51.3	52.5	52.4	54.5	51.3	50.9	52.4	55.6	50.9	...
Sri Lanka, *nsa*	71.1	65.2	53.4	60.3	60.5	71.1	58.5	56.5	69.8	60.6	57.0	...

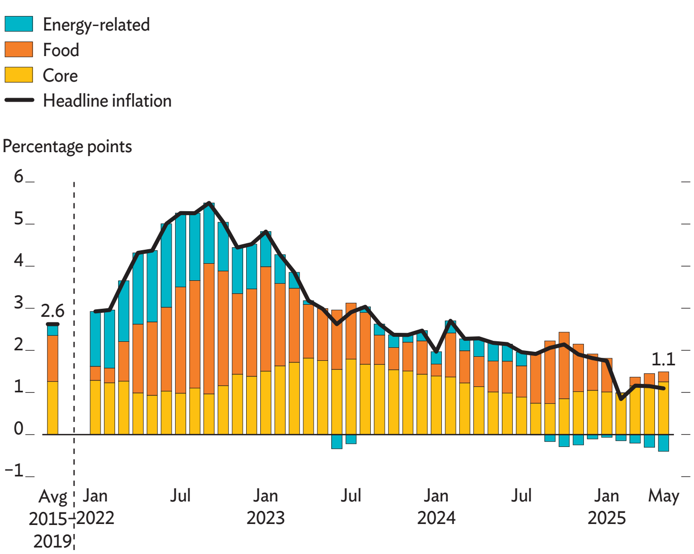
... = data not available, PRC = People's Republic of China, nsa = non seasonally adjusted, Q = quarter.

Notes: Pink to red indicates deterioration (<50) and white to green indicates improvement (>50).

Source: CEIC Data Company.

Figure 2 Contributions to Inflation, Developing Asia

Inflation is trending downward across developing Asia.



Avg = average.

Notes: Core inflation excludes food and energy sectors. For some economies, core is estimated as the residual between overall inflation and the sum of food and non-alcoholic beverages and energy-related items. For lack of a more disaggregated breakdown, energy-related consumer prices for most economies includes housing, water, and non-fuel transport. The regional average is calculated using GDP Purchasing Power Parity shares as weights, for 23 economies.

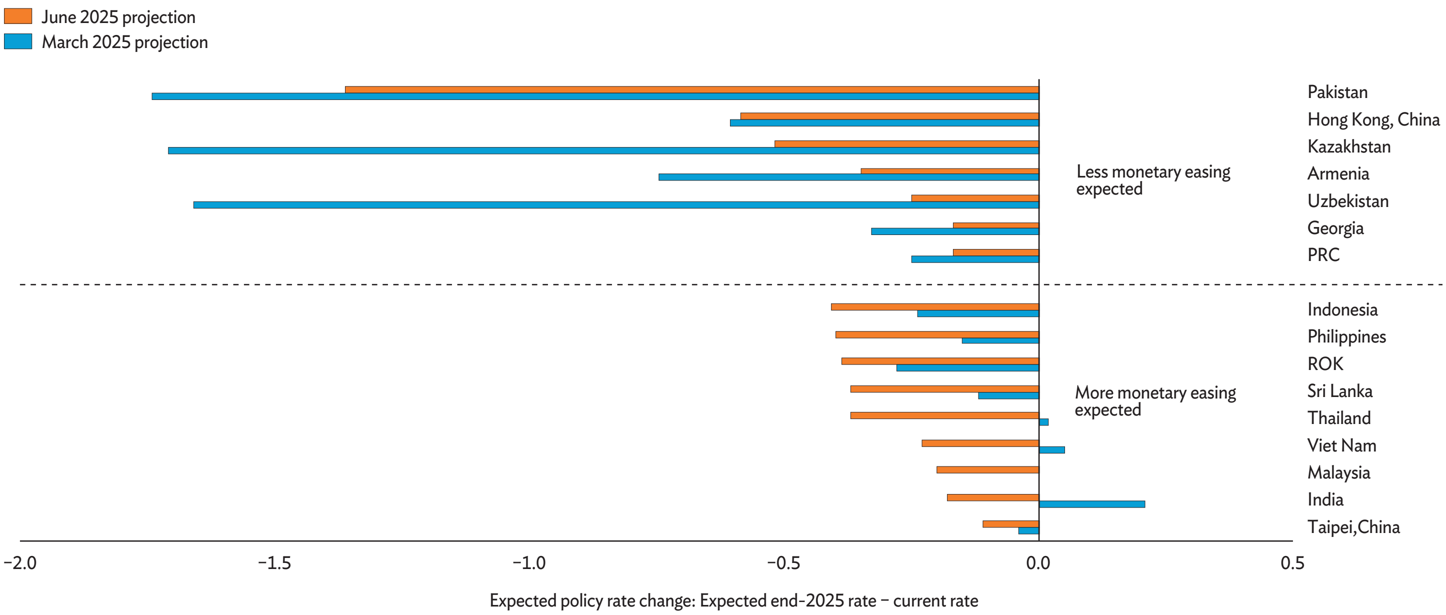
Source: Asian Development Bank calculations using data from Haver Analytics; CEIC Data Company; national sources.

Monetary policy easing will continue but, reflecting increasing uncertainty about the effects of trade and other shocks, its pace is expected to shift. Available forecasts in June for selected regional economies indicate that 16 central banks are projected to cut policy rates further this year. Out of these 16, 9 are forecast to loosen monetary policy by more than projected in March, by an average of 23 basis points (Figure 3). For some economies, expectations have even turned from policy rate hikes in March to cuts in June. However, less monetary easing is now projected for the other 7 economies. This varied picture reflects changing trade-offs and risks related to growth and inflation across the region, with economy-specific factors—such as current and expected inflation rates, financial conditions, and exchange rate stability—shaping monetary policy decisions in the face of common external shocks.

Financial markets remained resilient despite market uncertainty and increased volatility in April. Investor concerns over US tariffs escalated in March, with the US administration's announcement of new tariffs on 2 April further damping sentiment and amplifying market uncertainty. This triggered a sharp decline in equity markets and a spike in financial volatility (Figure 4). Market sentiment began to recover following the announcement of a 90-day pause on the 2 April tariffs and the start of trade negotiations between the US and key trading partners. Additionally, the Middle East conflict of 13–24 June exerted only limited impact on regional financial markets. As a

Figure 3 Projected Policy Rate Changes by End-2025

Monetary policy loosening is projected to continue, but the expected pace has shifted compared to March.



PRC = People's Republic of China, ROK = Republic of Korea.

Note: The projected policy rates are simple averages of end-2025 forecasts from surveyed banks and investment banks, independent economic research firms and consultancies, and financial institutions.

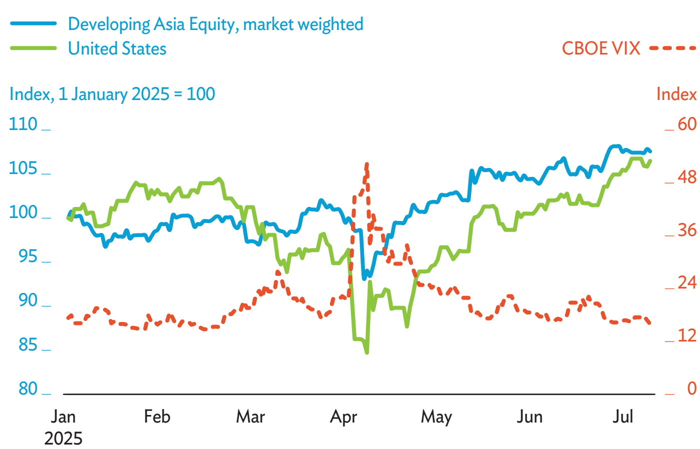
Source: Focus Economics; Haver Analytics.

result, equity markets rebounded, risk premiums narrowed, and net portfolio inflows resumed (Figure 5). Concerns about the potential adverse effects of tariffs on the US economy and global trade weighed heavily on the US dollar, raising questions about its status as a safe-haven asset (Box 1). From 1 April to 9 July, the US dollar depreciated 5.0% against a basket of major currencies representing key US trading partners and by 1.4% against a weighted average of regional currencies.

The growth outlook in major advanced economies is dimming. The GDP growth forecast for the US has been revised downward to 1.7% in 2025, from 2.0% in *ADO April 2025*, reflecting strains from higher tariffs on imports and policy uncertainty on investment (Box 2). Growth is expected to edge up to 1.9% in 2026, as the enactment of the One Big Beautiful Bill Act approved on 4 July is expected to lift GDP in the short run (Box 3). Japan's growth outlook has also weakened, with growth projected to slow to 0.8% in 2025 and to 0.6% in 2026. US tariffs on key goods—such as automobiles, steel, and ships—are expected to reduce US-bound exports and weaken manufacturing activity. In contrast, the euro area growth projection for 2025 remains unchanged at 1.2%, reflecting recent signs of momentum, and the assumption that US tariffs on imports from the euro area will stay at the current manageable levels. Growth is projected to accelerate to 1.3% in 2026, also thanks to the lagged effects of monetary policy easing and the expected fiscal expansion in Germany.

Figure 4 Equity Market Performance and CBOE VIX

The region's market-weighted equity index rebounded following the announcement of a 90-day pause in tariffs amid easing market volatility.



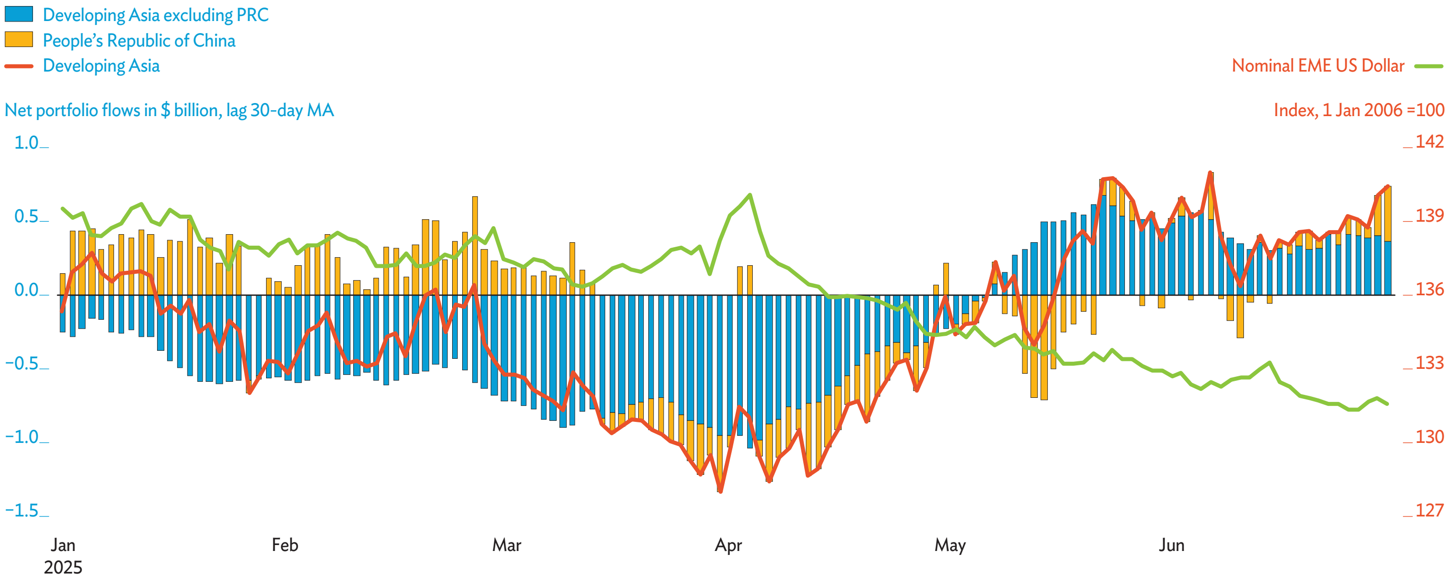
CBOE VIX = Chicago Board Options Exchange Volatility Index.

Note: Developing Asia comprises Bangladesh; People's Republic of China; Hong Kong, China; India; Indonesia; Kazakhstan; Republic of Korea; Malaysia; Pakistan; Philippines; Singapore; Sri Lanka; Taipei,China; Thailand; and Viet Nam. The S&P 500 index is used for United States.

Source: Bloomberg.

Figure 5 Portfolio Flows in the Region

Net portfolio flows have turned positive since May on improved investor sentiment and continued US dollar weakness.



PRC = People's Republic of China, EME = emerging market economies, MA = moving average, US = United States.

Notes: The nominal emerging US dollar Index includes the currencies of 19 emerging market economies for which bilateral trade with the United States accounts for at least 0.5% of total US bilateral trade. The lower value of the USD index indicates depreciation.

Sources: Institute of International Finance and Federal Reserve Bank of St. Louis. https://fred.stlouisfed.org/series/DTWEXBGS, 14 July 2025.

This report revises developing Asia's growth forecasts downward compared to *ADO April 2025*, to 4.7% in 2025 and to 4.6% in 2026. Higher US tariffs and global trade uncertainty will dampen exports from the region, while weaker domestic demand will also weigh on growth. Excluding the PRC, the region's 2025 growth forecast has been lowered 0.2 percentage points, reflecting downward revisions of forecasts in South Asia and Southeast Asia from *ADO April 2025* (Table 2). Southeast Asia faces the largest downward revisions among subregions, with projected growth adjusted to 4.2% for 2025 and 4.3% for 2026. In a partial deviation from the pattern, growth projections for the Caucasus and Central Asia have been raised, largely reflecting an anticipated boost in oil production from the launch of Kazakhstan's Future Growth Expansion project. The inflation forecast for the region has been revised down to 2.0% in 2025 on lower inflation projections in the PRC and South Asia outweighing a steep upgrade in the Caucasus and Central Asia. Ongoing moderation in oil and rice prices, along with reduced demand-side price pressures due to slower growth, are anticipated to support continuing disinflation. The inflation forecast for 2026 is also revised down to 2.1%.

Risks to the outlook still tilt to the downside. Uncertainty related to US tariffs continues to weigh on global trade and economic activity. The 90-day truce, originally set to end on 8 July, has been officially extended to 1 August, while the separate US-PRC truce is set to expire on 10 August. Negotiations between the US and several of its trading partners are ongoing. However, on 7 July, the US sent tariff letters to 14 economies, warning that if no trade deals are finalized by 1 August, new tariff rate hikes will take effect on that date. A renewed imposition of the US reciprocal tariffs or a re-escalation in US–PRC trade tensions could reduce regional growth by 0.5 to 1.4 percentage points (Box 4). Other policy changes in the US could affect the regional outlook. Although its overall impact on the region will be minimal, the 1% US remittance tax could slightly dampen private consumption in 2026 in economies heavily reliant on US remittances, especially some Pacific Island economies (Box 5). Geopolitical tensions outside the region persist, as peace talks over Russia's war in Ukraine stalled and the 24 June ceasefire in the latest Middle East conflict remains fragile. Renewed escalation could disrupt shipping and supply chains and increase commodity price volatility. In particular, the potential closure of the Strait of Hormuz by Iran would affect about 20% of the world's oil transit and around 25% to 30% of global liquefied natural gas exports (Box 6). A further deterioration in the PRC's ongoing property slump could also weigh on growth prospects. Despite brief signs of stabilization in early 2025, real property prices and investment continued to decline in recent months.

Table 2 GDP Growth Rate and Inflation, %

Developing Asia's growth is expected to ease in 2025 and 2026.

	GDP Growth					Inflation				
	2024	2025		2026		2024	2025		2026	
Subregion/Economy		April	July	April	July		April	July	April	July
Developing Asia	**5.1**	**4.9**	**4.7**	**4.7**	**4.6**	**2.6**	**2.3**	**2.0**	**2.2**	**2.1**
Developing Asia excluding the PRC	**5.1**	**5.0**	**4.8**	**5.1**	**4.9**	**4.8**	**4.0**	**3.6**	**3.7**	**3.7**
Caucasus and Central Asia	**5.7**	**5.4**	**5.5**	**5.0**	**5.1**	**6.8**	**6.9**	**7.8**	**5.9**	**6.7**
Kazakhstan	4.8	4.9	5.1	4.1	4.3	8.7	8.2	10.2	6.5	8.4
East Asia	**4.7**	**4.4**	**4.3**	**4.0**	**4.0**	**0.5**	**0.6**	**0.4**	**0.9**	**0.6**
People's Republic of China	5.0	4.7	4.7	4.3	4.3	0.2	0.4	0.2	0.7	0.4
Hong Kong, China	2.5	2.3	2.0	2.5	2.1	1.7	1.9	1.6	2.0	1.6
Republic of Korea	2.0	1.5	0.8	1.9	1.6	2.3	1.9	1.9	1.9	1.9
Taipei,China	4.8	3.3	3.5	3.0	3.0	2.2	2.0	1.8	1.8	1.5
South Asia	**5.9**	**6.0**	**5.9**	**6.2**	**6.2**	**6.5**	**4.9**	**4.4**	**4.5**	**4.5**
India	6.5	6.7	6.5	6.8	6.7	4.6	4.3	3.8	4.0	4.0
Southeast Asia	**4.8**	**4.7**	**4.2**	**4.7**	**4.3**	**3.0**	**3.0**	**2.6**	**2.8**	**2.7**
Indonesia	5.0	5.0	5.0	5.1	5.1	2.3	2.0	1.5	2.0	2.0
Malaysia	5.1	4.9	4.3	4.8	4.2	1.8	2.5	2.4	2.5	2.4
Philippines	5.6	6.0	5.6	6.1	5.8	3.2	3.0	2.2	3.0	3.0
Singapore	4.4	2.6	1.6	2.4	1.5	2.4	2.0	1.0	1.7	1.2
Thailand	2.5	2.8	1.8	2.9	1.6	0.4	1.0	0.5	1.1	0.8
Viet Nam	7.1	6.6	6.3	6.5	6.0	3.6	4.0	3.9	4.2	3.8
The Pacific	**4.1**	**3.9**	**3.9**	**3.6**	**3.5**	**2.0**	**3.4**	**3.4**	**3.7**	**3.7**

PRC = People's Republic of China, GDP = gross domestic product.

Note: **Developing Asia** refers to the following 46 members of the Asian Development Bank. The **Caucasus and Central Asia** comprises Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan. **East Asia** comprises People's Republic of China; Hong Kong, China; Republic of Korea, Mongolia, and Taipei,China. **South Asia** comprises Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka. **Southeast Asia** comprises Brunei Darussalam, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Philippines, Singapore, Thailand, Timor-Leste, and Viet Nam. **The Pacific** comprises Cook Islands, Fiji, Kiribati, Marshall Islands, Federated States of Micronesia, Nauru, Niue, Palau, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu.

Source: *Asian Development Outlook* database.

Growth and Inflation Outlook by Subregion

East Asia

The 2025 growth outlook for East Asia has been revised downward to 4.3%, while the 2026 forecast remains unchanged at 4.0%. The downward revisions for the Republic of Korea and Hong Kong, China reflect the impact of US tariff hikes, which are expected to dampen trade activity. GDP projections for the PRC remain unchanged, supported by continued and strengthened policy measures.

The ADO holds its PRC growth forecasts for 2025 and 2026 steady at 4.7% and 4.3%, reflecting the strong economic performance in the first half (H1). The PRC's economy expanded by 5.3% in H1 driven by policy-led boosts to consumption, robust industrial output and strong export performance. However, the economic outlook for the rest of the year remains challenging due to both internal and external pressures, though policy support should help mitigate them. Fragile household confidence, financial distress among property developers, and cautious investor sentiment still constrain domestic demand for investment and consumption. While exports to the US declined sharply in Q2 amid rising trade tensions, overall exports remained resilient in H1 of the year. However, despite temporary agreement between the US and the PRC, trade uncertainties persist and weakening external demand is likely to dampen its export outlook in the second half of the year, weighing on GDP. Policy measures such as larger-scale and expanded-scope consumer goods trade-in and equipment upgrade programs, accelerated issuance of government bonds, and monetary easing are nonetheless anticipated to counterbalance the domestic weaknesses and external headwinds.

In Taipei,China, 2025 growth is forecast at 3.5%, up from the April forecast at 3.3%, and remains at 3.0% for 2026. Exceptionally strong demand for AI products drove growth in exports in Q1 and is expected to continue through Q4, despite the threat of tariffs and the easing of front-loading in the second half. However, the appreciation of the local currency could weigh on exporters and has already cut the value of life insurers' holdings of US dollar-denominated assets.

Growth in the Republic of Korea is forecast at 0.8% in 2025 and 1.6% in 2026, down from 1.5% and 1.9%, respectively, in the April forecast. The revision reflects weaker-than-expected Q1 performance, with zero real GDP growth due to falling investment, particularly in construction, and a slight dip in goods exports. Exports are expected to soften further amid rising global trade uncertainty and higher US tariffs. Investment will likely remain subdued, constrained by a weak property market. The manufacturing PMI signaled contraction for the fifth consecutive month, although it showed slight improvement in June 2025. On a positive note, domestic consumption is expected to pick up in the second half of 2025, supported by easing political uncertainty following the June elections and a government budget stimulus. Growth in 2026 will be driven by stronger domestic demand amid an accommodative monetary policy, although trade risks and the lagged impact of higher tariffs will continue to weigh on the outlook.

Projected growth in Hong Kong, China is revised down to 2.0% for 2025 and 2.1% for 2026, from 2.3% and 2.5% in the April forecast. Growth rose to 3.1% in Q1 2025 from 2.5% in Q4 2024, supported by stronger exports and modest investment gains. Goods exports grew 8.4% on sustained external demand and front-loading ahead of expected tariff hikes, while services exports rose 6.6% on increased cross-border financial activity. However, growth is expected to slow in the coming quarters due to weaker global trade, which will weigh on exports and trade-related financial services. On the domestic side, private spending declined 1.1%, the fourth straight quarterly drop, and will likely remain weak amid sluggish retail sales and outbound spending. Private investment is also soft, held back by a weak property market and high interest rates. In contrast, public investment should support growth through bond-financed infrastructure projects.

East Asia's inflation forecast is adjusted down to 0.4% in 2025 and to 0.6% in 2026, from 0.6% and 0.9%. In the PRC, consumer prices deflated to 0.1% in the first 6 months of 2025 as food prices fell 0.9% despite a 4.0% rise in pork prices. Nonfood inflation rose 0.1%, driven by a 0.4% increase in services. Core inflation stayed low, at 0.5%, reflecting weak demand. With ample pork supply and rising competition among producers and retailers, inflation is expected to stay soft. Forecasts are lowered to 0.2% in 2025 and 0.4% in 2026. In Hong Kong, China, inflation forecasts are trimmed to 1.6% for 2025 and 2026. Headline inflation averaged 1.7% in the first 5 months and should remain low as weak domestic activity and subdued global demand limit price pressures. Inflation forecasts for other East Asian economies remain unchanged and on target.

South Asia

The growth outlook for South Asia for 2025 is 5.9%, from 6.0% in the *April 2025 ADO*. The slight downward revisions for GDP growth in India and Sri Lanka in 2025 are primarily due to the effects of US tariff policies. Bhutan's downward revision reflects weaker-than-expected industry performance in the first quarter of 2025, due to delayed commissioning of the Punatsangchhu II hydroelectric plant, slower uptake in construction activities in the Khorlochhu hydroelectric power project, and sluggish mining output. The growth forecast for the subregion in 2026 is 6.2%. Afghanistan's growth forecast is kept unchanged for fiscal year (FY) 2026 (ending 21 March 2026) as the economy grew modestly in FY2025, due to a robust performance in the agriculture sector, even as the industry and services sector remained lackluster and constrained. In Bangladesh, FY2026 (ending 30 June 2026) growth has been lowered on account of slower growth in exports and manufacturing, partly reflecting expected impacts from US reciprocal tariffs. Bhutan's growth outlook in 2026 remains unchanged and will be driven by ongoing construction momentum in major hydropower projects. Maldives' growth forecast remains steady for 2025 and 2026, as strong tourism and fisheries sectors offset declining construction activity; however, the forecast is subject to downside risks on account of debt sustainability concerns. Nepal's GDP projection for FY2025 (ending mid-July 2025) is revised upwards on stronger-than-expected agriculture and industry, with the FY2026 forecast unchanged given limited trade links with the US economy. Pakistan provisionally grew 2.7% in FY2025 (ended 30 June 2025), resulting in the slight upward revision for FY2025, while the growth forecast for FY2026 is unchanged. The revised growth forecast in Pakistan accounted for the higher-than-expected uptick in the industry and services sector, even as the expected declines in agricultural output come to pass. Economic growth in Sri Lanka was broad-based in Q1 2025, but growth forecasts have been revised down, with US tariff uncertainty weighing on 2025 and risks from under execution of capital spending affecting the 2026 outlook.

The Indian economy is projected to grow 6.5% in FY2025, lower than the 6.7% forecast in the *April 2025 ADO* but still one of the fastest growing major economies in the world. This revision is primarily due to the impact of US baseline tariffs and associated policy uncertainty. In addition to the effects of lower global growth and the direct impact of additional US tariffs on Indian exports, heightened policy uncertainty may affect investment flows. Despite this, economic activity remains robust, with domestic consumption set to grow strongly on the back of revival of rural demand. Services and agriculture sectors are expected to be key drivers of growth, the latter supported by a forecast of above-normal monsoon rains. The central government's fiscal position remains strong, with higher-than-expected dividends from the Reserve Bank of India, and it is on track to meet the targeted reduction in its fiscal deficit. In FY2026, growth is forecast to improve to 6.7% on account of rising investments, under the assumption of reduced policy uncertainty and favorable financial conditions backed by recent reductions of the repo rate and the cash reserve ratio by the monetary authorities. The baseline expectations of lower crude oil prices will also support economic activity in FY2025 and FY2026.

South Asia's inflation is forecast at 4.4% in 2025, from 4.9% in the *April 2025 ADO*, and retained at 4.5% in 2026. India's inflation forecast for FY2025 has been revised downward to 3.8%, reflecting faster-than-expected decline in food prices due to better agricultural production, while the FY2026 forecast remains unchanged. Likewise, Bangladesh's actual inflation is marginally lower than forecast for FY2025 amid easing global commodity prices and tighter monetary and fiscal policies, while the outlook keeps the FY2026 forecast the same in anticipation of continued tight policies and moderating global oil prices. In Afghanistan, the deflationary trend is easing—reversing in March 2025 with positive headline inflation—and contributes to a revised upward outlook for FY2025, while the forecast for FY2026 is revised downward on account of a stronger currency. Nepal's inflation forecast is revised downward based on actual 10-month inflation data for food and nonfood items in FY2025, with the FY2026 outlook also lowered due to expected moderation in inflation in India, Nepal's primary source of imports. In contrast, Maldives' inflation is revised upward for both years, driven by tax hikes and rising import costs from a widening gap between the official and parallel exchange rates, raising overall import costs. In Pakistan, the accelerated decline in food and nonfood prices for the first 11 months of FY2025 revised the inflation forecast for FY2025 downward, while the outlook for FY2026 remains unchanged. Sri Lanka's inflation forecast remains unchanged for 2025 and 2026, as recent trends—such as rising food prices and electricity tariff hikes—align with earlier expectations, though risks from credit growth and geopolitical tensions persist. Bhutan's inflation outlook is also unchanged, reflecting stable price trends.

Southeast Asia

Economic forecasts for Southeast Asia have been downgraded for 2025 and 2026 due to the continuing global growth slowdown and increased trade uncertainty. Weaker external conditions have hurt business and consumer sentiment and threaten to disrupt investment in the subregion. The subregion's performance in the first quarter shows signs of slowing, particularly for those reliant on external demand, despite delays in implementing the US reciprocal tariffs and some frontloading of exports. Except for Indonesia, the largest economy in the subregion, all Southeast Asian economies are expected to post weaker growth in the next 2 years. Thus, growth forecasts for the subregion have been lowered from 4.7% to 4.2% in 2025 and from 4.7% to 4.3% in 2026.

Indonesia's 2025 and 2026 growth forecasts are unchanged at 5.0% and 5.1%, driven by resilient domestic demand despite weak net exports. Q1 2025 growth eased to 4.9% due to post-election effects. Private consumption remained the key driver, while investment growth slowed. To sustain growth, the government raised the 2025 fiscal deficit target to 2.8% of GDP and launched a stimulus package, including food aid, cash transfers, and transport discounts. The free meal program is being fast-tracked to reach 82.9 million people. In support, monetary authorities eased policy gradually amid benign risks to price stability. April and May import data suggest a possible rebound in domestic demand. However, sluggish industrial production, weak formal job creation, and slow private investment may weigh on the outlook, with renewed external risks potentially adding pressure.

Malaysia's GDP growth forecast is revised down to 4.3% in 2025 and 4.2% in 2026 due to a weakening outlook for trade and investment amid heightened global uncertainty, from 4.9% and 4.8% respectively. Despite strong Q1 growth, concerns over US tariffs have dampened export and investment prospects. While foreign-approved investments rose in Q1, domestic investments fell 27.4% to RM29.3 billion. Nonetheless, household spending indicators remained positive, and the unemployment rate dropped to 3.0% in May from 3.1% in January 2025, signaling continued resilience in the labor market.

Growth forecasts for the Philippines are revised down to 5.6% in 2025 and 5.8% in 2026, from 6.0% and 6.1%, amid external headwinds. GDP growth in Q1 2025 was lower than expected at 5.4%. Domestic demand grew 6.7%, supported by easing inflation and monetary policy. However, net exports dragged on growth as brisk imports outpaced exports. The manufacturing PMI recovered slightly to 50.7 in June from 50.1 in May. Business confidence softened amid heightened global policy uncertainties. Consumer sentiment was positive in the near term. Unemployment was low at 3.9% in May, and remittance growth of 3.0% helped sustain household spending.

Singapore's GDP outlook for 2025 and 2026 was downgraded due to weaker external demand and persistent trade policy uncertainty. GDP grew 3.9% year-on-year in Q1 2025, down from 5.0% in Q4 2024, as manufacturing and services moderated while construction expanded. Manufacturing and electronics PMI deteriorated in May, and ongoing trade tensions dampened business sentiment. Exports growth also slowed in May, signaling the end of front-loading export surge. As a result, GDP is now projected to grow 1.6% in 2025 and 1.5% in 2026, from projections of 2.6% and 2.4% in April, with external sector weakness potentially spilling over into the domestic economy.

Growth momentum in Thailand is weakening amid rising global uncertainties and a drop in foreign tourist arrivals. GDP slowed in Q1 2025 from the previous quarter due to weaker household spending and private investment. Growth is now projected at 1.8% in 2025 and 1.6% in 2026, down from earlier forecasts of 2.8% and 2.9%, respectively. The downgrade reflects the impact of trade tensions, tourism slowdown, and household debt burdens. Export gains from early shipments ahead of US tariffs may fade in H2 2025. On a positive note, public consumption and investment, along with a new stimulus plan targeting infrastructure, are expected to support growth moving forward. Aside from uncertainty around US trade policies, the outbreak of conflict in the Middle East and domestic political instability could pose additional threats to the Thai economy.

Viet Nam's economy is expected to remain resilient in 2025 and 2026, though growth will slow due to tariff pressures. Strong export and import growth and a surge in foreign investment disbursement drove H1 2025 performance. Investment pledges rose 32.6% while disbursement increased 8.1% year-on-year, indicating strong international confidence in the country's economic prospects. Public disbursement reached the highest level since 2018 at 24.3% of the annual plan. The trade deal with the US, announced in early July 2025, imposed staggered higher US tariffs on exports from Viet Nam, which is expected to dampen export demand for the rest of 2025 and into 2026. The PMI has signaled slowing manufacturing since late 2024. As a result, projected GDP growth is revised down to 6.3% in 2025 and 6.0% in 2026, from 6.6% and 6.5% in the April forecast.

Average inflation in Southeast Asia as of July is below earlier forecasts for 2025 and 2026. Most economies saw inflation ease below central bank targets in the first 5 months of 2025, due to lower energy and food prices, subdued consumer demand, and stronger regional currencies. Bank Indonesia cut its policy rate by 25 basis points in July, following similar cuts in May and January. The 2025 inflation forecast was revised down to 1.5%, rising gradually toward the 2.5% ±1% official target by 2026. Malaysia's inflation is forecast at 2.4% for both years, with a 5-month average of 1.5%, supported by low oil prices and delayed tax reforms. Philippine inflation, averaging 1.8% in the first half with subdued food inflation, is projected at 2.2% in 2025 and 3.0% in 2026. Singapore's inflation averaged 0.9% in the first 5 months, with downward revisions in the forecast to 1.0% and 1.2% for 2025 and 2026. Thai inflation averaged 0.5% in the same period, leading to lower projections of 0.5% in 2025 and 0.8% in 2026. Viet Nam's inflation is expected to remain below 4% through 2026.

Caucasus and Central Asia

The subregional growth outlook for the Caucasus and Central Asia is revised upward to 5.5% for 2025 and 5.1% for 2026, from 5.4% and 5.0%, respectively. This reflects a stronger growth trajectory in Kazakhstan. The growth records of other countries remained in line with earlier ADO expectations. Armenia's economy decelerated sharply, with growth moderating to 4.4% in January-April 2025 compared to 12.9% in the same period last year, due to contractions in industrial output. Azerbaijan's expansion slowed to 1.5% in January-May 2025, down from 4.2% in the same period last year, due to declining hydrocarbon production. Georgia maintained its momentum, growing 9.3% in Q1 2025 and nearly matching the 9.4% in Q1 2024, supported by robust receipts from trade, tourism, and transfers. The Kyrgyz Republic's growth accelerated to 13.1% in Q1 2025, up from 10% in Q1 2024, underpinned by strong domestic demand and increased public investment in infrastructure. Tajikistan grew 8.2% in January-April 2025, fueled by strong consumer spending, remittances, and a surge in mining output. Turkmenistan is set to grow 6.5% in the first half of 2025, supported by public investments and net gas exports. Uzbekistan expanded 6.8% in Q1 2025, reflecting solid domestic demand and investment. Renewed conflict in the Middle East in mid-June poses growth risks to Armenia and Uzbekistan. Apart from Uzbekistan, recently imposed US tariffs are expected to have limited impact on the subregion given its countries' small export exposures to the US.

In Kazakhstan, the subregion's largest economy, GDP expanded 5.6% in Q1 2025, up from 3.8% in Q1 2024. Increases in transport (21.0%), construction (16.9%), manufacturing (8.7%), and mining (6.1%) drove growth. With higher tax collections, Kazakhstan's faster growth is reinforced by stronger than expected government spending on capital investments and social services. The earlier launch of the Tengiz oil field expansion project, ahead of the previous ADO's mid-year expectation, will also support mining output. On 31 May 2025, OPEC+ raised oil production for a third consecutive month, further bolstering growth prospects for Kazakhstan as it operates at maximum available capacity. The country's consolidated business activity index in May 2025 also signaled an expansion of business activities.

The subregional inflation forecast for the Caucasus and Central Asia was adjusted upward to 7.8% for 2025 and 6.7% for 2026, from 6.9% and 5.9%, respectively. This is due to stronger inflationary pressures in Armenia, Kazakhstan, and the Kyrgyz Republic. Armenia's annual inflation rate rose to 3.0% for January-May 2025, compared to 0.8% in the same period last year. Despite a relatively tight monetary stance, Kazakhstan's inflation rate reached 10.1% for the first five months of 2025, compared to 9.0% a year earlier, amid rising utility prices. The Kyrgyz Republic's inflation rate reached 8.0% in May 2025, largely due to its continued reliance on food and energy imports. In Tajikistan, consumer inflation remained muted at 0.1% in May 2025. Inflation in the other countries remained in line with earlier ADO forecasts. Azerbaijan's inflation rate stood at 5.9% for January to May 2025, reflecting the lagged effects of administered price hikes in fuel and utilities. Georgia's annual inflation amounted to 3.5% in May 2025. According to reports, Turkmenistan's inflation is projected to be 6.0% for 2025, primarily due to extensive credit to state-owned enterprises and a 10.0% increase in public sector wages and pensions. Uzbekistan's inflation rate reached a high of 10.3% in March 2025, prompting its central bank to hike interest rates, citing rising investment, energy tariff increases, and slower-than-expected disinflation.

The Pacific

Growth projections for the Pacific are maintained at 3.9% in 2025 and adjusted downward to 3.5% in 2026, from 3.6% in the April forecast. The economic outlook for the subregion is predominantly determined by Papua New Guinea and Fiji, the two largest economies. Growth projections for these two countries remain unchanged. In Papua New Guinea, mining activity continues to support the growth outlook, while in Fiji, tourism and stimulus from public infrastructure projects are the key growth drivers. Although the subregional average remains unchanged in 2025, trends in tourist arrivals influence changes in the outlook for certain economies. Growth in FY2025 is expected to be higher in the Cook Islands (ended 30 June 2025) due to an estimated increase in visitor arrivals. Conversely, the growth projection for Palau is adjusted downward for FY2025 (ends 30 September 2025) as visitor arrivals are estimated to be lower than initially projected. The downward adjustment to the 2026 subregional average growth projection is driven by a weaker outlook for both the Cook Islands and Palau, based on anticipated trends in visitor arrivals. While the growth projections for Samoa remain unchanged, the power crisis that occurred in early 2025 is expected to weigh on performance in FY2025 (ended 30 June 2025) and possibly FY2026. Moreover, the introduction of a US remittances tax may also marginally constrain growth in 2026 particularly in remittance-dependent economies (Box 5). Overall, the subregion's growth is moderating as it continues to face challenges in expanding tourism and implementing public infrastructure projects, such as capacity constraints, vulnerability to disasters and external shocks, limited fiscal space, and an elevated risk of debt distress.

Inflation in the Pacific is still forecast to be 3.4% in 2025 and 3.7% in 2026. The outlook is driven by international commodity price trends. The subregional averages mask adjustments in smaller Pacific economies. In FY2025, inflation is estimated to be lower than initially forecast in Samoa and higher in the Marshall Islands and Palau, based on observed domestic price movements. For FY2026, higher inflation is projected in Palau and lower inflation in the Marshall Islands and Samoa. More volatile international commodity prices, particularly for fuel, and supply chain disruptions—including those that might arise from geopolitical tensions—pose significant risks to the outlook.

Box 1 Safe Haven or Policy Driven? Understanding Recent US Dollar Dynamics

The sharp depreciation of the United States (US) dollar in 2025 has raised questions about its underlying drivers. It may signal an erosion of the traditional US safe-haven status, reflect shifting expectations about US monetary policy, or both.

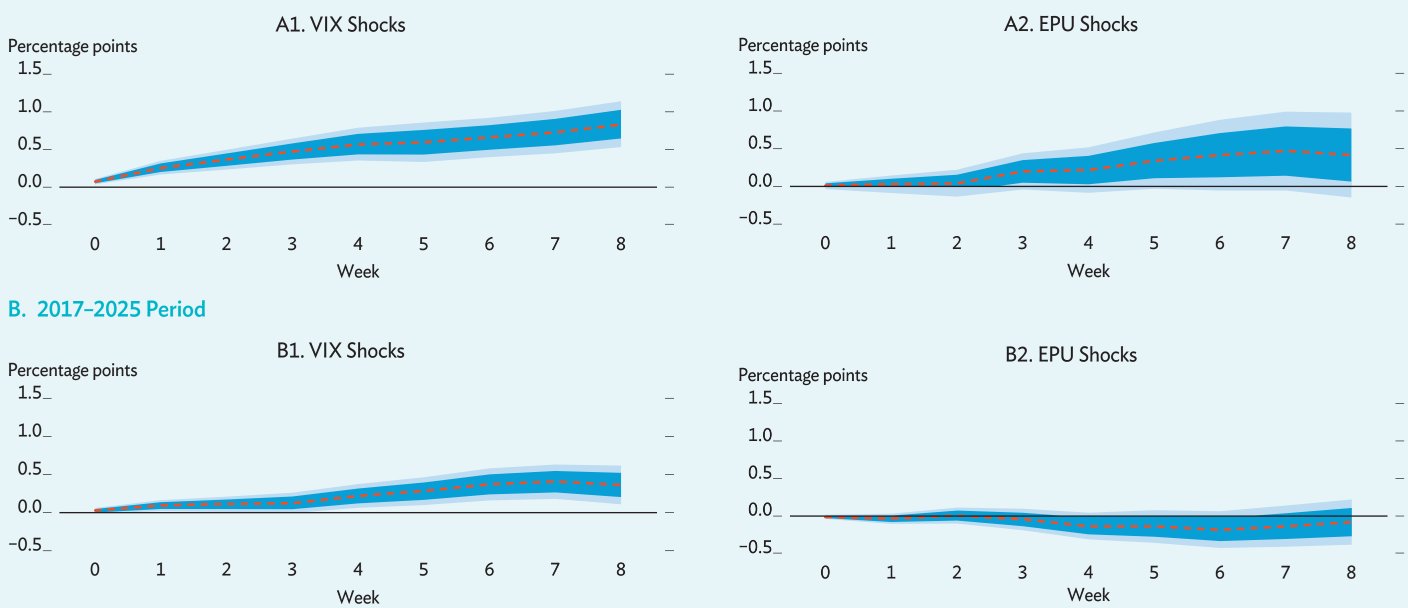
The US dollar and US Treasuries have long been considered the quintessential global safe-haven assets. This status reflects the exceptional depth and liquidity of US capital markets, which are supported by strong institutions and creditor protections (Caballero, Farhi, and Gourinchas 2008; Krishnamurthy and Vissing-Jorgensen 2012). In particular, short-term US government bonds (Treasuries) offer unique liquidity services and are the global benchmark for risk-free assets (Gorton 2017). Their market size, stability, and accessibility enable investors to adjust portfolios swiftly without significant price impact. This property—reinforced by the US dollar's central role in global finance and trade—has historically triggered flight-to-quality flows into Treasuries during global stress, allowing them to command a sizeable negative liquidity premium (Longstaff 2004).

Recent market developments have cast doubt on the continued status of the US as a global financial safe haven, however. A broad, trade-weighted measure of the US dollar depreciated more than 7% over the first 6 months of 2025, the most since the series began in 2006. At the same time, US government debt experienced a selloff following the reciprocal tariff announcement by the US administration on 2 April, which ushered in unprecedented trade-related policy uncertainty. The selloff was especially strong at the long end of the curve, with the 30-year US Treasury yield rising over 50 basis points in the 50 days following the announcement. This episode marks a partial erosion of the convenience premium traditionally enjoyed by US Treasuries (Acharya and Laarits 2025). Debt sustainability concerns following the recent passage of the One Big Beautiful Bill Act and worries about the independence of the Federal Reserve in the face of intensified political pressures, may have contributed to the perceived erosion of US safe-haven credentials.

1 Investor Allocations into US Government Bond Mutual Funds in Response to Uncertainty Shocks

Safe-haven demand for US Treasuries has weakened

A. 2007–2016 Period



EPU = economic policy uncertainty, US = United States, VIX = volatility Index.

Note: Dashed red lines denote point estimates, dark and light blue areas are respectively 67% and 90% confidence bands obtained using two-way clustered standard errors (fund and time). The estimation employs the local projections method (Jorda 2005) over a 9-week horizon in a fund-week panel. The dependent variable is cumulative investors' allocations into mutual funds over the horizon considered divided by funds' initial assets. The main explanatory variables are the first difference of the US VIX and EPU indexes divided by their standard deviation and interacted with period dummies. Control variables include (i) eight lags of the first difference of the US EPU and VIX indexes; (ii) six monthly lags of the fund's net asset value percentage return and previous fund inflows; (iii) forward shocks, following the methodology of Teulings and Zubanov (2014) to account for EPU and VIX shocks occurring within the t+k horizon but not captured by the explanatory variables at time t; and (iv) the log of fund initial assets.

Sources: Ciminelli and Raabe (forthcoming), based on data from Emerging Portfolio Fund Research, Baker, Bloom and Davis (2016); and Chicago Board Options Exchange. CBOE Volatility Index: VIX [VIXCLS]. Federal Reserve Bank of St. Louis. https://fred.stlouisfed.org/series/VIXCLS (accessed 9 July 2025).

continued on next page

Box *Continued*

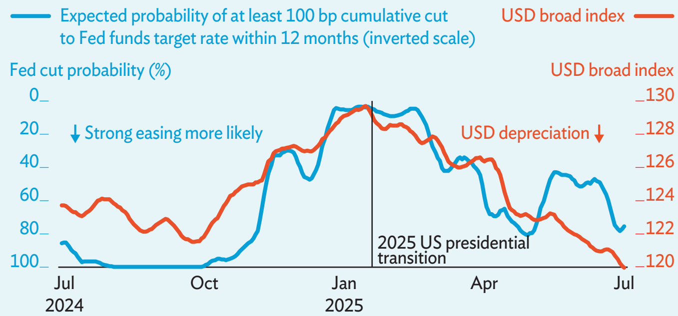
Empirical evidence suggests US safe-haven status may be weakening. Ciminelli and Raabe (forthcoming) study how investors reallocate capital in and out of mutual funds investing in US Treasuries in response to increases in US expected stock market volatility (VIX) and economic policy uncertainty. Responses are estimated separately for the periods 2007–2016 and 2017–2025 (box figure 1). The latter period covers trade tensions and tariff hikes on the People's Republic of China and other economies dating back to 2018, as well as the COVID-19 pandemic. Comparing the two periods suggests a weakening in US Treasuries' safe-haven role. While VIX and economic policy uncertainty shocks triggered inflows into US Treasuries funds over the 2007–2016 period, 2017–2025 shows smaller inflows in response to VIX shocks and even some outflows following economic policy uncertainty shocks.

At the same time, recent US dollar weakness is likely to have also been driven by shifting monetary policy expectations. According to the uncovered interest rate parity theory, exchange rates adjust to reflect differences in expected returns across currencies, particularly those driven by short-term interest rate differentials. Analyzing market expectations of future US Federal Reserve (Fed) policy moves offers revealing insights. In October 2024, the expected probability of at least 100 basis points of Fed rate cuts over the following 12 months was about 100% (box figure 2, blue line, shown on an inverted scale). While the Fed delivered two 25 basis point cuts, in November and December 2024, the expected probability of a further 100 basis points of cuts had fallen to near zero by the end of the year. This reflected confidence that the incoming US administration's policies would boost growth, thus leading the Fed to delay further easing. This shift supported a notable appreciation of the US dollar (box figure 2, red line, right axis). However, as the extent of tariff policies planned by the new administration started to become clearer, expectations reversed sharply. Markets increasingly anticipated that the imposition of steep tariffs would prompt the Fed to cut rates substantially given the expected detrimental effects for the US economy. This repricing of interest rate cuts in the US—together with a more hawkish outlook in some of the US's biggest trade partners, like the euro area and Japan—may have contributed to the substantial depreciation of the US dollar observed over 2025.

Taken together, the evidence suggests that while US safe-haven status may be weakening, monetary policy expectations have played an important role in shaping recent currency movements. Structural advantages—such as deep and liquid markets—continue to support the role of US assets in global portfolios, but recent developments highlight that this status is no longer unconditional. Political risk, fiscal sustainability concerns, attacks on central bank independence, and trade-related uncertainty are weighing on investor perceptions. If sustained, these factors could see a US risk premium emerge, which could more than offset the negative liquidity premium historically enjoyed by US Treasuries and exert structural downward pressure on the US dollar. At the same time, however, shifts in relative monetary policy expectations are and will remain important in driving short-term exchange rate dynamics.

2 Fed Rate Cut Expectations and the US Dollar

The US dollar fell in 2025 as markets priced in deeper rate cuts.



bp = basis point, US = United States, USD = United States dollar.

Note: The expected probability of at least 100 basis points of cumulative cuts to the US federal funds target rate over the next 12 months is computed from CME FedWatch data by summing the probabilities of all target rate outcomes 100 basis points or more below the current rate across upcoming Federal Open Market Committee meetings. The probability and USD broad index series are smoothed using a 7-day lagging moving average representation.

Source: CME FedWatch Tool. Target Rate Probability History for Federal Reserve Meeting. CME Group. https://www.cmegroup.com/markets/interest-rates/cme-fedwatch-tool.html (9 July 2025); Board of Governors of the Federal Reserve System. Nominal Broad U.S. Dollar Index [DTWEXBGS]. Federal Reserve Bank of St. Louis https://fred.stlouisfed.org/series/DTWEXBGS (9 July 2025).

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Box 2 Global Assumptions

Growth in the major advanced economies in 2025 and 2026 is now projected to be lower than anticipated in *Asian Development Outlook April 2025*, primarily due to the impact of higher tariffs. In the United States (US), tariff hikes are expected to dampen trade activity, increase production costs, and weigh on household consumption amid ongoing uncertainty over the possible resumption of reciprocal trade measures. The decline in US-bound exports is already affecting Japan's economy. In aggregate, the growth forecast for major advanced economies is revised down from 1.6% to 1.4% in 2025 and from 1.6% to 1.5% in 2026 (box table).

Baseline Assumptions on the International Economy

Growth in advanced economies is weakening, oil prices will ease further.

	2024	2025		2026	
	Actual	April	July	April	July
GDP growth, %					
Major advanced economies	**1.7**	**1.6**	**1.4**	**1.6**	**1.5**
United States	2.8	2.0	1.7	1.9	1.9
Euro area	0.9	1.2	1.2	1.4	1.3
Japan	0.1	1.2	0.8	0.8	0.6
Prices and inflation					
Average Brent crude spot prices, $/barrel	81	74	67	71	62
CPI inflation, major advanced economies' average, %	2.7	2.4	2.5	2.2	2.2

CPI = consumer price index, GDP = gross domestic product.

Note: Average rates are weighed by GDP purchasing power parity.

Sources: Bloomberg; CEIC Data Company; Haver Analytics; IMF World Economic Outlook; Asian Development Bank estimates.

The US economy shows signs of a deceleration. US GDP contracted 0.5% in Q1 2025, reversing 2.4% growth in the fourth quarter (Q4) 2024. A sharp, 4.6-percentage-point drag from net exports drove the decline, reflecting a surge in imports ahead of tariff hikes. Personal consumption contributed only 0.3 points, down from 2.7, while private investment rebounded, adding 3.9 points. Government spending also subtracted slightly from growth. Headline inflation rose to 2.7% in June from 2.4% in May, with core inflation edging up to 2.9% from 2.8%. Core personal consumption expenditures increased to 2.7% in May from 2.6% in April. Despite these moderate gains, tariff-related price pressures are emerging. Consumer sentiment improved to 60.7 in June from 52.2 in May, although concerns about rising inflation expectations and tariff persist. ISM Manufacturing and Services Indexes weakened, reflecting policy-related uncertainty. Industrial production stagnated and labor market gains narrowed. The United States Federal Reserve (The Fed) held rates steady at 4.25%–4.50%, citing inflation risks.

Growth is expected to slow to 1.7% in 2025 and 1.9% in 2026, while inflation will remain above target at 2.8% in 2025 and 2.6% in 2026. The front-loading of imports is expected to fade, but higher tariffs and policy uncertainty will continue denting private investment and growth this year. Trade uncertainty, in particular, remains elevated on the potential resumption of reciprocal tariffs announced on 2 April. As the effects of higher tariffs are passed on to producer and consumer prices, household confidence and consumption will also remain subdued. The enactment of the One Big Beautiful Bill Act, approved 4 July, is expected to provide a short-term lift to GDP from H2 2025, offsetting the negative growth effects of tariffs in 2026. By boosting household demand, increased government spending and tax cuts will temporarily stimulate economic activity and lead to a slight uptick in price pressures. Inflation remains above target, and the labor market continues to be tight. The Fed is expected to cautiously start cutting interest rates only towards Q4 2025, limiting credit growth and economic activity into 2026.

GDP growth in the euro area is forecast at 1.2% for 2025 and 1.3% for 2026. GDP surprised to the upside in Q1 2025, growing at 2.5% seasonally adjust annualized rate (1.5% year-on-year), the fastest pace since Q2 2022. While the strong growth was influenced by one-off factors related to export front-loading in Ireland, the region's four largest economies all posted positive and increasing or stable growth rates (Spain 2.3%, Germany 1.7%, Italy 1.1%, and France 0.5%). Leading indicators suggest that the euro area may have moderately expanded in Q2 2025, with the composite Purchasing Managers' Index (PMI) always settling above 50, and the manufacturing PMI in June reaching its highest point since August 2022. The labor market remains resilient, with the unemployment rate of 6.3%, near its record low, and stable wage growth, which continue to support consumer spending. Further monetary policy easing in the first part of this year and expected fiscal expansion in Germany will support aggregate demand over the rest of this year and the next.

Headline inflation is forecast to settle at 2.1% in 2025 and 1.9% in 2026. Inflation fell to 1.9% in May 2025 from 2.2% in April, as energy inflation remained negative and services inflation declined to 3.2%, its lowest level in 3 years. Looking ahead, a strong euro and developments in energy markets suggest that these dynamics may persist, with low goods inflation continuing to offset higher services inflation.

continued on next page

Box *Continued*

Japan's growth outlook has weakened, compared to projections in the *April 2025 ADO*, with GDP now forecast to rise 0.8% in 2025 (from 1.2%) and 0.6% in 2026 (from 0.8%). Japan's GDP growth was flat quarter-on-quarter in Q1 2025, or a 0.2% contraction on an annualized basis, the first decline in four quarters. Weaker net exports led the contraction, while private consumption remained sluggish, rising by just 0.1% for the second straight quarter. The effects of US tariffs started to materialize in April, with US-bound exports down 1.8%—the first decline in 4 months—due to weaker demand for automobiles, steel, and ships. The au Jibun Bank Flash Manufacturing PMI edged up to 49 in May from 48.7 in April, reflecting milder declines in new orders and exports. Consumption is expected to improve gradually, supported by income growth, fuel subsidies, and tax reforms. Government consumption will rise with healthcare and elderly care needs, while public investment remains flat. These domestic drivers will only partly offset external headwinds.

Inflation for Japan is forecast at 3.0% for 2025 (up from 2.6%) and 1.9% for 2026 (unchanged). While headline inflation eased slightly from 4.0% in January to 3.6% in April, the core consumer price index—which excludes volatile fresh food—climbed to 3.5% in April following a dip in February. Both headline and core inflation remained well above the Bank of Japan's 2% target. The waning impact of government energy subsidies led to sharp increases in electricity and gas prices in April, indicating that part of the recent moderation in headline inflation may be temporary. Underlying inflationary pressures were further driven by rising costs in housing and healthcare, as well as a sharp 94.8% year-on-year surge in rice prices as extreme weather led to the lowest domestic harvest levels in over a decade. Inflationary pressures are expected to ease gradually as monetary policy is cautiously normalized and global crude oil prices decline.

Brent crude oil prices fluctuated significantly from April to early June 2025. Prices fell sharply in April from end-March, about $16 per barrel, hitting a 4-year low below $60/barrel by end-April, driven by rising US tariffs and unexpected OPEC+ output hikes. A rebound followed, with prices climbing to around $66/barrel by mid-May after the US reached a trade deal with the UK (May 8) and a 90-day accord with the People's Republic of China (PRC) (12 May). These developments underscored the market's sensitivity to geopolitical and trade news. Volatility persisted through late May and early June, with prices hovering in the mid-$60s as escalating geopolitical tensions and relief over a smaller-than-feared July Organization of the Petroleum Exporting Countries (OPEC) production increase supported prices. As of 6 June, Brent traded at $66/barrel, with a year-to-date average of $71/barrel.

Muted demand growth, alongside rising supply and structural shifts in energy use, is expected to keep prices subdued. According to the International Energy Agency, global oil supply is projected to rise by 1.6 million barrels per day (mb/d) to 104.6 mb/d in 2025 and by another 970,000 barrels per day in 2026. This growth is driven by strong output from non-OPEC+ producers such as the US, Canada, Brazil, and Guyana, along with increased production from OPEC+ members. Eight OPEC countries that had voluntarily cut output by 2.2 mb/d in November 2023 announced a fourth consecutive rollback of those cuts on 31 May. At the current pace, the full reduction could be reversed by October 2025. The International Energy Agency projects oil demand growth to slow from 990 thousand barrels per day (kb/d) in Q1 2025 to 650 kb/d for the remainder of the year, averaging 740 kb/d in 2025 and 760 kb/d in 2026—down from 870 kb/d in 2024. With supply consistently exceeding demand, inventories are expected to rise. Policy signals—including the US administration's preference for lower prices and weakening cohesion within OPEC+—further reinforce expectations of easing price pressures. Futures markets reflect this outlook, with longer-term contracts priced above near-term ones—a so-called "contango structure" that signals expectations of future oversupply or weaker demand, as traders factor in storage costs and risks over time. Brent crude oil prices are now forecast to be lower than projected in April, averaging $67 per barrel in 2025 and $62 in 2026. Risks around these forecasts are two-sided—renewed increases in tariffs could dent global demand and lower oil prices even more, but simmering tensions in the Middle East could push prices higher than forecast.

This box was written by John Beirne, Gabriele Ciminelli, Jaqueson Galimberti, Pilipinas Quising, and Dennis Sorino of the Economic Research and Development Impact Department (ERDI) and Emmanuel Alano, ERDI consultant.

Box 3 The One Big Beautiful Bill Act: Fiscal Stimulus with Mixed Spillovers for Developing Asia

The One Big Beautiful Bill Act (OBBBA) updates fiscal priorities for the United States (US) and could have limited effects in developing Asia. Signed into law on 4 July 2025, the legislation combines tax relief with increased spending on defense and immigration control, while rolling back clean energy support and certain social programs. The OBBBA is expected to boost US economic activity in the short to medium term but carries implications for debt sustainability. The Act may have mixed effects in developing Asia through different channels.

On the revenue side, the OBBBA introduces various tax breaks and reductions. First, the legislation extends key provisions of the 2017 Tax Cuts and Jobs Act, including the reduced corporate income tax rate of 21%. Second, it introduces new tax deductions for elderly Americans, and higher state and local tax deductions. Some policy measures introduced with the OBBBA are also projected to raise revenue modestly, including higher excise taxes on university endowments and a 1% remittances tax (see Box 5 for an analysis of the implications of the new remittance tax for Asian economies).

On the expenditure side, the new act reduces spending on social programs and clean energy, while increasing it for military and immigration enforcement. Healthcare funding and social transfers are subject to steep cuts, while tax incentives promoting clean energy technologies and renewable resources are eliminated. In contrast, the OBBBA raises the defense and immigration enforcement annual budgets by a combined $242 billion, worth about 0.8% of gross domestic product (GDP).

The Congressional Budget Office (2025) estimates that the OBBBA will increase US GDP by an average of 0.5% over 2025–2034. The positive impact is projected to peak at 0.9% in 2026, relative to the office's January forecast. The estimated growth effects result from higher aggregate demand, greater incentives to work as lower marginal tax rates boost labor force participation and hours worked, and a short-term increase in private capital investment. These gains are expected to taper over the longer term, as stricter immigration enforcement lowers labor supply and various investment tax breaks expire.

The OBBBA is also projected to increase the US debt-to-GDP ratio by up to 10 percentage points by 2034 (Committee for a Responsible Federal Budget 2025). The increased supply of US government debt is expected to push up the interest rate on the 10-year Treasury note by an average of 14 basis points over 2025 to 2034. Moreover, stronger aggregate demand and inflationary pressure may result in a higher Federal Reserve policy rate path, further increasing federal borrowing costs. Rising debt and financing rates would increase interest payments, which already reached 3% of US GDP in 2024.

For developing Asia, the OBBBA short-term stimulus could provide modest support to growth through trade channels. Simulations conducted using the Oxford Global Economic Model indicate that a 1.0 percentage point rise in US GDP growth increases GDP growth in Asia by about 0.1 percentage points, on average. Economies with stronger trade ties to the US, including Viet Nam and Taipei,China, experience larger effects. However, in the current environment, the positive impact via this trade channel could be offset by the effects of higher US tariffs on economies in the region.

At the same time, tighter-than-expected US monetary policy could exert pressure on Asian central banks to follow suit. This is especially the case for economies concerned about possible capital outflows and exchange rate depreciation. Higher US interest rates would also increase the cost of servicing US dollar-denominated debt, posing challenges for economies more exposed to this type of external debt.

The OBBBA's industrial policy focus may further impact Asia's high-tech sectors. Section 48D of the legislation institutes 25%–35% subsidies for domestic semiconductor manufacturing (CNBC 2025), potentially diverting investment away from Asian producers. Major firms such as TSMC and Intel have already expanded US-based operations in response.

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This box was written by Gabriele Ciminelli of the Economic Research and Development Impact Department and Ahmad Miraj of the Central and West Asia Department.

Box 4 Recent Tariff Developments and Risk Scenarios

Reciprocal tariffs announced by the United States (US) continue to hover over the region and the globe. On 2 April 2025, the US administration introduced a set of “reciprocal tariffs” ranging from 10% to 50%, targeting economies with merchandise trade surpluses with the US. The average tariff imposed on developing Asia exceeded 30%. Most economies opted not to retaliate, with the exception of the People’s Republic of China (PRC), which responded with a matching retaliatory tariff on US imports. This tit-for-tat escalation continued until US tariffs on imports from the PRC reached 125%, with the PRC responding with an equivalent retaliatory tariff on 11 April.

Pauses of 90 days were introduced for both the 2 April US tariffs and the PRC-US tariff escalation, providing a window for economies to begin trade negotiations with the US. On 9 April, the US paused reciprocal tariffs for all economies except the PRC for 90 days, reducing them to a flat 10%. Eventually, on 12 May, the US and the PRC agreed to de-escalate, reducing their additional tariffs to 10%, also for 90 days. The de-escalation temporarily eased tensions and trade negotiations between the US and several economies began. Partial agreements signaled a possible shift toward a “new normal” of elevated US tariffs. These include the 9 May US–United Kingdom deal, the 3 July US–Viet Nam trade agreement, which imposes a 20% tariff on any and all goods imported to the US, and the 15 July US–Indonesia deal including a 19% tariff on imports to the US. Meanwhile, aside from the reciprocal tariffs, the US also raised tariffs on steel and aluminum to 50% on 4 June.

In early July, the US extended its tariff pause deadline and announced the updated tariff rates for some economies. While the 90-day pause was initially set to end on 8 July, the US extended trade negotiations and delayed the implementation of higher tariffs until 1 August. As of 17 July, it had also issued letters to several economies informing them of new tariff rates, including key trading partners such as Japan and the Republic of Korea, now facing tariffs at 25% unless trade agreements are reached before the revised deadline.

Given the continued trade uncertainty, this box explores two tariff scenarios that could potentially materialize. All scenario results are expressed as deviations from a baseline that incorporates tariff changes up to 17 July. As such, the baseline includes: the latest US trade agreements with Indonesia, the UK, and Viet Nam; a 10% US tariff on all other economies as implemented during the 90-day tariff pause; full retaliation by the PRC and partial retaliation by the European Union (EU); and the additional US tariffs for aluminum and steel. The two tariff scenarios, described below, were implemented starting in the third quarter of 2025 and the tariff changes were assumed to apply throughout the 2025–2026 forecast horizon:

- **Reciprocal tariffs scenario:** This scenario incorporates updated tariff rates announced by the US as of 17 July and assumes the 2 April reciprocal tariff rates for other economies, adjusted for exemptions. Retaliation by the PRC (34%) and EU (20%) is assumed to be full, while other economies are assumed not to retaliate.

- **US–PRC re-escalation scenario:** This scenario retains the baseline assumptions for all economies, except for US–PRC trade relations. These are assumed to follow the same tit-for-tat retaliation, peaking at 125% tariffs, as announced on 11 April.

The simulations were carried out using the Global Economic Model of Oxford Economics.

Scenario results show growth falling across the board as a result of higher tariffs. With tariff hikes constraining trade, global growth is reduced (box figure 1a). Weaker economic activity, worsening financial conditions, and lower confidence compound the tariff impact, further leading to lower consumption and investment. Given the timing of the tariff shocks, most of the impact is felt in 2026.

Inflation is lower in most economies. The global slowdown reduces demand-side price pressures, leading to falling oil and commodity prices. With lower energy inflation and weaker growth, headline inflation decreases in both 2025 and 2026. The main exceptions to this pattern are the US and the PRC, which are assumed to hike tariffs on each other in both scenarios.[a]

The reciprocal tariffs scenario yields modest growth impacts for developing Asia. Over 2025–2026, growth in the PRC decreases by a cumulative 0.7 percentage points, while the rest of developing Asia sees a 0.4 percentage point fall. US growth declines 1.7 percentage points and global growth by 0.8 percentage points. Inflation rises 0.2 percentage points in the PRC in 2025 because of higher tariffs on US imports, but then reverts in 2026 as growth slows. The rest of developing Asia sees a cumulative 0.6 percentage point fall in inflation, mostly in 2026. Oil prices decrease 1.3% in 2025 and drop nearly 11% in 2026.

Under the US–PRC escalation scenario, growth and inflation impacts are steeper. Over 2025–2026, US growth drops by 2.5 percentage points, the PRC’s by 2.3 percentage points, and global growth by 1.4 percentage points.

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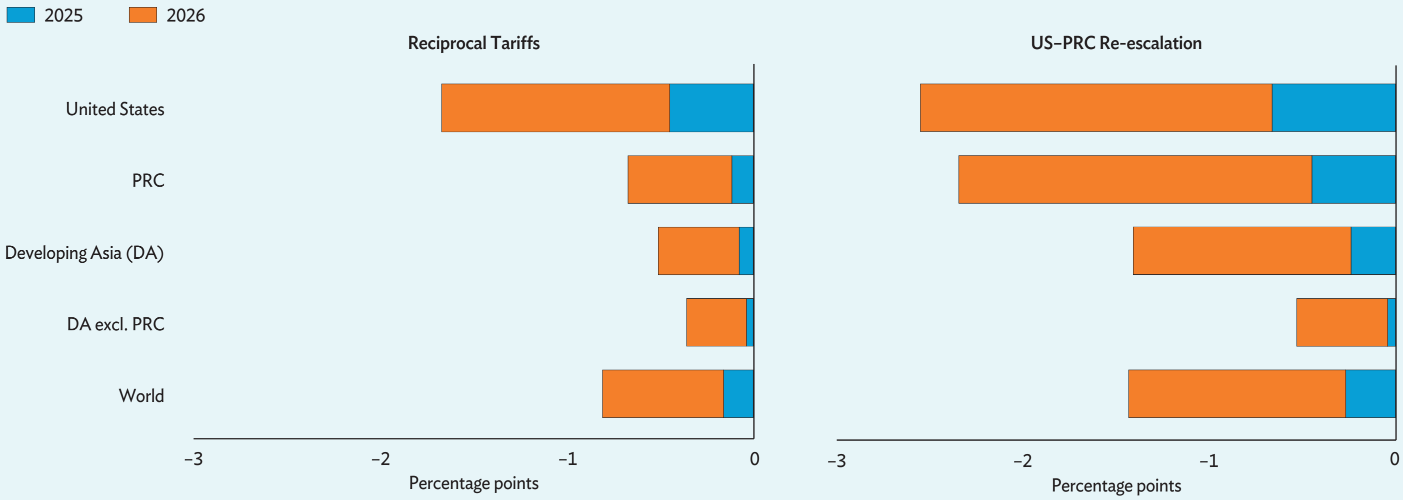
Box *Continued*

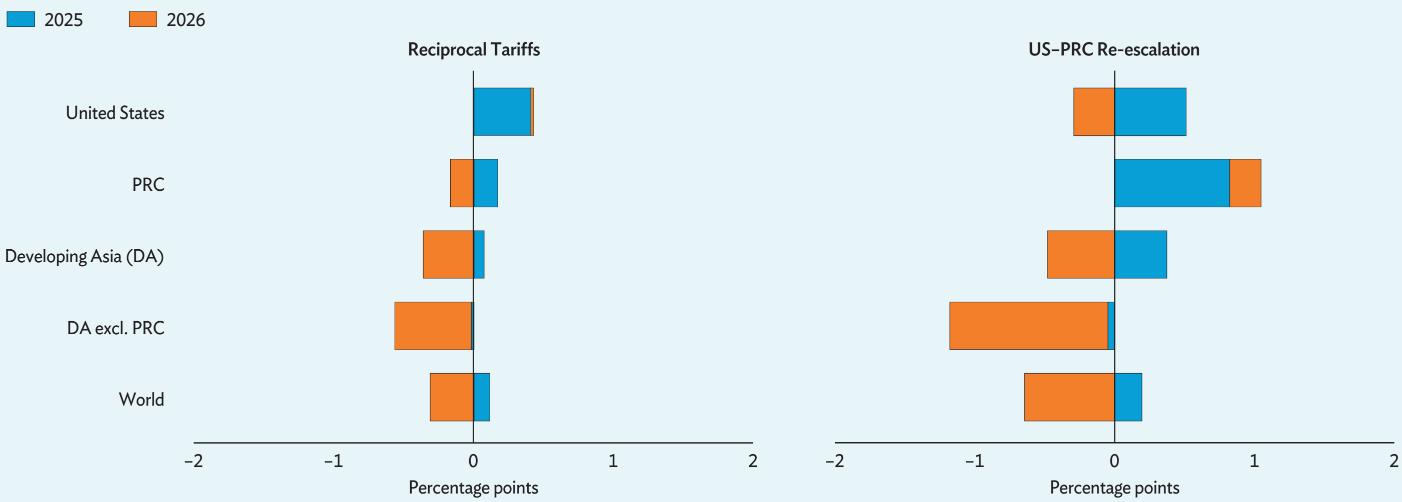
1a Estimated Impact of Tariffs on GDP Growth

In both scenarios, growth is slower and most of the impact is felt in 2026.



1b Estimated Impact of Tariffs on Inflation

Slower inflation is anticipated, except in US and PRC.



PRC = People's Republic of China, GDP = gross domestic product, US = United States.

Notes: Modeled tariff impact estimates do not account for discretionary policy responses, nor do they fully incorporate frontloading, trade diversion, heightened policy uncertainty, market volatility, or risk aversion. All scenarios take into account US tariff developments up to 17 July 2025.

Source: Asian Development Bank staff estimates.

Developing Asia (excluding the PRC) sees a 0.5 percentage points growth decline as the broader global slowdown outweighs the direct effect of higher tariffs in the reciprocal tariffs scenario. Effects on inflation are also stronger in this scenario. With oil prices falling 2.7% in 2025 and plummeting 21.0% in 2026, inflation in developing Asia, excluding the PRC, drops by a cumulative 1.2 percentage points. In contrast, as a result of their tariff escalation, the US sees a rising inflation rate, by 0.2 percentage points in 2025–2026 and the PRC by 1.0 percentage point.

[a] Most currencies also appreciate against the US dollar, making imports of US-dollar-priced products cheaper. In the model, these currency appreciations stem from the US Federal Reserve cutting interest rates more aggressively than most other central banks, in response to larger tariff-induced output losses in the US. Still, the model's estimates of monetary easing in the US are modest compared to market expectations. For example, just after the announcement of the US reciprocal tariffs, futures markets were pricing up to 125 basis points in cuts to the Federal Funds rate by the end of 2025.

This box was written by Matteo Lanzafame, Melanie Grace Quintos, and Priscille Villanueva of the Economic Research and Development Impact Department.

Box 5 The US Remittance Tax is Unlikely to Disrupt Flows to Developing Asia

The 1% tax on remittances from the United States (US) is expected to have minimal effects in developing Asia. This tax was included in the One Big Beautiful Bill Act, which was enacted on 4 July 2025 and will become effective on 1 January 2026. The tax will shift part of the tax burden to immigrants. It will be collected by physical and online money transfer service providers while transfers through US banks or US-issued debit or credit cards will be exempt. The final rate of 1% adopted by the US Congress is much lower than the originally proposed 5%. As a result, the impact on remittances flows to Asia and the Pacific is projected to be very modest.

The US is a key source of remittances for economies in the region. In 2021, the last year with bilateral data available, US remittances to the region were $61 billion—about 30% of the total received. For four countries in the region, the US was the main source of remittances, accounting for more than 40% of remittances received in Tonga, the Marshall Islands, Viet Nam, and the Republic of Korea. India received the largest absolute amount with about $16 billion, followed by the Philippines and the People's Republic of China—both $13 billion (box figure 1, panel A). In relative terms, US remittances are most critical for economies in the Pacific, where they were equivalent to 16.5% of gross domestic product (GDP) in Tonga in 2021, 11.7% in the Marshall Islands, and 6.6% in Samoa (box figure 1, panel B).

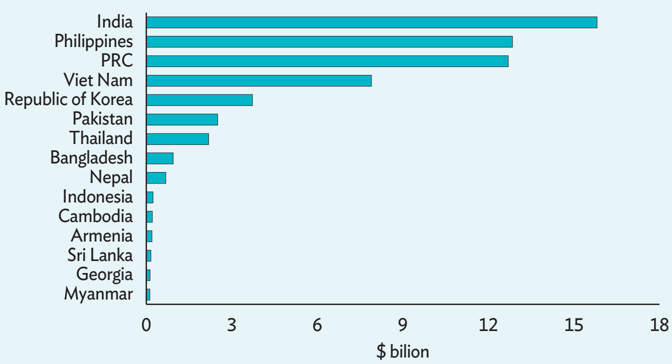
The impact of the tax will be limited, even in the most affected Pacific Island economies. Tonga will be hardest hit, but even there, the estimated decline of inflows only amounts to 0.31% of its 2026 GDP (box figure 2, panel B). The Marshall Islands' projected loss is slightly lower, at 0.22% of GDP, while Samoa (0.10%) and Fiji (0.03%) would also be marginally affected (see methodological details in the note to box figure 2). Though the impact may be small from a macroeconomic perspective, low-income households that rely on remittances are likely to be disproportionately affected by these losses.

Economies outside of the Pacific will barely feel the tax. In the rest of the region, the Philippines is projected to face the largest proportional decline, with US remittance inflows falling by the equivalent of 0.05% of GDP, followed by Viet Nam and Nepal (both 0.03%). India's loss would be the largest in absolute terms, at $315 million (box figure 2, panel A), but amounting to just 0.01% of its GDP.

1 Value of US Remittances to Developing Asia in 2021

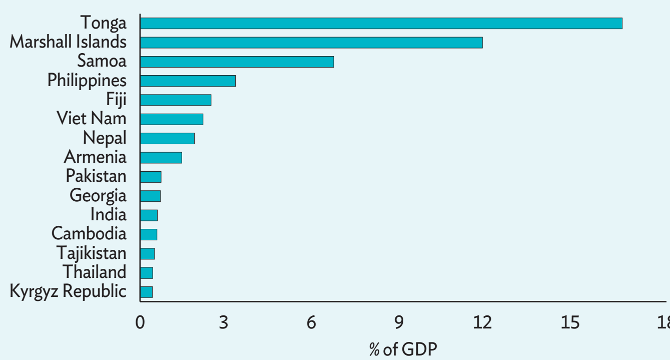
A. Value

India receives the largest amount of US remittances, followed by the Philippines and the PRC.



B. Share of GDP

Pacific Island economies like Tonga, the Marshall Islands, and Samoa depend the most on US remittances.



PRC = People's Republic of China, GDP = gross domestic product, US = United States.
Source: Asian Development Bank calculations based on World Bank (2025).

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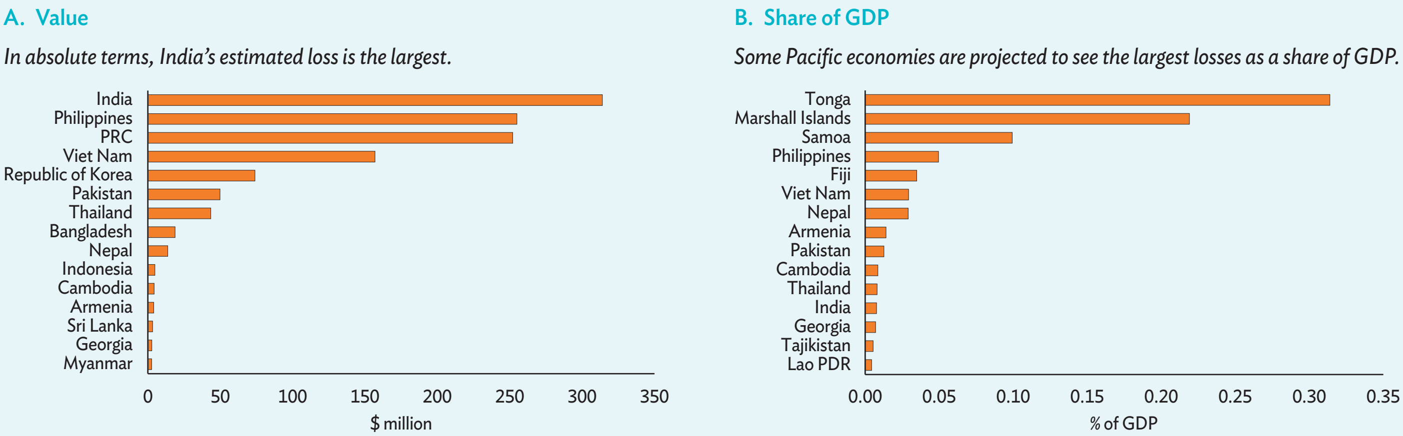
Box *Continued*

2 Estimated Loss in US Remittances for Developing Asia in 2026



PRC = People's Republic of China, GDP = gross domestic product, Lao PDR = Lao People's Democratic Republic, US = United States.

Note: The remittance losses were estimated using the method developed by Dempster et al (2025). This involves two steps: (i) inflating US remittances to each economy in 2021 by 24.6%, to reflect the estimated global remittance increase over 2021–2026; and (ii) calculating remittance losses as 1.6% of the amount obtained in step (i), reflecting the −1.6 elasticity estimated in Ahmed et al. (2021). GDP levels in 2026 were estimated based on ADB's latest GDP growth forecasts.

Source: Asian Development Bank calculations based on World Bank (2025).

Senders' ability to circumvent the tax will further curtail its impact. The estimations in this box are likely to represent upper bounds of the actual impact of the tax, as they assume that it will be levied on all remittances. However, remittance service providers may absorb part or all of the tax to remain competitive against US banks, which are exempt. This would primarily hit the profit margins of money transfer services such as Western Union, PayPal, or MoneyGram—all US companies. And if transfer costs do rise, users may turn even more to the banking system to transfer money. Users may also rely more on informal methods such as physical cash transfer or the *hawala* system—a trust-based network where brokers settle transactions informally. Lastly, the tax could accelerate the shift toward cryptocurrency transfers, which are quickly gaining ground.

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This box was written by Ed Kieran Reyes and Jules Hugot of the Economic Research and Development Impact Department.

Box 6 Risk Scenarios around a Re-Escalation of Conflict between Israel and Iran

The mid-June 2025 conflict escalation between Israel and Iran raised alarm over energy security, regional stability, and the global economic outlook. On 13 June, Israel launched a surprise airstrike on Iranian military and nuclear facilities—its most direct confrontation with Iran to date. Oil prices responded immediately, rising from $71 per barrel on 11 June to $78 by 19 June (box figure 1). Still, the spike was modest compared to previous shocks, such as the surge to $134 in March 2022 following Russia's invasion of Ukraine. After a ceasefire was announced on 24 June, prices fell to $66 and have since stabilized around that level.

Global oil shipping volumes remained stable despite elevated tensions, but shipping costs have increased. Daily vessel traffic through the Strait of Hormuz was consistent with past trends. However, shipping costs rose sharply. The Baltic Dirty Tanker Index, a benchmark for crude and fuel oil transport costs, rose 20% from 13 to 23 June and remains above pre-conflict levels, reflecting continued uncertainty and risk premiums.

Financial markets barely budged. Asian equity markets were mixed on 23 June, while United States (US) stocks posted modest gains, reflecting expectations of a short-lived conflict. The US dollar appreciated slightly during the escalation but retreated after the ceasefire. These modest responses suggest that markets priced in a quick resolution, which did materialize. Still, the risk of renewed conflict persists.

History shows that tensions involving major oil producers can severely disrupt markets. The Gulf War (1990–91), Arab Spring (2011), and Russia's war in Ukraine (2022) all triggered sharp oil price spikes and broader global macroeconomic fallout, including higher inflation and tighter monetary policy.

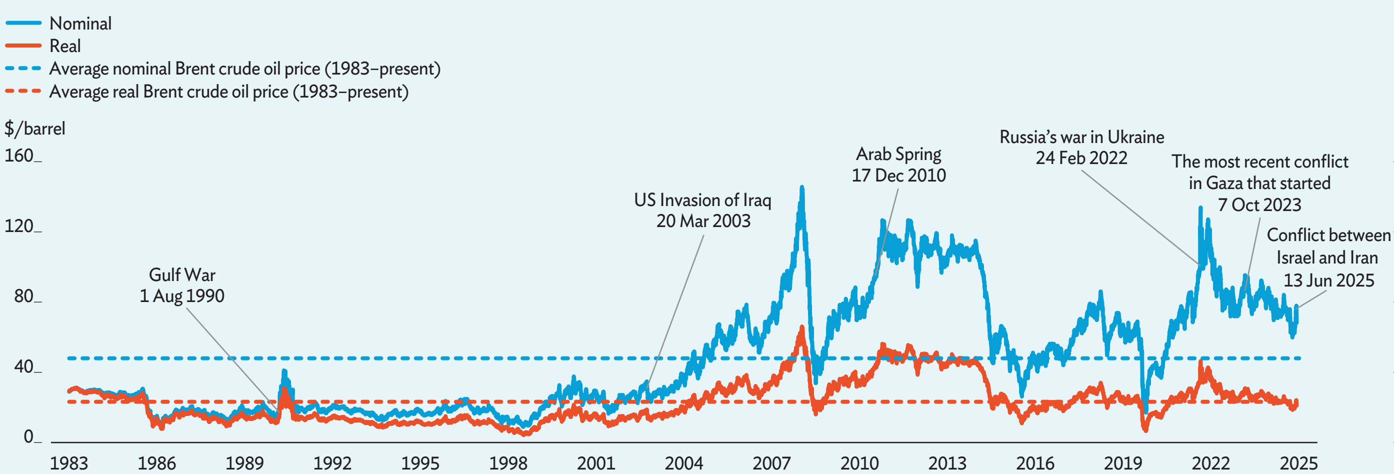
Asia particularly depends on oil from the Persian Gulf. About 20% of global oil flows transit through the Strait of Hormuz, and Asia receives nearly 90% of its oil imports via the strait.[a] Any disruption affecting shipping through the strait could impact Asia's energy security and macroeconomic stability. The strait has been a frequent flashpoint, with Iran having repeatedly threatened to block or disrupt the route.

Renewed conflict in the Middle East could impact growth and inflation in developing Asia. The Oxford Economics Global Economic Model June 2025 version is employed to simulate the potential effects (box figures 2a and 2b).[b] We explore three scenarios:

- ***Scenario 1: Brief Re-escalation of conflict.*** The conflict re-escalates in the third quarter (Q3) of 2025, it lasts one quarter, and is followed by a ceasefire and de-escalation. Oil prices increase by $25 per barrel for one quarter before reverting to baseline levels.

1 Brent Crude Oil Prices

With the surge driven by the conflict between Israel and Iran in June 2025 proving short-lived, oil prices remain well below their 2022 peak.



US = United States.

Note: The dashed lines represent the average oil price over the period shown. Daily Brent crude oil prices have been adjusted for inflation using the US monthly consumer price index.

Source: Staff calculations using Bloomberg data.

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Box *Continued*

2a Estimated Impact of Oil Price Hike on GDP Growth

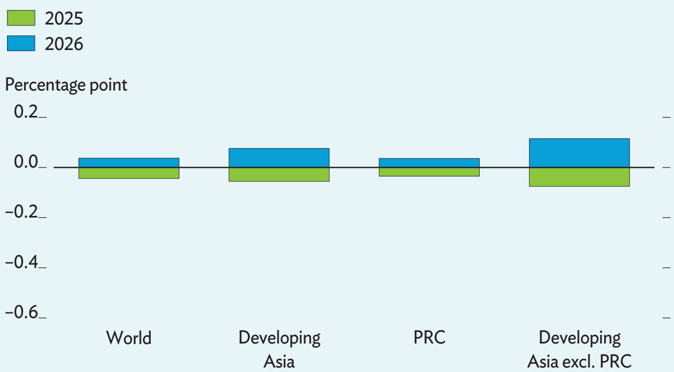
The effects on GDP growth worsen with the duration and severity of the conflict…

2b Estimated Impact of Oil Price Hike on Inflation

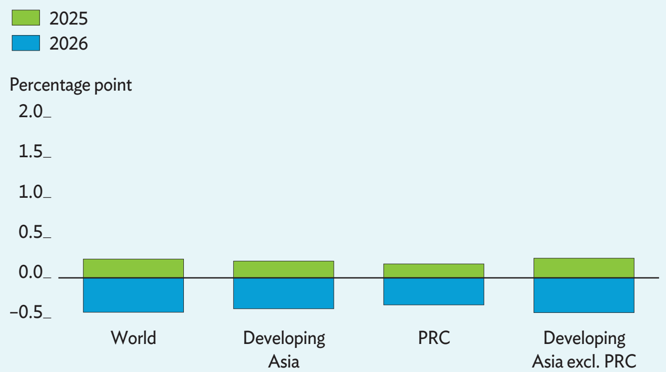
… as does the inflationary impact.

Scenario 1: Brief Re-escalation of Conflict

(Oil price increase by $25.00 for 1 quarter)

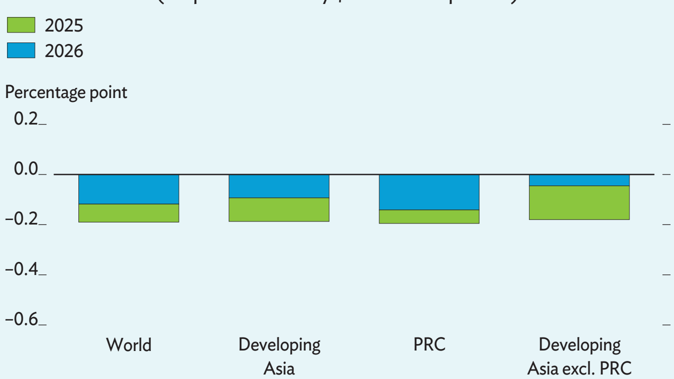


(Oil price increase by $25.00 for 1 quarter)

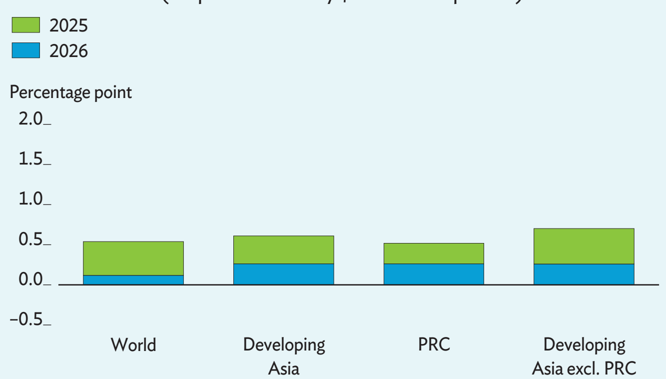


Scenario 2: Protracted Conflict

(Oil price increase by $25.00 for 4 quarters)

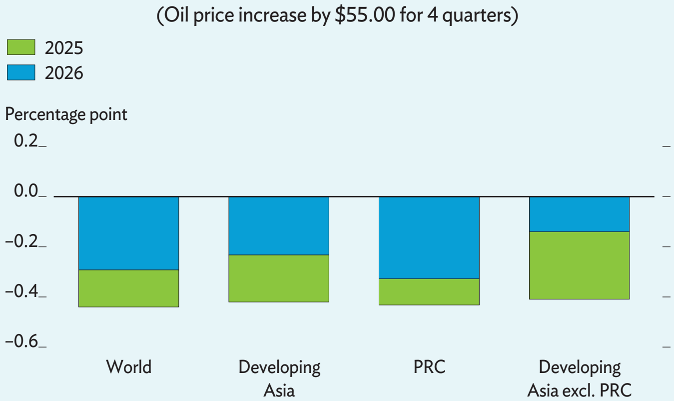


(Oil price increase by $25.00 for 4 quarters)

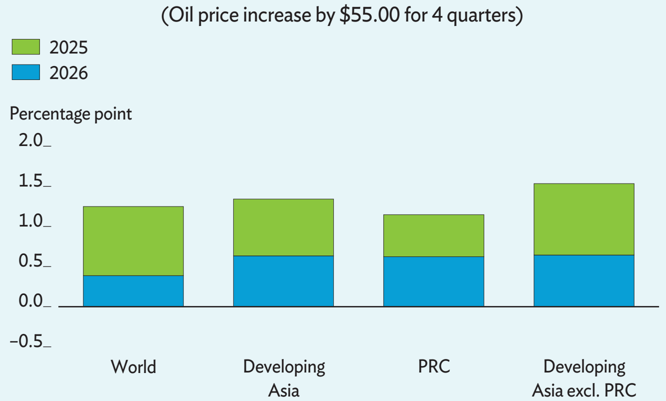


Scenario 3: Protracted Conflict with More Severe Disruptions

(Oil price increase by $55.00 for 4 quarters)



(Oil price increase by $55.00 for 4 quarters)



PRC = People's Republic of China, GDP = gross domestic product.

Source: Asian Development Bank staff estimates using Global Economic Model of Oxford Economics.

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Box *Continued*

- ***Scenario 2: Protracted conflict.*** Hostilities re-escalate in Q3 2025 and persist through Q4 2025 and the first half of 2026. Oil prices rise by $25 per barrel for four consecutive quarters.

- ***Scenario 3: Protracted conflict with more severe supply disruptions.*** The conflict re-escalates, leading to temporary supply disruptions—such as closure or restricted access to the Strait of Hormuz. Oil prices surge $55 per barrel for four quarters.

In the first scenario, the cumulative effect on GDP growth in developing Asia over 2025–2026 is close to zero, as a slight drag in 2025 is followed by a rebound in 2026. Inflation rises temporarily—by 0.2 percentage points (pp) in 2025—but moderates the following year.

The second scenario leads to more persistent inflationary pressures, at 0.6 percentage points above baseline across 2025–2026. And growth weakens more, with cumulative output losses of around 0.2 pp relative to baseline. The prolonged uncertainty and elevated energy prices weigh on consumption and investment, particularly in oil-importing economies.

The third scenario has the most severe implications: regional growth is reduced by 0.4 pp over the 2 years, and inflation increases by 1.3 pp relative to baseline. In addition to energy shocks, financial market volatility rises sharply, and investor sentiment deteriorates amid fear of broader regional instability.

While the ceasefire between Israel and Iran has provided markets with relief and helped stabilize oil prices, risks remain. Reignited conflict could lead to renewed oil price spikes, which could in turn raise headline inflation, narrow monetary policy space, and weaken currencies for energy importers. Investor sentiment would also deteriorate, leading to higher risk premiums and capital outflows. Net oil and gas importers, such as small island economies in the Pacific, would be particularly vulnerable. Besides raising prices, a sustained price shock would widen their current account deficits and strain their fiscal resources.

[a] While this box focuses on crude oil, the Strait of Hormuz is also a critical route for liquefied natural gas (LNG) trade. In 2024, 83% of LNG transiting the strait was shipped from Persian Gulf countries to Asian markets. The People's Republic of China, India, and the Republic of Korea accounted for 52% of these flows, underscoring the region's dependence on this strategic chokepoint.

[b] The Oxford Economics Global Economic Model is a fully integrated system comprising detailed models for 85 economies, plus the eurozone, all linked through global assumptions on trade, competitiveness, capital flows, interest and exchange rates, and commodity prices. The rest of the world economy is represented through six regional trading blocs.

This box was written by Jules Hugot, Pilipinas Quising, and Dennis Sorino of the Economic Research and Development Impact Department.

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