ASIAN DEVELOPMENT OUTLOOK

SEPTEMBER 2025

GROWTH SLOWS AS A NEW GLOBAL TRADE ENVIRONMENT TAKES SHAPE

ASIAN DEVELOPMENT BANK

ADB

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Notes:
In this publication, "$" refers to United States dollars, "¥" refers to yen, "A$" refers to Australian dollars, "AF" refers to afghanis, "B" refers to baht, "CNY" refers to yuan, "K" refers to kina, "NZ$" refers to New Zealand dollars, "RM" refers to ringgit, "SI$" refers to Solomon Islands dollars, "TJS" refers to somoni, "Tk" refers to taka, and "VND" refers to dong.
ADB recognizes "China" as the People's Republic of China, "USA" as the United States, and "Bombay" as Mumbai.

Cover design by Anthony Victoria.

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FOREWORD

Asia and the Pacific is navigating an increasingly complex economic landscape marked by rising trade barriers and persistent policy uncertainty. Growth momentum has become uneven, with some economies facing sharply higher tariffs while others benefit from trade diversification and shifting supply chains. These forces highlight the urgency of coordinated policy action at both national and regional levels.

Despite these headwinds and the downward revisions to growth forecasts from April presented in this report, the region continues to demonstrate resilience. Inflation is moderating, supported by easing food and energy prices and prudent monetary policy. Robust domestic demand and strong performance in high-technology sectors show that our economies can grow under pressure. Yet the uneven impact of current disruptions makes clear that one-size-fits-all approaches will not work. Tailored domestic measures, combined with deeper regional cooperation, are critical to sustaining growth.

But risks remain, threatening to reverse recent gains. Beyond trade, the possibility of sharp slowdowns in major economies could trigger financial market volatility and add further uncertainty, while geopolitical tensions could reignite inflationary pressures. In this environment, monetary and fiscal policy will remain essential tools to cushion shocks and protect vulnerable populations.

This edition's analytical chapter turns to another vital issue: how foreign capital inflows react to global shocks. Volatility linked to shifts in United States monetary policy, trade tensions, or geopolitical risks poses real challenges for emerging economies. The chapter provides policymakers with timely insights to strengthen financial resilience and safeguard stability.

The findings of this report reinforce the need for policies that not only respond to immediate pressures but also build longer-term resilience. Greater regional cooperation, more diversified exports, and stronger supply chains will be central to ensuring sustainable and inclusive growth.

The Asian Development Bank remains committed to reducing poverty and supporting the most vulnerable, while helping its members build a more prosperous, inclusive, resilient, and sustainable Asia and the Pacific. I am confident that the analysis in this report will provide valuable guidance as the region charts its course through an uncertain global environment.

MASATO KANDA
President
Asian Development Bank

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DEFINITIONS AND ASSUMPTIONS

The economies discussed in *Asian Development Outlook September 2025* are classified by major analytic or geographic group. The following apply in this report:

- **Association of Southeast Asian Nations** (ASEAN) comprises Brunei Darussalam, Cambodia, Indonesia, the Lao People's Democratic Republic, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Viet Nam. ASEAN 5 includes Indonesia, Malaysia, the Philippines, Thailand, and Viet Nam.
- **Developing Asia** comprises the 46 members of the Asian Development Bank listed below by geographic group.
- **Caucasus and Central Asia** comprises Armenia, Azerbaijan, Georgia, Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan.
- **East Asia** comprises the People's Republic of China; Hong Kong, China; the 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, the Lao People's Democratic Republic, Malaysia, Myanmar, the Philippines, Singapore, Thailand, Timor-Leste, and Viet Nam.
- **The Pacific** comprises the Cook Islands, Fiji, Kiribati, the Marshall Islands, the Federated States of Micronesia, Nauru, Niue, Palau, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu.

Unless otherwise specified, the symbol "$" and the word "dollar" refer to US dollars.

A number of assumptions have been made for the projections in Asian Development Outlook September 2025. The policies of domestic authorities are maintained. Real effective exchange rates remain constant at their average from 1 August–12 September 2025. The average price of oil is $67/barrel in 2025 and $57/barrel in 2026. The US federal funds rate averages 4.24% in 2025 and 3.74% in 2026, the European Central Bank deposit facility rate averages 2.21% in 2025 and 2.0% in 2026, and the Bank of Japan's overnight call rate averages 0.47% in 2025 and 0.50% in 2026.

All data in *Asian Development Outlook September 2025* were accessed from 15 August–12 September 2025.

ABBREVIATIONS

ADB	Asian Development Bank
ADO	Asian Development Outlook
AI	artificial intelligence
ASEAN	Association of Southeast Asian Nations
BNM	Bank Negara Malaysia
CFM	capital flow management measures
COFA	Compact of Free Association
COVID-19	coronavirus disease
CPI	consumer price index
ECB	European Central Bank
EME	emerging market economy
EU	European Union
EV	electric vehicle
FDI	foreign direct investment
FRED	Federal Reserve Economic Data
FSM	Federated States of Micronesia
FY	fiscal year
GDP	gross domestic product
GPR	geopolitical risk
H	half
HITE	high-income technology exporter
IMF	International Monetary Fund
ISM	Institute for Supply Management
Lao PDR	Lao People's Democratic Republic
LNG	liquefied natural gas
MAS	Monetary Authority of Singapore
MPC	Monetary Policy Committee (India)
MPP	macroprudential policies
NPL	nonperforming loan
OPEC+	Organization for the Petroleum Exporting Countries and partners
PBOC	People's Bank of China
PMI	purchasing managers' index
PNG	Papua New Guinea
PRC	People's Republic of China
Q	quarter
QE	quantitative easing
ROK	Republic of Korea
RPC	Regional Processing Centre (Nauru)
saar	seasonally adjusted annualized rate
SBV	State Bank of Viet Nam

TIA	Tribhuvan International Airport (Nepal)
TPU	trade policy uncertainty
US	United States
VAT	value-added tax
VIX	volatility index
yoy	year on year

ADO SEPTEMBER 2025
HIGHLIGHTS

United States (US) tariffs have now settled at historically high rates, even as trade uncertainty remains highly elevated. The impact is shaping the outlook for developing Asia and the Pacific. Export front-loading anticipating the tariffs, particularly of artificial intelligence equipment and electronics, underpinned growth acceleration in the region in the first half of 2025. However, higher US tariffs will weigh on external demand and activity going forward. Alongside fiscal support, looser monetary policy as inflation eases will partly offset trade headwinds, sustaining growth. This report trims the region's growth forecasts to 4.8% in 2025 and 4.5% in 2026, from 4.9% and 4.7% in April. The revisions reflect downgrades for India, hit by steep tariff hikes, and Southeast Asia, driven by a worse and more uncertain global environment. In contrast, the People's Republic of China's (PRC) growth forecasts are unchanged, with policy support and export diversification expected to cushion tariff and property market challenges. Inflation in developing Asia and the Pacific will fall to 1.7% in 2025 as energy and food prices moderate further, before increasing modestly to 2.1% in 2026 as food prices normalize. Trade risks pose the main threats to the outlook. To varying degrees, unresolved US–PRC tensions, sectoral duties on semiconductors and pharmaceuticals, and further tariff hikes could all impact economies in the region.

In this edition of the *Asian Development Outlook*, the analytical chapter examines the sensitivity of capital inflows in emerging market economies to global factors and domestic fundamentals during the period 1990 to 2024. The chapter identifies a structural shift in emerging market foreign capital inflows around the end of 2008 when the US Federal Reserve introduced its quantitative easing (QE) policy. A further shift is identified after QE concluded in 2014. During the QE period, ample global liquidity and highly accommodative US monetary policy triggered a surge in capital flows into emerging market economies. Focusing on the current post-QE period, when global financial conditions started to tighten, the chapter finds that US monetary policy and trade policy uncertainty significantly drive emerging market economy portfolio debt and equity inflows. Geopolitical risk, meanwhile, is a key global factor influencing both cross-border loans and foreign direct investment flows. While capital flows into these economies remain sensitive to global factors, the chapter finds that strong domestic fundamentals can provide a stabilizing role. Robust growth prospects can boost investor confidence, while trade openness, well-developed financial markets, and sound institutions enhance resilience, mitigating the impacts of volatile foreign capital flows and negative shifts in global factors.

Albert F. Park
Chief Economist
Asian Development Bank

Growth Slows as a New Global Trade Environment Takes Shape

- **United States (US) tariffs have soared to historic heights amid continued elevated trade policy uncertainty.** Though generally lower than announced on 2 April, the additional tariffs that took effect in August are historically high. From 2.4% in 2024, the average effective US tariff rate has surged to 17.4%, the highest since the Great Depression of the 1930s. Trade policy uncertainty remains at very high levels, despite easing from April's peak. Uncertainty is fueled by announcements of several bilateral US trade agreements without finalized terms, the prospect of new US sectoral tariffs on pharmaceuticals and semiconductors, and possible revisions to tariffs already in place.

- **Growth in developing economies in Asia and the Pacific (developing Asia) accelerated in the first half of 2025, driven by strong exports.** Growth picked up to 5.4% in the first half of 2025, compared to 4.9% in the second half of 2024, as strong external demand offset weaker investment. In the People's Republic of China (PRC), growth strengthened on resilient export growth and supportive monetary and fiscal policies. India's growth also accelerated, as strong public capital spending outweighed easing net exports and consumption. In the high-income technology exporters and larger Association of Southeast Asian Nations economies, higher net exports offset declines in investment and consumption, amid trade and tariff uncertainties and weaker consumer and business confidence.

- **Disinflation continued amid falling global energy and food prices, declining prices in the PRC, and moderate core inflation.** Energy-related inflation continued to decline in January to August 2025, mirroring lower oil prices. Food inflation also decreased, due to better harvests and crop production boosting supply. In the PRC, average inflation fell into negative territory, to –0.1%, in the first 8 months of the year. This was driven by weak demand, ample pork supply, and factory-gate deflation, partly due to intense price competition. Elsewhere, regional inflation eased to 2.2% in August, as food price inflation in India and other economies likewise slipped into negative territory. Excluding volatile components, underlying price pressures remain moderate. In August, core inflation in the PRC was 0.9%, edging up slightly on rising services prices. In the rest of the region, the contribution of core price pressures to overall headline inflation has stabilized at about 1.6–1.7 percentage points since mid-2024.

- **Tariff frontrunning supported an 8.1% rise in developing Asia's exports in the first half of the year.** This was mainly driven by electronics, with rising global demand for AI-related equipment boosting the region's exports—notably semiconductor chips. Hong Kong, China; Singapore; and Taipei,China were major contributors, while Southeast Asia's exports also saw strong growth, particularly in Cambodia, Malaysia, and Thailand. The PRC recorded milder but still positive export growth, at 5.3%, as rising exports to other markets largely offset lower shipments to the US. In contrast, exports from the Republic of Korea declined slightly, dragged down by the new US tariffs on automobiles and automobile parts.

- **Tourist arrivals continued to rise toward pre-pandemic levels, albeit more slowly.** Visitors to the region reached 94% of 2018–2019 average levels in the first half of 2025, compared to 88% in the same period last year. Tourist numbers surpassed pre-pandemic levels in several destinations, including Armenia, the Cook Islands, Fiji, Maldives, and Sri Lanka. However, other economies continue to lag behind, particularly in Southeast Asia, where arrivals fell short in Indonesia, Singapore, and Thailand—Asia's largest tourism destination.

- **Financial conditions improved in the third quarter despite uncertainty over trade and US monetary policy.** Investors remained cautious given uncertainty over trade negotiations and the risk of higher tariffs. Nevertheless, the recent trade agreements and the continued US–PRC trade talks have supported investor sentiment, moderating volatility. Weak US labor market data and steady inflation figures released in August boosted market expectations of a policy rate cut by the US Federal Reserve. Against this backdrop, most Asian equities rose, risk premiums narrowed, long-term bond yields declined, and portfolio inflows rose. Regional currencies depreciated modestly against the US dollar.

- **Central banks in much of developing Asia continued loosening monetary policy, and current conditions may support further easing.** In July 2025, inflation was at or below target in 11 of the 17 inflation-targeting economies, while 10 out of 15 non-inflation targeting economies with available data had lower inflation than at the beginning of the year. This supported monetary policy easing, with 11 economies lowering their policy rates over January to August. Growing expectations of US Federal Reserve rate cuts, continued disinflation, and stable exchange rates are also creating room for further rate cuts across the region.

- **Debt ratios remain contained, although debt service is a growing concern in some economies.** Robust growth and higher inflation have helped limit debt-to-GDP ratios across the region, despite rising government debt stocks during and after the COVID-19 pandemic. However, high debt service relative to revenues may present challenges for some economies if global economic volatility results in slower growth and higher interest rates.

- **Growth forecasts for major advanced economies are reduced to 1.4% for both 2025 and 2026, reflecting higher tariffs and trade uncertainty.** In the US, persistently high inflation and policy uncertainty are weighing on private consumption and investment, prompting downgrades for 2025 and 2026. The euro area's 2025 forecast is unchanged and the 2026 projection is cut marginally, as robust domestic demand offsets external headwinds. Japan's growth forecasts are lowered for both years, as higher US tariffs are expected to dampen export growth and manufacturing activity. Among commodities, oil prices are expected to decline due to greater global supply and reduced demand as the world economy slows. Rice prices are also projected to ease amid favorable weather conditions and record harvests in India.

- **Developing Asia's growth forecasts are trimmed to 4.8% in 2025 and 4.5% in 2026, down by 0.1 and 0.2 percentage points from April.** The revisions reflect offsetting factors. The updated trade agreements and tariffs led to a broad shift toward higher US tariffs, which will weigh on the region's exports and growth. However, fiscal and monetary policy responses are expected to cushion the impact. East Asia's growth forecast for 2025 remains unchanged as fiscal policy and robust AI-related exports are, respectively, expected to sustain growth in the PRC and Taipei,China. The 2026 projection is lowered as the broader impact of higher tariffs weakens export demand in the subregion. South Asia's growth projections for both years are revised down due to the impact of US tariff hikes, especially in India. Southeast Asia's growth forecasts are also reduced for both years, due to weak global demand and heightened trade uncertainty. In contrast, the Caucasus and Central Asia's forecast is revised up for 2025 due to higher oil production and increased public infrastructure investment in Kazakhstan. However, the 2026 outlook is lowered, primarily due to declining hydrocarbon production in Azerbaijan. The Pacific's growth forecast for 2025 is raised mainly on stronger mining and liquified natural gas output in Papua New Guinea (PNG), the subregion's largest economy. The 2026 projection is lowered on expectations of moderating resource output and a worse external environment denting commodity exports from PNG.

- **Inflation in developing Asia is projected to ease further in 2025, driven by lower energy and food prices, before edging up in 2026.** The region's 2025 inflation forecast is revised down to 1.7%, from 2.3% in April. Easing food and oil prices prompted downward revisions to inflation forecasts in East Asia, South Asia, and Southeast Asia. In the Pacific, the outlook is revised down, mainly due to reduction in value-added tax in Fiji and lower food prices in some economies. These outweighed upward revisions in the Caucasus and Central Asia, where rising utility costs and currency depreciation in some economies will push inflation higher. For 2026, inflation is expected to edge higher to 2.1%, albeit marginally slower than April's forecast of 2.2%, partly due to normalization of food prices.

- **Trade agreements have eased tensions, but unresolved US–PRC negotiations and elevated uncertainty keep risks elevated.** Major trading partners, including several developing Asian economies, agreed to new trade deals with the US before the 1 August deadline. This has reduced but not removed global trade risks. Following a 3-month extension, US–PRC trade negotiations are ongoing. Thus, while tensions have subsided somewhat since April, the risk of renewed tariff escalation persists. Additionally, trade policy uncertainty remains high. Although the specifics are still unclear, the expected US sectoral tariffs on semiconductors and pharmaceuticals could be particularly high. And while US tariffs settled at new, higher levels on 7 August, some economies risk even steeper US duties related to transshipment and other factors. If these risks were to materialize, growth in the region could be dented.

- **Other risks include geopolitical tensions, further deterioration in the PRC's property market, and possible financial market volatility.** Geopolitical risks remain elevated. Renewed escalation in the Middle East could increase oil and food prices, disrupt supply chains, and dampen growth. The outlook regarding Russia's war in Ukraine is also uncertain; if a peace deal emerges it could bring greater stability, but the potential timing and terms remain unclear. Despite government support measures and the sector's declining economic weight, a further deterioration in the PRC's property market could increase default risks for property developers and dampen growth. A stronger-than-expected US growth slowdown could heighten global market volatility, raise risk aversion, and tighten financial conditions. Developing Asia, particularly regional economies with fragile fundamentals, could be affected through various channels, including weaker trade, currency depreciation, imported inflation, reduced confidence, and lower capital inflows—as discussed in this report's analytical chapter.

Capital Inflows to Emerging Market Economies: Global Factors and the Role of Fundamentals

- **The ADO analytical chapter presents new empirical evidence on the sensitivity of foreign capital inflows to emerging market economies to global factors, and the role of domestic fundamentals.** The topic is especially timely given heightened global risks including trade policy uncertainty and geopolitical risks. While capital inflows (i.e., purchases of emerging market assets by non-residents) are an important source of financing for these economies, they continue to exhibit recurring boom–bust cycles, with foreign capital outflows from emerging market economies associated with currency depreciations and macroeconomic and financial instability. Global shocks and changes in global conditions can impact different types of emerging market capital inflows to varying degrees, depending on the nature of the global factors as well as the domestic fundamentals of individual emerging market economies. The responsiveness of emerging market capital inflows to global drivers is also likely to change over time, reflecting evolving structural features in those economies such as increasing integration into global financial markets and stronger macro-prudential frameworks. The chapter investigates the sensitivity of four different emerging market economy capital inflows—portfolio debt, portfolio equity, cross-border loans, and foreign direct investment (FDI)—to global risk aversion, trade policy uncertainty, geopolitical risk, and US monetary policy. The analysis also examines the role of domestic fundamentals in emerging market economies in attracting foreign capital inflows and the extent to which these act as a counterweight to the effects of negative shifts in global factors.

- **Global factors have emerged in recent literature as the dominant drivers of emerging market economy capital flows.** The concept of a global financial cycle gained traction following the seminal work of Rey (2013), who argued that a global financial cycle drives asset prices, credit growth, and capital flows. More specifically, the concept holds that a large share of the variation in risky assets and capital flows can be explained by a single global factor, and that this factor is highly correlated with the volatility index (VIX, a common measure of global risk aversion) and US monetary policy. Empirical evidence indicates that the global financial cycle mainly affects portfolio debt, portfolio equity, and cross-border investment flows, with a more limited impact on FDI. However, even for FDI, which is long-term investment, global financial conditions and the cost of capital still matter. While pointing to the key role of global risks as drivers of fluctuations in emerging market economy capital flows, the literature also highlights the importance of fundamentals in these economies in attracting long-term stable capital flows and enhancing resilience to external shocks. The analytical chapter contributes to this strand of the literature by systematically examining shifts in the influence of both the VIX and US monetary policy, as well as two other, less researched global risk factors on emerging market economy capital flows—trade policy uncertainty and geopolitical risk.

- **Capital flows to emerging market economies go through recurring boom bust-cycles.** Capital flows to these economies have shown strong cyclicality around major global shocks. While periods of abundant global liquidity and low interest rates have led to foreign capital inflows to emerging market economies, shifting global financial conditions have triggered reversals. Surges of foreign capital inflows to emerging market economies preceded abrupt withdrawals during the Asian financial crisis (1997–1998) and the Russian default (1998). A similar pattern was observed in the run-up to the global financial crisis (2008–2009), when capital inflows collapsed as global liquidity and risk sentiment tightened, and then rebounded strongly during the US Federal Reserve's (Fed) quantitative easing period. More recently, emerging market economies experienced sudden stops during the taper tantrum (2013), the COVID-19 shock (2020), and bouts of volatility tied to US monetary tightening (2022–2023).

- **The US Federal Reserve's quantitative easing (QE) policy, which began at the end of 2008 and ended at the end of 2014, coincided with a structural shift in emerging market capital flow dynamics.** For a panel of 36 emerging market economies over 1990–2024, formal statistical tests identify structural breaks across the four types of capital flow around the beginning and end of the QE period. The QE period was characterized by ample global liquidity, resulting from large scale purchases of long-term securities by the US Fed. As the Fed injected liquidity into the financial system, long-term interest rates in the US and other advanced economies fell to historic lows, triggering capital inflows to emerging market economies as investors searched for yield.

- **Empirical analysis reveals that emerging market economies foreign capital inflows remain significantly influenced by global shocks.** Findings for the current post-QE period show that emerging market economy portfolio debt and equity inflows from abroad are negatively associated with US Fed rates and, to a lesser extent, trade policy uncertainty. The uncertainty over the future trajectory of US Fed rates thus poses a risk to emerging market capital flows—lower Fed rates in response to a US slowdown could trigger portfolio inflows into these economies, but tighter monetary policy in response to continued US inflationary pressure is likely to lead to foreign outflows. In addition, elevated and volatile trade policy uncertainty poses significant risks to emerging market economy portfolio flows. Meanwhile, geopolitical risk emerges as a key global risk factor affecting cross-border loans and FDI.

- **While emerging market capital inflows remain vulnerable to shifts in global factors, analysis in the chapter indicates that strong macroeconomic fundamentals can play an important stabilizing role.** In particular, robust growth prospects in emerging market economies can help strengthen investor confidence, thereby sustaining capital inflows. Trade openness also reinforces foreign capital inflows, with open trade regimes signaling integration into global value chains. Well-developed domestic financial markets and sound institutions further help to support the resilience of the capital flows. While global factors will continue to influence capital flow dynamics in these economies, policymakers can mitigate the negative impacts through reforms that strengthen domestic fundamentals. These should be complemented with effective macroprudential and capital flow management frameworks to better manage capital flow volatility during surges or sudden stops.

Gross Domestic Product Growth Rate, % per year

	2024	2025		2026	
		April	*September*	*April*	*September*
Developing Asia	**5.1**	**4.9**	**4.8**	**4.7**	**4.5**
Developing Asia excluding the PRC	**5.1**	**5.0**	**4.9**	**5.1**	**4.8**
Caucasus and Central Asia	**5.7**	**5.4**	**5.5**	**5.0**	**4.9**
Armenia	5.9	5.0	5.0	4.7	4.7
Azerbaijan	4.1	3.4	2.4	3.3	2.0
Georgia	9.4	6.0	7.0	5.0	5.0
Kazakhstan	5.0	4.9	5.3	4.1	4.3
Kyrgyz Republic	9.0	8.5	8.3	8.6	8.4
Tajikistan	8.4	7.4	7.4	6.8	6.8
Turkmenistan	6.3	6.5	6.3	6.0	6.0
Uzbekistan	6.0	6.6	6.6	6.7	6.7
East Asia	**4.7**	**4.4**	**4.4**	**4.0**	**3.9**
People's Republic of China	5.0	4.7	4.7	4.3	4.3
Hong Kong, China	2.5	2.3	2.2	2.5	2.0
Republic of Korea	2.0	1.5	0.8	1.9	1.6
Mongolia	5.1	6.6	5.7	5.9	5.7
Taipei,China	4.8	3.3	5.1	3.0	2.3
South Asia	**5.9**	**6.0**	**5.9**	**6.2**	**6.0**
Afghanistan	2.3	2.6	1.8	2.2	1.7
Bangladesh	4.2	3.9	4.0	5.1	5.0
Bhutan	7.5	8.5	8.1	6.0	6.0
India	6.5	6.7	6.5	6.8	6.5
Maldives	3.3	5.0	5.0	4.8	4.9
Nepal	3.7	4.4	4.6	5.1	3.0
Pakistan	2.5	2.5	2.7	3.0	3.0
Sri Lanka	5.0	3.9	3.9	3.4	3.3
Southeast Asia	**4.8**	**4.7**	**4.3**	**4.7**	**4.3**
Brunei Darussalam	4.2	2.5	1.0	2.0	1.5
Cambodia	6.0	6.1	4.9	6.2	5.0
Indonesia	5.0	5.0	4.9	5.1	5.0
Lao People's Democratic Republic	4.0	3.9	3.7	4.0	3.8
Malaysia	5.1	4.9	4.3	4.8	4.2
Myanmar	–0.7	1.1	–3.0	1.6	2.0
Philippines	5.7	6.0	5.6	6.1	5.7
Singapore	4.4	2.6	2.5	2.4	1.4
Thailand	2.5	2.8	2.0	2.9	1.6
Timor-Leste	4.1	4.0	3.8	3.8	3.4
Viet Nam	7.1	6.6	6.7	6.5	6.0
The Pacific	**3.8**	**3.9**	**4.1**	**3.6**	**3.4**
Cook Islands	14.0	8.1	10.4	2.9	2.5
Fiji	3.5	3.0	3.0	3.2	3.0
Kiribati	5.3	4.1	3.9	3.3	3.3
Marshall Islands	3.0	2.5	3.0	3.0	3.5
Federated States of Micronesia	1.7	1.7	0.8	1.1	1.1
Nauru	1.8	2.5	2.3	2.5	2.5
Niue	8.7	3.4	3.4	3.0	3.0
Palau	6.6	9.5	8.2	4.5	3.9
Papua New Guinea	4.0	4.2	4.6	3.8	3.6
Samoa	4.6	5.5	4.0	3.0	2.7
Solomon Islands	2.5	2.9	2.9	3.2	3.2
Tonga	1.4	2.5	2.5	2.3	2.3
Tuvalu	3.3	2.7	2.7	2.5	2.5
Vanuatu	1.0	2.0	1.5	2.5	2.5

ADB = Asian Development Bank, PRC = People's Republic of China.

Notes: 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.

Source: *Asian Development Outlook* database.

Inflation, % per year

	2024	2025		2026	
		April	*September*	*April*	*September*
Developing Asia	**2.6**	**2.3**	**1.7**	**2.2**	**2.1**
Developing Asia excluding the PRC	**4.8**	**4.0**	**3.3**	**3.7**	**3.7**
Caucasus and Central Asia	**6.8**	**6.9**	**7.7**	**5.9**	**6.6**
Armenia	0.3	3.0	3.5	2.8	2.8
Azerbaijan	2.2	4.2	4.2	3.5	3.5
Georgia	1.1	4.0	4.0	3.5	3.5
Kazakhstan	8.7	8.2	10.5	6.5	8.4
Kyrgyz Republic	5.0	6.0	7.0	7.8	8.0
Tajikistan	3.6	5.0	4.5	5.8	5.2
Turkmenistan	5.5	6.0	4.0	6.0	5.0
Uzbekistan	9.4	8.0	8.0	7.0	7.0
East Asia	**0.5**	**0.6**	**0.3**	**0.9**	**0.6**
People's Republic of China	0.2	0.4	0.0	0.7	0.4
Hong Kong, China	1.7	1.9	1.6	2.0	1.6
Republic of Korea	2.3	1.9	1.9	1.9	1.9
Mongolia	6.2	9.1	8.6	7.0	7.2
Taipei,China	2.2	2.0	1.8	1.8	1.5
South Asia	**6.5**	**4.9**	**3.7**	**4.5**	**4.7**
Afghanistan	–7.7	–5.3	–4.2	5.0	1.0
Bangladesh	9.7	10.2	10.0	8.0	8.0
Bhutan	2.8	3.4	3.2	3.5	3.7
India	4.6	4.3	3.1	4.0	4.2
Maldives	1.4	4.7	4.5	2.2	3.5
Nepal	5.4	5.2	4.1	5.0	4.5
Pakistan	23.4	6.0	4.5	5.8	6.0
Sri Lanka	1.2	3.1	0.5	4.5	4.5
Southeast Asia	**3.0**	**3.0**	**2.5**	**2.8**	**2.7**
Brunei Darussalam	–0.4	0.5	–0.3	–0.2	0.5
Cambodia	0.8	3.7	2.0	2.4	2.0
Indonesia	2.3	2.0	1.7	2.0	2.0
Lao People's Democratic Republic	23.3	13.5	9.5	10.4	8.5
Malaysia	1.8	2.5	1.8	2.5	2.2
Myanmar	27.8	29.3	30.0	20.0	23.0
Philippines	3.2	3.0	1.8	3.0	3.0
Singapore	2.4	2.0	1.0	1.7	1.2
Thailand	0.4	1.0	0.5	1.1	0.8
Timor-Leste	2.1	2.9	1.2	2.6	1.9
Viet Nam	3.7	4.0	3.9	4.2	3.8
The Pacific	**1.9**	**3.4**	**3.0**	**3.7**	**3.4**
Cook Islands	4.6	2.3	2.0	2.0	2.8
Fiji	4.5	2.6	0.5	2.4	1.0
Kiribati	2.5	2.5	7.8	2.2	3.5
Marshall Islands	5.7	3.6	3.8	3.0	3.4
Federated States of Micronesia	5.4	3.0	3.9	2.7	3.2
Nauru	11.6	3.5	6.5	2.5	5.0
Niue	5.4	3.7	2.3	3.2	3.2
Palau	3.7	2.5	2.5	2.6	2.7
Papua New Guinea	0.6	3.8	3.8	4.3	4.3
Samoa	3.6	3.0	1.9	2.7	2.7
Solomon Islands	4.2	2.7	3.8	2.5	2.5
Tonga	8.0	3.2	3.0	3.0	3.0
Tuvalu	1.2	2.5	2.5	2.0	2.0
Vanuatu	1.1	3.5	1.5	2.4	2.4

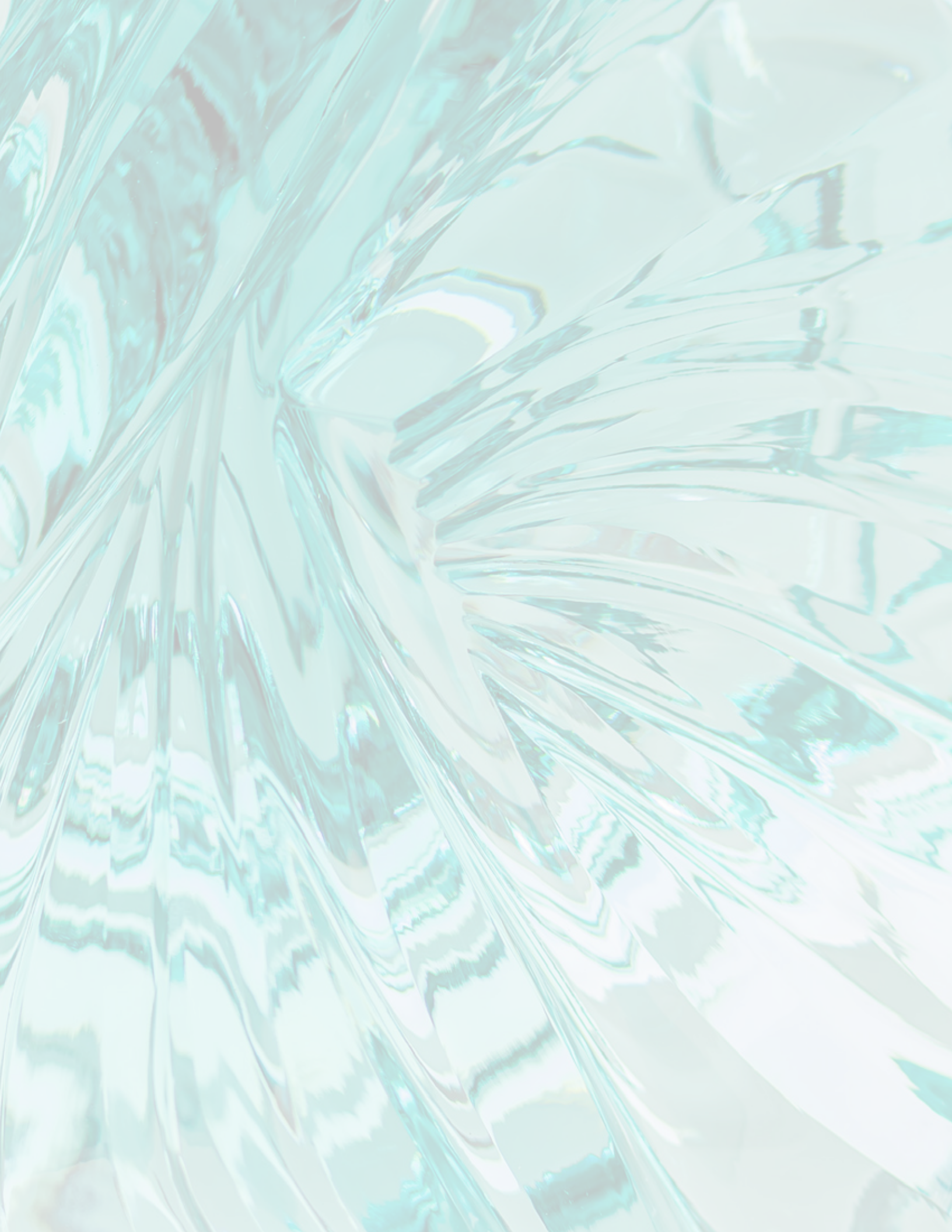
ADB = Asian Development Bank, PRC = People's Republic of China.

Notes: 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.

Source: *Asian Development Outlook* database.

1

GROWTH SLOWS AS A NEW GLOBAL TRADE ENVIRONMENT TAKES SHAPE



GROWTH SLOWS AS A NEW GLOBAL TRADE ENVIRONMENT TAKES SHAPE

Economic growth accelerated in the first half of 2025 in developing Asia, amid a shifting global trade environment and elevated uncertainty. *Following trade negotiations, pauses, and a series of announcements, US tariffs settled at historically high levels in August. Trade policy uncertainty has also remained elevated, fueled by the prospect of new US sectoral duties, and possible revisions to trade deals and tariffs already in place. Against this backdrop, regional growth was underpinned by front-loading of exports ahead of expected US tariff hikes and solid domestic demand. Strong global demand for electronics and artificial intelligence-related products also benefited the region's high-income technology exporters.*

Growth forecasts for developing Asia have been cut to 4.8% for 2025 and 4.5% in 2026, from 4.9% and 4.7% in April, respectively. *The revisions reflect downgrades in India and Southeast Asia, driven by higher tariffs and a more challenging external environment. The 2025 inflation projection is 1.7%, down 0.6 percentage points from April, due to easing global food and oil prices. For 2026, inflation is forecast to edge up to 2.1% as food prices normalize.*

Several risks cloud the region's outlook. *The main risks stem from renewed tariff hikes and higher trade policy uncertainty. Others include financial market volatility, geopolitical tensions, and further deterioration in the PRC's property market.*

This section was written by Abdul Abiad, John Beirne (lead), Shiela Camingue-Romance, Gabriele Ciminelli, Suzette Dagli, Jaqueson Galimberti, Jules Hugot, Matteo Lanzafame (colead), Henry Ma, Ahmad Miraj, Madhavi Pundit, Melanie Grace Quintos, Pilipinas Quising, Ed Kieran Reyes, Shu Tian, Michael Timbang, and Mai Lin Villaruel of the Economic Research and Development Impact Department, ADB, Manila.

Growth Benefited from Export Front-loading as Price Pressures Continued to Subside

Developing Asia's growth picked up in the first half (H1) of 2025, driven largely by strong exports (Figure 1.1.1, panel A). Front-loading of exports in anticipation of higher US tariffs, trade diversification, and strong global demand for electronics and high-tech manufacturing buoyed shipments, offsetting weaker investment. In the PRC, growth accelerated to 5.3% in H1 from 5.0% in H2 2024. Higher tariffs weighed on exports to the US, but this was offset by faster export growth to the rest of the world and supportive monetary and fiscal policies. The country's consumer goods trade-in program and a brief hiring boost in the early second quarter (Q2) as factories increased production and shipments under the US–PRC trade truce supported consumption, offsetting weaker investment. India's GDP, meanwhile, grew 7.6% in H1, as higher investment from strong public capital spending, offsets lower net exports and consumption despite firm rural demand. Excluding the PRC and India, regional growth gained modestly as higher exports offset lower domestic demand, which was held back by trade and tariff uncertainties and weaker consumer and business confidence. Aggregate growth in high-income technology-exporters edged up slightly in H1, driven by front-loading of AI-related semiconductor and electronics exports from Taipei,China. Meanwhile, economic performance in the four larger Association of Southeast Asian Nations (ASEAN) economies edged down only slightly, as higher net exports offset declining investments and a marginal decrease in consumption.

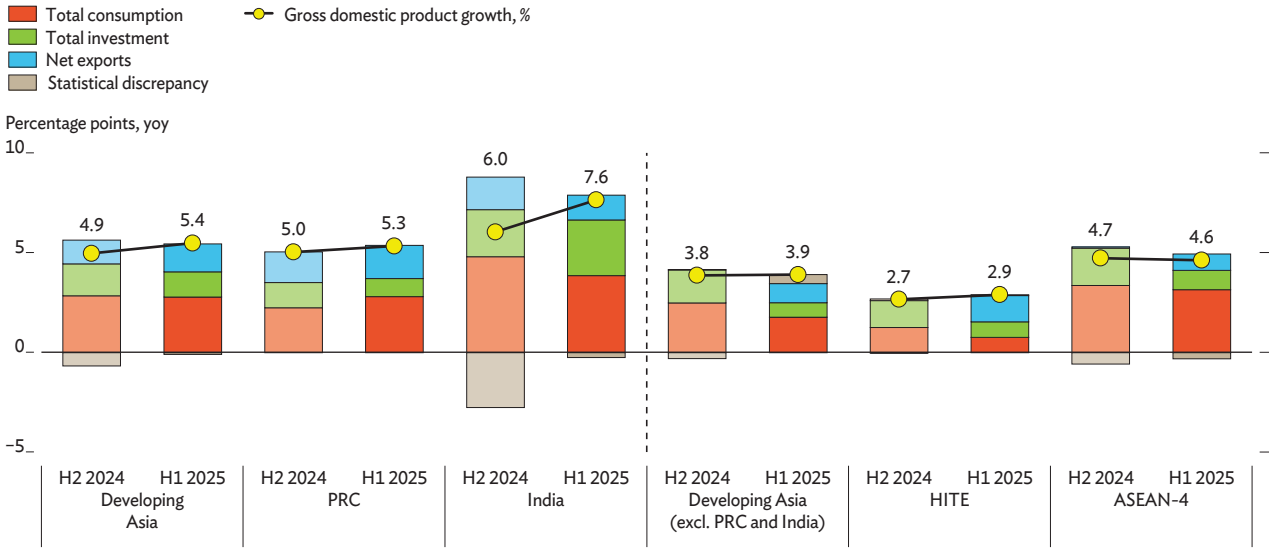
Industrial performance strengthened slightly, buoyed by growing manufacturing and construction activity in India, while services remained robust (Figure 1.1.1, panel B). Developing Asia has, so far, largely fended off risks to manufacturing activity following new US tariffs and heightened global trade uncertainty. In the PRC, the manufacturing sector continued to post solid growth—led by high-tech products, electric vehicles, and electronics—as exporters expanded to non-US markets. Industrial growth likewise improved in India, with manufacturing and construction performing well, offsetting declines in mining and utilities. Meanwhile, industrial activity in the rest of the region moderated slightly, in part due to lower construction. A manufacturing boom in Taipei,China—driven by strong global demand for AI and high-performance chips—propelled industry growth to a record 10% in Q2. In contrast, it declined in the Republic of Korea, largely reflecting the impact of broader US tariffs on automobiles and steel and US export restrictions on high-bandwidth electronics. Industrial output also moderated in the ASEAN-4 economies. This was due to generally weaker construction in all four, and particularly to weaker expansions in mining in Malaysia and Indonesia. It was also due to weaker growth in the machinery, metals, and electronics sectors in the Philippines and to more moderate growth in energy-related and automotive sectors in Thailand—where rising competition from PRC-made electric vehicles weighed on these industries. Services growth remained robust in H1, as higher domestic activity boosted demand, particularly in the PRC.

Industrial production trends were uneven across economies as trade uncertainty weighed on sentiment. Taipei,China and Viet Nam expanded rapidly, while other economies exhibited only modest or declining growth (Figure 1.1.2). The Manufacturing Purchasing Managers' Index (PMI)—a forward-looking indicator which leads manufacturing by 1 to 2 months—followed a similar pattern. While smaller downgrades in Q1 PMI implied caution had not yet fully set in on manufacturing activities in some economies, increased tariffs and trade uncertainty from April pushed Q2 readings into contraction. Improvements in July and August readings suggest a reversal in trend in many economies in Q3. In August, PMI improved in most regional economies with available data, with the readings for India, Thailand, the Philippines, and Viet Nam remaining above 50, while also rising to above

Figure 1.1.1 Contributions to GDP Growth, H2 2024 and H1 2025

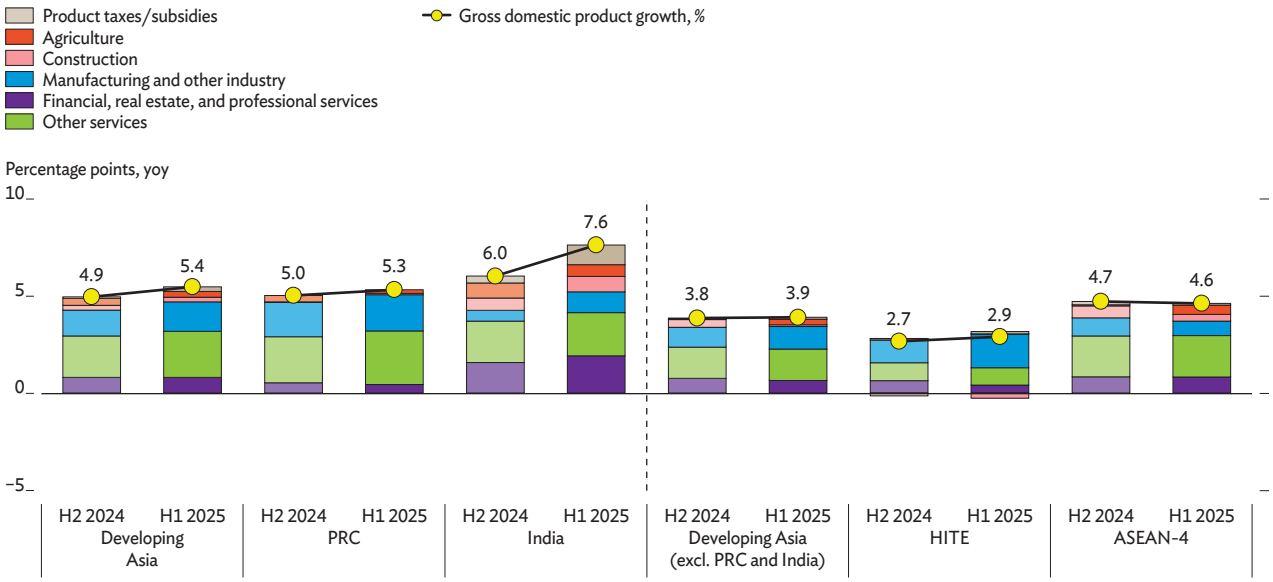
A. Demand-Side

Growth in developing Asia accelerated in H1 2025, driven largely by net exports.



B. Supply-Side

Industrial performance remained strong, improving in India and the HITEs, and services were largely robust.



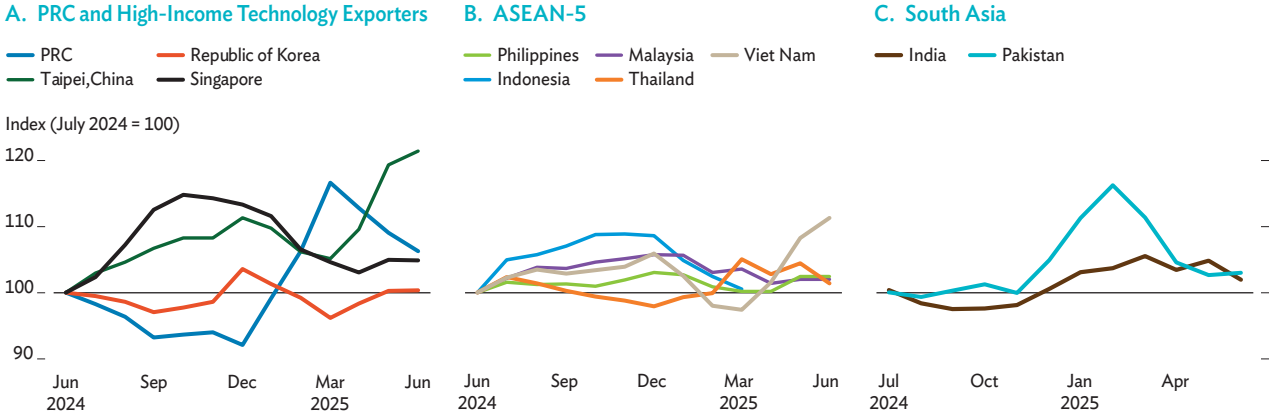
ASEAN-4 = Indonesia, Malaysia, the Philippines, and Thailand in the Association of Southeast Asian Nations, PRC = People's Republic of China, GDP = gross domestic product, H = half, HITE = high-income technology exporter (Hong Kong, China; Republic of Korea; Singapore; and Taipei,China), yoy = year on year.

Notes: Economies included are those with available quarterly GDP data and demand-side breakdowns, accounting for about 90% of developing Asia. Components do not add up to the total due to statistical discrepancies and differences from the chain-linking method (panel A) and to product taxes and subsidies (panel B). All data are for calendar years. H2 2024 GDP growth is the semi-annual growth rate in 2024 over the same period in 2023. Further breakdown of the PRC's supply-side contributions were estimated using sectoral shares from the 2023 ADB Multiregional Input-Output Table, while financial, real estate, and professional services exclude professional services.

Sources: Asian Development Bank staff estimates; Haver Analytics; CEIC Data Company.

Figure 1.1.2 Industrial Production Indexes in Selected Developing Asian Economies

US tariffs weighed on industrial production in the region, except in Viet Nam and Taipei,China, where strong electronics demand drove record growth.



ASEAN = Association of Southeast Asian Nations.

Notes: For the PRC, industrial product refers to the industrial value added, with the January and February numbers averaged due to the Lunar New Year effect. Industrial production generally refers to manufacturing production and excludes agriculture, mining, and construction, except for India and Viet Nam, where mining is included. The index is calculated by taking the 3-month moving averages and indexing them to July 2024.

Source: CEIC Data Company.

Table 1.1.1 Manufacturing Purchasing Managers' Indexes in Selected Developing Asian Economies

August readings signal better manufacturing conditions ahead; services remain robust.

Manufacturing PMI, seasonally adjusted

	2024			2025							
	Q4			Q1			Q2			Q3	
Economy	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug
India	57.5	56.5	56.4	57.7	56.3	58.1	58.2	57.6	58.4	59.1	59.3
Thailand	50.0	50.2	51.4	49.6	50.6	49.9	49.5	51.2	51.7	51.9	52.7
Indonesia	49.2	49.6	51.2	51.9	53.6	52.4	46.7	47.4	46.9	49.2	51.5
Philippines	52.9	53.8	54.3	52.3	51.0	49.4	53.0	50.1	50.7	50.9	50.8
PRC	50.3	51.5	50.5	50.1	50.8	51.2	50.4	48.3	50.4	49.5	50.5
Viet Nam	51.2	50.8	49.8	48.9	49.2	50.5	45.6	49.8	48.9	52.4	50.4
Singapore, *nsa*	50.8	51.0	51.1	50.9	50.7	50.6	49.6	49.7	50.0	49.9	50.0
Malaysia	49.5	49.2	48.6	48.7	49.7	48.8	48.6	48.8	49.3	49.7	49.9
Republic of Korea	48.3	50.6	49.0	50.3	49.9	49.1	47.5	47.7	48.7	48.0	48.3
Taipei,China	50.2	51.5	52.7	51.1	51.5	49.8	47.8	48.6	47.2	46.2	47.4

Services PMI, seasonally adjusted

India	58.5	58.4	59.3	56.5	59.0	58.5	58.7	58.8	60.4	60.5	62.9
PRC	52.0	51.5	52.2	51.0	51.4	51.9	50.7	51.1	50.6	52.6	53.0
Sri Lanka, *nsa*	60.3	60.5	71.1	58.5	56.5	69.8	60.6	57.0	61.9	70.1	68.9
Philippines, *nsa*	52.5	52.4	54.5	51.3	50.9	52.4	55.6	51.0	50.1	48.3	50.6

PRC = People's Republic of China, nsa = not seasonally adjusted, PMI = purchasing managers' index, Q = quarter.

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

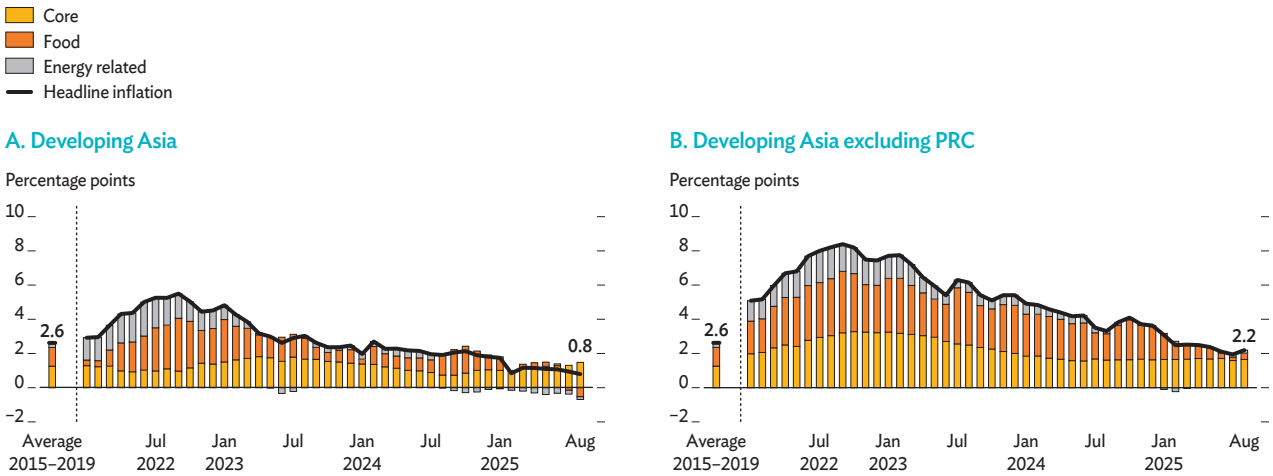
Sources: CEIC Data Company; iMetrics Asia.

50 for Indonesia following 4 months in contraction (Table 1.1.1). Manufacturing conditions strengthened in India and most ASEAN economies, partly as the PRC and other regional manufacturers tapped alternative markets within the region or shifted orders to lower-tariffed economies. The PRC's readings fluctuated around the threshold since April, but reverted to above 50 in August as manufacturing production returned to growth on rising new orders. Meanwhile, the index for Singapore inched up to neutral but remained below the threshold for the Republic of Korea, Malaysia, and Taipei,China as weaker readings during Q2 2025 continued. In Taipei,China however, weaker export orders for traditional products—such as textiles, basic metals, plastics, chemicals, and mineral products—have weighed on the PMI, even as export orders for AI-related products surged. Export orders in the Republic of Korea and Taipei,China—often considered bellwethers for regional export trends due to their significant roles in global electronics and semiconductor supply chains—were rising or positive since Q1, indicating external demand will continue to support growth. Many Taipei,China companies, led by tech giants like TSMC, have their production bases in Asia. In January to July 2025, 43.0% of orders were fulfilled in Asia, including 38.4% of electronics and 28.7% of ICT products. Historically, these orders have led regional exports by 3 to 4 months. Meanwhile, services PMIs in the PRC and India stayed strong, driven by rising demand for travel and recreation services while in the Philippines the index briefly fell below the threshold in July due to flooding disruptions during the typhoon season.

Disinflation continued across the region, as food and energy price pressures eased. Headline inflation in developing Asia declined further to 0.8% in August, as global energy and food prices declined and downward price pressures persisted in the PRC (Figure 1.1.3, panel A). Average fuel prices in the region continued to decline from March to August 2025, mirroring global fuel price trends. Following Israel's 13 June strikes on Iranian sites, Brent crude prices spiked 10.2% from $70.7 per barrel to $78.1 in the week ending 19 June. As geopolitical tensions eased, oil prices retreated to $67.4 on 29 August, weighed down by higher OPEC+ output and a global supply surplus amid weak economic prospects. Average food inflation continued to moderate due to good harvests and ample food supply. The benchmark Thai rice price (5% broken) fell to an 8-year low of $375 per metric ton in August 2025, while wheat prices continued to drop for 30 consecutive months thanks to record harvests and improved crop production. India's return to export markets weighed heavily on rice prices, as the country continued to boost shipments of low-cost long-grain rice amid record production and

Figure 1.1.3 Contributions to Inflation by Food, Energy, and Core Price Basket, Developing Asia

Disinflation continued across developing Asia, as food and energy prices retreated further.



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

Notes: For lack of a more disaggregated breakdown, energy-related consumer prices for most economies include housing, water, and non-fuel transport. 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. Subregional averages are calculated using GDP Purchasing Power Parity shares as weights.

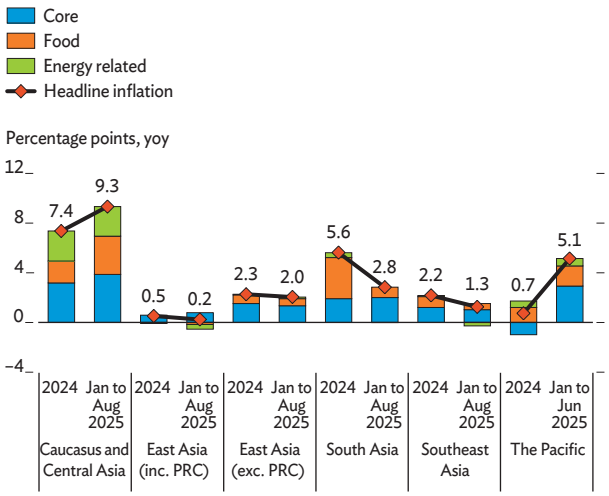
Sources: Haver Analytics; national sources.

elevated inventories. In the PRC, subdued domestic demand, abundant pork supply, and persistent factory-gate deflation pulled average inflation down to –0.1% for the first 8 months of 2025. Despite a government campaign to rein in excessive competition, inflation came in at –0.4% in August. Excluding the PRC, regional headline inflation eased to 2.2% as food inflation in some of the larger economies, particularly India, the Philippines, and Thailand, slipped into contraction (Figure 1.1.3, panel B). Excluding volatile components, underlying price pressures remain moderate. In August, core inflation in the PRC was 0.9%, edging up slightly on rising services prices. Excluding the PRC, the contribution of core price pressures to overall headline inflation has stabilized at about 1.6–1.7 percentage points since mid-2024.

Inflation rose in the Caucasus and Central Asia and in the Pacific, but fell in other subregions on lower food and energy prices (Figure 1.1.4). From January to August 2025, average headline inflation rose in the Caucasus and Central Asia, as poor weather impacted food production and utility costs, and supply chain disruptions hindered the availability of imported goods in some economies. Price pressures also rose in the Pacific. In Papua New Guinea, further depreciation of the exchange rate in H1 2025 accelerated imported inflation and higher prices of domestic items, including food, pushed up overall prices, offsetting price declines in other island economies. In contrast, inflationary pressures declined in East Asia, South Asia, and Southeast Asia, reflecting lower food and energy prices. The largest drop occurred in South Asia, where improved harvests and crop production eased food prices. This helped reduce headline inflation in August to a 6.5-year low in India and keep it below 1% for the fourth consecutive month in Sri Lanka. In Southeast Asia, lower food and energy prices continued to underpin consumer price disinflation, even as core inflation remained largely steady since mid-2024 and food price pressures edged up in some economies in August. Lower food prices, mainly rice, helped ease inflation in July in the Philippines, to 0.9%, the lowest rate in nearly 6 years. In Indonesia, headline inflation was dampened early in the year by temporary electricity discounts and easing food prices after bumper harvests, before edging up mid-year on seasonally higher education costs. In East Asia, excluding the PRC, energy inflation also fell, while food inflation stayed elevated as poor weather and factory price hikes drove up prices for processed and raw foods. In the PRC, pork prices contracted 16.1% in August amid an oversupply in the hog sector.

Figure 1.1.4 Contributions to Inflation by Food, Energy, and Core Price Basket, by Subregion

Most subregions experienced falling food and energy prices, except in the Caucasus and Central Asia and the Pacific.



PRC = People's Republic of China, yoy = year on year.

Notes: See Figure 1.1.3. Data refers to the average from January to August 2025, except the Pacific, which is as of June or Q2 2025.

Source: Haver Analytics.

US Tariffs Reset the Global Trade Landscape

US trade policy uncertainty surged in the first half of the year. A myriad of announcements and introductions of new US tariffs have shaken the global trade system. This has been compounded by uncertainty on retaliatory measures; several delays, exemptions, and changes in scope in the announced US tariffs; announcements of bilateral trade agreements between the US and its trading partners before their terms were finalized; continued uncertainty about the final level of US tariffs on the PRC; and the threat of sector-specific US tariffs on semiconductors, pharmaceuticals, and possibly other products (Box 1.1.1). In this context, US trade policy uncertainty soared to its highest level since at least 1960, as tariff announcements escalated between the US and the PRC in April (Figure 1.1.5). The index remains at historic highs despite retreating from its

Box 1.1.1 Trade Policy—The Risks of Re-Escalation of US–PRC Trade Tensions and Other Tariffs

If the United States (US) and the People's Republic of China (PRC) resumed trade tensions with the end of their trade truce in November, it would drag on global growth. However, threatened US tariffs on semiconductors and pharmaceuticals would have only marginally negative impacts on economies in the US, PRC, and developing Asia (excluding the PRC). This box explores both of these scenarios.

US "reciprocal" tariffs of 7 August 2025 imposed rates up to 50% on selected trading partners, aiming at economies with persistent merchandise trade surpluses with the US. Initially proposed and made effective in early April, the tariffs were paused on 9 April for 90 days, remaining at a 10% base rate during this negotiation window with partner economies. That window was later extended until 1 August. During this time, several economies successfully concluded new trade agreements with the US that secured lower tariff rates than those announced on 2 April.

While a tariff truce between the US and the PRC was extended to November 2025, prospects for a full de-escalation remain fragile. Earlier in April, the "reciprocal" tariffs led to an escalation in tariff rates between the two economies, reaching a peak of 125% additional tariffs. These extreme rates lasted for over a month until a 90-day truce was agreed on 14 May and later extended until 10 November 2025. Prior to 7 August, the average additional effective tariff rate imposed on developing Asia's economies stood at about 10%. This increased to about 15% from 7 August, following the lapse of negotiations and implementation of the new tariff schedule.

Since April, the US has also imposed a series of product-specific tariffs, with further related tariffs under consideration. A 25% tariff on automobiles took effect on 3 April, while a 25% tariff on automobile parts was introduced on 3 May. These were followed by a blanket 50% tariff on steel and aluminum imports on 4 June, and a 50% tariff on copper on 1 August. The US has also threatened to impose a 100% tariff on semiconductors and an initial 25% tariff on pharmaceutical products, with a follow-up that it could increase to 250%.

Beyond economic considerations, the US imposed additional tariffs on certain economies for geopolitical reasons. Brazil faced an additional 40% tariff on top of the original 10% due to political factors. Meanwhile, India was hit by an extra 25% tariff, bringing the total to 50%, with the US administration citing India's continued purchases of Russian oil as the motivating consideration.

The US Court of Appeals for the Federal Circuit ruled on 29 August 2025, however, that US President Donald Trump lacked legal authority under the 1977 International Emergency Economic Powers Act to impose such sweeping reciprocal and economy-specific tariffs. Although the ruling was stayed until 14 October to allow for a potential Supreme Court appeal, if upheld it could dismantle the administration's ability to swiftly impose broad tariffs on trade partners. This could also lead to delays in ongoing negotiations and weaken US leverage in future trade agreements.

Two adverse tariff scenarios are considered here. All scenario results are expressed as deviations from a baseline that incorporates tariff changes up to 4 September. As such, the baseline includes: the revised "reciprocal" tariffs that came into effect from 7 August, the additional 25% tariff on India, the additional 40% tariff on Brazil, and the additional US tariffs for automobiles, automobile parts, aluminum, steel, and copper. The two tariff scenarios are described below, with tariff changes assumed to apply throughout the 2025–2026 forecast horizon:

- **US–PRC re-escalation scenario:** Assumes imposition of additional 125% tariffs by both the US and the PRC if retaliatory measures resume after the truce expires on 10 November 2025.
- **Tariffs on semiconductors and pharmaceuticals:** Assumes 100% tariffs on semiconductors and 25% tariffs on pharmaceuticals.

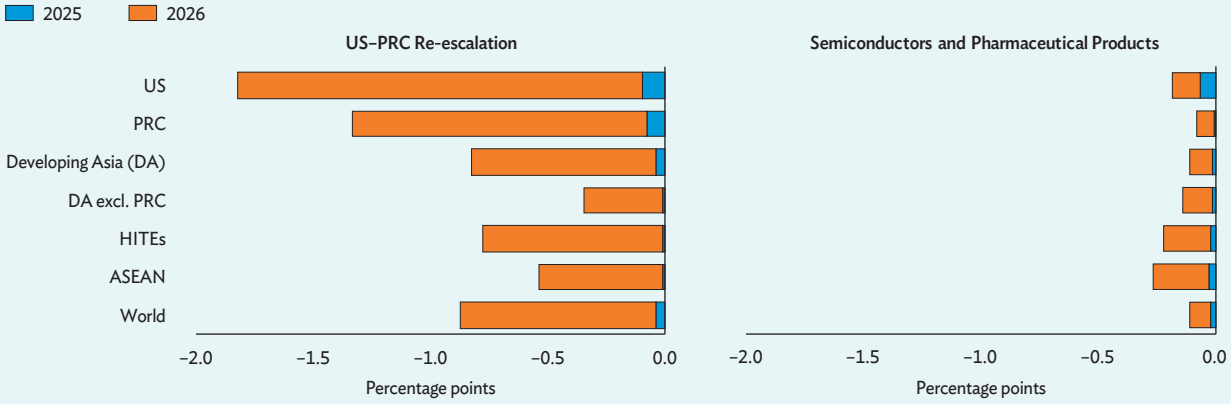
continued on next page

Box 1.1.1 *Continued*

The simulations were carried out using the Global Economic Model of Oxford Economics.
A renewed escalation of US–PRC trade tensions would weigh on global growth. With the truce set to expire on 10 November, re-escalation could occur immediately thereafter, with the largest effects materializing in 2026 (box figure 1A). Over 2025–2026, US gross domestic product (GDP) growth would decline by 1.8 percentage points, the PRC's by 1.3 points, and global growth by 0.9 points. Developing Asia excluding the PRC would see a more modest decline of 0.3 percentage points. Inflation effects diverge, however. In developing Asia excluding the PRC, cumulative inflation would fall by 0.5 points as the slowdown in economic activity resulted in a $7.91 decline in oil prices, leading to disinflationary pressures. In contrast, the tariff escalation would push inflation higher in the US (up 0.6 points) and the PRC (up 1.2 points) over the same period due to the direct impacts of higher tariffs on imported goods and production inputs (box figure 1B).

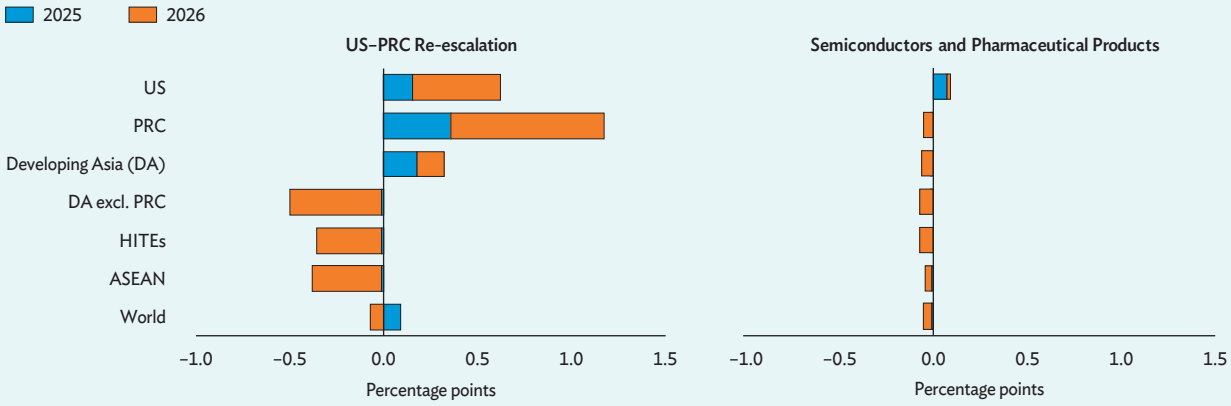
1A Estimated Impact of Additional Tariffs on GDP Growth

GDP growth would decline sharply if US–PRC trade tensions re-escalated; while targeted tariffs on semiconductors and pharmaceuticals would have more marginal impacts.



1B Estimated Impact of Additional Tariffs on Inflation

US and PRC inflation could surge if their trade escalation returns.



ASEAN = Association of Southeast Asian Nations, PRC = People's Republic of China, HITE = high-income technology exporter, US = United States.

Notes: Modeled tariff impact estimates do not account for potential discretionary policy responses, nor do they fully incorporate front-loading, trade diversion, heightened policy uncertainty, market volatility, or risk aversion. All scenarios are relative to a baseline that takes into account US tariff developments up to 4 September 2025. HITE includes Hong Kong, China; the Republic of Korea; Singapore; and Taipei,China. ASEAN includes Indonesia, Malaysia, the Philippines, Thailand, and Viet Nam.

Source: Asian Development Bank staff estimates.

continued on next page

Box 1.1.1 *Continued*

On their own, the threatened tariffs on semiconductors and pharmaceuticals would still result in negative, albeit marginal, impacts. Should these tariffs be imposed, US growth would drop by 0.19 percentage points, the PRC's by 0.08 points, and global growth by 0.11 points. Developing Asia excluding the PRC would see growth decline by 0.14 points due to the high exports from Malaysia, the Philippines, and Taipei,China of semiconductors and from Singapore of pharmaceuticals, relative to their total exports to the US. Finally, these tariffs would have only marginal inflationary impacts on the US in 2025–2026.

This box was written by Jaqueson Galimberti, Dennis Sorino, and Ed Kieran Reyes of the Economic Research and Development Impact Department.

peak as bilateral trade deals were reached with key economies in May–August and the additional tariffs effectively applied on most other economies were announced on 1 August.

US tariffs rose sharply on 7 August, though not as much as announced on 2 April. The average effective US tariff rate was 17.4% as of 4 September—the highest level since the Great Depression of the 1930s, and up from 2.4% in 2024 (Figure 1.1.6). For 23 developing Asian economies, the new US tariff rates are around half the levels announced in April, but still much higher than in 2024 (Figure 1.1.7). For these economies, the new tariffs range from 15% to 50% for India. Tariffs are also particularly high on several Southeast Asian economies, including the Lao People's Democratic Republic (Lao PDR) and Myanmar. For the remaining 23 developing Asian economies, the additional US tariffs remain 10%.

Developing Asia, especially the PRC, has been hit harder than the rest of the world. Accounting for exemptions and sector-specific tariffs, the region now faces an average effective tariff 28.1 percentage points higher than the tariffs agreed through the World Trade Organization or free trade agreements (Figure 1.1.8). This is well above the average excess tariff the US imposes on its imports from countries outside Asia. The PRC faces the highest excess effective tariff, at 42.1 percentage points as of 19 September. And this is even though the US government, on 11 August, suspended further tariff increases until 10 November.

Cambodia, Viet Nam, and Malaysia would be hit the most if all announced sector-specific tariffs materialized, on top of the existing ones. These tariffs could affect exports to the US accounting for up to 5.4% of GDP in Cambodia, and 4.1% in Malaysia and Viet Nam (Figure 1.1.9). However, the overall impact

Figure 1.1.5 Trade Policy Uncertainty Index

Trade policy uncertainty spiked in the first half of the year, though it has eased from its peak in April.

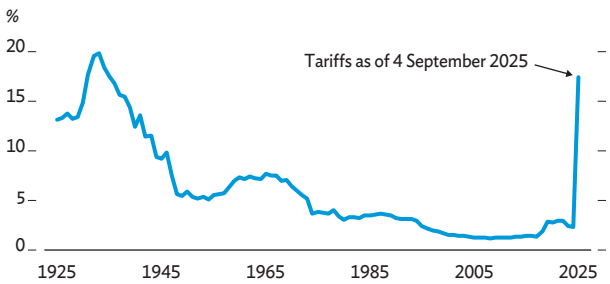
PRC = People's Republic of China, US = United States.

Note: The measure reflects the frequency of articles discussing trade policy uncertainty in six US newspapers and one British daily since 1960.

Source: D. Caldara et al. 2020. The Economic Effects of Trade Policy Uncertainty. *Journal of Monetary Economics*. 109. pp. 38–59.

Figure 1.1.6 US Average Effective Tariff Rate

US tariffs have surged to levels not seen since the 1930s.



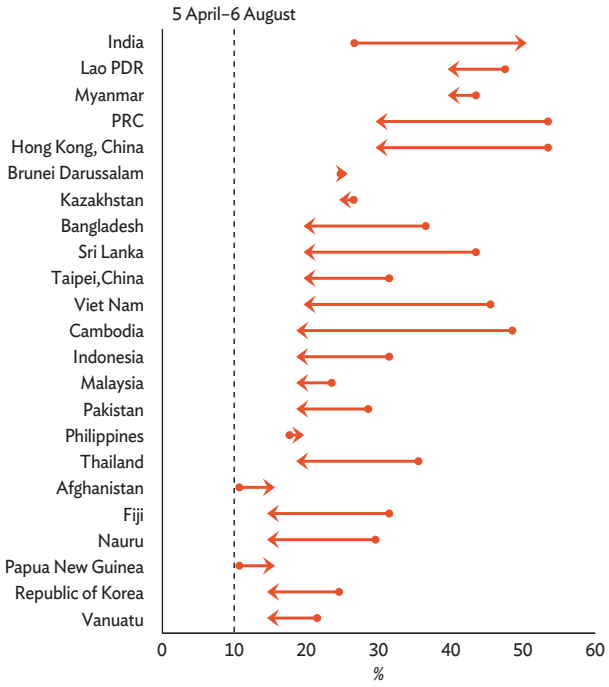
US = United States.

Note: The chart shows customs duties-to-imports ratio up to July 2025. The effective tariff rate for August 2025 is estimated at 17.4% using 2024 trade weights.

Source: The Budget Lab. State of U.S. Tariffs: September 4, 2025.

Figure 1.1.7 Changes between 2 April Announcements and US Excess Tariffs as of 19 September

The latest US tariffs on many regional economies are about half those announced on 2 April.



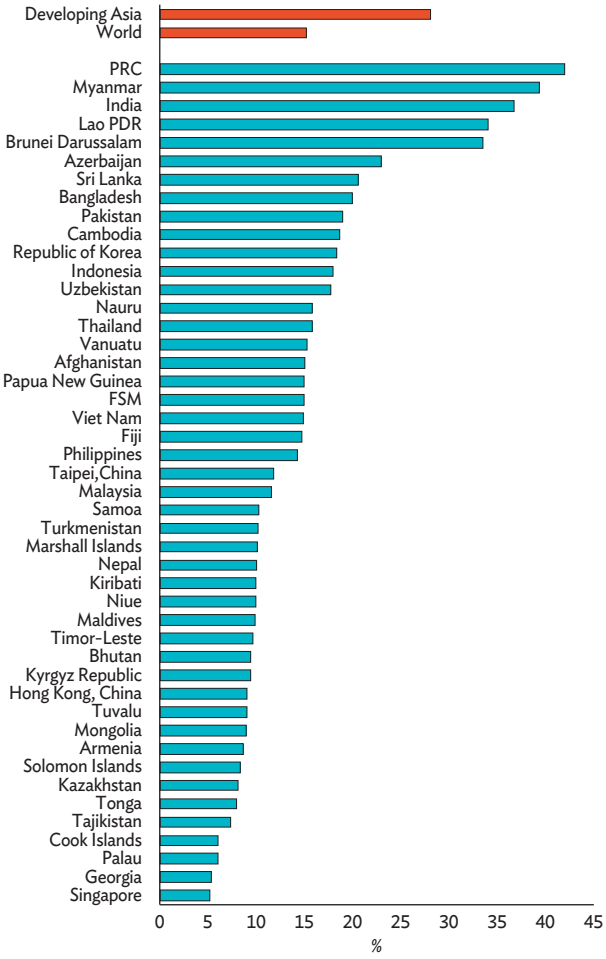
PRC = People's Republic of China, Lao PDR = Lao People's Democratic Republic.

Notes: The dots show the additional tariffs announced on 2 April and arrow heads show those implemented as of 19 September. This chart covers the developing Asian economies for which additional implemented tariffs exceed 10%. The remaining developing Asian economies have had an additional 10% tariff imposed. For the PRC and Hong Kong, China, the additional US tariff between 5 April and 6 August was 30%, not 10%.

Sources: The White House. 2025. Regulating Imports with a Reciprocal Tariff to Rectify Trade Practices that Contribute to Large and Persistent Annual United States Goods Trade Deficits. Executive Order 12457 of 2 April 2025; The White House. 2025. Further Modifying the Reciprocal Tariff Rates. Executive Order 12457 as amended on 31 July 2025; The White House. 2025. Addressing Threats to the United States by the Government of the Russian Federation. Executive Order 14329 of 6 August 2025.

Figure 1.1.8 US Effective Tariff in Excess of the Tariffs Agreed Through the World Trade Organization or Free Trade Agreements, by Trading Partner

Developing Asia now faces effective additional tariffs well above the average US additional tariff.



PRC = People's Republic of China, Lao PDR = Lao People's Democratic Republic, FSM = Federated States of Micronesia, US = United States.

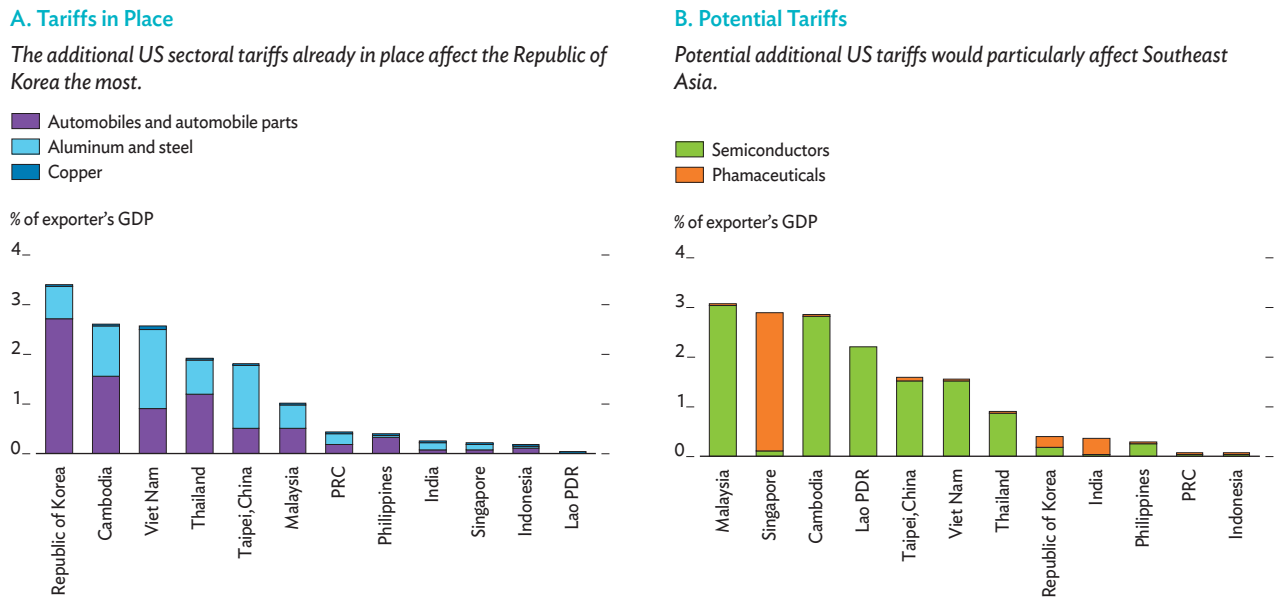
Notes: Data as of 19 September. The average for developing Asia is weighted by US import shares. Excess tariff for the world is obtained by deducting the trade-weighted average US most-favored nation tariff in 2023 (2.2%) from the current effective tariff. The rate for the PRC includes the tariffs added during 2018–2024 (18.2%), the "Fentanyl tariff" and the "Reciprocal tariff" (23.9%, accounting for product exemptions), and the sector-specific tariffs adopted between March and August (3.1%). The sector-specific tariffs do not stack up with the economy-specific tariffs, except for the "Fentanyl tariff" applied on US imports from the PRC.

Source: Asian Development Bank estimates.

on the region would depend on the extent to which the US can substitute domestic production for imports.

The additional sectoral US tariffs already in place have hit the Republic of Korea the hardest. This includes the 25% tariff on auto and auto parts and 50% on aluminum and steel which became effective between March and May. The tariff on steel was extended to certain household appliances in April, while the tariffs were expanded to cover the aluminum and steel content of other products on 18 August. These sectoral measures also include a 50% tariff on the value of the copper contained in certain products, implemented since 1 August. The Republic of Korea is hit particularly hard by the tariff on auto and auto parts, a sector which accounts for about one-third of its exports to the US (Figure 1.1.9, panel A). This

Figure 1.1.9 Exports Affected by Actual and Potential Additional US Sectoral Tariffs



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

Notes: The economies in these charts are those with more than 0.1% of their GDP accounted for by combined US imports of copper, aluminum and steel, automobiles and automobile parts, semiconductors, and pharmaceuticals. Copper is defined as per the Executive Order that imposes 50% additional tariffs and is assumed to make up 80% of the value of these products. Aluminum and steel include goods defined in Proclamations 10895 and 10896, respectively. Automobiles and automobile parts include goods defined in Proclamation 10908. Semiconductors include goods under harmonized system codes 8541 and 8542. Pharmaceuticals include goods under code 30.

Sources: The White House. 2025. Adjusting Imports of Copper into the United States. Proclamation 10962 of 30 July 2025; The White House. 2025. Adjusting Imports of Aluminum into the United States. Proclamation 10895 of 10 February 2025; The White House. 2025. Adjusting Imports of Steel into the United States. Proclamation 10896 of 10 February 2025; The White House. 2025. Adjusting Imports of Automobiles and Automobile Parts into the United States. Proclamation 10908 of 26 March 2025; and US International Trade Commission Database.

tariff has also hit Cambodia's exports of tires to the US. The current sectoral tariffs also affect Viet Nam and Thailand which, besides tires, also export metal products to the US. The impact of the copper tariff, however, is muted for the region as dutiable products represent less than 1% of the region's exports to the US.

Additional US tariffs on pharmaceuticals and semiconductors would mostly affect Southeast Asia. On 8 July, the US President mentioned a tariff on pharmaceuticals gradually rising to 200%, and up to 250% on 5 August; and on 7 August, a 100% tariff on semiconductors was announced. This could exclude firms manufacturing or committing to manufacture in the US, thus exempting major chipmakers from the Republic of Korea and Taipei,China which have struck deals for investment in the US. In contrast, these tariffs would likely hit Malaysia, Cambodia, and the Lao PDR severely, while tariffs on pharmaceuticals would primarily affect Singapore, a major exporter of vaccines to the US (Figure 1.1.9, panel B).

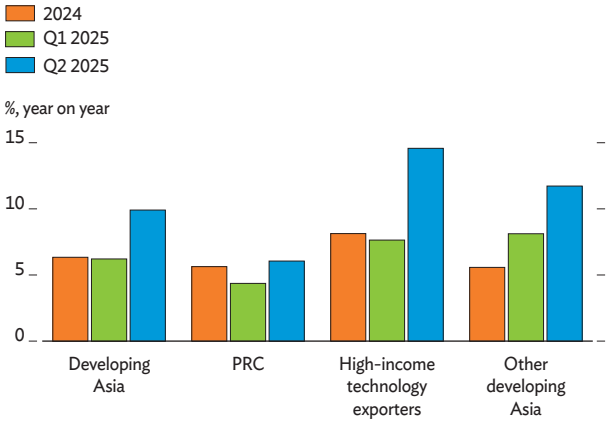
Exports Surge Ahead of New US Tariffs

Developing Asia's exports grew 8.1% in the first half of the year, boosted by tariff frontrunning. Growth accelerated from 6.2% in the first quarter to 9.9% in the second (Figure 1.1.10) after record-high new US tariffs were announced on 2 April and capped at 10% first until 7 August. This led US importers to stock up in anticipation of higher tariffs.

Exports surged in high-income technology exporters while the PRC's exports growth was more moderate. High-income technology exporters performed particularly well, with Taipei,China posting 20% export growth in the first quarter, accelerating to 32% in the second as strong global demand for AI server chips compounded with tariff frontrunning. Exports also rose by a solid 11% in Singapore and 13% in Hong Kong, China in the first half of the year. In the

Figure 1.1.10 Changes in Nominal Exports

Developing Asia's exports accelerated in Q2 as most US additional tariffs were paused.



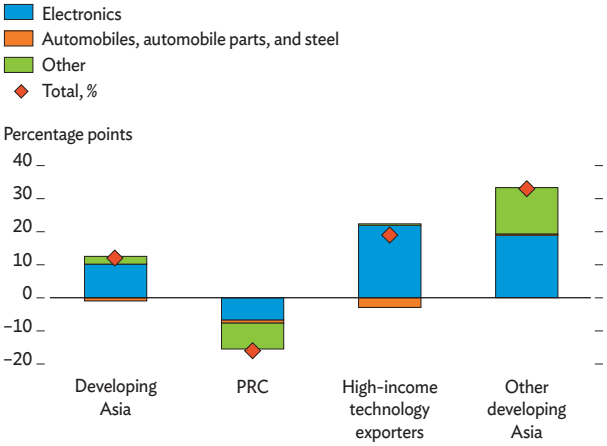
PRC = People's Republic of China, Q = quarter, US = United States.

Note: High-income technology exporters = Hong Kong, China; Republic of Korea; Singapore; and Taipei,China.

Source: CPB Netherlands Bureau for Economic Policy Analysis. World Trade Monitor June 2025.

Figure 1.1.11 Changes in US Imports in the First Half of 2025

The region's high-income technology exporters and other developing Asian economies filled the gap left by falling US imports from the PRC.



PRC = People's Republic of China, US = United States.

Note: High-income technology exporters include Hong Kong, China; the Republic of Korea; Singapore; and Taipei,China.

Sources: US International Trade Commission and Haver Analytics Database.

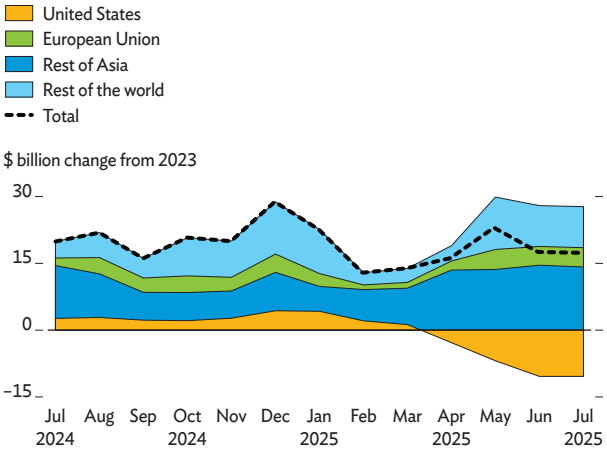
Republic of Korea, however, exports declined by 0.1% as rising semiconductor exports were not sufficient to offset declining exports of automobiles and steel, hit by the new sectoral US tariffs. Elsewhere, exports rose by 89% in the Lao PDR in the first half of the year, 26% in Thailand, 19% in Cambodia, and 15% in Bangladesh, Malaysia, and Sri Lanka. In contrast, the PRC registered modest export growth of 5.3% in the first half of the year, though facing a slight uptick in the second quarter as the US tariffs announced on 2 April were paused.

Falling US imports from the PRC were offset by rising imports from other regional economies. Rising exports from high-income technology exporters and other regional economies to the US largely offset the decline in PRC exports to the US (Figure 1.1.11). Electronic products, which have so far been exempted from additional US tariffs, contributed 88% of this increase. In contrast, US imports of automobiles and automobile parts, which have been subject to a 25% additional tariff since 3 April 2025, declined, notably from the Republic of Korea.

The PRC succeeded in reallocating its exports to the US to alternative markets. In July 2025, while the PRC's exports to the US contracted by 25%, they

Figure 1.1.12 Changes in the PRC's Exports by Destination

The PRC redirected its exports to alternative markets.



PRC = People's Republic of China.

Note: Changes are calculated as three-month moving averages.

Source: Haver Analytics Database.

expanded by 9% to Europe and Asia, and 12% to the rest of the world (Figure 1.1.12). This trade redirection spanned all key sectors, including mechanical and electrical products, automobiles and automobile parts, and textiles.

Tourist Arrivals Approach Pre-Pandemic Levels

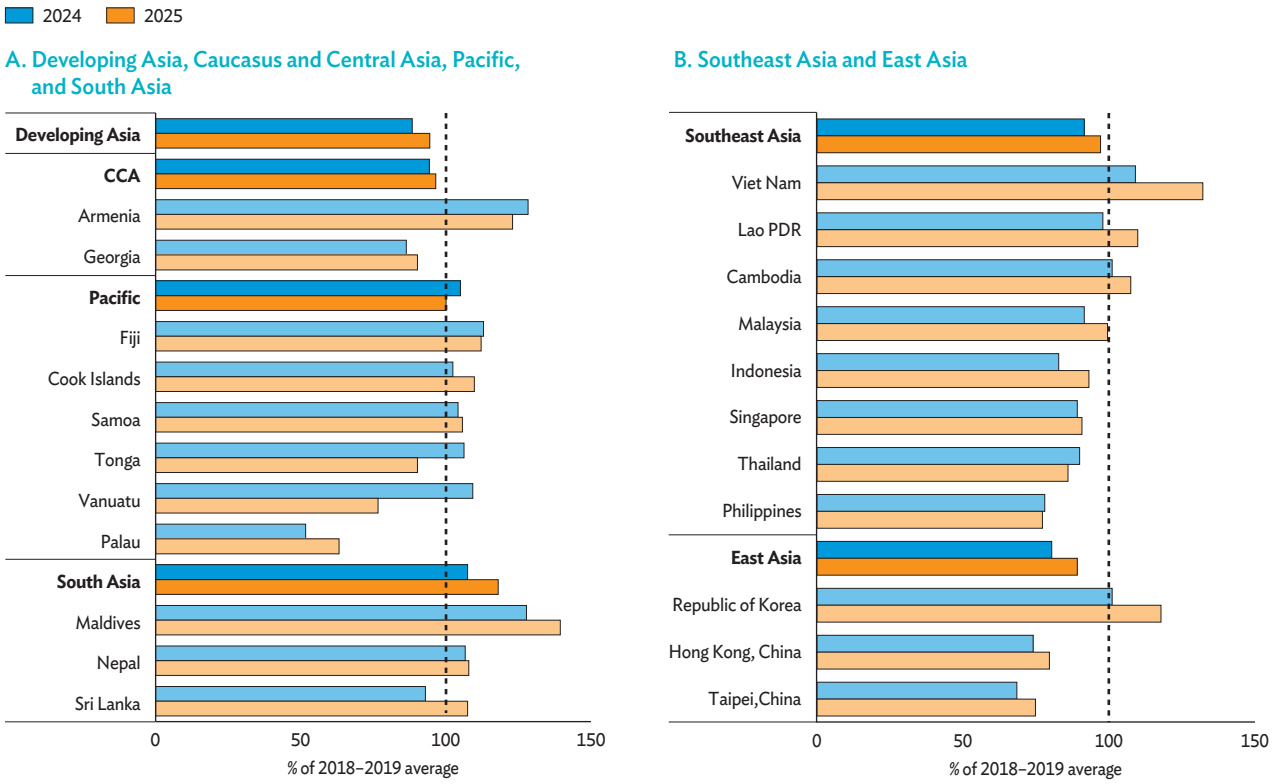
Tourist arrivals continued to rise, albeit at a slower pace. Tourist arrivals in developing Asia recovered to 94% of pre-pandemic levels in the first half of this year, from 88% in the first half of 2024 (Figure 1.1.13, panel A). This 6-percentage point increase represents a slowdown in the catch-up from 23 percentage points in the first half of last year as arrivals now approach pre-pandemic levels.

Several destinations have fully recovered from the COVID-19 pandemic. In the Caucasus and Central Asia, total arrivals neared pre-pandemic levels, with Armenia's 23% increase compared to before the pandemic offsetting the remaining 10% shortfall in Georgia. Visitors to the Pacific have largely caught up to pre-pandemic levels. In the first half of the year, arrivals in Fiji and the Cook Islands exceeded pre-pandemic levels by 12% and 10%, respectively, and those in Samoa by 6%. However, visitors to Palau were 63% of pre-pandemic arrivals as tourism from most East Asian markets remains muted. In South Asia, arrivals kept rising beyond pre-pandemic levels in Maldives and Sri Lanka.

Tourist arrivals still lag behind in East Asia and Southeast Asia. In East Asia, tourism remained 12% below pre-pandemic levels despite a significant upturn (Figure 1.1.13, panel B). Hong Kong, China; and Taipei,China drove this poor performance as they both attracted just over 75% of the number of pre-pandemic visitors. On the other hand, tourism in the Republic of Korea has been booming, now exceeding pre-pandemic levels by 16%. In Southeast Asia, arrivals still fall short of pre-pandemic levels, particularly in Thailand and the Philippines. This is notably driven by sluggish arrivals from the PRC (Box 1.1.2). Viet Nam stands out, with arrivals in the first half of this year at 30% above pre-pandemic levels, notably boosted by the unilateral visa exemptions adopted in 2023.

Figure 1.1.13 International Tourist Arrivals in the First Half of the Year

The post-pandemic tourism recovery is coming to an end.



CCA = Caucasus and Central Asia, Lao PDR = Lao People's Democratic Republic.
Note: The data for Tonga is for the first 5 months of the year.
Sources: CEIC Data Company; official sources.

Box 1.1.2 Shortfall Persists in PRC Travelers to Southeast Asia

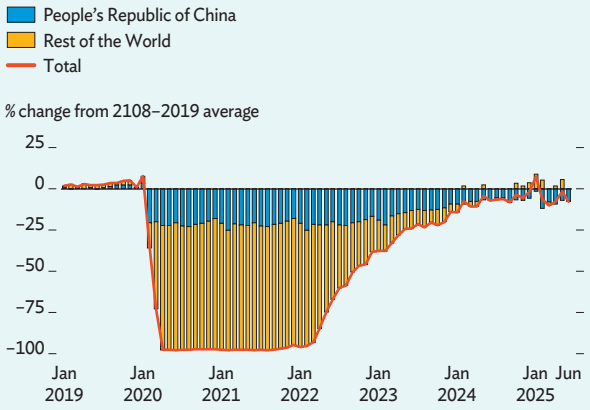
Tourist arrivals in Southeast Asia from the People's Republic of China (PRC) remain below pre-pandemic levels, with steep shortfalls in Thailand, Cambodia, and the Philippines. This reflects PRC tourists increasingly favoring domestic and alternative destinations, as well as economy-specific barriers such as safety concerns and restrictive visa policies. Targeted policy action can help address these barriers and accelerate the tourism recovery, leading to meaningful macroeconomic gains.

Tourism in Southeast Asia still lags pre-pandemic levels, held back by a sharp drop in visitors from the PRC. In the second quarter of 2025, tourist arrivals in Southeast Asia were 6% below the 2018–2019 average, entirely driven by a 37% shortfall from the PRC (box figure 1). This means about 1.5 million PRC tourists visited Southeast Asia each month in the second quarter (Q2), down from 2.3 million per month in 2018–2019. As a result, just 15% of visitors in Southeast Asia were from the PRC in Q2 2025, down from 22% before the pandemic.

The downturn in PRC tourists has been steepest in the Philippines, Thailand, and Cambodia. Despite a broad recovery from other source markets, PRC tourist arrivals were still down a staggering 82% from pre-pandemic levels in the first half of the year in the Philippines, 61% in Thailand, 47% in Cambodia, 41% in Indonesia, and 17% in Singapore. They were up 8% in Viet Nam, and 23% in Malaysia. In Viet Nam, the widening of e-visa eligibility to all passports in 2023 has boosted tourism, but less from the PRC than from other markets. In fact, Malaysia is the only Southeast Asian economy where arrivals from the PRC have outperformed those from elsewhere. In sum, about 820,000 fewer PRC tourists visited Southeast Asia every month in the first half of this year compared to before the pandemic, while arrivals from the rest of the world increased by 340,000 monthly.

1 Visitor Arrivals in Southeast Asia

Tourist arrivals from the People's Republic of China still lag behind pre-pandemic levels in Southeast Asia.



Source: CEIC Data Company.

In the Philippines and Cambodia, restrictive visa policies and concerns over crime have limited the return of PRC tourists. In the Philippines, e-visas for PRC passport holders were suspended in 2023, requiring advance applications and complicating travel. Cambodia continues to require visas for PRC visitors, unlike Malaysia and Thailand, which lifted this requirement in 2023 and 2024, respectively. Just 14% of surveyed PRC travelers viewed Cambodia as safe in March, with negative media stories about organized crime and scams darkening its image (Dragon Trail International 2025).

Safety concerns have delayed the recovery in Thailand. The kidnapping in January of an actor from the PRC lured in Bangkok via an online scam sharply reduced arrivals. Heavy media coverage of scams and related human trafficking further damaged perceptions. In March, only 19% of the PRC travelers surveyed by a tourism marketing company considered Thailand safe, down from 24% in 2024. In response, Thailand intensified security checks and monitoring for tourist safety. An earthquake in March also likely contributed to the slowdown.

PRC travelers are increasingly choosing domestic destinations. By 2024, domestic tourism trips had rebounded to near pre-pandemic numbers, while outbound travel was still 12% lower (box figure 2). Internal tourism promotion, investment in infrastructure and attractions, and pandemic-era travel restrictions, have strengthened internal tourism. Trade policy uncertainty, youth unemployment, and property sector challenges may also encourage travelers to stay closer to home.

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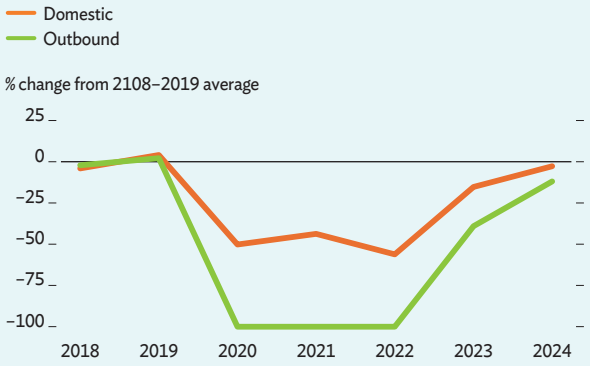
Box 1.1.2 *Continued*

2 Number of Tourism Trips in the People's Republic of China

Domestic destinations attract a larger portion of PRC tourists.



Source: CEIC Data Company.

Competition from Japan and the Republic of Korea has intensified. In the second quarter of 2025, arrivals from the PRC in these countries were 5% above pre-pandemic levels, compared to 37% below in Southeast Asia. Favorable exchange rates—especially the yuan's 14% appreciation against the won and 33% against the yen—make travel more attractive. Japan has relaxed visa rules and the Republic of Korea now allows visa-free entry for PRC tour groups. Rising interest in these two destinations known as very safe also mirrors concerns over safety in Southeast Asia. Their greater popularity could also reflect rising interest in cultural heritage, food, and nature, besides more traditional shopping and seaside tourism.

A full recovery of PRC tourism could boost GDP in Cambodia, Thailand, and the Philippines. Before the pandemic, tourism contributed 14% to Cambodia's GDP, 11% in Thailand, and 2% in the Philippines. The current shortfall in PRC visitors is equivalent to about 2.3% of GDP in Cambodia, 2.0% in Thailand, and 0.4% in the Philippines. Closing this gap would thus deliver a meaningful economic lift.

To expedite the return of PRC tourists, governments should combine policies addressing practical barriers and travelers' perceptions. Easing visa requirements by expanding visa-free or e-visa options would make travel more accessible, while enhancing safety through visible law enforcement and clear communication could reassure potential visitors. Marketing campaigns within the PRC can also help reshape perceptions and highlight each economy's unique attractions. By addressing both entry barriers and travelers' concerns, Southeast Asia could attract more visitors from the PRC and revitalize its tourism sector.

Reference

Dragon Trail International. 2025. Planning and Preparing for New Journeys: Chinese Traveler Sentiment Report. Dragon Trail Research. April 2025.

This box was written by Jules Hugot and Nedelyn Magtibay-Ramos.

Remittances Remain a Robust Source of Income

Remittances remained steady in most of the region in the first half of the year. Inbound money transfers as a share of GDP were stable across most regional economies, at around 35% in Samoa, 25% in Fiji (Figure 1.1.14, panel A), 20% in Armenia and the Kyrgyz Republic, and 10% in Georgia and the Philippines (Figure 1.1.14, panels B and C). Money transfers to Bangladesh soared, exceeding the equivalent of 10% of GDP, driven by the government's crackdown on informal channels and 2.5% cash bonus on formal transfers. Transfers to Sri Lanka also rose sharply, to 8% of GDP in the first half of this year, boosted by emigration during the recent economic crisis. In both countries, this has provided a welcome boost to the foreign reserves held by the central bank.

Figure 1.1.14 Inbound Cross-Border Money Transfers in the First Half of the Year

Money transfers kept progressing in South Asia while they remained robust in the Caucasus and Central Asia and the Pacific.

GDP = gross domestic product.

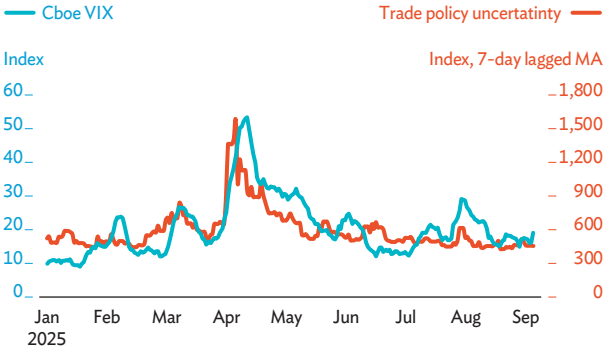
Sources: CEIC Data Company; International Monetary Fund. World Economic Outlook Database, April 2025; official sources.

Regional Financial Markets Remain Resilient

Despite uncertainty over trade and US monetary policy, financial market conditions have improved since July. Investor sentiment was shaped by concerns over the scope of potential US tariffs during trade negotiations in July–August. Trade policy uncertainty intensified when the expiration of the negotiation deadline led the US to impose higher tariffs on several major trading partners, on 1 August (Figure 1.1.15). Nevertheless, the recent trade agreements and the continuining US–PRC trade talks helped temper market concerns, as reflected in the relative stability of the Cboe Volatility Index (VIX). On the monetary side, weaker US labor market data released in August and September boosted expectations of a September Fed rate cut (Figure 1.1.16). As anticipated, the Fed cut the policy rate by 25 bps at its FOMC meeting on 17 September. Nevertheless, tariff-related inflation pressures have added uncertainty to the Fed's policy path beyond

Figure 1.1.15 Trade Policy Uncertainty and Volatility Index

Since July, market volatility responded modestly to the rise in trade policy uncertainty.



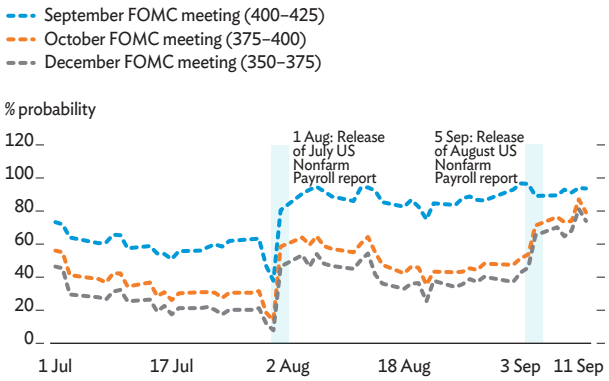
Cboe = Chicago Board Options Exchange, MA = moving average, VIX = Volatility Index.

Sources: Bloomberg and Caldara et al. 2019. The Economic Effects of Trade Policy Uncertainty. *Journal of Monetary Economics* 109 (2020): 38–59.

2025 (Box 1.1.3). Despite these mixed signals, the prospect of near-term US rate cuts has supported regional financial markets, lifting equities in most,

Figure 1.1.16 Market-Implied Probabilities of Fed Funds Rate Ranges

Weak US job market data raised expectations of rate cuts.



FOMC = Federal Open Market Committee, US = United States.
Source: CME Group FedWatch Tool.

Figure 1.1.17 Equity Indexes

Except in South Asia, equity markets strengthened over July-September on positive expectations of trade deals and rate cuts by the Fed.

Notes: The Caucasus and Central Asia data comprise Kazakhstan only. East Asia comprises People's Republic of China; Hong Kong, China; Republic of Korea; and Taipei,China. South Asia comprises Bangladesh, India, Pakistan, and Sri Lanka. Southeast Asia comprises Indonesia, Malaysia, Philippines, Singapore, Thailand, and Viet Nam. Subregional indexes are aggregated using 2024 market capitalization shares as weights. Equity indexes are in local currency terms.
Source: Bloomberg.

narrowing risk premiums, lowering long-term sovereign yields, and sustaining portfolio inflows. Regional currencies depreciated slightly against the US dollar.

Equity markets rose in all subregions except South Asia. Regional equity markets recorded average return of 8.2%, weighted by market capitalization, from 1 July to 12 September. Performances varied across subregions. Gains were recorded in East Asia, Southeast Asia, and Caucasus and Central Asia on optimism over trade negotiations in July and solid economic performance in the first half of 2025 (Figure 1.1.17). However, South Asian markets marginally declined, led by India, where steep US tariffs introduced on 27 August, large-scale tech sector layoffs, and foreign investor withdrawals weighed on equities. Most major regional markets retreated on 1 August as the deadline for trade negotiations with the US elapsed but subsequently rallied amid rising expectations of a Fed rate cut in September. Moreover, at the end of August, equities were weighed down by a global tech sell-off over weaker profit margins and a cautious outlook about data-center equipment demand by a few leading companies. Most regional equity markets rallied in September amid increased expectations of a more dovish US monetary stance following the release of weak labor market data.

Risk premiums continued to ease in the third quarter of 2025 on improved investor sentiment. From 1 July to 12 September, the GDP-weighted regional average of risk premiums, as measured by the credit default swap spread, narrowed 10.6 bps. This decline, which extended the downward trend from the first half of 2025, was shaped by progress on trade agreements, solid economic growth, and expectations of a rate cut by the Federal Reserve in September. The narrowing of spreads was particularly pronounced in the PRC and Viet Nam, where sound economic fundamentals and favorable market stability measures of the government boosted investor confidence (Figure 1.1.18). In the PRC, better-than-expected Q2 GDP growth and a series of policy support measures—including an interest rate cut in May and increased liquidity injections of about $82 billion—helped strengthen investor sentiment. The PRC's ongoing trade negotiations with the US and the extension of their trade truce until 10 November reinforced confidence. In Viet Nam, optimism over ongoing stock market reforms added to strong economic growth in H1 2025 to boost investor sentiment.

Moderating inflation and continued monetary easing contributed to the decline in long-term government bond yields. From 1 July to 12 September, 10-year government bond yields decreased in 6 of the 11 regional bond markets where data is available, as domestic inflation and monetary

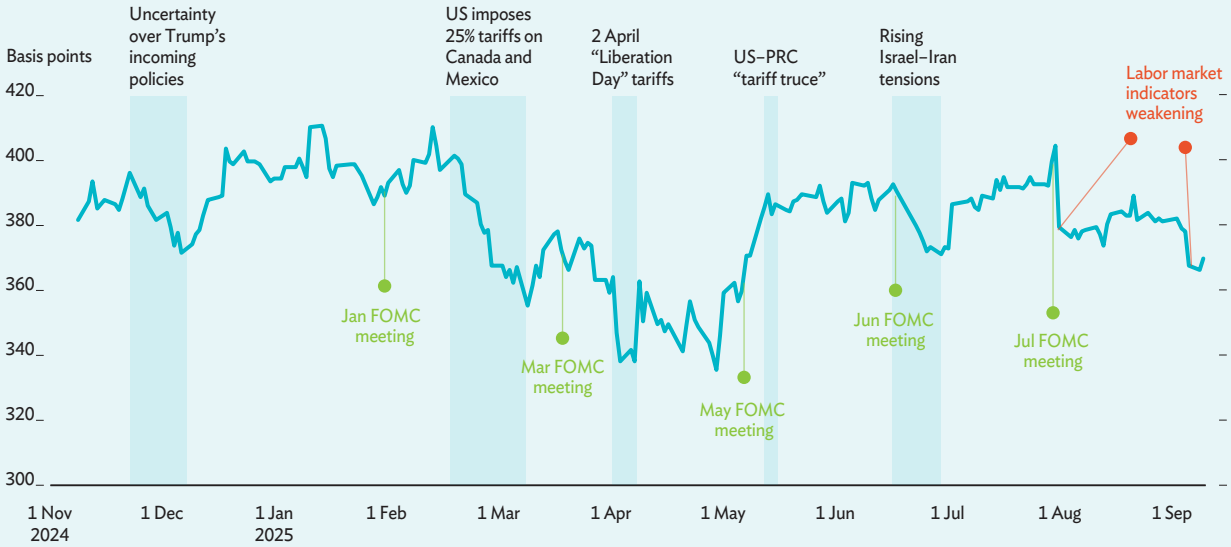
Box 1.1.3 The Federal Reserve at a Crossroads: Potential Impacts of Alternative US Policy Rate Paths

The outlook for United States (US) monetary policy is clouded by uncertainty, as the Federal Reserve (Fed) encounters conflicting signals from inflation and the labor market. Recent readings of the core Personal Consumption Expenditures (PCE) Price Index, the Fed's preferred measure of underlying inflation in the US, have trended away from target, with July's data showing a 3.1% increase year on year. While inflationary pressures are expected to persist as higher tariff rates on imports are passed through to consumer prices, labor market signals are more ambiguous. Nonfarm payrolls growth, one of the most closely watched indicators of employment, reached a 5-year low in June and came out below expectations in July and August, though unemployment claims and the jobless rate remain broadly stable (see Box 1.2.1). This mix puts the Fed at a crossroads in its dual policy mandates of maintaining price stability and maximum sustainable employment. Will the Fed ease monetary policy to sustain credit growth and boost the economy or will it keep interest rates high for longer to contain inflationary pressures? This box explores two corresponding risk scenarios with a focus on the potential impacts for developing Asia.

Evolving trade policy, macroeconomic conditions, and geopolitical risks throughout 2025 have played a significant role in shaping market expectations for US policy rates. Market expectations have been swinging between recessionary fears associated with trade policy developments and recurring signals of a cautious approach by the Fed about inflation (box figure 1). The imposition of 25% tariffs on Canadian and Mexican imports in February, followed by the "Liberation Day" tariffs announced on 2 April, led to significantly lower interest rate expectations. However, as persistent inflationary pressures became evident and the US–PRC temporary tariff truce provided a moment of relief in trade tensions, concerns about inflation came back to the fore and led to higher interest rate expectations in mid-May.

1 Market Expectations of Fed Funds Rate by December 2025

Trade policy, macroeconomic conditions, and geopolitical risks have been key drivers of market interest rate expectations.



PRC = People's Republic of China, FOMC = Federal Open Market Committee, US = United States.
Source: Asian Development Bank staff estimates using CME FedWatch, December 2025 probabilities.

[a] Simulations are conducted using ADB's version of the Global Projection Model, a semi-structural quarterly gaps model. The ADB version of the model includes the following economies from developing Asia: People's Republic of China; Hong Kong, China; India; Indonesia; Republic of Korea; Malaysia; Philippines; Singapore; Taipei,China; and Thailand.

continued on next page

Box 1.1.3 *Continued*

In June, escalating conflict between Israel and Iran reignited geopolitical volatility, while labor market indicators published in August and September suggested a reassessment of US labor market strength. Although weakening in employment data might justify monetary policy easing, the inflationary impacts from tariffs and rising inflation expectations—particularly in sectors exposed to trade disruptions—may warrant a more careful approach. Balancing these competing forces will be vital to the Fed's interest rate decisions.

The path of future US monetary policy can impact developing Asia's outlook. US monetary policy can have a direct impact on developing Asian economies through aggregate demand and exchange rates. To assess the potential impacts of alternative US policy rate paths on the region's outlook, this box conducts model-based simulations of two risk scenarios:[a]

i. **Faster-than-expected interest rate cuts.** Under this scenario, the US economy is hit by a sequence of negative demand shocks that lead to a decline in gross domestic product (GDP) growth and inflation rates, prompting the Fed to cut rates faster than currently expected. Such shocks can be interpreted as a labor market slowdown and a deterioration of consumer and business confidence amid persistently high economic policy uncertainty (box figure 2).

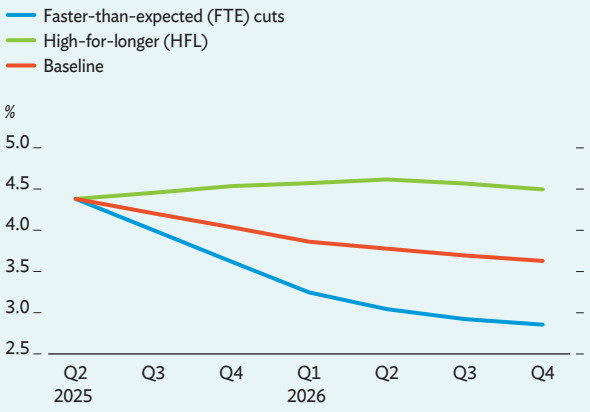
ii. **High-for-longer interest rates.** Under this scenario, the US economy is hit by a mix of positive demand and adverse supply shocks that lead to an acceleration in inflation and slightly faster GDP growth. This prompts the Fed to keep interest rates higher throughout 2026. Such shocks can be interpreted as upside pressures on prices coming from higher tariff rates and tightening labor markets due to restrictive immigration policies, alongside expansionary fiscal policy and a recovery in sentiment that counterbalances the adverse supply effects of higher costs and declining supply of labor.

This box also considers how monetary policy responses from regional economies can shape the impact of alternative US monetary policy

2 US Policy Rate Scenarios: Faster-than-Expected Cuts versus High-for-Longer

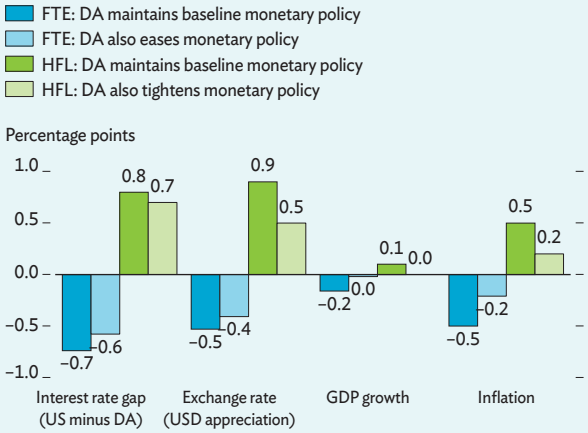
A. US Policy Rates in the Baseline and Scenarios

Mixed inflation and jobs outlook could lead to a Fed pivot in either direction.



B. Impact of Scenarios on Developing Asia, 2025–26

Alternative US policy rate paths could impact developing Asia through exchange rates.



DA = developing Asia, FTE = faster-than-expected US policy rate cuts, GDP = gross domestic product, HFL = high-for-longer US policy rates, Q = quarter, US = United States, USD = United States dollar.

Notes: Interest rate gaps and exchange rates reported in panel B are 2026 averages, while GDP growth and inflation are the sum of 2025 and 2026 impacts. For the exchange rate, negative values indicate an appreciation of developing Asian currencies, while positive values indicate depreciation.

Source: Asian Development Bank staff estimates.

continued on next page

Box 1.1.3 *Continued*

scenarios. First, this box looks at the impacts if the modeled developing Asian economies are assumed to maintain their interest rates at the baseline—this exercise will serve as a reference to understand the relevance of regional monetary policy responses. Second, the box looks at a case where monetary policy in developing Asian economies is allowed to adjust endogenously according to the model equations—namely, the model assumes central banks adjust policy rates in response to deviations of inflation forecasts from target and output gaps using an inertial rule. All results are reported relative to a baseline that incorporates 50 basis points of cuts to the Fed funds rate by December 2025 and a further 50 basis points in 2026 (box figure 2, panel A).

Faster-than-expected US policy rate cuts would lead to a depreciation of the US dollar and disinflationary pressures in developing Asian economies. As US interest rates decline faster, the gap between US dollar and developing Asia's interest rates would decline, leading to an inflow of portfolio capital into developing Asia's economies and an appreciation of the local currencies relative to the US dollar (box figure 2, panel B, blue bars). The main macroeconomic effects of this exchange rate appreciation are disinflationary pressures, whereas developing Asia's GDP growth declines by a lower margin, driven by the negative external demand impact of the shock to the US economy. But the magnitude of these effects would also depend critically on how developing Asian economies respond. Particularly, when developing Asian economies also ease their monetary policy stance to counterbalance the negative GDP growth effects, the disinflationary impact declines by more than half.

Higher-for-longer US policy rates would have opposite impacts, leading to an appreciation of the US dollar and inflationary pressures in developing Asia. The same interest rate differentials channel would be in operation if the Fed decides to keep interest rates higher throughout 2026 (box figure 2, green bars). The widening gap between the US and developing Asia's interest rates would lead to a depreciation of the regional currencies and corresponding inflationary effects due to higher import prices in local currency units. If these economies follow the US policy by also hiking their interest rates, the inflationary impacts can be substantially reduced.

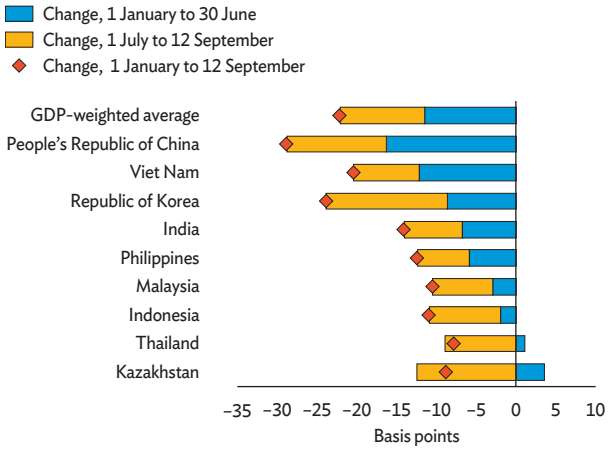
Central banks in developing Asia should remain attentive to US monetary policy and, where conditions allow, respond accordingly to mitigate negative spillovers. The Fed is approaching a key juncture in the future path of US policy rates. Whereas mixed signals about inflationary pressures and labor market weakness have so far been matched with a cautious approach, new data may shift the balance to a sharp Fed pivot in either direction. Heightened policy uncertainty and political threats to the US central bank's independence may further complicate the task of achieving its dual mandate. As this box has illustrated, monetary policy in the US can have direct impacts on developing Asia's economies, particularly through exchange rates. Policymakers in the region should remain vigilant to these shifts and, where domestic goals allow, adjust their monetary policy stances accordingly to avoid the potential impacts of alternative US policy rate paths.

This box was written by Jaqueson Galimberti, Dennis Sorino, and Deborah Kim Sy of the Economic Research and Development Impact Department.

policies eased and amid growing market expectations of rate cuts in the US (Figure 1.1.19). Bucking this trend, bond yields increased in the PRC; Hong Kong, China; India; the Republic of Korea; and Viet Nam, largely reflecting the impact of domestic factors. Bond yields in the PRC rose on better-than-expected GDP growth and optimism over the extension of US–PRC trade negotiations, while yields in Hong Kong, China increased over higher bond issuance this year to support the delivery of government infrastructure projects. In India, yields increased on expectations of higher bond issuance amid concerns that tariffs could prompt additional fiscal stimulus. In the Republic of Korea, yields edged higher, in part because of the government's additional Korean won 21.1 trillion bond issuance to fund the second supplementary budget aimed at supporting the economy. Meanwhile, rising 10-year government bond yields in Viet Nam reflect

Figure 1.1.18 Credit Default Swap Spreads

Credit default swap spreads narrowed on improved investor sentiment.

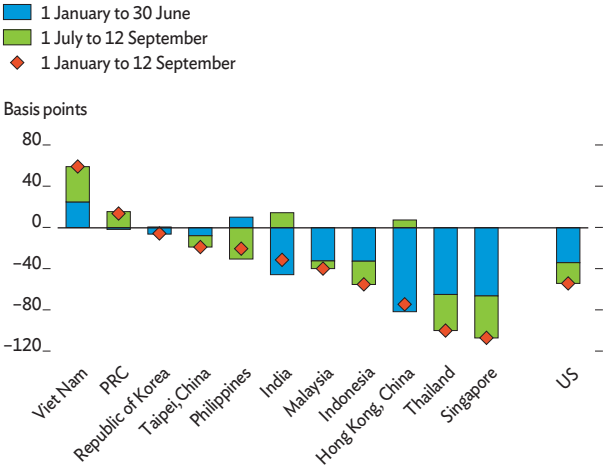


Note: The average is aggregated using ADO weights based on purchasing power parity gross domestic product (GDP) in current international dollars.

Source: Bloomberg.

Figure 1.1.19 10-Year Government Bond Yields

10-year yields in the region have generally contracted this year.



PRC = People's Republic of China, US = United States.

Source: Bloomberg.

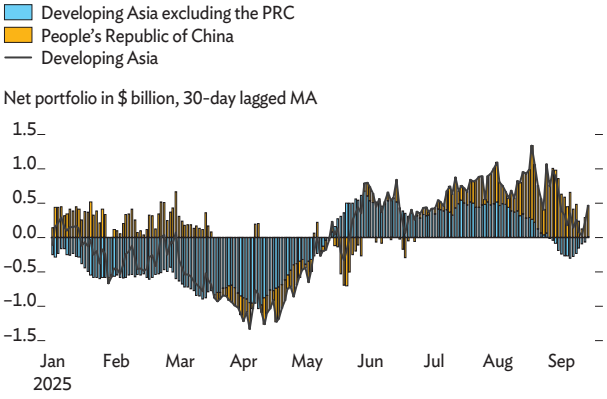
strong growth and higher government bond issuance to finance public investment and support domestic consumption.

Portfolio inflows into developing Asia's equity and debt markets continued in the third quarter of 2025, supported by rising expectations of US interest rate cuts and progress in trade negotiations in some regional economies. From 1 July to 12 September, net portfolio inflows into the region reached $36.0 billion, sustaining the momentum of recent months particularly in the PRC (Figure 1.1.20). The PRC attracted $25.3 billion, supported partly by equity market reforms aimed at boosting shareholder confidence and by attractive valuations. Inflows were seen in the Republic of Korea ($7.0 billion) and Taipei,China ($13.3 billion) over strong performance in the AI and technology sectors and optimism about the conclusion of trade negotiations, while equity outflows of $7.3 billion were recorded in India, due to weak corporate earnings and uncertainty surrounding US–India trade negotiations.

Regional currencies weakened slightly against the US dollar since 1 July amid various domestic factors. After a 5.6% decline in H1 2025, the US dollar index has appreciated marginally by 0.5% against a broad basket of currencies from 1 July to 12 September over a mix of positive and negative

Figure 1.1.20 Equity and Debt Portfolio Flows into the Region

The region saw net portfolio inflows in the third quarter.



PRC = People's Republic of China, MA = moving average.

Source: Institute of International Finance.

drivers. Better-than-expected Q2 growth in the US, the Fed's decision to hold rates at its July meeting, and progress in trade negotiations supported the US dollar. But negative market sentiment over weak US labor market data in July and August and rising expectations of a Fed rate cut in September partly offset those positive factors. Against this backdrop, the GDP-weighted aggregate of developing Asian currencies fell slightly, by 0.7%, against the US dollar over the same period, with 20 out of 36 currencies depreciating (Figure 1.1.21). Various economy-specific

factors contributed to currency performance in the region. Taipei,China's NT dollar depreciated in part due to equity portfolio outflows by end-August amid a tech stock selloff as investors worried about equity stakes in chipmakers. Kazakhstan's tenge depreciated on falling oil prices and a weaker Russian ruble. The Republic of Korea's won depreciated over trade uncertainty. The Indian rupee weakened following the imposition of new tariffs amid geopolitical tensions over oil trade, which dampened foreign inflows. Meanwhile, Tajikistan's somoni gained the most amid sustained remittance inflows through 2025, while Afghanistan's currency strengthened as Da Afghanistan Bank interventions helped stabilize the exchange rate.

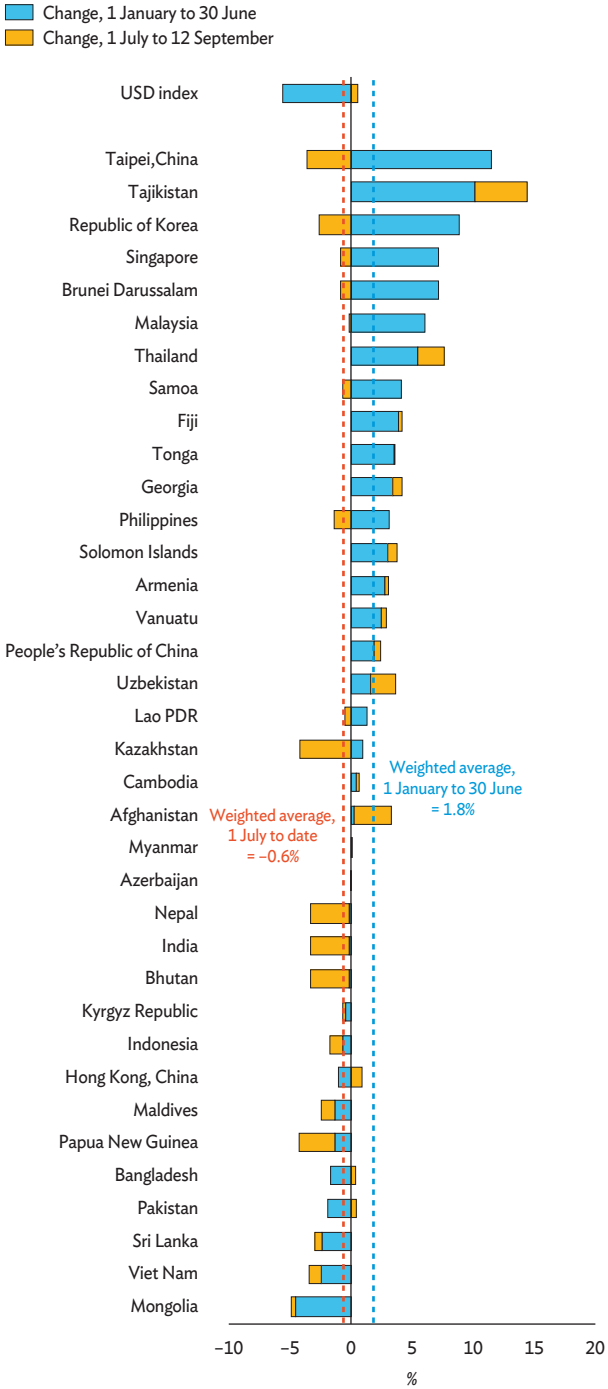
Conditions Ripe for Further Monetary Easing

Inflation is in check in most of the region. In July 2025, inflation was at or below target in 11 of the 17 inflation-targeting economies (Figure 1.1.22), while 10 out of the 15 non-inflation targeting economies with available data had lower inflation than at the beginning of the year. The Philippines, Sri Lanka, and Thailand had inflation rates at least 1 percentage point below the midpoint of their target range, while the PRC and Nepal had inflation rates at least 1 percentage point below target. Bucking this trend, Bangladesh's and Kazakhstan's inflation exceeded their central banks' targets by over 3 percentage points, while inflation in Georgia and the Kyrgyz Republic was higher than the upper bound of the target range, by about 1 and 2 percentage points, respectively. Inflation was only marginally above target in the Republic of Korea and Mongolia.

External and domestic factors have driven disinflation in developing Asia. Externally, falling global energy and food prices, including Brent crude oil and Thai rice, have exerted downward pressure on inflation. Domestic drivers include improved food supply, through record harvests in Cambodia, India, and the Philippines, as well as lower utility and fuel costs in economies such as Thailand and Hong Kong, China. Additionally, weak consumer demand, particularly in the PRC and Nepal, have further dampened domestic price pressures.

Figure 1.1.21 Exchange Rate Movements

The recent uptick in the US dollar was reflected in a slight depreciation across most currencies in the region.



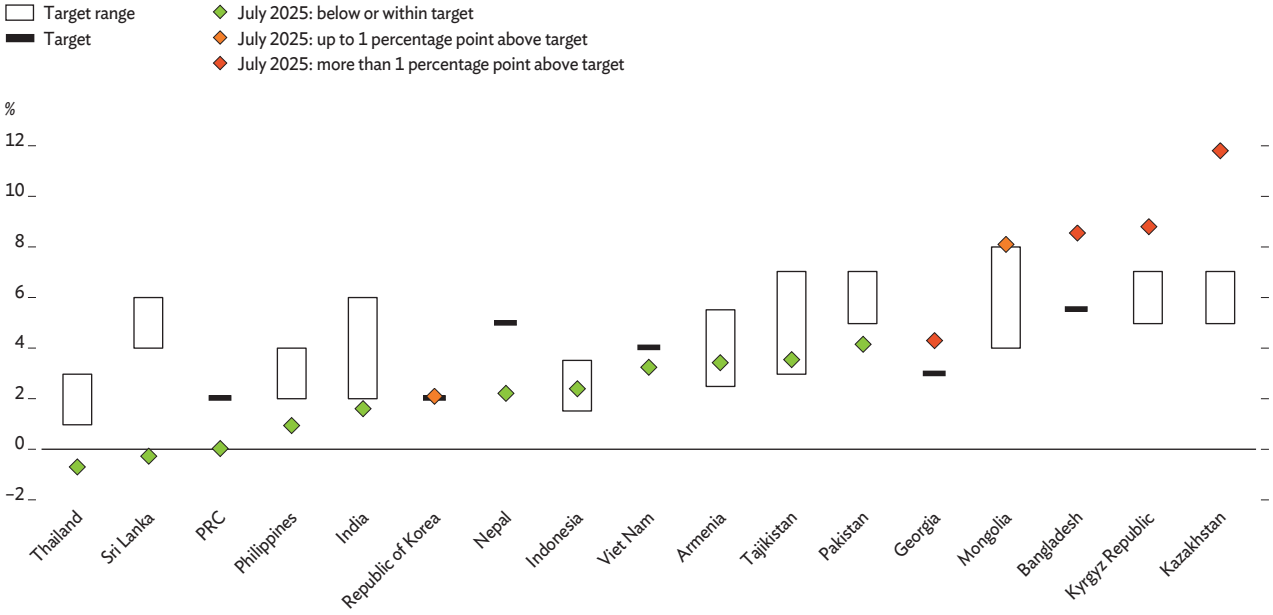
Lao PDR = Lao People's Democratic Republic, USD = United States dollar.

Note: The US dollar index is a nominal index for emerging economies, comprising the currencies of 19 economies for which bilateral trade with the United States accounts for at least 0.5% of total US bilateral trade from Board of Governors of the Federal Reserve System (US) via FRED®.

Sources: Bloomberg and CEIC Data Company.

Figure 1.1.22 Inflation and Inflation Targets

Inflation is below or within target for most inflation-targeting economies in the region.



PRC = People's Republic of China.
Sources: CEIC Data Company and official sources.

Against this backdrop, monetary policy easing is already under way. Over January–August 2025, 11 economies lowered their policy rates to stimulate activity amid global trade uncertainties and slowing inflation. The largest cuts were in India, Pakistan, and Tajikistan (Figure 1.1.23). Only Kazakhstan, the Kyrgyz Republic, and Mongolia tightened their monetary policies, as they counter elevated inflation and exchange rate depreciation.

Expected easing by the US Federal Reserve may create monetary policy space for Asian central banks. Recent data suggesting a cooling US labor market have raised expectations for further policy rate cuts by the Federal Reserve. Market participants now anticipate a cumulative reduction of 125–150 basis points by the end of 2026. Possibly reflecting these expectations, most Asian economies' exchange rates appreciated against the US dollar in August. The expected easing of US monetary policy, along with disinflationary pressures and currency appreciation, paves the way for further monetary easing in many regional economies (Figure 1.1.24).

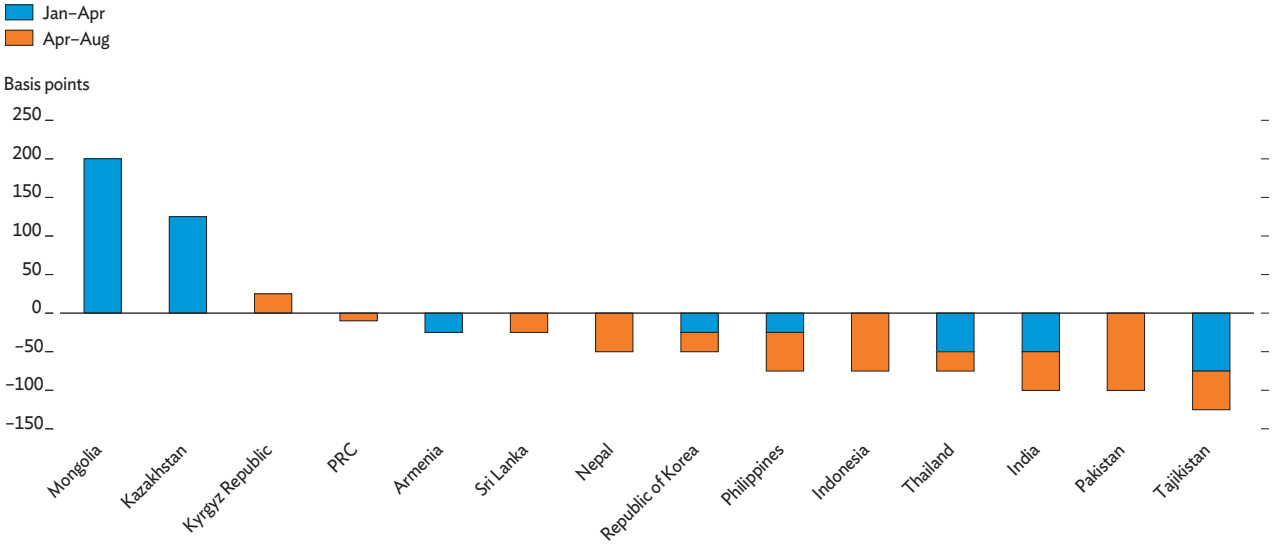
While conditions broadly support further monetary easing, central banks will need to tread carefully. The pace and extent of rate cuts will depend on the stability of inflation expectations and the strength of external demand: weak exports strengthen the case for easing to support domestic demand, while stronger global demand would warrant more caution to avoid reigniting price pressures. Striking the right balance between supporting growth and safeguarding price stability will remain the key challenge.

Debt Ratios Easing, but Debt Service Worsening

Favorable growth and inflation developments helped contain debt ratios. The average government debt-to-GDP ratio for developing Asia (excluding the PRC; and the financial centers of Hong Kong, China; and Singapore) declined from its peak of 49.5% in 2020 to 45.2% in 2024 albeit, remaining above the pre-pandemic level of 40.6%

Figure 1.1.23 Change in End-of-Month Policy Rates, January to August 2025

Interest rate cuts have been widespread among Asian economies.



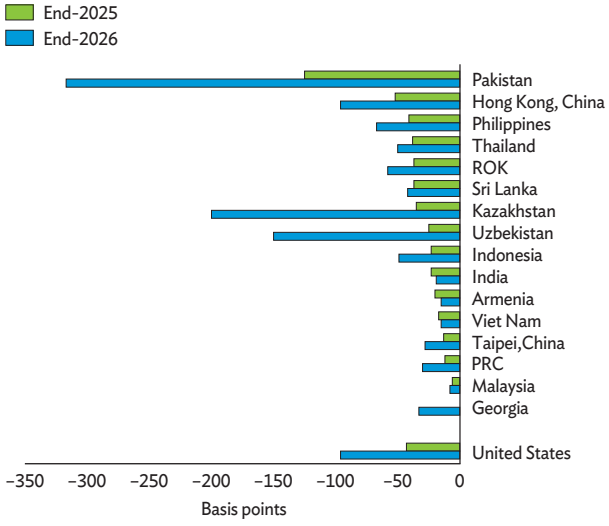
PRC = People's Republic of China.

Notes: Change in policy rate (basis points) = end-of-August 2025 policy rate – end-of-January 2025 policy rate * 100. January to 2 April 2025 (blue bars) and post-2 April to August 2025 (orange bars). Only economies which changed their policy rates from January 2025 through August 2025 are included.

Sources: CEIC Data Company and official sources.

Figure 1.1.24 Forecast Policy Rate Changes by End-2025 and End-2026

Further monetary easing is anticipated across many Asian economies through 2025 and 2026.



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

Notes: Forecast rate change = forecast policy rate at the end of the year – 14 August, policy rate. Included economies are only those with available forecast data.

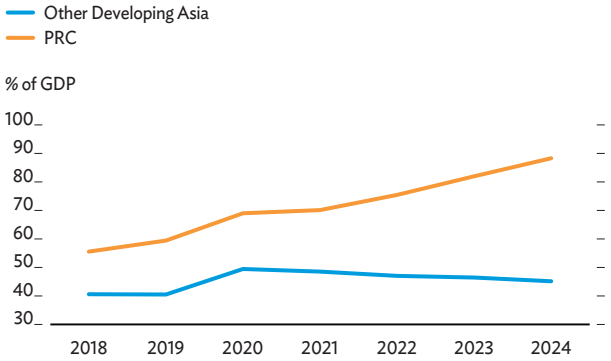
Sources: Focus Economics for end of year forecasts and official sources for current policy rates.

in 2018–2019 (Figure 1.1.25). Resilient growth and higher inflation in 2024 jointly offset the impact of persistent primary deficits, rising interest rates, and weaker local currencies, helping debt ratios stabilize or even decline in most economies in the region (Figure 1.1.26). In the PRC, however, the debt ratio rose (to 88.3% of GDP in 2024 as measured by the IMF, and 68.7% according to the government), driven by a larger government debt stock and slowing growth of nominal GDP. Several other economies also saw significant increases in their debt-to-GDP ratios, mainly due to higher primary deficits and interest costs, and local currency depreciation outweighing the impact of growth and inflation.

Debt service burdens pose a growing vulnerability. Public debt service absorbed 30% of public revenues in 2024 across much of developing Asia, and is projected to rise to 38% by 2025–2026. This reflects both the amortization of COVID-19 pandemic-era debt, now reaching maturity, and the impact of rising interest payments. Debt service ratios range from as high as 135% of fiscal revenues in Sri Lanka to around 1% in Timor-Leste in 2024 (Figure 1.1.27). Interest payments alone are 40% of government revenues in Pakistan, 23% in the Lao PDR, 19% in Bangladesh, and

Figure 1.1.25 Government Debt

For most economies, debt ratios were contained.



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

Notes: Other Developing Asia excludes the PRC; Hong Kong, China; and Singapore and shows the computed simple average of individual economies' ratios.

Sources: Asian Development Bank. Asia Sovereign Debt Monitor; International Monetary Fund.

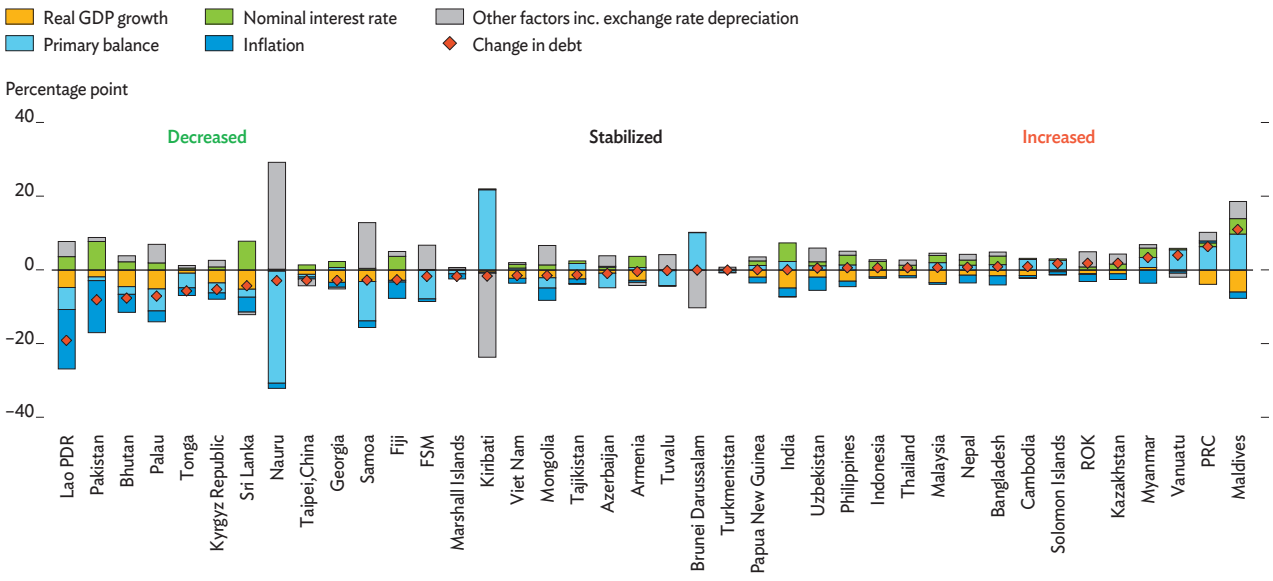
18% in India. Elevated interest costs were a sizable share of fiscal deficits in many economies with already-high government debt-to-GDP ratios in 2024, such as Sri Lanka, India, Fiji, and Pakistan (Figure 1.1.28).

This highlights the importance of improved debt management, greater transparency, and accessible financing to reduce the risk of liquidity shocks turning into solvency crises.

Some economies are still grappling with debt challenges. The Lao PDR and Maldives are under severe debt pressure. The Lao PDR's government debt-to-GDP ratio is projected to decline from 96.4% in 2024 to 89.5% in 2025, driven by fiscal tightening. Nevertheless, it faces substantial near-term debt servicing obligations and potential rollover constraints. In Maldives, the primary deficit is expected to be around 11% of GDP in 2025, raising government debt from 134% of GDP in 2024 to a projected 141% in 2025, and its external debt service obligations in 2025 and 2026 are about $1 billion, more than its foreign reserves. In contrast, Sri Lanka and Pakistan show some improvement, owing to economic policy adjustments under International Monetary Fund (IMF)-supported programs and favorable macroeconomic conditions. Sri Lanka's debt is expected to stabilize at around 109% of GDP by 2025–2026 and Pakistan's at 75% of GDP.

Figure 1.1.26 Drivers of Change in Government Debt-to-GDP Ratio, 2024

Favorable growth and inflation developments offset primary deficits.



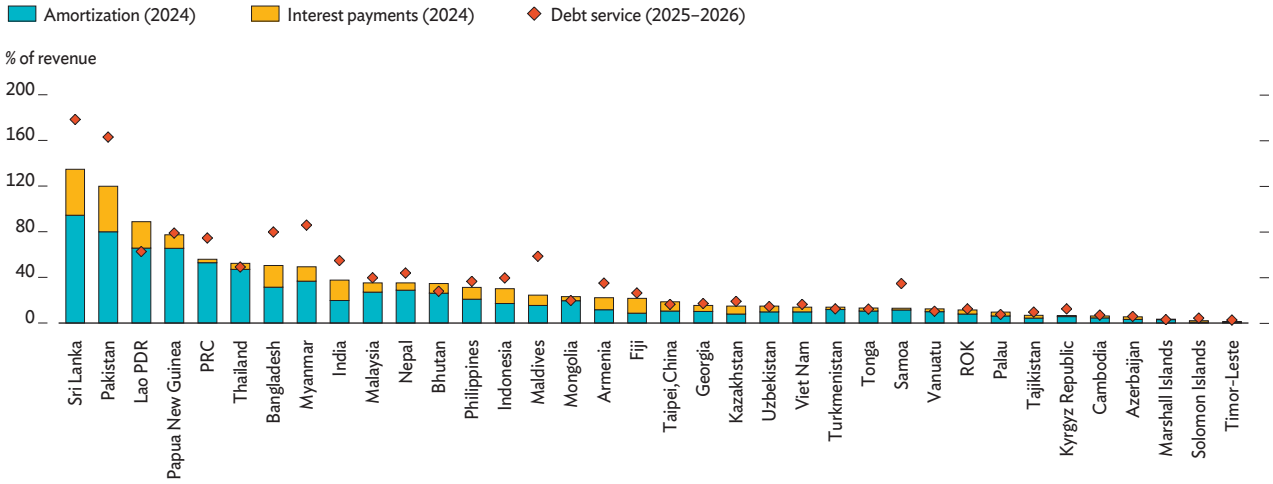
PRC = People's Republic of China, FSM = Federated States of Micronesia, GDP = gross domestic product, ROK = Republic of Korea, Lao PDR = Lao People's Democratic Republic.

Notes: Excludes Cook Islands; Hong Kong, China; Niue; Singapore; Timor-Leste. Decreasing = negative change in debt (<0 percentage point); Stabilizing = change in debt is between 0 and 1 percentage point; Increasing = change in debt greater than 1 percentage point.

Source: Asian Development Bank. Asia Sovereign Debt Monitor.

Figure 1.1.27 Government Debt Service, 2024 and 2025–2026 Average

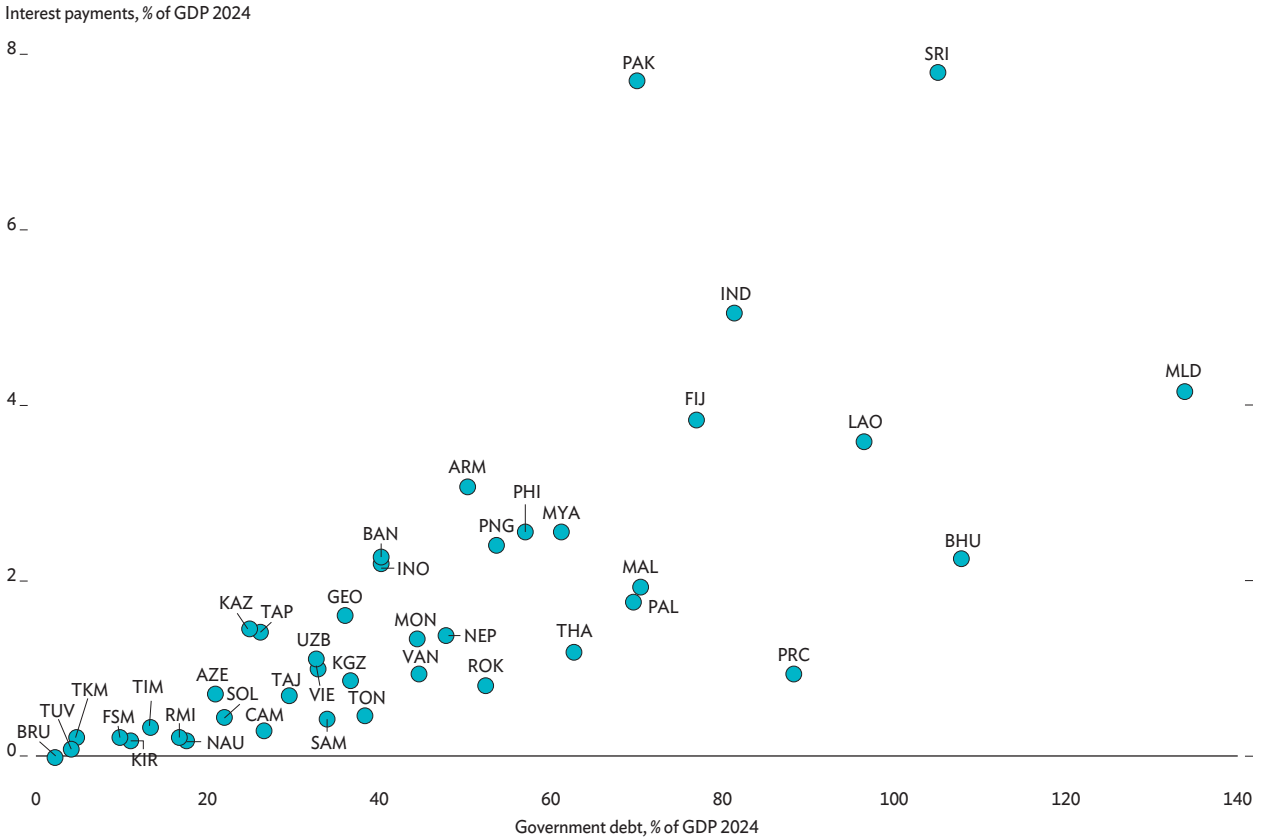
Rising debt service poses a growing vulnerability.



PRC = People's Republic of China, ROK = Republic of Korea, Lao PDR = Lao People's Democratic Republic.
Note: The debt service (2025–2026) values are computed as simple average of debt service ratios for these two years.
Source: Asian Development Bank. Asia Sovereign Debt Monitor.

Figure 1.1.28 Government Debt and Interest Payments, 2024

Interest payments are elevated in economies with already-high debt.



ARM = Armenia; AZE = Azerbaijan; BAN = Bangladesh; BHU = Bhutan; BRU = Brunei Darussalam; CAM = Cambodia; FIJ = Fiji; FSM = Federated States of Micronesia; GEO = Georgia; GDP = gross domestic product; IND = India; INO = Indonesia; KAZ = Kazakhstan; KGZ = Kyrgyz Republic; KIR = Kiribati; LAO = Lao People's Democratic Republic; MAL = Malaysia; MLD = Maldives; MON = Mongolia; MYA = Myanmar; NAU = Nauru; NEP = Nepal; PAK = Pakistan; PAL = Palau; PHI = Philippines; PNG = Papua New Guinea; PRC = People's Republic of China; RMI = Marshall Islands; ROK = Republic of Korea; SAM = Samoa; SOL = Solomon Islands; SRI = Sri Lanka; TAJ = Tajikistan; TAP = Taipei,China; THA = Thailand; TIM = Timor-Leste; TKM = Turkmenistan; TON = Tonga; TUV = Tuvalu; UZB = Uzbekistan; VAN = Vanuatu; VIE = Viet Nam.

Source: Asian Development Bank. Asia Sovereign Debt Monitor.

Growth Slows on Trade Headwinds

A Challenging Global Environment

The growth outlook for major advanced economies for 2025 and 2026 is revised down from April forecasts, mainly due to higher tariffs and elevated trade uncertainty. The US growth forecasts are lowered to 1.7% for 2025 and 1.8% for 2026, from 2.0% and 1.9% in April (Table 1.2.1). Stricter immigration policies and higher import tariffs are expected to contribute to inflationary pressures by adding to labor and other production costs (Box 1.2.1). Above-target inflation and prolonged policy uncertainty will likely continue to loom over private consumption and investment. Despite this, increased government spending and tax cuts are likely to provide a short-term boost to economic activity in 2026. The growth forecast for the euro area in 2025 remains unchanged at 1.2%. Healthy real wage growth and low interest rates are expected to increasingly support domestic demand, while slightly higher US tariffs weigh on exports. For 2026, the growth projection is revised down to 1.2% from 1.4% in the April forecast, reflecting a weak external environment. At the same time, domestic demand will benefit from supportive fiscal and monetary policies. In Japan, GDP growth for 2025 is now projected at 1.1%, down from 1.2% in April, due to the impacts expected from higher tariffs on manufacturing. And for 2026, it is lowered to 0.6%, reflecting moderating exports and reduced fiscal support. In July, the US and Japan reached a trade agreement setting US tariffs at 15%—below the 24% announced on 2 April, but still above the 10% base rate applied during the 90-day negotiating pause.

New trade agreements and revised tariff rates after 1 August confirm a shift toward higher tariffs, but uncertainty remains elevated. While the universal tariff on goods entering the US will remain at 10%, several economies that have trade surpluses

Table 1.2.1 Baseline Assumptions on the International Economy

The growth outlook for 2025 and 2026 is downgraded, while inflation forecasts are revised upward for both years.

	2024	2025		2026	
		April	September	April	September
Gross domestic product growth, %					
Major advanced economies[a]	**1.7**	**1.6**	**1.4**	**1.6**	**1.4**
United States	2.8	2.0	1.7	1.9	1.8
Euro area	0.9	1.2	1.2	1.4	1.2
Japan	0.1	1.2	1.1	0.8	0.6
Inflation, %					
Major advanced economies[a]	**2.7**	**2.4**	**2.5**	**2.2**	**2.3**
United States	3.0	2.5	2.8	2.4	2.8
Euro area	2.4	2.2	2.1	2.0	1.9
Japan	2.7	2.6	3.0	1.9	1.9
Brent crude spot prices, average, $/barrel	81	74	67	71	57

[a] Average growth rates are weighted by gross domestic product purchasing power parity.

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

Box 1.2.1 Immigration Slowdown Complicates Monetary Policy in the United States

Recent changes to United States (US) immigration policy appear to be reducing labor supply. Net migration into the US was strong post COVID-19, with foreign-born workers accounting for most of the increase in the US labor force and employment between 2021 and 2024 (box figure 1, panel A). This trend has begun to reverse since 2025 as the US administration has stepped up efforts to curb illegal immigration. According to Capital Economics (2025), the number of foreign-born workers declined by more than 1 million between March and June, while the overall US labor force contracted by over 400,000 since the presidential transition in January, according to the US Bureau of Labor Statistics.

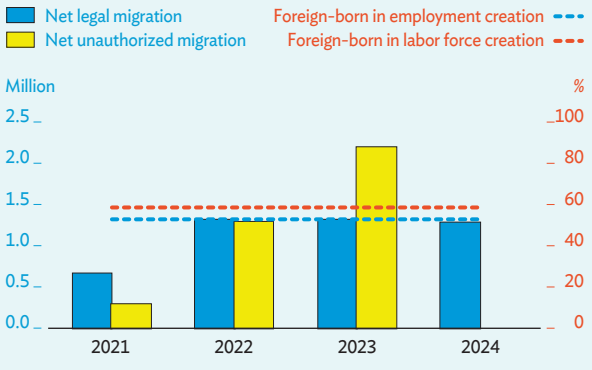
The tightening of immigration policy may weigh on net job creation. On the one hand, foreign-born workers have been a key source of labor supply in recent years. And other things being equal, with now fewer foreign-born workers in the labor force, the pool of available labor shrinks, limiting firms' ability to fill vacancies. At the same time, immigration fuels labor demand: migrants act as consumers, spending on goods and services, and some also create businesses that generate new jobs. A slowdown in immigration therefore not only constrains the supply of workers but also curbs demand-side drivers of employment growth.

These developments complicate the job of the Federal Reserve in evaluating data releases as it sets monetary policy. The Fed typically relies on nonfarm payroll gains as a key barometer of labor market strength. However, if changes to immigration policy are limiting the economy's capacity to generate new jobs, weak payroll numbers may not (only) reflect soft labor demand, but (also) a constrained labor supply and a reduced potential for job growth. The 3-month lagged moving average of net job creation slipped to about 35,000 in July–August from over 230,000 in January (box figure 1, panel B). At the same time, the unemployment rate, though edging higher, has remained close to levels seen in the second half of 2024 while initial unemployment claims have remained broadly stable through 2025 (box figure 1, panel B). Although the slowdown in job creation may partly reflect genuine demand-driven weakness, the modest rise in unemployment also suggests that fewer new jobs are needed to keep the

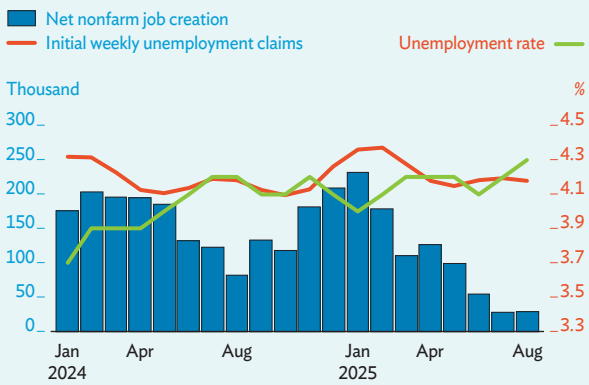
1 Net Immigration and Labor Market Outcomes in the US after the COVID-19 Pandemic

Net immigration drove US labor force and employment gains after the pandemic, but job creation slowed as immigration tightened in 2025.

A. Net Migration and Share of Foreign-Born in Labor Force and Employment Creation, 2021–2024



B. Nonfarm Job Creation and Unemployment, 2024–2025



US = United States.

Notes: Net unauthorized migration is an estimate, and no data is available for 2024. Foreign-born workers in employment and labor force creation are 2021–2024 averages. Net nonfarm job creation and initial weekly unemployment claims are 3-month trailing moving averages. The nonfarm job creation does not include preliminary benchmark revisions announced on 9 September by the US Bureau of Labor Statistics for the 12 months to March 2025.

Sources: US Bureau of Labor Statistics retrieved from Federal Reserve Economic Data (FRED), Federal Reserve Bank of St. Louis; PEW Research Center, World Bank, World Development Indicators.

continued on next page

Box 1.2.1 *Continued*

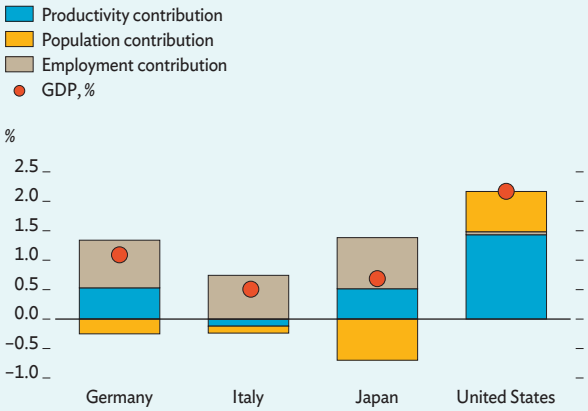
labor market in balance under stricter immigration policies. Indeed, as noted by Fed Chairman Jerome Powell and Federal Reserve Bank of New York President John Williams, considerable uncertainty exists regarding the rate of job creation needed to hold the unemployment rate constant. As such, the Fed may need to increase emphasis on the unemployment rate and related indicators of slack when evaluating labor market conditions (Federal Reserve Bank of New York 2025; Federal Reserve Board 2025).

The reduction of net immigration also risks igniting inflationary pressures. By curtailing labor supply, lower immigration might amplify labor shortages and can put upward pressure on wages in some sectors. Even if labor shortages do not materialize, the workforce composition will increasingly shift towards US-born workers. This could raise labor costs, as these workers typically have higher reservation wages than foreign-born ones. Moreover, they may also have a higher marginal propensity to consume, which could lead to higher prices through aggregate demand pressures (Capital Economics 2025; Dustmann, Speciale, Fasani 2017). Together, these factors could add to inflation and further limit the Fed's room to cut rates as job creation slows.

Lower immigration will translate into structurally lower gross domestic product (GDP) growth rates unless employment rates and/or productivity rise. GDP can be decomposed into output per worker (productivity), the employment rate, and the size of the working-age population. Slower immigration directly reduces the growth of the working-age population, mechanically lowering GDP growth unless participation or productivity rise. The experience of other advanced economies suggests that when the working-age population declines, increasing labor force participation and employment can play an important compensating role (box figure 2). In the US, however, participation has trended down over the past 2 decades, while fertility rates have also declined and are now well below the replacement rate of 2.1 births per woman (box figure 3). Lower immigration may also affect growth through the direct impact of labor shortages: McKibbin, Hogan, and Noland (2024), estimate that the deportation of 1.3 million undocumented workers in 2025 would reduce GDP by as much as 1.2% in 2028 relative to a no-policy-change baseline, mainly due to tighter labor supply.

2 GDP Growth Rate Decomposition, 2000–2024 Average, Selected Economies

Increases in employment rates contributed positively to GDP growth in advanced economies with declining working-age populations.



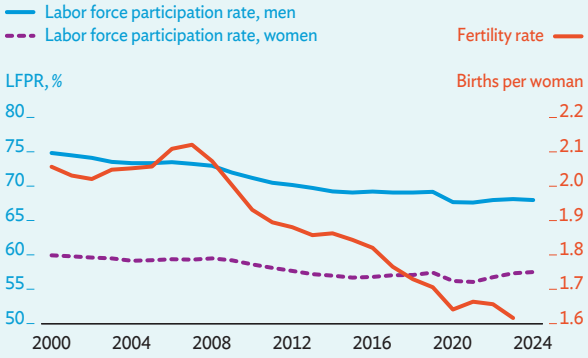
GDP = gross domestic product.

Notes: GDP growth = constant United States dollars GDP growth, productivity = labor productivity growth (GDP per employed people), employment = employment rate (employed people per working-age population) growth, population = working-age population growth.

Sources: World Bank, World Development Indicators; Asian Development Bank staff calculations.

3 US Labor Force Participation and Fertility Rates, 2000–2024

Labor force participation in the US has been declining, while women are having fewer children.



LFPR = labor force participation rate, US = United States.

Sources: US Bureau of Labor Statistics and World Bank; Federal Reserve Economic Data (FRED), Federal Reserve Bank of St. Louis.

continued on next page

Box 1.2.1 *Continued*

Raising labor productivity and participation will be crucial to mitigate the negative growth consequences of tighter immigration policies. Continuing investments in new technologies, including artificial intelligence, can sustain productivity growth. Expanding tax credits for low-income workers and phasing out social benefits more gradually, as envisaged in the One Big Beautiful Bill Act (Box 3 of the July 2025 *Asian Development Outlook* reviews the act), would make working more attractive. Participation could also be increased through adjusting retirement incentives and promoting age-friendly workplace practices. Expanding affordable childcare, paid family leave, and elder care provision would raise female participation. Together, these reforms can expand the US labor supply and augment productivity, potentially offsetting part of the double drag on growth from lower immigration and declining fertility.

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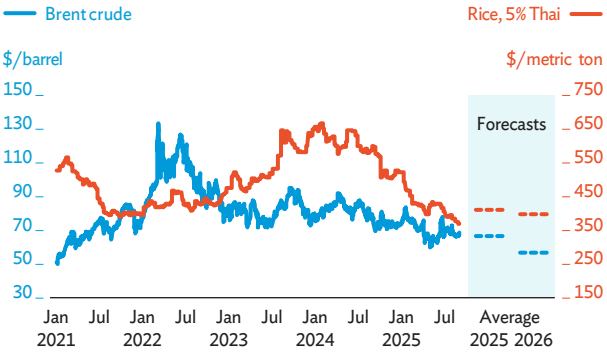
with the US will now face a higher rate between 15% and 20%. Some regional economies will be subject to even steeper rates, including 50% for India; 40% for the Lao People's Democratic Republic and Myanmar; and 25% for Brunei Darussalam and Kazakhstan. These higher tariffs are anticipated to dampen global growth in both 2025 and 2026, with the most pronounced impacts in the US, the PRC, and other economies heavily reliant on trade with the US. In addition, despite the conclusion of certain tariff negotiations, several factors are keeping uncertainty high. These include the absence of detailed formal trade agreements; lack of implementation guidelines; a new US policy that introduces a 40% penalty tariff on transshipments intended to circumvent US duties; and impending additional product-level tariffs on semiconductors, pharmaceuticals, and other goods (Box 1.1.1). Heightened trade uncertainty will continue to weigh on growth via consumer and business confidence, and other channels.

Oil prices are expected to moderate due to increased supply and weaker global demand. Brent crude oil averaged $70.3 per barrel from January to mid-September 2025. Barring any major geopolitical or supply disruptions, it is projected to trend downward in the rest of H2, averaging $67 for the full year (Figure 1.2.1). Since April, the Organization of the Petroleum Exporting Countries and its partners (OPEC+) have steadily increased production to regain market share, with an additional output hike announced for September. At the same time, rising US tariffs are forecast to dampen global economic growth, reducing oil demand and easing upward pressure on prices.

Figure 1.2.1 Commodity Prices

Oil prices are forecast to average $67/barrel in 2025, while rice prices are projected to ease further.



Note: Rice price refers to 5% broken white rice, milled from Thailand.
Sources: Bloomberg; FocusEconomics.

Excess supply is projected to lead to a sharp increase in global oil inventories, pushing prices down further to about $57 per barrel in 2026.

Rice prices are projected to decline further in 2025 before stabilizing in 2026. In mid-September, the benchmark Thai rice (5% broken) price fell to its lowest level in 8 years. The decline was driven by favorable weather conditions and a record harvest in India, the world's largest rice exporter, accounting for around 40% of global exports. Combined with subdued global demand from moderating growth, ample supply is expected to gradually ease and stabilize rice prices through 2026.

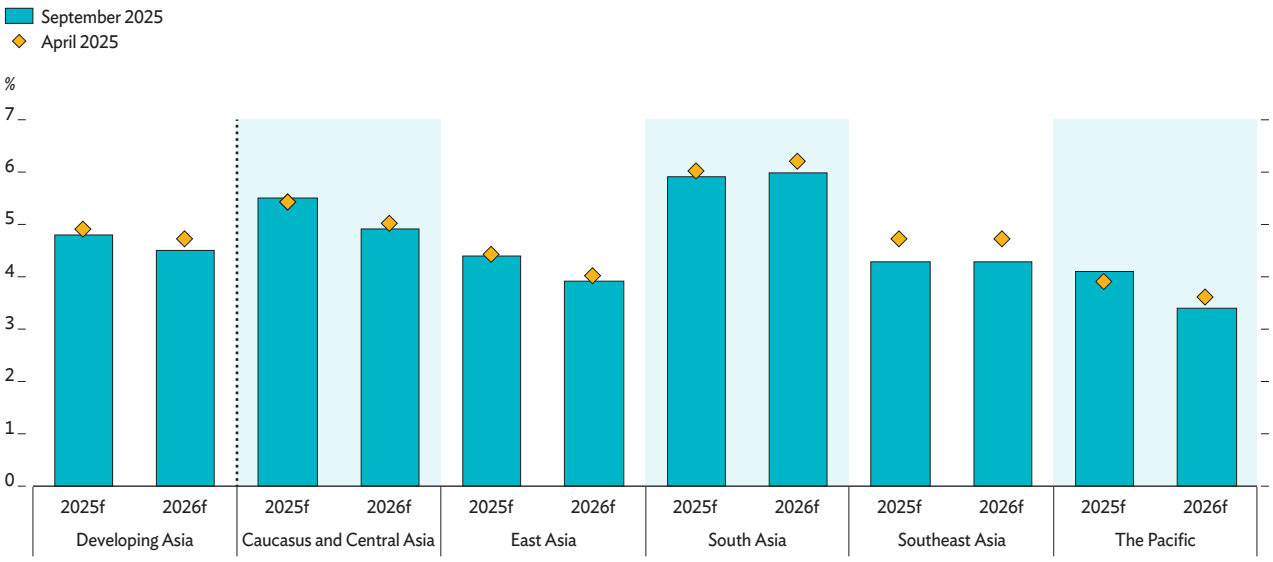
Trade Headwinds Weigh on Region's Growth Momentum

Developing Asia's growth projections are revised downward to 4.8% in 2025 and 4.5% in 2026, down by 0.1 and 0.2 percentage points from April projections (Figure 1.2.2). The downgrades reflect mounting external pressures—most notably greater trade uncertainty and the imposition of higher tariffs, particularly for economies now facing significantly steep hikes. These developments are expected to constrain export performance across the region over the forecast horizon. Domestic demand, however, is anticipated to remain resilient, supported by countercyclical measures, including fiscal stimulus and accommodative monetary policy, helping to cushion some of the negative external effects.

In the People's Republic of China (PRC), the growth forecast is maintained at 4.7% in 2025 and 4.3% in 2026 (Table 1.2.2). The outlook reflects cautious optimism amid a prolonged slowdown in the domestic property market, persistent trade uncertainty, and higher tariffs. Rising US trade barriers are anticipated to dampen export growth over the forecast horizon by directly reducing demand for PRC goods from the US and indirectly from the rest of the world, as global growth slows. Nonetheless, targeted government policies are expected to mitigate headwinds and sustain domestic economic activity. These include continued support for consumer goods trade-in and equipment upgrade programs; a CNY500 billion relending facility aimed at boosting the service sector and elderly care; the gradual implementation of free pre-school programs; and higher investment in public infrastructure projects.

Figure 1.2.2 Comparison of Growth Forecasts in Developing Asia

Growth in developing Asia is expected to be slightly lower this year and next, primarily due to higher tariffs and continued trade uncertainty.



f = forecast.

Source: *Asian Development Outlook* database.

Table 1.2.2 Gross Domestic Product Growth Rate and Inflation, %

Subregion/Economy	Gross Domestic Product Growth					Inflation				
	2024	2025		2026		2024	2025		2026	
		Apr	Sep	Apr	Sep		Apr	Sep	Apr	Sep
Developing Asia	**5.1**	**4.9**	**4.8**	**4.7**	**4.5**	**2.6**	**2.3**	**1.7**	**2.2**	**2.1**
Developing Asia excluding the PRC	**5.1**	**5.0**	**4.9**	**5.1**	**4.8**	**4.8**	**4.0**	**3.3**	**3.7**	**3.7**
Caucasus and Central Asia	**5.7**	**5.4**	**5.5**	**5.0**	**4.9**	**6.8**	**6.9**	**7.7**	**5.9**	**6.6**
Armenia	5.9	5.0	5.0	4.7	4.7	0.3	3.0	3.5	2.8	2.8
Azerbaijan	4.1	3.4	2.4	3.3	2.0	2.2	4.2	4.2	3.5	3.5
Georgia	9.4	6.0	7.0	5.0	5.0	1.1	4.0	4.0	3.5	3.5
Kazakhstan	5.0	4.9	5.3	4.1	4.3	8.7	8.2	10.5	6.5	8.4
Kyrgyz Republic	9.0	8.5	8.3	8.6	8.4	5.0	6.0	7.0	7.8	8.0
Tajikistan	8.4	7.4	7.4	6.8	6.8	3.6	5.0	4.5	5.8	5.2
Turkmenistan	6.3	6.5	6.3	6.0	6.0	5.5	6.0	4.0	6.0	5.0
Uzbekistan	6.0	6.6	6.6	6.7	6.7	9.4	8.0	8.0	7.0	7.0
East Asia	**4.7**	**4.4**	**4.4**	**4.0**	**3.9**	**0.5**	**0.6**	**0.3**	**0.9**	**0.6**
People's Republic of China	5.0	4.7	4.7	4.3	4.3	0.2	0.4	0.0	0.7	0.4
Hong Kong, China	2.5	2.3	2.2	2.5	2.0	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
Mongolia	5.1	6.6	5.7	5.9	5.7	6.2	9.1	8.6	7.0	7.2
Taipei,China	4.8	3.3	5.1	3.0	2.3	2.2	2.0	1.8	1.8	1.5
South Asia	**5.9**	**6.0**	**5.9**	**6.2**	**6.0**	**6.5**	**4.9**	**3.7**	**4.5**	**4.7**
Afghanistan	2.3	2.6	1.8	2.2	1.7	–7.7	–5.3	–4.2	5.0	1.0
Bangladesh	4.2	3.9	4.0	5.1	5.0	9.7	10.2	10.0	8.0	8.0
Bhutan	7.5	8.5	8.1	6.0	6.0	2.8	3.4	3.2	3.5	3.7
India	6.5	6.7	6.5	6.8	6.5	4.6	4.3	3.1	4.0	4.2
Maldives	3.3	5.0	5.0	4.8	4.9	1.4	4.7	4.5	2.2	3.5
Nepal	3.7	4.4	4.6	5.1	3.0	5.4	5.2	4.1	5.0	4.5
Pakistan	2.5	2.5	2.7	3.0	3.0	23.4	6.0	4.5	5.8	6.0
Sri Lanka	5.0	3.9	3.9	3.4	3.3	1.2	3.1	0.5	4.5	4.5
Southeast Asia	**4.8**	**4.7**	**4.3**	**4.7**	**4.3**	**3.0**	**3.0**	**2.5**	**2.8**	**2.7**
Brunei Darussalam	4.2	2.5	1.0	2.0	1.5	–0.4	0.5	–0.3	–0.2	0.5
Cambodia	6.0	6.1	4.9	6.2	5.0	0.8	3.7	2.0	2.4	2.0
Indonesia	5.0	5.0	4.9	5.1	5.0	2.3	2.0	1.7	2.0	2.0
Lao People's Democratic Republic	4.0	3.9	3.7	4.0	3.8	23.3	13.5	9.5	10.4	8.5
Malaysia	5.1	4.9	4.3	4.8	4.2	1.8	2.5	1.8	2.5	2.2
Myanmar	–0.7	1.1	–3.0	1.6	2.0	27.8	29.3	30.0	20.0	23.0
Philippines	5.7	6.0	5.6	6.1	5.7	3.2	3.0	1.8	3.0	3.0
Singapore	4.4	2.6	2.5	2.4	1.4	2.4	2.0	1.0	1.7	1.2
Thailand	2.5	2.8	2.0	2.9	1.6	0.4	1.0	0.5	1.1	0.8
Timor-Leste	4.1	4.0	3.8	3.8	3.4	2.1	2.9	1.2	2.6	1.9
Viet Nam	7.1	6.6	6.7	6.5	6.0	3.7	4.0	3.9	4.2	3.8
The Pacific	**3.8**	**3.9**	**4.1**	**3.6**	**3.4**	**1.9**	**3.4**	**3.0**	**3.7**	**3.4**
Cook Islands	14.0	8.1	10.4	2.9	2.5	4.6	2.3	2.0	2.0	2.8
Fiji	3.5	3.0	3.0	3.2	3.0	4.5	2.6	0.5	2.4	1.0
Kiribati	5.3	4.1	3.9	3.3	3.3	2.5	2.5	7.8	2.2	3.5
Marshall Islands	3.0	2.5	3.0	3.0	3.5	5.7	3.6	3.8	3.0	3.4
Federated States of Micronesia	1.7	1.7	0.8	1.1	1.1	5.4	3.0	3.9	2.7	3.2
Nauru	1.8	2.5	2.3	2.5	2.5	11.6	3.5	6.5	2.5	5.0
Niue	8.7	3.4	3.4	3.0	3.0	5.4	3.7	2.3	3.2	3.2
Palau	6.6	9.5	8.2	4.5	3.9	3.7	2.5	2.5	2.6	2.7
Papua New Guinea	4.0	4.2	4.6	3.8	3.6	0.6	3.8	3.8	4.3	4.3
Samoa	4.6	5.5	4.0	3.0	2.7	3.6	3.0	1.9	2.7	2.7
Solomon Islands	2.5	2.9	2.9	3.2	3.2	4.2	2.7	3.8	2.5	2.5
Tonga	1.4	2.5	2.5	2.3	2.3	8.0	3.2	3.0	3.0	3.0
Tuvalu	3.3	2.7	2.7	2.5	2.5	1.2	2.5	2.5	2.0	2.0
Vanuatu	1.0	2.0	1.5	2.5	2.5	1.1	3.5	1.5	2.4	2.4

ADB = Asian Development Bank, PRC = People's Republic of China.

Notes: 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.

Source: *Asian Development Outlook* database.

The growth outlook in most high-income technology exporters is lowered for both years. Front-loading ahead of anticipated tariff hikes boosted growth in H1 2025, but this momentum is expected to fade as tariff hikes come into full effect. Forecast growth for Hong Kong, China is revised down to 2.2% for 2025 and 2.0% for 2026, as weakening global trade and higher tariffs weigh on exports and trade-related financial services. For the Republic of Korea, growth is projected at 0.8% in 2025 and 1.6% in 2026, down from April forecasts. The downgrade reflects an expected decline in exports due to a 15% tariff under the new trade deal with the US, as well as subdued investment driven by a weak property sector. Reflecting the broader impact of global policy uncertainty and higher tariffs, Singapore's growth projections are also lowered, with a slight adjustment to 2.5% for 2025 and a sharper reduction to 1.4% for 2026. Bucking the trend, Taipei,China's 2025 growth projection is revised sharply upward from April, by 1.8 percentage points to 5.1%, driven by strong exports of AI-related products. However, growth is expected to decline to 2.3% in 2026 as domestic demand remains subdued, higher tariffs dampen export activity, and AI-related spending moderates.

The expectation of a larger impact from US tariffs also led to a downward revision of South Asia's growth outlook, now projected at 5.9% in 2025 and 6.0% in 2026. India faces the steepest tariff hikes among developing Asian economies, prompting a downgrade in its growth outlook. For fiscal year (FY) 2025, growth is now projected at 6.5%, down from 6.7% in April. Effective 7 August, the US imposed a 25% reciprocal tariff on Indian exports, with a further increase to 50% from 27 August. The sharp escalation in tariffs is expected to weigh heavily on key export sectors such as textiles, ready-made garments, jewelry, shrimp, and chemicals. For FY2026, the growth forecast is revised down to 6.5%. Afghanistan's projections are reduced to 1.8% in FY2025 and 1.7% in FY2026 due to reduced international humanitarian aid, limited access to external finance, and fiscal constraints. In Bhutan, the 2025 growth forecast is revised down to 8.1%, reflecting slower-than-expected progress in the operation of the Punatsangchhu II Hydroelectric Power Plant, largely due to the delays on agreement on power tariffs with India. The 2026 forecast remains unchanged. The FY2025 growth slightly exceeded expectations in Bangladesh, Nepal, and Pakistan. However, the FY2026 outlook is lowered for Bangladesh, due to the impact of US tariffs on exports, and for Nepal, mainly due to ongoing domestic political instability. Pakistan's FY2026 outlook remains unchanged from April. Maldives' 2025 growth outlook is unchanged, while the 2026 forecast is revised upward on strong tourism and fishery sectors. Sri Lanka's growth forecast for 2025 is unchanged, but the 2026 projection is revised down, as the 20% US tariff is expected to weaken exports and dampen consumption due to potential job losses.

Similarly, projected growth for Southeast Asia is lowered. The subregional growth forecast is revised down to 4.3% for 2025 and 2026, compared to 4.7% for both years in April. Growth projections for 2025 have been reduced for nearly all Southeast Asian economies. Brunei Darussalam's growth outlook is downgraded to 1.0% in 2025 and 1.5% in 2026, as slower growth in key trading partners amid higher tariffs weighs on demand for oil, liquefied natural gas, and petrochemicals. Cambodia's growth is also expected to ease, with the forecast revised down to 4.9% in 2025 and 5.0% in 2026, due to border tensions with Thailand and trade uncertainty. Indonesia's growth outlook is reduced slightly to 4.9% in 2025 and 5.0% in 2026 to reflect weaker global demand, albeit domestic demand is expected to remain robust. In Malaysia, growth is forecast at 4.3% in 2025 and 4.2% in 2026, each down by 0.6 percentage points from April projections, due to the impact of restrictive trade policies. In the Philippines, forecasts are lowered to 5.6% in 2025 and 5.7% in 2026 as global trade uncertainty dampens investor sentiment. However, low inflation and an accommodative monetary policy are expected to support domestic demand in the near term. Thailand's economy is anticipated to grow by 2.0% in 2025, down from 2.8% in April, due to slower export growth amid tariff hikes and weaker-than-expected tourist arrivals. Growth is expected to slow to 1.6% in 2026. Timor-Leste's 2025 growth projection is revised down to 3.8%, partly due to base effects, and is projected to continue slowing to 3.4% in 2026 amid fiscal consolidation. Myanmar's 2025 growth forecast has been cut sharply to –3.0% from 1.1% in April, as the 7.7-magnitude earthquake in March further deepened macroeconomic instability. In contrast, Viet Nam's growth outlook for 2025 is raised to 6.7%. The adjustment is driven by continued policy stimulus

and strong growth in H1, partly due to front-loading of export. Growth is expected to moderate to 6.0% in 2026.

In the Caucasus and Central Asia, the growth projection is raised for 2025, driven by stronger prospects in Kazakhstan, but lowered for 2026 due to falling hydrocarbon production in Azerbaijan. The subregion is now expected to grow by 5.5% in 2025, before moderating to 4.9% in 2026. Kazakhstan's forecasts are raised to 5.3% in 2025 and 4.3% in 2026, supported by increased oil production and ongoing public infrastructure investment. Georgia's 2025 growth projection is adjusted upward to 7.0% on robust H1 performance driven by domestic demand. The 2026 projection remains at 5.0%. In contrast, Azerbaijan's growth projections are lowered to 2.4% in 2025 and 2.0% in 2026, amid weaker hydrocarbon production. The Kyrgyz Republic's forecast is lowered to 8.3% in 2025 and 8.4% in 2026, due to expected moderation in reexport trade flows. Turkmenistan's 2025 growth forecast is revised down to 6.3%, reflecting moderate growth in hydrocarbon production, while the 2026 forecast remains unchanged at 6.0%.

The Pacific's 2025 growth forecast is revised upward, reflecting stronger mining activity in Papua New Guinea, the subregion's largest economy. Growth in the subregion is projected to increase to 4.1% in 2025, before slowing to 3.4% in 2026. Papua New Guinea's 2025 growth forecast is raised to 4.6%, driven by stronger mining performance from higher prices for precious metal and robust liquefied natural gas production following the launch of the Angore gas field. In 2026, growth is projected to ease to 3.6% as resource output is expected to moderate and a weaker external environment could dampen exports. In the Cook Islands, FY2025 growth is recorded at 10.4%, higher than April's forecast, buoyed by strong tourist arrivals. However, growth is expected to slow sharply to 2.5% in FY2026 due to airline and hotel capacity constraints, while skilled labor shortages could delay infrastructure project implementation. In the Marshall Islands, growth forecasts are revised up to 3.0% for FY2025 and 3.5% for FY2026, supported by capital investments funded by the Compact of Free Association (COFA) and other development partners. Moreover, the increase in minimum wage is expected to boost household consumption. In contrast, downward revisions are made for both fiscal years in Palau on weaker-than-expected tourism growth, and in Samoa on bleaker prospects for agriculture and fisheries. In the Federated States of Micronesia, the FY2025 forecast is revised down to 0.8% due to slower-than-expected utilization of COFA grants, while the FY2026 outlook remains unchanged. The 2025 growth projections are also lowered for Nauru, due to lower-than-expected infrastructure spending, and for Vanuatu, due to delays in recovery and reconstruction efforts following the December 2024 earthquake. The 2026 outlook for these economies remains unchanged. In Fiji, the growth outlook is unchanged for 2025 but lowered for 2026 due to anticipated impacts of slower global growth.

Disinflation Continues

Inflation in developing Asia is projected to ease further in 2025, driven by lower energy and food prices, before picking up next year as food prices normalize. The inflation forecasts for the region are revised down to 1.7% in 2025 and 2.1% in 2026, from April's 2.3% and 2.2%, respectively. Almost all subregions have lower inflation forecasts for 2025, except the Caucasus and Central Asia.

The PRC's inflation forecast is downgraded due to lower food and oil prices. Consumer price inflation is now projected at zero in 2025 and 0.4% in 2026, down 0.4 and 0.3 percentage points, respectively, from April. Ample pork supply and falling prices for several domestically manufactured goods, including electric vehicles, are anticipated to limit price pressures. While government trade-in programs may help boost sales, intense price competition is likely to keep the prices of durable goods in check.

Inflation is expected to ease in the region's high-income technology exporters. For Hong Kong, China, inflation is forecast at 1.6% for both 2025 and 2026, due to weak domestic and external demand. The forecast for Taipei,China is lowered to 1.8% in 2025 and 1.5% in 2026 on moderate food and energy prices and currency appreciation. Singapore's inflation forecasts are also reduced to 1.0% in 2025 and 1.2% in 2026, reflecting lower global commodity prices and continued government subsidies for essential services. The Republic of Korea's inflation forecasts remain unchanged from April at 1.9% for both 2025 and 2026.

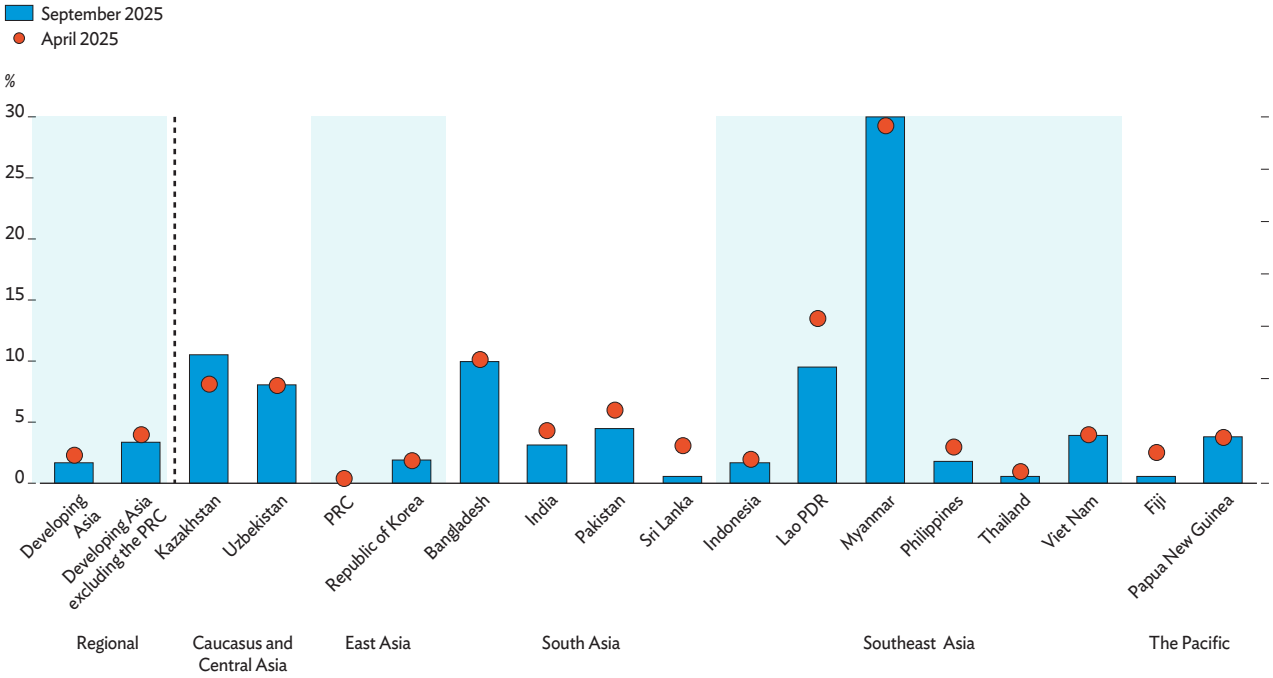
Lower food prices from improved agricultural output and favorable weather conditions are expected to reduce South Asia's inflation in 2025. The 2025 inflation forecast for the subregion is lowered to 3.7%, down by 1.2 percentage points from April. Inflation is anticipated to pick up to 4.7% in 2026 on normalizing food prices, as well as currency depreciation in some cases. The FY2025 inflation projection for India is revised downward to 3.1%, reflecting subdued global oil prices and a faster-than-expected decline in food prices due to higher agricultural production. However, food prices are expected to normalize in FY2026, leading to an upward revision of the inflation forecast to 4.2%. Pakistan's actual FY2025 inflation is recorded at 4.5%, from April's forecast of 6.0%, on continued moderation in food and oil prices. Inflation is expected to rise to 6.0% in FY2026 due to flood-related supply chain disruptions affecting food prices and higher gas tariffs. Sri Lanka's 2025 inflation forecast is reduced to 0.5% mainly due to falling energy prices, while the 2026 outlook remains unchanged at 4.5%. Maldives' inflation forecast is revised downward to 4.5% in 2025, owing to temporary discounts on utility bills in H1, including a reduction in electricity tariffs. The government also postponed its planned implementation of subsidy reforms to prevent further price increases. Inflation is expected to further decline to 3.5% in 2026, albeit higher than April's forecast of 2.2%, due to repayments of external debt that could strain foreign exchange reserves and put downward pressure on the currency. Deflation continued in Afghanistan, albeit at a slower pace of –4.2% in FY2025, compared to the –5.3% projected last April. The inflation forecast for FY2026 is revised to 1.0%, down from 5.0% in April, due to currency appreciation. In Bhutan, the inflation outlook for 2025 is lowered to 3.2% as food prices are expected to ease in H2. In contrast, the inflation forecast for next year is raised to 3.7%, in line with the expected increase in food prices in India.

Similarly, Southeast Asia's inflation forecasts are revised down for both 2025 and 2026 on lower energy and food prices. Inflation projections for the subregion are cut to 2.5% in 2025 and 2.7% in 2026, with 2025 forecasts downgraded for all economies except Myanmar. In Brunei Darussalam, 0.3% deflation is now expected in 2025 due to weak domestic demand and lower global food prices, while inflation will pick up to 0.5% in 2026 due to an anticipated rebound in consumption and private investment. Cambodia's inflation outlook is revised down to 2.0% for both 2025 and 2026 due to a weaker-than-expected increase in food prices along with falling fuel costs. In Indonesia, the inflation forecast for 2025 is reduced to 1.7% due to lower food prices following a good harvest, while the 2026 forecast remains unchanged at 2.0%. The inflation outlook for the Lao People's Democratic Republic is revised down to 9.5% in 2025 and 8.5% in 2026 attributed to tightened monetary policy, with lower oil prices and food inflation also contributing to the decrease. The forecast for the Philippines is lowered to 1.8% for 2025, reflecting subdued global commodity prices and improved agriculture output, while it remains unchanged for 2026. Thailand's inflation forecasts are revised down to 0.5% in 2025 and 0.8% in 2026, due to lower oil and food prices, as well as government subsidies for electricity and retail fuel consumption. Timor-Leste's inflation projections are adjusted downward to 1.2% in 2025 and 1.9% in 2026 on lower food prices, weaker demand-side pressures, and moderating shipping costs. Viet Nam's inflation projections are revised down to 3.9% in 2025 and 3.8% in 2026 due to lower global oil prices. In contrast, Myanmar's inflation outlook is raised to 30.0% in 2025 and 23.0% in 2026, the highest in the region, as the disruptions from the 28 March earthquake are expected to further intensify inflationary pressures (Figure 1.2.3).

Higher utility prices, currency depreciation, and lagged effects of monetary policy easing will drive inflation higher in the Caucasus and Central Asia. Headline inflation for the subregion is expected to accelerate to 7.7% in 2025 and 6.6% in 2026, up by 0.8 and 0.7 percentage points compared to April forecasts. In Kazakhstan, inflation projections are revised up to 10.5% in 2025 and 8.4% in 2026. Price dynamics will be shaped by currency depreciation and rising utility costs, as the government continues implementing its Tariff-in-Exchange-for-Investment policy to modernize utilities infrastructure. Moreover, the Kazakh government announced that it would increase the value-added tax rate from 12% to 16% next year, amplifying inflationary pressures. The Kyrgyz Republic's inflation forecasts are increased to 7.0% in 2025 and 8.0% in 2026, primarily due to strong domestic demand and utility tariff adjustments. Armenia's inflation outlook is raised to 3.5% in 2025, due to higher-than-expected inflation in January to July as the effects of loose monetary policy lingered. The 2026 projection is unchanged at

Figure 1.2.3 Inflation Forecasts for 2025 for Selected Developing Asian Economies

Regional inflation will further moderate, but price pressures will remain highly elevated in Myanmar.



PRC = People's Republic of China, Lao PDR = Lao People's Democratic Republic.
Source: *Asian Development Outlook* database.

2.8%. In contrast, Tajikistan's currency appreciation is expected to lower inflation to 4.5% in 2025 and 5.2% in 2026. Turkmenistan's inflation forecast is reduced to 4.0% in 2025 and 5.0% in 2026, from 6.0% in April, as monetary policy remains tight. Inflation projections in the other economies in the subregion remain in line with April forecasts.

The 2025 inflation forecast for the Pacific is downgraded, mainly due to a reduction in value-added tax in Fiji and easing food prices in some economies. The projection for the subregion is adjusted down to 3.0% in 2025 and 3.4% in 2026. In Fiji, the 2025 inflation forecast is significantly reduced to 0.5%, from 2.6% in April, due to a reduction in the value-added tax, a bus fare subsidy, and lower custom duties for several food items starting August 2025. The 2026 forecast is also lowered to 1.0% as these policies continue to affect prices alongside a decline in global oil prices. Actual FY2025 inflation in the Cook Islands, Niue, Samoa, and Tonga is weaker-than-expected, mainly due to lower food and other commodity prices. In Vanuatu, the 2025 forecast is revised down to 1.5% due to a slower increase in food prices and price declines in housing utilities, communication, and clothing and footwear, while the 2026 forecast remains unchanged. In contrast, in Kiribati, upward adjustments in fuel prices and electricity tariffs to improve the sustainability of state-owned enterprises are expected to result in higher inflation for both 2025 and 2026. In Nauru, the inflation estimate was 6.5% in FY2025, higher than projected in April, and the forecast is raised to 5.0% in FY2026 due to shipping delays caused by mechanical and maintenance issues. The inflation outlook for Papua New Guinea remains unchanged at 3.8% for 2025 and 4.3% for 2026.

Risks to the Outlook Still Tilt to the Downside

Trade deals have lowered tensions, but heightened uncertainty and unresolved US–PRC negotiations continue to pose risks. Several developing Asian economies concluded trade deals with the US before the 90-day deadline of 1 August—notably Cambodia, the Republic of Korea, Malaysia, the Philippines, Thailand, and Viet Nam. Alongside US trade deals with key trading partners such as the European Union and Japan that have eased heightened global trade risks, tensions have come down since April. However, uncertainties around the implementation of new deals continue and US trade policy uncertainty remains elevated, owing to several factors. First, economies that did not conclude a new trade deal with the US were hit with higher tariffs from 7 August, but some may risk even steeper US duties related to transshipment and other factors. Second, following a 3-month extension, trade negotiations between the US and the PRC are still ongoing. This suggests that the risk of tariff escalation between the world's two largest economies has subsided somewhat since April, but tensions remain unresolved. Third, the possible US sector-specific tariffs on semiconductors and pharmaceuticals could be particularly high. If these risks were to materialize, they could constrain investment, disrupt supply chains, and dampen consumer confidence, with adverse implications for the regional outlook (Box 1.1.1).

A potential growth slowdown in the US would also likely trigger volatility and sentiment shifts in global markets. There are growing signs that economic activity in the US is moderating, as trade uncertainty, higher tariffs, and other policy shifts affect the labor market and the broader economy. A sharp deceleration of US growth might worsen uncertainty and raise risk aversion, roiling financial markets and leading to tighter global financial conditions. This could affect developing Asia through trade and other channels. Lower consumer spending in the US would dampen the region's export prospects. More open economies—such as the PRC, the Republic of Korea, and Singapore—would suffer a larger impact. Some developing Asian economies could also be affected through reversals of financial flows. During heightened global uncertainty, investors tend to re-position toward safe-haven assets, and this can lead to capital outflows and currency depreciation in emerging economies. This could also fuel imported inflation, hamper consumer and business confidence, and give rise to balance-of-payments and debt-servicing difficulties in economies with weaker macroeconomic fundamentals.

Geopolitical tensions outside the region persist. The situation in the Middle East poses the most immediate concern, with the United Nations warning on 5 August about the potential for renewed escalation. A wider conflict in the area could trigger higher oil and food prices, disrupt supply chains, and heighten global risk aversion, weighing on global and regional growth prospects. And the outlook around Russia's war in Ukraine also remains uncertain following a US–Russia summit on 15 August that resulted in no ceasefire or formal agreement and the US–European–Ukrainian meeting at the White house a few days later. A peace deal could bring greater stability and support investment in the region, particularly in the Caucasus and Central Asia. However, the timing and terms of any settlement remain unclear, leaving the balance of risks unresolved.

A further deterioration in the PRC's ongoing property market downturn could dent growth prospects. After signs of stabilization in early 2025, new home sales dropped 12.6% year on year in June, while home prices declined a further 0.3% month on month. Real estate investment was also down, by 12.0%, in the first 7 months of 2025. If the property market correction worsened, the adverse effects on household wealth and income would intensify. This would further constrain consumer and business sentiment, weaken domestic demand, and put property developers under more pressure. However, the property sector downturn may diminish over the next 2 years amid a deceleration in the pace of decline and the sector's reduced weight in the broader economy. Estimates based on the Asian Development Bank's

Multiregional Input–Output Tables indicate that the real estate's share of GDP fell from 7.6% in 2020 to 6.3% in 2024. Thus, this downside risk can decrease substantially over the forecast horizon, especially with the government's continued efforts to stabilize the sector.

ANNEX

Forecasts Downgraded on Higher US Tariffs and Trade Uncertainty

The aggregate growth forecasts for the United States (US), the euro area, and Japan are downgraded to 1.4% for both 2025 and 2026 (Table A.1). Persistent inflation and policy uncertainty are expected to continue weighing on private consumption and investment growth in the US. In the euro area, a gradual recovery in fixed investment and the full effects of monetary easing will support the economy, though higher US tariffs will slightly constrain export growth. In Japan, economic recovery will slow as the impact of fiscal measures wanes and global demand for the country's exports moderates.

Table A.1 Baseline Assumptions on the International Economy

Growth forecasts for major advanced economies are revised down from April projections.

	2024	2025		2026	
		April	September	April	September
Gross domestic product growth, %					
Major advanced economies[a]	**1.7**	**1.6**	**1.4**	**1.6**	**1.4**
United States	2.8	2.0	1.7	1.9	1.8
Euro area	0.9	1.2	1.2	1.4	1.2
Japan	0.1	1.2	1.1	0.8	0.6
Inflation, %					
Major advanced economies[a]	**2.7**	**2.4**	**2.5**	**2.2**	**2.3**
United States	3.0	2.5	2.8	2.4	2.8
Euro area	2.4	2.2	2.1	2.0	1.9
Japan	2.7	2.6	3.0	1.9	1.9
Brent crude spot prices, average, $/barrel	81	74	67	71	57
Interest rates					
United States federal funds rate, average, %	5.14	4.15	4.24	3.69	3.74
European Central Bank deposit facility rate, average, %	3.56	2.31	2.21	2.00	2.00
Bank of Japan overnight call rate, average, %	0.10	0.59	0.47	0.91	0.50

GDP = gross domestic product.

[a] Average growth rates are weighted by GDP purchasing power parity.

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

This annex was written by John Beirne, Gabriele Ciminelli, Jaqueson Galimberti, Jules Hugot, Matteo Lanzafame, Nedelyn Magtibay-Ramos, Pilipinas Quising, Dennis Sorino, and Michael Timbang of the Economic Research and Development Impact Department (ERDI), ADB, Manila, and Emmanuel Alano and Jesson Pagaduan, ERDI consultants.

Recent Developments in the Major Advanced Economies

United States

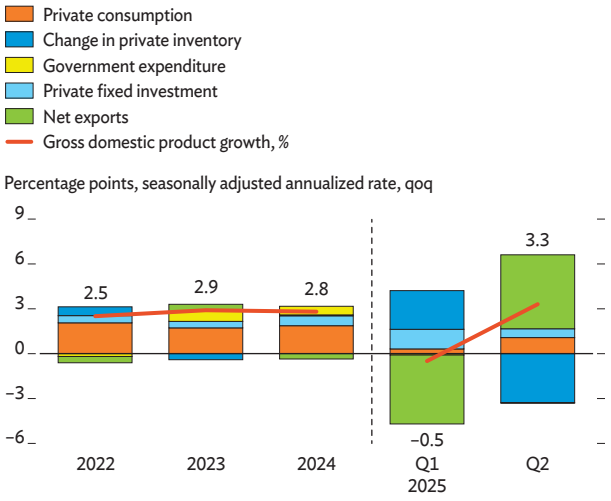
GDP growth rebounded to 3.3% in the second quarter (Q2) 2025, reversing the 0.5% contraction in Q1, but underlying momentum remains weak. The sharp increase was largely driven by a 29.8% drop in imports following pre-tariff stockpiling, which raised net exports' contribution by 5.0 percentage points (Figure A.1). Inventory drawdowns subtracted 3.3 percentage points from growth. Concurrently, private fixed investment stalled, with 5.7% growth in business investment offset by declines in structures and residential investment. Government spending declined 0.2%, due to a sharp drop in non-defense federal expenditures. Personal consumption grew 1.6%, up from 0.5% in Q1, but still slower than previous years, showing signs of fragile momentum in household sentiment.

The recent shift in US tariff policy has significantly reshaped its trade dynamics. Following the 2024 US presidential election, goods imports from the People's Republic of China (PRC) started to decline and dropped even more sharply after the April 2025 announcement of reciprocal tariffs (Figure A.2). After an initial front-loading, goods exports to the PRC also declined, though less steeply than imports. In contrast, front-loading of trade with the rest of developing Asia and the broader global market led to a significant increase in imports over Q1 2025, suggesting a diversion of sourcing and export destinations toward economies with lower or negotiated tariff rates. This pattern reflects the impact of the tariff strategy in redirecting trade flows, though it also raises concerns about supply chain disruptions and potential retaliatory measures from affected trade partners, which can lead to higher consumer prices and lower growth.

The US economy continues to send mixed signals, with labor market indicators weakening and inflationary pressures persisting. August's labor market data showed further weakening, with nonfarm payrolls rising only 22,000 (Figure A.3)—alongside a downward revision to June's figure—and the unemployment rate ticking up to 4.3%. While the weaker labor market figures have led to expectations of interest rate cuts, sharply slowing population and labor force growth amid rising immigration restrictions may instead reflect a structural change in sustainable employment (Box 1.2.1). Manufacturing remains weak, with the August Institute for Supply Management (ISM) index

Figure A.1 Demand-Side Contributions to Growth, United States

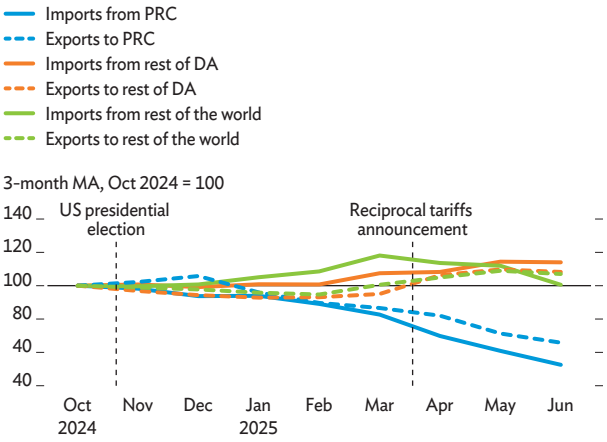
Net exports drove Q2 2025 GDP growth, offsetting weak private investment and consumption.



GDP = gross domestic product, Q = quarter, qoq = quarter on quarter.
Sources: US Department of Commerce. Bureau of Economic Analysis; Haver Analytics.

Figure A.2 Goods Imports and Exports by Origin/Destination, United States

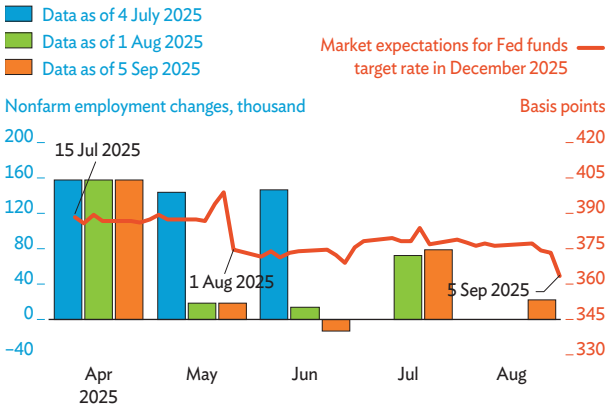
US trade pivots post-tariff, with imports from the PRC plunging.



PRC = People's Republic of China, DA = developing Asia, MA = moving average, US = United States.
Source: ADB staff estimates using data from UN Comtrade.

Figure A.3 Nonfarm Employment and Market Expectations of the Fed Funds Target Rate, United States

Recent labor market indicators point to a weakening in momentum, lowering interest rate expectations.

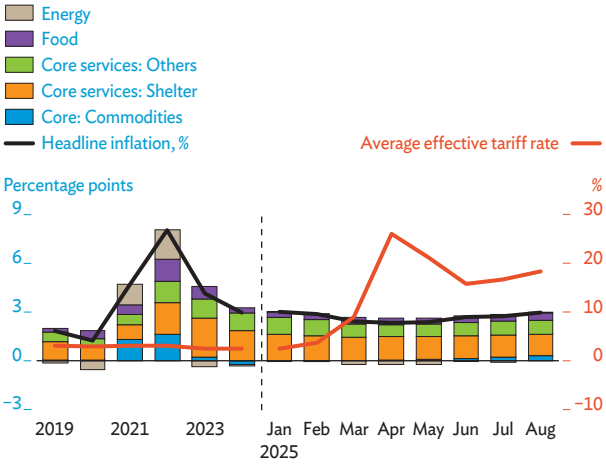


Note: Market expectations for the Fed Funds target rate are calculated as the expected value of the median range of the target rate as implied by 30-Day Fed Funds futures prices.

Sources: CME FedWatch; Haver Analytics.

Figure A.4 Inflation and Average Effective Tariff Rate, United States

Headline inflation remains largely driven by persistent core services pressures.



Sources: Haver Analytics; The Budget Lab at Yale.

at 48.7, though a rebound in the new orders index to a 7-month high of 51.4 suggests improving domestic demand. Production fell, employment edged up, and input prices eased. Industrial production rose 0.4% month-on-month in June but declined 0.1% in July, with continued declines in motor vehicle output and contraction in primary metals. The ISM services index rose to 52.0 in August, driven by stronger new orders and business activity, but weak employment and persistently high input costs. Inflation remained elevated, with headline inflation rising to 2.9% (Figure A.4) and core inflation holding at 3.1%, driven by broad-based gains in goods and services, including apparel, new vehicles, and shelter. Despite tariff pressures, core commodities prices rose only modestly, as declines in medical care goods offset gains in used vehicles and cyclical services like motor vehicle repair and airline fares. The US Federal Reserve (Fed) cut its policy rate by 25 basis points at its September meeting, citing a weakening labor market. With services inflation firming and labor market momentum fading, the Fed faces a renewed narrative shift and a delicate balancing act in the months ahead.

Growth is expected to slow to 1.7% in 2025 and 1.8% in 2026, while inflation will remain above target at 2.8% in 2025 and 2026. Persistent inflation and policy uncertainty are expected to continue restraining private consumption and investment growth. Increasing tariffs on imports and immigration constraints will renew inflationary pressures. Above-target inflation will put the Fed in a difficult position as subdued economic sentiment continues hindering economic activity and employment growth. The Fed is expected to continue adopting a cautious data-dependent approach for the rest of the year and towards 2026. Increased government spending and tax cuts will stimulate economic activity and partially offset the negative growth effects of tariffs, leading to a short-term lift to gross domestic product (GDP) in 2026.

Risks to the outlook are tilted to the downside as uncertainty remains about key trade talks. After the US and the PRC extended a tariff truce until 10 November, failed negotiations and a resumption of triple-digit tariff rates would hurt growth and lead to further inflation pressures. Heightened tensions with other important trade partners, such as Brazil, Canada, and India, add to this uncertainty. Recurring above target inflation rates may lead to unanchored inflation expectations and undermine monetary policy and financial stability. Higher-than-expected interest rates and lower real income can increase households' financial stress, which could further dent aggregate demand and reinforce stagflationary pressures in the broader economy. A more expansionary fiscal policy stance driven by increasing tariff revenues may also

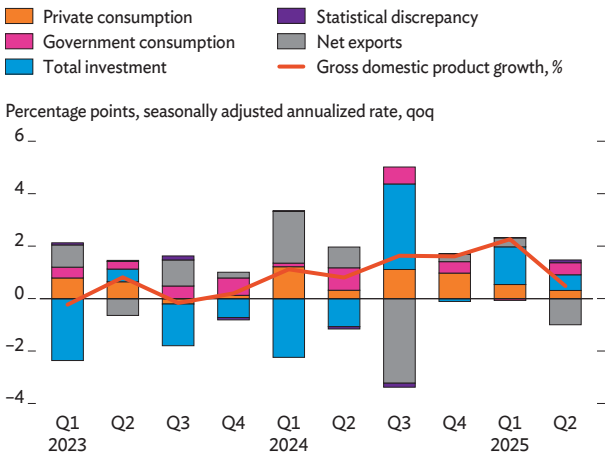
add to inflationary and debt sustainability risks, putting further pressure on bond yields and financial stability. In addition, the 29 August 2025 Court of Appeals decision invalidating the president's authority to impose sweeping tariffs under the 1977 International Emergency Economic Powers Act, if upheld, would lead to contrasting fiscal and monetary risks—while the withdrawal of corresponding tariffs would widen the government budget deficit, it would also ease inflationary pressures, creating conditions for lower interest rates.

Euro area

The euro area economy grew at a seasonally adjusted annualized rate (saar) of 0.5% in Q2 2025, the lowest since Q4 2023 (Figure A.5). This moderation was largely expected and followed a particularly strong Q1 performance (saar growth of 2.3%), driven by one-off export front-loading in the face of high US trade policy uncertainty early in the year. Growth in Q2 was mostly supported by investment and government consumption. The contribution of private consumption was marginal, while net exports exerted a large drag. Growth patterns were divergent across the four largest member economies: Germany and Italy contracted 1.1% and 0.3% saar respectively, while France and Spain expanded 1.3% and 3.0% saar, respectively.

Figure A.5 Demand-Side Contributions to Growth, Euro Area

Growth fell in Q2 after an upward surprise in Q1.



Q = quarter, qoq = quarter on quarter.
Source: Haver Analytics.

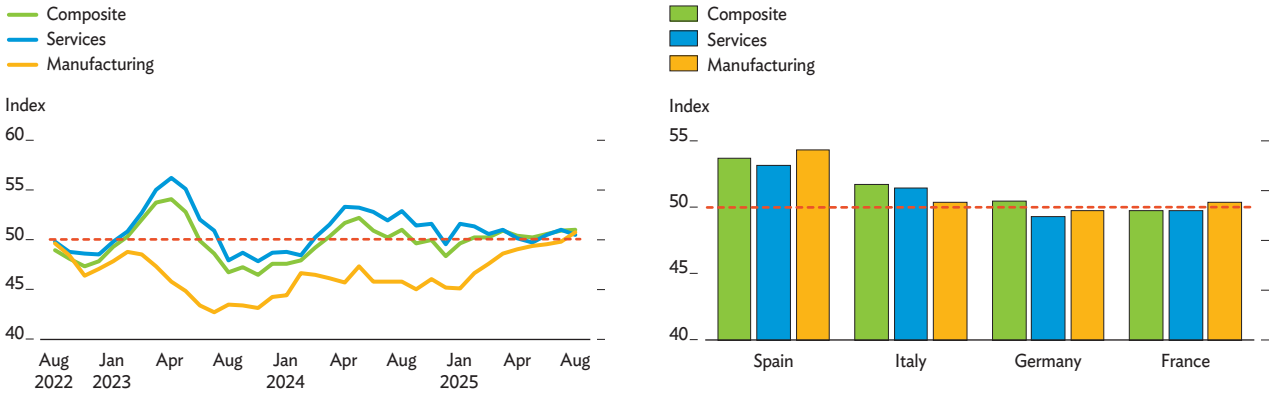
Leading indicators suggest rising activity in the coming months. The services purchasing managers' index (PMI) recovered over June–August following a drop in April–May, while the manufacturing PMI in August turned above the 50-expansion threshold for the first time since June 2022, suggesting that the sector has finally turned the corner (Figure A.6, panel A). Spain posted the strongest readings, with Italy also in expansion, while France and Germany remained close to the 50-threshold (Figure A.6, panel B). On the demand side, retail sales rose in April and June but dipped in May and July, signaling uneven momentum. Labor market conditions remain strong, with unemployment at a record low of 6.2% and healthy wage growth. Together with easing inflation, real income gains, and improved credit conditions, this should lift consumer confidence, which remains well below its long-term average.

Inflation is projected at 2.1% in 2025 and 1.9% in 2026. Headline inflation has hovered around the central bank target of 2.0% since May 2025 and is expected to remain close to that level through year-end, supported by favorable energy prices and recent exchange rate movements. The slight easing projected for 2026 reflects expected moderating wage growth, as labor market tightness eases, and continued euro strength, reflecting a relatively hawkish European Central Bank (ECB) stance relative to other central banks. The ECB has lowered its main policy rate 235 basis points since June 2024 to 2.0% but kept rates unchanged at its September meeting while emphasizing its data-dependent approach. With inflation near target, the ECB can hold rates still, standing ready to ease policy if inflation falls below target, growth weakens, or the euro appreciates sharply.

GDP is projected to grow 1.2% in both 2025 and 2026. The projection assumes modest growth in the last two quarters of this year, driven mainly by a pickup in private consumption, supported by lower inflation and interest rates, and alongside a gradual recovery in fixed investment. External demand will drag modestly on activity as somewhat higher US tariffs constrain export growth. Growth is projected to edge up over the course of 2026 as the full effects of monetary easing implemented in 2024–2025 feed through, and as fiscal contraction over 2023–2024 eases, with the de-facto extension of the Next Generation EU public investment program, fiscal expansion in Germany, and

Figure A.6 Purchasing Managers' Index, Euro Area

Leading indicators suggest modest growth in services and manufacturing activity.

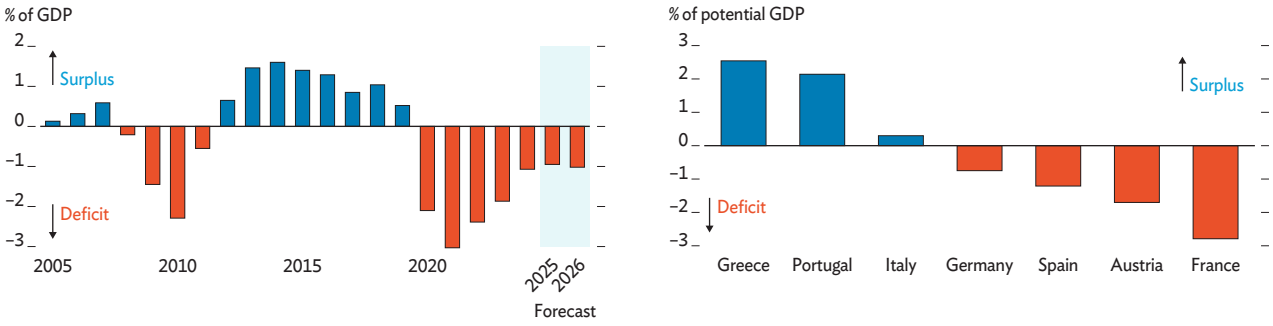


Notes: An index reading < 50 signals deterioration, > 50 improvement. The services and manufacturing PMIs are calculated as averages of different components, while the composite PMI is a weighted average of the output component of the services and manufacturing PMIs.

Source: CEIC Data Company.

Figure A.7 Primary Budget Balance, Euro Area

A neutral fiscal policy impulse is expected, while some economies are running large primary deficits.



GDP = gross domestic product.

Note: The primary budget balance represents general government net lending or net borrowing, excluding interest payments, as a percentage of GDP.

Source: European Commission AMECO database.

higher defense spending (Figure A.7, panel A). Private consumption is expected to strengthen, offsetting the drag from persistently weak external demand.

Risks are tilted to the downside. The late-July 2025 trade deal between the European Union and the US averted a full-blown trade war, but steep US tariffs elsewhere could add to global goods price pressures, raise inflation and reduce the ECB's room to cut rates if growth weakens. A larger-than-expected slowdown in the US can dampen external demand more than currently anticipated. Some euro area member economies maintain large fiscal deficits (Figure A.7, panel B). This, together with elevated debt levels and political uncertainty, may drive up borrowing costs and endanger fiscal sustainability. Upside risks include a possible peace deal between Ukraine and Russia, which may lead to lower energy prices.

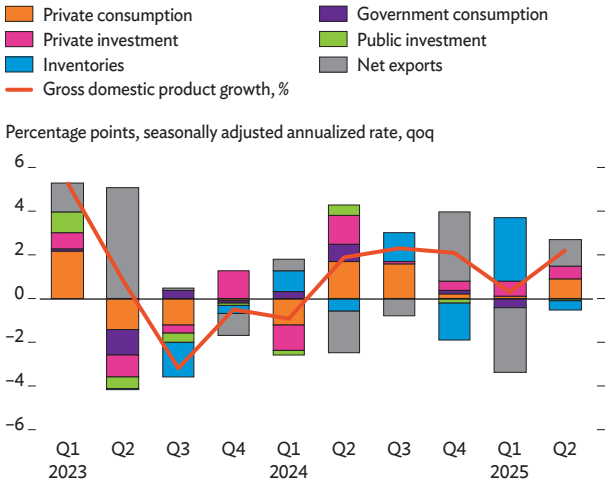
Japan

Japan's economy expanded faster than expected in Q2 2025, driven by solid domestic demand and resilient exports. GDP grew at an annualized 2.2% from the previous quarter, up from an earlier estimate of 1.0%, while Q1 growth was revised down to

0.3% from the previously reported 0.6% (Figure A.8). Non-residential investment rose 0.6% qoq, supported by robust corporate sentiment; the Bank of Japan's Tankan survey indicates that large firms plan to lift investment by 11.5% this fiscal year, well above the earlier 3.1% estimate. Private consumption, which accounts for nearly 60% of GDP, edged up 0.4% despite prolonged inflation, aided by steady wage gains from this year's *shunto* pay negotiations. Household spending increased in both May and June, signaling underlying resilience. Net exports added 0.3 percentage point to quarterly growth as real exports climbed 2%, with companies cutting prices to offset heavier US tariffs and front-loading shipments ahead of a potential levy hike of 10% to 25%. Although goods export values fell in May and June, volumes held firm. Inbound tourism also buoyed net exports, with visitor spending surging 17% year over year in Q2 and tourist arrivals in the first half of 2025 hitting a record 21 million.

Figure A.8 Contributions to GDP Growth (Demand Side)

Robust domestic demand, coupled with steady export performance, underpinned economic growth in the second quarter of 2025.



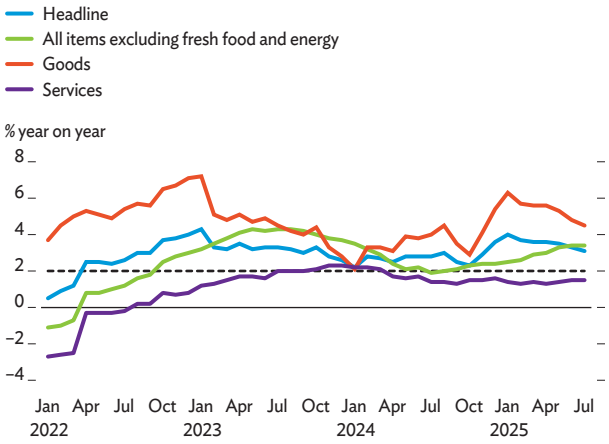
Q = quarter, qoq = quarter on quarter.
Source: CEIC Data Company.

Despite this strong Q2 performance, the growth outlook for Japan remains modest, with GDP projected to grow 1.1% in 2025 and 0.6% in 2026. The manufacturing PMI remained in contraction in August at 49.7, reflecting trade uncertainty and softer global demand, while the services PMI continued in expansion for the fifth straight month at 53.1, supported by robust domestic demand. The composite PMI stood at 52.0, with service-sector strength offsetting manufacturing weakness. External developments present both tailwinds and risks. The July US–Japan trade agreement resulted in a tariff rate of 15% on Japanese goods imports, higher than the base rate of 10% but lower than the threatened 25%. The 15% deal also extended to automobile imports from Japan, which had been subject to the global 25% tariff rate by the US on automobile imports, providing relief to the sector. Domestically, continued positive momentum on wages should help households to better cope with higher prices and support consumption. Political shifts—particularly the ruling coalition's loss of its upper house majority in July, and Prime Minister Ishiba's resignation, which was announced in early September—could also raise the likelihood of fiscal stimulus through higher spending and tax cuts, and further support growth in 2025. However, growth is expected to soften in 2026 as the boost from fiscal measures fades and global demand for Japan's exports moderates. A slower pace of wage gains and the potential for a stronger yen could also weigh on export competitiveness and private-sector investment.

Consumer prices inflation (CPI) in Japan remains elevated despite recent moderation in headline figures. Headline inflation eased for the seventh straight month in July, to 3.1% year on year from 3.3% in June, with the decline largely due to continued government energy subsidies, which cut household electricity and gas bills by an estimated 15%–20% compared to a year earlier (Figure A.9). Energy prices fell 0.3% from a year earlier,

Figure A.9 Monthly Inflation

Inflation is trending lower but remains above the Bank of Japan's 2% target.



Source: CEIC Data Company.

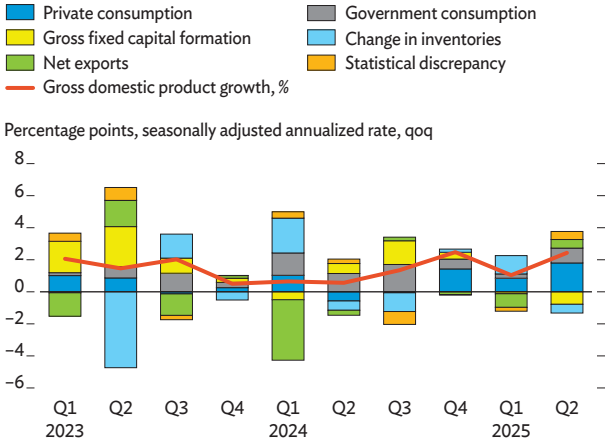
marking the first decline since March 2024. Food prices remain the largest contributor to inflation. Overall food inflation accelerated to 7.6% in July from 7.2% in June, adding roughly 2 percentage points to the headline CPI. Within this category, rice prices—although falling since June—remained exceptionally high, hovering at around 91% above year-earlier levels, mainly reflecting weather-related supply constraints and stronger demand. Core inflation excluding fresh food and energy—a key gauge of underlying price momentum—remained at 3.4% in July from 3.3% in May. Although inflation has remained higher than the Bank of Japan's inflation target of 2%, interest rates were held unchanged at 0.5% in July, given uncertainty around the impact of US trade policy and tariffs.

Inflation is forecast to reach 3.0% in 2025 and 1.9% in 2026. High food inflation—above 7%, as noted—and rising labor costs in labor-intensive sectors will keep CPI elevated in the near term. In 2026, inflation is expected to ease as global commodity prices and input costs fall, and agricultural output improves. Continued government subsidies and base effects from high 2024–2025 inflation will also temper price growth, bringing CPI closer to the Bank of Japan's 2% target. Further momentum on nominal wage growth is also expected to support the case for monetary policy normalization by the central bank over the forecast horizon.

Risks to the outlook are tilted to the downside. While a tariff deal with the US was agreed in July, ongoing uncertainties around implementation could become elevated and worsen Japan's growth outlook. A proposed US global tariff of 100% on semiconductors, announced on 6 August, could pose a headwind, but the impact would be expected to be limited for Japan as the US accounts for less than 5% of Japan's semiconductor exports.

Figure A.10 Demand-Side Contributions to Growth, Australia

Growth accelerated in Q2 2025, boosted by private consumption.



Q = quarter, qoq = quarter on quarter.
Source: CEIC Data Company.

Recent Developments and Outlook in Other Economies

Australia

GDP growth accelerated to a seasonally adjusted 2.4% in the second quarter of this year from 1.0% in the first. This was driven by private consumption, government consumption, and exports (Figure A.10). Private consumption rose by 3.6%, on real income growth and spending on tourism and leisure as the proximity of Easter and the Anzac Day led many people to take time off in April. Government consumption increased by 4.1%, driven by health expenditure due to a strong flu season, spending on military exercises, and the preparation of the parliamentary elections in May. Net exports also slightly boosted growth as iron ore and liquefied natural gas exports rebounded following weather disruptions in Q1. In contrast, public investment in infrastructure declined, while private investment stagnated.

The Monetary Policy Board cut its benchmark interest rate to 3.6% on 12 August 2025, continuing a monetary easing trajectory started in February as inflation cools. Inflation further decreased from a 32-year high of 7.8% in Q4 2022 to 2.1% in Q2 this year on declining fuel and housing prices, as well as an increase in electricity subsidies for households since July 2024.

Growth is expected to slightly pick up in 2025, but global risks cloud the outlook. Growth is expected to gain momentum this year due to easing inflation and lower interest rates. But exports will likely be hit in the second half of the year after the steep rise in US tariffs on 7 August. The US has imposed a 10% tariff on most imports from Australia since 5 April 2025, with a 50%

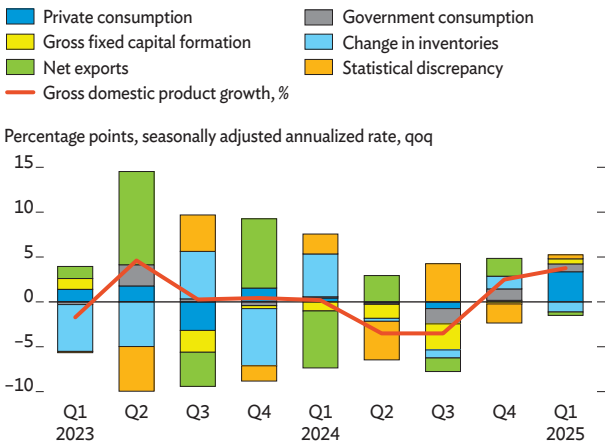
tariff on copper products effective 1 August 2025. As only 5% of Australia's total exports are bound for the US, the most concerning potential effects are indirect. The additional US tariffs raise global trade uncertainty, which is expected to weaken investment and lower the price of commodities Australia exports, such as iron ore, coal, and copper. Australia is also exposed to slowing growth in the PRC, which absorbs around 35% of its exports. Inflation is expected to tick up slightly in the second half of the year and next year as growth accelerates and electricity subsidies are reduced and eventually phased out. As of 5 September 2025, Consensus Forecasts had GDP growing by 1.6% in 2025 and 2.2% in 2026, and inflation at 2.5% this year and 2.7% next year.

New Zealand

GDP expanded 3.8% in Q1 2025 from 2.5% in Q4 2024, on strong domestic demand. This was primarily driven by private consumption, which grew 5.4%, contributing 3.4 percentage points to growth (Figure A.11). Household consumption was notably boosted by lower interest rates and real wage growth. Government spending added another 0.9 percentage point to growth as it expanded 4.3%. Fixed investment also expanded, by 2.3%, contributing another 0.6 percentage point, led by a rebound in manufacturing and construction after a poor performance last year. On the other hand, changes in inventories and net exports constrained growth. Exports of lumber and seafood decreased due to weaker demand and rising competition with lobster from Australia in the PRC following the lifting of an import ban on Australian rock lobster in December 2024. This decline was cushioned by rising exports of dairy, meat, and kiwi, boosted by favorable weather and global prices.

Figure A.11 Demand-Side Contributions to Growth, New Zealand

GDP surged in Q1 2025 on strong household consumption.



Q = quarter, qoq = quarter on quarter.
Source: CEIC Data Company.

Modest growth is expected this year and next, supported by rate cuts and despite global headwinds. On 20 August 2025, the Reserve Bank of New Zealand cut its benchmark interest rate to 3.0%. This was made possible as inflation remains within the 1%–3% target band, although it increased to 2.7% in Q2 from 2.5% in Q1. Rising US tariffs are expected to dampen demand for New Zealand exports, notably in the PRC, which absorbs about 25% of New Zealand's exports. In turn, this is likely to mitigate price pressures, enabling further monetary easing. Risks to the outlook include uncertainty about US trade and tariff policy and a weaker-than-expected labor market as wage growth has slowed and unemployment has kept rising since 2021. As of 5 September 2025, Consensus Forecasts had GDP growing 1.0% in 2025 and 2.4% in 2026, and inflation at 2.7% this year and 2.1% next year.

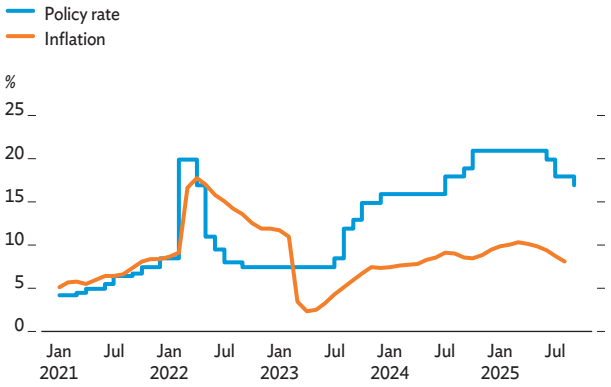
Russian Federation

In the first half of 2025, the Russian economy grew at its slowest pace since the invasion of Ukraine. Growth slowed to 1.4% year on year in Q1 and further down to 1.1% in Q2, from 4.5% in Q4 2024. This was driven by record-high interest rates and falling real wages. It was also caused by stricter sanctions, including US secondary sanctions on companies helping Russia evade sanctions and a ban on US IT services exports, and a ban on Russian diamond imports by G7 countries and the EU. Gas exports were also affected by the expiration of the contract that allowed Russia to export gas exports to Austria, Hungary, and Slovakia via Ukraine. Public spending growth, which had boosted growth in the last few years, was also sluggish.

The central bank has accelerated monetary policy easing amid cooling inflation. At its meeting on 12 September, it cut the policy rate 100 basis points to 17.0%, following a 200 basis points cut in July (Figure A.12). This was made possible as inflation

Figure A.12 Inflation and Policy Rate in the Russian Federation

Cooling inflation has led the Central Bank of the Russian Federation to ease the policy rate.



Source: Haver Analytics Database.

eased from 8.8% in July to 8.1% in August on weakening domestic demand, easing labor shortages, and sluggish wage growth.

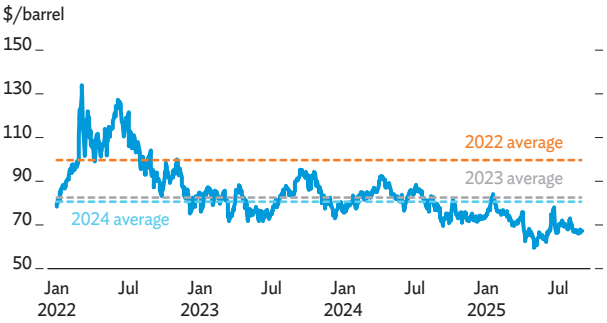
GDP growth will slow this year and in 2026 as domestic headwinds mount. The economy will grapple with still very high interest rates. Exports are expected to further shrink due to sanctions, while the secondary tariffs hitting India since 27 August due to its Russian oil imports could be extended to other economies. A banking crisis further clouds the outlook, with several major banks already discussing potential bailouts by the central bank in 2026 amid rising nonperforming loans. On the upside, a peace deal over Russia's war in Ukraine could support growth in 2026 if it involves at least partially lifting sanctions. As of 5 September 2025, Consensus Forecasts had GDP growing 1.3% in 2025 and 2026.

Oil Prices

Brent crude oil prices were volatile in July and August 2025. In July, prices initially slipped from about $68 per barrel on oversupply concerns from the Organization of the Petroleum Exporting Countries and its partners (OPEC+) and other producers, alongside weak economic data from the PRC (Figure A.13). As the month progressed, a US–EU trade agreement, US President Donald Trump's threats to penalize India for buying Russian crude, and a drop in US drilling rigs, stoked fears of tighter global supply, lifting prices

Figure A.13 Brent Crude Oil Prices

Brent crude remains below recent annual averages.



Source: Bloomberg.

to nearly $73 per barrel by month-end. In August, momentum reversed sharply after OPEC+ on 3 August announced a larger-than-expected September production increase of 547,000 barrels per day, fully unwinding a previous 2.2 million barrel cut. Coupled with weak US economic data and the imposition of new tariffs, the news deepened recession and demand concerns, driving prices down steadily to around $68 per barrel by mid-August.

Based on the International Energy Agency's August 2025 Oil Market Report, the global oil market is projected to remain in a state of oversupply through both 2025 and 2026. This is primarily because robust supply is outpacing sluggish demand growth. For 2025, the agency forecasts global oil demand growth at a low 680 thousand barrels per day, the slowest rate since 2009 (excluding the COVID-19 pandemic), with consumption reaching 103.7 million barrels per day. In contrast, supply is expected to grow an average of 2.5 million barrels a day, driven largely by non-OPEC+ nations. Looking to 2026, the report projects slightly faster demand growth of 700 thousand barrels per day, but this will again be exceeded by a significant supply increase of 1.9 million barrels a day, with non-OPEC+ producers continuing to dominate the growth. This persistent imbalance will likely lead to further buildup of inventory and put sustained downward pressure on prices.

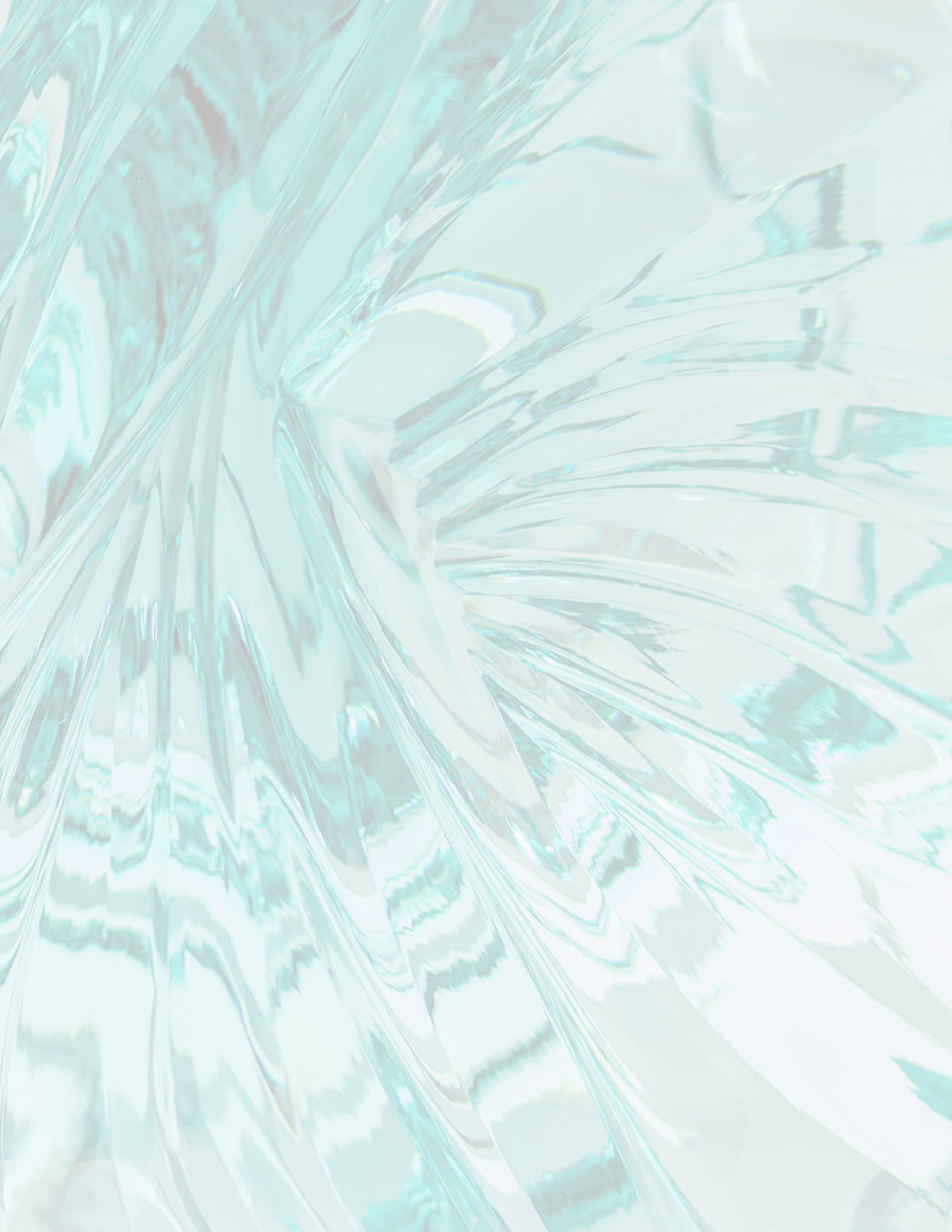
Brent crude prices are forecast to average $67 per barrel in 2025 and $57 in 2026. From January to mid-September 2025, prices averaged $70.30 per barrel, with recent trading holding near $68.00 amid uncertainty from competing supply constraints,

geopolitical risks, and demand weakness. With supply expected to exceed demand in both years, global oil inventories are likely to rise sharply—a pattern that in past episodes has preceded steep price drops. Ample supply, trade frictions, and OPEC+'s pivot toward defending market share point to persistent downward pressure. While sanctions on Russian oil, diesel shortages in key markets, and stockpiling by the PRC may soften the decline, large surpluses will strain storage capacity, pushing prices toward marginal storage costs. This, in turn, could prompt production cuts from some suppliers and modest demand gains, slowing the pace of inventory accumulation in 2026 and preventing a sharper price fall.

While these forecasts reflect current market dynamics, considerable uncertainty could still upend the outlook. Geopolitical tensions in the Middle East or Eastern Europe may trigger major supply disruptions and sudden price spikes. Likewise, an abrupt shift in global economic conditions—positive or negative—could reshape demand projections. Absent any major unforeseen events, however, Brent crude oil prices are likely to trend downward.

2

CAPITAL INFLOWS TO EMERGING MARKET ECONOMIES: GLOBAL FACTORS AND THE ROLE OF FUNDAMENTALS



CAPITAL INFLOWS TO EMERGING MARKET ECONOMIES: GLOBAL FACTORS AND THE ROLE OF FUNDAMENTALS

The sensitivity of foreign capital inflows to shifts in global financial conditions can lead to boom-bust cycles and macro-financial stability risks in emerging market economies (EMEs). The contribution of EME capital inflows to economic growth is well-documented, particularly through the expansion of credit and the deepening of domestic capital markets. However, their volatility, often driven by shifts in global liquidity and investor sentiment, can threaten the macro-financial stability of EMEs. Episodes of surging inflows or reversals have been associated with exchange rate pressures, asset price fluctuations, and heightened financial fragility. The large potential benefits and risks of foreign capital inflows underscores the importance of robust macroeconomic policy frameworks and sound fundamentals, which can help maximize the benefits while mitigating the risks.

This *Asian Development Outlook* analytical chapter provides empirical evidence on the influence of global factors on foreign capital inflows to EMEs and the stabilizing effect of domestic fundamentals. The issue is particularly important in light of heightened global uncertainty in trade policy, persistent geopolitical risks, and shifts in global monetary policies. The recent literature on EME capital flows has stressed the dominant role of the "global financial cycle", which holds that a large share of the variation in capital flows can be explained by global risk aversion and United States (US) monetary policy. Empirical work suggests that the global financial cycle primarily affects portfolio debt, portfolio equity, cross-border loans, and, to a lesser extent, foreign direct investment. At the same time, the literature stresses the role of the domestic fundamentals in EMEs in driving foreign capital inflows and potentially counteracting the impact of the global financial cycle. The analytical chapter contributes to this literature by systematically examining the influence of both the Chicago Board Options Exchange's Volatility Index (VIX) and US monetary policy, as well as two other less researched global risk factors—trade policy uncertainty (TPU) and geopolitical risk (GPR).

More specifically, the chapter examines the impact of four global factors and four domestic factors on four types of foreign capital inflow in EMEs. The global factors comprise US monetary policy, global risk aversion, trade policy uncertainty, and geopolitical risk; while the domestic factors are gross domestic product (GDP) growth, trade openness, financial development, and rule of law. The types of EME foreign capital inflows considered are portfolio debt, portfolio equity, cross-border loans, and foreign direct investment. The following questions are addressed:

- Have EME capital inflow dynamics shifted over time?
- Are EME capital inflows more sensitive to particular global factors and are there variations in the sensitivity of different types of capital inflows?

This chapter was written by Donna Faye Bajaro, John Beirne (lead), Donghyun Park, and Pilipinas Quising, of the Economic Research and Development Impact Department (ERDI), ADB, Manila, and Emmanuel Alano, ERDI Consultant.

- How important are domestic factors in driving EME capital inflows?
- Which domestic fundamentals are important?

The analytical approach involves examining whether EME capital inflow dynamics have shifted structurally and assessing the responsiveness of these foreign inflows to global and domestic factors over time. The analysis yields the following main findings:

- ***The US Federal Reserve's quantitative easing (QE) policy, which began at the end of 2008 and concluded in late 2014, coincided with a structural shift in EME capital flow dynamics.*** Based on a panel of 36 EMEs covering 1990–2024, structural breaks are identified around the QE period, when global liquidity was ample due to large scale purchases of long-term securities by the US Federal Reserve (Fed). The Fed's injection of global liquidity resulted in historically low long-term US interest rates, which triggered EME capital inflows as investors searched for yield. The end of QE and tighter global financial conditions marked a further shift in dynamics, as foreign capital outflows from EMEs initially materialized before reverting as risk sentiment improved and global liquidity conditions stabilized.

- ***In the current post-QE period (2015 to 2024), while EME portfolio debt and equity inflows are negatively related to US monetary policy and trade policy uncertainty, trade openness is a key counterweight.*** The analysis indicates that US monetary policy is the main global factor affecting EME portfolio debt and equity inflows. While lower US interest rates due to a slowing US economy could trigger foreign capital inflows to EMEs, persistent US inflation could prompt tighter US monetary policy and portfolio reallocation by global investors out of EMEs. TPU is also found to be negatively associated with EME portfolio debt and equity inflows, with rising TPU likely to lead to flight-to-safety flows. On domestic factors, higher trade openness is identified as a key driver of EME portfolio debt and equity inflows. Moreover, the magnitude of the trade openness effect is greater than that of US monetary policy and TPU. For portfolio equity investors, trade openness signals a commitment to open markets and globalization, and broader market access. This tends to boost an economy's growth prospects and attractiveness as an investment destination. Trade openness also positively influences global bond investors as it signals a diversity in export revenue sources which can help to dampen balance of payments vulnerabilities.

- ***EME cross-border loans are strongly negatively affected by escalations in geopolitical risk, but financial development helps boost foreign lending inflows.*** Heightened GPR disincentivizes international banks to lend abroad. Under these circumstances, international banks are likely to tighten credit standards and reallocate lending toward safer jurisdictions. However, the analysis also reveals a significant positive role for financial development in attracting foreign lending. While this effect is somewhat smaller than the GPR effect, efficient domestic financial systems with sound prudential and supervisory frameworks help to reassure international bank lenders in EMEs.

- ***Geopolitical risk significantly deters foreign direct investment (FDI) inflows into EMEs, as do trade policy uncertainty and global risk aversion, while GDP growth acts as the main domestic driver of inflows.*** Elevated GPR and TPU significantly raise the risk on long-term investment such as FDI. Higher global risk aversion, which reflects weaker investor sentiment, also discourages FDI inflows. The effects on FDI are most pronounced due to GPR. On the other hand, the analysis shows that GDP growth can significantly boost FDI inflows, although its impact remains smaller than that of the global factors overall.

The chapter proceeds by first discussing the related literature and stylized facts on the evolution of EME capital flows, which is followed by the methodology, empirical results and policy implications. The next section of the chapter sets the scene with a review of previous work carried out in this field, and the contribution of the current study to that literature. This is followed by a discussion of how capital inflows have evolved in EMEs over the period 1990 to 2024. The chapter then describes the data and methodology used in the study and the empirical results, before concluding with some policy implications for managing capital flows in this highly uncertain global environment.

The Literature on Drivers of Capital Flows in Emerging Market Economies

Empirical work on the drivers of capital flows in EMEs became prominent in the 1990s, when capital flows to emerging markets surged following the Latin American debt crisis. The boom marked the beginning of a debate that continues to shape the literature on the drivers of capital flows in EMEs. The early consensus credited the resurgence of EME inflows to successful economic reforms and improved macroeconomic fundamentals (Lopez-Mejia 1999, Schadler et al. 1993). This view was challenged by the seminal work of Calvo, Leiderman, and Reinhart (1993), who present compelling evidence that global factors—such as declining US interest rates, recession in the US, regulatory shifts in capital markets, and movements in the US balance of payments—played a major role in driving flows to Latin America. While acknowledging the relevance of domestic reforms, their study highlighted the significant influence of external conditions on emerging market capital flows.

Fernandez-Arias (1996) stressed the role of global factors, attributing much of the new wave of emerging market inflows in the 1990s to lower global interest rates. These findings shifted the academic debate toward the significance of so-called "push" factors—global variables that push capital outward toward emerging markets. Subsequent empirical work strengthens this perspective (CGFS 2021, Koepke 2019) and identifies a core set of external drivers that include investor risk aversion, often proxied by the VIX or measures of policy uncertainty; monetary policy stances of advanced economies, particularly policy rates and global liquidity conditions; US dollar movements, especially its effective exchange rate, given its centrality in global finance; and real activity indicators, such as global commodity prices and GDP growth in major economies (Scheubel, Stracca, and Tille 2024).[1]

However, the earlier literature lacked a consensus on whether global or domestic factors dominated as drivers of capital flows to EMEs. Many highlighted the continued relevance of domestic fundamentals and policy choices of EMEs in attracting foreign capital (Hannan 2018). Using an intertemporal model, Ghosh and Ostry (1993) find that domestic fundamentals largely explain capital flows to a wide range of developing economies. Similarly, applying an international capital asset pricing model to the 1980–1994 period, Bohn and Tesar (1996) find that domestic factors were more important than global factors in shaping Asian investment flows. Using panel data from 1977 to 1997, Hernandez, Mellado, and Valdes (2001) find that private capital inflows to developing economies are largely determined by domestic conditions, with global variables having only limited explanatory power. Chuhan, Claessens, and Mamingi (1998) examine US gross inflows to 18 EMEs and conclude that domestic factors are at least as influential as external ones, especially in Asia. In particular, they find that the importance of US interest rates and US industrial production for EME capital flows is counterbalanced by domestic fundamentals including sovereign credit ratings and equity returns. Likewise, the World Bank (1997) observes that investors were becoming more discerning, assigning greater weight to economy-specific fundamentals when allocating capital.

Extreme Capital Flows and the Global Financial Cycle

A major turning point in the capital flows literature came during the global financial crisis in 2008. During the crisis, the collapse of US and European markets triggered a classic flight to safety away from

[1] Koepke (2019) provides a widely cited review of empirical studies on the determinants of capital flows. More recent literature surveys include ECB (2023) and Braiton and Odhiambo (2025).

emerging markets. This episode underscored the significant influence of global factors in driving capital flows out of EMEs, particularly as global risk aversion soared during this period. Milesi-Ferretti and Tille (2011) also show that this surge in global risk amplified foreign capital outflows from emerging markets, even those with strong fundamentals. The episode highlights how global financial conditions can test domestic resilience during severe financial stress.

Several studies identified global factors to be the main driver of emerging market portfolio investment flows in the crisis period. Fratzscher (2012) finds that global factors dominated during the crisis, explaining 73% of flows to the median country, although domestic factors became more influential post-2009, accounting for 82% of flow variance in emerging Asia and 63% in Latin America. Domestic fundamentals in EMEs gained in importance during the post-crisis recovery of 2008–2010. Ahmed and Zlate (2014) highlight the relevance of both global (e.g., global risk appetite) and domestic factors (e.g., growth and interest rate differentials) from 2002 to 2013, with sensitivity to interest rate differentials intensifying in the post-global financial crisis period. Avdjiev et al. (2020) find that the sensitivity of cross-border loans and international debt securities to US monetary policy rose sharply between the global financial crisis and the 2013 Federal Reserve "taper tantrum", before reverting to pre-crisis levels. Increased sensitivity within individual banking systems mainly drove these fluctuations, largely due to the post-crisis convergence of advanced-economy monetary policies—which began to normalize after 2013. In contrast, the responsiveness of cross-border lending to global risk steadily declined, driven by compositional shifts. Better-capitalized banking systems expanded their international lending shares while remaining less sensitive to global risk, resulting in a marked decline in overall vulnerability. These shifts led to a post-crisis convergence in the sensitivity of loan and bond flows to global factors.

To better conceptualize extreme capital flow episodes, Forbes and Warnock (2012) introduce terms such as *surges* and *stops* (sharp changes in gross inflows) and *flight* and *retrenchment* (sharp changes in gross outflows). Their analysis confirms that global risk is a key driver. Rising risk leads to sudden stops by foreign investors and retrenchments by domestic ones, while falling risk triggers surges and capital flight. These patterns are primarily driven by shifts in economic uncertainty and investor sentiment.

Building on these insights, Rey (2013, 2015) introduces the concept of the global financial cycle. According to the concept, a large proportion of the variation in risky assets and capital flows across economies can be explained by a single common factor, which is highly correlated to measures of global financial conditions such as the VIX and US monetary policy. It follows that capital flows to emerging market economies are strongly determined by fluctuations in the global financial cycle. Under this framework, global shocks can undermine the effectiveness of independent monetary policy, even under floating exchange rates. The transmission of capital flow shocks occurs through multiple channels: (i) trade channels, where global shocks reduce external demand; (ii) financial channels, such as cross-border lending, foreign ownership of local assets, and sovereign borrowing; (iii) balance sheet channels, whereby currency depreciation worsens the real burden of foreign-currency debt; and (iv) contagion and confidence effects, where crises in one economy spill over to others. These transmission mechanisms are amplified in economies with shallow financial markets, weak institutions, and high external financing needs.

A substantial body of more recent empirical work supports the global financial cycle hypothesis. Studies consistently show that global factors, especially risk aversion, are strongly associated with extreme capital flow episodes, including surges, stops, retrenchments, and flights (Cerutti, Claessens, and Rose 2019; Scheubel, Stracca, and Tille 2024). Elevation of global risk typically results in more outflows (stops and retrenchments) and fewer inflows (surges and flights). Eller, Huber, and Schuberth (2020) further show that the explanatory power of global variables in country-level capital flows increased significantly after the global financial crisis.

That said, some studies caution against overstating the dominance of global forces. Ghosh et al. (2014) offer a more nuanced view. They show that while global factors such as US interest rates and risk aversion determine the timing of the flows, domestic variables such as financing needs, capital account openness, and exchange rate regimes shape how

shocks are transmitted. Caceres, Carriere-Swallow, and Gruss (2016) provide evidence that domestic monetary autonomy persists, especially under floating exchange rate regimes. By isolating *autonomy-impairing spillovers*—foreign-induced interest rate movements misaligned with domestic objectives—they find that even financially liberalized small open economies with flexible exchange rates often show no statistically significant interest rate response to US monetary shocks. Similarly, Habib and Venditti (2019) show that while global risk and US monetary policy shocks influence capital flows, their transmission is mediated by domestic monetary and exchange rate frameworks, particularly for bank loans. This suggests that domestic policies can amplify or buffer global shocks, rather than being entirely overpowered by them. Cerutti, Claessens, and Rose (2019) argue that a large share of capital flow variation cannot be explained solely by global push variables, as evidenced by the low explanatory power (low R-squared) of common global factors.

The interaction between global and domestic factors was evident during the quantitative easing period starting in 2009 and the 2013 taper tantrum. In response to the global financial crisis, the US Fed and other advanced economy central banks slashed interest rates and launched quantitative easing policies to support economic recovery and financial stability. This triggered substantial capital flows to EMEs as investors searched for yield (Fratzscher, Lo Duca, and Straub 2018). As the crisis eventually subsided, investors increasingly differentiated among different emerging markets based on fundamentals and policy credibility, with greater sensitivity to rate differentials, notably for portfolio flows (Ahmed and Zlate 2014). QE boosted overall inflows to EMEs, particularly portfolio debt (see also Fratzscher, Lo Duca, and Straub 2018), but economies with higher yields attracted more. In short, QE provided the liquidity, but domestic factors guided the specific allocation. The 2013 taper tantrum also illustrates this dynamic. When the Fed signaled QE tapering, EMEs suffered outflows but the impacts differed. Economies with weaker fundamentals at that time, including India, Indonesia, and Thailand, suffered sharper depreciation and outflows (Eichengreen and Gupta 2014), underscoring how domestic factors shape sensitivity to global shocks.

Heterogeneity Across Capital Flow Types

A significant evolution in the capital flows literature is the analysis of the drivers of different types of capital flows. In particular, FDI tends to be less sensitive to global factors than other types of capital flows. As Koepke (2019) notes, FDI exhibits limited sensitivity to global push shocks such as shifts in risk aversion or changes in advanced-economy interest rates. Compared to portfolio investment and banking flows, FDI is less affected by the business cycle fluctuations of advanced economies and the vulnerabilities of recipient economies, such as high external debt. Such resilience stems from FDI's long-term, strategic orientation.

Among domestic fundamentals, domestic output growth consistently emerges as a key determinant of FDI inflows. Other unique determinants include the tax regime, trade protection, bilateral trade relationships, exchange rate effects, and gravity factors (Koepke 2019). Several empirical studies reinforce the importance of domestic factors for FDI. Adam and Filippaios (2007) report that GDP per capita positively influences US FDI inflows in the full sample and in the non-OECD economies, consistent with a market-seeking motive. They also find that trade openness is positive and significant for OECD countries—a result echoed by Alfaro, Kalemli-Ozcan, and Volosovych (2008), who likewise show that trade openness encourages FDI, with its significance evident mainly in OECD countries. Despite the relative stability of FDI, Albuquerque, Loayza, and Servén (2005) observe that its sensitivity to global economic conditions has grown as a result of deepening global financial integration. Even the most stable type of capital flows is not immune to global influences.

Portfolio investment flows, comprising equity and debt securities, are found to be far more responsive to global financial conditions. Global risk sentiment, advanced-economy monetary policy, global commodity prices, and US dollar movements play a major role. Taylor and Sarno (1997) find that equity flows in Asia and Latin America respond to both global and domestic factors, whereas bond flows are driven largely by global forces. Baek (2006) finds

that portfolio inflows to emerging Asia are driven primarily by global risk appetite and external conditions, whereas Latin American inflows are more responsive to domestic output growth and external financial factors but not investor risk sentiment.

Banking flows, often recorded as "other investment" in the balance of payments, similarly exhibit high sensitivity to global push shocks—especially spikes in global risk aversion (Koepke 2019). The impact of interest rates in advanced economies is mixed, often depending on broader macroeconomic conditions. On the pull side, domestic output growth, the performance of the domestic banking sector, and economy risk indicators are key drivers. Push shocks tend to have particularly persistent effects on the lower tail of banking flow distributions—i.e., during large outflow episodes—indicating elevated vulnerability during periods of global financial stress (Eguren-Martin et al. 2024). Cross-border bank lending remains a central transmission mechanism in the global financial cycle and plays a critical role in the ongoing debate surrounding the monetary policy trilemma (Habib and Venditti 2019).

This chapter builds on the existing literature by examining how several global factors affect the suite of capital flow types in EMEs, covering portfolio debt, portfolio equity, cross-border loans, and FDI. The empirical work covers global factors extending beyond US monetary policy and global risk aversion, also including trade policy uncertainty and geopolitical risk. These latter factors remain relatively less researched as determinants of EME capital flows, although this literature is growing. Focusing on gross capital inflows, which are the most relevant for capturing the transmission of global shocks, the empirical framework used permits an assessment to be made of the comparative effects of global factors on capital inflows. Finally, the framework also features domestic fundamentals in EMEs, enabling an assessment to be made of the extent to which these can counteract the negative impacts of global factors.

Evolving Capital Flow Dynamics in Emerging Market Economies

EME capital inflows have shown strong cyclical behavior over the past 3 decades, reflecting deeper integration into global financial markets. These flows are a vital source of financing for investment and growth, but their volatility can also transmit shocks and amplify macro-financial risks. This section describes developments in EME gross capital inflows during 1990 to 2024.[2] It examines gross flows, as opposed to net, given that the former provides a more complete picture of financial vulnerabilities and investor behavior, as global shocks tend to propagate through shifts in gross capital flow positions (Broner et al. 2011).[3]

Long-Term Trends in Emerging Market Economy Capital Flows

Gross capital inflows to EMEs have closely mirrored global financial conditions (Figure 2.2.1, panels A and B). Capital inflows rose sharply during the era of financial globalization in the 1990s and early 2000s, collapsed abruptly during the global financial crisis, rebounded in the QE period amid abundant liquidity, and have since stabilized at more moderate levels relative to GDP in the post-crisis period. Highly accommodative monetary policy in the advanced economies following the global financial crisis, particularly the Fed's QE, led to substantial capital inflows to EMEs as global risk appetite strengthened. In line with the global financial cycle hypothesis, US monetary policy conditions pushed capital to emerging economies during the QE period. Higher asset returns and stronger growth prospects also increased their attractiveness to global investors. Investor behavior has been shaped by a combination of global monetary and financial developments, EME growth prospects and policy environment, and economic cycles (BIS 2021a). Although the COVID-19 pandemic brought another sharp retrenchment in 2020, swift policy responses helped flows rebound quickly (Adrian, Natalucci, and Qureshi 2023).

Liberalization and privatization in the 1990s opened up EMEs' FDI. FDI inflows to EMEs rose from an average of around 0.7% of GDP in 1990 to about 2.7% by 1999. Although they dipped during the 1997–1998 Asian financial crisis, they rebounded in the 2000s, supported by commodity booms and rapid economic growth. From 2008 onward, Asia's economic resilience helped to keep inflows relatively robust for over a decade. More recently, however, they have fallen sharply—to $417 billion in 2023, the lowest since 2005—amid softer global growth and heightened uncertainty. While FDI remains the largest component of capital flows (Figure 2.2.2), and the most stable, a recent World Bank report highlights its concentration in the largest economies, with the People's Republic of China (PRC) alone taking nearly one-third of inflows during 2012–2023 (World Bank 2025). However, the PRC's share plunged to just one-tenth in 2023—the lowest in more than a decade.

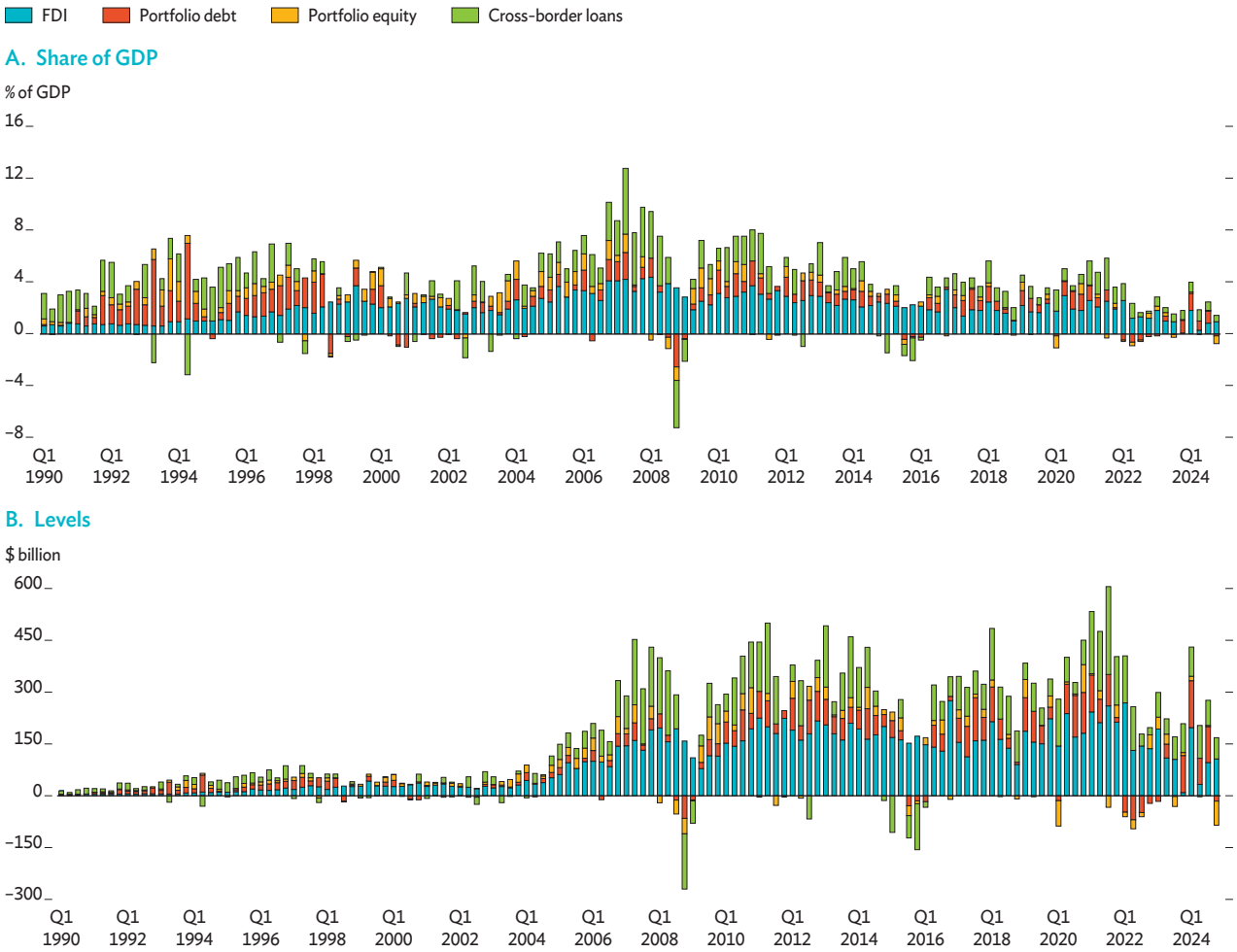
Non-FDI capital inflows to EMEs since 1990 have been marked by pronounced volatility and recurring boom–bust cycles. In the 1990s, reforms that opened financial markets spurred a surge of portfolio debt and equity investment flows and cross-border bank lending. These quickly reversed during the financial crises across Asia, Latin America, and Russia, underscoring their sensitivity to shifts in investor sentiment (Calvo, Leiderman, and Reinhart 1996). The 2000s brought

[2] Excludes major offshore financial centers. The eight major pass-through economies—Bermuda; British Virgin Islands; Cayman Islands; Hong Kong, China; Ireland; Luxembourg; the Netherlands; and Singapore, as well as Switzerland—host more than 85% of the world's investment in special purpose entities, which are often set up for tax reasons (Damgaard, Elkjaer, and Johannesen 2019).

[3] Asset transactions represent gross capital outflows, while liabilities correspond to gross capital inflows.

Figure 2.2.1 Capital Inflows to Emerging Market Economies

FDI remains the largest and most stable flow, while other flows exhibit more pronounced fluctuations.



FDI = foreign direct investment, GDP = gross domestic product, Q = quarter.

Notes: Aggregate figures are GDP-weighted averages. Cross-border loans (or other investment) include loans, currency, and deposits from banks and other financial institutions. Sample includes 107 emerging market economies. Table A2.1 provides the list of economies.

Source: Asian Development Bank estimates using International Monetary Fund Balance of Payments Statistics and Oxford Economics Forecasting data.

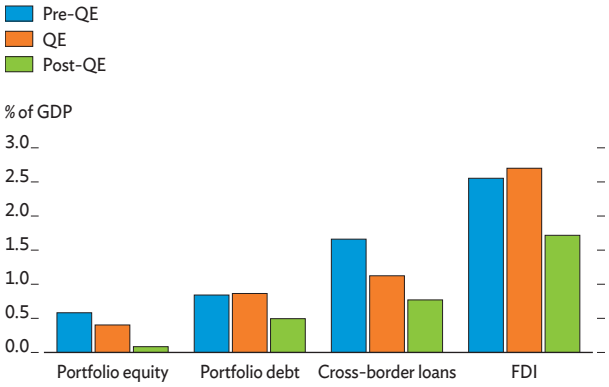
a substantial and sustained increase in non-FDI flows, particularly to emerging Europe, fueled by low interest rates in advanced economies and the rapid expansion of global banks. For example, the share of foreign banks in the Central and Eastern Europe region rose from around 10% in 1995 to 77% by 2008, with cross-border bank claims playing a pivotal role in the region's economic and financial development (Nițoi, Clichici, and Moagăr-Poladian 2021). Yet the riskiness of such heavy reliance on cross-border loans was fully exposed during the 2008 global financial crisis when a "sudden stop" in lending occurred (BIS 2010; IMF 2011). Since then, the composition of non-FDI flows has changed. Emerging economies have relied less on bank loans and increasingly on international bond markets (Aldasoro, Hardy, and Tarashev 2021; BIS 2025).

The same pattern of boom and bust is evident in developing Asia (Figure A2.1, panels A and B). Liberalization in the early 1990s attracted capital toward emerging markets, with net private flows alone increasing roughly sevenfold from 1990 to 1996—with about two-thirds going to Asia (Ito 2000).[4] The 1997–1998 Asian financial crisis then saw abrupt

[4] In the balance-of-payments framework, gross capital inflows comprise private and official flows, but in 1990–1996, net private inflows were over nine times larger than official borrowing, making them the dominant source (IMF 1997, 2003).

Figure 2.2.2 Average Gross Capital Inflows to Emerging Market Economies

Foreign direct investment remains the largest component of capital flows.



FDI = foreign direct investment, GDP = gross domestic product, Q = quarter, QE = quantitative easing.

Notes: Pre-QE: 1990Q1–2008Q3; QE: 2008Q4–2014Q4; Post-QE: 2015Q1–2024Q4. Cross-border loans (other investment) include loans, currency, and deposits from banks and other financial institutions. Sample includes 107 emerging market economies. Table A2.1 provides the list of economies.

Sources: Asian Development Bank estimates using International Monetary Fund Balance of Payments Statistics and Oxford Economics Forecasting data.

reversals, with foreign capital outflows equivalent to 4% of GDP—including about $26 billion in cross-border loans—from severely affected economies like Indonesia, the Republic of Korea, Malaysia, the Philippines, and Thailand in 1998. In the 2000s, inflows bounced back. Foreign investment in the most affected economies had recovered to more than 1% of GDP by 2005–2007. In East Asia (the PRC; the Republic of Korea; Taipei,China), gross capital flows surged to about $255 billion (2% of GDP) by 2005, up from just $39 billion (0.5% of GDP) in 1997–1998, as exports and reforms strengthened the subregion's balance sheets. After the 2008 global financial crisis, capital flows to emerging Asia recovered at a record pace, even raising concerns about overheating as policy rates stayed "too low for too long" (Balakrishnan et al. 2012).

FDI remained the anchor in developing Asia, while portfolio channels grew in importance after the global financial crisis. FDI continues to make up the bulk of overall capital inflows in the region, accounting for around 53% of total gross inflows, or 1.4% of GDP, during the period 2015 to 2024. Despite weak global demand and tighter financial conditions in 2024, FDI inflows to developing Asia still amounted to an estimated $176 billion (or 0.6% of GDP). In addition, portfolio capital flow became more prominent over the past 10 years—helped by further capital account opening and financial market deepening—with nonbank financial institutions now supplying more than 40% of external financing to emerging Asia (OECD 2025). While capital flow volatility spiked in 2022, as global interest rate hiking cycles commenced and geopolitical tensions buffeted portfolio and other investment flows, FDI inflows to several economies proved resilient on the back of supply-chain diversification and infrastructure programs (UNCTAD 2025).

For developing Asia excluding the PRC, FDI flows have remained relatively stable, while foreign lending inflows have fluctuated over time (Figure A2.1, panels C and D). Cross-border loans (or other investments) remained volatile within a high range, peaking at $309 billion (2.8% of GDP) in 2021, underscoring the region's strong appeal for banking flows. Though portfolio flows are increasing, they remain comparatively small. In contrast, portfolio flows have become a major driver of capital inflows to the PRC since 2017 (Figure A2.1, panels E and F), reflecting the country's rapid integration into global capital markets (OECD 2025).

Cross-Border Patterns Between and Within Economy Groups

Advanced economies dominate global capital flows to EMEs but intra-emerging economy flows have expanded rapidly. The International Monetary Fund (IMF) bilateral investment data show that financial linkages between advanced economies remain immense, with portfolio holdings of nearly $11 trillion and direct investments of $1.2 trillion in 2023.[5] Advanced economies continue to dominate flows to the emerging economies by volume, accounting for around 68% of FDI and 76% of portfolio investment in 2023. While flows from advanced economies to emerging economies—particularly portfolio

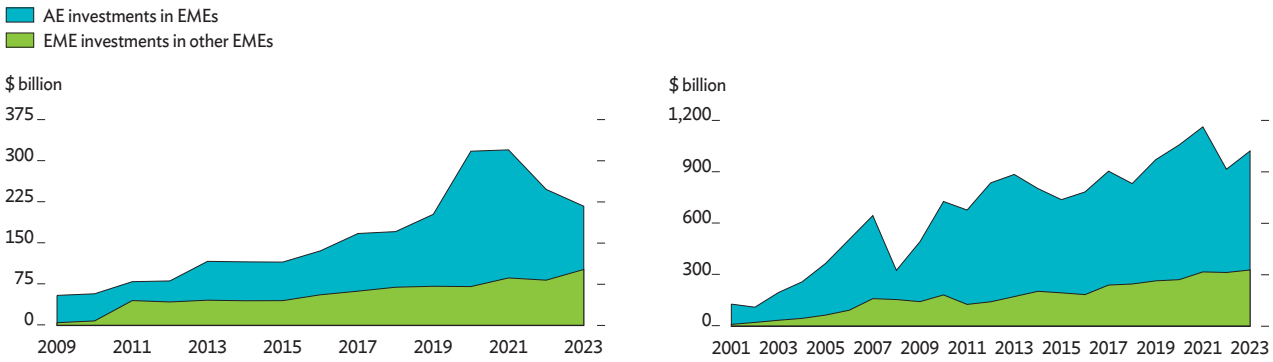
[5] Excludes major offshore financial centers.

Figure 2.2.3 Direct and Portfolio Investments

A. Direct Investments in AEs and EMEs

B. Portfolio Investments in AEs and EMEs

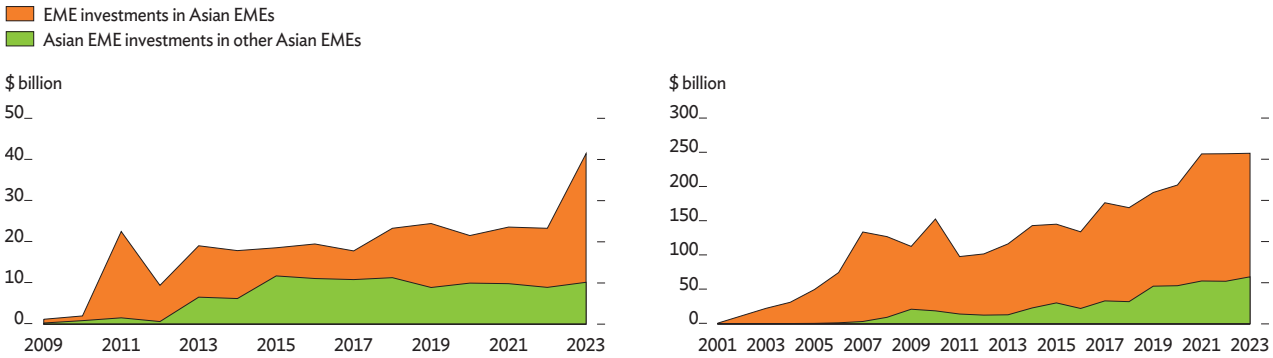
FDI flows among emerging economies have grown more than twenty-fold since 2009, while intra-emerging economy portfolio investment more than doubled.



C. Direct Investments in Asian EMEs

D. Portfolio Investments in Asian EMEs

Intra-Asian FDI and portfolio flows made up a fifth of EMEs' investments to Asia in 2023.



AE = advanced economy, EME = emerging market economy, FDI = foreign direct investment.

Notes: Direct investment inflows correspond to balance of payment methods. Portfolio investment includes resident investments abroad (assets). The sample comprises 29 advanced economies and 36 emerging market economies, including 13 from developing Asia. Table A2.1 provides the list of economies.

Sources: Asian Development Bank estimates using data from the International Monetary Fund's Direct Investment Positions by Counterpart Economy and Portfolio Investment Positions by Counterpart Economy databases.

investments—have grown substantially, the more striking structural shift is the surge in investment between emerging economies (Figure 2.2.3, panels A and B). FDI between emerging economies grew from just $5 billion in 2009 to nearly $102 billion in 2023, driven by the growing size of the emerging market economies, the rise of emerging market economy multinationals, the deepening of regional supply chains, and infrastructure-led growth strategies. Over the same period, intra-emerging economy portfolio investment more than doubled from $144 billion to $328 billion, reflecting greater cross-listings, stronger regional fund flows, and the increasing participation of domestic institutional investors in neighboring markets (Figure 2.2.3, panels C and D).

This shift reflects both stronger growth prospects and deeper financial integration within emerging economies. In emerging Asia in particular, trade integration, regional production networks, and capital market development have reinforced one another. Trade liberalization fostered regional production networks, which created demand for deeper capital markets, while stronger capital markets in turn financed further trade and investment integration. The rising share of long-term flows, such as FDI, between emerging economies suggests greater confidence in sustained regional growth as well as a diversification of funding sources beyond traditional advanced economy investors. Overall, growing regional economic and financial integration between emerging market

economies is an important source of resilience. However, the continuing dominance of capital flows emanating from advanced economies continues to expose emerging market economies to external shocks.

Capital Flow Surges and Stops in Emerging Market Economies

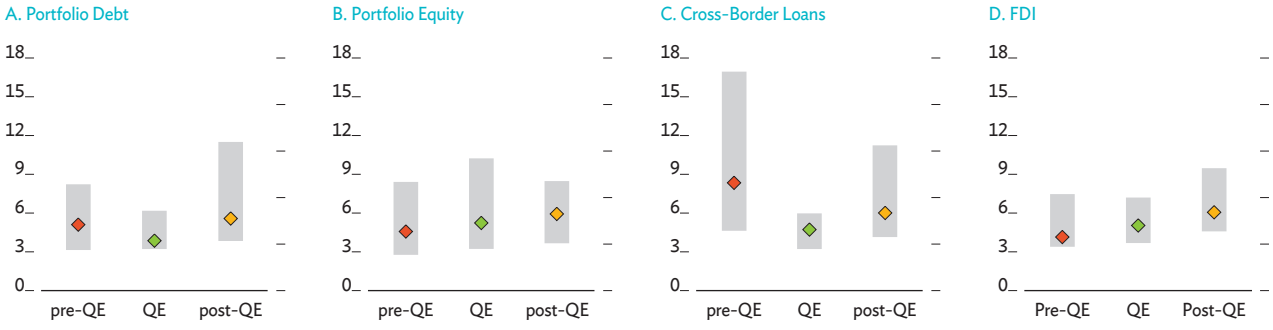
Spikes in global risk aversion have historically coincided with sharp swings in emerging market economy portfolio flows. The 1997–1998 Asian financial crisis, the 2008 global financial crisis, and the 2020 COVID-19 shock all triggered rapid reversals in emerging market economy portfolio debt and equity flows (Figure 2.2.1, panel B), as investors retreated to safe havens. Comparative measures of capital flow volatility across regions and investment types highlight this vulnerability. Episodes of surges and sudden stops—often linked to shifts in global risk sentiment, monetary policy in major economies, and global commodity price cycles—leave clear imprints on capital flow patterns. More recent data point to subdued emerging economy inflows, higher funding costs, and renewed sensitivity of portfolio flows to global shocks.

EME capital volatility has risen notably during the post-QE period, suggesting increased vulnerability to global financial shocks (Figure 2.2.4). Even in the case of FDI, emerging market economies show increased vulnerability, as investment decisions can be delayed or scaled back under heightened uncertainty. The volatility of portfolio equity inflows has steadily increased over time, reflecting their sensitivity to global risk appetite and rapid investor reallocation. By contrast, the volatility of portfolio debt and cross-border loans declined during the quantitative easing period, as abundant global liquidity supported steadier demand for emerging-market debt and post-crisis bank deleveraging curbed swings in cross-border lending (Apostolou and Beirne 2019; Fratzscher, Lo Duca, and Straub 2018; Steeley and Matyushkin, 2015). Cross-border loans have historically been the most volatile category, but their volatility has diminished in later years as their share in total inflows declined.

Capital flow "surges" are periods of unusually large and sustained inflows while "stops" describe abrupt and sustained reversals of inflows (Forbes and Warnock 2012). Surges are often driven by healthy global risk appetite, accommodative monetary conditions in advanced economies, and strong emerging market growth prospects—as seen in the pre-global financial crisis boom of 2003–2007 and the post-global financial crisis QE wave of 2010–2013. On the other hand, stops are typically triggered by sharp changes in global monetary policy or investor sentiment, such as during the 2013 taper tantrum and the COVID-19 shock in 2020 (Table 2.2.1 details key

Figure 2.2.4 Volatility by Type of Capital Inflow to Emerging Market Economies

FDI is the least volatile capital flow in emerging markets.



FDI = foreign direct investment, Q = quarter, QE = quantitative easing.

Median and interquartile range:

◆ = pre-QE period (1990Q1–2008Q3), ◆ = QE period (2008Q4–2014Q4), ◆ = post-QE period (2015Q1–2024Q4). Grey bars denote interquartile range.

Notes: Volatility is measured as the coefficient of variation (based on quarter on quarter changes) obtained by dividing the standard deviation of capital inflows to each economy over the relevant periods (pre-QE, QE, and post-QE) by the absolute value of mean capital inflows to that economy during the same period. Cross-border loans (or Other investment) include loans, currency, and deposits from banks and other financial institutions. The sample includes 107 emerging market economies. Table A2.1 provides the list of economies.

Source: Asian Development Bank estimates using International Monetary Fund Balance of Payments Statistics data.

Table 2.2.1 Episodes Since the Mid-1990s

Episode and Period	Trigger and Impact	Flow Types Most Affected
Tequila Crisis (1994–1995)	Mexico's peso collapse triggered sudden portfolio and bank outflows from emerging market economies until IMF support restored confidence.	Portfolio equity, bank loans
Asian Financial Crisis (1997–1998)	Massive reversals in short-term bank loans and portfolio flows hit Thailand, Malaysia, Indonesia, and the Republic of Korea; spillovers reached Russia's 1998 default.	Bank loans, portfolio equity and debt
Pre-Global Financial Crisis Surge (2003–2007)	Strong global growth, low volatility, and cheap credit fueled record inflows to both emerging market economies.	All major flows (FDI, portfolio, bank)
Global Financial Crisis (2008–2009)	Collapse of US subprime markets caused the deepest global stop in decades; global gross inflows fell.	Portfolio debt and equity, bank loans
Post-Global Financial Crisis "QE" Surge (2010–2014)	Ultra-low advanced economy rates and quantitative easing drove record emerging market portfolio inflows and bond issuance.	Portfolio debt and equity
Taper Tantrum (2013)	Interest rate repricing sparked rapid emerging markets bond and equity outflows.	Portfolio debt and equity
Commodity/PRC Slowdown (2015–2016)	Oil price collapse, PRC's yuan devaluation, and growth concerns triggered outflows from commodity exporters and the PRC.	Portfolio debt and equity, bank loans
COVID-19 Pandemic (Q1 2020)	Fastest emerging market outflows on record as pandemic panic gripped markets; massive policy support reversed flows quickly.	Portfolio debt and equity, FDI slowdown
Recent Tightening (2022–2023)	Rapid advanced rate hikes slowed emerging market portfolio inflows and raised borrowing costs; global FDI fell to multi-year lows.	Portfolio debt and equity, FDI

PRC = People's Republic of China, FDI = foreign direct investment, IMF = International Monetary Fund, Q = quarter, QE = quantitative easing, US = United States.

Sources: BIS (2021b); Crescenzio and Lepers (2021); IMF (2011).

episodes). During stops and surges, the size and speed of flows are most evident in portfolio debt and equity. Although FDI tends to be more resilient, it can also slow markedly after major shocks, as in the post-2008 and 2020 downturns.[6]

Emerging economies have experienced repeated surges and sudden stops in capital flows. Data show that these cycles tend to coincide with global risk events, with portfolio flows often reversing sharply during crises. The share of EMEs experiencing stops relative to the total number of EMEs peaked during the global financial crisis and again at the onset of the COVID-19 pandemic. By contrast, surges were most widespread in 2010 and 2013 during the quantitative easing period. In recent years, inflow surges have become less frequent, but sudden stops still remain common, underscoring the vulnerability of emerging market economies to global shocks.

Developing Asia has also experienced similar episodes of sharp surges and sudden stops, often in step with global financial cycles. Figure 2.2.5, panels A and B illustrate episodes of portfolio flow surges and sudden stops in developing Asian economies since 1997, highlighting their frequency and alignment with major global shocks. For example, East and Southeast Asian economies experienced sudden stops in portfolio

[6] After falling by 16% in 2008, global FDI inflows fell another 37% in 2009 (UNCTAD 2010). In the 2020 COVID 19 shock, global FDI plunged by about 35%, with advanced economies experiencing the most severe declines (e.g., a 58% drop), while emerging economies proved relatively more resilient—but still declined by around 8% (UNCTAD 2021).

Figure 2.2.5 Sudden Stops and Surges in Selected Developing Asian Economies

A. Stops and Surges in Portfolio Debt Inflows

Developing Asia experienced nearly equal occurrences of stops and surges in portfolio debt inflows.

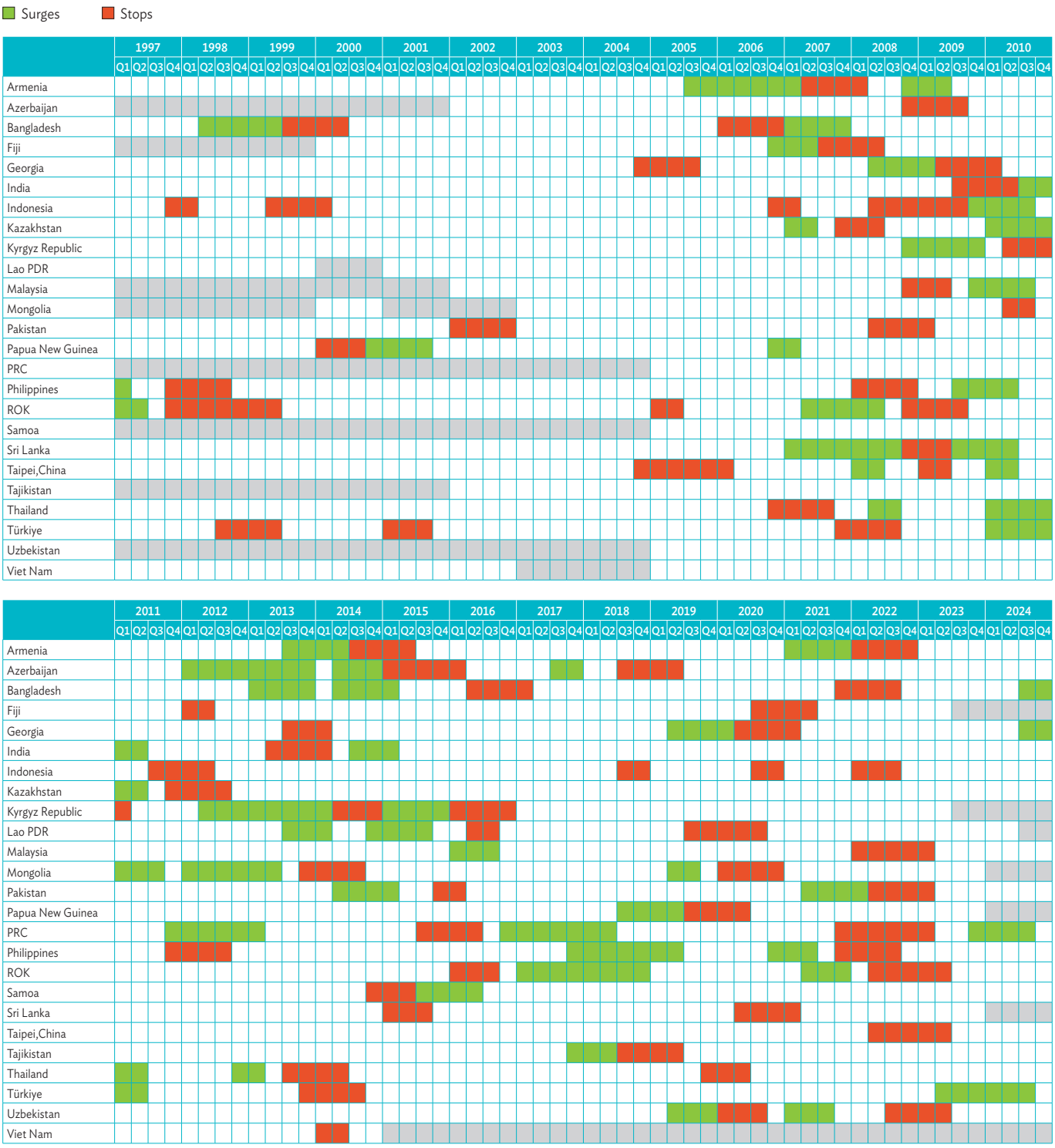


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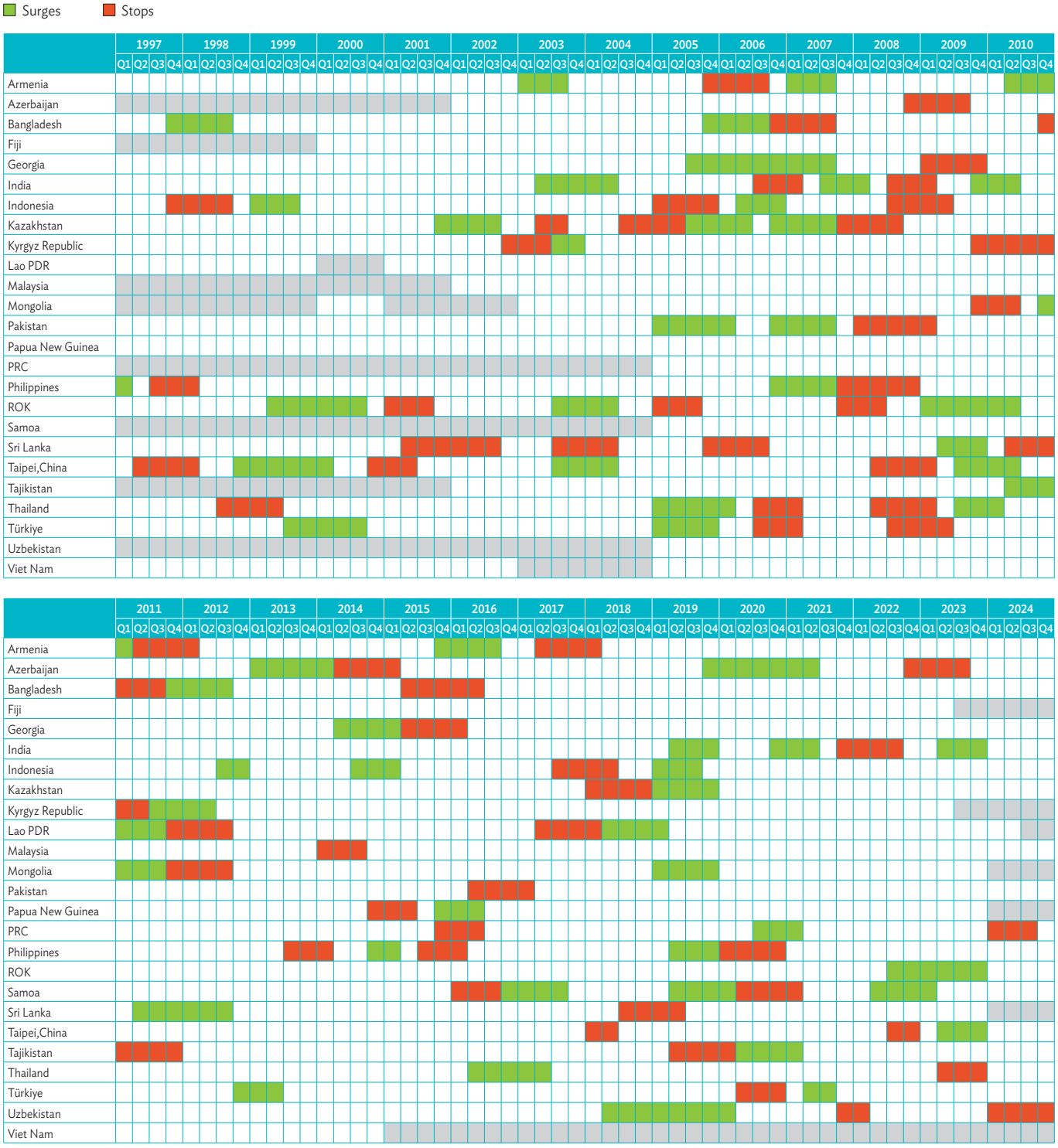
Figure 2.2.5 *Continued*

B. Stops and Surges in Portfolio Equity Inflows

Portfolio equity inflows exhibit fewer sudden stops and surges compared with portfolio debt inflows.



PRC = People's Republic of China, ROK = Republic of Korea, Lao PDR = Lao People's Democratic Republic, Q = quarter.

Notes: These tables extend the work done in OECD (2025) following the methodology of Forbes and Warnock (2012). The grey-shaded cells denote missing data.

Source: Asian Development Bank estimates using International Monetary Fund Balance of Payments Statistics data.

debt and equity inflows during the Asian financial crisis.[7] Developing Asian economies also experienced repeated stops in portfolio inflows—particularly in portfolio debt—during subsequent periods of global financial stress such as the global financial crisis and the COVID-19 pandemic. In general, stops tend to follow periods of surges, reflecting the reversal of capital once global conditions tighten. In contrast, the quantitative easing period (2008Q4–2014Q4) was marked by more surges than stops, as abundant global liquidity supported debt inflows. This pattern reversed thereafter, with developing Asian economies once again experiencing more frequent stops. Portfolio debt inflows exhibit more surges and stops than portfolio equity, reflecting a greater responsiveness to the global environment and relative rates of return (Claessens and Ghosh 2013). These patterns indicate that while developing Asian economies have diversified capital inflows, effectively managing capital flows against abrupt shifts in global financial conditions may require a policy toolkit that includes macroprudential and capital flow management levers of adjustment (see Box 2.2.1).

Box 2.2.1 Macroprudential Policy and Capital Flow Management Measures for Mitigating Capital Flow Volatility

To manage capital flows, economies can adjust monetary and fiscal policies, use exchange rate flexibility, or accumulate reserves, but there are trade-offs. Lowering interest rates can narrow differentials but risks inflation and asset price overheating. Fiscal consolidation eases appreciation pressures but may weigh on growth. Exchange rate appreciation aids adjustment but hurts competitiveness. And reserve accumulation smooths volatility and builds buffers, though at fiscal cost.

Given these limitations, many economies have turned to macroprudential policies (MPPs) and capital flow management measures (CFMs) as complementary instruments. MPPs are prudential tools designed to contain systemic financial risks, maintain financial stability, and dampen the impact of global monetary cycles. They typically include caps on loan-to-value ratios, countercyclical capital requirements, and limits on maturity mismatch. CFMs are administrative or price-based measures aimed specifically at influencing capital flows, particularly those deemed destabilizing or speculative (ECB 2016), and tend to comprise taxes on capital inflows, limits on foreign holdings of domestic assets, and minimum holding periods for foreign capital inflows. While emerging market policymakers cannot prevent swings in global liquidity, MPPs and CFMs can help to mitigate the impact of these on capital flow volatility.

Across emerging economies, macroprudential and capital flow management policies have evolved from ad hoc crisis responses to core components of policy frameworks.[a] These tools have been deployed to rein in credit booms (e.g., property bubbles), reduce currency mismatches on financial sector balance sheets, and buffer economies against volatile capital movements. While MPPs are designed to address financial stability vulnerabilities and the build-up of systemic risks, they can also overlap with CFMs where capital flows are the source of such risks and vulnerabilities. These tools have been used to reinforce macroeconomic management in emerging economies, including across several Asian economies (box table 1).

Going forward, the deployment of well-targeted CFMs and MPPs can bolster macrofinancial stability in the face of a range of global shocks. Capital flows in emerging markets have become increasingly shaped by global factors, including risks related to shifts in trade policy uncertainty

[a] See the IMF taxonomy of Capital Flow Management and Macroprudential Measures and the ASEAN+3 Macroeconomic Research Office database of Capital Flow Management and Macroprudential Policy Measures in the ASEAN+3.

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[7] BIS (2021b) finds that regional spillovers are a key trigger of sudden stops, as investor stress in one market often prompts withdrawals across neighboring economies, exemplified by the Asian financial crisis.

Box 2.2.1 *Continued*

1 CFMs and MPPs in Selected Asian Economies

Economies	Capital Flow Management Measures (CFMs)	Macroprudential Policies (MPPs)
People's Republic of China	• Bank foreign exchange (FX) reserve ratio and controls on bank FX forward sales	• Countercyclical capital buffer requirement • Restrictions on loan maturity structures
Republic of Korea	• Cap on banks FX derivative positions • Maximum loan-to-deposit ratio on won-denominated loans and deposits	• Countercyclical capital buffer requirement • Loan-to-value ratio limits
India	• Limits on overseas banks' foreign currency borrowings • Limits on purchases by foreign portfolio investors	• Loan-to-value ratio limits • Debt-service-to-income ratio limits • Limit on maturity mismatches
Indonesia	• Withholding tax on non-residents for dividends, interests and royalties	• Countercyclical capital buffer requirement • Loan-to-value ratio limits
Philippines	• Registration of inward investments with the Bangko Sentral ng Pilipinas (BSP) • Foreign-exchange funded outward investments above $60 million require prior notification to the BSP	• Countercyclical capital buffer requirement • Cap on the proportion of a bank's total loan portfolio allocated to real estate lending • Liquidity risk regulation
Kazakhstan	• Ban on residents exporting foreign currency cash above set limits and gold beyond threshold	• Liquidity coverage ratio • Net stable funding ratio • Capital conservation buffer requirement • Debt-service-to-income ratio limits • Countercyclical capital buffer requirement

Sources: AMRO (2024); IMF (2023, 2024).

and geopolitical tensions. While sound domestic fundamentals are important for enhancing resilience to external shocks, EME policymakers are likely to refine further their macroprudential and capital flow management toolkits as additional levers of adjustment to global shocks. The ongoing challenge will be on calibrating these tools alongside monetary and fiscal policies, maintaining an appropriate balance between constraining overheating, and supporting sustainable growth.

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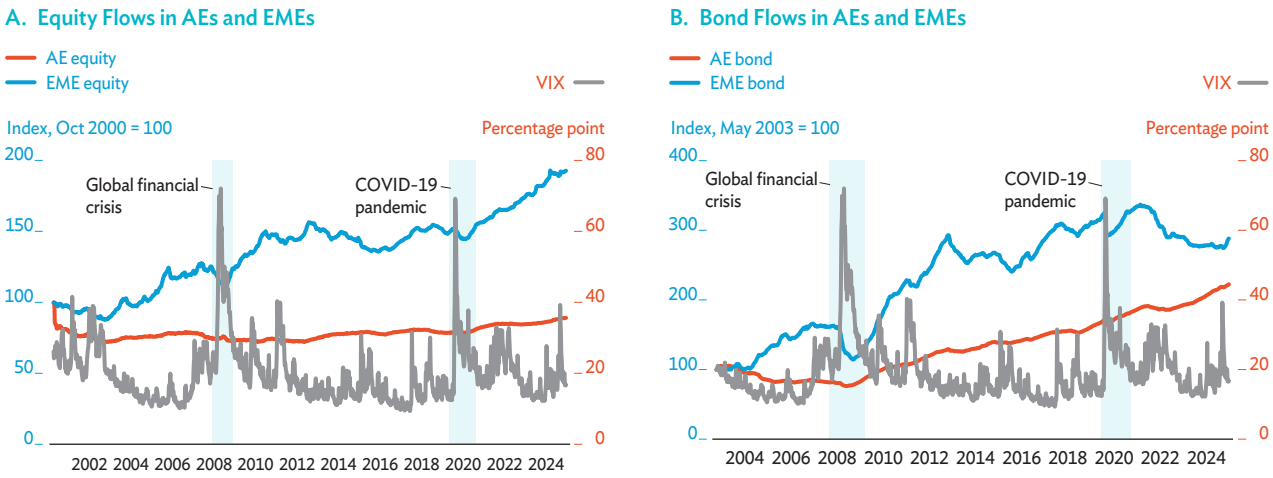
Recent Trends in Capital Flows

Portfolio inflows to emerging markets have remained resilient despite a challenging global backdrop. The Institute for International Finance's July 2025 report notes that flows have sustained strong momentum in recent months. The resilience is evident in both debt and equity markets, with debt once again leading the recovery. In emerging Asia, however, non-resident net equity outflows persisted for the second consecutive quarter, reflecting growth concerns and uncertainties over trade policies. By contrast, net inflows into Asian bonds have shown more strength since July 2025 (see Part 1 for further discussion). Even so, the report stresses that fragmentation, elevated policy risks, and geopolitical tensions continue to define the broader investment environment, forcing investors to navigate a complex landscape despite improving near-term sentiment.

High-frequency data confirm that emerging market economy portfolio flows are highly sensitive to global shocks. Weekly data confirm the upward trend in inflows to emerging economy equities and bonds and their high-growth potential, as well as their vulnerability to global risk factors. As volatility rises (proxied by surges in the VIX), equity prices fall and bond yields rise, leading to market reversals in emerging markets (Figure 2.2.6, panels A and B). By contrast, in the 2013 taper tantrum, portfolio inflows fell despite muted VIX readings, suggesting that an interest rate repricing, rather than heightened portfolio-market fear, drove the pullback in EME portfolio flows (Harikrishnan, Silk, and Yoldas 2023; Sahay et al. 2014). These trends highlight the importance of understanding the drivers of capital flows in EMEs. The next section provides an empirical analysis of the drivers, with a focus on disentangling the roles of global and domestic factors in influencing EME inflows over time.

Figure 2.2.6 Equity and Bond Flows

Portfolio inflows to emerging markets are rising but remain highly vulnerable to global shocks and volatility.



AE = advanced economy, EME = emerging market economy, VIX = Cboe volatility index.

Notes: The figures show the weekly cumulative total capital flows (net capital flows in US dollars to total assets under management) relative to the beginning of the sample period (October 2000/May 2003), between advanced and emerging economies. VIX is expressed as weekly averages. Sample includes data from October 2000 (equity) and May 2003 (bond) to July 2025.

Sources: EPFR Data Portal, Cboe Global Markets.

Sensitivity of Emerging Market Capital Inflows to Global Factors and the Role of Domestic Fundamentals

This section examines the impact of global factors on EME capital inflows over time and the role of domestic fundamentals. The global factors under consideration extend beyond US monetary policy and global risk aversion to include trade policy uncertainty (TPU) and geopolitical risk (GPR), two factors that remain relatively less researched in the capital flows literature.

The empirical work undertaken makes a number of new and robust empirical findings on EME capital flow dynamics. First, it identifies structural breaks in EME capital inflows across portfolio debt, portfolio equity, cross-border loans, and foreign direct investment (FDI) around the start and end of the US Federal Reserve's quantitative easing (QE) policy in 2008 Q4 and 2014 Q4, respectively. Second, US monetary policy and TPU have emerged as the main global factors driving EME portfolio debt and equity inflows in the post-QE period from 2015 Q1 to 2024 Q4. Third, GPR is a key global factor affecting EME cross-border loans and FDI flows in this period. Fourth, it identifies trade openness, GDP growth, rule of law, and financial development levels in EMEs as counterweights to the impacts of global factors on EME capital inflows. The empirical findings highlight that while global factors continue to influence the trajectory of EME foreign capital inflows, domestic fundamentals have an important role to play in offsetting the effects of negative shifts in global factors.

Data and Methodology

Quarterly data from 1990 to 2024 across 36 EMEs forms the basis of the primary analysis. The dependent variables of interest are based on gross capital inflows, relative to GDP, disaggregated into four main types—FDI, portfolio equity, portfolio debt, and cross-border loans. These components are widely used in the literature to capture the nuanced behavior of cross-border capital movement and to allow for type-specific sensitivities to global and domestic factors (Koepke 2019, ECB 2020, Crescenzio and Lepers 2021). Other variables include the global factors affecting capital flows, namely US monetary policy, global risk aversion (measured by VIX), US trade policy uncertainty, and global geopolitical risk. In US monetary policy, the Wu and Xia (2016) Fed funds shadow rate is used as it is regarded in the literature as the preferred measure of the US monetary policy stance given that it reasonably accounts for both conventional and unconventional monetary policy regimes (Avdjiev et al. 2020). EME domestic macroeconomic fundamentals and institutional development factors in the analysis comprise GDP growth, trade openness, financial development, and rule of law.

The main methodology comprises a panel regression estimated across the 36 EMEs over the sample period, across each type of capital flow.[8] The analysis examines whether global and domestic factors affecting EME capital flows have evolved over time. Given that EMEs have become more financially integrated globally in recent decades, with global financial markets more interconnected, it is intuitive to examine EME exposure over time to shifts in global risk and susceptibility to systemic risks. At the same time, conceptually, EME domestic fundamentals can help bolster resilience to external shocks. As a result, it remains an empirical question whether the sensitivity of EME capital flows to global factors has become more pronounced and whether EME domestic conditions help to act as a buffer.

[8] Full details of the empirical methodology are provided in section A3 of the Technical Appendix.

Capital Inflow Structural Shifts and Drivers in EMEs

Boom-bust cycles impacted capital flows to EMEs from 1990 to 2024. Capital flows to EMEs are strongly cyclical in reaction to major global shocks. While periods of abundant global liquidity and low interest rates have led to foreign capital inflows to EMEs, shifting global financial conditions have triggered reversals. Surges of foreign capital inflows to EMEs preceded abrupt withdrawals during the Asian financial crisis (1997–98) and the Russian default (1998). A similar pattern was observed in the run-up to the global financial crisis (2008–09), when capital inflows collapsed as global liquidity and risk sentiment tightened, and then rebounded strongly during the US Federal Reserve's quantitative easing period. More recently, EMEs experienced sudden stops during the taper tantrum (2013), the COVID-19 shock (2020), and bouts of volatility tied to US monetary tightening (2022–23). The cyclical fluctuation in EME capital inflows around major turning points in global financial conditions suggests shifting dynamics over time.

The US Federal Reserve's quantitative easing policy, from end 2008 and to end 2014, coincided with a structural shift in EME capital inflow dynamics. For a panel of 36 EMEs over 1990–2024, formal statistical tests identify structural breaks across the four types of capital flow around the beginning of the QE period (2008 Q4) and at the end of QE (2014 Q4).[9] The QE period was characterized by ample global liquidity, resulting from large scale purchases of long-term securities by the US Federal Reserve (Fed). As the Fed injected liquidity into the financial system, long-term interest rates in the US and other advanced economies fell to historic lows, triggering capital inflows to EMEs as investors searched for yield.

Heterogenous factors drove EME capital inflows in the post-QE period during 2015 to 2024, according to type of capital flow. A panel regression of EME capital inflows on global and domestic factors reveals differences in the sensitivities, with the main results shown in Figure 2.2.7.[10]

Which Global Factors Matter for EME Foreign Capital Inflows?

EME portfolio debt inflows are negatively associated with US Fed rates and trade policy uncertainty. EME portfolio debt is most affected by US monetary policy. Changes in the Federal Reserve's policy rate and monetary policy stance are shown to inversely affect bond investors' allocation decisions. For example, a one standard deviation rise in US Fed rates is associated with a fall in EME bond inflows (relative to GDP) of 0.10 standard deviations. Changes in US monetary policy directly impact interest rate differentials in EMEs and the relative attractiveness of EME debt. The results therefore indicate that a tighter US monetary policy stance is associated with retrenchments from EME bond markets, also driven by higher borrowing costs and lower risk appetite. The results also identify TPU as a significant determinant of portfolio debt, negatively affecting EME bond inflows. The magnitude of the effect is lower than that of US Fed rates, at −0.06 standard deviations. Nonetheless, the result shows that heightened TPU, such as during the escalation of US-PRC trade tensions in 2018–2019, can trigger retrenchment from riskier EME debt toward

[9] Formal statistical tests identify structural breaks across the four types of capital flow around the beginning of the QE period (2008 Q4) and at the end of QE (2014 Q4). Please refer to the Technical Appendix for further details on the tests implemented and the rationale for selecting breaks around the start and end of QE.

[10] The main analysis focuses on the current post-QE period, given that this is the period of most relevance to policymakers. The Technical Appendix details extended results that compare the global and domestic factors driving EME capital inflows in the post-QE period (2015Q1 to 2024Q4) with the QE period (2008Q4 to 2014Q4) and the pre-QE period (1990Q1 to 2008Q3). Table A2.4 in the Technical Appendix presents the full set of empirical results for all periods. The use of standardized coefficients in the analysis enables direct comparison of the relative influence of global factors on gross capital inflows and the role of domestic variables. Expressed in standard deviation units, these coefficients reflect the strength and direction of each predictor—where larger absolute values indicate stronger effects, and the sign denotes the direction. This approach aligns with recent empirical literature emphasizing the importance of disentangling the magnitude and significance of explanatory channels (Koepke 2019; Forbes and Warnock 2012).

Figure 2.2.7 Impact of Global and Domestic Factors on EME Capital Inflows during Post-QE Period

EME domestic fundamentals help to counteract the negative effects of global factors.

EME = emerging market economy, FDI = Foreign Direct Investment, GDP = gross domestic product, GPR = geopolitical risk, QE = quantitative easing, TPU = trade policy uncertainty, US = United States, VIX = Cboe volatility index.

Note: Reported are standardized coefficients from a regression of EME gross capital inflows (as a share to GDP) on global and domestic factors during the post-QE period, from 2015Q1 to 2024Q4. Coefficients that are statistically significant are shown in dark color, while those that are not statistically significant are shown in faint color. The magnitude of each coefficient can be interpreted as the expected standard-deviation change in the share of capital flows to GDP for a one-standard-deviation increase in an explanatory variable, while controlling for other variables in the model. Sample includes 36 EMEs. Table A2.1 provides the list of economies.

Source: Asian Development Bank estimates.

safe haven assets. Overall, given the risk sensitivity of bond investors and preference for stable and predictable returns, the empirical results indicate that a more uncertain trade environment can lead to negative effects on debt inflows.

US monetary policy and trade policy uncertainty affect portfolio equity inflows in a manner similar to portfolio debt. EME equity investors pay close attention to fluctuations in US interest rates and yield differentials relative to the US. As in the case of EME portfolio debt, an inverse relationship between US monetary policy and EME portfolio equity is found. Higher US rates and tighter global financial conditions can result in lower equity valuations and a reallocation of global investors out of EME equities. The magnitude of the effect on EME equity inflows due to a one standard deviation tightening in US monetary policy equates to −0.09 standard deviations, which is also similar to the effect in respect of EME bond inflows. In addition, TPU exerts a negative effect on EME portfolio equity inflows, albeit lower in magnitude than that of US Fed rates, at −0.07 standard deviations. Elevated uncertainty in trade and tariffs can have a dampening impact on EME equities given their exposure to external demand and global value chains.

Geopolitical risk significantly reduces cross-border loans. The empirical findings indicate that geopolitical risk is the primary global factor influencing cross-border loans, with a one standard deviation rise in GPR reducing inflows relative to GDP by 0.20 standard

deviations. During periods of elevated geopolitical risks, international banks may be less willing to lend abroad. Given that loans can be rapidly withdrawn, rolled over at shorter maturities, or priced at higher spreads, they are highly sensitive to shifts in the risk preferences of global lenders. The results suggest that where geopolitical risk heightens, international banks are likely to tighten credit standards and reallocate toward safer jurisdictions, which implies lower cross-border lending in EMEs.

Geopolitical risk also strongly reduces FDI, as do trade policy uncertainty and global risk aversion. A one standard deviation rise in GPR reduces EME FDI inflows relative to GDP by 0.08 standard deviations, which acts as a significant deterrent to longer-term investors. FDI is particularly sensitive to GPR given the scale and duration of investment, with investor preference for stable and predictable long-term policy environments. Likewise, TPU tends to dampen FDI activity in EMEs, given that foreign investors are more likely to invest under stable trade and investment conditions, with easier access to global value chains and export markets. The magnitude of the effect of TPU is lower than that of GPR, at –0.04 standard deviations. Nonetheless, new FDI projects in EMEs are less likely amid uncertainties around tariffs, with TPU disincentivizing investment. Elevated global risk aversion also dampens EME FDI inflows, at a slightly lower magnitude than GPR, as investors delay or scale back long-term commitments during uncertain times.

What Role Can Domestic Fundamentals Play in Driving EME Foreign Capital Inflows?

Trade openness is the most important domestic driver of EME foreign inflows for portfolio debt and equity. The magnitude of the positive impact of trade openness is found to outweigh the negative impacts of global factors, namely US monetary policy and TPU, affecting debt and equity portfolio flows. More specifically, a one standard deviation rise in trade openness increases EME portfolio debt and equity inflows relative to GDP by 0.12 and 0.13 standard deviations, respectively. Strong trade openness signals integration in the global economy. With more diversified sources of export revenue, this can enhance the resilience of balance of payments and ability to service external debt obligations, which can help attract global bond investors. For equity investors, trade openness signals growth opportunities with the potential for broadening market access and strengthening corporate earnings and capital gains. Institutional development, as reflected by rule of law, also importantly supports EME bond inflows from abroad. In addition, GDP growth significantly affects both debt and equity portfolio inflows. For debt, a negative relationship is found, which reflects bond investor risk preferences for a more stable economic environment and potentially lower growth. This compares to the positive relationship between GDP growth and portfolio equity inflows, reflecting the higher risk appetite of global equity investors and preference for higher growth.

For cross-border loans, financial development turns out to be the most important domestic factor, followed by trade openness. A rise in financial development by one standard deviation is associated with higher cross-border loans to EME as a share of GDP by 0.15 standard deviations. Well-developed financial systems typically comprise efficient banking infrastructure, deep domestic credit markets, and robust prudential and regulatory frameworks. These factors strengthen the capacity of banks and firms to intermediate financing, better manage financial risks, and access international capital markets. In turn, EMEs with higher financial development are more likely to attract cross-border lending by foreign banks. Trade openness is also an important driving factor, as broader export diversification can help further assure foreign lenders concerned about risk management. The magnitude of the effect of trade openness on cross-border loans, at 0.09 standard deviations, is lower than that of financial development, but remains significant. While both financial development and trade openness are key drivers of EME cross-border loans, the size of the dampening impact of geopolitical risk is higher.

GDP growth strongly determines EME FDI inflows as the key domestic factor. Strong GDP growth signals robust aggregate demand and an expanding market size, with positive spillovers to corporate earnings and profitability. The results show that a one standard deviation rise in GDP growth

increases FDI inflows to EMEs as a share of GDP by 0.03 standard deviations. In higher growth economies, this may be more conducive with a faster scaling of production and efficiency gains, leading to higher returns on investment. Such conditions therefore help to attract foreign investors to commit long-term capital to EMEs through FDI. While GDP growth is an important counterweight to the negative effects of global factors on FDI inflows, it remains lower in magnitude overall.

Robustness and Sensitivity Tests

Sensitivity tests carried out verify the robustness of the findings of the baseline empirical analysis. An overview is provided of the main robustness tests carried out in this sub-section. Full details are provided in section A5 of the Technical Appendix.

Empirical results based on structural break points identified using two alternative approaches are consistent with those of the baseline. While common structural break points around the Fed's QE period were used in the baseline for all four types of EME capital flows, results based on the precise breaks identified for each flow using two different methods to estimate the breaks are in line with the baseline.

The baseline results are robust to the inclusion of additional controls for macroeconomic stability. Recognizing that global investors, particularly portfolio debt and equity investors, are also likely to take into account macroeconomic stability as a factor for influencing investment decisions, additional domestic controls for GDP volatility, inflation volatility, and exchange rate volatility were added in extended analysis. The results confirm the robustness of the baseline analysis.

Conclusions and Policy Implications

This chapter examines shifting EME capital inflow dynamics from 1990 to 2024 and the role of global and domestic drivers. While capital inflows are a key source of financing for EMEs, they can also be subject to boom–bust cycles. Surging inflows or abrupt foreign capital outflows have often been accompanied by sharp currency fluctuations and macroeconomic and financial instability in EMEs. The chapter analyzes how capital inflows to EMEs are influenced by external factors, namely US monetary policy, global risk aversion, trade policy uncertainty, and geopolitical risk. The role of EME domestic fundamentals in attracting foreign capital inflows is also examined and compared to the effects of global factors.

A structural break in EME capital inflows is identified around the start and end of the US Fed's QE policy after the global financial crisis of 2008. Abundant global liquidity conditions at the start of QE in 2008Q4 triggered surges in capital inflows to EMEs as global investors searched for yield. The end of QE in 2014Q4 and the tightening of global liquidity conditions marks a subsequent break in EME capital flows. This triggered a sharp decline in EME capital inflows. The implication is that abrupt shifts in global liquidity can amplify procyclical capital flow dynamics in EMEs, heightening the risk of boom–bust cycles.

The chapter finds that the effect of global risk factors on EME inflows varies by type of capital flow. In the post-QE period, US Fed rates and TPU emerge as the main global drivers of EME portfolio debt and equity inflows. Global debt and equity investors are particularly sensitive to shifts in US monetary policy. The uncertainty over the future trajectory of US Fed rates thus poses a risk to emerging market capital flows—lower Fed rates in response to a US slowdown could trigger portfolio inflows into these economies, but tighter monetary policy in response to continued US inflationary pressure is likely to lead to foreign outflows. As regards TPU, this has receded from its April 2025 peak, but it remains highly elevated by historical standards. While trade agreements reached between the US and several trading partners in August 2025 have contributed to some easing in TPU, the risk of further escalation remains as the global trade environment continues to evolve. Set against this context, EME portfolio debt and equity inflows could be negatively affected and subject to bouts of volatility. Meanwhile, both cross-border loans to EMEs and FDI are highly sensitive to geopolitical risk (GPR), which redirects international banks and long-term investors toward safer destinations. Escalating geopolitical tensions can lead to higher default risks and a retrenchment of global banks from affected economies. This can also deter FDI inflows, where worsening geopolitical risks could disrupt the performance of assets and operations in host economies. This can also have wider negative effects on cross-border loans and FDI where investors would withdraw or redirect investment not only from economies directly affected by geopolitical tensions, but also on a regional basis given trade and financial linkages. Geopolitical tensions currently remain fragile. These spiked in June due to an escalation of conflict in the Middle East, while the outlook regarding Russia's war in Ukraine is uncertain.

While global factors continue to exert a significant influence on EME capital inflows, the chapter highlights the mitigating role of domestic fundamentals. For EME portfolio debt and equity inflows, the impact of both US monetary policy and TPU is outweighed by trade openness. This suggests that notwithstanding growing protectionism around the world, openness to exports and imports can cushion the impact of tighter US monetary policy or TPU on debt and equity flows. Trade openness signals a commitment to open markets and globalization, which tends to boost an economy's growth prospects and its attractiveness to global equity investors. A greater diversity of export revenue sources can also help to assure more risk-averse global bond investors. For cross-border loans, financial development is a key driver of inflows, helping to offset the negative impact of GPR. International banks tend to be risk-averse but sound, safe, and efficient financial systems with

robust supervision frameworks help to mitigate the risk of retrenchment. In addition, domestic policies that support robust and sustainable growth can help sustain FDI inflows into EMEs. While strong domestic fundamentals can help to offset the negative effects of global shocks on EME capital inflows, EME policy makers should also consider the use of macroprudential policy and capital flow management measures to alleviate capital flow volatility driven by sharp shifts in global liquidity conditions.

As EMEs and financial markets become more globalized, EME capital flows will likely be shaped by a more complex interplay of global and domestic drivers. Further analysis can delve into understanding different responses of different types of FDI capital inflows to global and domestic factors, notably during extreme financial stress. Another important avenue for future research is the role of regional cooperation and integration in insulating EME capital flows from o global shocks. Finally, effectively managing capital flows given the ongoing digitalization of financial markets and cross-border payments systems also warrants further analysis.

Technical Appendix

The Technical Appendix details the data sources, empirical methodology, and supplementary results that support the main analysis of the analytical chapter. Section A1 briefly reviews the data. Section A2 discusses diagnostic tests conducted prior to the econometric analysis, which validate key assumptions and ensure robustness of the regression framework. Section A3 outlines the model and estimation method, aligned within the broader context of the research objectives and related literature. Section A4 presents estimation results alongside interpretation of the findings. Section A5 includes a series of sensitivity analyses designed to assess the robustness of the results across alternative structural break periods and model specifications. For simplicity, the term flows is used throughout this section to denote gross capital inflows. These represent liability-creating financial transactions undertaken by resident entities vis-à-vis non-residents.

A1. Data

The analysis is based on a sample of 36 emerging economies, including 13 from developing Asia. The dataset is constructed at quarterly frequency, spanning the first quarter (Q1) of 1990 to Q4 2024. Table A2.2 details the variable definitions and data sources.

The dependent variable of interest is gross capital inflows, disaggregated by type and expressed as a share of gross domestic product (GDP). This normalization is common in empirical macro-financial studies and facilitates comparability across economies and over time. However, it introduces an important caveat: capital inflows scaled by GDP may exhibit mechanical co-movement with domestic economic activity. That is, if both capital inflows and GDP increase at similar rates due to global cyclical conditions or structural growth, the ratio may understate the actual changes in the financial openness or attractiveness of an economy. This issue has been flagged in the literature as a potential source of misinterpretation when using scaled financial flow variables (see Koepke 2019; ECB 2020). Building on this normalization caveat, the analysis proceeds by examining the determinants of capital inflows. The explanatory variables are organized into two broad categories. Global factors comprise US monetary policy (Wu-Xia shadow federal funds rate), global risk aversion (proxied by VIX), trade policy uncertainty (TPU), and geopolitical risk (GPR). Domestic fundamentals include GDP growth, trade openness, financial development, and institutional quality, proxied by the rule of law.

A2. Statistical Tests

The empirical analysis begins with diagnostic tests to verify key econometric assumptions and enhance the robustness of the framework. Tests for cross-sectional dependence are applied to detect unobserved common factors or interdependencies across economies, while structural break tests are used to identify possible regime shifts that may affect parameter stability. These procedures ensure that the subsequent panel regression analysis rests on a reliable methodological foundation.

A2.1 Cross-Sectional Dependence

Detecting cross-sectional dependence is important for understanding the systemic nature of capital flow linkages. The presence of unobserved common shocks is assessed using the Pesaran test, which helps determine whether latent cross-sectional dependencies remain after controlling for observable global factors. As reported in Table A1.1, the Pesaran tests indicate significant cross-sectional dependence. This violates the assumption of independence across economies, which is critical for the consistency of conventional standard error estimates. Hence, subsequent panel regressions are estimated using Driscoll-Kraay standard errors.

Table A1.1 Pesaran's Cross-Sectional Dependence Test

H_0: No cross-sectional dependence.
H_1: Cross-sectional dependence exists.

	Pesaran Test	P-value	Decision Rule
Portfolio debt	11.14	0.00	Reject the null hypothesis.
Portfolio equity	31.34	0.00	Reject the null hypothesis.
Cross-border loans	17.40	0.00	Reject the null hypothesis.
FDI	39.59	0.00	Reject the null hypothesis.

FDI = foreign direct investment, H = hypothesis.
Source: Authors' estimates.

A2.2 Structural Breaks

The existence of structural breaks is examined using the Bai and Perron (1998) methodology, which has been extended to a panel setting by Ditzen, Karavias, and Westerlund (2024). This approach enables the endogenous identification of multiple breakpoints, allowing detection of data-driven regime shifts in capital flow dynamics. The method splits the time periods into candidate regimes and subsequently estimates the model using ordinary least squares (OLS) and chooses the breakpoints that minimize the sum of squared residuals. The approach is to test multiple structural breaks at unknown dates. Given that the dataset contains a maximum of 140 quarters, a minimum segment length of 20%—equal to 28 quarters—is imposed to ensure adequate temporal coverage between breaks. This constraint defines the shortest permissible interval between two structural changes. Two model specifications are evaluated: one regresses capital flows on a linear time trend, while the other incorporates a set of global and domestic factors, as outlined in section A1. Table A1.2 presents two statistically significant structural breaks, suggesting changes in the underlying dynamics of capital flow responses to relevant factors.

The structural breaks identified with a linear time trend capture broad shifts in emerging market economy (EME) capital flow dynamics over time. As can be seen in Table A1.2, these often align with major global crises or shifts in global financial conditions, notably the period after the 2008/09 global financial crisis, including the US Federal Reserve's (Fed) quantitative easing (QE), which started at the end of 2008 and concluded in late 2014. With some exceptions, the breaks obtained from models with regressors are broadly consistent. In particular, breaks identified in portfolio equity, cross-border loans, and foreign direct investment (FDI) across both types of structural break tests appear to be largely consistent with the period around the start and end of QE, or thereafter when global liquidity conditions tightened. A notable exception relates to portfolio debt. Based on the linear time trend break test, a first break is identified for portfolio debt around the period of the Asian financial crisis in 1997, and a second break around the global financial crisis. Whereas for the break test with global and domestic regressors, the first break is identified at the global financial crisis, and a second around the period after the end of the US Fed's post-global financial crisis quantitative easing policy. Taking all into account, break points at the start and end of QE were applied in the empirical analysis across all types of

Table A1.2 Structural Break Test, by Type of Capital Flow

H_0: No structural break.
H_1: Two structural breaks.

	Linear Trend		Regressors	
	Year-Quarter	t-stat	Year-Quarter	t-stat
Portfolio debt	1997 Q2, 2007 Q3	10.59	2007 Q3, 2016 Q4	2.34
Portfolio equity	2009 Q4, 2019 Q3	2.33	2009 Q4, 2013 Q1	4.57
Cross-border loans	2010 Q3, 2015 Q4	13.10	2010 Q4, 2015 Q4	5.90
FDI	2009 Q4, 2015 Q1	17.35	2009 Q3, 2012 Q4	10.04

FDI = foreign direct investment, H = hypothesis, Q = quarter.
Source: Authors' estimates.

capital flow, as explained in section A3. While a much earlier break may have occurred in 1997 in the case of portfolio debt, this period is part of the first regime for portfolio debt in the baseline estimation.

A3. Regression Framework

The average responsiveness of gross capital inflows to global and domestic factors is examined for a sample of 36 emerging economies across three distinct structural break periods, capturing shifts in the underlying dynamics of capital flow behavior over time. Equation (1) is estimated using a fixed-effects panel regression with OLS, and Driscoll–Kraay standard errors are computed to correct for cross-sectional dependence:

$$y_{i,t} = \alpha + \beta_0 z_{i,t} + \beta_0 x_{i,t} + \sum_{n=1}^{2} \beta_n d_n (1 + z_{i,t} + x_{i,t}) + \rho_i + \varepsilon_{i,t} \quad (1)$$

where the subscripts i and t denote economy and year-quarter period, respectively. The dependent variable y represents a particular type of gross capital inflow—namely, portfolio debt, portfolio equity, cross-border loans, and FDI—as a share of GDP. The vector z captures global factors such as the US Fed rates, global risk aversion, trade policy uncertainty, and geopolitical risk; while x denotes domestic fundamentals such as GDP growth, trade openness, financial development, and rule of law. The term ρ accounts for country fixed-effects, and ε the unaccounted factors.

A key feature of the specification is the inclusion of interaction terms with d, which represent two structural break periods n that are uniformly imposed in estimating all types of capital flows. The uninteracted terms correspond to the remaining period, serving as the base period. Specifically, β_1 captures the pre-QE period from 1990 Q1 to 2008 Q3, β_2 reflects the QE period from 2008 Q4 to 2014 Q4, and β_0 represents the post-QE period from 2015 Q1 to 2024 Q4.[1,2] These temporal distinctions allow identification of shifts in the responsiveness of capital inflows to global and domestic factors across major phases of US monetary policy intervention. The magnitude of each coefficient denotes the expected standard-deviation change in the share of gross capital inflows to GDP for a one-standard-deviation increase in an explanatory variable, while controlling for other variables in the model.

While the present study focuses on cross-economy patterns, economy-specific analyses are equally important in uncovering more granular transmission mechanisms and policy-relevant insights in emerging economies. These are beyond the scope of this analytical chapter and are left for future research.

A4. Baseline Analysis

Figure A1.1 illustrates the results of the estimation of equation (1), revealing shifts in the sensitivity of EME foreign capital inflows to global and domestic drivers across the pre-QE, QE, and post-QE periods.

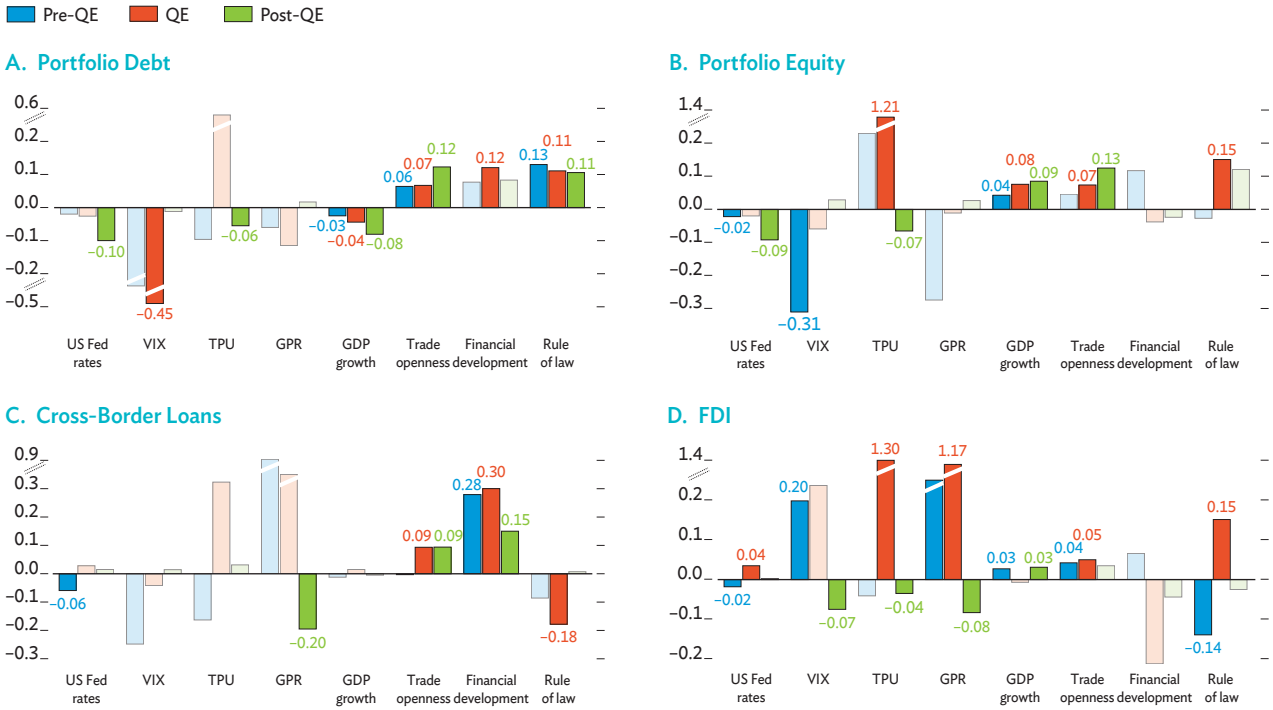
A4.1 Portfolio Debt

In the pre-QE period, trade openness and rule of law are the main significant drivers of portfolio debt inflows, while the effects of global factors during this period are found to be not statistically significant. During the QE period, however, global risk aversion (VIX) exerted a significantly negative effect on portfolio debt inflows (–0.45). Ample global liquidity conditions and lower risk aversion overall during this period triggered inflows of foreign capital from global bond investors. As in the pre-QE period, trade openness and rule of law continued to significantly drive portfolio bond inflows in the QE period, and to a similar extent. In the post-QE period, the effect of the VIX became insignificant, as global bond investors became more sensitive to US monetary policy and, to a lesser extent, TPU. Domestic fundamentals also continued to support inflows, notably in the case of trade openness, where the magnitude of the effect doubled compared to earlier periods. Interestingly, GDP growth displayed a negative association with portfolio debt inflows in all periods. One possible explanation is that rapid output growth was often

1 Table A2.3 provides relevant descriptive statistics by structural break periods.

2 The total marginal effect of a given domestic or global factor on gross capital inflows is equal to $\beta_0 + \beta_1$ in pre-QE period and to $\beta_0 + \beta_2$ in QE period.

Figure A1.1 Changing Sensitivity of Gross Capital Inflows to Global and Domestic Factors



FDI = foreign direct investment, GDP = gross domestic product, GPR = geopolitical risk, TPU = trade policy uncertainty, QE = quantitative easing, VIX = Cboe volatility index.

Notes: Reported are standardized coefficients from a regression of EME gross capital inflows (as a share to GDP) on global and domestic factors during the pre-QE (1990Q1–2008Q3), QE (2008Q4–2014Q4), and post-QE (2015Q1–2024Q4). Coefficients that are statistically significant are shown in dark color, while those that are not statistically significant are shown in faint color. The magnitude of each coefficient denotes the expected standard-deviation change in the share of capital flows to GDP for a one-standard-deviation increase in an explanatory variable, while controlling for other variables in the model. Sample includes 36 EMEs. Table A2.1 provides the list of economies.

Source: Asian Development Bank estimates.

concentrated in economies perceived as riskier, prompting investors to favor economies with stable but moderate growth. Moreover, abundant global liquidity under QE may have compressed risk premiums, leading capital to flow disproportionately toward economies with weaker cyclical positions but greater financing needs, rather than to high-growth economies. An alternative interpretation is that weak growth may be perceived as a signal of monetary easing, with interest rates expected to decline in response to subdued economic activity. Such expectations are favorable for portfolio debt, as falling yields raise bond prices and improve returns for investors.

A4.2 Portfolio Equity

In the pre-QE period, VIX (–0.31) played a dominant role, with elevated volatility strongly deterring equity inflows. Global equity investors during this period also exhibited marginal sensitivity to US Fed rates. Meanwhile, on the domestic side, domestic GDP growth helped to drive inflows. During the QE period, the importance of GDP growth doubled in magnitude, while trade openness and rule of law became statistically significant. Interestingly, TPU emerged as a positive key driver (+1.21) during QE. A possible explanation could be that the very low level of TPU at that time, combined with abundant global liquidity, triggered a reallocation of equity toward EMEs as a diversification strategy. In the post-QE period, GDP growth and trade openness became more important as domestic drivers of portfolio equity inflows, with positive coefficients higher in magnitude than previous periods. In addition, US monetary policy and TPU emerged as the main global factors in the post-QE period, negatively affecting inflows.

A4.3 Cross-Border Loans

In the pre-QE period, US Fed rates significantly and negatively impacted cross-border lending, albeit marginally. This outweighed by the effect of financial development, which exhibited the strongest positive association with foreign lending inflows (+0.28), suggesting that international banks favored economies with deeper and more sophisticated financial systems. Such financial systems are characterized with intermediation channels that can efficiently absorb and allocate credit. The positive effect of financial development (+0.30) maintained during the QE period. Trade openness also became a significant driver, underscoring the role of integration with global markets in attracting bank lending. Interestingly, the rule of law was negatively associated with cross-border loans (–0.18) during QE. This counterintuitive finding could suggest that lenders may have targeted jurisdictions with weaker institutions but higher short-term financing needs, reflecting the opportunistic nature of bank lending under loose global liquidity. In the post-QE period, GPR exerted a dampening effect on foreign lending inflows. During this period of tightening global liquidity conditions, the findings indicates a retrenchment of international banks as geopolitical tensions elevate. Domestic fundamentals such as financial development and trade openness continued to support inflows of cross-border loans during this period.

A4.4 FDI

During the pre-QE period, FDI is countercyclical to shifts in global risk aversion. Financial liberalization was underway during this period in many EMEs, as well as the privatization of state-owned firms. So despite higher VIX, FDI in EMEs may have provided firms with a hedge against volatility in advanced economies, which was made easier given the period of structural reform (growth markets, lower costs, and integration into regional supply chains). During the QE period, both TPU (+1.30) and GPR (+1.17) showed strong positive associations with FDI inflows. Low levels of TPU and GPR during QE could suggest that higher TPU and GPR were associated with a reallocation of investment toward EMEs as a hedge against further potential risks. Other factors may include the lower premium on advanced economies over EMEs during this period given that the global financial crisis originated in advanced economies, as well as the growing integration of EMEs in the global trade system. Abundant global liquidity conditions due to QE reinforced the feasibility of longer-term FDI projects in EMEs. Trade openness and rule of law also positively affected FDI during QE. During the post-QE period, FDI, the VIX, TPU and GPR are negatively related with FDI inflows, and to a similar extent. Meanwhile, domestic fundamentals did not always show statistically significant effects during this period, with only domestic GDP growth significantly driving FDI inflows.

A5. Robustness and Sensitivity Analyses

To assess the robustness of the baseline regression results in section A4, two supplementary sensitivity analyses are conducted. First, the model is re-estimated using alternative sets of endogenously identified structural breaks based on the Bai-Perron methodology as discussed in section A2.2. This approach tests whether the timing of regime changes affect the estimated relationships between capital inflows and their determinants. Second, the baseline model is augmented to incorporate measures of macroeconomic stability, defined as the 12-quarter rolling standard deviation and coefficient of variation of GDP growth, inflation, and exchange rate (USD per local currency unit). Both extensions provide a more nuanced understanding of the resilience and sensitivity of capital inflow dynamics under varying global and domestic fundamentals.

A5.1 Endogenously Identified Structural Breaks

Each specification in Table A2.4 is presented first in a baseline model, followed by robustness checks. The latter re-estimates equation (1) while incorporating the structural break periods endogenously identified in Table A1.2—one with a linear time trend and another with the full set of regressors.

The sensitivity analyses broadly reinforce the baseline findings for the post-QE period. Even though certain coefficients, such as TPU in select specifications, lose significance, the core relationships remain robust. Global factors continue to exert consistent negative

effects across all types of capital inflows, except for the US Fed rates which exhibit positive effects on cross-border loans. Moreover, the results affirm the resilience of rule of law in supporting portfolio debt inflows; the robustness of domestic growth and trade openness in sustaining portfolio equity inflows; the consistent role of trade openness in facilitating cross-border loans; and the persistent relevance of domestic growth in attracting FDI.

A5.1.1 Portfolio Debt

In the baseline estimation, US Fed rates and TPU have a negative and significant relationship with portfolio debt inflows, although the significance of these effects does not always hold across other specifications. Meanwhile GDP growth has a negative effect on inflows in the baseline, which remains consistent across other break models. Rule of law and trade openness showed a positive and significant relationship, significant in baseline and in line with sensitivity analyses. Overall, the robustness checks confirm the broad direction of results, although magnitudes fluctuate.

A5.1.2 Portfolio Equity

US Fed rates and TPU significantly and negatively affect portfolio equity inflows in the baseline, which remains consistent across other models. The exception is US Fed rates in the model with regressors, which loses significance, although the direction of the effect remains in line. Domestic GDP growth and trade openness are strongly positive and significant across all models, underscoring their importance in attracting foreign equity investment.

A5.1.3 Cross-Border Loans

In the baseline, GPR exerted a significant and negative effect on cross-border loans, highlighting the vulnerability of loan-based financing from abroad to geopolitical shocks. Meanwhile, no significant effect is found for the VIX or TPU in the baseline, fully consistent across other models. In addition, trade openness remains consistent as a significant driver of foreign lending inflows in all specifications, while the lack of significance for GDP growth and rule of law holds across models.

A5.1.4 FDI

For FDI inflows, VIX is consistently negative and significant across all specifications. GPR and TPU are negative and significant, consistent across the majority of cases. On domestic factors, GDP growth emerged as the main driver of FDI inflows in the baseline, although with an effect lower in magnitude than global factors. This pattern holds across other models, with some differences in significance. The relationships between FDI inflows and other global and domestic factors are fully consistent.

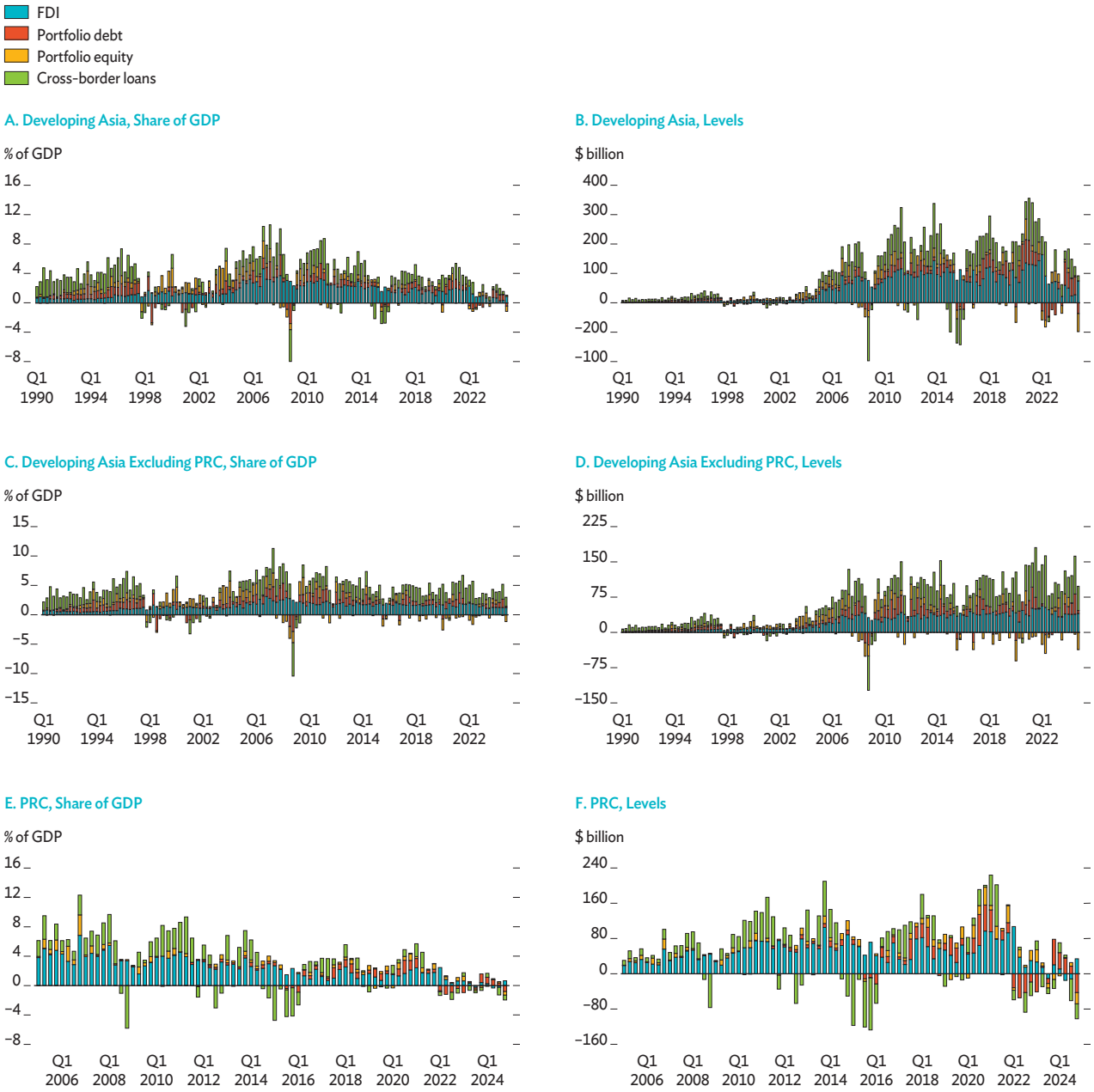
A5.2 Volatility Measures

The inclusion of macroeconomic volatility measures such as inflation, GDP growth, and exchange rate did not alter the main baseline finding in the post-QE period. For portfolio flows, US Fed rates and TPU remained negative, and trade openness continued to attract inflows. GDP growth effects diverged robustly between portfolio debt (negative) and portfolio equity (positive), emphasizing the structural difference in how these flows respond to domestic fundamentals. Unlike portfolio flows, US Fed rates did not significantly influence either cross-border loans or FDI. This reflects the longer maturity and relationship-based nature of these flows, which are less sensitive to short-term interest rate differentials.

This comparison underscores the heterogeneous nature of capital inflows: while portfolio flows are driven by global factors, cross-border loans and FDI hinge more on domestic institutions, stability, and long-term fundamentals. See Tables A2.5–A2.8.

Appendix Figures

Figure A2.1 Gross Capital Inflows



PRC = People's Republic of China, FDI = foreign direct investment, GDP = gross domestic product, Q = quarter.

Notes: Aggregate figures are GDP-weighted averages. Cross-border loans (or other investment) includes loans, currency, and deposits from banks and other financial institutions. The sample for developing Asia includes 36 economies. PRC data available from 2005. Table A2.1 provides the list of economies.

Sources: Asian Development Bank estimates using International Monetary Fund Balance of Payments Statistics and Oxford Economics Forecasting data.

Appendix Tables

Table A2.1 Economies

Emerging Market Economies		Developing Asia	Advanced Economies	Economies in the Empirical Analysis
Afghanistan	Mauritania	Afghanistan	Australia	Azerbaijan
Albania	Mauritius	Armenia	Austria	Bolivia
Algeria	Mexico	Azerbaijan	Belgium	Brazil
Angola	Moldova	Bangladesh	Canada	Bulgaria
Argentina	Mongolia	Bhutan	Croatia	Chile
Armenia	Montenegro	Brunei Darussalam	Cyprus	Colombia
Azerbaijan	Morocco	Cambodia	Czechia	Ecuador
Bahamas	Mozambique	Fiji	Denmark	Georgia
Bangladesh	Myanmar	Georgia	Estonia	Hungary
Belarus	Namibia	India	Finland	India
Belize	Nepal	Indonesia	France	Indonesia
Bhutan	Nicaragua	Kazakhstan	Germany	Jordan
Bolivia	Nigeria	Kiribati	Greece	Kazakhstan
Bosnia and Herzegovina	North Macedonia	Kyrgyz Republic	Iceland	Malaysia
Brazil	Pakistan	Lao PDR	Israel	Mauritius
Brunei Darussalam	Panama	Malaysia	Italy	Mexico
Bulgaria	Papua New Guinea	Mongolia	Japan	Moldova
Cabo Verde	Paraguay	Myanmar	Latvia	Mozambique
Cambodia	People's Rep. of China	Nepal	Lithuania	North Macedonia
Cameroon	Peru	Pakistan	Malta	Pakistan
Chile	Philippines	Papua New Guinea	New Zealand	Panama
Colombia	Poland	People's Rep. of China	Norway	People's Rep. of China
Costa Rica	Qatar	Philippines	Portugal	Peru
Dominican Republic	Republic of Korea	Republic of Korea	Slovak Republic	Philippines
Ecuador	Romania	Samoa	Slovenia	Poland
Egypt, Arab Rep.	Russian Federation	Solomon Islands	Spain	Republic of Korea
El Salvador	Rwanda	Sri Lanka	Sweden	Romania
Eswatini	Samoa	Taipei,China	United Kingdom	Russian Federation
Ethiopia	Sao Tome and Principe	Tajikistan	United States	Seychelles
Fiji	Saudi Arabia	Thailand		South Africa
Gambia, The	Serbia	Timor-Leste		Thailand
Georgia	Seychelles	Tonga		Türkiye
Ghana	Solomon Islands	Türkiye		Uganda
Guatemala	South Africa	Uzbekistan		Ukraine
Guinea	Sri Lanka	Vanuatu		Uruguay
Guyana	Sudan	Viet Nam		Viet Nam
Haiti	Suriname			
Honduras	Taipei,China			
Hungary	Tajikistan			
India	Tanzania			
Indonesia	Thailand			
Iraq	Timor-Leste			
Jamaica	Tonga			
Jordan	Trinidad and Tobago			
Kazakhstan	Tunisia			
Kiribati	Türkiye			
Kuwait	Uganda			
Kyrgyz Republic	Ukraine			
Lao PDR	Uruguay			
Lebanon	Uzbekistan			
Lesotho	Vanuatu			
Liberia	Viet Nam			
Madagascar	Zambia			
Malaysia				

Lao PDR = Lao People's Democratic Republic.
Source: Authors' compilation.

Table A2.2 Data and Data Sources

Variable	Description	Source
Portfolio debt inflows	Portfolio debt (liabilities), $ million, quarterly	IMF Balance of Payment Statistics, CEIC Data Company
Portfolio equity inflows	Portfolio equity (liabilities), $ million, quarterly	IMF Balance of Payment Statistics, CEIC Data Company
Cross-border loans	Other investment (liabilities), $ million, quarterly	IMF Balance of Payment Statistics, CEIC Data Company
FDI inflows	Direct investment (liabilities), $ million, quarterly	IMF Balance of Payment Statistics, CEIC Data Company
Nominal GDP	GDP (current market prices), $ million, quarterly	Oxford Economics Forecasting, CEIC Data Company
US Fed rates	US Federal funds rate, %, quarterly	Wu-Xia Federal funds rate
VIX	Cboe Market Volatility index, quarterly	Bloomberg
TPU	Trade Policy Uncertainty index, quarterly	Caldara et al, 2020
GPR	Geopolitical Risk index, quarterly	Caldara and Iacoviello, 2022
GDP growth	Real GDP growth rate (seasonally adjusted), % year on year, quarterly	CEIC Data Company
Trade openness	Sum of exports of goods and services, % of GDP, annual	World Bank World Development Indicators
Financial development	Financial development index, annual	IMF
Rule of law	World Governance Index, annual	World Bank Worldwide Governance Indicators
Macro stability	Volatility measures of GDP growth, inflation rate, and exchange rate, quarterly	Authors' estimates using data from CEIC Data Company

FDI = foreign direct investment, GDP = gross domestic product, GPR = geopolitical risk, IMF = International Monetary Fund, TPU = trade policy uncertainty, VIX = Cboe volatility index.

Note: Gross inflows refers to net incurrence of liabilities by residents to non-resident investors.

Source: Authors' compilation.

Table A2.3 Descriptive Statistics, by Structural Break Period

	Period	Obs	Mean	Std. dev.	Min	Max
Dependent variables						
Portfolio debt (% of GDP)	Overall	4,218	0.86	5.10	−66.11	124.43
	Pre-QE	1,925	0.74	5.05	−62.87	124.15
	QE	900	1.15	3.33	−20.29	23.44
	Post-QE	1,393	0.85	6.03	−66.11	124.43
Portfolio equity (% of GDP)	Overall	4,218	0.47	5.50	−88.29	205.17
	Pre-QE	1,925	0.36	1.34	−13.21	12.64
	QE	900	0.85	6.55	−10.76	124.58
	Post-QE	1,393	0.39	7.82	−88.29	205.17
Cross-border loans (% of GDP)	Overall	4,303	2.07	9.41	−154.33	142.90
	Pre-QE	1,970	2.03	8.19	−154.33	53.56
	QE	900	1.18	10.48	−106.85	39.47
	Post-QE	1,433	2.68	10.20	−67.16	142.90
FDI (% of GDP)	Overall	4,303	5.77	26.02	−311.35	565.14
	Pre-QE	1,970	4.18	6.93	−6.87	86.63
	QE	900	10.06	46.48	−59.53	565.14
	Post-QE	1,433	5.24	24.41	−311.35	400.04
Global factors						
D.US Fed rates (%)	Overall	4,291	−0.01	0.56	−1.73	1.73
	Pre-QE	1,958	−0.08	0.52	−1.33	1.00
	QE	900	−0.19	0.39	−1.73	0.45
	Post-QE	1,433	0.19	0.62	−1.06	1.73
VIX (logs)	Overall	4,303	2.93	0.32	2.31	3.95
	Pre-QE	1,970	2.92	0.31	2.42	3.60
	QE	900	3.03	0.37	2.50	3.95
	Post-QE	1,433	2.87	0.30	2.31	3.62
TPU (logs)	Overall	4,303	3.70	0.54	3.03	5.47
	Pre-QE	1,970	3.47	0.21	3.10	4.29
	QE	900	3.28	0.12	3.03	3.55
	Post-QE	1,433	4.27	0.55	3.19	5.47
GPR (logs)	Overall	4,303	4.57	0.32	3.84	5.86
	Pre-QE	1,970	4.56	0.41	3.84	5.86
	QE	900	4.45	0.12	4.30	4.91
	Post-QE	1,433	4.64	0.24	4.24	5.41
Domestic factors						
D.GDP growth (% yoy)	Overall	4,189	0.00	3.86	−33.13	50.02
	Pre-QE	1,864	0.05	3.03	−30.69	50.02
	QE	900	−0.07	2.53	−12.88	11.13
	Post-QE	1,425	−0.01	5.28	−33.13	49.90
D.Trade openness (% of GDP)	Overall	4,152	0.13	4.06	−35.46	40.19
	Pre-QE	1,956	0.41	3.68	−35.46	40.19
	QE	900	−0.28	4.26	−32.00	21.53
	Post-QE	1,296	−0.02	4.42	−29.65	30.29
Financial development	Overall	3,878	0.35	0.16	0.07	0.85
	Pre-QE	1,970	0.32	0.15	0.07	0.82
	QE	900	0.37	0.17	0.08	0.85
	Post-QE	1,008	0.40	0.17	0.09	0.85
Rule of law	Overall	3,430	−0.16	0.59	−1.30	1.35
	Pre-QE	1,234	−0.20	0.62	−1.22	1.26
	QE	900	−0.15	0.59	−1.21	1.35
	Post-QE	1,296	−0.14	0.56	−1.30	1.25

D = first difference, FDI = foreign direct investment, GDP = gross domestic product, GPR = geopolitical risk, logs = natural logarithms, QE = quantitative easing, std dev = standard deviation, TPU = trade policy uncertainty, VIX = Cboe volatility index, yoy = year on year.

Source: Asian Development Bank estimates.

Table A2.4 Panel Estimation Results, by Category of Structural Break Periods

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
	Portfolio Debt			Portfolio Equity			Cross-Border Loans			FDI		
	Baseline	Linear Trend	Regressors	Baseline	Linear Trend	Regressors	Baseline	Linear Trend	Regressors	Baseline	Linear Trend	Regressors
Pre-QE period												
US Fed rates	−0.020	−0.007	−0.009	−0.022**	−0.009	−0.001	−0.059***	−0.055**	−0.055**	−0.018**	−0.009	−0.011
	(0.030)	(0.028)	(0.043)	(0.010)	(0.014)	(0.010)	(0.018)	(0.023)	(0.023)	(0.008)	(0.010)	(0.009)
VIX	−0.327	−0.447***	−0.413*	−0.310**	−0.544***	−0.357**	−0.248	−0.463***	−0.462***	0.198***	0.229***	0.145**
	(0.251)	(0.133)	(0.211)	(0.141)	(0.170)	(0.143)	(0.156)	(0.142)	(0.143)	(0.068)	(0.062)	(0.067)
TPU	−0.096	−0.120**	0.111	0.230	0.162	0.069	−0.163	0.240	0.242	−0.041	0.024	−0.007
	(0.175)	(0.056)	(0.257)	(0.153)	(0.120)	(0.152)	(0.327)	(0.367)	(0.366)	(0.108)	(0.137)	(0.149)
GPR	−0.060	0.321***	−0.421	−0.274	−0.642*	−0.035	0.867	1.348***	1.339***	0.420*	0.420*	0.021
	(0.597)	(0.085)	(0.739)	(0.371)	(0.375)	(0.280)	(0.549)	(0.510)	(0.507)	(0.238)	(0.233)	(0.305)
GDP growth	−0.025*	−0.026*	−0.024*	0.043***	0.047***	0.049***	−0.012	−0.011	−0.011	0.027***	0.018*	0.013
	(0.013)	(0.014)	(0.014)	(0.011)	(0.012)	(0.013)	(0.021)	(0.024)	(0.024)	(0.009)	(0.011)	(0.012)
Trade openness	0.064**	0.038	0.098***	0.046	0.057***	0.027	−0.003	0.033	0.033	0.042**	0.032**	0.033**
	(0.032)	(0.029)	(0.032)	(0.033)	(0.021)	(0.025)	(0.016)	(0.031)	(0.031)	(0.018)	(0.015)	(0.015)
Financial development	0.077	0.141**	0.068	0.117	0.160*	0.117	0.279**	0.227**	0.229**	0.066	0.072	0.072
	(0.063)	(0.069)	(0.069)	(0.099)	(0.096)	(0.096)	(0.114)	(0.101)	(0.099)	(0.089)	(0.087)	(0.088)
Rule of law	0.130***	0.117***	0.153***	−0.027	0.065	−0.054	−0.086	−0.057	−0.059	−0.139***	−0.145***	−0.135***
	(0.042)	(0.044)	(0.046)	(0.045)	(0.070)	(0.054)	(0.079)	(0.079)	(0.079)	(0.052)	(0.052)	(0.051)
QE period												
US Fed rates	−0.026	0.019	−0.010	−0.020	−0.080**	−0.083**	0.028	0.056*	0.058**	0.035***	0.009	0.033
	(0.021)	(0.040)	(0.026)	(0.020)	(0.036)	(0.034)	(0.028)	(0.029)	(0.029)	(0.013)	(0.015)	(0.023)
VIX	−0.450***	−0.031	−0.549***	−0.059	−0.044	−0.105	−0.042	−0.086	−0.157	0.237	0.462**	−0.029
	(0.168)	(0.211)	(0.172)	(0.162)	(0.219)	(0.203)	(0.163)	(0.220)	(0.165)	(0.148)	(0.185)	(0.201)
TPU	0.577	−0.034	−0.416**	1.213**	0.041	0.243	0.323	−0.491	−0.486	1.358***	1.068**	1.173***
	(0.415)	(0.179)	(0.173)	(0.547)	(0.096)	(0.334)	(0.603)	(0.331)	(0.326)	(0.423)	(0.425)	(0.190)
GPR	−0.115	0.881*	−1.243	−0.011	−0.599	0.289	0.629	0.315	0.413	1.173**	0.959*	0.124
	(0.607)	(0.514)	(0.756)	(0.379)	(0.443)	(0.569)	(0.591)	(0.463)	(0.455)	(0.560)	(0.527)	(0.664)
GDP growth	−0.044***	−0.027*	−0.042***	0.076***	0.067***	0.068***	0.015	0.038*	0.041**	−0.007	−0.009	0.015
	(0.016)	(0.015)	(0.015)	(0.018)	(0.020)	(0.021)	(0.028)	(0.021)	(0.021)	(0.019)	(0.023)	(0.016)
Trade openness	0.067**	0.058**	0.068***	0.074**	0.117***	0.071	0.093**	0.068**	0.068**	0.050***	0.039**	0.032
	(0.032)	(0.029)	(0.025)	(0.031)	(0.024)	(0.044)	(0.037)	(0.029)	(0.029)	(0.014)	(0.017)	(0.021)
Financial development	0.121*	0.098	0.108	−0.038	0.036	−0.113	0.300***	0.322***	0.321***	−0.212	−0.247	−0.300**
	(0.073)	(0.076)	(0.075)	(0.132)	(0.119)	(0.130)	(0.096)	(0.094)	(0.095)	(0.159)	(0.153)	(0.147)
Rule of law	0.111***	0.140***	0.127***	0.151***	0.220***	0.203***	−0.178**	−0.190**	−0.193**	0.151*	0.180**	0.235***
	(0.043)	(0.049)	(0.044)	(0.053)	(0.060)	(0.062)	(0.088)	(0.086)	(0.087)	(0.082)	(0.079)	(0.080)
Post–QE period												
US Fed rates	−0.100***	0.006	−0.059	−0.092***	−0.105**	−0.046	0.015	0.070**	0.070**	0.002	0.002	−0.005
	(0.034)	(0.035)	(0.058)	(0.028)	(0.050)	(0.029)	(0.041)	(0.028)	(0.028)	(0.015)	(0.015)	(0.019)
VIX	−0.012	−0.084**	0.015	0.029	0.099**	0.045	0.014	0.021	0.021	−0.075***	−0.075***	−0.050***
	(0.052)	(0.035)	(0.040)	(0.043)	(0.049)	(0.041)	(0.018)	(0.016)	(0.016)	(0.015)	(0.015)	(0.018)
TPU	−0.055**	−0.041**	−0.093	−0.065***	−0.059*	−0.024*	0.031	0.001	0.001	−0.035**	−0.035**	−0.022
	(0.023)	(0.017)	(0.064)	(0.021)	(0.032)	(0.014)	(0.024)	(0.029)	(0.029)	(0.014)	(0.014)	(0.014)
GPR	0.017	−0.126	0.075	0.027	0.082	−0.011	−0.195**	−0.256***	−0.256***	−0.083**	−0.083**	−0.021
	(0.086)	(0.078)	(0.107)	(0.051)	(0.054)	(0.039)	(0.082)	(0.076)	(0.076)	(0.034)	(0.034)	(0.046)
GDP growth	−0.081***	−0.055***	−0.080***	0.085***	0.090***	0.093***	−0.005	−0.002	−0.002	0.031**	0.031**	0.019
	(0.016)	(0.019)	(0.016)	(0.021)	(0.023)	(0.026)	(0.016)	(0.018)	(0.018)	(0.014)	(0.014)	(0.016)
Trade openness	0.123*	0.065	0.177***	0.125*	0.229***	0.107*	0.094***	0.094***	0.094***	0.035	0.035	0.038
	(0.065)	(0.044)	(0.061)	(0.065)	(0.051)	(0.064)	(0.029)	(0.034)	(0.034)	(0.023)	(0.023)	(0.024)
Financial development	0.083	0.125*	0.062	−0.024	−0.130*	−0.003	0.150**	0.105	0.105	−0.044	−0.042	−0.048
	(0.060)	(0.072)	(0.064)	(0.076)	(0.066)	(0.076)	(0.071)	(0.069)	(0.069)	(0.092)	(0.090)	(0.093)
Rule of law	0.106*	0.124***	0.161**	0.121	0.445**	0.066	0.007	0.072	0.071	−0.025	−0.026	−0.008
	(0.060)	(0.045)	(0.071)	(0.087)	(0.192)	(0.060)	(0.111)	(0.112)	(0.112)	(0.059)	(0.059)	(0.061)
Observations	3,061	3,061	3,061	3,061	3,061	3,061	3,107	3,107	3,107	3,107	3,107	3,107
Number of EMEs	36	36	36	36	36	36	36	36	36	36	36	36
R2 within	0.0326	0.0222	0.0346	0.0302	0.0416	0.0415	0.0386	0.0500	0.0521	0.0441	0.0547	0.0649

EMEs = emerging market economies, FDI = foreign direct investment, GDP = gross domestic product, GPR, geopolitical risk, QE = quantitative easing, TPU = trade policy uncertainty, VIX = Cboe volatility index.

Notes: Driscol-Kraay standard errors in parentheses. Significance levels: *** p<0.01, ** p<0.05, * p<0.1. Reported are standardized coefficients from a regression of EME gross capital inflows (as a share to GDP) on global and domestic factors during the pre-QE (1990Q1–2008Q3), QE (2008Q4–2014Q4), and post-QE (2015Q1–2024Q4). The magnitude of each coefficient denotes the expected standard-deviation change in the share of capital flows to GDP for a one-standard-deviation increase in an explanatory variable, while controlling for other variables in the model. Sample includes 36 EMEs.

Source: Asian Development Bank estimates.

Table A2.5 Drivers of Portfolio Debt Inflows to Emerging Market Economies

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	Baseline	Inflation Rate	Inflation Rate	GDP Growth	GDP Growth	Exchange Rate	Exchange Rate
		Std Dev	COV	Std Dev	COV	Std Dev	COV
Pre-QE period							
US Fed rates	−0.020	−0.022	−0.023	−0.019	−0.019	−0.016	−0.019
	(0.030)	(0.030)	(0.030)	(0.033)	(0.031)	(0.032)	(0.030)
VIX	−0.327	−0.330	−0.347	−0.314	−0.321	−0.280	−0.327
	(0.251)	(0.248)	(0.250)	(0.265)	(0.248)	(0.261)	(0.245)
TPU	−0.096	−0.103	−0.128	−0.129	−0.093	−0.041	−0.054
	(0.175)	(0.170)	(0.181)	(0.165)	(0.174)	(0.178)	(0.176)
GPR	−0.060	−0.038	−0.041	−0.162	−0.002	−0.090	−0.198
	(0.597)	(0.592)	(0.594)	(0.544)	(0.600)	(0.593)	(0.593)
GDP growth	−0.025*	−0.026**	−0.024*	−0.026**	−0.023*	−0.023*	−0.024*
	(0.013)	(0.013)	(0.013)	(0.013)	(0.014)	(0.014)	(0.013)
Trade openness	0.064**	0.065**	0.063*	0.062*	0.064*	0.066**	0.068**
	(0.032)	(0.033)	(0.032)	(0.032)	(0.032)	(0.033)	(0.032)
Financial development	0.077	0.082	0.076	0.064	0.078	0.079	0.075
	(0.063)	(0.062)	(0.063)	(0.053)	(0.061)	(0.063)	(0.062)
Rule of law	0.130***	0.119***	0.131***	0.132***	0.127***	0.126***	0.129***
	(0.042)	(0.041)	(0.042)	(0.047)	(0.042)	(0.043)	(0.042)
Macro stability control[a]		0.068***	0.028*	0.002	−0.024	−0.055	0.002
		(0.017)	(0.016)	(0.028)	(0.019)	(0.046)	(0.025)
QE period							
US Fed rates	−0.026	−0.024	−0.025	−0.024	−0.023	−0.025	−0.022
	(0.021)	(0.022)	(0.021)	(0.025)	(0.023)	(0.021)	(0.022)
VIX	−0.450***	−0.422**	−0.452***	−0.462***	−0.447***	−0.448***	−0.422**
	(0.168)	(0.175)	(0.168)	(0.169)	(0.166)	(0.169)	(0.171)
TPU	0.577	0.611	0.581	0.522	0.604	0.587	0.613
	(0.415)	(0.434)	(0.414)	(0.407)	(0.428)	(0.416)	(0.423)
GPR	−0.115	−0.098	−0.089	−0.223	−0.057	−0.109	−0.201
	(0.607)	(0.601)	(0.608)	(0.578)	(0.610)	(0.606)	(0.600)
GDP growth	−0.044***	−0.042***	−0.043***	−0.046***	−0.041**	−0.043***	−0.042***
	(0.016)	(0.016)	(0.016)	(0.015)	(0.018)	(0.016)	(0.015)
Trade openness	0.067**	0.067**	0.067**	0.064**	0.067**	0.067**	0.072**
	(0.032)	(0.031)	(0.031)	(0.032)	(0.032)	(0.032)	(0.030)
Financial development	0.121*	0.116	0.118	0.109*	0.122*	0.128*	0.123*
	(0.073)	(0.072)	(0.073)	(0.063)	(0.072)	(0.073)	(0.072)
Rule of law	0.111***	0.099**	0.113***	0.115**	0.107**	0.111***	0.110***
	(0.043)	(0.044)	(0.042)	(0.047)	(0.042)	(0.042)	(0.042)
Macro stability control[a]		−3.414*	0.008	0.032	−0.028	−0.002	−0.186***
		(1.901)	(0.013)	(0.055)	(0.034)	(0.044)	(0.048)
Post-QE period							
US Fed rates	−0.100***	−0.098***	−0.099***	−0.094**	−0.095**	−0.100***	−0.095***
	(0.034)	(0.034)	(0.034)	(0.042)	(0.037)	(0.034)	(0.035)
VIX	−0.012	−0.014	−0.011	−0.017	−0.014	−0.012	−0.011
	(0.052)	(0.052)	(0.051)	(0.052)	(0.051)	(0.051)	(0.049)
TPU	−0.055**	−0.054**	−0.054**	−0.046*	−0.056**	−0.055**	−0.069***
	(0.023)	(0.023)	(0.023)	(0.027)	(0.023)	(0.024)	(0.024)
GPR	0.017	0.019	0.014	0.033	0.009	0.017	0.038
	(0.086)	(0.085)	(0.085)	(0.077)	(0.086)	(0.086)	(0.086)
GDP growth	−0.081***	−0.081***	−0.081***	−0.083***	−0.079***	−0.081***	−0.081***
	(0.016)	(0.016)	(0.016)	(0.014)	(0.021)	(0.016)	(0.016)
Trade openness	0.123*	0.123*	0.123*	0.119*	0.123*	0.123*	0.132**
	(0.065)	(0.064)	(0.065)	(0.066)	(0.065)	(0.065)	(0.062)
Financial development	0.083	0.081	0.080	0.077	0.089	0.092	0.087
	(0.060)	(0.059)	(0.060)	(0.059)	(0.060)	(0.061)	(0.059)
Rule of law	0.106*	0.090	0.108*	0.109*	0.099*	0.106*	0.096
	(0.060)	(0.064)	(0.060)	(0.064)	(0.056)	(0.060)	(0.059)
Macro stability control[a]		−3.421*	0.012***	0.034	−0.077	0.011	−0.209***
		(1.904)	(0.004)	(0.096)	(0.054)	(0.050)	(0.039)
Observations	3,061	3,059	3,059	3,061	3,061	3,061	3,061
Number of EMEs	36	36	36	36	36	36	36
R2 within	0.0326	0.0340	0.0333	0.0330	0.0361	0.0347	0.0347

COV = coefficient of variation, EMEs = emerging market economies, GDP = gross domestic product, GPR = geopolitical risks, QE = quantitative easing, std dev = standard deviation, TPU = trade policy uncertainty, VIX = Cboe volatility index.

[a] Macro stability control refers to specifications that include measures of volatility for inflation, GDP growth, and exchange rates.

Notes: Driscol-Kraay standard errors in parentheses. Significance levels: *** p<0.01, ** p<0.05, * p<0.1. Reported are standardized coefficients from a regression of EME gross capital inflows (as a share to GDP) on global and domestic factors during the pre-QE (1990Q1–2008Q3), QE (2008Q4–2014Q4), and post-QE (2015Q1–2024Q4). The magnitude of each coefficient denotes the expected standard-deviation change in the share of capital flows to GDP for a one-standard-deviation increase in an explanatory variable, while controlling for other variables in the model. Sample includes 36 EMEs.

Source: Asian Development Bank estimates.

Table A2.6 Drivers of Portfolio Equity Inflows to Emerging Market Economies

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	Baseline	Inflation Rate Std Dev	Inflation Rate COV	GDP Growth Std Dev	GDP Growth COV	Exchange Rate Std Dev	Exchange Rate COV
Pre-QE period							
US Fed rates	−0.022**	−0.023**	−0.023**	−0.016	−0.021**	−0.021**	−0.023**
	(0.010)	(0.010)	(0.011)	(0.010)	(0.010)	(0.011)	(0.010)
VIX	−0.310**	−0.320**	−0.318**	−0.235	−0.306**	−0.300**	−0.319**
	(0.141)	(0.145)	(0.142)	(0.144)	(0.139)	(0.141)	(0.145)
TPU	0.230	0.231	0.227	0.102	0.232	0.242	0.218
	(0.153)	(0.155)	(0.153)	(0.109)	(0.154)	(0.153)	(0.138)
GPR	−0.274	−0.256	−0.266	−0.790	−0.231	−0.280	−0.255
	(0.371)	(0.359)	(0.373)	(0.687)	(0.371)	(0.372)	(0.345)
GDP growth	0.043***	0.042***	0.043***	0.039***	0.044***	0.043***	0.043***
	(0.011)	(0.011)	(0.011)	(0.012)	(0.009)	(0.011)	(0.011)
Trade openness	0.046	0.047	0.047	0.040	0.046	0.047	0.046
	(0.033)	(0.033)	(0.033)	(0.032)	(0.033)	(0.032)	(0.032)
Financial development	0.117	0.121	0.115	0.094	0.117	0.119	0.119
	(0.099)	(0.102)	(0.099)	(0.069)	(0.099)	(0.099)	(0.099)
Rule of law	−0.027	−0.021	−0.023	−0.019	−0.029	−0.029	−0.025
	(0.045)	(0.044)	(0.042)	(0.047)	(0.045)	(0.045)	(0.043)
Macro stability control[a]		0.010	0.002	0.022	−0.018	−0.009	0.010
		(0.010)	(0.007)	(0.017)	(0.021)	(0.007)	(0.012)
QE period							
US Fed rates	−0.020	−0.022	−0.022	0.006	−0.018	−0.020	−0.020
	(0.020)	(0.020)	(0.020)	(0.022)	(0.019)	(0.020)	(0.020)
VIX	−0.059	−0.089	−0.068	0.131	−0.056	−0.059	−0.046
	(0.162)	(0.167)	(0.161)	(0.201)	(0.161)	(0.162)	(0.168)
TPU	1.213**	1.174**	1.157**	1.316*	1.221**	1.210**	1.216**
	(0.547)	(0.522)	(0.530)	(0.711)	(0.554)	(0.549)	(0.557)
GPR	−0.011	−0.034	−0.097	−0.321	0.026	−0.011	0.002
	(0.379)	(0.375)	(0.387)	(0.655)	(0.379)	(0.381)	(0.376)
GDP growth	0.076***	0.075***	0.076***	0.076***	0.077***	0.076***	0.076***
	(0.018)	(0.018)	(0.018)	(0.020)	(0.015)	(0.018)	(0.018)
Trade openness	0.074**	0.072**	0.071**	0.069**	0.074**	0.074**	0.074**
	(0.031)	(0.031)	(0.030)	(0.028)	(0.031)	(0.031)	(0.029)
Financial development	−0.038	−0.026	−0.030	−0.057	−0.038	−0.036	−0.037
	(0.132)	(0.135)	(0.133)	(0.099)	(0.133)	(0.133)	(0.132)
Rule of law	0.151***	0.159***	0.153***	0.153***	0.148***	0.151***	0.154***
	(0.053)	(0.054)	(0.055)	(0.051)	(0.053)	(0.052)	(0.058)
Macro stability control[a]		1.990	0.042***	−0.011	−0.029	0.016	0.004
		(2.798)	(0.016)	(0.078)	(0.039)	(0.026)	(0.067)
Post-QE period							
US Fed rates	−0.092***	−0.093***	−0.092***	−0.059*	−0.088***	−0.092***	−0.092***
	(0.028)	(0.029)	(0.028)	(0.030)	(0.026)	(0.028)	(0.029)
VIX	0.029	0.030	0.029	0.003	0.028	0.029	0.029
	(0.043)	(0.044)	(0.043)	(0.042)	(0.043)	(0.043)	(0.043)
TPU	−0.065***	−0.065***	−0.065***	−0.022	−0.065***	−0.064***	−0.064***
	(0.021)	(0.021)	(0.021)	(0.029)	(0.021)	(0.021)	(0.021)
GPR	0.027	0.026	0.027	0.107	0.021	0.027	0.026
	(0.051)	(0.050)	(0.052)	(0.101)	(0.051)	(0.051)	(0.048)
GDP growth	0.085***	0.084***	0.085***	0.075***	0.087***	0.085***	0.085***
	(0.021)	(0.021)	(0.021)	(0.024)	(0.015)	(0.021)	(0.021)
Trade openness	0.125*	0.124*	0.125*	0.106*	0.125*	0.125*	0.125*
	(0.065)	(0.066)	(0.066)	(0.063)	(0.066)	(0.065)	(0.063)
Financial development	−0.024	−0.019	−0.026	−0.021	−0.021	−0.022	−0.022
	(0.076)	(0.082)	(0.076)	(0.063)	(0.076)	(0.076)	(0.075)
Rule of law	0.121	0.131	0.126	0.126	0.115	0.120	0.123
	(0.087)	(0.094)	(0.088)	(0.099)	(0.088)	(0.088)	(0.088)
Macro stability control[a]		1.982	0.001	0.166*	−0.057	0.017	0.015
		(2.816)	(0.002)	(0.087)	(0.065)	(0.028)	(0.062)
Observations	3,061	3,059	3,059	3,061	3,061	3,061	3,061
Number of EMEs	36	36	36	36	36	36	36
R2 within	0.0302	0.0306	0.0310	0.0382	0.0316	0.0303	0.0303

COV = coefficient of variation, EMEs = emerging market economies, GDP = gross domestic product, GPR = geopolitical risks, QE = quantitative easing, std dev = standard deviation, TPU = trade policy uncertainty, VIX = Cboe volatility index.

[a] Macro stability control refers to specifications that include measures of volatility for inflation, GDP growth, and exchange rates.

Notes: Driscol-Kraay standard errors in parentheses. Significance levels: *** p<0.01, ** p<0.05, * p<0.1. Reported are standardized coefficients from a regression of EME gross capital inflows (as a share to GDP) on global and domestic factors during the pre-QE (1990Q1–2008Q3), QE (2008Q4–2014Q4), and post-QE (2015Q1–2024Q4). The magnitude of each coefficient denotes the expected standard-deviation change in the share of capital flows to GDP for a one-standard-deviation increase in an explanatory variable, while controlling for other variables in the model. Sample includes 36 EMEs.

Source: Asian Development Bank estimates.

Table A2.7 Drivers of Cross-Border Loans to Emerging Market Economies

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	Baseline	Inflation Rate	Inflation Rate	GDP Growth	GDP Growth	Exchange Rate	Exchange Rate
		Std Dev	COV	Std Dev	COV	Std Dev	COV
Pre-QE period							
US Fed rates	−0.059***	−0.058***	−0.057***	−0.049***	−0.060***	−0.059***	−0.058***
	(0.018)	(0.018)	(0.018)	(0.017)	(0.018)	(0.019)	(0.018)
VIX	−0.248	−0.242	−0.242	−0.135	−0.252	−0.241	−0.232
	(0.156)	(0.154)	(0.155)	(0.164)	(0.156)	(0.159)	(0.153)
TPU	−0.163	−0.170	−0.157	−0.272	−0.162	−0.154	−0.140
	(0.327)	(0.326)	(0.332)	(0.330)	(0.326)	(0.332)	(0.333)
GPR	0.867	0.883	0.887	0.233	0.837	0.882	0.854
	(0.549)	(0.556)	(0.549)	(0.496)	(0.523)	(0.554)	(0.577)
GDP growth	−0.012	−0.014	−0.012	−0.022	−0.013	−0.012	−0.012
	(0.021)	(0.021)	(0.021)	(0.020)	(0.021)	(0.022)	(0.021)
Trade openness	−0.003	−0.003	−0.003	−0.009	−0.003	−0.002	−0.003
	(0.016)	(0.015)	(0.016)	(0.016)	(0.016)	(0.015)	(0.015)
Financial development	0.279**	0.286**	0.279**	0.228**	0.279**	0.289**	0.280**
	(0.114)	(0.114)	(0.114)	(0.108)	(0.114)	(0.114)	(0.113)
Rule of law	−0.086	−0.095	−0.085	−0.081	−0.085	−0.101	−0.081
	(0.079)	(0.081)	(0.080)	(0.083)	(0.079)	(0.083)	(0.080)
Macro stability control[a]		0.045**	−0.004	−0.029	0.005	0.009	−0.014
		(0.019)	(0.009)	(0.026)	(0.009)	(0.011)	(0.035)
QE period							
US Fed rates	0.028	0.030	0.027	0.051*	0.027	0.027	0.030
	(0.028)	(0.029)	(0.028)	(0.028)	(0.028)	(0.029)	(0.029)
VIX	−0.042	0.001	−0.049	0.076	−0.044	−0.043	0.019
	(0.163)	(0.200)	(0.167)	(0.239)	(0.164)	(0.165)	(0.209)
TPU	0.323	0.391	0.284	0.299	0.304	0.294	0.343
	(0.603)	(0.706)	(0.632)	(0.722)	(0.595)	(0.606)	(0.637)
GPR	0.629	0.677	0.582	0.197	0.595	0.631	0.657
	(0.591)	(0.614)	(0.626)	(0.625)	(0.570)	(0.595)	(0.601)
GDP growth	0.015	0.017	0.016	0.011	0.014	0.015	0.017
	(0.028)	(0.026)	(0.028)	(0.027)	(0.028)	(0.028)	(0.025)
Trade openness	0.093**	0.095**	0.092**	0.085**	0.093**	0.093**	0.096**
	(0.037)	(0.038)	(0.037)	(0.038)	(0.037)	(0.037)	(0.038)
Financial development	0.300***	0.291***	0.308***	0.260***	0.300***	0.304***	0.301***
	(0.096)	(0.110)	(0.099)	(0.080)	(0.096)	(0.096)	(0.094)
Rule of law	−0.178**	−0.190**	−0.178**	−0.175*	−0.176**	−0.186**	−0.168*
	(0.088)	(0.082)	(0.089)	(0.092)	(0.088)	(0.091)	(0.097)
Macro stability control[a]		0.871	0.035	0.053	0.014	0.157***	−0.043
		(4.409)	(0.031)	(0.088)	(0.014)	(0.042)	(0.111)
Post-QE period							
US Fed rates	0.015	0.014	0.016	0.051	0.012	0.014	0.015
	(0.041)	(0.040)	(0.041)	(0.034)	(0.040)	(0.042)	(0.041)
VIX	0.014	0.015	0.015	−0.014	0.015	0.013	0.014
	(0.018)	(0.018)	(0.018)	(0.023)	(0.018)	(0.018)	(0.018)
TPU	0.031	0.030	0.031	0.078***	0.031	0.033	0.030
	(0.024)	(0.024)	(0.024)	(0.021)	(0.023)	(0.024)	(0.021)
GPR	−0.195**	−0.195**	−0.197**	−0.104	−0.190**	−0.198**	−0.195**
	(0.082)	(0.083)	(0.082)	(0.073)	(0.077)	(0.082)	(0.086)
GDP growth	−0.005	−0.005	−0.005	−0.015	−0.006	−0.005	−0.005
	(0.016)	(0.015)	(0.016)	(0.014)	(0.016)	(0.016)	(0.015)
Trade openness	0.094***	0.094***	0.093***	0.075***	0.094***	0.094***	0.094***
	(0.029)	(0.029)	(0.029)	(0.028)	(0.029)	(0.030)	(0.026)
Financial development	0.150**	0.160**	0.150**	0.137*	0.147**	0.157**	0.154**
	(0.071)	(0.068)	(0.071)	(0.070)	(0.071)	(0.071)	(0.068)
Rule of law	0.007	−0.003	0.009	0.008	0.011	−0.002	0.012
	(0.111)	(0.117)	(0.111)	(0.119)	(0.112)	(0.114)	(0.117)
Macro stability control[a]		0.917	0.008*	0.188***	0.043**	0.168***	−0.005
		(4.441)	(0.005)	(0.070)	(0.018)	(0.049)	(0.106)
Observations	3,107	3,105	3,105	3,107	3,107	3,107	3,107
Number of EMEs	36	36	36	36	36	36	36
R2 within	0.0386	0.0396	0.0391	0.0471	0.0396	0.0396	0.0393

COV = coefficient of variation, EMEs = emerging market economies, GDP = gross domestic product, GPR = geopolitical risks, QE = quantitative easing, std dev = standard deviation, TPU = trade policy uncertainty, VIX = Cboe volatility index.

[a] Macro stability control refers to specifications that include measures of volatility for inflation, GDP growth, and exchange rates.

Notes: Driscol-Kraay standard errors in parentheses. Significance levels: *** p<0.01, ** p<0.05, * p<0.1. Reported are standardized coefficients from a regression of EME gross capital inflows (as a share to GDP) on global and domestic factors during the pre-QE (1990Q1–2008Q3), QE (2008Q4–2014Q4), and post-QE (2015Q1–2024Q4). The magnitude of each coefficient denotes the expected standard-deviation change in the share of capital flows to GDP for a one-standard-deviation increase in an explanatory variable, while controlling for other variables in the model. Sample includes 36 EMEs.

Source: Asian Development Bank estimates.

Table A2.8 Drivers of Foreign Direct Investment to Emerging Market Economies

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	Baseline	Inflation Rate	Inflation Rate	GDP Growth	GDP Growth	Exchange Rate	Exchange Rate
		Std Dev	COV	Std Dev	COV	Std Dev	COV
Pre-QE period							
US Fed rates	−0.018**	−0.019**	−0.019**	−0.016*	−0.021**	−0.017**	−0.017**
	(0.008)	(0.009)	(0.009)	(0.009)	(0.010)	(0.009)	(0.008)
VIX	0.198***	0.200***	0.189***	0.203**	0.187***	0.210***	0.208***
	(0.068)	(0.068)	(0.070)	(0.081)	(0.064)	(0.067)	(0.067)
TPU	−0.041	−0.040	−0.048	0.035	−0.042	−0.028	−0.030
	(0.108)	(0.106)	(0.108)	(0.092)	(0.101)	(0.107)	(0.103)
GPR	0.420*	0.405*	0.421*	0.501	0.286	0.423*	0.437*
	(0.238)	(0.227)	(0.238)	(0.333)	(0.206)	(0.239)	(0.246)
GDP growth	0.027***	0.027***	0.026***	0.026***	0.024***	0.027***	0.027***
	(0.009)	(0.010)	(0.009)	(0.010)	(0.009)	(0.009)	(0.009)
Trade openness	0.042**	0.043**	0.043**	0.044**	0.043**	0.043**	0.041**
	(0.018)	(0.018)	(0.018)	(0.018)	(0.018)	(0.018)	(0.018)
Financial development	0.066	0.062	0.065	0.107	0.070	0.071	0.071
	(0.089)	(0.091)	(0.089)	(0.076)	(0.084)	(0.088)	(0.087)
Rule of law	−0.139***	−0.139**	−0.136***	−0.147***	−0.133***	−0.148***	−0.129***
	(0.052)	(0.054)	(0.051)	(0.056)	(0.050)	(0.054)	(0.048)
Macro stability control[a]		−0.006	0.005	−0.013	0.054	−0.005	−0.005
		(0.007)	(0.006)	(0.016)	(0.053)	(0.006)	(0.012)
QE period							
US Fed rates	0.035***	0.035**	0.033**	0.047**	0.027*	0.035***	0.038***
	(0.013)	(0.014)	(0.013)	(0.019)	(0.016)	(0.013)	(0.013)
VIX	0.237	0.216	0.230	0.438*	0.225	0.238	0.339**
	(0.148)	(0.154)	(0.143)	(0.236)	(0.148)	(0.148)	(0.167)
TPU	1.358***	1.315***	1.317***	1.698**	1.367***	1.352***	1.388***
	(0.423)	(0.422)	(0.419)	(0.672)	(0.430)	(0.424)	(0.453)
GPR	1.173**	1.136**	1.109**	1.454*	1.074*	1.181**	1.235**
	(0.560)	(0.550)	(0.552)	(0.763)	(0.553)	(0.561)	(0.578)
GDP growth	−0.007	−0.007	−0.007	0.006	−0.011	−0.007	−0.004
	(0.019)	(0.019)	(0.019)	(0.025)	(0.018)	(0.019)	(0.021)
Trade openness	0.050***	0.048***	0.048***	0.061***	0.049***	0.050***	0.054***
	(0.014)	(0.014)	(0.014)	(0.017)	(0.015)	(0.014)	(0.015)
Financial development	−0.212	−0.206	−0.206	−0.168	−0.210	−0.208	−0.208
	(0.159)	(0.163)	(0.158)	(0.127)	(0.156)	(0.159)	(0.157)
Rule of law	0.151*	0.152*	0.153*	0.131*	0.159**	0.144*	0.170*
	(0.082)	(0.080)	(0.083)	(0.074)	(0.081)	(0.082)	(0.093)
Macro stability control[a]		−3.953	0.029	−0.163*	0.112	0.073***	−0.043
		(3.182)	(0.034)	(0.098)	(0.095)	(0.024)	(0.053)
Post-QE period							
US Fed rates	0.002	0.004	0.002	−0.004	−0.011	0.001	0.001
	(0.015)	(0.015)	(0.015)	(0.018)	(0.021)	(0.015)	(0.015)
VIX	−0.075***	−0.077***	−0.075***	−0.070***	−0.071***	−0.075***	−0.075***
	(0.015)	(0.015)	(0.015)	(0.020)	(0.014)	(0.015)	(0.015)
TPU	−0.035**	−0.034**	−0.035**	−0.045**	−0.033**	−0.034**	−0.033**
	(0.014)	(0.014)	(0.014)	(0.019)	(0.014)	(0.014)	(0.014)
GPR	−0.083**	−0.081**	−0.082**	−0.099*	−0.062**	−0.084**	−0.085**
	(0.034)	(0.033)	(0.034)	(0.051)	(0.029)	(0.035)	(0.036)
GDP growth	0.031**	0.031**	0.031**	0.032*	0.025***	0.031**	0.031**
	(0.014)	(0.014)	(0.014)	(0.017)	(0.008)	(0.014)	(0.014)
Trade openness	0.035	0.034	0.034	0.039	0.035	0.035	0.033
	(0.023)	(0.023)	(0.023)	(0.028)	(0.025)	(0.023)	(0.023)
Financial development	−0.044	−0.057	−0.045	−0.011	−0.052	−0.039	−0.036
	(0.092)	(0.098)	(0.091)	(0.077)	(0.094)	(0.091)	(0.087)
Rule of law	−0.025	−0.029	−0.021	−0.034	−0.008	−0.032	−0.014
	(0.059)	(0.066)	(0.057)	(0.063)	(0.048)	(0.061)	(0.055)
Macro stability control[a]		−4.008	−0.001	−0.036	0.181	0.088***	0.028
		(3.201)	(0.003)	(0.054)	(0.163)	(0.030)	(0.037)
Observations	3,107	3,105	3,105	3,107	3,107	3,107	3,107
Number of EMEs	36	36	36	36	36	36	36
R2 within	0.0441	0.0448	0.0446	0.0513	0.0587	0.0444	0.0459

COV = coefficient of variation, EMEs = emerging market economies, GDP = gross domestic product, GPR = geopolitical risks, QE = quantitative easing, std dev = standard deviation, TPU = trade policy uncertainty, VIX = Cboe volatility index.

[a] Macro stability control refers to specifications that include measures of volatility for inflation, GDP growth, and exchange rates.

Notes: Driscol-Kraay standard errors in parentheses. Significance levels: *** p<0.01, ** p<0.05, * p<0.1. Reported are standardized coefficients from a regression of EME gross capital inflows (as a share to GDP) on global and domestic factors during the pre-QE (1990Q1–2008Q3), QE (2008Q4–2014Q4), and post-QE (2015Q1–2024Q4). The magnitude of each coefficient denotes the expected standard-deviation change in the share of capital flows to GDP for a one-standard-deviation increase in an explanatory variable, while controlling for other variables in the model. Sample includes 36 EMEs.

Source: Asian Development Bank estimates.

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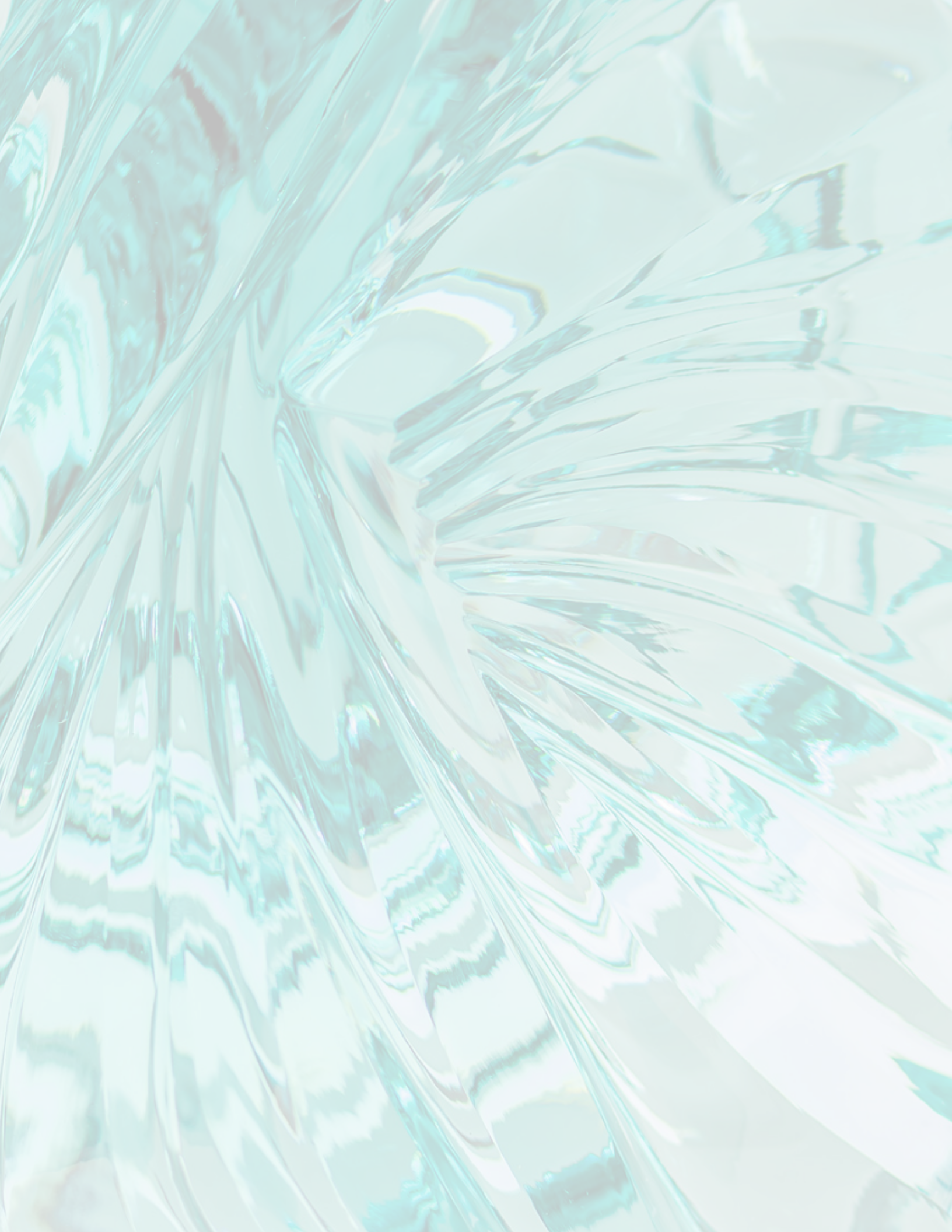
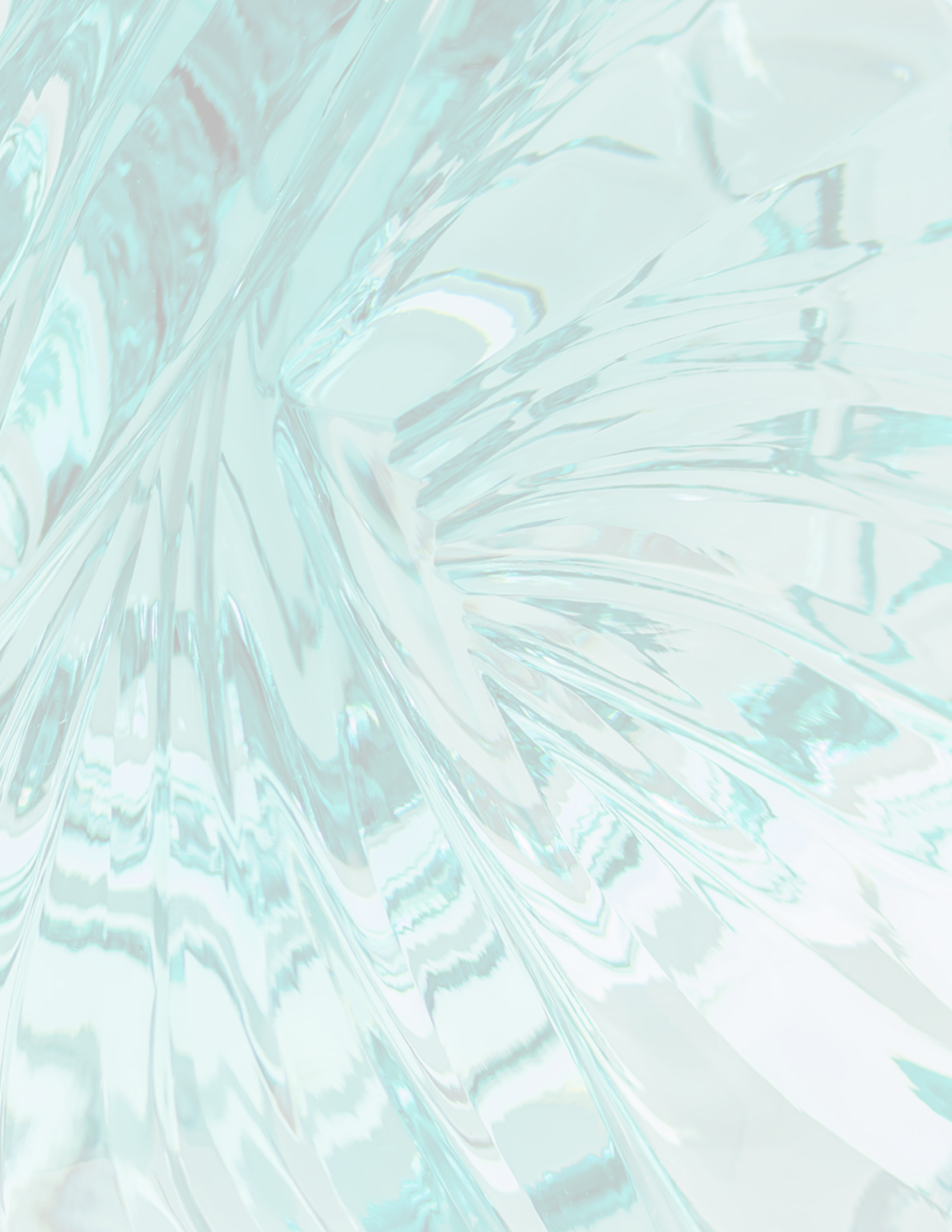


3

ECONOMIC TRENDS AND PROSPECTS IN DEVELOPING ASIA



CAUCASUS AND CENTRAL ASIA

With most economies in the subregion growing steadily in the first half of 2025, the aggregate growth projection in *Asian Development Outlook April 2025* (*ADO April 2025*) has been raised slightly for 2025 but reduced for 2026. Inflation forecasts for both years are increased after three economies saw higher trends from rising food prices, utility tariff adjustments, or currency depreciation. While some countries have benefited from higher commodity prices, the external positions of others remain exposed to regional and global trade tensions.

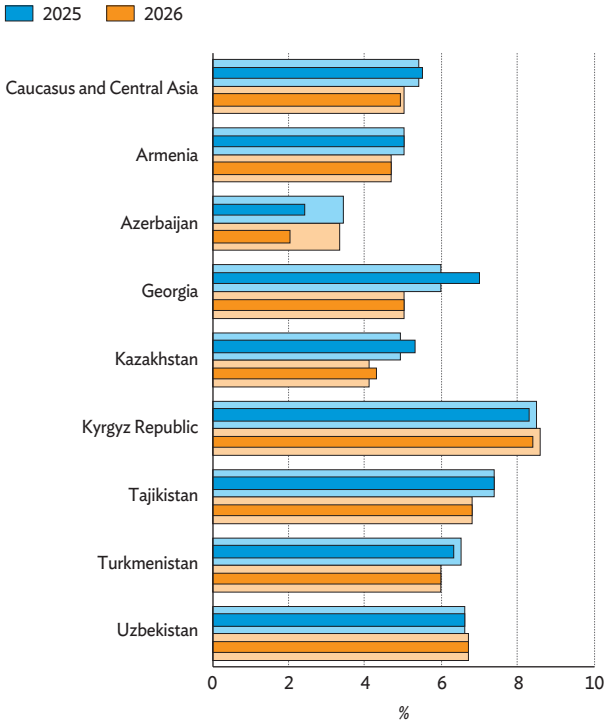
Subregional Assessment and Prospects

The subregional growth outlook is raised by 0.1 percentage point to 5.5% for 2025 but reduced by 0.1 percentage point to 4.9% for 2026 (Figure 3.1.1). This reflects a higher growth forecast for Kazakhstan in both 2025 and 2026 and for Georgia in 2025, which offsets reduced growth projections for Azerbaijan, the Kyrgyz Republic, and Turkmenistan in 2025, but not 2026. In the first half of 2025, Georgia reported robust growth driven by significant expansion in services, industry, and construction. Considerable expansion in Kazakhstan drew support from higher oil production, continued investment in public infrastructure, and strong domestic demand. In Azerbaijan, declines in hydrocarbons and services slowed growth despite strong expansion in construction. The Kyrgyz economy grew by an estimated 11.7%, but the result for the whole year will be brought down by uncertainty over trade. Growth in other countries in the subregion remained in line with *ADO April 2025* projections.

Economies in the Caucasus experienced moderate growth. In the first half of 2025, expansion slowed in Armenia, with contraction in industry and slower growth in services outweighing faster growth in agriculture and construction. On the demand side, growth surged on higher consumption and investment

Figure 3.1.1 Gross Domestic Product Growth in the Caucasus and Central Asia

Growth projections are raised slightly for 2025 but are revised down slightly for 2026, reflecting a significantly lower projection for Azerbaijan that offsets smaller increases for other countries.



Note: Lighter-colored bars are *Asian Development Outlook April 2025* forecasts.

Source: *Asian Development Outlook* database.

The subregional assessment and prospects were written by Parvina Rakhimova. Kazakhstan was written by Genadiy Rau, and the other economies by Sherzod Akbarov, Grigor Gyurjyan, Jennet Hojanazarova, Elvin Imanov, Khagani Karimov, Gulnur Kerimkulova, George Luarsabishvili, and Shuhrat Mirzoev. All authors are in the Central and West Asia Department.

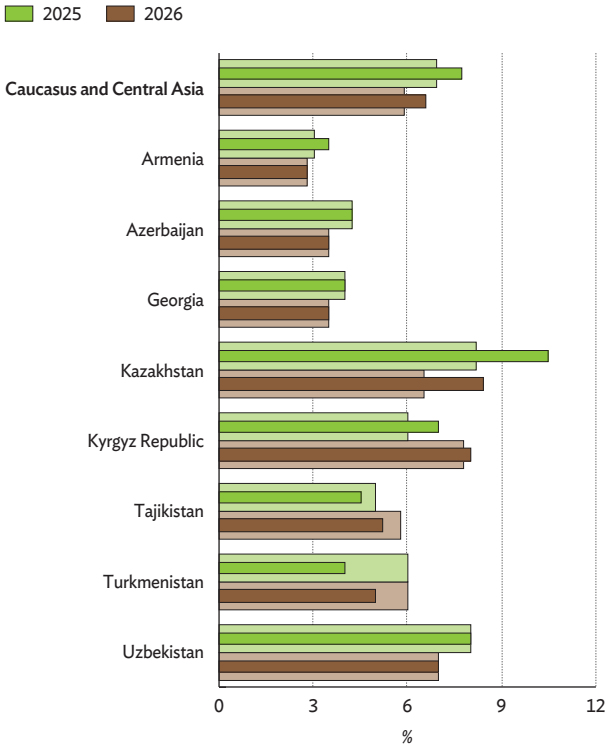
while net exports declined. In Azerbaijan, economic activity moderated, with growth slowing to 1.5% from 4.3% in the same period of 2024 as 3.1% contraction in the hydrocarbon sector from lower oil and gas production more than offset 3.9% expansion in other activities, particularly construction. In Georgia, strong performance in information technology and construction drove growth, as did robust private consumption. Higher receipts from tourism and transportation supported expansion in the external sector and Georgia's emerging role as a key transit route and tourist destination in the region.

Central Asia continued to grow robustly in the first half of 2025 on strong performance in construction, trade, and services. Kazakhstan saw growth surge to 6.2%, backed by higher oil production, government investment in infrastructure, and gains in manufacturing and services. The Kyrgyz Republic grew by 11.7%, driven by strong gains in construction, trade, and private consumption, with notable expansion in services and a rebound in industry, though agriculture moderated. Tajikistan maintained robust growth at 8.1%, led by booming industry, especially metal ore production, as well as expanding services and agriculture, with consumption benefiting from higher remittances and public salaries. Turkmenistan reported steady growth at 6.3% with moderate gains in industry, expansion in agriculture and services, and large public investments in industrial and social infrastructure. Expansion in Uzbekistan reached 7.2%, fueled by consumption, investment, and surging gold exports. Strong performance in these areas offset decline in exports of some manufactures, with trade tension posing a risk to growth.

Inflation projections are raised for both 2025 and 2026 as rising utility prices and, in some countries, currency depreciation raise inflationary expectations. The subregional inflation forecast is increased from 6.9% to 7.7% in 2025 and from 5.9% to 6.6% in 2026 (Figure 3.1.2). In the first half of 2025, inflation rose to 3.2% in Armenia, prompting a higher forecast for 2025. Meanwhile in Georgia, inflation remained moderate, and projections for 2025 and 2026 are unchanged. With inflation in Kazakhstan reaching double digits as currency depreciation continues, tighter monetary policy may be implemented if conditions worsen. In the Kyrgyz Republic, inflation exceeded the central bank target, prompting an upward revision to the forecast for the whole year. In contrast, inflation projections for Tajikistan are reduced following a further decline in inflation and currency appreciation. In Uzbekistan, inflation remained near 9%, so April forecasts are retained.

Figure 3.1.2 Inflation in the Caucasus and Central Asia

Inflation projections are raised for both 2025 and 2026, reflecting higher anticipated inflation in Kazakhstan and several other countries.



Note: Lighter-colored bars are *Asian Development Outlook April 2025* forecasts.

Source: *Asian Development Outlook* database.

Countries in the Caucasus maintained expansionary fiscal policies to boost investment in infrastructure. Capital outlays in Armenia increased sharply as public infrastructure investment rose to equal 6.7% of GDP, while current expenditure growth slowed. Revenue growth doubled on improved tax administration. Azerbaijan maintained a budget surplus as revenue increased, enabling the Ministry of Finance to accumulate reserves.

In Central Asia, strong revenue performance supported expansionary policies in most countries. In Kazakhstan, tax revenue increased on higher growth and enhanced tax administration. Despite greater

fiscal spending in nominal terms on infrastructure modernization and social programs, the budget deficit declined marginally. The Kyrgyz Republic achieved an 8.5% fiscal surplus in early 2025, driven by higher revenue from robust economic growth, increased trade, and improved tax collection, as well as increased central bank transfers. This strong fiscal position allowed higher public investment while keeping public debt sustainable. In Tajikistan, an 11.5% increase in revenue—well above projections—enabled the government to enhance public spending in social sectors while maintaining a budget surplus and reducing public debt. Turkmenistan is projecting a balanced budget with moderate revenue growth and low public debt. Uzbekistan's fiscal policy remained focused on stability, with continued investment in infrastructure and social sectors, and reform to strengthen fiscal resilience.

External trade pressures and volatile prices for export commodities had varying effects on external positions in the subregion. In Armenia, exports fell by 61.3%, and the merchandise trade deficit rose to equal 14.0% of GDP, mostly because of declining gold reexports. With expected growth in transportation and tourism services, the current account deficit is projected to narrow over the rest of the year. Azerbaijan maintained a strong external position in the first quarter of 2025, with a $1.1 billion current account surplus and foreign exchange reserves increasing to $77.6 billion, equal to 105% of GDP and far exceeding public external debt. Robust oil and gas trade despite volatile hydrocarbon prices, and growth in nonhydrocarbon exports, offset remittance contraction. However, the service balance remained in deficit. Georgia's external sector expanded in early 2025, with merchandise exports up by 13.7% and vehicle reexports—a key source of foreign exchange—increasing by 30.3%. Kazakhstan's current account deficit doubled to equal 2.9% of GDP, reflecting a decline in merchandise exports and a moderate increase in imports. In the Kyrgyz Republic, the current account deficit narrowed to 16.0% of GDP in the first quarter of 2025 with a sharp decline in imports, helping to raise official reserves. Strong remittance inflows to Tajikistan generated a current account surplus equal to 7.7% of GDP despite a higher merchandise trade deficit. In Uzbekistan, rising gold exports and increased remittances trimmed the current account deficit and supported economic stability.

Kazakhstan

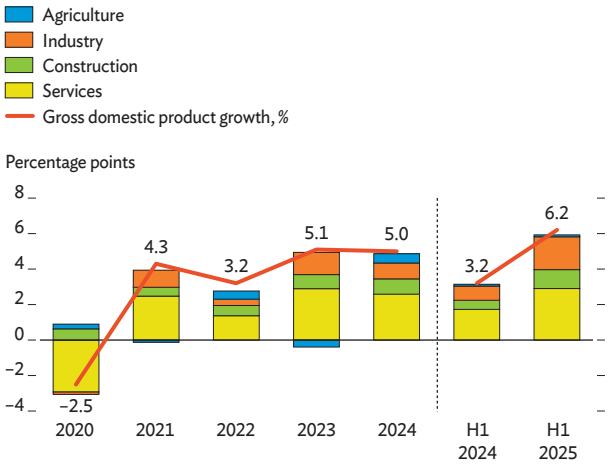
Higher oil production and government-initiated investment projects boosted growth in the first half of 2025. Continued infrastructure investment and increasing resource extraction support upward revisions of growth forecasts for both 2025 and 2026. Inflation projections for both years are also raised in light of anticipated utility price increases and currency depreciation. Higher investment and consumer goods imports are projected to outpace export growth, bringing a sustained current account deficit.

Updated Assessment

Growth in the first half of 2025 was the highest in the past decade. GDP expanded by 6.2% year on year, twice 3.2% in the same period of 2024, on an 11.6% rise in oil production and an 18.4% surge in construction from higher government support for infrastructure modernization projects (Figure 3.1.3). Expansion in manufacturing rose from 5.1% in the first half of 2024 to 5.5%, supported by increases of 11.1% in machine production, 8.6% in construction materials, and 7.0% in chemical products. Growth in services accelerated from 3.4% to 5.2%, with trade rising by 8.4% and transport services by 22.7%. Agriculture expanded by 3.7% on increases of 14.5% for crop production and 3.2% for livestock.

Figure 3.1.3 Supply-Side Contributions to Growth

Growth in the first half of 2025 was the highest in the past decade.



H = half.

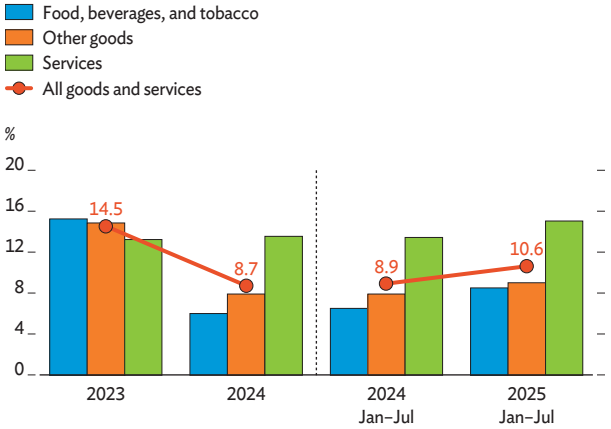
Source: Republic of Kazakhstan. Agency for Strategic Planning and Reforms. Bureau of National Statistics.

Consumption and investment expanded while net exports declined. Demand-side data—available for only the first quarter of 2025—indicate gains in consumption and investment and lower net exports. Consumption growth rose from 4.4% year on year in the first quarter of 2024 to 5.5% in the same period of 2025, with increases of 6.6% in private consumption and 0.9% in public consumption. Investment rose by 9.8% as capital outlays on infrastructure grew by 7.4%. Net exports of goods and services fell as imports rose by 9.3% and exports by 5.8%.

Inflation accelerated to double digits on large utility price hikes and currency depreciation. Average inflation increased from 8.9% in the first 7 months of 2024 to 10.6% a year later, more than double the medium-term target of 5% set by the National Bank of Kazakhstan, the central bank (Figure 3.1.4). Prices rose by 15.0% for services, 8.6% for food, and 9.0% for other goods. The government approved increases in tariffs to fund investment to upgrade aging utility infrastructure, with fees rising by 83.3% for water, 19.4% for heating, and 14.2% for electricity. In the first 7 months of 2025, the Kazakhstan tenge depreciated by 13.6% on average against the US dollar and by 19.9% against the Russian ruble. As the tenge reached a record low of 550 to the dollar in July 2025, the central bank sold $125.6 million in foreign exchange to support the currency (Figure 3.1.5). Tenge depreciation and double-digit inflation in neighbors and key trade partners raised import costs, as Kazakhstan remains a net importer of food and consumer products. Despite rising inflation, the central bank has kept its key policy rate unchanged since March at 16.5%, but it signaled potential tightening if inflation expectations worsen.

Figure 3.1.4 Average Inflation

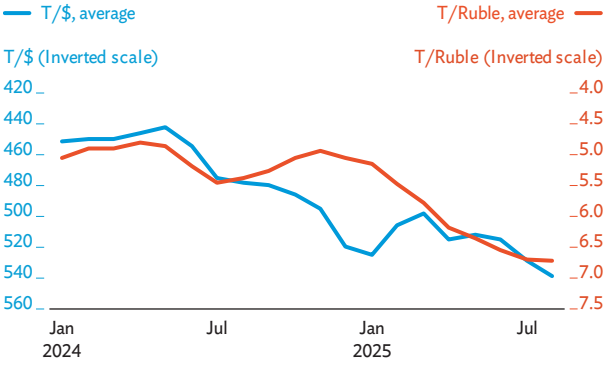
Inflation accelerated to double digits in the first 7 months of 2025.



Source: Republic of Kazakhstan. Agency for Strategic Planning and Reforms. Bureau of National Statistics.

Figure 3.1.5 Exchange Rate

The tenge depreciated against the US dollar and Russian ruble in the first 7 months of 2025.



Source: National Bank of Kazakhstan.

Bank deposits and credit rose at a moderate pace, while nonperforming loans remained near a historic low. In the first half of 2025, deposits grew by 5.4% and credit by 8.0%, with loans rising by 4.7% for mortgages, 6.5% for firms, and 11.3% for consumer credit. Foreign currency deposits, representing 19.4% of total deposits, declined by 2.1%, while tenge deposits rose by 7.4%. To further stimulate demand for tenge-denominated bank accounts, the government removed the ceiling on interest rates for tenge deposits while keeping it at 1% for foreign currency deposits. Nonperforming loans edged up to 3.4% from 3.1% in January 2025. Broad money grew by a moderate 2.7% in the first half of 2025.

Tax revenue strengthened in the first half of 2025, and total revenue grew to equal 23.7% of GDP. Economic growth and improved tax administration boosted state budget tax collection by 20.4% over a year earlier to reach 17.5% of GDP, with increases of 25.6% for corporate tax receipts, 21.9% for value-added taxes, and 12.9% for personal income tax. Despite the decline in oil prices, oil export duty receipts, supported by tenge depreciation, increased by 19.1%. Nontax receipts declined marginally, while transfers from the sovereign wealth fund, the National Fund of the Republic of Kazakhstan, equaled 5.1% of GDP, down from 5.3% in the first half of 2024. In nominal terms,

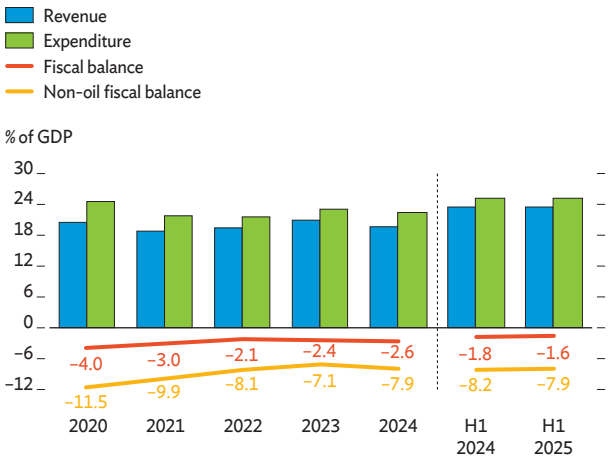
fund transfers were 15.2% above those in the first half of 2024 and were almost 60% of planned transfers for the whole year.

Despite higher fiscal spending in nominal terms, the budget deficit declined marginally as a share of GDP. In the first half of 2025, the deficit declined to 1.6% of GDP from 1.8% a year earlier as the non-oil fiscal deficit declined to 7.9% from 8.2% (Figure 3.1.6). Total state budget outlays remained at 25.3% of GDP, with social outlays—at 12.9% of GDP, or about half of the state budget—rising in nominal terms by 14.2% for education, 10.8% for social support, and 9.6% for health care. Expenditure on infrastructure modernization increased by 88.4% from a low base to reach 0.3% of GDP, and for housing and communal services by 40.1% to reach 1.4% of GDP. Debt service costs expanded by 18.6%, corresponding to 2.7% of GDP and reaching almost two-thirds of planned state budget allocations for the year. Debt service absorbed 11.5% of total revenue, up from 11.4% a year earlier and 9.4% in the same period in 2023. In July 2025, the yield on domestic government bonds rose to 17.2% as more than two-thirds of the debt was issued on the domestic market.

Higher intercompany and bank sector borrowing raised external debt. In the first quarter of 2025, external debt increased to $170.4 billion, equal to 59.7% of GDP (Figure 3.1.7). Intercompany debt—primarily for mining projects—inched up by 1.4% to $92.4 billion, or 32.4% of GDP, with $21.4 billion maturing in 2025. Public sector external debt remained unchanged at $32.2 billion, or 11.2% of GDP. Banks' external debt rose by 11.1% to $14.5 billion, equal to 5.1% of GDP, following government measures to encourage the entry of foreign banks into Kazakhstan.

Figure 3.1.6 Fiscal Indicators

The state fiscal budget deficit was marginally lower in the first half of 2025.

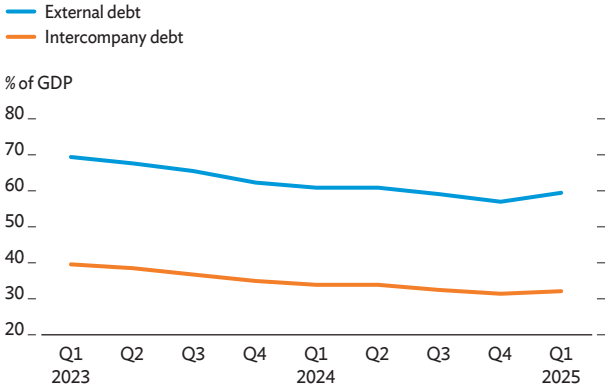


GDP = gross domestic product, H = half.

Source: Republic of Kazakhstan. Agency for Strategic Planning and Reforms. Bureau of National Statistics.

Figure 3.1.7 External Debt and Intercompany Debt

External and intercompany debt increased in tandem in the first quarter of 2025.



GDP = gross domestic product, Q = quarter.

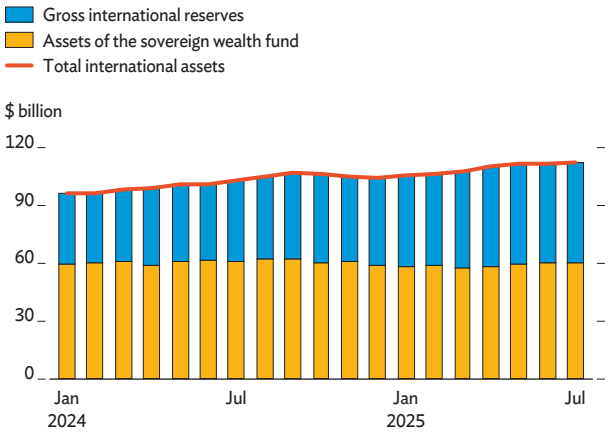
Source: National Bank of Kazakhstan.

Lower exports and higher imports doubled the current account deficit. Preliminary estimates show the current account deficit rising to $3.4 billion in the first half of 2025, equal to 2.9% of GDP, from $1.7 billion a year earlier, or 1.4% of GDP. Merchandise exports declined by 5.3% to $37.7 billion, while imports increased by 3.7% to $29.6 billion. The deficit in primary income narrowed by 11.0% to $10.8 billion, reflecting a 12.3% decrease in profit repatriation and a 7.6% drop in reported sovereign wealth fund earnings. Higher outward transfers by foreign workers helped raise the deficit for secondary income by 30.4% to $229.6 million. The widening current account deficit and increasing money supply are key factors depreciating the tenge.

Combined sovereign wealth fund and central bank reserves exceeded $113 billion. In the first 7 months of 2025, gross foreign exchange reserves increased by 14.5% to $52.4 billion, of which 62.6% were in monetary gold, providing cover for 8.3 months of imports of goods and services (Figure 3.1.8). Gold reserves rose by 37.7% in the period, reflecting both

Figure 3.1.8 Foreign Currency Reserves and Sovereign Wealth Fund Assets

Gross reserves and sovereign wealth fund assets both increased.



Source: National Bank of Kazakhstan.

higher global prices and larger volumes. By July 2025, sovereign wealth fund foreign financial assets rose to an estimated $60.6 billion on $4.7 billion in investment income and $4.2 billion in receipts from subsoil users, with income exceeding transfers to the state budget. Over the period, the central bank converted $5.6 billion in sovereign wealth fund foreign exchange reserves to tenge before transferring proceeds to the state budget.

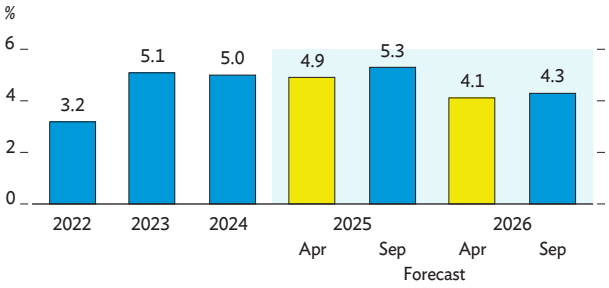
Prospects

Mining growth is projected to slow by 2026. Gains from the recent completion of Tengiz oilfield expansion will gradually fade as Kazakhstan reaches maximum oil production capacity in 2026. Growth in mining is expected to peak earlier, at 7.7% in 2025, before moderating to 3.9% next year—both forecasts up from 7.2% and 4.3% projected in *ADO April 2025*. Kazakhstan's raw material exports are assumed to face minimal constraints from tariffs and no additional restrictions under the OPEC+ oil production agreement of the Organization of the Petroleum Exporting Countries and its partners. State manufacturing and investment support programs are expected to raise manufacturing output by 4.8% this year and 5.2% in 2026, slightly above forecasts in *ADO April 2025*. Growth in services is now projected slightly curtailed as higher inflation weakens consumer purchasing power. The government's infrastructure modernization program will raise 2025 construction growth to 13.0%, exceeding the April projection of 9.8%.

Expansion in investment and public consumption will support demand-side growth. With capital investment rising by 19.3% in the first half of 2025, the forecast for expansion in gross capital formation is raised to 6.0% for 2025 from 3.9% projected in *ADO April 2025*, and to 5.7% in 2026 from 4.3%. The forecast for growth in public consumption is also raised, to 4.6% this year and 3.0% in 2026, from 1.0% and 1.8% projected earlier. Higher projected investment imports will surpass the moderate increase in exports. In view of these developments, the forecast for GDP growth is raised for both 2025 and 2026 (Figure 3.1.9 and Table 3.1.1).

Figure 3.1.9 Gross Domestic Product Growth

Faster growth in the first half of 2025 prompts upward revisions for 2025 and 2026 growth forecasts.



Source: *Asian Development Outlook* database.

Table 3.1.1 Selected Economic Indicators in Kazakhstan, %

Faster growth in the first half of 2025 prompts upward revisions to 2025 and 2026 growth forecasts, while local currency depreciation and utility price increases warrant upward adjustments to inflation projections.

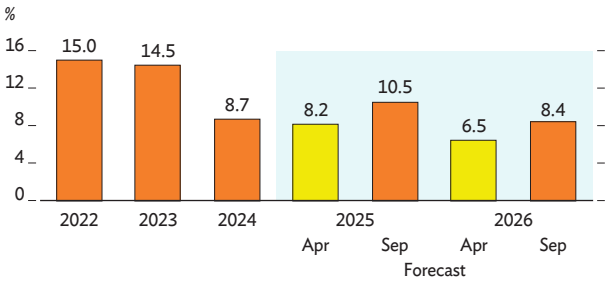
	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	5.0	4.9	5.3	4.1	4.3
Inflation	8.7	8.2	10.5	6.5	8.4

GDP = gross domestic product.
Source: Asian Development Bank estimates.

Government-approved utility price increases and tax hikes will raise inflation over the forecast period (Figure 3.1.10). In July 2025, the government reiterated its commitment to utility modernization by implementing tariff increases, while slowing their pace to limit the impact on inflation in 2025. Also boosting inflation in 2026 is the government's announced

Figure 3.1.10 Inflation Forecast

Local currency depreciation and utility price increases warrant upward adjustments in inflation projections.



Source: *Asian Development Outlook* database.

rate hike for value-added taxes from 12% to 16%. Accordingly, inflation forecasts for services are raised to 14.5% this year and 11.2% in 2026 from 12.0% and 7.4% projected earlier. With further pressure on prices from currency depreciation and relatively high inflation in Russia, which supplies nearly half of Kazakhstan's food imports, food prices are expected to rise by 8.7% in 2025 and 6.1% in 2026, and other prices by 8.1% and then 8.6%.

Measures have been taken to moderate credit expansion. On 25 July 2025, the central bank approved a phased increase in minimum reserve requirements. Minimum reserves for tenge liabilities were raised from 1.3% to 3.5% on 25 August 2025 and will rise further to 5.0% in April 2026, and for foreign currency liabilities in similar manner from 2.5% to 10.0% and subsequently to 15.0%. The bank also introduced sectoral countercyclical capital buffers for 2026, obliging commercial banks to set aside an additional 2% of their capital for reserves when issuing consumer loans. The Agency for Regulation and Development of Financial Markets introduced new legislation to strengthen due diligence on potential borrowers that requires banks to verify income using tax declarations starting from 2026. Despite credit expansion below expectation, increases to tax rates and utility prices prompt higher inflation projections for 2025 and 2026.

Higher tax revenue will narrow the budget deficit. The 2025 state budget deficit is projected to remain at 2.8% of GDP before declining to 2.2% in 2026. No substantial budget revision is expected this year, while budget expenditure is forecast to increase moderately next year to finance rising social outlays. Tax revenue is projected to reach 15.1% of GDP in 2026, reflecting economic growth and additional revenue under a new tax code. Higher tax revenue will allow smaller transfers from the sovereign wealth fund, leaving the forecast for total revenue unchanged.

The current account is expected to remain in deficit through 2026. As growth causes imports to rise faster than exports, the merchandise trade surplus will narrow. The service deficit will ease gradually, supported by higher earnings from the booming transport sector. However, the primary income deficit should widen further as rising export revenue boosts profit repatriation by foreign investors.

Other Economies

Armenia

As external demand softened, growth moderated but remained solid. Contraction in industry slowed growth to 5.6% in the first half of 2025 from 7.1% a year earlier, despite continued strong but slower growth in services and higher growth in agriculture and construction. Expansion in services slowed to 6.5% from 8.4% a year earlier as growth moderated across the sector, except for finance and information and communication technology services, both of which continued to grow by double digits. Agriculture expanded by 6.2%, versus 5.4% a year earlier, on higher crop and livestock production. Industry, excluding construction, contracted by 4.7%, reversing 5.2% growth in the first half of 2024 as a 10.8% decline in manufacturing attributable to diminished processing of gold for reexport outweighed gains in utilities and small increases in mining and quarrying. Construction grew by a solid 20.8%, up from 16.3% a year earlier, on higher public investment in roads and social infrastructure and increased private construction.

On the demand side, consumption and investment were the main growth drivers. Expansion in private consumption surged to 11.5% from 4.2% a year earlier, buoyed by continued strong growth in lending to households and private firms. Growth in public consumption jumped to 8.6% from 0.5% a year earlier on higher government spending. Expansion in gross fixed capital formation more than doubled to 25.8% in line with sustained growth in construction fueled by public and private investment in infrastructure.

However, net exports declined as exports fell more than imports. On balance, growth forecasts for 2025 and 2026 are unchanged from *ADO April 2025* (Table 3.1.2).

Table 3.1.2 Selected Economic Indicators in Armenia, %

Growth projections for 2025 and 2026 remain unchanged, while developments in the first half of 2025 prompt a higher inflation forecast for 2025, with no change for 2026.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	5.9	5.0	5.0	4.7	4.7
Inflation	0.3	3.0	3.5	2.8	2.8

GDP = gross domestic product.
Source: Asian Development Bank estimates.

Inflation edged up in the first 7 months of 2025. Average inflation increased to 3.2% in the first 7 months of 2025, reversing 0.3% deflation a year earlier. Prices rose by 5.1% for food and 3.0% for services, offsetting a 0.6% drop in prices for other goods. Inflation at 3.4% year on year in July 2025 was within the Central Bank of Armenia's target of 2%–4%. The central bank has kept its refinancing rate at 6.75% following a cut by 25 basis points in February 2025. Price developments in the first 7 months of 2025, reflecting a lagged effect of earlier relaxation of monetary policy, prompt a higher inflation forecast for 2025 but not for 2026.

Fiscal policy in the 2025 budget is expansionary. Growth in capital outlays surged to 90.6% from 35.3% a year earlier, reflecting increased infrastructure spending toward the goal of raising capital expenditure to the equivalent of 6.7% of GDP in 2025 from 5.3% in 2024. Growth in current expenditure slowed by half to 9.2% from 18.2% a year earlier, with slower increases across all items except purchases of goods and services. Revenue growth doubled to 15.3% in the first half of 2025 from 7.1% a year earlier on improved tax administration and enhanced tax legislation.

The current account deficit widened to 11.9% of GDP in the first quarter of 2025 from 6.7% a year earlier. The merchandise trade deficit expanded to 14.0% of GDP from 8.6% a year earlier, while exports dropped markedly by 61.3%, and imports by 49.3%, as gold reexports faded. The surplus in services fell to 4.0% of GDP in the first quarter of 2025 from 7.0% a year earlier as a larger deficit in transport and tourism services offset stronger surpluses in finance and in information and communication technology services. As the impact of gold reexports fades further, and assuming that transportation and tourism move into surplus, the resulting smaller merchandise trade deficit and larger surplus in services is expected to narrow the current account deficit over the rest of the year.

Azerbaijan

Contraction in hydrocarbon production slowed overall growth in the first half of 2025. Growth declined from 4.3% in the first half of 2024 to 1.5% a year later as the hydrocarbon economy contracted by 3.1% while the rest of the economy expanded by 3.9%. Oil production fell by 5.3%, and gas by 0.4%, causing industry to contract by 0.5% year on year despite an 8.5% rise in construction on higher public investment in reconstruction projects. Growth in services fell by half from 6.1% in the first half of 2024 to 3.1% this year, as growth slowed in transportation and communication. Expansion in agriculture accelerated from 0.2% in the first half of 2024 to 1.4% in the first 6 months of 2025 on higher crop production. As slow growth is expected to continue to the end of 2026, this report reduces *ADO April 2025* growth forecasts for 2025 and 2026 (Table 3.1.3).

Table 3.1.3 Selected Economic Indicators in Azerbaijan, %

Slow growth to the end of 2026 prompts lower growth projections for 2025 and 2026, while earlier inflation forecasts remain unchanged.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	4.1	3.4	2.4	3.3	2.0
Inflation	2.2	4.2	4.2	3.5	3.5

GDP = gross domestic product.
Sources: State Statistical Committee of Azerbaijan; Asian Development Bank estimates.

Inflation accelerated in the first half of 2025 on higher import prices and administrative price increases in mid-2024 and early 2025. Average annual inflation rose from 0.7% in the first half of 2024 to 5.9% as prices increased by 6.6% for food, 2.7% for other goods, and 7.5% for services. However, inflation is

expected to slow during the rest of the year as spillover from administrative price adjustments fades. Because inflation remained within its target range of 2%–6%, the Central Bank of Azerbaijan cut its policy rate from 7.25% to 7.00% in July 2025, the first adjustment since May 2024. With the expected slowdown in inflation in the second half of 2025, inflation projections for 2025 and 2026 remain unchanged.

Strong budget revenue kept the budget in surplus. In the first half of 2025, revenue rose from 31.4% of 2024 GDP to 31.9%, driven by higher tax receipts and increased transfers from the sovereign wealth fund to the budget. Expenditure increased from 26.8% of 2024 GDP to 27.5% in 2025, reflecting an 11.1% rise in capital expenditure and a 7.5% increase in current spending. During the first 6 months of 2025, the budget had a surplus equal to 4.4% of GDP.

Azerbaijan's external position remained strong despite volatility in hydrocarbon prices. In the first quarter of 2025, the current account recorded a surplus of $1.1 billion, equal to 6.5% of GDP. Merchandise trade totaled $10.0 billion, with exports of $6.2 billion and imports of $3.8 billion. A surplus in oil and gas offset a deficit in other goods, yielding an overall trade surplus of $2.5 billion. Exports of non-hydrocarbon goods grew by 11.8%, while imports expanded by 8.2%. Remittance inflows contracted by 22%. Meanwhile, the balance of services was in deficit, with exports up by 19.9% but outpaced by imports up by 24.1%. Over the first 6 months of 2025, combined foreign exchange reserves in the sovereign wealth fund and the central bank increased by $6.7 billion to $77.6 billion, equal to 105% of GDP and about 15 times the economy's public external debt. Central bank reserves stood at $11.2 billion, covering 8.9 months of goods imports.

Georgia

Growth remained strong at an estimated 8.3% in the first half of 2025, near the 9.2% attained a year earlier. On the supply side, services expanded by 12.9%, led by 28.6% growth in information and communication, which reflected strong productivity gains in information technology following 24.3% growth in 2024. Industry expanded by 1.7% on 12.9% growth in mining and 4.5% in construction, while agriculture contracted by 4.6% under adverse weather. On the demand side, growth was driven by resilient private consumption. A two-fold increase in reinvestment of profits by foreign investors also contributed to growth. Absolute poverty, or the share of the population with consumption below 40% of the median, decreased by 2.4 percentage points to 9.4%. Unemployment registered a small 0.8-point rise to 14.7% as labor force expansion outpaced employment. Growth is expected to moderate, reflecting external vulnerabilities and tighter global financial conditions. Nevertheless, given the first half performance, this report raises the *ADO April 2025* growth forecast for 2025, while keeping the 2026 forecast unchanged (Table 3.1.4).

Table 3.1.4 Selected Economic Indicators in Georgia, %

Strong growth and moderate inflation in the first half of 2025 prompt a higher 2025 growth projection, with no change to other forecasts.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	9.4	6.0	7.0	5.0	5.0
Inflation	1.1	4.0	4.0	3.5	3.5

GDP = gross domestic product.
Source: Asian Development Bank estimates.

Inflation remained contained by lower global fuel prices, a stronger Georgian lari, and prudent fiscal policy. Inflation reached 4.0% year on year in June 2025, up from 1.9% at the end of 2024, driven by 10.1% higher food prices and partly offset by 5.3% deflation for transport and 13.0% for communication, with inflation in services at only 0.2%. Average inflation in the first half of 2025 was 3.1%, with core inflation at 2.2%. Productivity growth kept demand-side inflation low. The National Bank of Georgia, the central bank, kept its policy rate at 8.0% to guard against external shocks and support price stability. A weakening US dollar contributed to 3.5% appreciation of the lari in the first half of 2025, while the fiscal deficit remained well within 3.0% of GDP and public debt stood at 35.0%. On balance, inflation forecasts for 2025 and 2026 are maintained.

Georgia's external sector expanded. The value of merchandise exports increased by 13.7% in the first half of 2025, while imports rose by 12.4%. Vehicle reexports, a key source of foreign exchange, grew

by 30.3%. A 25% US tariff on imported vehicles introduced in April 2025 may raise prices for second-hand vehicles sourced from the US, possibly reducing Georgian reexports. Nevertheless, services—in particular tourism, transport, and information technology rendered buoyant by rapid technological advances—can offset any future weakening in merchandise exports. Revenue from tourism grew at an annual rate of 3.8%, on top of record high receipts in 2024, while service exports expanded by 10.2% overall, in part reflecting Georgia's emerging role as a key transit route for Trans-Caspian movements of goods and cargo. Higher transfers from the US and Europe helped raise overall money transfers by 3.5% in the first half of 2025 despite a 26.5% reduction in transfers from Russia. Investment declines in most sectors other than information and communication reduced foreign direct investment by 7.7%, though the share of reinvested foreign direct investment remained quite high at 83.6%.

Regional geopolitical tensions and heightened trade and financial vulnerabilities in international markets pose downside risks. Global economic fragmentation and trade sanctions, and slowing growth in Russia and other trade partners, may weaken demand for Georgia's exports, while high global interest rates and tight financial markets may dampen investor appetite and curb capital inflow. These risks, along with high underemployment in the economy, may hamper growth prospects, underlining the need for continued reform.

Kyrgyz Republic

Growth surged to an estimated 11.7% in the first half of 2025, up from 8.6% a year earlier. It was led by continued strong performance in construction and trade, alongside robust private consumption. Construction rose by 42.5%, propelled by higher government infrastructure spending and vigorous investment. Services grew by 10.0%, with solid but moderating gains in trade, and expansion in accommodation and food services. Growth in industry rebounded to 9.8% from 1.3% a year earlier, reflecting greater expansion in manufacturing despite ongoing declines in metal production, mainly gold. Agriculture grew by 3.8%, down from 5.1% during the first half of 2024, with gains in livestock production supporting the sector.

On the demand side, with data available for only the first quarter, growth in private consumption remained robust at 12.9%, though moderating from 21.6% a year earlier. Gross capital formation rose by 4.8%, down from 14.3% during the same period of 2024. Net exports contributed to growth on the demand side as the trade deficit narrowed. Underpinning domestic demand were a 26.2% increase in remittance inflows, 11.5% growth in real wages, and a 37.9% increase in consumer lending. Despite the strong first-half performance, this report revises growth forecasts down slightly from *ADO April 2025* in view of an expected moderation of reexport trade flows (Table 3.1.5). Downside risks include potential changes in regional trade patterns and external developments affecting key partner economies.

Table 3.1.5 Selected Economic Indicators in the Kyrgyz Republic, %

Trade moderation spells slightly lower growth forecasts than those in ADO April 2025, despite strong first-half growth, while rising consumer prices prompt higher inflation projections.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	9.0	8.5	8.3	8.6	8.4
Inflation	5.0	6.0	7.0	7.8	8.0

GDP = gross domestic product.

Sources: National Statistics Committee of the Kyrgyz Republic; Asian Development Bank estimates.

Inflation accelerated above the central bank's target range, reflecting persistent price pressures. Average annual inflation rose from 5.1% in the first half of 2024 to 7.3% a year later, reaching 8.0% year on year in June 2025—above the 5%–7% target of the National Bank of the Kyrgyz Republic, the central bank. An 8.4% jump in food prices, up from 1.0% a year earlier, contributed significantly to total inflation. The rise in inflation reflected persistent demand-supply imbalances, the economy's continued import dependence, external price pressures, and utility tariff adjustments. Despite rising inflationary pressures, the central bank maintained its policy rate at 9.0% through June, though a July increase to 9.25% signaled heightened monetary vigilance. Given sustained upward pressure from strong domestic demand and structural vulnerabilities, this report revises up inflation projections for both 2025 and 2026.

Fiscal performance remained solid, supporting ongoing public investment. The government recorded a surplus equal to 8.5% of GDP in the first half of 2025, as a 38.6% surge in budget revenue outpaced a 35.0% rise in expenditure. The surge in revenue reflected enhanced economic activity, higher trade-related earnings, improved administration, and increased transfers of central bank profits to the budget, which alone accounted for 39.0% of total revenue growth. The strong fiscal position has provided space for continued infrastructure development while maintaining debt sustainability. The government has prioritized capital spending on strategic initiatives, including transport and housing infrastructure improvements. Fiscal policy is expected to turn more expansionary over the rest of this year, generating a modest full-year deficit as planned investments accelerate.

The external position improved further as the current account deficit narrowed to 16.0% of GDP in the first quarter of 2025 from 49.6% a year earlier. This reflected primarily a merchandise import decline by 17.0%, particularly for vehicles, machinery, and equipment, while recorded exports fell by 11.6%, mainly from lower nonmonetary gold shipments. Import contraction likely stemmed from moderating reexports and a correction following exceptionally high imports in previous years. Official reserves rose from 2.8 months of import cover at the end of March 2024 to 4.3 months a year later. External risks to the outlook are potential changes in global trade conditions and regional economic developments.

Tajikistan

Growth stayed robust at 8.1% in the first half of 2025, near the 8.2% recorded in the first 6 months of 2024. Mining, trade, and services remained the main drivers of growth. Industry grew by 24.0% year on year, as production of metallic ores rose by 110.0% and food products by 8.0%, with garments down by 3.5% and oil products by 1.7%. Services expanded by 12.8% on growth of 80.2% in financial intermediation, 21.1% in hospitality services, 16.5% in medical services, and 13.3% in transportation. Despite unfavorable weather for crops and locust infestation in the south, growth in agriculture rebounded to 15.9%, while construction output rose by 7.1%.

On the demand side, a surge in remittances and higher public salaries continued to boost private consumption. Remittance inflows surged from $1.1 billion in the first quarter of 2024 to $1.8 billion a year later, despite more stringent regulations in Russia on foreign labor. The delayed effect of last year's increase in public salaries—and an anticipated 30% rise in public salaries, the minimum wage, stipends, and pensions on 1 September 2025—stimulated consumption and helped boost growth in credit and deposits. Average wages rose by 24.2% year on year, reaching an estimated $268 per month. While risks weigh on the medium-term outlook, a surge in remittances and strong growth in the first 6 months of the year justify retaining earlier growth forecasts for 2025 and 2026 (Table 3.1.6).

Table 3.1.6 Selected Economic Indicators in Tajikistan, %

Growth forecasts are unchanged, but low inflation in the first half of 2025 prompts downward revisions to inflation projections for 2025 and 2026.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	8.4	7.4	7.4	6.8	6.8
Inflation	3.6	5.0	4.5	5.8	5.2

GDP = gross domestic product.
Source: Asian Development Bank estimates.

Average annual inflation remained low at 1.8% in the first half of 2025. Twelve-month inflation was 3.6% in June 2025, close to the 3.5% recorded in June 2024. Inflation remained at the lower end of the 3%–7% target band of the National Bank of Tajikistan, the central bank, for a second successive year due to stable commodity prices, a slack labor market, and changes to tax rates. The strong domestic currency also contributed to low inflation. In the first 6 months of 2025, the somoni appreciated by 11.4% against the US dollar. Partly offsetting these deflationary pressures, the central bank lowered its policy rate from 10.00% in 2024 to 7.75% in August 2025, while the government raised public investment by 59% relative to the first half of 2024 to finance public infrastructure, fueling consumption and prices. In addition, the somoni depreciated by 14.4% against the Russian ruble, contributing to a surge in ruble-denominated

remittances. In view of these developments, inflation projections for 2025 and 2026 are reduced from *ADO April 2025*.

Revenue rose by 11.5% in the first half of 2025 for a fiscal surplus equal to 3.5% of GDP. Revenue was $2.57 billion, or 38.8% of GDP, and tax revenue was $1.3 billion, or 19.6% of GDP, 5.7% above projections. Expenditure was $2.34 billion, or 35.3% of GDP, with social sectors accounting for 41.4% of total outlays. With the budget in surplus, public debt declined to $3.6 billion, or 21.4% of GDP, down from 27.5% at the end of June 2024.

Strong remittances fueled a current account surplus in the first quarter of 2025. The surplus was $0.43 billion, or 7.7% of GDP, reflecting the jump in remittances and reversing a deficit of $0.11 billion, or 1.6% of GDP, a year earlier. However, the merchandise trade deficit expanded by 16.6% in the first half of 2025. Merchandise exports fell by 4.3%, while imports rose by 10.5%. Gross international reserves rose from $3.8 billion in 2024 to $4.7 billion at the end of April 2025, providing cover for 7 months of imports of goods and services.

Turkmenistan

The government reported growth at 6.3% in the first half of 2025, the same as in the corresponding period of 2024. Growth was reported in all sectors. Industry is estimated to have grown by 1.8%, mainly driven by construction and moderate expansion in hydrocarbon production. The rest of the economy benefited from expansion in agriculture by 4.5% and services by 9.6%, with wholesale and retail trade growing by 9.9%, transport and communications by 10.8%, and catering and other services by 8.6%.

On the demand side, the government reported higher investment in industrial and social infrastructure. Investment was reported to grow by 15.6%, with 44.8% going to industrial infrastructure, mainly oil, gas, and petrochemicals; chemicals; textiles and light industry; food and consumer goods; and construction materials. The rest was allocated for social projects in housing and urban development, health care and education, and social welfare. Comprising 17.7% of GDP, most investment is public. Assuming the current pace of economic expansion with moderate growth in hydrocarbons, this report slightly reduces the *ADO April 2025* growth projection for 2025 and maintains the growth forecast for 2026 (Table 3.1.7).

Table 3.1.7 Selected Economic Indicators in Turkmenistan, %

The growth forecast is reduced for 2025 but maintained for 2026, while projected inflation is revised down for both 2025 and 2026.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	6.3	6.5	6.3	6.0	6.0
Inflation	5.5	6.0	4.0	6.0	5.0

GDP = gross domestic product.
Source: Asian Development Bank estimates.

Inflation slowed in the first half of the year. Observed price increases for both imported and domestic goods appear to have decelerated slightly to an estimated 4.0% during the first half of 2025. Monetary policy remains focused on containing inflation, with a fixed exchange rate and administrative price controls for basic goods and services. Financial support in the form of concessional credits and official foreign exchange convertibility remains confined to priority firms engaged in import substitution or oriented toward exports. Foreign exchange market pressures continue because of foreign currency rationing but remain broadly stable. In view of the latest inflation developments, this report reduces inflation forecasts for both 2025 and 2026.

The fiscal outlook is broadly consistent with containing inflation. The government aims to keep the state budget balanced in 2025 and 2026, with a moderate increase in revenue from hydrocarbons and higher nonhydrocarbon revenue. In July 2025, Fitch Ratings affirmed Turkmenistan's long-term foreign-currency issuer default rating at *BB–* with a stable outlook. This reflects the economy's strong sovereign balance sheet, notably high net foreign assets thanks to significant natural gas reserves, and low public debt, which is projected to decline to the equivalent of 2.9% of GDP by the end of 2026. These strengths are weighed, however, against unconventional economic policy, particularly its exchange-rate framework; high commodity dependence; and export market concentration. Despite some improvement, significant gaps remain in official data reporting.

Overall, imports and exports are both projected to rise slowly, with exports sensitive to volatility in energy prices. Given recent trends, the current account surplus is projected to narrow to 2.0% of GDP in 2025 and 1.5% in 2026.

Growth in gas exports to the People's Republic of China (PRC) in the first half of 2025 is estimated to have been stable. Gas exports may expand in the future, with higher demand indicated by a recently concluded agreement on gas exports with the PRC, a February 2025 gas supply agreement with Türkiye, and rising demand from Iran, Iraq, and Azerbaijan. Negotiations continue with the PRC to construct a fourth gas pipeline as part of the ongoing development of the Galkynysh gas field, which could boost gas export capacity to the PRC to 65 billion cubic meters from the current 40 billion.

Uzbekistan

Growth remained robust during the first half of 2025. The economy expanded by 7.2% year on year, up from 6.5% a year earlier and exceeding prior expectations. Growth was driven by robust consumption, strong investment and construction, and a surge in gold exports that offset lower exports of some manufactured goods. On the supply side, services expanded by 13.3%, led by gains of 21.9% in information and communication technology, 11.3% in transport, 9.7% in retail trade, and 48.9% in tourism. Industry excluding construction rose by 6.6%, reflecting expansion by 7.1% in manufacturing and 5.1% in mining. Public infrastructure projects boosted construction by 10.7%. Agriculture, forestry, and fishing grew by 4.0%, reflecting gradual increases in agricultural productivity.

Demand-side expansion was broad-based. Private consumption rose by 9.6%, supported by remittances and wage growth, while public consumption grew by 2.6%. Fixed capital investment grew strongly by 5.5%, with large projects in energy, manufacturing, and transport. Net exports also contributed to growth as exports rose by 34.7% to $20.1 billion and imports by 19.9% to $24.3 billion from January to July 2025. Total foreign trade rose by 19.9% during this period to $44.4 billion, or about 70% of GDP, as a surge in gold exports more than offset declines in textiles, automobiles, steel, and petroleum products. Despite the strong first half performance, earlier growth forecasts for 2025 and 2026 are retained because of the risks to external demand from trade tensions (Table 3.1.8).

Table 3.1.8 Selected Economic Indicators in Uzbekistan, %

Despite a strong first half this year, growth and inflation forecasts are maintained for 2025 and 2026 in view of downside risks.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	6.0	6.6	6.6	6.7	6.7
Inflation	9.4	8.0	8.0	7.0	7.0

GDP = gross domestic product.

Sources: State Statistics Committee; Central Bank of Uzbekistan; Asian Development Bank estimates.

Inflation remained elevated during the first 7 months of 2025. Inflation averaged 9.0%, close to the 9.5% observed a year earlier, with increases of 6.5% for food, 7.1% for other goods, and 16.3% for services. Headline inflation slowed from 10.1% year on year in April to 8.7% in June and 8.9% in July, averaging 9.2% in the second quarter, with core inflation at 8.1%. The inflation decline in the second quarter reflected easing pressures on food prices and stabilizing service prices after earlier adjustments to utility tariffs. With inflation moderating somewhat in the second quarter, earlier inflation forecasts for 2025 and 2026 are retained.

Monetary and fiscal policies remain focused on stability. The Central Bank of Uzbekistan kept its policy rate at 14.0% in June, maintaining a tight stance to contain inflation expectations and offset the effects of changes in administered prices. During the first half of 2025, budget revenue grew by 19.2% year on year, driven by strong growth in collections of value-added tax and excise and customs duties. Expenditure rose by 13.4% as the government continued priority spending on infrastructure and social sectors and approved the Fiscal Strategy, 2026–2028, which aims to strengthen fiscal resilience.

Gold exports and remittances trimmed the current account deficit. Exports rose notably in the first half of 2025, led by gold, while imports grew modestly. Remittances increased materially, supporting domestic demand and external buffers. The central bank purchased 11.1 tons of gold in June,

reversing earlier sales in a shift in reserve strategy. Sovereign risk perceptions improved in light of stronger macroeconomic fundamentals, fiscal consolidation, ample reserves, and continued reform. S&P Global revised its outlook on Uzbekistan to positive in May, while Moody's affirmed in June its Ba3 rating with a positive outlook. Moreover, Fitch upgraded its long-term foreign-currency rating from BB– to BB with a stable outlook.

Risks tilt to the downside. The main downside risks would be trade tensions weakening external demand for exports other than gold, notably agricultural products, textiles, and industrial products; higher fuel and transport costs from regional instability and higher tariffs; and persistent inflation expectations that could require tighter policy and slow economic activity.

EAST ASIA

The *ADO April 2025* East Asia growth forecast for this year and next remains unchanged, reflecting the trend in the People's Republic of China (PRC). Growth is projected to be lower than forecast in April for the other East Asian economies this year, except for Taipei,China. Inflation will edge down more than previously forecast, remaining below 1% for the subregion. The East Asia current account surplus will narrow as the United States (US) tariffs start to bite.

Subregional Assessment and Prospects

The East Asian economy grew by 4.9% year on year in the first half (H1) of 2025 compared to 4.8% in H1 2024. Expansionary fiscal policy, strong industrial activity, and robust exports helped drive GDP growth higher in the PRC, averaging 5.3% in H1 2025 year on year, up from 5.0% in H1 2024. Exports grew with gains in non-US markets offsetting US losses, while imports declined on subdued domestic demand, lower commodity prices, and PRC tariffs on US imports. Continuing real estate issues tamped down investment, while tepid real income growth and the weakened property market slowed the expansion in consumption. The pattern varied across the other economies in the subregion. In the Republic of Korea (ROK), weak exports from higher US tariffs and lower investment buffeted by political uncertainty tamped down growth to 0.3% in H1 2025 from 2.8% in H1 2024. Front-loading of exports in anticipation of US tariffs and a boom in artificial intelligence-related products raised export growth in Taipei,China, pushing GDP growth to 6.8%, the second-fastest in 15 years, despite softening domestic demand. In Hong Kong, China, growth accelerated to 3.1%, driven by higher domestic demand as wages rose and interest rates eased, and by rising exports even as shipments to the US declined. The recovery in agriculture drove growth in Mongolia, but mining's contribution to growth fell sharply on weaker PRC demand for coal, pushing growth down slightly to 5.7%.

Inflation in East Asia remained low at 0.2% in H1 2025. Declining food and property prices in the PRC pushed down the consumer price index by 0.1% year on year in the first 7 months of 2025. Producer price deflation also widened, but core inflation rose slightly above the previous forecast on modest increases in prices for services. Inflation remained broadly stable in the ROK, averaging 2.1% year on year in H1 2025, just above the central bank's target of 2.0%. In Taipei,China, lower food prices and a stronger currency kept inflation down to a 4-year low of 1.9%. Inflation in Hong Kong, China rose to 1.7% in H1 2025 as electricity subsidies declined despite subdued core inflation. In Mongolia, inflation remained much higher than elsewhere in the subregion, rising to an average of 8.8% in H1 on higher costs for services.

East Asia's current account surplus widened in H1 2025. In the PRC, the current account surplus tripled to 3.3% of GDP compared to H1 2024 as the trade surplus rose to a record 5.0% of GDP and the services deficit narrowed to 1.2% of GDP. Surpluses also rose in other economies in the subregion, except in Mongolia where the deficit widened on a drop in coal

The section on the PRC was written by Akiko Terada-Hagiwara, Yothin Jinjarak, Wen Qi, and Yajing Wang. The part on other economies by Jules Hugot, Henry Ma, Martino Pelli, Madhavi Pundit, Melanie Grace Quintos, Ed Kieran Reyes, Michael Timbang, and Munkh-Orgil Zorig. All authors are in the East Asia and Economic Research and Development Impact departments of ADB. Subregional assessment and prospects was written by Reza Vaez-Zadeh, consultant, Economic Research and Development Impact Department of ADB.

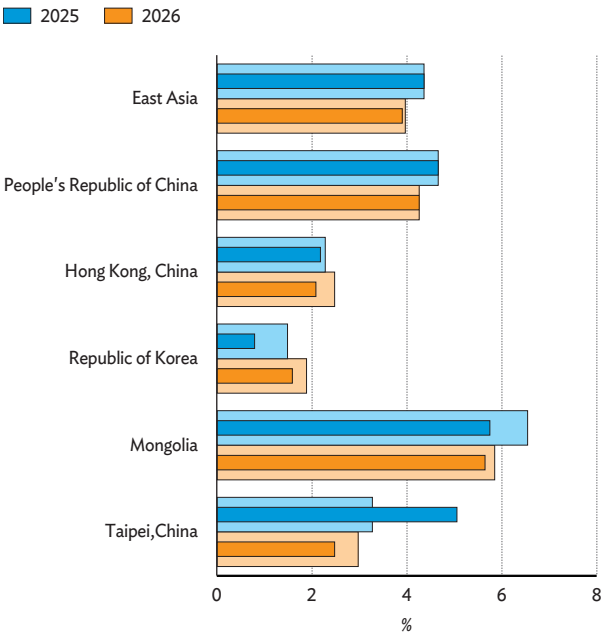
exports. In Hong Kong, China, and Taipei,China, export growth helped widen the current account surplus. In the ROK, while exports declined, imports fell more sharply, widening the current account surplus. The subregional current account surplus will likely decline in 2025 and 2026, as the impact of US tariffs begins to take effect should they remain in place.

The subregional GDP growth forecast for 2025 remains unchanged from *ADO April 2025* projection, at 4.4%, but the forecast for 2026 is revised down to 3.9% (Figure 3.2.1). In the PRC, growth will likely be trending down, falling to 4.7% in 2025 and 4.3% in 2026 as forecast earlier, on the ongoing contraction in real estate investment and moderating growth in services. Competitive pricing of PRC exports could defray the impact of US tariffs if imposed later this year following the currently agreed pause, but a slowdown in export momentum cannot be ruled out. Although consumption is gradually improving, continued sluggishness in construction and the negative impact of US tariffs have led to a downward revision of GDP growth forecasts for the ROK in both 2025 and 2026, compared to April projections. The growth forecasts for Hong Kong, China are also revised down on increased trade uncertainty, though tempered by a rebound in domestic consumption. GDP growth in Mongolia is now projected to be lower than previously forecast both for this year and next as fiscal spending is expected to fall and US tariffs on PRC exports will likely adversely impact PRC demand for Mongolia's mineral products. In contrast, growth in Taipei,China is now forecast to be higher this year than projected earlier on stronger H1 export growth, then moderate in 2026 more than originally expected on weakening domestic demand and the impact of US tariffs.

Inflation in East Asia is forecast to edge down further than projected in *ADO April 2025* to 0.3% in 2025 and 0.6% in 2026 (Figure 3.2.2). Persistent food price deflation, excess supply in certain manufacturing industries, and likely lower oil prices will tamp down inflation in the PRC more than previously forecast, with no change in the consumer price index this year and 0.4% next year. As global oil prices ease and domestic demand remains weak, inflation in the ROK should moderate this year and next to the levels forecast in

Figure 3.2.1 Gross Domestic Product Growth in East Asia

Growth in East Asia will moderate slightly in 2025 and 2026, reflecting trends in the PRC.

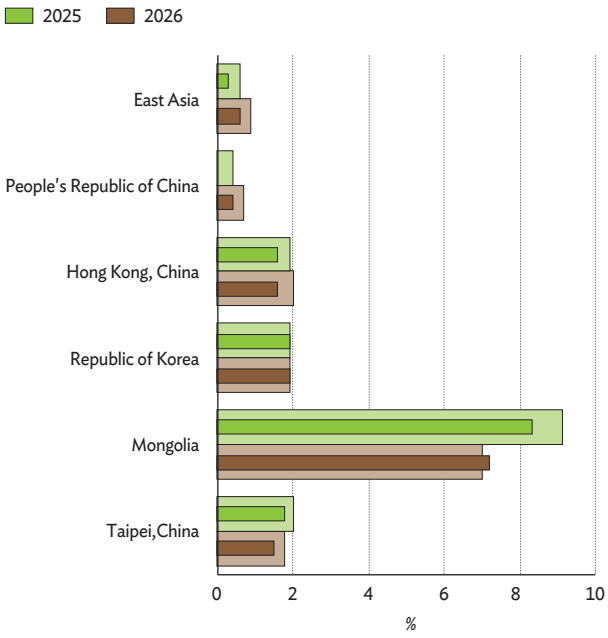


Note: Lighter-colored bars are *Asian Development Outlook April 2025* forecasts.

Source: *Asian Development Outlook* database.

Figure 3.2.2 Inflation in East Asia

Inflation in East Asia will be lower in 2025 and 2026 than ADO April 2025 forecasts mainly on food price deflation in the PRC.



Note: Lighter-colored bars are *Asian Development Outlook April 2025* forecasts.

Source: *Asian Development Outlook* database.

April. In Hong Kong, China, inflation is expected to be below that forecast in *ADO April 2025*, but could move closer to the April forecast in case of monetary policy easing in the US. Based on lower H1 2025 inflation, likely moderating import prices, and an appreciating currency, inflation in Taipei,China is now forecast below *ADO April 2025* projections for 2025 and 2026. In Mongolia, inflation will remain high at 8.6% in 2025, lower than the previous forecast, as planned increases in utility tariffs are postponed, and at 7.2% in 2026, higher than projected in April, as tariffs are raised.

The risks to the East Asian economic outlook are tilted to the downside. These risks include further trade policy uncertainties and heightened trade tensions with the US—which will not only affect external trade but also erode consumer and investor confidence. In the PRC, risks also include a further deterioration in the property market that could lower economic growth and affect exports of other economies in the subregion. On the upside, PRC policy measures aimed at supporting the property market and encouraging consumption could boost consumer and investor confidence more than expected, pushing PRC growth and inflation above forecasts, with positive spillovers throughout East Asia.

People's Republic of China

Expansionary fiscal policy, strong industrial activity, and robust exports helped drive GDP growth higher in the first half (H1) of 2025. Inflation remained low due to falling food prices and subdued domestic demand. The current account surplus widened on strong exports, aided by real exchange rate depreciation and diversified export strategies. The strong GDP growth in H1 is unlikely to continue given the ongoing slowdown in the property market, the sluggish growth of household income and private consumption, and the uncertain trade environment. On balance, GDP growth projections remain unchanged from the *ADO April 2025* forecasts of 4.7% for 2025 and 4.3% for 2026. Inflation forecasts are lowered to 0.0% for 2025 and 0.4% for 2026.

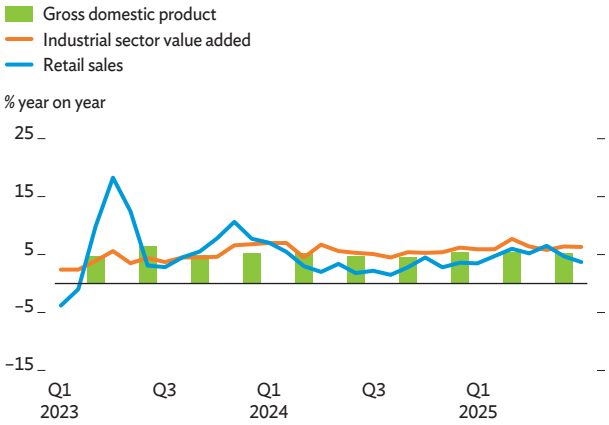
Updated Assessment

Amid trade tensions, growth averaged 5.3% year on year in H1 2025, up from 5.0% in H1 2024. GDP grew by 5.4% in the first quarter (Q1) year on year and 5.2% in Q2, driven by expansionary fiscal policy, including larger consumption subsidies, robust industrial activity, and rising exports (Figure 3.2.3).

Consumption remained the largest contributor to growth in H1 2025, although below that in H1 2024 (Figure 3.2.4). The consumer goods trade-in program helped sustain retail sales growth, which increased by 4.8% in the first 7 months of 2025. Subsidized categories such as communication equipment, household appliances, audiovisual products, electric vehicles (EVs), and furniture grew strongly. However,

Figure 3.2.3 Economic Growth

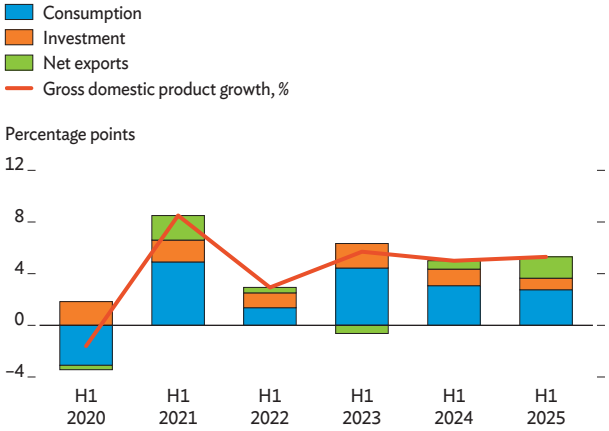
GDP grew strongly in the first two quarters supported by fiscal expansion, robust industrial activities, and rising exports.



Q = quarter.
Sources: CEIC Data Company; Asian Development Bank estimates.

Figure 3.2.4 Demand-Side Contributions to Growth

Compared to last year, net exports contributed more to growth in H1, while contributions from investment and consumption fell.

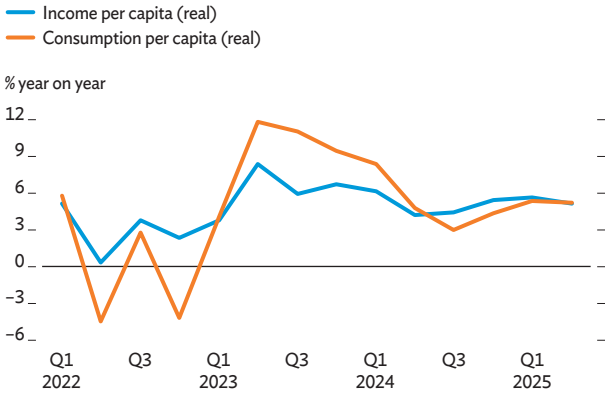


H = half.
Source: CEIC Data Company.

sales growth of products not included in the subsidy program lagged. Consumers remain cautious, with confidence still below pre-pandemic levels. Indeed, the People's Bank of China (PBOC) depositors' Q2 survey showed a reduced preference for spending among urban consumers, with fewer respondents favoring higher spending compared to the end of 2024 survey. Reflecting this, H1's real household consumption grew more slowly than real household income (Figure 3.2.5). Consumer confidence remained weak due to slower real income growth and the negative wealth effects from the weakened property market. Low consumer confidence continues as a headwind to economic recovery and can benefit from further supportive policies.

Figure 3.2.5 Real Growth in Income and Consumption Expenditure per Capita

Per capita household consumption grew more slowly in H1 than per capita household income



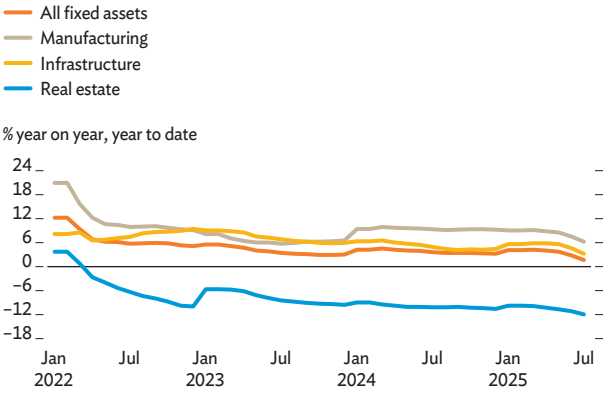
H1 = first half, Q = quarter.

Sources: CEIC Data Company; Asian Development Bank estimates.

Investment added 0.9 percentage points to growth in H1 2025 (down 0.4 points from H1 2024), due to slower growth in infrastructure and manufacturing investment and a sharper decline in real estate investment (Figure 3.2.6). Despite early signs of recovery in first-tier cities, real estate investment fell by 12.0% in the first 7 months of 2025 (compared to last year's 10.2% drop) because of large property inventories and weak demand for real estate in lower-tier cities. However, fixed asset investment increased by 1.6% during the same period, driven by manufacturing and infrastructure growth. Manufacturing investment rose 6.2%, supported by policies encouraging equipment upgrades and high-tech manufacturing. Infrastructure investment rose by 3.2% on the accelerated issuance of local government special bonds.

Figure 3.2.6 Growth in Fixed Asset Investment

Infrastructure and manufacturing investment growth slowed in H1 2025 compared to the same period last year, while real estate investment declined more sharply.



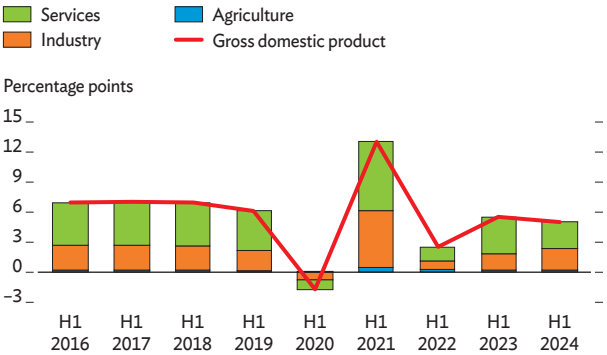
Source: CEIC Data Company.

Despite trade tensions, net exports increased in H1 2025, contributing 1.7 percentage points to GDP growth, up 1.0 points from the previous year. In H1, export volume grew by 5.3%, with gains in non-United States (US) markets offsetting US declines. Imports dropped by 3.0% in volume on subdued domestic demand, lower commodity prices, and People's Republic of China (PRC) tariffs on US exports.

Services expanded, while robust exports and government policies supported industry in H1 2025 (Figure 3.2.7). Driven by strong technology and professional services, the tertiary sector growth rate increased to 5.5%, up from 4.6% in H1 2024. The secondary sector also maintained solid 5.3% growth

Figure 3.2.7 Supply-Side Contributions to Growth

Services expanded, while strong exports and supportive policies contributed to industrial growth.



H1 = first half.

Source: CEIC Data Company.

thanks to robust manufacturing and exports, which benefited from government support for high-tech and equipment-related industries. The value-added in equipment manufacturing rose by 10.2% and high-tech manufacturing by 9.5%. However, industry's profitability remained low due to intense price competition within industries (referred to as "involution"), leading to a 1.8% decline in total profits during H1 2025. Meanwhile, the primary sector grew by 3.7% with its contribution to GDP growth steady at 0.2 percentage points.

Labor markets remained soft in H1 2025. The surveyed urban unemployment rate eased from 5.3% in Q1 to 5.0% in Q2, averaging 5.2% for H1. New urban job creation was 6.95 million in H1, against the full-year government target of over 12 million. This represents a 0.4% year on year decline in urban job creation. Meanwhile, the growth in per capita household income from wages and salaries slowed marginally from 5.8% in H1 2024 to 5.7% in H1 2025.

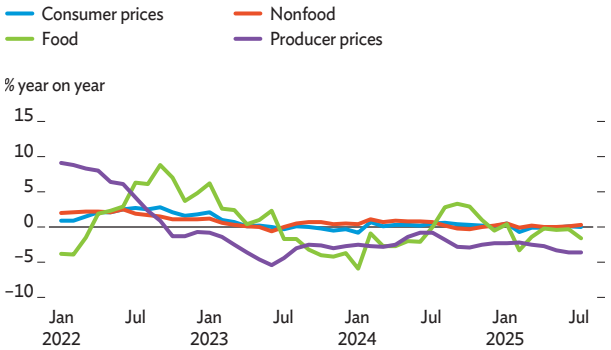
Low inflation persisted amid weak domestic demand. The average consumer price index (CPI) fell 0.1% in the first 7 months of 2025, as ongoing food price deflation continued to hold down headline inflation (Figure 3.2.8). Food prices decreased by 1.0%, driven by declines in fresh vegetables, lamb, and beef, while pork prices dropped by 9.5% in July. However, core inflation rose slightly to an average 0.5% during the same period, supported by modest increases in service prices. Meanwhile, producer price index (PPI) deflation widened to 2.9% on weaker global crude oil prices and intense price competition driven by strong industrial output, low industrial profitability, and weak downstream demand. Prices for newly built homes in 70 major cities continued to fall with the largest declines in lower-tier cities.

Monetary policy eased in H1 2025. Financial authorities, led by the PBOC, eased monetary policy specifically through a reduction in the reserve requirement ratio, cuts to policy rates, and expanded relending facilities. However, credit demand remained low and loan growth slowed from 8.1% year on year in the first 7 months of 2024 to 6.6% year on year by the end of July (Figure 3.2.9). Government borrowing drove social financing, an aggregate that includes bank loans, shadow bank financing, government and corporate bonds, and equity financing. Outstanding government bonds increased 21.9% by end-July, and local government special bond issuance rose by CNY2.2 trillion in H1, representing 55.4% of the local government annual issuance quota (Figure 3.2.10). With monetary easing and low interest rates, bank net interest margins declined further to 1.43% in Q1 2025, down from 1.52% at the end of 2024. Although the nonperforming loans (NPL) ratio remained at 1.51%, weak profit growth limited banks' ability to replenish capital through retained earnings, prompting the government to recapitalize four large state-owned banks in April 2025.

Fiscal policy became more expansionary in H1 2025. The fiscal deficit widened to 3.9% of GDP, up from 3.3% a year earlier, as fiscal spending increased

Figure 3.2.8 Monthly Inflation

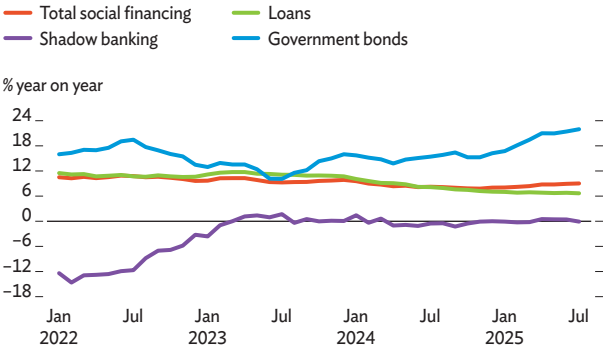
Inflation remained low in the first 7 months of 2025 on declining food prices and producer price deflation.



Source: CEIC Data Company.

Figure 3.2.9 Growth in Credit and Government Bonds Outstanding

Larger government bond issuance contributed to growth in social financing.

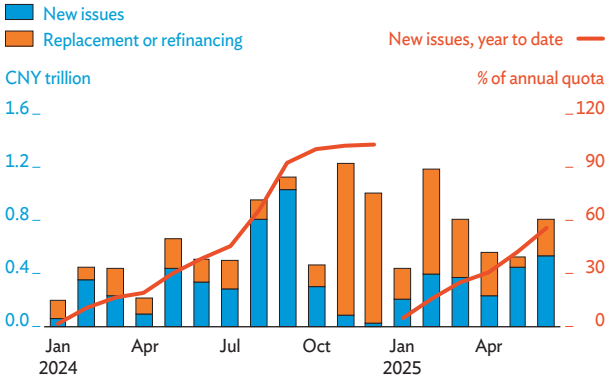


Note: Shadow banking comprises entrusted loans, trust loans, and banks' acceptance bills. Entrusted loans are loans made on behalf of large companies by banks;, trust loans are loans made by trust companies.

Sources: CEIC Data Company; Asian Development Bank estimates.

Figure 3.2.10 Local Government Special Bond Issues

Local government special bond issuance accelerated in H1 2025 compared to H1 2024.

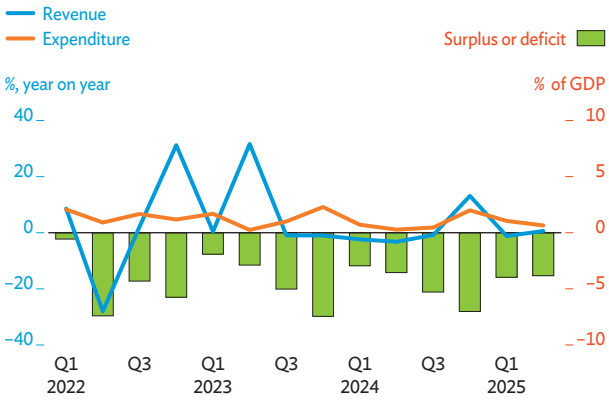


Sources: CEIC Data Company; Asian Development Bank estimates.

and revenue decreased (Figure 3.2.11). Expenditure grew by 3.4%, mainly driven by higher spending on science and technology (up 9.1%), social security and employment (9.2%), and education (5.9%). On the revenue side, subdued business earnings dampened tax receipts. Although value-added tax rose by 2.8% on resilient retail sales, fiscal revenue declined by 0.3% as corporate income tax receipts fell by 1.9% due to lower profitability. Local government revenue also fell as land lease revenues, an important local revenue source, decreased by 6.5% because of the ongoing property market downturn.

Figure 3.2.11 General Government Fiscal Revenue and Expenditure

The budget deficit widened in H1 2025 amid increased spending and falling revenue compared to the same period last year.



GDP = gross domestic product, Q = quarter.

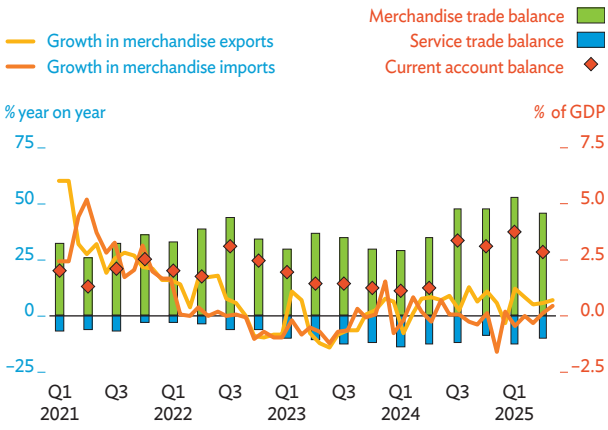
Note: Public finance budget only.

Sources: CEIC Data Company; Asian Development Bank estimates.

The current account surplus reached 3.3% of GDP in H1 2025 compared to 1.2% in H1 2024. Strong exports and subdued imports boosted the merchandise trade surplus to 5.0% of GDP, well above the 3.2% in H1 2024, while the services trade deficit narrowed slightly to 1.2% of GDP (Figure 3.2.12). In the first 7 months of 2025, merchandise exports increased by 6.1% in US dollar terms driven by front-loaded shipments ahead of US tariffs, diversified export strategies, and the trade-weighted depreciation of the renminbi. Growth mainly came from mechanical and electrical products such as electronic integrated circuits, lithium batteries, and ships. Amid the US tariff announcements, PRC exports to the US declined by 12.6% in the first 7 months of 2025. The decline in exports to the US was more than offset by increases elsewhere, including exports to ASEAN (up by 13.5%), Africa (24.5%), the European Union (7.0%), and Japan (4.4%). Imports decreased by 2.7% in dollar terms, reflecting lower commodity prices and subdued domestic demand.

Figure 3.2.12 Current Account Balance and Merchandise Trade

The merchandise trade surplus surged in H1 2025, while the services trade deficit remained stable.



GDP = gross domestic product, Q = quarter.

Note: January and February data are combined to exclude the Lunar New Year effect.

Sources: CEIC Data Company; Asian Development Bank estimates.

Official reserve assets reached $3.6 trillion at the end of June 2025, up by $171.5 billion from a year earlier due to the current account surplus. Net foreign direct investment outflows decreased from 1.3% of GDP in H1 2024 to 0.6% in H1 2025 on an increase in foreign direct investment inflows and a decrease

in outbound direct investment. However, portfolio investment outflows of $901 billion were three times higher than inflows, raising net portfolio investment outflows to $61.2 billion in Q1 2025 from $21.6 billion in Q1 2024. In the first 6 months of 2025, the renminbi depreciated by 0.4% against the US dollar and by 5.8% in real effective terms (weighted by trade shares and adjusted for inflation differentials).

Prospects

As projected in *ADO April 2025*, GDP is forecast to grow by 4.7% in 2025, close to the government's target of about 5.0%, and by 4.3% in 2026 (Table 3.2.1). The economy grew strongly in H1 2025, but major headwinds loom—including uncertain export momentum, ongoing weakness in the property market, deflationary pressures, as well as low household confidence and investor sentiment. Policy measures, including continued support for consumer goods trade-ins and equipment upgrade programs, along with faster deployment of local government special bonds should help mitigate the impact. On balance, growth is expected to moderate in H2 2025 and in 2026 due to these headwinds.

Table 3.2.1 Selected Economic Indicators in the People's Republic of China, %

Growth forecasts remain unchanged from ADO April 2025, but the inflation forecast is revised down for 2025 and 2026.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	5.0	4.7	4.7	4.3	4.3
Inflation	0.2	0.4	0.0	0.7	0.4

GDP = gross domestic product.
Sources: CEIC Data Company; Asian Development Bank estimates.

Supported by government-led investments and policy measures, domestic demand will contribute more to growth this year and next. Support measures include a CNY500 billion relending facility to promote services and elderly care, subsidies for childcare, the gradual rollout of free pre-school programs, and public projects such as a newly launched CNY1.2 trillion hydropower project, which is expected to provide a modest boost (around 0.1% of GDP) to growth during its initial investment phase. However, consumption growth will be dampened by falling house prices and low income growth. Infrastructure and government-backed projects will likely drive investment this year and next, raising its contribution to overall growth. However, the property sector remains a significant drag with the ongoing decline in real estate investment likely to dampen investment growth through the rest of the year and into 2026.

Export growth momentum may slow this year and next. The US and the PRC have reached a temporary agreement to extend the reciprocal tariff pause until November, with current tariff levels remaining for the foreseeable future. The competitive pricing of PRC products should continue to support exports, but uncertain trade conditions and external demand could start to drag on exports in H2 2025. On top of last year's high base, exports will likely contribute less to GDP growth in H2 2025. Import growth will also likely remain tepid due to weak domestic demand and ongoing trade tensions. Overall, the contribution of net exports to GDP should fall in H2 2025 and into 2026. With merchandise trade likely to decline due to trade frictions, and the services account expected to remain stable, the current account surplus is projected to narrow this year and next.

Supporting employment remains a key government policy priority. The Purchasing Managers' Employment index declined in Q2, indicating a contraction in labor demand, rebounding only slightly in July. Going forward, through fiscal expansion and CNY67 billion in employment subsidies for advanced manufacturing, the PRC aims to create new urban jobs in 2025 to absorb the 12.2 million new college graduates (about 7% of the urban workforce) that are expected to enter the job market this year, a 3.6% rise from 2024. Increased government spending will also boost job growth in construction and public infrastructure, benefiting low- and medium-skilled workers, especially migrant workers.

Consumer price inflation this year and next is now expected to be lower than the *ADO April 2025* projections. Inflation will likely remain low, mainly due to lower food prices and an abundant pork supply. While trade-in programs may boost sales volumes, prices of durable goods will likely remain stable due to intense price competition. Also, the downward trend in global oil prices along with falling prices in many

domestic manufacturing industries, including EVs, will likely continue to put downward pressure on inflation. The forecast for consumer price inflation is thus revised down from 0.4% to 0.0% for 2025 and from 0.7% to 0.4% for 2026.

Fiscal and monetary policies should remain supportive in H2 2025 and in 2026. With GDP growth remaining above 5% in H1, the focus will be on timely implementation rather than new significant stimulus measures or expansion in H2, as suggested during the July Politburo meeting. Monetary policy will likely remain accommodative but play a secondary role in stimulating demand as bank net interest margins are at record lows and borrowing sentiment remains subdued.

Risks to the outlook are tilted on the downside. The risk of renewed escalating trade tensions with the US and trade policy uncertainties remains a significant challenge to the growth outlook. As PRC–US trade negotiations still evolve, the volatile nature of the bilateral relationship could heighten policy uncertainty, thus weakening household and business confidence and reducing private consumption. Growing trade uncertainty could also dampen job prospects of export-related industries. The government might respond with additional fiscal and monetary measures to offset these negative effects, though measures need to be implemented quickly to be effective.

Other Economies

Hong Kong, China

The economy grew by 3.1% year on year in the first half (H1) of 2025, up from 2.5% in 2024. GDP gained from rising exports of goods and services and increased investment in H1, along with a revival in private spending in the second quarter (Q2). Goods exports rose 10.0% year on year in H1, rising by 8.4% in Q1 and accelerating to 11.5% in Q2, driven by strong external demand and shipments ahead of higher United States (US) tariffs. Exports to the People's Republic of China (PRC)—accounting for about 60% of Hong Kong, China's exports—continued to outperform, posting 18.0% growth in H1. In contrast, exports to the US, which account for about 6% of exports, declined by 3.8%. Services exports also rose by a healthy 6.9% in H1, with all major service groups showing increases. Notably, exports of financial services increased by 10.0% in H1, supported by the buoyant local stock market. In sum, net exports contributed 0.4 percentage points to growth in H1 2025, though the contribution in Q2 was negative as imports outpaced exports.

Domestic demand rose by 2.7% year on year in H1 2025 as private consumption resumed growth in Q2 after 4 quarters of contraction. Private consumption increased by 1.9% year on year in Q2 and 0.4% in H1, contributing about half of GDP growth in Q2 and adding 0.3 percentage points to H1 growth. Consumption in Q2 was supported by rising wages, easing interest rates, and the wealth effects from the strong local stock market and some recovery in the residential property market as transactions increased 37% over the preceding quarter. Government spending rose by 1.6% in H1 and investment expanded by 14.6%, thanks in part to an increase in expenditure on machinery, equipment, and intellectual property products.

Growth forecasts for 2025 and 2026 are revised down from *ADO April 2025* projections despite the better-than-expected growth in H1 2025 (Table 3.2.2). The boost from H1 exports will likely fade in H2 on increased US tariffs and continued trade uncertainty. This will also impact the economy through trading and logistics services, which account for about 20% of GDP, and trade-related financial services. While net exports reduced Q2 growth, the rebound in domestic consumption, if sustained, may cushion any future impact. This would be supported by a healthy domestic labor and stock markets, along with a likely recovery in the property sector. Nevertheless, even with the US accounting for only 6%

Table 3.2.2 Selected Economic Indicators in Hong Kong, China, %

Growth forecasts for 2025 and 2026 are lowered on heightened trade uncertainty.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	2.5	2.3	2.2	2.5	2.0
Inflation	1.7	1.9	1.6	2.0	1.6

GDP = gross domestic product.
Source: Asian Development Bank estimates.

of exports, the increased US tariffs—currently 54% as of 9 September but possibly significantly higher—along with uncertainties in global demand, continue to cloud the outlook into 2026.

The *ADO April 2025* inflation forecasts are revised down for 2025 and 2026. Headline inflation remained at 1.7% year on year in H1 2025—the same as in 2024. The inflation in H1 was mostly driven by housing rental costs. Electricity, gas, and water also contributed, partly because of a reduction in electricity subsidies. Food price inflation was muted, slowing to 0.5% in H1 from 1.5% in 2024. Netting out the one-off government relief measures, underlying inflation only averaged 1.2% in H1. Somewhat stronger domestic demand and potential US policy rate cuts could slightly raise underlying inflation in H2 2025, but these domestic price pressures are expected to remain contained and further moderate in 2026.

Republic of Korea

Growth slowed to 0.3% year on year in the first half (H1) of 2025 on weak investment and exports. Real GDP remained flat in the first quarter (Q1), followed by a modest 0.6% expansion in Q2. Investment fell by 1.9% in H1, deducting 0.5 points from growth, largely due to a sharp 12.2% decline in construction. Although exports picked up in Q2 on higher semiconductor shipments, overall export growth slowed to 3.0% in H1 2025 amid rising global trade uncertainty and higher tariffs. Exports to the People's Republic of China declined by 4.6% in H1, while shipments to the United States (US) fell by 3.8%. With imports offsetting exports, the contribution of net exports to growth was close to zero. Private consumption improved slightly in Q2 as domestic political uncertainty eased, contributing 0.3 points to H1 growth. Consumer confidence rose for the fifth consecutive month in August, reaching its highest level since January 2018, supported by the implementation of the government's budget stimulus and growth in exports. Public spending rose by 2.4%, adding 0.4 percentage points to growth. On the supply side, services grew by 1.0% and were the main driver of growth. Manufacturing expanded by a tepid 1.3% on weak investment and exports, while agriculture grew by 3.2%.

Inflation averaged 2.0% year on year in the first 8 months of the year, in line with the central bank's target. Transport inflation eased to 0.7% due to lower oil prices. Core inflation, which excludes food and energy prices, averaged 1.9% given the modest growth in domestic demand. To support the economy, the central bank cut its policy rate by 25 basis points to 2.50% in May and has held it steady since then. By end-August, the Korean won had appreciated by 6.2% against the US dollar since the start of the year, buoyed by a rebound in investor confidence following the resolution of political instability.

The current account surplus widened to 5.5% of GDP in H1 2025. While merchandise exports declined by 0.3%, imports fell more sharply by 2.5%, contributing to a higher surplus. However, services posted a larger deficit, primarily due to losses in travel and other business services. The current account surplus may narrow by the end of the year due to weaker exports stemming from higher US tariffs.

The growth forecasts for 2025 and 2026 are revised down from April on weaker investment and exports, but inflation projections remain unchanged (Table 3.2.3). Investment is expected to remain subdued, with high inventories of unsold residential properties and sluggish building permits pointing to continued weak construction. The seasonally adjusted manufacturing purchasing managers' index edged up slightly to 48.3 in August from 48.0 in July, though it remained in contractionary territory for the seventh consecutive month. The decline in output and new orders reflects subdued domestic demand and global trade headwinds. On 30 July, the US announced a trade agreement with an updated 15% tariff on imports from the Republic of Korea, further clouding the export outlook. The government's countercyclical measures include fiscal stimulus and accommodative monetary policy which

Table 3.2.3 Selected Economic Indicators in the Republic of Korea, %

Growth is revised down for 2025 and 2026, with inflation forecasts unchanged.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	2.0	1.5	0.8	1.9	1.6
Inflation	2.3	1.9	1.9	1.9	1.9

GDP = gross domestic product.
Source: Asian Development Bank estimates.

should support domestic spending in H2 2025. Inflation projections remain the same as the April forecasts for both 2025 and 2026, as weak domestic demand and easing global oil prices subdue price pressures.

There remain downside risks to the outlook. These stem largely from the uncertain impact of higher US tariffs and the possibility of additional levies on specific sectors. Global trade tensions and geopolitical uncertainties also continue to weigh on the outlook, while persistent weakness in construction remains a domestic concern.

Mongolia

The economy grew by 5.6% year on year in the first half (H1) of 2025 driven by a recovery in agriculture. After two consecutive years of contraction, agriculture rebounded in H1 2025 on favorable weather conditions. The sector expanded by 35.6% year on year, contributing 3.6 percentage points to GDP growth. Mining, the largest driver of economic growth in recent years, contributed only 0.1 percentage points. Despite the ramp-up in Oyu Tolgoi production of copper concentrates, there was a drop in coal exports, affected by weakening steel market conditions in the People's Republic of China (PRC). Non-mining industry grew by 9.6% year on year and contributed 1.0 percentage points to growth on additional electricity generation and increased residential construction. On the demand side, economic growth was primarily driven by a 6.7% increase in consumption, largely due to public sector and minimum wage increases, and a 7.9% increase in gross capital formation on a buildup of livestock resources.

Consumer price inflation averaged 8.8% year on year in H1 2025, above the central bank's upper 8% target. Inflation in services accelerated to 16.6% year on year on electricity tariff adjustments in November 2024 and city bus fare increases in February 2025, becoming the largest contributor to headline inflation. Significant currency depreciation in early 2025 drove up imported goods inflation to 5.0% year on year during H1 2025. The central bank responded by hiking its policy rate by 200 basis points to 12% in March 2025 and has since maintained the policy rate with inflation gradually easing.

Current account and government budget balances deteriorated amid declining coal prices. Coal export revenue fell by more than 40% year on year, widening the current account deficit to 14.5% of GDP in H1 2025, despite broadly unchanged imports and slightly better services trade and primary income balances. The coal revenue shortfall also resulted in a 6.1% year on year government revenue contraction in H1 2025, requiring the government to amend budget projections down and targeting a smaller 1.1% of GDP surplus for fiscal year 2025.

Economic growth projections are adjusted down for 2025 and 2026 on lower mineral exports and reduced fiscal spending (Table 3.2.4). The recovery in herd size and ramp-up of the Oyu Tolgoi underground mine will continue to add to GDP growth. Nevertheless, higher international restrictions and the United States tariffs on PRC steel will likely dampen the demand for Mongolia's minerals, especially for coking coal, resulting in lower mining growth throughout 2025–2026. Moreover, the recent retrenchment in government spending, including cuts in public sector employment, are expected to weaken consumption and public investment especially during H2 2025.

Table 3.2.4 Selected Economic Indicators in Mongolia, %

Growth forecast is revised down for 2025 and 2026, but inflation forecast is revised down for 2025 and raised for 2026.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	5.1	6.6	5.7	5.9	5.7
Inflation	6.2	9.1	8.6	7.0	7.2

GDP = gross domestic product.

Sources: National Statistics Office of Mongolia, Bank of Mongolia, Ministry of Finance databases and Asian Development Bank estimates.

The consumer price inflation forecast is revised down for 2025 but raised for 2026. Inflation in 2024 was updated based on a new consumption basket, resulting in a decrease of 0.6 percentage points. A comparable decrease is expected for 2025. In addition, the government's decision to postpone any impending tariff increases on heating and water supplies to 2026 should ease price pressures this year, but increase

them in 2026. Domestic food prices face upward pressure due to an anticipated drop in crop production. As external imbalances are expected to persist, inflationary pressure from imported goods will likely remain high.

Risks to the outlook are tilted to the downside. Demand for Mongolia's export commodities, especially coal, may suffer in case steel production in the PRC faces additional restrictions. Any delays in Oyu Tolgoi underground mine development may slow mineral production and associated revenue. The upcoming winter may be harsh due to drought during the 2025 summer, hurting agricultural production.

Taipei,China

Booming technology exports fueled the economy in the first half (H1) of 2025 with GDP rising by 6.8%, the second-fastest in 15 years. Growth sped up from 5.5% in the first quarter (Q1) of 2025 to 8.0% in Q2. Export growth jumped from 19% in Q1 to 35% in Q2, driven by front-loading shipments in anticipation of higher United States (US) tariffs. The surge was also due to the structurally robust demand for the high tech and AI-related products that are Taipei,China's strong suit. Import growth was also strong in H1 given that the economy's exports are import-intensive. Net exports contributed 3.2 percentage points to growth.

Other demand components showed signs of slowing in H1 2025. Private consumption growth, already tepid at 2.0% in H2 2024, weakened further to 0.9% on lower property prices, a slump in the stock market in April following the threat of higher US tariffs, and continuing global uncertainty. Growth in government consumption slowed to 1.7%, and government investment grew by only 4.3%. Private investment grew by 18.2%, driven by investment in machinery and equipment, which grew by 43.3%, as inventories were massively drawn down to fulfill export orders.

Inflation eased to a 4-year low in H1 2025 on lower food prices and a stronger currency. Headline inflation fell from 2.7% year on year in January to 1.6% year on year in August as food price inflation dropped from 3.7% to 2.9%, primarily due to lower fruit prices after the January uptick (when fruits were used as Lunar New Year gifts). Lower energy prices and the local currency's appreciation against the US dollar (11.5% during H1 2025) also helped keep inflation down. Core inflation also dropped from 2.3% to 1.3% during H1 2025 on the currency's appreciation and moderating import prices. Producer price inflation, meanwhile, has been negative since May. With overall price pressures contained, the inflation forecasts for 2025 and 2026 are revised down relative to the *ADO April 2025* projections.

Growth in 2025 is forecast to be higher than the *ADO April 2025* projection and lower in 2026 (Table 3.2.5). Based on the robust expansion in H1 and slower growth expected in H2, GDP is forecast to rise by 5.1% in 2025. Export growth will likely slow in H2 as front-loading unwinds and the 20% US tariffs take effect. However, they will remain robust, as the 38% growth in exports (64% for tech products) in July–August indicates. Limited available substitutes for Taipei,China's high-end semiconductors, and surging demand for AI-related tech products will cushion the slide. Domestic demand, however, is expected to remain weak in H2. Private consumption is projected to grow by just 0.8%. Inventories will continue to be drawn down, and fixed investment will weaken in response to trade pressures. The downward revision in the 2026 growth forecast assumes that domestic demand will remain modest, restrictive US trade policies will reduce export demand, and AI-related spending will moderate.

Table 3.2.5 Selected Economic Indicators in Taipei,China, %

Booming tech exports are driving growth in 2025, but the pace could ease in 2026 with inflation remaining lower than expected in both years.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	4.8	3.3	5.1	3.0	2.3
Inflation	2.2	2.0	1.8	1.8	1.5

GDP = gross domestic product.
Source: Asian Development Bank estimates.

Risks to the outlook lean upward in 2025 and downward in 2026. Although trade policy shocks could hurt export growth in Q4 2025, AI-related spending is becoming stronger than expected and could more than offset negative shocks, such as the People's Republic of China's (PRC) ban on its largest

tech firms ordering Nvidia AI chips. For 2026, however, the full impact of US tariffs on the economy may be more evident and the AI investment boom could slow. In addition, efforts in the US, the PRC, and Japan to produce high-end chips could erode Taipei,China's advantage. An upside risk in 2026 is higher government expenditure as authorities plan to raise defense spending by 23% to 3.3% of GDP and to provide as much as 18.6 billion USD in special budget support for households and sectors harmed by US tariffs.

SOUTH ASIA

The subregional economic growth forecast is revised down from *ADO April 2025* for both 2025 and 2026. In 2025, only Bangladesh, Nepal, and Pakistan are now expected to outperform the earlier projection, and in 2026 only Maldives. Aggregate inflation is now forecast much lower in 2025, with lower projections for every economy except Afghanistan, and slightly higher in 2026, with lower projections for only Afghanistan and Nepal. Risks to the outlook, largely external, tilt to the downside.

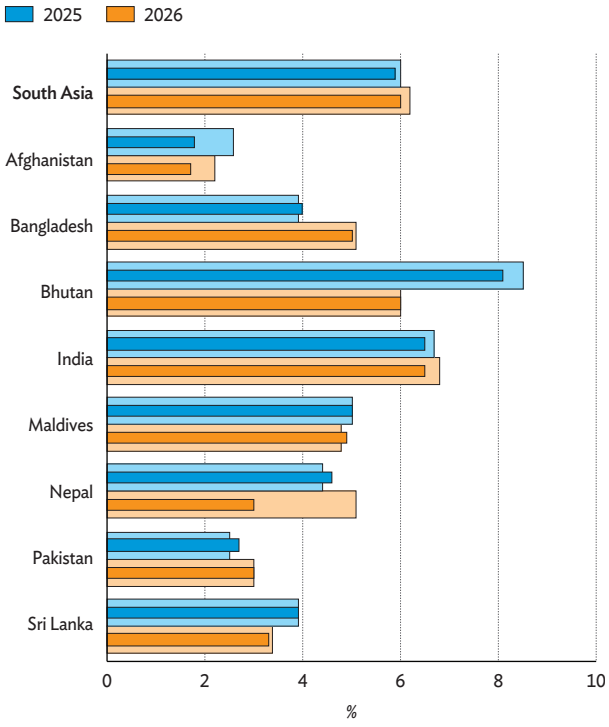
Subregional Assessment and Prospects

Aggregate subregional GDP is forecast to grow by 5.9% in 2025 and 6.0% in 2026, both slightly less than projected in *ADO April 2025* (Figure 3.3.1). The 2025 forecast is revised down from 6.0% in April, reflecting the expected impact of US tariffs imposed in the first half of 2025 and likely to remain in effect throughout 2026. The 2026 projection is also lower than expected earlier, as the tariffs are expected to dampen export and industrial performance across the region. Tariff impact will be uneven in the subregion, with Bangladesh, Sri Lanka, and particularly India likely to be more affected by higher tariff rates.

In India, GDP growth is forecast at 6.5% this year and next, revised down from earlier projections. Despite strong growth in the first quarter of fiscal year 2025 (FY2025, ending 31 March 2026), driven by consumption and public investment, elevated US tariffs affecting about 60% of goods exported to the US will weigh on growth starting in the second half of FY2025 and in FY2026. Merchandise exports are expected to grow only modestly, constrained by US tariffs on key exports, while exports of services are expected to remain robust and a key driver of growth. Investment growth is expected to be lower than previously

Figure 3.3.1 Gross Domestic Product Growth in South Asia

Economic growth in South Asia will remain strong but slightly lower than projected in April.



Notes: ADB placed on hold its regular assistance in Afghanistan effective 15 August 2021. Lighter-colored bars are *Asian Development Outlook April 2025* forecasts.

Source: *Asian Development Outlook* database.

The subregional assessment and prospects was written by Rana Hasan, Kiyoshi Taniguchi, and consultant Mia Andrea Soriano. The section on Bangladesh was written by Barun K. Dey and Chandan Sapkota; Bhutan by Sonam Lhendup; India by Chinmaya Goyal, Deeksha Bhardwaj, and consultant Simran Uppal; Maldives by Elisabetta Gentile and consultants Macrina Mallari and Nasheeda Rasheed; Nepal by Manbar Singh Khadka and Neelina Nakarmi; Pakistan by Khadija Ali and Maleeha Rizwan; and Sri Lanka by Lilia Aleksanyan, Lakshini Fernando, Nirukthi Kariyawasam, and Dinuk de Silva. ADB placed on hold its regular assistance in Afghanistan effective 15 August 2021.

forecast, with corporate investment still subdued by global trade uncertainty. On the other hand, consumption demand will grow more than previously expected, helped by lower food prices and cuts to consumption and income taxes.

Afghanistan GDP expanded for a second consecutive year in FY2025 (ended March 2025), but a slowdown prompts downward revision for FY2026. Persistent structural challenges and a 10% decline in international assistance constrained growth in FY2025. The economic outlook remains highly problematic, with low growth likely over the medium term. The FY2026 growth forecast is revised down in light of reduced international humanitarian aid, the forced return of Afghan refugees, little support for basic needs, and a fragile private sector.

Bangladesh officially estimated GDP growth slowing slightly to 4.0% in FY2025 (ended 30 June 2025). This is closely aligned with the April projection. Growth was supported by a rebound in manufacturing late in the year despite political unrest, labor disruption, flooding, and high inflation that dampened demand. In FY2026, growth is expected to accelerate to 5.0%, slightly lower than the April forecast on account of US tariffs. In addition, tight fiscal and monetary policies may further weigh on investment. The outlook is subject to several downside risks: geopolitical tensions, trade uncertainty from US tariffs, inflationary pressure from election-related spending, and vulnerability in the finance sector.

Bhutan's growth forecast for 2025 is revised down to 8.1% but unchanged for 2026. The downward revision primarily reflects delay in finalizing a power tariff agreement with India, which constrained the large hydropower sector despite favorable hydrological conditions, and base effects from strong growth in 2024. The outlook for 2026 remains steady, supported by increased government spending, ramped-up construction on major hydroelectric projects, and continued recovery in tourism and agriculture.

In Maldives, the April GDP growth projection for 2025 is maintained at 5.0%, while the forecast for 2026 is raised to 4.9%. Growth in both years is expected to be driven primarily by strong tourism and fisheries. Tourist arrivals and receipts rose significantly in the first half of 2025, and fish exports surged by volume and value following the removal of price controls. Growth is still expected to moderate slightly in 2026 as rising external debt obligations constrain government infrastructure spending.

Growth in Nepal is expected to weaken sharply in FY2026 (ending mid-July 2026) following political unrest. GDP growth in FY2025 exceeded the April forecast, supported by a favorable monsoon for agriculture and a rebound in industry. However, growth in FY2026 is projected to slow to 3.0%, well below the earlier projection in light of civil unrest in September that toppled the government. Manufacturing is expected to decelerate under heightened political uncertainty and weakened investor confidence, while construction will remain subdued. Services, especially tourism, will remain weak, but remittance inflows are expected to stay resilient, and Nepal's sound macroeconomic fundamentals are expected to temper the downgrade—assuming a stable interim government until elections.

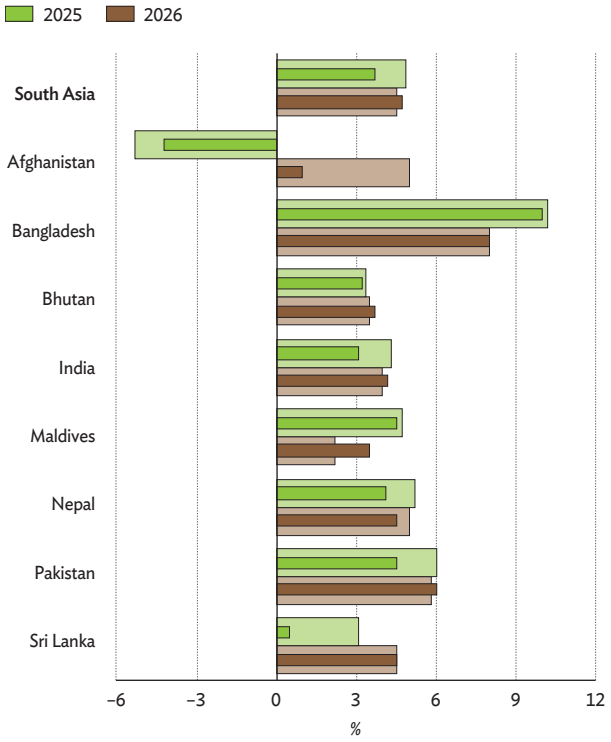
In Pakistan, growth accelerated in FY2025 (ended 30 June 2025), while the forecast for 2026 is unchanged. The economy grew by 2.7% in FY2025 as investment increased, attracted by stable macroeconomic conditions and ongoing policy reform. Growth came primarily from industry and services while bad weather affected agriculture. The FY2026 growth forecast remains unchanged at 3.0%, reflecting the expectation that economic performance will be buoyed by continued reform to address structural weaknesses.

Sri Lankan GDP growth forecasts remains unchanged for 2025 at 3.9% but is revised down for 2026. Growth momentum was sustained in the first quarter of 2025 as consumption recovered on stronger remittances and credit. Leading indicators suggest continued strength in key sectors, as rising private credit buoys growth throughout the year. The growth forecast for 2026 is revised down to 3.3%, reflecting heightened external risks, notably higher US tariffs, which may weigh on Sri Lanka's exports of garments and rubber in particular and adversely affect employment in export-oriented industries.

Inflation across South Asia is projected to moderate in 2025 and rise slightly in 2026 (Figure 3.3.2). Moderation in 2025 has reflected easing food prices, favorable weather, and subdued global commodity prices. However, inflation is projected to rise slightly

Figure 3.3.2 Inflation in South Asia

Inflation in South Asia is now expected to moderate more in 2025 than expected in April and accelerate more in 2026.



Notes: ADB placed on hold its regular assistance in Afghanistan effective 15 August 2021. Lighter-colored bars are *Asian Development Outlook April 2025* forecasts.

Source: *Asian Development Outlook* database.

in 2026 as base effects fade and domestic pressures reemerge. Inflation in India is now forecast to fall to 3.1% in FY2025 as food prices decline more than expected, then rise to 4.2% in FY2026 as food price trends normalize. In Bangladesh, inflation eased slightly in FY2025 but remained in double digits due to supply chain constraints and currency depreciation; it is expected to moderate further in FY2026 as monetary and fiscal policies tighten. Sri Lanka has experienced deflation for most of 2025, but inflation has since turned positive and is forecast to return in 2026 and converge on the central bank's inflation target. In Maldives, inflation is expected to ease in 2025 with lower utility costs and delayed subsidy reform but increase in 2026 as external debt repayment strains foreign exchange reserves and weakens the rufiyaa on the parallel exchange market. Bhutan and Nepal face upward inflationary pressures in 2026 as prices rise in neighboring India.

Risks to the outlook tilt to the downside. They stem largely from external factors, most notably heightened trade tensions and geopolitical instability. Domestic risks are climate shocks, low external reserves, fiscal pressures, and finance sector vulnerability.

Bangladesh

GDP growth in fiscal year 2025 (FY2025, ended 30 June 2025) slowed, as expected, as demand weakened under political unrest, supply disruption caused by labor disputes and repeated flooding, and tighter macroeconomic policies. Inflation surged into double digits on supply chain constraints and currency depreciation. The current account turned into a small surplus as exports rebounded sharply compared with imports. However, growth is expected to recover in FY2026 with improved domestic demand and inflation should ease. Given the uncertain impact of the US tariffs on Bangladesh's international trade and elevated banking sector vulnerabilities, achieving higher growth will require improving the business environment to boost competitiveness and attract investment, as well as securing reliable energy supplies.

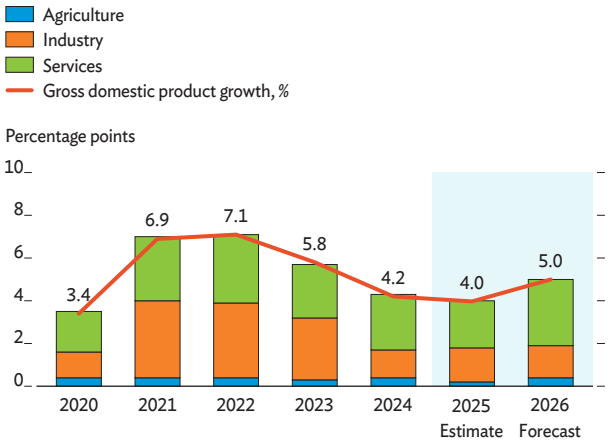
Updated Assessment

GDP growth is officially estimated at 4.0% in FY2025, close to 3.9% as projected in *ADO April 2025* but lower than 4.2% in FY2024 (Figure 3.3.3). Recent quarterly data reveal that, despite challenges, growth strengthened from 2.0% year on year in the first quarter of FY2025 (July–September 2024) to 4.5% in the second quarter and 4.9% in the third quarter, primarily on improved manufacturing. However, overall growth in FY2025 is estimated to have been lower than in the previous year due to political turmoil, adverse weather, labor disruption at factories, elevated inflation, sluggish global demand affecting exports, currency depreciation, and domestic policy uncertainty—all of which dampened demand.

These factors also affected the supply side. The service sector slowed due to ongoing political unrest, vulnerabilities within the finance industry, and diminished purchasing power for households, and agricultural output declined with repeated flooding. In contrast, industry is estimated to have rebounded

Figure 3.3.3 Supply-Side Contributions to Growth

Growth ended down under political unrest and floods in 2025 but is forecast to rise in 2026 as services rebound.

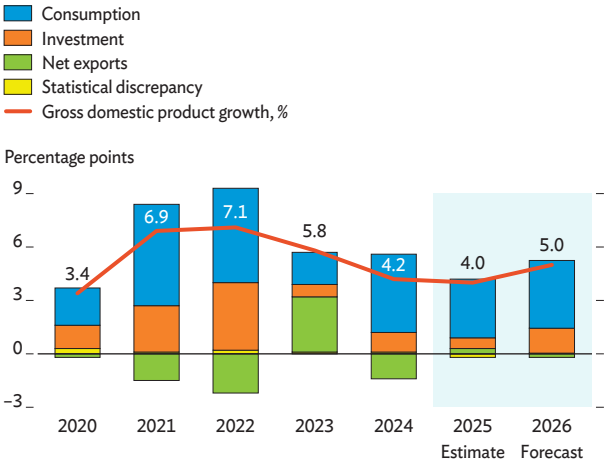


Note: Years are fiscal years ending on 30 June of that year.

Sources: Bangladesh Bureau of Statistics; Asian Development Bank estimates.

Figure 3.3.4 Demand-Side Contributions to Growth

Growth slowed in 2025 as consumption and investment weakened, but higher consumption is forecast to boost growth in 2026.



Note: Years are fiscal years ending on 30 June of that year.

Sources: Bangladesh Bureau of Statistics; Asian Development Bank estimates.

on rising external demand for merchandise exports, despite factory disruptions in the early part of FY2025.

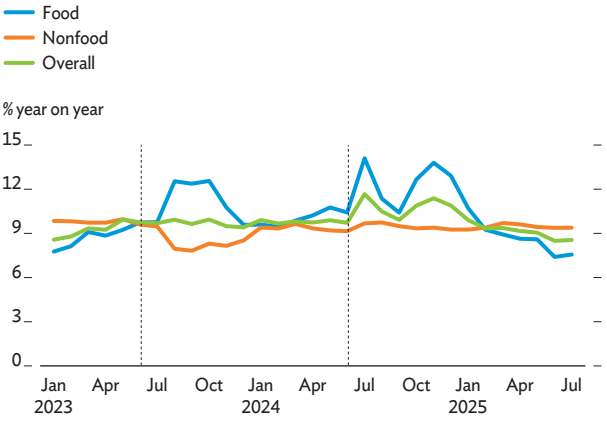
Consumption, investment, and net exports contributed modestly to growth in FY2025 (Figure 3.3.4). Despite high inflation, both consumption and investment grew modestly, buoyed by healthy remittance inflows but hampered somewhat by tight monetary and fiscal measures, as well as a cautious approach adopted by investors. Restrictive policies and deferred payment for imports of energy and fertilizer dampened import expansion. As export growth slowed, net exports contributed only modestly to overall economic growth.

Inflation accelerated to an average of 10.0% in FY2025 from 9.7% in FY2024 (Figure 3.3.5). It gradually declined in the second half of FY2025 with stable or lower prices for many food items. However, average annual inflation for FY2025 surged over the previous fiscal year as nonfood inflation increased to 9.5% from 8.9% in FY2024, while food inflation persisted in double digits at 10.7%.

Banks remain under considerable stress, primarily from high nonperforming loans (NPLs), a legacy of prolonged regulatory forbearance and weak institutional governance. Recently tightened loan

Figure 3.3.5 Monthly Inflation

Price pressures accelerated in the first half of FY2025 and eased in the second half.



FY = fiscal year.

Source: Bangladesh Bank. 2025. *Monthly Economic Trends*. August.

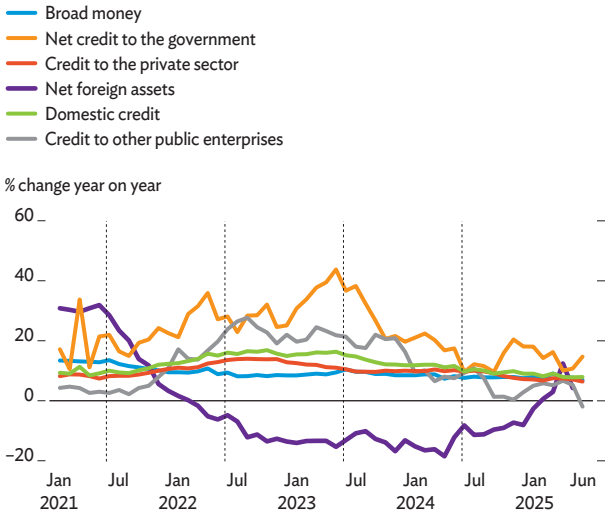
classification standards pushed up the systemwide NPL ratio from 12.6% at the end of June 2024 to 24.1% by the end of March 2025, with NPLs in state-owned commercial banks now exceeding 45%. Asset quality reviews undertaken with support from ADB and other development partners are expected to reveal further vulnerabilities, with implications for credit growth and broader financial and macroeconomic stability. Addressing these challenges will require stricter provisioning; credible bank restructuring and

recapitalization; enhanced regulatory capacity in Bangladesh Bank, the central bank; and the creation of a robust bank resolution framework.

Money supply growth slowed to 7.0% in FY2025 from 7.7% in FY2024 (Figure 3.3.6). Growth in credit to the public sector increased sharply to 13.1% in FY2025 from 9.7% in FY2024, primarily on higher credit demand from the government to meet its spending needs following a significant shortfall in revenue collection. Private sector credit increased by 6.5%, down from 9.8% because of political uncertainty and high borrowing costs. The central bank adopted a cautious approach to monetary policy, prioritizing exchange rate stability and economic resilience over rapid policy changes. It has kept the repo rate steady at 10.0% since October 2024.

Figure 3.3.6 Monetary Indicators

Credit growth moderated in FY2025 as contractionary monetary policy came into effect.



FY = fiscal year.

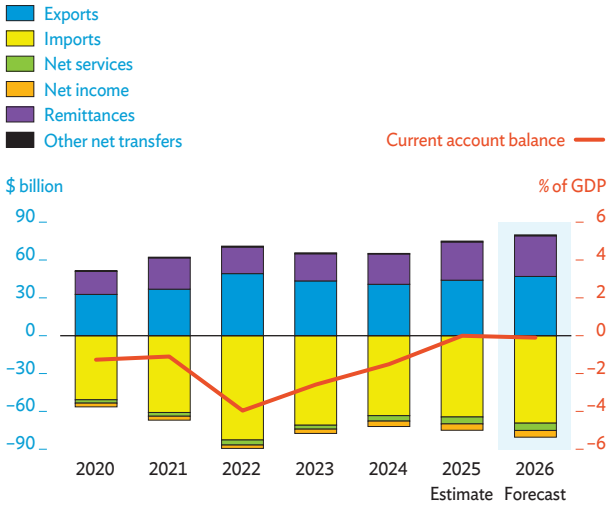
Source: Bangladesh Bank. 2025. *Major Economic Indicators: Monthly Update*. July.

The FY2025 fiscal deficit was targeted to increase to 4.1% of GDP from 4.0% in FY2024. This assumed increases in expenditure to 13.4% of GDP and revenue to 9.3%, but these targets probably were not met. Despite a value-added tax (VAT) increase from 5% to 15% and supplementary duties on many items by more than 50% in January 2025, overall revenue collection grew only by 9.1% in the first 10 months of FY2025 over the same period of the previous year, or 67.1% of the target. The shortfall reflected poor annual development program implementation, stagnant investment, and sluggish business sentiment, which depressed imports and duty receipts from them. Expenditure under the annual development program fell to 67.9% of the planned amount in FY2025, down from 80.9% in FY2024. Total expenditure rose by 13% in the first 10 months of FY2025 but reached only 57.9% of the annual target.

The current account crossed into a small surplus equal to 0.03% of GDP in FY2025 against a deficit of 1.5% in FY2024. The notable cause was a surge in remittances (Figure 3.3.7). Despite economic and political challenges and factory disruptions, exports rose by 7.7% in FY2025, reversing 5.9% decline the previous year, thanks to competitive pricing and cash incentives (Figure 3.3.8). Imports grew by 1.8% in FY2025, compared with a 10.6% decline a year before. Remittances rose to a record $30.3 billion in FY2025, a 26.8% increase from the previous year, supported by the market-based competitive exchange rate, ongoing cash incentives, and improved capture of transfers through strict oversight. Foreign exchange reserves increased by $6 billion to $26.7 billion in FY2025, or cover for 4.2 months of imports of goods and services, driven by the sharp rise in remittances and the release of pledged funds by various multilateral agencies

Figure 3.3.7 Current Account Components

The current account turned to a small surplus in 2025 on lower imports and stronger remittances but to reverse to a small deficit in 2026 on slower export growth.



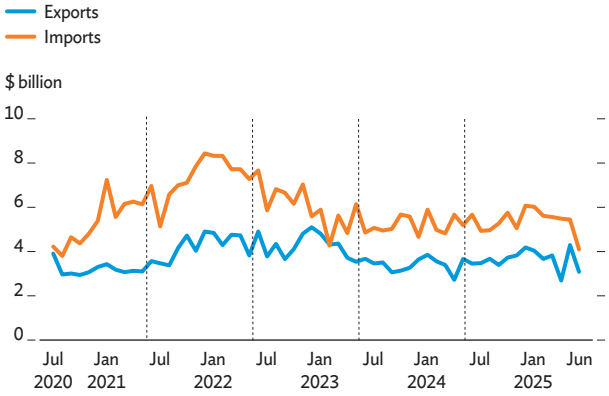
GDP = gross domestic product.

Note: Years are fiscal years ending on 30 June of that year.

Source: Bangladesh Bank.

Figure 3.3.8 Monthly Exports and Imports

The trade deficit widened marginally in FY2025 on slower growth in exports.

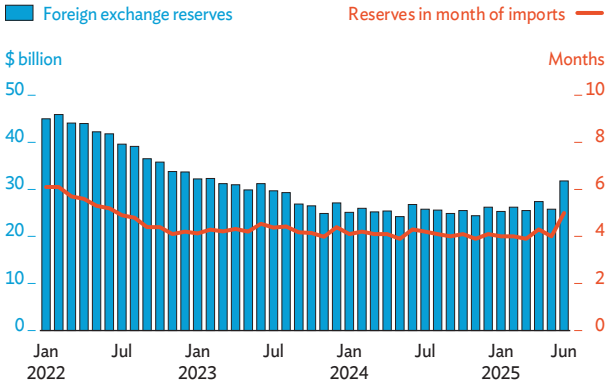


FY = fiscal year.

Source: Bangladesh Bank. 2025. *Major Economic Indicators: Monthly Update*. July.

Figure 3.3.9 Gross Foreign Exchange Reserves

Central bank reserves stabilized in FY2025.

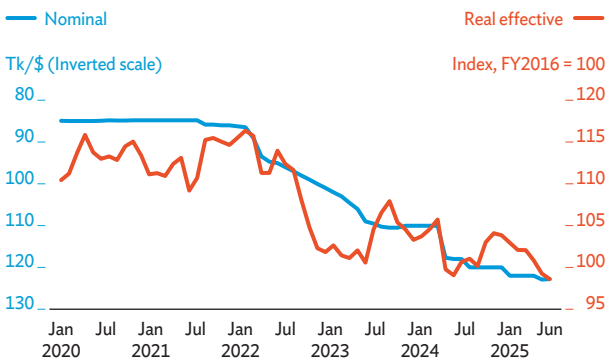


FY = fiscal year.

Source: Bangladesh Bank.

Figure 3.3.10 Exchange Rates

The taka depreciated markedly against the dollar.



FY = fiscal year.

Source: Bangladesh Bank.

following the central bank's adoption of a floating exchange rate regime on 14 May 2025 (Figure 3.3.9). Despite an improving balance of payments, the taka depreciated by 3.9% against the US dollar in FY2025 (Figure 3.3.10).

Prospects

GDP growth is projected to rise to 5.0% in FY2026, slightly lower than the projection in *ADO April 2025* (Table 3.3.1). Services are expected to drive growth in tandem with a return to normal growth in agriculture, assuming favorable weather and government policy support. Despite contractionary monetary and fiscal policies, growth in services will be higher, supported by stronger household purchasing power and election-related spending. Investor confidence should improve with general elections scheduled for February 2026 and ongoing finance sector reform to strengthen the stability, transparency, and efficiency of the finance system. However, industrial output is expected to grow more slowly as US tariffs on Bangladesh exports tamp down GDP growth.

Table 3.3.1 Selected Economic Indicators in Bangladesh, %

The growth forecast for FY2026 is revised marginally down from the April projection, but the inflation forecast is unchanged.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	4.2	3.9	4.0	5.1	5.0
Inflation	9.7	10.2	10.0	8.0	8.0

FY = fiscal year, GDP = gross domestic product.

Note: Years are fiscal years ending on 30 June of that year.

Sources: Bangladesh Bureau of Statistics; Asian Development Bank estimates.

Consumption will be the main driver of growth in FY2026. Easing inflation and rising remittances are expected to increase private consumption. Public consumption is also expected to increase ahead of the elections. However, tight monetary and fiscal policies could dampen both private and government investment. Imports are expected to increase with the central bank lifting restrictions on letters of credit. Exports should continue to grow on expected recovery in major destinations for Bangladesh's exports, but at a slower pace due to the possible impact of US

tariffs. Net exports are likely to drag down economic growth marginally.

A 20% US tariff on Bangladesh exports since August 2025 will likely hit exports to the US substantially and thus impacts GDP. These exports amounted in FY2025 to 18% of total exports and 1.9% of GDP. The new tariff will raise average duties on Bangladesh exports to the US from 15% to 35%, with apparel tariffs climbing from 16.8% to 36.8% and some items such as manmade fiber sweaters reaching 52%, disproportionately affecting women workers. While the tariffs are less stringent than those applied to India or the People's Republic of China, they can erode demand for Bangladesh exports to the US. In addition, exports to the European Union will face stiffer competition, forcing exporters to lower prices unless they manage to diversify markets, explore new trade agreements, and take measures to enhance competitiveness.

Inflation is expected to ease to 8.0% in FY2026, as projected in the April forecast. Inflationary pressures are likely to moderate, assuming favorable weather, lower global oil prices notwithstanding conflict in the Middle East, and tighter monetary and fiscal stances. The central bank's monetary policy statement for the first half of FY2026 emphasizes containing inflation and managing inflation expectations amid ongoing domestic and external challenges. The central bank is expected to keep policy rates steady unless headline inflation falls below 7%.

Fiscal and current account balances are likely to improve in FY2026. The budget targets a deficit equal to 3.6% of GDP, narrower than the 4.1% target in the revised FY2025 budget. Fiscal revenue is planned to grow to 9.0% of GDP, while expenditure will be contained at 12.6%, with current expenditure targeted to increase by only 3.3% and capital expenditure by 11.5%. About 55% of the deficit will be financed domestically and the remaining 45% from foreign sources. To boost revenue in FY2026, the government has raised the tax-free income threshold for individuals, simplified tax compliance by revising tax slabs, increased corporate tax rates for listed companies, and raised VAT rates. At the same time, it extended import tax exemptions for critical raw materials used in health care and pharmaceuticals. To boost efficiency, the government has introduced incentives to curb cash transactions and streamlined VAT regulations. Based on expected developments in exports and imports, and a likely rise in remittances owing to a more flexible exchange rate regime, a small current account deficit equal to 0.08% of GDP is forecast for FY2026.

The outlook for FY2026 is subject to downside risks. Trade uncertainty arising from new US tariffs and potential disruption from geopolitical tensions could hinder export growth. Poor implementation of the new managed float exchange rate policy could worsen external imbalances. Despite recent monetary tightening, higher election-related spending and unsterilized liquidity support to weak banks may raise inflation and pressures in the foreign exchange market while weakening governance reform. If banking sector weaknesses persist, credit could tighten, growth slow, and fiscal liabilities rise. Government financing needs may rise due to weak domestic revenue. Further downside risks are climate-related shocks and potential slippage in fiscal and monetary management. These issues underscore the importance of maintaining prudent macroeconomic policies and accelerating structural reform to fortify economic resilience in FY2026.

India

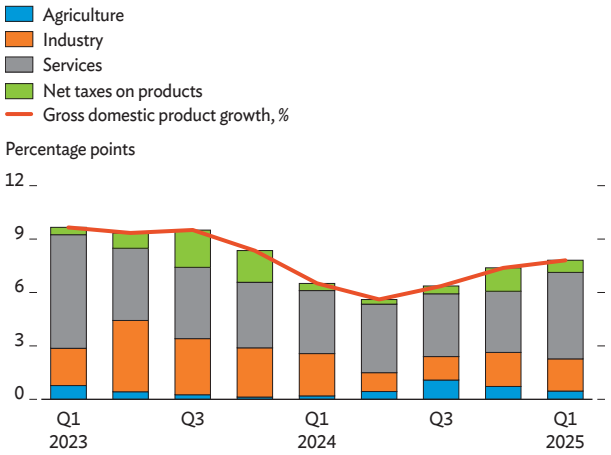
The economy is now projected to grow less than forecast in *ADO April 2025*. While GDP grew strongly in the first quarter (Q1) of fiscal year 2025 (FY2025, ending 31 March 2026) on improved consumption and government spending, additional US tariffs on Indian exports will reduce growth, particularly in the second half of FY2025 and in FY2026, though resilient domestic demand and service exports will cushion the impact. The inflation forecast is lowered for FY2025, after food prices declined more quickly than expected, but raised marginally for FY2026.

Updated Assessment

GDP grew robustly by 7.8% year on year (yoy) in Q1 FY2025 (Figure 3.3.11). The service sector recorded strong growth of 9.3% yoy, up from 7.3% in Q4 FY2024, led by public administration, financial, real estate, and professional services. Industry maintained steady growth at 6.3%, led by higher growth in manufacturing and in construction supported by expanded government capital expenditure and

Figure 3.3.11 Supply-Side Contributions to Growth

Expansion in the service sector and manufacturing drove growth in Q1 FY2025.



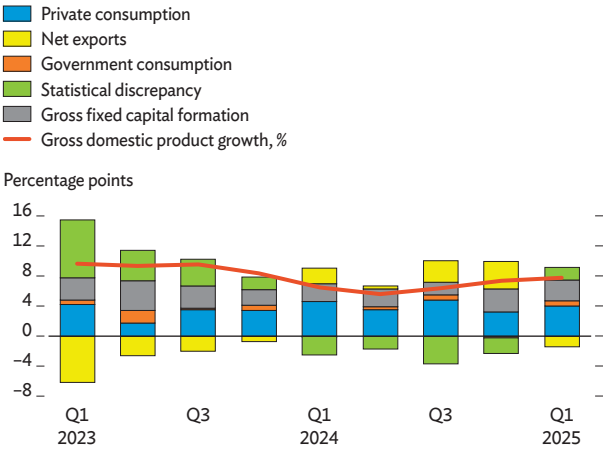
FY = fiscal year, Q = quarter (by fiscal year).

Notes: Years are fiscal years ending on 31 March of the next year. Growth rates are year on year. Net taxes on products are tax receipts minus subsidies.

Source: CEIC Data Company.

Figure 3.3.12 Demand-Side Contributions to Growth

Strong consumption and public investment drove growth in Q1 FY2025.



FY = fiscal year, Q = quarter (by fiscal year).

Notes: Years are fiscal years ending on 31 March of the next year. Growth rates are year on year.

Source: CEIC Data Company.

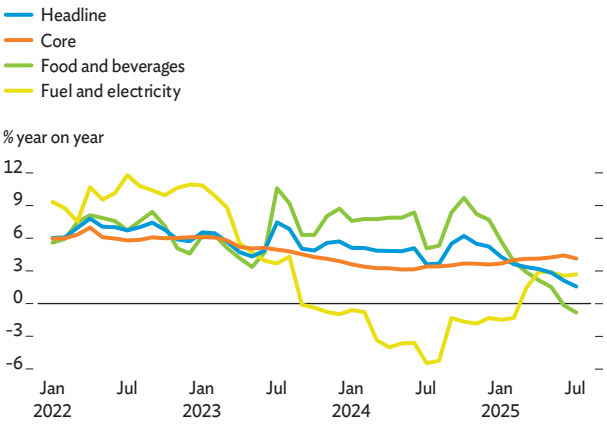
household investment. Agricultural growth, however, moderated from 5.4% in Q4 FY2024 to 3.7% in Q1 FY2025.

Public spending and private consumption grew strongly on rising domestic demand in Q1 FY2025 (Figure 3.3.12). Government consumption expenditure grew by 7.4% yoy, rebounding from a decline of 1.8% in Q4 FY2024. Government capital expenditure continued to expand strongly, raising growth in gross fixed capital formation to 7.8% in Q1 FY2025. Private consumption grew robustly by 7.0%, up from 6.0% in the previous quarter, driven by strong rural demand and falling food prices. Net exports subtracted from growth as imports expanded by a robust 10.9% and despite growth in exports rising to 6.3% from 3.9% in Q4 FY2024, helped by front-loading of goods exports to the US in anticipation of increased tariffs and strong growth in exports of services.

Consumer inflation eased to 2.4% yoy in the first 4 months of FY2025 as food price inflation moderated. Driven by robust agriculture supply in FY2024 and expectations of continued output growth under an above normal monsoon and moderate temperatures, food price inflation dropped from 6.7% yoy in FY2024 to 0.6% in first 4 months of FY2025 (Figure 3.3.13). Food inflation moderated across most

Figure 3.3.13 Consumer Inflation

Deflation in food prices further moderated inflation.



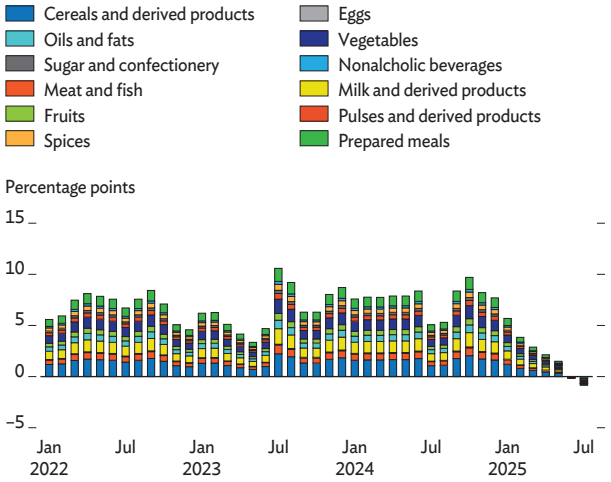
Source: CEIC Data Company.

categories (Figure 3.3.14). Fuel and electricity prices rose by 2.7% in the same period from the impact of a price hike in April for liquefied petroleum gas. Core inflation, excluding food and fuel, increased marginally to 4.2%, mainly due to gold prices rising by 34% in the period.

As inflation eased, the Reserve Bank of India, the central bank, undertook large policy rate cuts to support growth. After keeping the repo rate steady at

Figure 3.3.14 Sources of Food Inflation

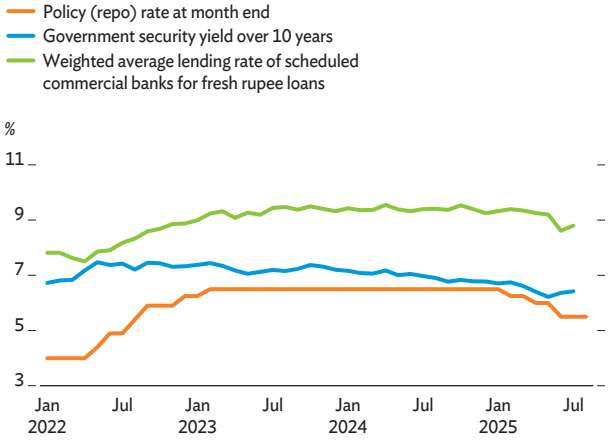
Prices for vegetables and pulses have fallen sharply.



Source: CEIC Data Company.

Figure 3.3.15 Interest Rates

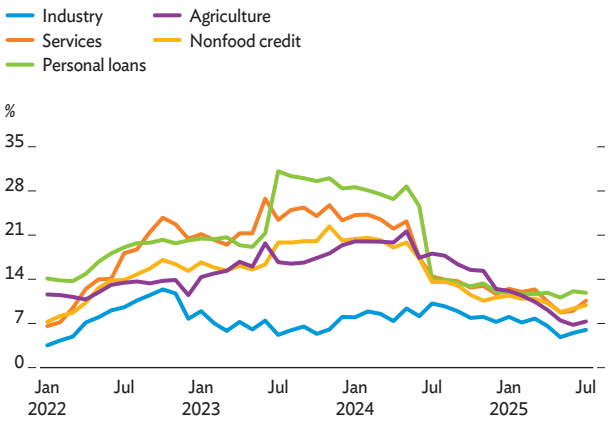
Monetary policy easing brought down lending rates.



Source: CEIC Data Company.

Figure 3.3.16 Growth in Bank Credit

Demand for credit remained weak across all segments.



Notes: Excludes public loans to buy crops from farmers and the impact of a merger combining HDFC, a large bank, with a nonbank financial corporation, which drove up outstanding bank credit.

Sources: CEIC Data Company; Reserve Bank of India.

6.5% for almost 2 years, the Monetary Policy Committee (MPC) cut the rate by 25 basis points in February and again in April 2025 and by 50 basis points in June, reducing the repo rate to 5.5%, the lowest since August 2022 (Figure 3.3.15). The MPC further announced a 100-basis-point cut to the cash reserve ratio in four equal tranches during September and November 2025 to enhance bank liquidity. As a result, bank lending rates on fresh rupee loans declined by 60 basis points from February to July 2025, while the yield on 10-year government securities fell by 32 basis points.

Credit growth moderated as demand weakened, but banks' asset quality continued to improve. Growth in outstanding bank credit declined to 10.0% yoy in July 2025 from 13.6% yoy in July 2024 as credit growth in all categories moderated (Figure 3.3.16). Growth in the personal loan segment was highest at 11.9% yoy in July 2025, while growth in credit to industry was lowest at 6.0%. Within the industry segment, growth was stronger for loans to micro and small businesses than to large firms, the latter driven by infrastructure. Banking sector health remained robust as gross nonperforming assets declined from 2.6% of all loans at the end of September 2024 to 2.3% at the end of March 2025. However, there are signs of stress in the microfinance sector, where stressed assets—defined as those past due by 31–180 days—increased from 4.3% of loans in September 2024 to 6.2% in March 2025. With the adoption of tighter underwriting standards, the percentage of stressed assets in the sector is likely to fall, but microfinance credit may also diminish.

Central government spending grew more strongly than revenue in the first 4 months of FY2025, widening the fiscal deficit from the same period of FY2024. Despite a decline in tax revenue by 7.5% yoy as direct tax collections fell, central government revenue rose by 4.8% on a ₹2.7 trillion dividend received from the central bank. Expenditure increased by 20.2% as capital spending rose by 32.8% and current

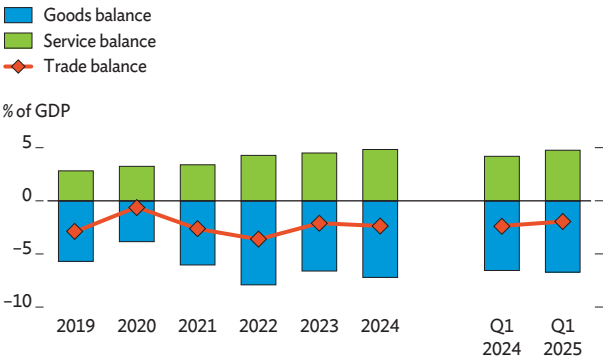
expenditure grew by 17.1%. Subsidies declined by 9.6% as food subsidies fell yoy in the quarter, while fertilizer subsidies increased by 36.9% yoy as global prices increased for di-ammonium phosphate.

The current account deficit narrowed to 0.2% of GDP in Q1 FY2025 compared to Q1 FY2024 with a narrower trade deficit and strong growth in remittances. The trade deficit narrowed to $20.5 billion from $24.1 billion in Q1 FY2024, as the surplus in service trade expanded by 20.8% yoy as service exports grew by 10.1% while imports grew at a modest 1.5%. The goods trade balance worsened as exports grew by 1.7% yoy and imports by 3.8% (Figure 3.3.17). Petroleum exports declined by 15.6%, but other exports grew robustly by 5.7%, led by electronics, pharmaceuticals, engineering goods, and ready-made garments. This mainly stemmed from traders stocking up on goods in anticipation of further US tariffs, with exports to the US increasing by 18.4%. Demand for imported machinery, electronic goods, chemicals, and nonferrous metals was strong, while growth in steel imports moderated as a 12% temporary duty was imposed in April 2025 on certain steel products to protect domestic manufacturers from rising imports of cheaper alternatives.

Foreign direct investment inflows remained muted amid global trade uncertainty. Net inflows amounted to $5.7 billion in Q1 FY2025, down from $6.2 billion in Q1 FY2024 (Figure 3.3.18). Outward foreign direct investment remained high as domestic firms stepped up investment for global expansion. Net foreign portfolio investment inflows were muted at $1.6 billion in Q1 FY2025, mainly due to outflows from debt segments, while equity inflows were positive. The Bombay Stock Exchange rose by 4.3% from April to August 2025. Foreign exchange reserves rose to $698.2 billion at the end of July 2025, sufficient to cover 11.4 months of imports (Figure 3.3.19). Amid volatility, the Indian rupee depreciated by 2.5% against the US dollar from April to July 2025 and appreciated by 0.04% in real effective terms, which take into account relative trade weights and inflation rates.

Figure 3.3.17 Trade in Goods and Services

The trade balance improved in Q1 FY2025 on higher service exports.



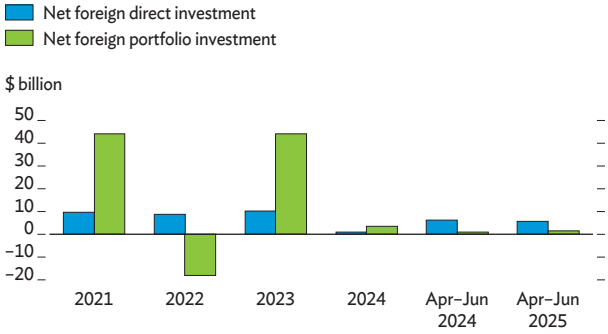
FY = fiscal year, GDP = gross domestic product, Q = quarter (by fiscal year).

Notes: Years are fiscal years ending on 31 March of the next year.

Sources: CEIC Data Company; Ministry of Commerce.

Figure 3.3.18 Net Foreign Direct and Portfolio Investment

Net foreign direct and portfolio investment inflows remained muted amid global trade uncertainty.

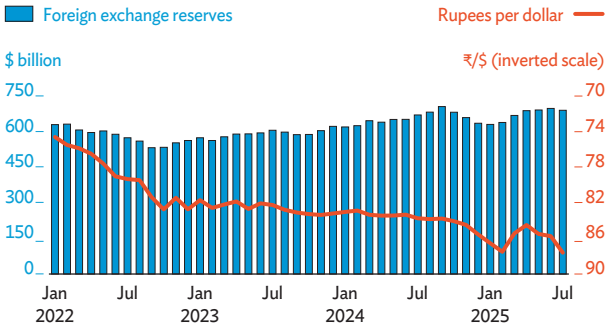


Note: Years are fiscal years ending on 31 March of the next year.

Source: CEIC Data Company.

Figure 3.3.19 Foreign Exchange Rate and Reserves

Foreign exchange reserves remained robust as the Indian rupee continued to weaken against the dollar.



Sources: CEIC Data Company; Reserve Bank of India.

Prospects

Growth in FY2025 and FY2026 will be lower than forecast in *ADO April 2025* as additional US tariffs affect exports and manufacturing growth (Table 3.3.2). Effective on 7 August 2025, the US imposed a tariff rate of 25% on its imports from India, increased to 50% on 27 August, significantly affecting about 60% of India's goods exported to the US, with a value equal to 1.2% of GDP in FY2024. Pharmaceuticals, smartphones, and oil are currently exempted, while steel and automobiles are subjected to a separate earlier tariff. Textiles, ready-made garments, jewellery, shrimp, and chemicals are likely to be particularly affected as higher tariffs imposed on India erode the competitiveness of these Indian exports (Figure 3.3.20). The reduction in exports will impact India's GDP in both FY2025 and FY2026 as the tariffs are implemented. As a result, net exports will subtract from growth more than previously forecast in April. However, the impact on GDP will be limited by a relatively low share of exports in GDP, increased exports to other countries, continued robust services exports that are not directly affected by tariffs, and a boost to domestic demand from fiscal and monetary policy.

Table 3.3.2 Selected Economic Indicators in India, %

The growth forecast is revised down for both FY2025 and FY2026, while the inflation forecast is lowered for this fiscal year and raised for the next.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	6.5	6.7	6.5	6.8	6.5
Inflation	4.6	4.3	3.1	4.0	4.2

FY = fiscal year, GDP = gross domestic product.

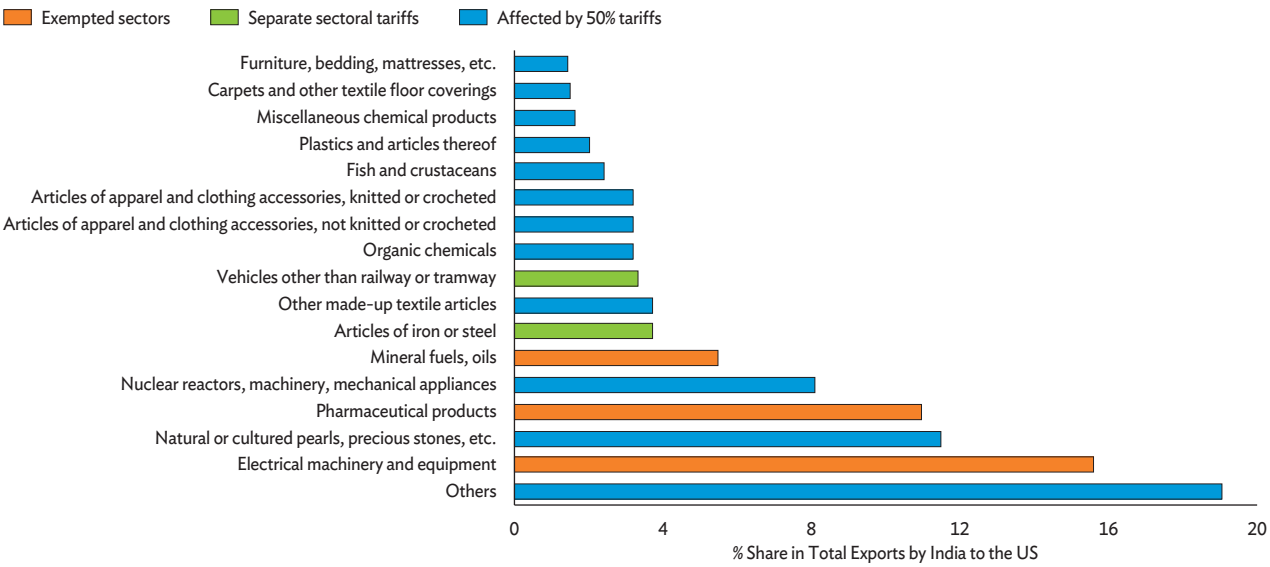
Note: Years are fiscal years ending on 31 March of the next year.

Sources: Ministry of Statistics and Programme Implementation, Government of India; Reserve Bank of India; Asian Development Bank estimates.

Consumption will rise, especially in rural areas, on fiscal measures and rapid moderation in food prices. Lower inflation expectations have fueled greater optimism in rural and urban households alike about their economic conditions currently and in the next 12 months (Figure 3.3.21). A cut in personal income tax rates effective in FY2025, and a likely hike to central government employees' salary and benefits in FY2026, will also support consumption. Further boosts will come from employment-linked fiscal incentives such as cash transfers to employees and to firms for additional employment creation from 1 August 2025

Figure 3.3.20 Key Products India Exports to the US

Exports to the US are wide ranging, with electrical machinery and pharmaceuticals topping the list.

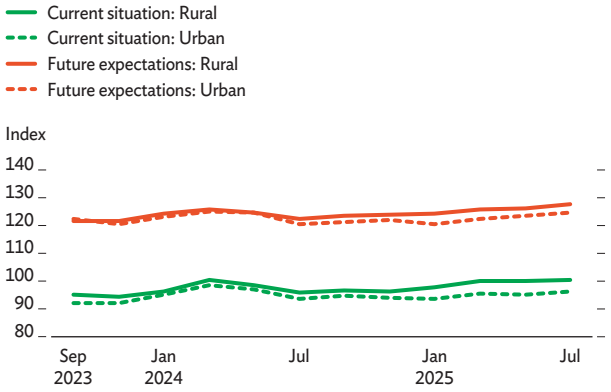


Notes: Key export categories from India to the United States in 2024 are shown at the 2-digit Harmonized System (HS) code level. Sectoral tariffs are separate under Section 232 of the U.S. Trade Expansion Act. Key products exported by India such as pharmaceuticals, smartphones and oil listed under relevant HS codes are currently exempted.

Sources: ITC Trade Map; WITS-UNCTAD TRAINS.

Figure 3.3.21 Consumer Confidence Survey

Consumers sentiment about the future improved for rural and urban households alike.



Notes: The consumer confidence index is based on the responses of respondents on the economic situation, income, spending, employment, and prices. A value above100 indicates optimism, below 100, pessimism.

Source: Reserve Bank of India.

to 31 July 2027. A reduction in the goods and services tax (GST) rate and the merging of four existing slabs into two slabs, which primarily moved goods to a lower rate, will boost consumption demand. As a result, consumption's contribution to growth will be higher than expected earlier.

Investment growth will be slower than previously forecast, pulled down by corporate uncertainty. After a strong first 4 months of the fiscal year, central government capital spending in the remaining 8 months will likely be muted. However, government investment in urban infrastructure, especially from the urban challenge fund, are likely to ramp up in FY2026. Growth in housing construction has been robust in recent years and will continue strongly in the current and next fiscal years, driven by lower borrowing costs under monetary policy easing and relatively muted increases in prices for inputs such as cement and steel. However, corporate investment is likely to grow only slowly, weighed down by economic uncertainty associated with global trade policy disruption.

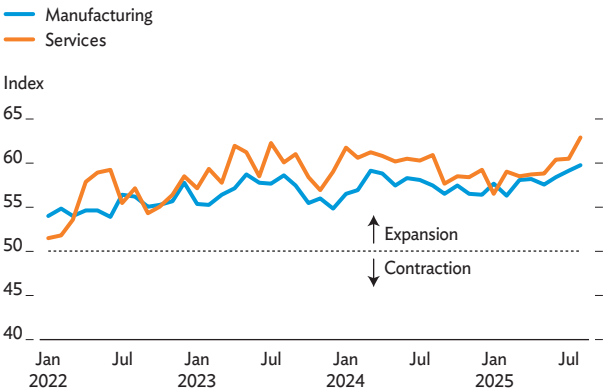
Favorable weather will likely boost growth in agriculture this fiscal year and next. With monsoon rainfall higher by 8% over the long-term average as on early September, the kharif (summer) season has an expanded sown area, above the average area in the past 5 years. Despite the delay in retreat of the monsoon leading to recent floods, the larger sown area will boost crop output, particularly for rice and pulses, likely above long-term average growth rates. The contribution of agriculture to GDP growth in FY2025 will thus be in line with April expectations.

Manufacturing will be adversely affected by US tariffs this fiscal year and in FY2026, weakening growth in industry despite stronger construction. Rising new orders and falling input prices pushed manufacturing growth higher in the first 5 months of FY2025. The purchasing managers' index for manufacturing improved from 56.3 in February 2025 to 59.3 in August 2025, but growth is likely to be slow with the imposition of US tariffs (Figure 3.3.22). Construction continued strong growth in Q1 FY2025 and will expand faster than previously expected, driven by higher housing demand and infrastructure construction. Services will continue to be the major driver of growth in FY2025 and FY2026, making a higher contribution to growth than previously forecast. The purchasing managers' index for services improved to 62.9 in August 2025 on higher export business and lower input prices. The sector's growth will be helped by higher demand for domestic consumption and export. The simplified GST rate structure due to reduced tax slabs will make compliance simpler, especially for small businesses, providing a boost to manufacturing and services.

Inflation is forecast to fall to 3.1% in FY2025, below the April forecast, as food price increases moderate. Food inflation, which significantly

Figure 3.3.22 Purchasing Managers' Indexes

Both services and manufacturing indexes remain robust.



Source: CEIC Data Company.

influences domestic inflation, will be lower in the current fiscal year than expected in *ADO April 2025*. This will be driven by likely expansion in cereals, pulses, fruit, and vegetables, aided by a healthy monsoon. However, the recent surge in monsoon, if continues, will affect the standing crops. The inflation outlook will be helped as well by lower global commodity prices, especially for crude oil; softer household inflation expectations; and the reduction in average GST rate. Core inflation is expected to remain close to 4% in FY2025. The inflation forecast for FY2026 is raised, as food price increases are expected to return increasingly to the long-term average inflation rate.

After reducing the policy rate in successive meetings, the MPC changed its stance from accommodative to neutral in June 2025. This stance indicates potentially slower rate cuts going forward. The cost of borrowing will continue to fall as policy rate cuts are transmitted to lending rates, boosting demand for loans, particularly for the purchase of real estate, housing, and automobiles, and raising borrowing by nonbank financial companies. A survey of major commercial banks shows that they expect loan demand to improve in FY2025.

The FY2025 fiscal deficit is likely to be higher than the budget estimate of 4.4% of GDP. Tax revenue growth may be lower than expected partly because GST cuts were not included in the original budget while spending levels are assumed to be maintained, pushing up the deficit. Nevertheless the deficit will likely be lower than the 4.7% of GDP recorded in FY2024.

The current account deficit will widen from 0.6% of GDP in FY2024 but remain moderate at 0.9% in FY2025 and 1.1% in FY2026. Import growth will be muted, with lower net petroleum imports due to lower Brent crude prices. Growth in service exports and remittances will be robust, but overall exports will be lower. Net capital inflows are also likely to be lower in both fiscal years due to global economic uncertainties. These trends may draw down international reserves, which will nevertheless remain robust.

Risks to the outlook tilt to the downside. The direction of bilateral trade policy between the US and India will pose both upside and downside risks to the outlook. On the upside, growth could be spurred if US tariffs on India are lowered to be more in line with those imposed on other countries in Asia and the Pacific. On the downside, further exacerbation of trade tensions could affect other sectors of the economy. Risks to global economic growth and geopolitical tensions could further lower demand for India's exports by raising global commodity prices. Domestically, weather shocks may pose risks to the outlook for agriculture, particularly if the recent floods continue for a longer period.

Pakistan

Macroeconomic conditions improved during fiscal year 2025 (FY2025, ending 30 June 2025). Growth increased slightly in FY2025, reflecting higher investment attracted by stable macroeconomic conditions and ongoing policy reform. Inflation eased substantially, and external vulnerability diminished, prompting global credit-rating agencies to give Pakistan higher sovereign ratings with a stable outlook. Growth is expected to strengthen in FY2026 as macroeconomic stability broadens through continued reform to address structural weaknesses. Policy consistency and climate resilience are crucial to sustaining growth.

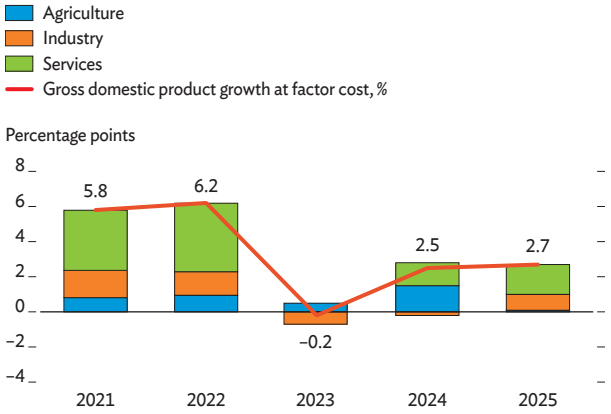
Updated Assessment

Bolstered by improving sentiment, the economy grew by 2.7% in FY2025. The government continued its reform program, making significant progress in stabilizing the economy and boosting confidence. Inflation reached record lows, fiscal consolidation targets were largely on track, and international reserves rose to their highest since March 2022. The first review of the International Monetary Fund (IMF) Extended Fund Facility program for Pakistan was completed in May 2025, allowing the release of $1 billion and approval of a Resilience and Sustainability Facility program for addressing climate vulnerability, which offers an additional $1.4 billion in tandem with the Extended Fund Facility program. A stronger macroeconomic policy framework and support from international financial institutions have begun to rebuild market confidence.

Growth came primarily from industry and services as climate change affected agriculture (Figure 3.3.23). The output of key crops—notably

Figure 3.3.23 Supply-Side Contributions to Growth

Growth increased slightly in 2025, driven by industry and services.

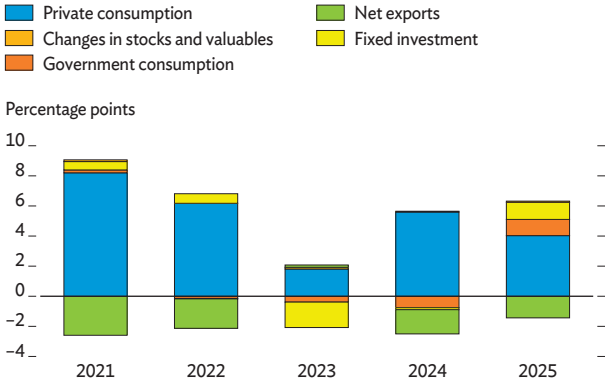


Notes: Years are fiscal years ending on 30 June of that year. Gross domestic product at basic prices excludes net indirect taxes.

Source: Pakistan Bureau of Statistics. National Accounts Tables Base FY2016: Table 6 and 7a.

Figure 3.3.24 Demand-Side Contributions to Growth

Investment boosted growth in 2025, supported by lower interest rates and elevated business sentiment.



Note: Years are fiscal years ending on 30 June of that year.

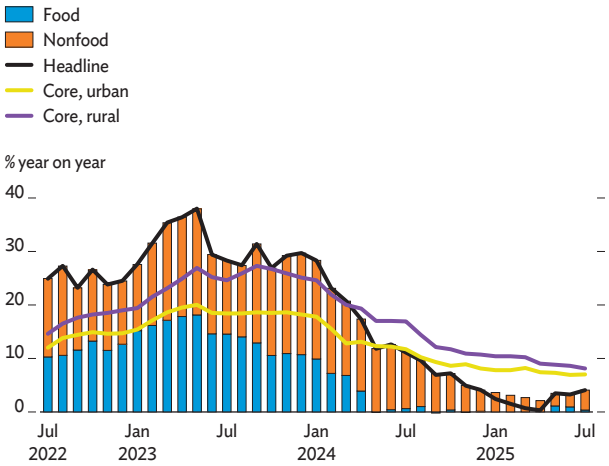
Source: Pakistan Bureau of Statistics. National Accounts Tables Base FY2016: Table 9.

wheat, rice, sugarcane, and cotton—declined because of changing weather patterns and temperature variation. Agriculture nevertheless expanded overall by 0.6% in FY2025 as livestock grew by 4.7% and provided about two-thirds of sector value added. Industry expanded by 4.8%, reversing a 1.4% decline in FY2024. Key contributions came from utilities and construction, both reversing contraction in FY2024. Large-scale manufacturing, representing roughly half of industry, declined by 1.5% due to lower crop production. Services proved resilient, growing by 2.9%, up from 2.2% last year, driven by increased value added in public administration, information and communication, real estate, and accommodation and food services.

Investment supported growth on the demand side. Growth in household consumption, representing nearly 80% of total domestic demand, slowed to 4.2% in FY2025 from 6.0% a year earlier, as lower crop output reduced farm incomes. However, strong workers' remittances partly offset this weak performance and supported household spending. Meanwhile, investment reversed a 1.8% decline in FY2024 to surge by 10.3%, reflecting lower interest rates and improved business sentiment from progress made toward macroeconomic stability. With imports steady at the equivalent of 23.8% of GDP and exports dwindling to 9.5% from 10.1% in FY2024, the net exports deficit trimmed 1.4 percentage points from GDP growth (Figure 3.3.24).

Figure 3.3.25 Monthly Inflation

Inflation declined sharply during 2025 as food inflation continued to moderate and global oil and commodity prices remained stable.

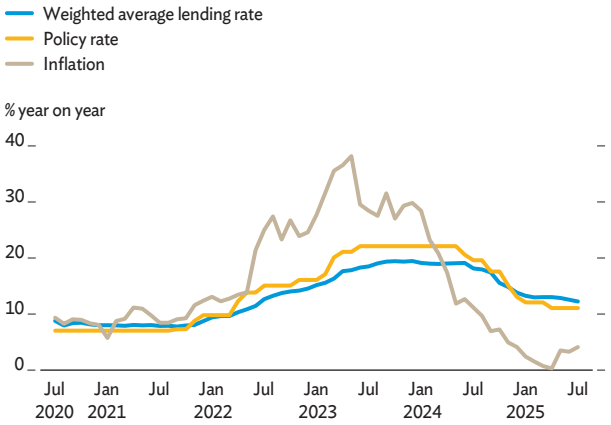


Source: Pakistan Bureau of Statistics. Monthly Review on Price Indices: July 2025.

The State Bank of Pakistan, the central bank, relaxed monetary policy as inflation fell to historic lows. Headline inflation continued to decline, reaching a record low of 0.3% year on year in April 2025 as food inflation continued to moderate and global oil and commodity prices remained stable (Figure 3.3.25). With space available for accommodative monetary policy, the central bank lowered its policy rate by a cumulative 1,100 basis points, from a peak of 22.0% in June 2024 to 11.0% in May 2025 (Figure 3.3.26). Although inflation rose from May 2025, reaching 4.1%

Figure 3.3.26 Interest Rates and Inflation

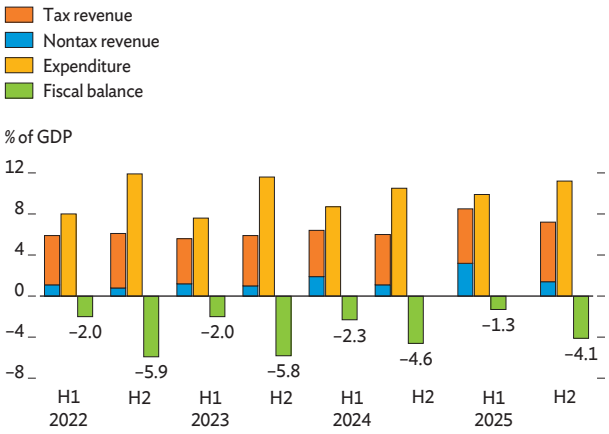
The central bank slashed the policy rate by a cumulative 1,100 basis points in 2025 as inflationary pressures eased.



Source: State Bank of Pakistan. Economic Data.

Figure 3.3.27 Fiscal Indicators

Higher revenue brought fiscal consolidation in 2025, reducing the fiscal deficit.



GDP = gross domestic product, H = half.

Notes: Years are fiscal years ending on 30 June of that year. Data refer to consolidated federal and provincial governments.

Source: Ministry of Finance. Fiscal Operations.

in July 2025, it remained below the central bank's target range of 5%–7%. Nevertheless, the central bank decided to pause further rate cuts as it assessed increased risks to the inflation outlook from upward adjustments in energy tariffs and the continuing impact of earlier rate cuts. In FY2025, average headline inflation declined to 4.5% from 23.4% in the previous year. During this period, food price inflation declined to 1.6% from 22.1% a year earlier in urban areas, and to 0.9% deflation from 21.6% inflation in rural areas. Inflation for other items declined to 7.9% from 25.5% a year earlier in urban areas, and to 7.7% from 23.3% in rural areas. Core inflation declined to 8.5% from 16.1% a year earlier in urban areas and to 11.1% from 22.7% in rural areas.

Lending strengthened on increased confidence and lower interest rates. Growth in loans to the private sector doubled to 12.3% in FY2025 from 5.8% in the previous year, led by increased lending for manufacturing, consumer financing, wholesale and retail trade, telecommunication, and construction. Lending for fixed investment jumped to 12.4% from 3.3% a year earlier, reflecting the government's self-employment schemes and other small loans. Expansion in loans for working capital rose to 13.7% in FY2025 from 8.9% in FY2024, led by higher export financing.

Higher revenue brought fiscal consolidation in FY2025. The budget achieved a primary surplus equal to 2.4% of GDP, nearly triple 0.9% in FY2024 and surpassing the target of 2.0%. The overall fiscal deficit decreased to 5.4% of GDP from 6.9% in FY2024 as revenue increased strongly to 15.7% of GDP from 12.6% the previous year (Figure 3.3.27). Tax revenue grew by 26.2%, reaching 11.1% of GDP from 9.6% in FY2024, as new tax measures introduced in the FY2025 budget raised income and sales tax, mainly by eliminating preferential income treatment for exports, ending various sales tax concessions and exemptions, and restructuring the personal income tax regime with revised income slabs and higher tax rates for both salaried and non-salaried individuals and for associations. Nevertheless, Federal Bureau of Revenue collection in FY2025 fell by about 0.5% of GDP, short of the already reduced target of PRs12.3 trillion, or 10.8% of GDP. Nontax revenue rose to 4.6% of GDP from 3.0% a year earlier, boosted by higher profit transfers from the central bank. Total expenditure increased to 21.1% of GDP during FY2025 from 19.5% the previous year, reflecting increases in both current and development spending. Provinces, defense spending, and subsidies drove the rise in current expenditure. Interest payments stayed equal to 7.7% of GDP, absorbing 70% of all tax revenue.

Fiscal consolidation has strengthened debt sustainability, reducing gross public debt to 67.8% of GDP in FY2024, the lowest in 6 years. The trend continued in FY2025, with gross public debt declining to 66.3% of GDP by the end of the third quarter FY2025

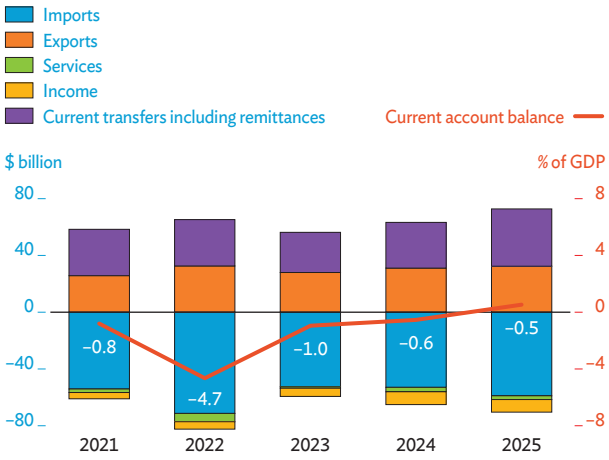
(the end of March 2025), reflecting the surplus in the primary fiscal balance. In absolute terms, gross public debt increased by 6.7% to reach PRs76.0 trillion at that point, primarily from interest expense. Public external debt increased to $99.2 billion. The IMF's latest debt sustainability analysis in May 2025 assessed public debt as sustainable. The ratio of public debt to GDP is expected to continue to decline, assuming consistent policy reform and gradual economic recovery.

The external position improved significantly, putting the current account in surplus. The current account recorded a surplus of $2.1 billion in FY2025, or 0.5% of GDP, the first surplus in 14 years and the highest since FY2003 (Figure 3.3.28). This achievement came mainly from strong remittance inflows, which rose by 26.6% in FY2025 to $38.3 billion, supported by external stability and a market-determined exchange rate (Figure 3.3.29). The trade deficit in goods and services widened by 16.3% to $29.4 billion in FY2025 as growth in imports outpaced exports. Imports of goods and services increased by 9.6% in FY2025, reflecting recovery in domestic demand and a smaller domestic cotton harvest, which caused raw cotton imports to surge from $0.5 billion to $1.3 billion. Merchandise imports increased generally, except for hydrocarbons, which declined by 5.8% in dollar value because of lower global oil prices and despite higher import volumes of crude and petroleum products. Exports of goods and services expanded by 5.2%, driven by textile exports including ready-made garments, bedwear, and knitwear.

Higher official inflows and workers' remittances boosted foreign exchange reserves. By the end of June 2025, gross reserves had reached $14.5 billion, up from $9.4 billion a year earlier, thanks to the central bank's foreign exchange purchases and a rebound in external financing inflows (Figure 3.3.30). As external risks diminished and market confidence grew, Fitch Ratings upgraded Pakistan's long-term foreign-currency issuer default rating in April 2025 from CCC+ to B– with a stable outlook. Similarly, S&P Global raised Pakistan's sovereign credit rating from CCC+ to B– with

Figure 3.3.28 Current Account Components

The current account recorded a surplus in 2025, supported by robust remittances.



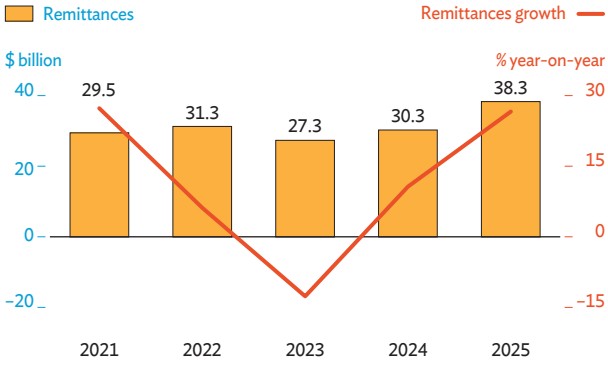
GDP = gross domestic product.

Note: Years are fiscal years ending on 30 June of that year.

Source: State Bank of Pakistan. Economic Data: External Sector. Summary Balance of Payments as per BPM6 - July 2025.

Figure 3.3.29 Remittances

Remittances grew robustly in 2025, supported by external stability and a market-determined exchange rate.

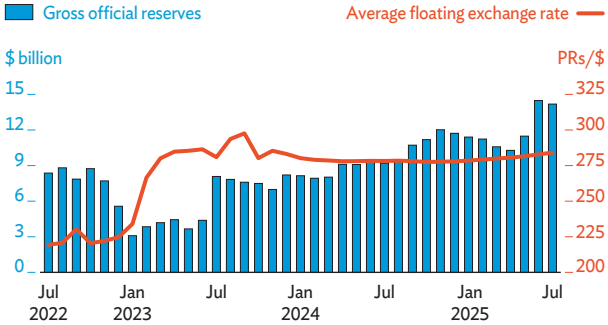


Note: Years are fiscal years ending on 30 June of that year.

Source: State Bank of Pakistan. Economic Data: External Sector. Workers' Remittances.

Figure 3.3.30 Gross Official Reserves and the Exchange Rate

International reserves increased in 2025, and the exchange rate stabilized.



Source: State Bank of Pakistan. Economic Data.

a stable outlook in July 2025, while Moody's elevated it in August 2025 from Caa2 to Caa1, also with a stable outlook.

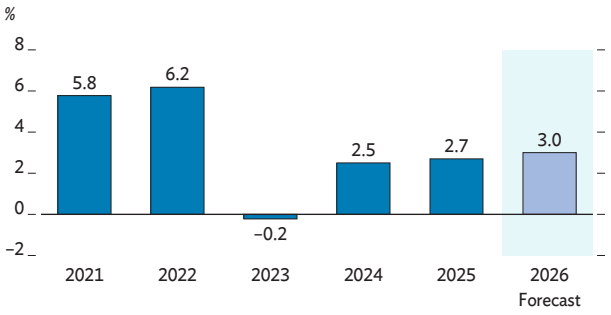
Prospects

Growth is expected to strengthen, assuming progress continues under the economic adjustment program. With greater macroeconomic stability, the program seeks to accelerate structural reform, boost Pakistan's competitiveness, and guide the economy toward sustainable growth. Pakistan continues to face significant structural challenges and vulnerabilities, intensified by recurring climate-induced natural hazards, such as floods this monsoon season. Given these challenges, consistent policy implementation is crucial to enhance resilience and policy credibility. Top priorities are to lower the energy sector's high costs, and tax reform to improve efficiency and fairness; others are to lower trade and investment barriers, advance reform in state-owned enterprises, strengthen the governance framework, and foster sustainability.

The growth forecast for FY2026 remains unchanged. While a boost to economic activity is expected from the rapid easing of risks tied to debt and the balance of payments, as seen in the upgrade of Pakistan's sovereign credit ratings by global credit-rating agencies, as well as renewed business confidence spurred by a recent US-Pakistan trade agreement, the damage caused to infrastructure and farmland during the recent floods may decelerate growth (Figure 3.3.31 and Table 3.3.3). Recovery and rehabilitation efforts following the floods, supported by fiscal incentives for construction announced in the FY2026 budget, may partly offset their adverse impact on growth.

Figure 3.3.31 Growth Outlook

Growth is projected at 3.0% in 2026 as the economic reform program boosts economic activity.



Note: Years are fiscal years ending on 30 June of that year.

Sources: Pakistan Bureau of Statistics. Updated National Accounts Tables Base FY2016: Table 5; Asian Development Bank estimates.

Table 3.3.3 Selected Economic Indicators in Pakistan, %

With growth proving to be higher, and inflation lower, in FY2025 than earlier projected, the forecast for growth in FY2026 remains unchanged, while that for inflation is raised slightly.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	2.5	2.5	2.7	3.0	3.0
Inflation	23.4	6.0	4.5	5.8	6.0

FY = fiscal year, GDP = gross domestic product.

Sources: Pakistan Bureau of Statistics. Updated National Accounts Tables Base 2015–16, and Price Statistics; and Asian Development Bank estimates.

Investment is expected to strengthen domestic demand, assuming continued structural reform and sound macroeconomic policies. Investment is anticipated to increase with greater business confidence, declining interest rates, and adherence to fiscal consolidation, which will lower government borrowing needs and allow more lending for private investment. Key tariff reforms under the updated National Tariff Policy 2025–2030 and liquidity support for exporters through a digitalized income tax refund system will improve export competitiveness, also encouraging private investment. Workers' remittances will be bolstered by maintaining external stability through a robust policy framework and a stable exchange rate, and by the need to support families back home who struggle to recover from the floods. Higher remittances may partly offset a decline in private consumption resulting from lower agricultural output and, consequently, reduced farm incomes.

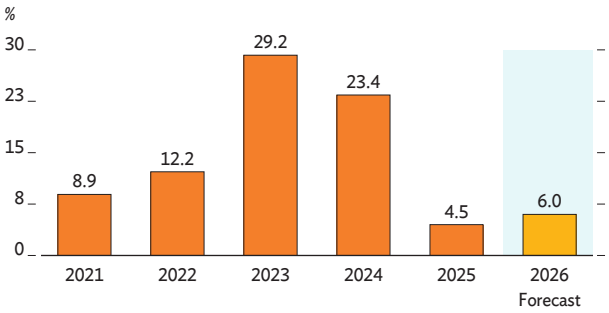
The government aims to sustain fiscal consolidation by increasing revenue and containing spending. The FY2026 budget targets a primary surplus equal to 2.4% of GDP and an overall deficit of 3.9%, gradually declining over the medium term. Tax revenue is projected to reach 13.2% of GDP in FY2026, underpinned by tax administration and policy efforts. These include restricting the ability of those who fail to file their tax returns to engage in major transactions, including the purchase of fixed or moveable assets; implementing compliance risk management in large

taxpayers' offices; and applying a standard 18% sales tax on goods sold through digital platforms, on solar panel imports, and on all vehicle sales. The government has introduced revenue measures to enhance climate resilience, including a 1%–3% levy on all vehicles with internal combustion engines, either locally made or imported, to encourage the adoption of greener options, as well as a carbon tax on petrol, diesel, and furnace oil of PRs2.5 per liter, doubling to PRs5.0 in FY2027. Notable measures on the expenditure side cut subsidies, revive stalled privatization, and curtail provincial spending to achieve a higher provincial budget surplus equal to 1.1% of GDP. Debt-servicing costs are expected to decrease in FY2026 owing to lower interest rates and a reduced overall budget deficit. Nevertheless, financing needs remain high, keeping interest payments elevated at 6.3% of GDP.

The central bank is committed to a data-driven monetary policy that aims to keep inflation within the medium-term target range. The projection for headline inflation in FY2026 is raised slightly, reflecting the impact of flood-induced supply chain disruption on food prices and increased gas tariffs effective on 1 July 2025 (Figure 3.3.32). Nevertheless, projected inflation remains within the central bank's medium-term target range of 5%–7%. While international commodity prices and the exchange rate are expected to remain stable, fiscal measures in the FY2026 budget and base effects from food and energy components will increase inflation in FY2026 from recent lows. Acknowledging the expected rebound in inflation, the central bank remains committed to maintaining a data-dependent monetary policy that is suitably tight.

Figure 3.3.32 Inflation Outlook

Inflation is projected to increase in FY2026, reflecting expectations of higher growth and the impact of higher administered energy prices.



Note: Years are fiscal years ending on 30 June of that year.

Sources: Pakistan Bureau of Statistics. Price Statistics: Monthly Review on Price Indices—June 2025; Asian Development Bank estimates.

The external balance is forecast to remain stable over the medium term. Export growth is expected to remain subdued by flood-related disruption to rice and cotton production. However, improved liquidity—driven by faster tax refunds and lower production costs under supportive monetary conditions—may help offset the impact of reduced agricultural output. Additionally, the recent US-Pakistan trade agreement will alleviate uncertainty, sustaining trade and investment flows between the two countries. Imports are expected to grow faster as food imports increase to address flood-induced shortages and raw material imports increase because of the expected recovery in manufacturing, thereby widening the trade deficit. However, a more functional foreign exchange market with a flexible exchange rate is expected to ensure resilience in workers' remittances and keep the current account nearly balanced in FY2026. Higher multilateral and bilateral inflows, including flood relief and assistance, along with ongoing central bank foreign exchange purchases, are expected to raise gross international reserves in June 2026 to $17.7 billion, providing 2.8 months of import cover.

Pakistan's economic outlook faces several downside risks that could adversely affect growth and macroeconomic stability. Key domestic risks stem from policy slippage and climate change. Failure to meet revenue and fiscal consolidation targets, or delays in implementing critical reforms, remain top concerns. Policy slippage could weaken business confidence, raise borrowing costs, and increase external financing risks. Pakistan's vulnerability to extreme weather and natural hazards like floods threatens agriculture and infrastructure, which could reverse last year's decline in food price inflation, disrupt economic activity, and strain household incomes. Global geopolitical risks, including uncertainty about international economic policies, could negatively affect inflation, external stability, and business confidence. On the upside, faster reform implementation and a more favorable external environment could boost investor confidence and push growth above current expectation, thereby strengthening Pakistan's overall economic resilience.

Other Economies

Afghanistan

The economy expanded for a second consecutive fiscal year, though more slowly. Ongoing structural challenges continued to impede economic activity, notably limits on access to finance, the suspension of international transactions via formal banking channels, restricted capital investment, a widening trade deficit, tight fiscal space, and restrictions on women's education and employment. Also constraining growth was a 10% decline in international assistance and support for basic needs in FY2025 (ending March 2025).

Revived demand lifted the consumer price index for the first time since March 2023, with inflation at 0.3% year on year in March 2025. Inflation reached 0.5% year on year in May 2025, though food prices fell by 1.7%, with the largest declines being for sugar and sweets by 8.5%, spices by 6.6%, and vegetables by 6.4%. Inflation for other goods and services was 2.7%, with housing, electricity, water, and gas recording the largest increase of 11.7%, alongside little or no increases for most other items.

Persistently tight fiscal space continued to hinder the delivery of essential services and infrastructure maintenance in FY2025. Despite a 14.8% increase in domestic revenue, the de facto government (DFG) allocated only 9.5% of this revenue to capital expenditure. With no development aid, capital spending in FY2025 was 85.5% down from 2021. Low revenue has required major cuts to spending on education, health, and infrastructure, slowing improvements in human capital, productivity, and social mobility. The DFG has struggled to pay salaries and deliver key public services.

The merchandise trade deficit widened by 46.8% in FY2025, driven mainly by a 36.6% surge in imports to $11.7 billion. All major import categories saw increases, including fuel and lubricants, consumer goods, industrial supplies, and capital goods. Exports fell by 2.1% to $1.7 billion, mainly reflecting lower carpet and coal shipments.

Afghanistan's economic outlook remains highly problematic, with expectations of low growth over the medium term (Table 3.3.4). With reduced international humanitarian aid, the forced return of Afghan refugees, little support for basic needs, and a fragile private sector, the growth forecast is trimmed for FY2026. According to the United Nations Office for the Coordination of Humanitarian Affairs, humanitarian funding for Afghanistan dropped by 61.5% in 2025, leaving the economy more vulnerable and putting recent economic progress at risk. The involuntary return of 1.5 million Afghans from Iran and Pakistan in the first 7 months of 2025 burdened social services, increased unemployment, heightened security risks, and weakened private consumption as normal remittance flows declined. Stringent fiscal conditions exacerbate the situation. The DFG recently laid off more than 100,000 officials, intensifying unemployment, diminishing incomes, and reducing consumer purchasing power.

Table 3.3.4 Selected Economic Indicators in Afghanistan, %

A growth slowdown in FY2025 prompts a lower growth forecast for FY2026, with a lower projected inflation rate.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	2.3	2.6	1.8	2.2	1.7
Inflation	–7.7	–5.3	–4.2	5.0	1.0

FY = fiscal year, GDP = gross domestic product.

Notes: Years refer to fiscal years ending in March of that year. ADB placed on hold its regular assistance to Afghanistan effective 15 August 2021.

Sources: National Statistics and Information Authority; Asian Development Bank estimates.

Agriculture is expected to be the main engine of growth, thanks to favorable weather and improved soil moisture earlier in 2025. Wheat production is projected to reach 5.3 million tons, the highest in 5 years. However, trade restrictions and weak domestic demand will limit growth in industry and services.

A strong afghani prompts a lower inflation forecast for FY2026. The currency has remained buoyant despite a decline in international humanitarian assistance, particularly US dollar cash inflows for humanitarian purposes. Afghani appreciation is driven by informal inflows of US dollars, some used to pay for reexports, and some arriving as savings brought in by returnees from Iran and Pakistan. Since Afghanistan is a net importer, currency appreciation should reduce

inflation. Moreover, lower global food prices will diminish food price pressures. Nevertheless, inflation is expected to rise somewhat during the second half of FY2026.

Bhutan

The growth forecast is revised down slightly for 2025 from the April projection, but remains unchanged for 2026 (Table 3.3.5). A lower contribution from the electricity sector will moderate industry growth to 14.0% in 2025, well below 18.6% forecast in *ADO April 2025*. While hydrological conditions have generally been favorable and the Punatsangchhu II Hydroelectric Power Plant has gradually begun operations, delayed agreement between Bhutan and India on a negotiated tariff for power from this plant has hampered sector performance. As a result, electricity generated by the plant is currently sold domestically at lower prices, which undermines hydropower's contribution to industrial growth. The revised forecast also reflects base effects following the sector's strong performance in 2024, according to recent data. Growth in 2024 was 2.0% points higher than the *ADO April 2025* estimates, due to stronger-than-expected services and industry performance. In 2025, the impact of lower industry growth on GDP will be countered by developments in other sectors. Construction is projected to benefit from ongoing mid-sized and small hydroelectric projects. An increase in government expenditure by 31% for fiscal year 2026 (FY2026, ending 30 June 2026), with substantial allocations toward capital outlays, is anticipated to stimulate both construction and aggregate consumption. The government's implementation of its 13th Five-Year Plan is expected to pick up in 2026, as is construction at the 600-megawatt Khorlochhu Hydroelectricity Power Plant. Services remain buoyed by a steady rise in international tourist arrivals—by 25% year on year in the first half of 2025. The outlook for agriculture also remains bright, underpinned by continued expansion in forestry and logging.

Table 3.3.5 Selected Economic Indicators in Bhutan, %

The growth forecast is revised down for 2025 but unchanged for 2026, while the inflation forecast is lowered for 2025 and raised for 2026.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	7.5	8.5	8.1	6.0	6.0
Inflation	2.8	3.4	3.2	3.5	3.7

GDP = gross domestic product.

Sources: Royal Government of Bhutan, Ministry of Finance; Royal Monetary Authority, Bhutan; Asian Development Bank estimates.

The inflation forecast for 2025 is lowered from *ADO April 2025*, but raised for 2026. In the first 6 months of 2025, headline inflation averaged 3.3% year on year, trending within expectations. The primary contributor was food price inflation, which averaged 5.6% over this period, reflecting ongoing pressures from higher import prices for consumption goods. With food prices projected to moderate in the second half of 2025 as domestic agricultural output expands and food price inflation eases in India, consumer price inflation is expected to reach 3.2% this year, less than earlier forecast. Inflation is expected to rise further to 3.7% in 2026 in line with higher food prices in India, underscoring similar trends between the two economies.

Risks to the growth outlook skew mainly to the downside. They arise mainly from external factors. Recent global dynamics have introduced additional volatility into Bhutan's macroeconomic outlook, particularly for services, as tourism is acutely exposed to shifts in international conditions. Tariff tensions between the US and India, and increased instability in the Middle East, elevate uncertainty in global trade and commodity markets. These external shocks risk affecting Bhutan's international tourist arrivals and exert upward pressure on the cost of essential imports, especially petroleum products. The fragility of Bhutan's external sector is further accentuated by persistently weak international reserves, which stood at just $816.8 million in May 2025, covering a little over 7.5 months of imports, marginally above the 6.8 months' cover for small economies recommended by the International Monetary Fund. Given Bhutan's import dependence, any additional shock to the reserve position could necessitate stringent import restrictions, further constraining economic activity and resources for development.

Maldives

The projection for GDP growth in 2025 is unchanged from *ADO April 2025* but raised marginally for 2026 (Table 3.3.6). Strong tourism

Table 3.3.6 Selected Economic Indicators in Maldives, %

The growth forecast for 2025 is unchanged from the April projection, and that for 2026 is revised slightly upward, while inflation forecasts are revised down for this year and up for 2026.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	3.3	5.0	5.0	4.8	4.9
Inflation	1.4	4.7	4.5	2.2	3.5

GDP = gross domestic product.

Source: Maldives Monetary Authority. *Monthly Statistics. July 2025*; Asian Development Bank estimates.

and fisheries will drive growth in both years. Tourist arrivals rose by 9.1% year on year (yoy) to 1.1 million in the first half (H1) of 2025, as arrivals from the People's Republic of China rose 16.7% and those from Europe increased by 10.0%. Robust inbound tourism lifted travel receipts by 16.1% yoy during January–May 2025. Fish export volume rose by 67.1% and its value by 43.3% in H1 2025, following the removal of price controls on fish. In contrast, construction weakened as public sector investment contracted by 42.9% yoy in July 2025. Supported by the July opening of a new airport terminal, a peak in seasonal demand in the fourth quarter, and expanded direct flights from India, tourist arrivals are projected to reach 2.0 million in 2025 and rise further in 2026, boosting revenue. Nevertheless, growth is expected to moderate slightly in 2026 as external debt obligations dampen government spending, especially on infrastructure.

Inflation is now projected to be lower this year than projected in April and decline further in 2026 but remain higher than earlier forecast. Price pressures intensified in the first four months of 2025, largely due to hikes in tobacco and green taxes. However, the forecast for 2025 has been revised downward as inflation eased later in H1, bringing the half-year average to 5.0% yoy. This moderation was supported by temporary discounts on electricity and water bills, reduced domestic electricity tariffs, and the postponement of planned subsidy reforms. Monetary measures introduced in 2025—requiring foreign exchange earners to deposit 90% of their earnings in the central bank, increasing central bank sales of foreign exchange to banks, and cutting the minimum reserve requirement for foreign currency deposits from 7.5% to 5.0%—are expected to narrow the premium in the parallel foreign exchange market and, in turn, ease pressure on import costs. Despite this, scheduled external debt repayment could strain foreign exchange reserves, weakening the parallel market exchange rate of Maldives rufiyaa in 2026 and worsening inflation.

Fiscal performance improved markedly, with sharp reductions as of July 2025 in both the overall and the primary deficit from July 2024. Revenue increased only marginally by 2.8% yoy on higher tax and nontax receipts, but a substantial drop in capital spending as the public sector development program was curtailed left a fiscal surplus of Rf314.3 million, a significant turnaround from a Rf4.9 billion deficit a year earlier. The primary balance strengthened to equal 2.6% of GDP. Despite these gains, public debt remained elevated at 129.1% of GDP in the first quarter of 2025. A 40% reduction in annual repayments to India on existing lines of credit is expected to ease fiscal pressure this year. However, debt service obligations could reach $1 billion next year. Public debt is projected to rise further following a new $565 million line of credit from India for infrastructure development.

The current account deficit is projected to narrow more than forecast in April to 13.5% of GDP in 2025 and 12.8% in 2026. Lower imports and stronger exports reduced the merchandise trade deficit in H1 2025 from the same period in 2024. The surplus in services improved on higher travel receipts. These trends are expected to continue through 2026. Driven by strong tourism receipts, the higher surrender requirement on foreign exchange earnings, and a currency swap with India, foreign exchange reserves climbed in H1 2025 but still covered only 1.9 months of imports.

High public debt remains a downside risk to the outlook. Continued delays in reforming state-owned enterprises and subsidies could deepen macroeconomic vulnerability. Rising global trade friction and the potential for economic slowdown could disrupt tourism, weaken the growth outlook, and undermine investor confidence and access to external financing.

Nepal

GDP growth was higher last fiscal year than forecast in *ADO April 2025*. Improved agricultural yields under a favorable monsoon drove growth in

fiscal year 2025 (FY2025, ended mid-July 2025), as did a rebound in industry from increased electricity generation, stable raw material prices, and lower interest rates. However, growth in services slowed slightly, as upgrades that reduced operating hours at Tribhuvan International Airport during the peak tourist season disrupted travel. On the demand side, private consumption, which accounts for 80% of GDP, grew modestly, and private investment increased marginally on a gradual revival of business confidence and reduced interest rates. Public investment growth dipped, however, as weak project implementation capacity slowed capital budget execution. Exports of goods and services grew substantially, outpacing growth in imports and narrowing the trade deficit.

Growth in FY2026 is projected to significantly underperform the April forecast following severe civil unrest in September that toppled the government (Table 3.3.7). A late monsoon is expected to reduce agricultural output, and industry growth will decelerate as mining and quarrying and construction remain subdued in a broader economic slowdown, with manufacturing weighed down by political uncertainty, security concerns, and eroded investor confidence.

Table 3.3.7 Selected Economic Indicators in Nepal, %

Growth will decelerate in FY2026, with inflation lower than projected in April.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	3.7	4.4	4.6	5.1	3.0
Inflation	5.4	5.2	4.1	5.0	4.5

FY = fiscal year, GDP = gross domestic product.
Note: Years are fiscal years ending in mid-July of that year.
Source: Asian Development Bank estimates.

While services will be hit, remittances are resilient, macroeconomic fundamentals are sound, and stability is expected in the near term. A mainstay of the economy, services will suffer under weakened consumer confidence and lingering political uncertainty. Tourism-dependent activities are expected to be hit hard. Food and accommodation services face severe contraction as tourist arrivals decline, compounding the effects of vandalism of major hotels during the civil unrest. Transportation and storage will likewise be affected. Domestic demand will be held back by the possibility of prolonged insecurity and political uncertainty. However, remittances will continue to grow because of increased out-migration and more widespread use of formal transfer mechanisms, which are expected to remain robust. The downgrade in the growth forecast is tempered by Nepal's sound macroeconomic fundamentals and assumptions that the transitional government will serve out a stable term until new elections are held and that civil disturbances will not last more than one quarter.

Average inflation slowed in FY2025 more than projected in April, and will rise marginally in FY2026. Prices for food and other goods stabilized in FY2025 thanks to robust agricultural production and lower international oil prices. The forecast for FY2026 is below the central bank's inflation ceiling of 5.0% and reflects a modest decline in inflation in India, Nepal's major source of imports, and limited supply chain disruption within the economy. The central bank reduced its policy rate in FY2025, and lower lending and deposit rates spurred growth in credit to the private sector. However, nonperforming loans rose, particularly in unregulated savings and credit cooperatives, and may rise further following recent disruption; close monitoring is required.

The fiscal deficit narrowed to equal 2.0% of GDP in FY2025, from 2.8% in FY2024, supported by improved revenue mobilization. Central government revenue rose by 12.9%, driven by higher imports and increased economic activity, while total expenditure increased by 7.3% on higher recurrent and capital expenditure. Public investment growth is expected to decline significantly under the FY2026 budget due to the lingering effects of civil unrest and political uncertainty. Priorities have shifted toward retrofitting damaged infrastructure and election-related expenditure.

The current account surplus rose to 6.7% of GDP in FY2025, supported by robust remittance inflows. Merchandise exports grew by 64.7%, reversing contraction in the previous year, while imports increased by 9.4%. Nepal expects minimal impact from US tariffs in FY2026, as trade with the US equaled only 0.3% of GDP in 2024, and new tariffs amount to a modest shift in import duties to a flat

10%. Further, Nepali exports such as *pashmina* shawls, dog chews, and handicrafts are either unique products that enjoy strong demand or face lower tariffs than similar goods from other economies. Perhaps more importantly, Nepal's soya bean oil exports to India, which account for almost 38% of Nepal's exports, are exempt from Indian tariffs. Nevertheless, recent disturbances will likely slow growth in exports as well as imports. The current account surplus is expected to remain unchanged in FY2026 as remittance inflows remain robust. Foreign exchange reserves reached $19.5 billion in FY2025, covering 15.4 months of imports.

The outlook is subject to downside risks. The major risk to growth is resurgence and deepening of civil unrest and political instability beyond one quarter, which could push the economy into an extended period of stagnation. Other risks are geopolitical tensions in the Middle East that could affect remittance inflows, and disasters triggered by natural hazards. Trade protectionism and other global economic developments may hit growth prospects, and food prices driven up by supply chain disruption, bad weather, or geopolitical tensions may stoke inflation.

Sri Lanka

Growth forecast remains unchanged for 2025 but is revised down slightly for 2026. The economy sustained growth momentum in the first quarter of 2025 as it expanded by 4.8% year on year (yoy), slightly below 5.1% recorded a year earlier. Government capital spending was below budget in the first half of 2025, but consumption showed signs of recovery on stronger remittances. Forward-looking indicators suggest continued momentum in manufacturing, construction, and services. The index of industrial production rose in the first half by 5.1% yoy, approaching the level before the economy's recent economic crisis. After a notable increase in private credit by 19.6% yoy in July 2025, loan demand is expected to continue to grow in the third quarter across all sectors, driven by increased vehicle imports, low interest rates, and a favorable business outlook. These developments will likely tamp down the impact on the economy this year from a 20% tariff imposed on Sri Lankan exports to the US, mostly garments and rubber, which accounted for 23% of all exports in 2024. But the tariffs will be more of a headwind, holding back external sector performance and consumption in 2026 because of possible job losses, both directly and indirectly (Table 3.3.8).

Table 3.3.8 Selected Economic Indicators in Sri Lanka, %

The growth forecast for 2025 is retained, while that for 2026 is lowered amid global headwinds. Inflation projections are lowered for 2025 due to longer-than-expected deflation but maintained for 2026.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	5.0	3.9	3.9	3.4	3.3
Inflation	1.2	3.1	0.5	4.5	4.5

GDP = gross domestic product.

Sources: Department of Census and Statistics; Asian Development Bank estimates.

With deflation easing since early 2025, inflation returned in August and will gradually accelerate through 2026. Headline inflation, measured by the Colombo consumer price index, declined by 1.7% yoy in the first 8 months of 2025, compared with a 0.5% increase in the same period of last year, driven mainly by falling energy and transport prices. Food inflation remained subdued at 1.5%, and nonfood prices declined by 3.2%. Deflation has eased since March 2025 as food prices rose and energy tariffs were adjusted upward in June. Following a cut by 25 basis points in May 2025, the Central Bank of Sri Lanka has maintained the overnight policy rate at 7.75% in July. With inflation remaining negative for longer than previously expected, the average inflation projection for 2025 is revised down significantly from the *ADO April 2025* forecast. The 2026 forecast is retained in line with expectations of inflation gradually accelerating on rising food prices, upward energy tariff adjustments, and the fading impact of earlier deflationary pressures.

The current account surplus grew by 30.2% yoy in the first half of 2025 on robust remittance inflows and steady tourism earnings. The trade deficit widened, as imports grew by 12.4%, driven by a sharp rise in vehicle imports, while merchandise exports rose by 5.7%, supported by continued demand from key markets. Over the first 8 months, workers' remittances surged by 19.3%, while tourism earnings rose by

8.4%. Gross official reserves stood at $6.2 billion at the end of August 2025, providing approximately 3.7 months of import cover, only marginally higher than in December 2024, as debt service payments resumed. The Sri Lanka rupee depreciated by 3.3% against the US dollar in January–August 2025. The International Monetary Fund completed Sri Lanka's fourth Extended Fund Facility review in July 2025, unlocking $1.74 billion in disbursements so far. Debt restructuring advanced as agreements were reached with France, India, Hungary, Japan, Saudi Arabia, and the United Kingdom so far in 2025, and is expected to be completed within the year.

Downside risks to the outlook remain elevated. They include stronger-than-expected impact from US tariff hikes on Sri Lankan exports, rising uncertainty in the Middle East affecting remittances, energy price volatility, and a potential global slowdown hitting tourism and external demand. Domestically, weather-related disruptions pose risks to agriculture and food prices.

SOUTHEAST ASIA

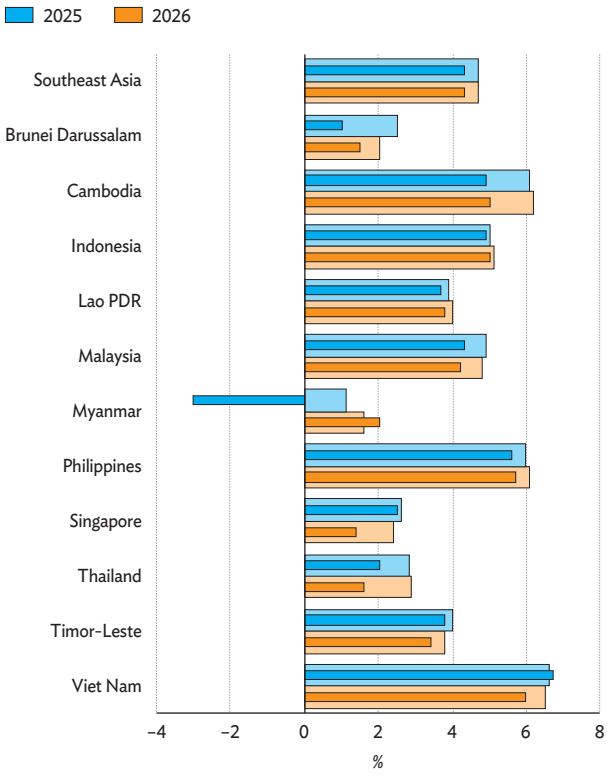
Growth in Southeast Asia is now forecast to be lower than in the *ADO April 2025*. While the front-loading of exports in anticipation of higher US tariffs boosted growth in the first half of this year, that effect is expected to evaporate and growth to slow. The inflation outlook is somewhat more favorable than in the *ADO April 2025* due to weak commodity prices and appropriate policies. Risks to the outlook are mostly related to the uncertain global environment.

Subregional Assessment and Prospects

Growth prospects have diminished as the subregion copes with domestic challenges and changes in the global trade environment (Figure 3.4.1). Performance across the region in the first half of the year varied. Certain economies experienced a pull-forward increase in exports in anticipation of higher US tariffs announced in early April, but subsequently revised by a Presidential executive order effective August 7. The highest import tariff rates are for the Lao PDR and Myanmar at 40%, followed by Brunei Darussalam at 25%, Viet Nam at 20%, Cambodia, Indonesia, Malaysia, the Philippines, and Thailand at 19%, and Singapore and Timor-Leste at 10%. As a result, economic forecasts for both years and in most economies in the subregion were downgraded, reflecting persistent global growth deceleration, heightened trade uncertainty, and some domestic challenges. Exceptions include Viet Nam, which was slightly upgraded in 2025 due to bullish investment and trade flows; and Myanmar in 2026 owing to contributions from rehabilitation efforts.

Figure 3.4.1 Gross Domestic Product Growth in Southeast Asia

Growth prospects have deteriorated for the subregion.



Lao PDR = Lao People's Democratic Republic.

Notes: Effective 1 February 2021, ADB placed a temporary hold on sovereign project disbursements and new contracts in Myanmar. Lighter colored bars are *Asian Development Outlook April 2025* forecasts.

Source: *Asian Development Outlook* database.

Domestic demand remains a cornerstone of economic resilience across several Southeast Asian economies, bolstered by macroeconomic policy support, labor market improvements, and

The subregional assessment and prospects was written by James Villafuerte and Dulce Zara. The section on Indonesia was written by Priasto Aji and Reza Anglingkusumo; Malaysia by Mae Hyacinth C. Kiocho, consultant, and James Villafuerte; the Philippines by Jacqueline Connell and Teresa Mendoza; Thailand by Chitchanok Annonjarn; Viet Nam by Chu Hong Minh, Nguyen Ba Hung, and Nguyen Luu Thuc Phuong. The other economies by Poullang Doung, Kavita Iyengar, Soulinthone Leuangkhamsing, Eve Cherry Lynn, Nedelyn Magtibay-Ramos, Ahmad Miraj, David Richard Fay, Bold Sandagdorj, Shu Tian, Milan Thomas, and Mai Lin Villaruel. The authors are in the Southeast Asia and Economic Research and Development Impact departments, ADB. Effective 1 February 2021, ADB placed a temporary hold on sovereign project disbursements and new contracts in Myanmar.

Table 3.4.1 Factors Supporting GDP Growth in Southeast Asian Economies

Economies benefit from macroeconomic policy support and improved labor markets conditions.

Stimulus Spending, Building Infrastructure, and Cutting Taxes	Lower Interest Rates	Improvements in the Job Market	Remittances
Cambodia Indonesia Malaysia Philippines Thailand Timor-Leste Viet Nam	Indonesia Malaysia Philippines Thailand Viet Nam	Malaysia Singapore	Philippines

GDP = gross domestic product.
Source: Asian Development Bank.

remittances (Table 3.4.1). Strong consumer demand has driven economic activity in Indonesia, Malaysia, the Philippines, Singapore, Timor-Leste, Thailand, and Viet Nam supported by an array of fiscal and monetary support, labor market improvements, and solid inflows of remittance. Improved budgeting and financial management have enhanced the effectiveness of government spending in Cambodia and Timor-Leste.

Public investment remains a steady growth driver across the subregion. In the Philippines, the government targets infrastructure spending to be 5%–6% of GDP, encompassing major projects in transportation, railways, bridges, and the Metro Manila subway. Malaysia's 13th Plan allocates RM611 billion for upgrades in semiconductors, AI, energy, tourism, and transport sectors. Thailand continues to focus on growth through public investment in water management and transportation. In Viet Nam, the accelerated rollout of infrastructure projects is expected to sustain construction momentum. Timor-Leste's budget reallocation towards critical infrastructure forms part of its broader fiscal consolidation strategy.

Exports have materially influenced economic outcomes across the subregion. Some countries, such as Cambodia, Indonesia, the Philippines, Singapore, Thailand, and Viet Nam, saw substantial export growth due to upbeat demand from front-loading ahead of tariff changes. In contrast, others faced challenges from global trade uncertainties, supply chain disruptions, and geopolitical tensions. Malaysia experienced mixed results, with declining energy-related exports. However, Brunei Darussalam, and Myanmar encountered significant export difficulties due to external shocks and domestic constraints.

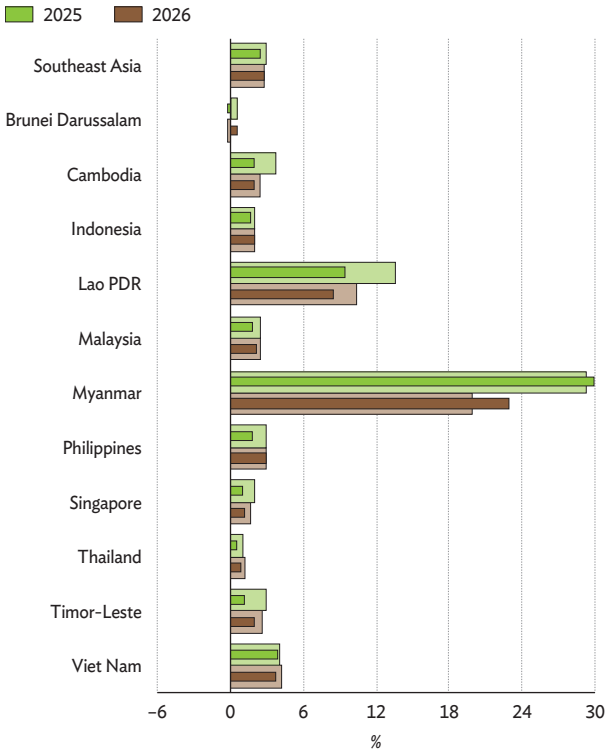
Sectoral performance also varies. Tourism was a key driver in several countries, though uneven recovery and geopolitical tensions dampened performance in Thailand and Cambodia. Retail, food, and accommodation services thrived in Malaysia, the Philippines, and Viet Nam, supported by domestic demand. Transport and logistics continued to support growth in Indonesia, Singapore and Viet Nam, though softened in Thailand. Financial services expanded in the Philippines and in Viet Nam, reflecting strong banking activity and investment flows.

The services sector is expected to remain a key contributor to growth in 2026. While some economies anticipate continued expansion driven by tourism, retail, and financial services, others may face headwinds from weak consumer sentiment, geopolitical risks, and fiscal tightening. There is a mixed outlook for tourism recovery across the region. While Indonesia and Viet Nam expect gains, Thailand and Cambodia face slower rebounds due to geopolitical and safety concerns. The Philippines also has yet to fully regain pre-pandemic levels of international tourist arrivals. There will be continued expansion in financial and business services in Viet Nam and Singapore, though global uncertainty may dampen investment sentiment. Growth in digital and logistics services in Viet Nam and Malaysia is supported by infrastructure investment and digital transformation.

Inflation dynamics are generally muted across the subregion, shaped by weak commodity prices and timely domestic policy responses (Figure 3.4.2). The only exception is Myanmar, where high inflation remains destabilizing. Low inflation offers policy flexibility but could also signal subdued demand, as seen in Thailand and Singapore. Thus, the inflation

Figure 3.4.2 Inflation in Southeast Asia

For most countries, inflation is expected to remain moderate in 2025 and 2026.



Lao PDR = Lao People's Democratic Republic.

Notes: Effective 1 February 2021, ADB placed a temporary hold on sovereign project disbursements and new contracts in Myanmar. Lighter colored bars are *Asian Development Outlook April 2025* forecasts.

Source: *Asian Development Outlook* database.

outlook for the subregion is downgraded to 2.5% and 2.7%, consistent with the expectation of slower growth in almost all economies over the next 2 years.

Monetary policy across Southeast Asia in 2025 has largely shifted toward easing, as inflation moderated and external risks intensified. In 2026, central banks are expected to maintain accommodative stances, though some may face pressure to tighten if inflation accelerates due to fiscal reforms or currency depreciation. Inflation across Southeast Asia is expected to remain broadly contained, with most economies projecting moderate price increases. While global commodity prices are expected to stabilize, domestic factors, including fiscal reforms, currency movements, and structural constraints, will shape inflation dynamics across the region.

Sectoral diversification, particularly in manufacturing, agriculture, and services, is helping economies to better withstand external shocks and explore new growth opportunities. In Cambodia, the expansion of non-garment manufacturing, such as electronics and furniture, complements its garment exports. Malaysia is enhancing its industrial capabilities through investments in renewable energy, digital infrastructure, and environmental, social, and governance (ESG) compliance. Thailand is expected to attract investment in emerging industries like smart electronics and data centers. Viet Nam's industry and construction sectors remain robust, bolstered by foreign direct investment (FDI) and export demand.

Structural reforms are unlocking new opportunities for private sector expansion and foreign investment. Governments are implementing reforms to enhance competitiveness, attract investment, and streamline public spending. In the Philippines, reforms are opening sectors to foreign ownership and improving fiscal incentives. In Timor-Leste, program-based budgeting and fiscal discipline aim to improve spending efficiency and reduce reliance on the Petroleum Fund. Regulatory reforms in Viet Nam target climate resilience, State-owned enterprise (SOE) restructuring, and digital transformation.

Efforts to deepen regional ties and diversify trade partners are helping mitigate external risks. Export diversification and resilient FDI inflows are supporting external sector stability in Cambodia. Association of Southeast Asian Nations (ASEAN) accession of Timor-Leste in October 2025 is expected to unlock new trade and investment opportunities. Despite tariff headwinds, Viet Nam's trade with ASEAN and the European Union (EU) remains strong, and diversification is underway.

Indonesia

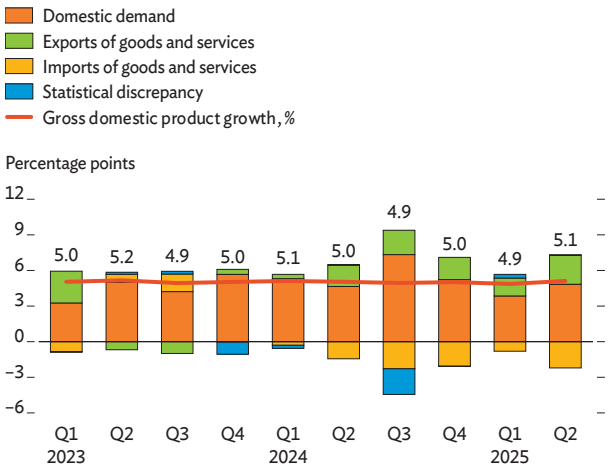
Growth is forecast to remain resilient, with the domestic economy expected to offset external headwinds more effectively in 2026. Domestic demand, supported by fiscal stimulus and monetary easing, will continue to underpin growth. Slower global activity and softer commodity prices may weigh on exports, but continuing trade agreements and structural reforms should strengthen competitiveness and support investment. Risks are broadly balanced, with global uncertainty and possible lagging reforms offset by a continued commitment to building a stronger trade and investment climate.

Updated Assessment

The economy grew by 5% during the first half (H1) of 2025. Domestic demand dominated growth, while net external demand contributed modestly. GDP grew by 4.9% in the first quarter (Q1) 2025 and strengthened to 5.1% in Q2, resulting in a 5.0% growth rate for H1 2025, slightly below the 5.1% in H1 2024. Resilient private consumption and a rebound in investment, alongside a lift in exports underpinned growth (Figure 3.4.3).

Figure 3.4.3 Demand-Side Contributions to Growth

Growth reached 5.0% in the first half of 2025, driven by domestic demand.



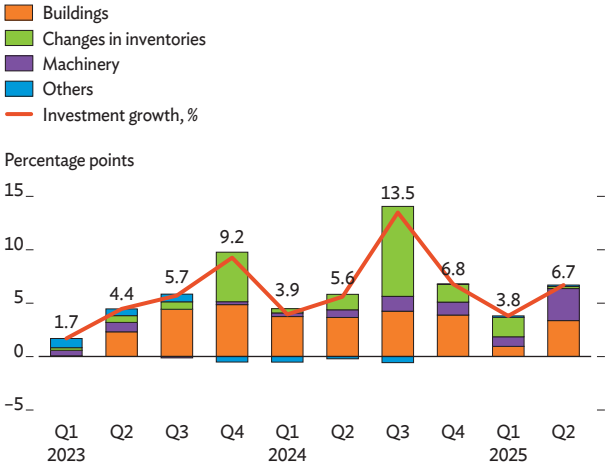
Q = quarter.
Source: Haver Analytics.

Consumption sustained growth alongside higher household mobility. Private consumption growth expanded from 4.9% in Q1 to 5.0% in Q2. It was more balanced in Q1, while in Q2, nonfood items, such as transportation, restaurants, and communications, expanded more strongly given the holiday season. Government consumption contracted by a less severe −0.3% in Q2 following a drop of −1.4% in Q1 as spending increased.

After a slow start, investment gained momentum in Q2. Gross fixed capital formation rose by 2.1% in Q1, accelerating to 7.0% in Q2 following the election transition. The investment pickup was consistent with growth in construction and machinery investment, supported by continuing public works projects (Figure 3.4.4).

Figure 3.4.4 Contributions to Investment Growth

Investment in buildings and machinery supported growth during the first half.



Q = quarter.
Source: Haver Analytics.

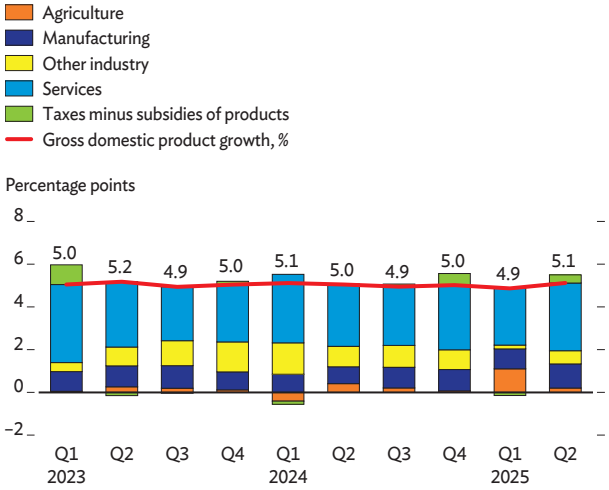
Net exports strengthened ahead of tariff hikes, supported by rising tourism. Exports to the top 10 destinations rose in both quarters, with stronger gains in Q2 as exports of manufactured goods accelerated ahead of the United States (US) tariff hikes. Imports also rose in Q2, driven by higher demand for capital goods in line with stronger manufacturing activity. Services exports improved as tourism picked up in Q2 with higher international arrivals. Net exports added 0.7 percentage points to growth in Q1 and 0.2 points in Q2.

Services and manufacturing remained the top drivers of supply-side growth, with manufacturing accelerating in Q2. In Q1 2025, agriculture surged by 10.5% on strong food harvests, while services grew by 6.0% and manufacturing by a modest 4.5% on softer external demand. By Q2, services growth edged up slightly, driven by trade and logistics in line with stronger consumption and tourism. Manufacturing growth accelerated by 5.7%, alongside higher exports, while agriculture slowed to 1.7% as the boost from earlier harvests tapered off (Figure 3.4.5).

Inflation averaged 1.5% year on year during January–August 2025, down from 2.6% a year earlier. Headline inflation fell at the start of the year by temporary electricity discounts and softer food prices following bumper harvests. It edged up in June

Figure 3.4.5 Supply-Side Contributions to Growth

Manufacturing and services remained key drivers of growth.



Q = quarter.

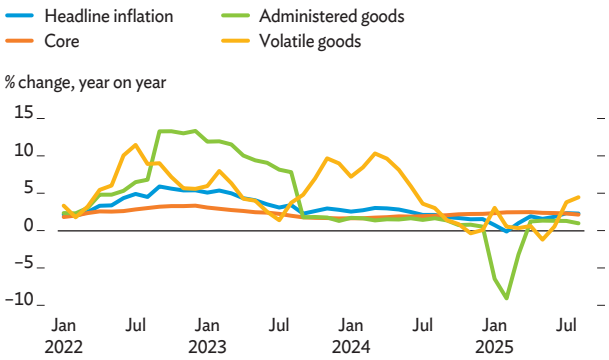
Source: Haver Analytics.

and July as rice and chili prices rose alongside the seasonal increase in education costs with the new school year. Price pressures eased slightly in August on monthly deflation of horticulture products during the harvest season and airfare discounts (Figure 3.4.6). Administered prices were broadly stable. Core inflation averaged 2.4% in January–August 2025, up from 1.8% a year earlier, but remained subdued given well-anchored expectations within the official target range of 2.5% ± 1%.

Despite external headwinds, the current account deficit remained within the central bank's range for the full year. In H1 2025, exports in US dollar terms increased by 7.8% year on year, driven by exports of palm oil and manufactured goods—including textiles, footwear, electrical machinery, organic chemicals, and non-ferrous metals—which rose ahead of new US tariffs (Figure 3.4.7). However, weaker global commodity prices limited overall gains (Figure 3.4.8). Imports rose 5.1%, broadly flat in Q1 but rebounding in Q2 on stronger demand for capital goods (Figure 3.4.9). As a result, the trade surplus rose to $23.6 billion in H1 2025 from $19.3 billion a year earlier. The services deficit was broadly stable, with gains from rising tourism partly offset by outbound travel and freight costs. The primary income

Figure 3.4.6 Monthly Inflation

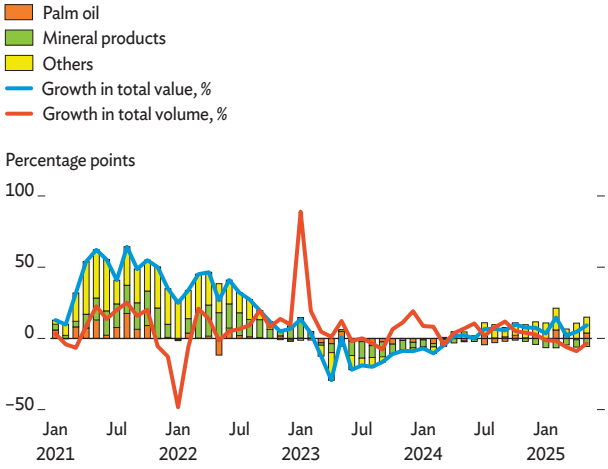
Well-anchored inflation expectations are reducing risks to price stability.



Source: Haver Analytics.

Figure 3.4.7 Contributions to Export Growth

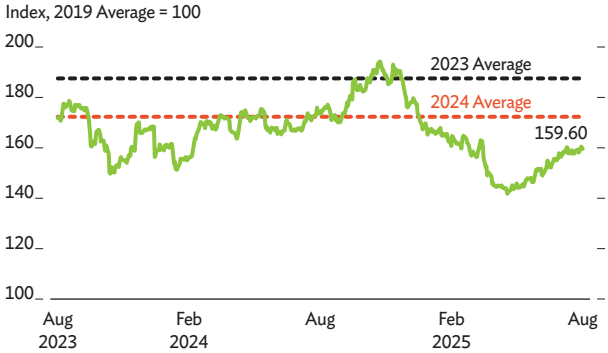
Exports surged ahead of new tariffs.



Source: Haver Analytics.

Figure 3.4.8 Commodity Prices

Weaker global commodity prices than last year limited export gains.

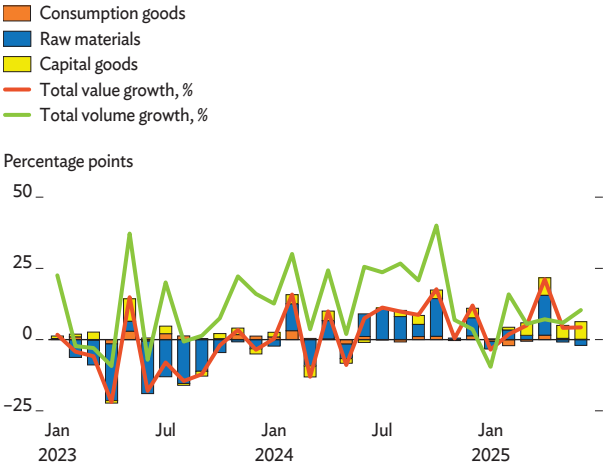


Notes: Prospera Commodity Price Index comprising crude palm oil, coal, nickel, rubber, and copper weighted by their 2019 export shares. Prices are the Malaysian CPO Spot Price, Newcastle Coal Price, CMX Copper Price, LME Nickel Spot Price, and the Singapore TSR20 Rubber Price.

Source: Prospera.

Figure 3.4.9 Contributions to Import Growth

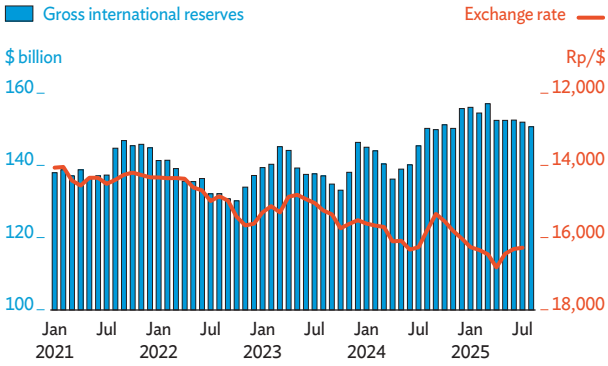
Imports climbed on stronger demand for capital goods.



Source: Haver Analytics.

Figure 3.4.10 Reserves and the Exchange Rate

Ample reserves provide a buffer to external shocks.



Rp = rupiah.

Source: Haver Analytics.

deficit persisted due to income transfers, while the secondary income surplus improved slightly with higher remittances. Combined, it led to a current account deficit of $3.2 billion (0.5% of GDP) in H1 2025, narrower than the 0.8% deficit in H1 2024, and broadly consistent with the central bank's projected 0.5%–1.3% of GDP range for 2025.

The capital and financial account was in deficit as investors adjusted to increased global uncertainty. In H1 2025 the deficit was $5.6 billion, driven by $6.5 billion in portfolio outflows from reduced bond and equity holdings. However, foreign direct investment inflows remained steady, rising slightly to $4.0 billion in Q2 from $3.9 billion in Q1. Indonesia's solid fundamentals maintain medium-term confidence, sustaining foreign direct investment inflows and helping stabilize the outlook.

The balance of payments was in deficit in H1 2025. The shortfall was $7.5 billion, but manageable. Ample international reserves remained at $150.7 billion at end-August 2025, sufficient to cover more than 6.1 months of imports and the government's external debt service (Figure 3.4.10). The rupiah weakened in early 2025 but has since stabilized, supported by the central bank's policy mix.

Prospects

Domestic factors should offset external headwinds more effectively next year, with GDP forecast to grow by 4.9% in 2025 and 5.0% in 2026 (Table 3.4.2). While weaker global growth will affect trade, domestic demand will continue to fuel the economy. Government spending has been slower in H1 2025 as new programs are being rolled out, but expenditure will improve gradually into 2026, allowing fiscal stimulus to better cushion any global impact. The lagged impact of monetary easing will also begin to support activity, and investment is expected to gain traction. With risks to price stability benign, the central bank retains sufficient space to maintain supportive monetary policy.

Faster yet prudent fiscal spending is expected in H2 2025. In H1 2025, state revenue and expenditure each reached approximately 40% of the annual budget, resulting in a modest 0.8% of GDP deficit and a primary surplus. Significant budget allocations are for people-

Table 3.4.2 Selected Economic Indicators in Indonesia, %

Domestic demand, supported by fiscal stimulus and monetary easing, will maintain steady growth despite external headwinds.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	5.0	5.0	4.9	5.1	5.0
Inflation	2.3	2.0	1.7	2.0	2.0

GDP = gross domestic product.

Sources: Central Bureau of Statistics; Asian Development Bank estimates.

oriented programs, including the free nutritious meal program. In July, the government raised its full-year deficit target from 2.5% of GDP to 2.8%, below the 3% legal cap, and launched a stimulus package of food aid, cash transfers, and transport discounts to maintain growth. Given slower H1 spending, the government will accelerate H2 expenditure to meet its 2025 deficit target.

The government's 2026 budget will likely support higher and more inclusive growth, supported by continued fiscal stimulus. The 2026 budget deficit is set at about 2.7% of GDP, well below the 3% legal limit. Expenditure will likely continue to emphasize people-centered spending that develops human capital, combats extreme poverty, and reduces inequality. The government will continue tax administration reforms through digitalization and better data integration. Customs and excise reforms will also continue to reduce leakage and improve enforcement.

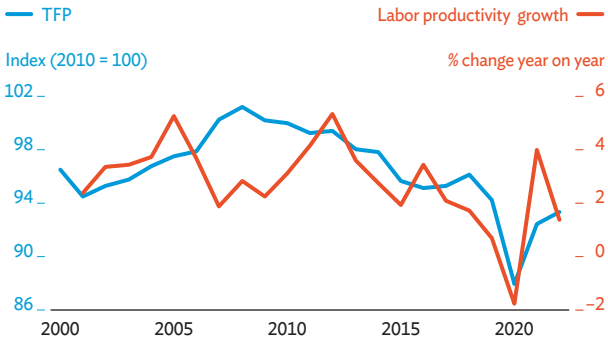
The central bank is calibrating a policy mix to stimulate growth while maintaining stability. Bank Indonesia has reduced its policy rate by a cumulative 150 basis points since September 2024, bringing the rate to 4.75% amid benign risks to price stability and well-anchored inflation expectations. Easier global financing conditions, with interest rates in advanced economies lower than expected in April, should also support capital flows. The central bank's monetary easing, together with accommodative macroprudential measures and government fiscal stimulus, should support domestic demand while keeping a cautious eye on any risks stemming from renewed external pressures.

Average inflation is forecast to stay within the official target. Orderly price adjustments, along with subdued core inflation, reflect well-managed overall macroeconomic balances. Thus, inflation expectations are projected to remain within the official target range of 2.5% ±1% in 2025 and 2026, providing room for a continued accommodative policy stance. The 2025 inflation projection has been revised down to 1.7% from 2.0% in *ADO April 2025* on the lower levels during the first 8 months of the year.

The growth outlook could improve if productive investment constraints were reduced. Stronger external competitiveness—which aligns with higher total factor productivity along with further capital deepening—could lead to higher growth and expanded job creation despite external headwinds (Figure 3.4.11). Human capital development to increase worker productivity becomes increasingly critical as the nature of work continues to rapidly evolve. Decent job creation would gain traction from an expanded labor force with productive skill sets that better align with new and more efficient business processes and technologies.

Figure 3.4.11 Total Factor Productivity

Long-term income creation would benefit from improvements in productivity.



TFP = total factor productivity.

Notes: Capital productivity is measured as output per unit of capital, while labor productivity is measured as output per employed worker.

Source: Asian Productivity Organization (APO) Database version 1c (2024) - APO Tokyo, Japan.

Continued supply-side reforms will strengthen capital deepening, productivity and job creation. Policy coordination and streamlined reforms to remove investment barriers would support broad-based capital deepening, raise firms' productivity, and expand job creation—including in labor-intensive sectors. Enhancing technical and vocational training together with stronger Science, Technology, Engineering, and Mathematics education would further improve labor-market outcomes and gradually support greater investment and job creation in higher-value manufacturing and services.

Trade agreements and a commitment to openness should increase competitiveness. Indonesia has trade and investment agreements with various countries and groupings, well beyond recent negotiations over US tariffs, that provide diversified access to international markets. Firms would benefit from scale efficiencies and maintain relative competitiveness in global markets from the

arrangements. Improved global market access could also enhance productivity through available high-quality industrial inputs, capital goods, and labor augmenting technologies. Accordingly, a consistent commitment to openness and reform may further stimulate investment, enhance domestic participation in global value chains, and promote job creation.

Risks are broadly balanced. Downside risks include heightened global trade policy uncertainty, slower growth among Indonesia's main trading partners, and further commodity price weakness. These could weigh on export revenues and domestic income. Domestically, slower fiscal disbursements could weigh on domestic demand, while delays in implementing structural reforms may slow capital deepening and improved productivity. Upside risks include higher global growth and accelerated supply-side reforms that could raise growth above baseline projections. A sustained commitment to openness and reform would support higher growth and expanded job creation in line with Indonesia's long-term development goals.

Malaysia

Growth weakened in the first half (H1) of 2025 supported by consumer spending and robust construction and services. However, net exports continued to drag on the overall economy. Inflation eased on weaker global commodity prices. Growth is expected to moderate further in 2025 and 2026, slowed by a deteriorating external environment. Inflation is projected to decline in 2025 but may rise in 2026 due to the impact of budgetary reforms. Risks to the outlook are mostly external.

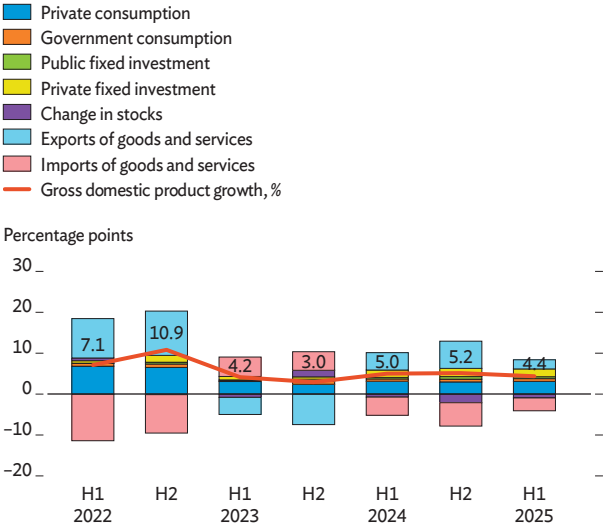
Updated Assessment

GDP growth slowed to 4.4% in H1 2025 from 5.0% in H1 2024 (Figure 3.4.12). Robust domestic activity, particularly in consumption and investment, along with construction and services, backed overall growth. In contrast, external trade along with mining and quarrying held back the expansion.

Both private and public consumption remained robust. Private consumption grew by 5.2% in H1 2025, the same as in H1 2024. Strong household spending was helped by improving labor market conditions and the lingering effects of the minimum wage hike earlier this year. The unemployment rate continued to decrease in the second quarter (Q2) of 2025, dropping to 3.0% from 3.1% in Q1. Meanwhile, government expenditure increased by 5.3% in H1 2025, up from 4.5% in H1 2024, primarily due to higher emoluments and spending on supplies and services.

Figure 3.4.12 Demand-Side Contributions to Growth

Growth gained from resilient domestic consumption and robust investment, while external trade moderated the overall expansion.



H = half.

Source: Haver Analytics.

Investment continued to grow by double-digits. Private investment grew by 10.6% in H1 2025, the same as in H1 2024, due to higher spending on structures and machinery and equipment. Larger capital expenditures by public corporations led to a 12.6% rise in public investment in H1 2025. Foreign direct investment (FDI) reached RM2.0 trillion in H1 2025, up by 5.5% from H1 2024. FDI in agriculture rose by 14.9% with services up 13.8%. Information and communications saw a 43.3% increase.

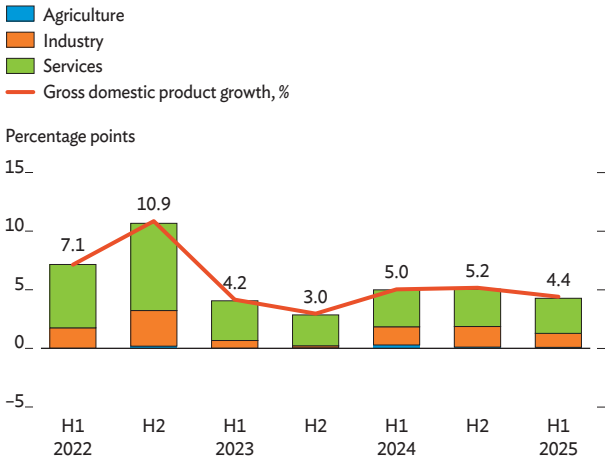
Exports and imports slowed relative to last year. Following front-loading in April in anticipation of expected new United States (US) tariffs, exports declined year on year in May and June but recovered somewhat in July. Exports grew by 4.3% from January to July 2025, slower than the 5.3% growth in the same period in 2024. Exports to major trading partners like

Japan contracted by 9.0% and the People's Republic of China (PRC) by 2.7%. Liquified natural gas and crude petroleum exports decreased by 22.2%. Imports also expanded at a slower 5.1% pace from January to July 2025, following a 15.5% increase in the same period last year. Capital goods rose by a substantial 36.4%, while consumption goods imports grew by a minimal 0.3% with intermediate goods down by 2.9%. With imports increasing faster than exports, the trade balance from January to July 2025 decreased by 4.7%.

Most supply side contributions to growth expanded (Figure 3.4.13). Strong growth in construction and services persisted, followed by solid growth in manufacturing. Agriculture improved slightly, while mining and quarrying contracted during H1 2025 due to lower oil and natural gas output and disruptions from planned maintenance activities.

Figure 3.4.13 Supply-Side Contributions to Growth

Robust construction and services continued to underpin economic growth.



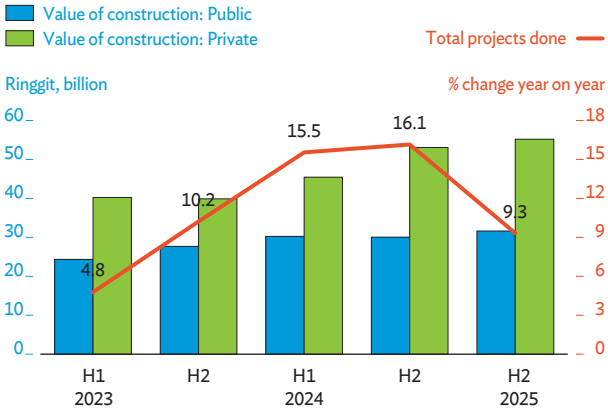
H = half.

Source: Haver Analytics.

Construction grew by 13.1% in H1 2025, down slightly from 14.5% in H1 2024, still fueled by private and public spending. Construction completed in H1 2025 was valued at RM86.8 billion, up by 14.7% from H1 2024 (Figure 3.4.14). The expansion was due to ongoing public infrastructure projects. Continued data center construction fueled much of the private sector activity.

Figure 3.4.14 Construction Indicators

Ongoing public and private initiatives continued to support construction.



H = half.

Sources: Haver Analytics; Department of Statistics Malaysia.

Services grew by 5.0% in H1 2025 from 5.3% in H1 2024, driven by sustained growth in consumer- and tourist-related services. Wholesale and retail trade grew by a strong 4.3% despite a 1.8% decline in motor vehicle services trade. Other services increased substantially, with accommodations up by 14.3%, real estate 11.2%, transport and storage 9.0%, business services 7.9%, and food and beverages by 6.5%. From January to May 2025, tourist arrivals reached 10.5 million, a 10.5% increase from the same period in 2024.

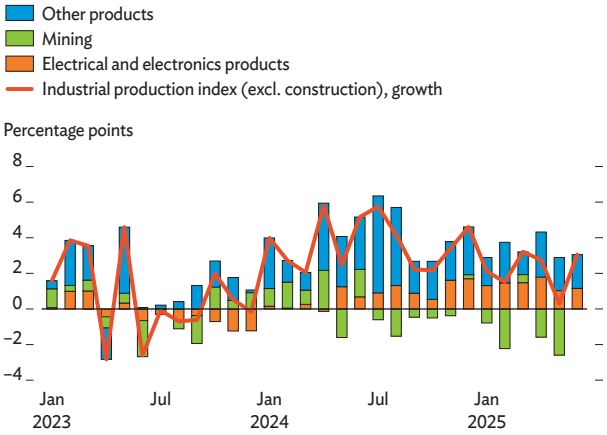
Manufacturing increased by 3.9% in H1 2025 compared with 3.4% in H1 2024. Manufacturing sales totaled RM955.8 billion in H1 2025, up by 3.7% from H1 2024. The Manufacturing Industrial Production Index increased an average 4.1% as food, beverages, and tobacco rose a sizable 9.6% with electrical and electronic products up 7.5% (Figure 3.4.15).

In H1 2025, agricultural growth slowed to 1.4% from 4.8% in H1 2024, while mining and quarrying contracted by 3.9% following 3.6% growth in H1 2024. Most agricultural subsectors grew moderately, while rubber and forestry along with logging declined. Weaker production in crude oil and natural gas led to a decline in mining and quarrying.

Inflation eased to 1.4% from January to July 2025, down from 1.8% a year earlier, while core inflation remained at 1.8%, the same as last year (Figure 3.4.16). Moderate increases in utility prices

Figure 3.4.15 Contributions to Industrial Production Growth

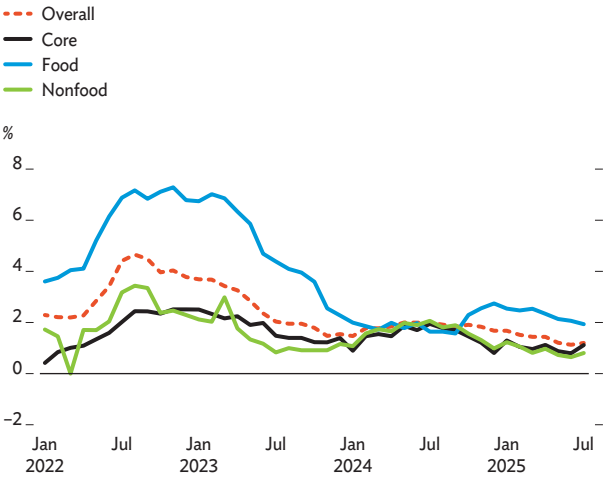
Key domestic- and export-related industries contributed to solid growth in manufacturing.



Sources: Haver Analytics; Department of Statistics Malaysia.

Figure 3.4.16 Monthly Inflation

Inflation eased with prices falling in select commodities and services.



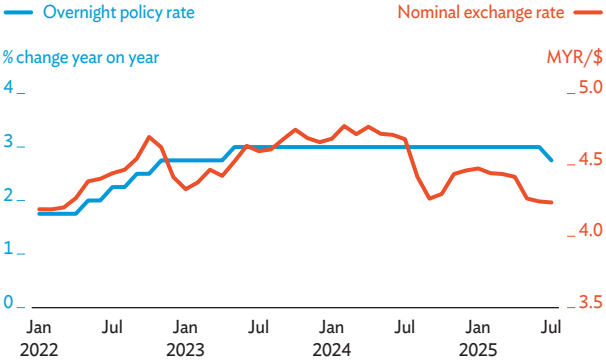
Source: Haver Analytics.

such as water, electricity, and gas along with services such as health, transport, and recreation kept inflation low. Prices fell for other commodities like clothing and footwear, and communication services.

The monetary policy rate was lowered to 2.75% in July 2025 after being held at 3.00% since 2023 (Figure 3.4.17). Bank Negara Malaysia (BNM) lowered the monetary policy rate by 25 basis points to support the domestic economy given uncertain tariff developments and geopolitical tensions.

Figure 3.4.17 Monetary Policy

The policy rate was lowered by 25 basis points to support the domestic economy amid ongoing external challenges.



MYR = Malaysian ringgit.
Source: Haver Analytics.

The ringgit strengthened to RM4.22 against the US dollar at the end of August 2025 from RM4.47 at end-December 2024, mainly due to external factors.

The fiscal deficit fell to RM40.5 billion in H1 2025 from RM51.6 billion in H1 2024. The budget improvements derived from a 6.1% increase in revenue as operating expenditure fell by 1.1% and net development spending dropped 2.4%. The H1 2025 fiscal deficit was 4.2% of GDP, still above the 2025 target of 3.8%.

External debt reached RM1.4 trillion, or 71.4% of GDP, at the end of June 2025. Average external debt outstanding in Q2 2025 was 4.1% higher than in Q2 2024. The rise came via larger interbank borrowings, intercompany loans, and nonresident holdings of government debt securities.

International reserves rose to $121.3 billion at end-July 2025. International reserves rose by 5.8% compared to July 2024. The import cover ratio was 4.8 months, below the 5.2 month average in 2024.

Prospects

Growth is expected to ease as restrictive trade policies begin to impact the economy in H2 2025 and into 2026. Domestic spending will likely continue to support expansion. Still, the outlook remains vulnerable to external pressures and prevailing uncertainties. GDP is projected to grow by 4.3% in 2025 and 4.2% in 2026 (Table 3.4.3 and Figure 3.4.18), slightly below *ADO April 2025* forecasts.

Table 3.4.3 Selected Economic Indicators in Malaysia, %

Growth and inflation forecasts have been revised down from April.

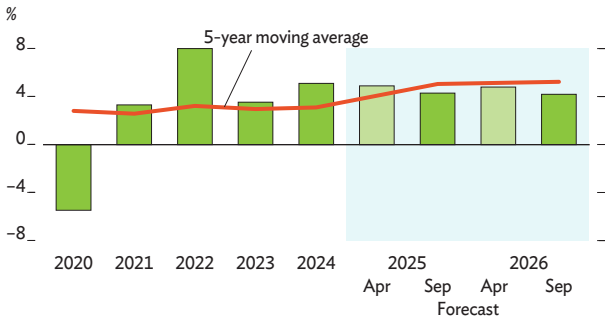
	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	5.1	4.9	4.3	4.8	4.2
Inflation	1.8	2.5	1.8	2.5	2.2

GDP = gross domestic product.

Sources: Department of Statistics Malaysia; Asian Development Bank estimates.

Figure 3.4.18 Gross Domestic Product Growth

GDP growth will likely moderate due to the effects of heightened external challenges.



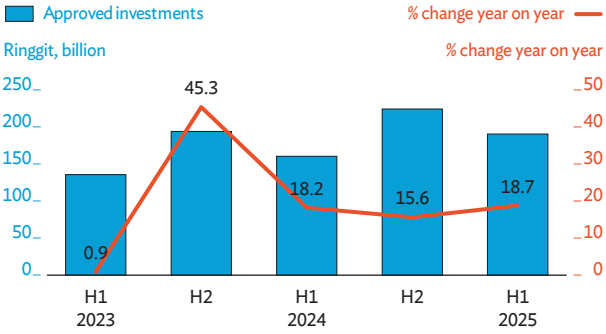
Source: *Asian Development Outlook* database.

Strong domestic consumption growth will likely continue, although concerns over the impact of impending reforms may temper demand. Stable employment and higher wages will continue to support household spending. However, recent and upcoming reforms have boosted concerns over rising living costs. The July 2025 expanded sales and services tax may limit household discretionary spending, driven by higher prices for non-essential goods and increased tax coverage of services. Also, there are concerns that the reconfiguration of electricity and water tariffs—resulting in higher rates for heavy users such as businesses and high-income households—may result in these higher costs being transferred to lower- and middle-income consumers. The government plans to give a RM100 one-time payout to all adult citizens at the end of August to ease these concerns.

Ongoing structural reforms and expected government initiatives should promote investment and construction. Approved investments reached RM190.3 billion in H1 2025, an 18.7% increase from H1 2024 (Figure 3.4.19). The state of Johor had the

Figure 3.4.19 Approved Investments

Investment will likely be bolstered by government initiatives and key sectoral growth.



H = half.

Sources: CEIC Data Company; Malaysian Investment Development Authority.

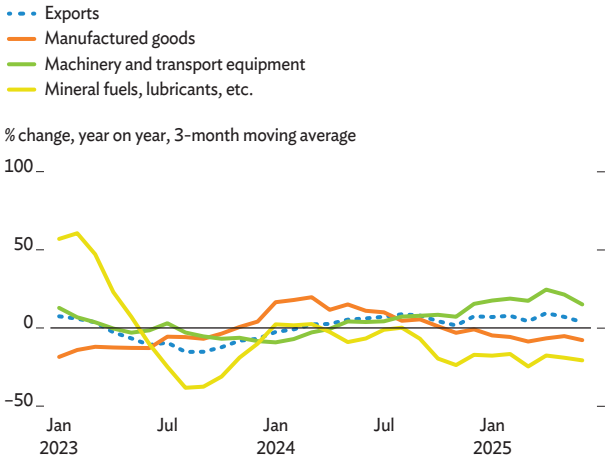
largest investments approved primarily due to the development of the Johor-Singapore Special Economic Zone, a collaborative hub offering incentives for technology, manufacturing, and tourism. Investment should also be fueled by various government initiatives, including the National Industrial Master Plan, National Energy Transition Roadmap, and MyDIGITAL, among others—all directed toward renewable energy, digital infrastructure, and environment, social, and governance compliance. The recent unveiling of the 13th Malaysia Plan, the country's 2026–2030 socio-economic roadmap, requires RM611.0 billion in investment. The plan aims to upgrade and strengthen the country's position in the global value chain by transforming sectors such as semiconductors, artificial intelligence, energy, tourism, and transportation, while also supporting workforce development.

The business outlook will likely remain cautious amid rising global trade risks. Business sentiment will be muted as firms confront increasing costs and growing uncertainty in external demand. Businesses are increasingly concerned over supply chain issues and the tariff impact on sales, profit margins, and cash flow, hoping for greater government assistance. Following the April US tariff announcement, the government announced a RM1.5 billion support package of government guarantees and soft loans to help small and medium enterprises mitigate the tariff impact.

Manufacturing and exports face uncertain global markets (Figure 3.4.20). The reduction of the announced US tariff rate from 25.0% to 19.0%

Figure 3.4.20 Export Growth

Changing external factors will likely hurt exports in the second half of 2025.



Source: Haver Analytics.

following government negotiations may briefly boost manufactured production and exports. But the ambiguous trade environment continues to weigh on the outlook. The growth of exports of electrical and electronic products may fall prey to restrictive policies. The government has set export controls on high-performance artificial intelligence chips to address US concerns that the country is being used to circumvent US export control restrictions. The US has also proposed a 100.0% tariff on microchips and semiconductors from countries that do not manufacture them in the US.

Inflation is expected to moderate, with upside risks from tax and subsidy reforms likely to take effect later this year and next. Due to more subdued demand and cost expectations, BNM expects inflation to fall between 1.5% and 2.3% in 2025, down from earlier projections of 2.0%–3.5%. Upward pressures from budget reforms will likely appear toward the end of the year and into 2026 due to the later-than-expected implementation of expanded sales and services taxes and the fuel subsidy rationalization. Inflation is projected to be 1.8% in 2025 and 2.2% in 2026, slightly below *ADO April 2025* forecasts.

BNM will likely maintain its monetary policy rate, but further moderating growth could induce additional cuts. The 25-basis-point rate cut to 2.75% is more aligned with sustaining domestic economic growth momentum amid elevated external risks. Given stable domestic economic conditions and a softer US dollar, the ringgit will likely remain near current levels.

The domestic economic outlook is stable despite uncertainties largely emanating externally. The global environment is affected by frequently changing trade policies and geopolitical tensions. These ambiguities can impact global commodity prices and financial markets which can subsequently affect the domestic economy.

Philippines

The growth outlook remains strong at 5.6% for 2025 and 5.7% for 2026, although both are slightly below *ADO April 2025* forecasts. External headwinds and heightened uncertainty over global economic policies have weighed down trade and investment prospects. Amid these challenges, however, low inflation and monetary easing are expected to sustain domestic demand, with overall inflation likely to ease more in 2025 than earlier projected.

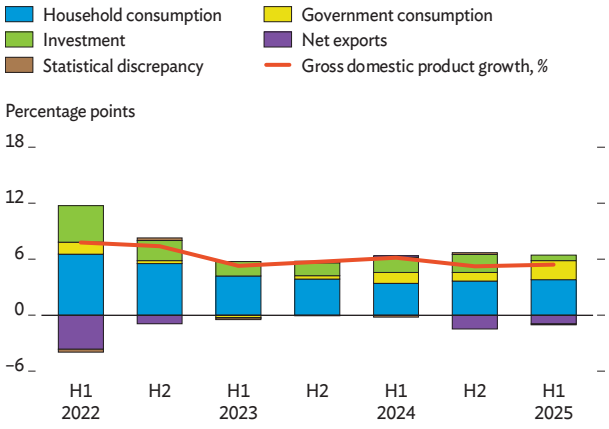
Updated Assessment

The economy maintained steady growth momentum in the first half (H1) of 2025, supported by domestic demand. GDP rose by 5.5% year on year in the second quarter (Q2), slightly faster than Q1, bringing H1 growth to 5.4%. Broad-based domestic demand drove growth, led by household spending (Figure 3.4.21). Household consumption, which accounts for about 70% of GDP, rose by 5.4% in H1 2025 from 4.7% in H1 2024, supported by low inflation, dynamic labor market conditions, and steady remittance inflows. Government consumption also rose (by 13.1% from 7.6%), including expenditure on social services, fiscal transfers to local governments, and spending ahead of the May 2025 midterm elections.

Investment continued to support GDP growth even as it eased from last year. Fixed investment rose by 4.3% in H1 2025 compared to 6.4% in H1 2024. Public infrastructure expenditure rose by 8.2% in Q1 but contracted in Q2 as an election ban suspended public spending before the polls in mid-May. This was cushioned by higher outlays for industrial machinery

Figure 3.4.21 Demand-Side Contributions to Growth

Broad-based domestic demand led by household spending lifted growth.

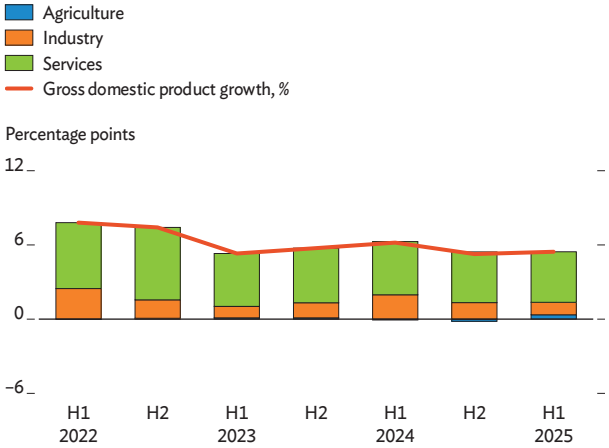


H = half.

Sources: Philippine Statistics Authority; CEIC Data Company.

Figure 3.4.22 Supply-Side Contributions to Growth

Buoyant services continued to dominate growth.



H = half.

Sources: Philippine Statistics Authority; CEIC Data Company.

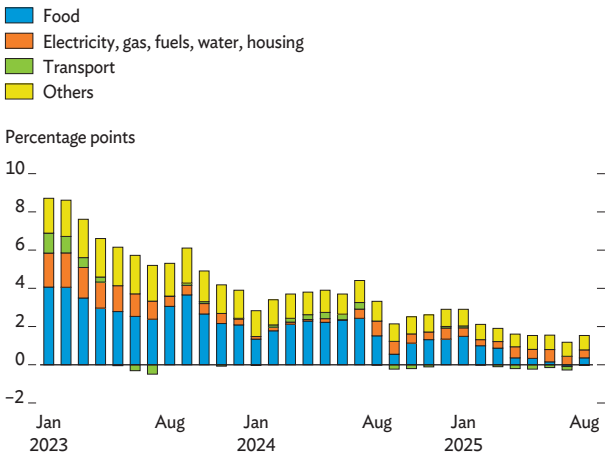
and road transport equipment alongside faster growth in private construction (up by 8.9% from 7.8%). Net exports dampened GDP growth as export gains were outweighed by strong imports. Exports of goods and services rose by 5.8% in H1 2025 in constant terms, while imports were 6.5% higher.

From the production side, robust services continued as the primary source of growth. Services expanded by 6.6% in H1 2025 from 6.9% in H1 2024, with retail trade, transportation, accommodation, financial, professional and business services key contributors. Industry growth eased (to 3.3% from 6.6%) with a manufacturing slowdown reflecting weak external demand, though it still contributed nearly a fifth of GDP growth (Figure 3.4.22). Agriculture rebounded from last year's dry spell (up by 4.5% from a 0.9% contraction) with a recovery in major crops, including rice and corn, along with poultry.

Inflation remained moderate mainly on subdued food prices. Inflation rose to 1.5% year on year in August 2025 from 0.9% in July, averaging 1.7% in the first 8 months (Figure 3.4.23). It remained below the government target range of 2% to 4%. Food inflation slightly picked up to 0.6% after falling by 0.5% in July as bad weather reduced supply of some food commodities, particularly vegetables and fish. Rice inflation has fallen since the start of the year. Given the higher share of food in the consumption basket of low-income households, inflation for the bottom

Figure 3.4.23 Contributions to Inflation, 2018 = 100

Muted food and transport prices have kept inflation low.



Sources: Philippine Statistics Authority; CEIC Data Company.

30% income households slid since June. It dropped by 0.6% in August, averaging 0.4% in the first 8 months. Meanwhile, transport inflation, had declined since February. Core inflation—which excludes volatile food and energy prices— increased, reaching 2.7% in August, averaging 2.4% over the first 8 months.

Monetary policy continued to ease amid subdued inflation. The policy rate fell further by a cumulative 75 basis points between April and August 2025, following a reduction of 75 basis points from August to December 2024. The reserve requirement ratio for universal and commercial banks was also lowered

further in March 2025 after a previous reduction in October 2024. A rise in domestic credit drove broad liquidity growth up by 6.2% year on year in July from 5.9% in June. Loans to businesses rose by 10.8% in July, while consumer lending increased by 23.6%.

The fiscal deficit widened as expenditure growth outpaced the rise in revenue. The fiscal deficit increased to 5.7% of GDP in H1 2025 from 4.9% in H1 2024. Revenue rose by 5.1%, while expenditure grew by 9.5%, covering social services, capital outlays, and allocations to local governments. Tax collection, approximately 90% of revenue, increased by 10.7% year on year. Non-tax revenue declined by 27.5% due to the high base effect of non-recurring remittances in 2024.

The current account deficit widened to 3.9% of GDP in H1 2025 from 3.6% in H1 2024, reflecting strong imports. The merchandise trade deficit widened by 2.8% with brisk imports rising along with the expansion in domestic demand. The services trade surplus narrowed on a decline in transport services exports and increased outbound travel. This was partly offset by higher revenues from business process outsourcing. Remittances continued to expand. In the financial account, net inflows declined on weaker portfolio and direct investment amid global uncertainty. Overall, the balance of payments shifted into a deficit of 2.4% of GDP in H1 2025 from a 0.6% surplus in H1 2024.

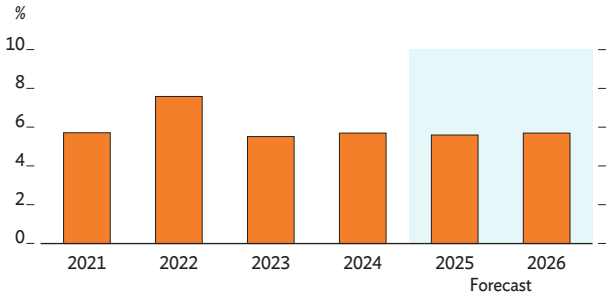
Official reserves were $107.1 billion at end-August 2025, equivalent to 7.2 months of import cover. The Philippine peso strengthened amid broad weakness of the US dollar, appreciating by 1.4% in the first 8 months of 2025. The ratio of external debt to GDP increased to 31.2% at end-June 2025 from 29.8% at end-December 2024.

Prospects

The growth outlook remains resilient despite external headwinds. GDP is projected to expand by 5.6% in 2025 and 5.7% in 2026 on continued strong domestic demand (Figure 3.4.24). The outlook is below *ADO April 2025* projections of 6.0% and 6.1% given more challenging external conditions, including increased global policy uncertainty and a slowdown in growth in major advanced economies (Table 3.4.4).

Figure 3.4.24 GDP Growth

The economy remains resilient on strong domestic demand.



Sources: *Asian Development Outlook* database.

Table 3.4.4 Selected Economic Indicators in the Philippines, %

Low inflation and accommodative monetary policy will support domestic demand.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	5.7	6.0	5.6	6.1	5.7
Inflation	3.2	3.0	1.8	3.0	3.0

GDP = gross domestic product.

Source: Asian Development Bank estimates.

The 19% US tariff rate on Philippine exports effective August 2025 will weigh on exports, though solid domestic demand should mitigate the impact and remain the main engine of growth.

Domestic demand will continue to anchor economic expansion, supported by low inflation and accommodative monetary policy. Sustained public infrastructure investment will also continue to boost growth. Infrastructure and other capital outlays rose by 6.5% year on year in June, following the end of the election spending ban in early May. The central bank's Q2 2025 surveys indicate that business sentiment remains positive, albeit softer in the face of external challenges. Meanwhile, consumer outlook remained optimistic for 2026 has improved. Minimum wage increases in several regions will support household spending. Remittance inflows have remained steady, growing by 3.1% in July, the same pace as the first 7 months of the year. Imports of consumer goods and capital goods continued to rise in July, particularly telecommunications and transport equipment, and electrical machinery.

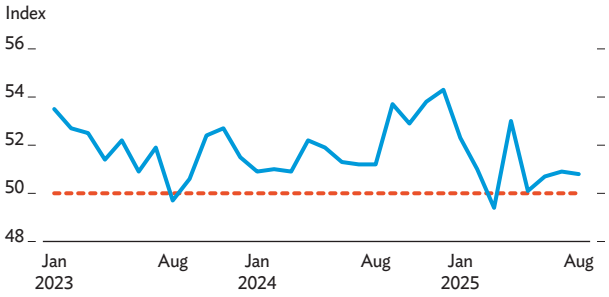
Labor market conditions have been broadly favorable, though challenges including youth unemployment persist. The unemployment rate averaged 4.0% in H1 2025, below pre-pandemic levels, but climbed to 5.3% in July, up from 4.7% a year earlier. Agriculture, which accounted for a fifth of total employment, posted heavy job losses, partly due to successive typhoons. Jobs in services fell slightly, with declines in wholesale and retail trade partly offset by gains in transport, health and education, information and communications, and professional and technical occupations. Industry employment expanded, led by manufacturing. The labor market is supported by government policy initiatives, including a national employment masterplan that covers industry-aligned upskilling and reskilling programs, employment facilitation, and broader active labor market programs. These aim to address persistent challenges, including the high youth unemployment rate which climbed to 18.1% in July 2025 from 14.8% a year earlier.

On the supply side, services and industry will remain the main drivers of growth, though slightly lower than earlier projections. Services, which account for around 60% of GDP and employment, will continue to expand with trade, transportation, professional and business services among key contributors. Tourism contributed 8.9% of GDP in 2024, up from 8.7% in 2023, although still below pre-pandemic levels. Domestic travel, supported by strong consumer spending, will continue to drive much of the recovery, while international arrivals have lagged amid the increased competition from regional destinations. From January to August 2025, international tourist arrivals declined by 2.8% year on year. In manufacturing, the Purchasing Managers' Index has been expansionary since April, at 50.8 in August, though gains in output and new orders were modest (Figure 3.4.25). Tariff hikes and weaker global demand remain challenges, particularly in export-oriented subsectors such as electronics, which account for half of total exports. Domestic-oriented subsectors, however, such as food processing, construction-related materials, and consumer durables, will likely remain resilient given robust domestic demand.

Recent structural reforms have lowered barriers against foreign participation. The Open Access in Data Transmission law, adopted in August 2025, is a major reform in telecommunications that allows new investors in broadband and data transmission facilities without the need for a congressional franchise, a requirement that has long hindered investment. The law also streamlines licensing procedures and promotes infrastructure sharing. It is expected to accelerate internet rollout, especially in unserved and remote communities. The law builds on previous reforms that have allowed full foreign ownership in sectors such as renewable energy, telecommunications, shipping, railways, and expressways. The government's "green lanes" program, which expedites permit and license processing for strategic investments, covered 222 projects as of June 2025 with an estimated total project cost of ₱5.7 trillion, the majority in renewable energy, digital infrastructure, and food security. Effective implementation of these reforms should boost private investment.

Figure 3.4.25 Manufacturing Purchasing Managers' Index

The index continues to show an expansion in manufacturing.



Note: A purchasing managers' index reading of <50 signals deterioration and >50 improvement.

Sources: CEIC Data Company, S&P Global.

The proposed 2026 national budget is 7.4% higher than the 2025 budget, with increased investment in public infrastructure and social programs. The government targets infrastructure spending at 5% to 6% of GDP in the medium term, after reaching 5.3% of GDP in H1 2025, including public private partnership (PPP) projects. The government's flagship infrastructure program includes large projects on road networks and railways, ports, bridges, and the Metro Manila subway. It also includes schools, hospitals and health centers, and investments in agriculture such as irrigation systems and post-harvest facilities. The Accelerated and Reformed Right-of-Way Act approved in September 2025 streamlines the land acquisition for government and PPP projects, which will help speed up infrastructure development. Spending on social services, comprising a third of the budget, includes

national health insurance, nutrition, education, training, and livelihood programs, as well as conditional cash transfers and food vouchers for low-income families. These aim to further reduce poverty, which fell to 15.5% of the population in 2023 from 18.1% in 2021.

Fiscal consolidation is anchored on higher revenue and reforms to enhance spending efficiency. Under the latest medium-term fiscal framework, the government will reduce the fiscal deficit to 5.3% of GDP in 2026 from 5.5% in 2025 and further to 4.3% by 2028. Recent additional revenue measures include imposing a value-added tax on non-resident digital service providers, reforms to real property valuation and assessment, and an enhanced tax regime for mining. Reforms to strengthen the efficiency of the value-added tax and improve tax administration are also important. These are complemented by reforms that enhance expenditure efficiency. These include the New Government Procurement Act of 2024, which simplifies government processes, and the Government Optimization Act of 2025, which aims to reorganize and streamline government operations by consolidating functions, strengthening alignment, and removing redundancies. The government aims to reduce debt to below 60% of GDP by 2028 from 63.1% at end-June 2025. Public debt is primarily sourced domestically, accounts for two-thirds of the total or 82%, and is long-term. The country's investment grade credit ratings have been affirmed.

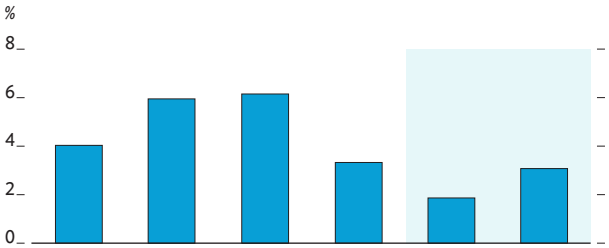
Inflation is expected to remain subdued, supported by lower global commodity prices. A rebound in agricultural output, along with lower global commodity prices, muted inflation during the first 8 months of 2025. Inflation in 2025 will likely be below earlier forecasts and return within the government's 2% to 4% target in 2026 (Figure 3.4.26). Following rice disinflation since January, the government announced that rice imports will be suspended for 60 days from September 2025 to protect local farmers hit by low rice prices during the harvest season. Monetary policy will likely remain accommodative given the low inflation outlook.

The current account will likely remain in deficit on buoyant imports to meet domestic demand. Imports of consumer goods will stay elevated, along with capital-intensive imports for infrastructure projects. Exports surged ahead of the US tariff hike—which raised duties on Philippine exports to 19% starting in August—but growth is expected to moderate afterward as the effect of front-loaded shipments fades. Exports rose by 17.3% year on year in July, bringing growth in the first 7 months to 13.9%, led by electronics. Shipments increased by a significant 12.7% to the US and 13.7% to the European Union. However, the tariff shock should weigh down external demand, including the key export markets of major advanced economies (Figure 3.4.27). Higher services export receipts, particularly business process outsourcing, will partly cushion the merchandise trade gap, while steady remittance growth will continue to support the current account.

The growth outlook faces increased downside risks. Heightened uncertainty over the external environment and shifts in trade and investment policies, along

Figure 3.4.26 Inflation

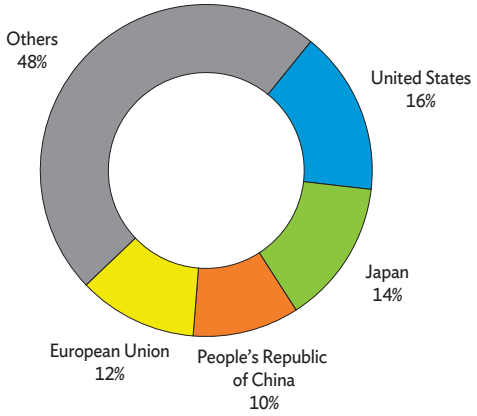
Inflation will likely remain modest, supported by lower global commodity prices.



Source: *Asian Development Outlook* database.

Figure 3.4.27 Merchandise Exports to Major Markets, H1 2025

Major advanced economies account for a significant share of total exports.



H = half.

Source: CEIC Data Company.

with the rise in trade barriers, could damage market sentiment and hinder economic growth. Heightened geopolitical tensions, adverse weather conditions, and climate shocks could also drive commodity prices higher.

Thailand

The economy was robust in the first half (H1) of 2025, driven by strong merchandise exports ahead of the tariff hikes from the United States (US). Growth is facing headwinds, however, with *ADO April 2025* forecasts revised down from both global and domestic impacts. Inflation should remain subdued during 2025–2026. Risks to the outlook are tilted on the downside, particularly should the US tariff impact exceed expectations and the tourism recovery is slower than anticipated. Significant domestic headwinds include political instability and persistent high household debt.

Updated Assessment

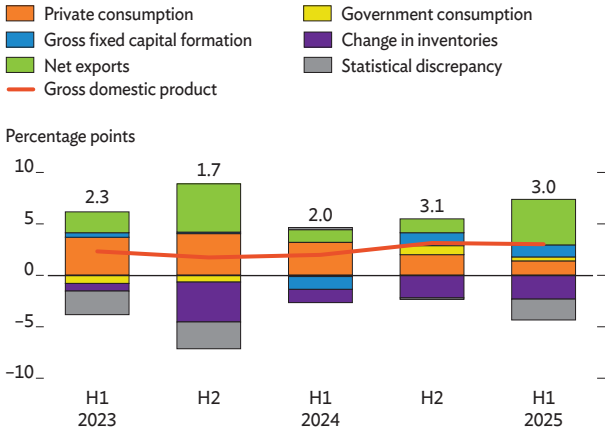
The economy grew robustly in H1 2025, primarily driven by strong merchandise exports (Figure 3.4.28). Real GDP expanded by 3.0% with exports of goods and services up 12.3%. Merchandise export growth was primarily driven by electronic and machinery exports given the increase in global demand, particularly for semiconductors and printed circuit board products. Automotive exports increased from rising demand in Southeast Asia and the Middle East. Agricultural exports also increased, particularly rice and fruit. The largest export market was the US, followed by the People's Republic of China (PRC), Japan, and India. Merchandise imports expanded by 9.6% in line with rising merchandise exports.

Exports to the US accelerated significantly in H1 2025, particularly June, driven by front-loaded shipments ahead of expected tariff hikes. To mitigate the tariff impacts, Thailand negotiated a 19% tariff rate with goods transshipped to evade tariffs paying 40%. The new rates apply to goods transported beginning 7 August. However, some US goods remain subject to 0% import tariffs, particularly items covered under Thailand's free trade agreements with other countries. Certain imports will be tariff-free for 3–5 years to allow domestic buyers to adjust to the new levies. Products for non-competitive local producers remain protected. In addition, the government has announced comprehensive financial support measures for affected exporters. These include a soft loan program, debt moratorium, debt restructuring, payment deferrals of up to 365 days, interest rate reductions around 20% for affected exporters, and export guarantee schemes to encourage market diversification.

Services exports declined in H1 2025 from a decrease in international tourist arrivals, due to safety concerns and the uncertain global economic environment (Figure 3.4.29). The tourist slowdown was most notable in those from the PRC and short-haul visitors. The number of long-haul tourists also slowed due to the start of the low

Figure 3.4.28 Demand-Side Contributions to Growth

Growth in H1 2025 was primarily driven by accelerating merchandise exports ahead of higher US tariffs.

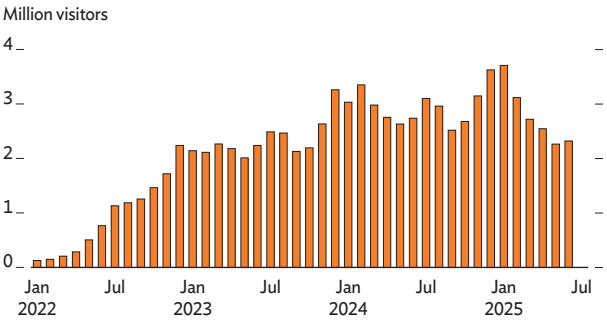


H = half, US = United States.

Source: Office of the National Economic and Social Development Council.

Figure 3.4.29 Tourist Arrivals

International tourist arrivals declined mainly due to safety concerns.



Source: CEIC Data Company

May–October season. From January to June 2025, international tourist arrivals reached 16.7 million, down by 4.7% from H1 2024.

Private consumption fell from weak consumer confidence, fragile economic conditions, and high household debt. In H1 2025, private consumption softened across several categories. Spending on services declined due to lower foreign tourist spending, even as domestic tourist spending continued to rise. Spending on fuel, consumer products, and alcoholic beverages continued to decrease amid concerns over US trade policy and higher debt. Spending on durables, especially passenger cars, increased in the second quarter (Q2). However, sales of pickup trucks, significant in Thailand, declined due to strict lending standards and high household debt, resulting in more auto loan rejections. To boost consumption, the government launched a "Half-Half Thai Travel" tourism stimulus scheme to subsidize domestic travel costs for local tourists. However, online registration issues temporarily delayed implementation.

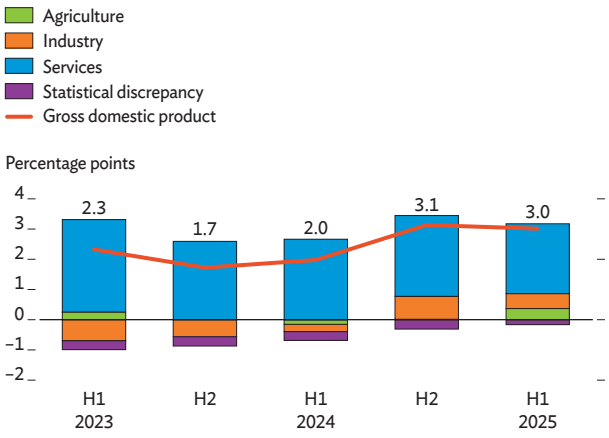
Private investment grew by a small 1.4% in H1 2025. A decline began during Q2 2024 and continued through Q1 2025, then grew by a modest 4.1% in Q2 2025. Investment in export-oriented sectors increased in line with the acceleration of merchandise exports, particularly in electronics. Most businesses continued with ongoing projects but held off on new investments due to the US trade negotiations. Investment in construction remained stable, despite a continuing decline in new residential building, as permits for single-family homes and townhouses fell. Business sentiment in H1 2025 remained subdued from slowing domestic consumption, falling international tourist arrivals, and concerns over the impact of US tariffs.

Government spending continued to grow with both central government expenditure and state enterprise investment increasing. Public investment rose, particularly from higher road project disbursements. The government announced a B151 billion stimulus package to boost growth and create jobs. The package focuses on infrastructure, particularly water management, transportation, and tourism promotion. The stimulus is designed to counteract global economic uncertainties and the US tariff impact.

On the supply side, agricultural production contributed to increased H1 2025 growth (Figure 3.4.30). Agricultural output increased from favorable rainfall and weather conditions, with yields rising for rice paddy, sugar cane, rubber, fruit, and livestock production. However, farmer income contracted from 2024 due to lower prices for key agricultural products, including rubber, white rice, and durian. These resulted from increased global supply, reduced demand (especially from the PRC), and increased rice market competition. Industrial production grew in line with merchandise exports. Manufacturing, particularly in computers, integrated circuits, and electrical appliances and parts, increased to restock inventories following the surge in exports.

Figure 3.4.30 Supply-Side Contributions to Growth

Agriculture's contribution to growth jumped in H1 2025.



H = half.

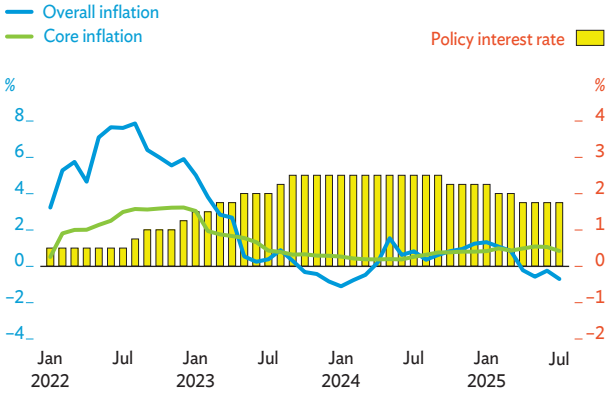
Source: Office of the National Economic and Social Development Council.

Services in H1 2025 grew moderately despite the slowdown in tourism. Growth in accommodation and food services fell to 4.7% from nearly 10% in H1 2024, despite an increase in spending from domestic tourists. Transportation and storage softened on reduced sales of consumer goods and a decline in automobile sales in Q1, decreasing freight transport volume.

Inflation was subdued, with headline inflation falling in several months. Headline inflation in H1 2025 averaged 0.37% year on year, with core inflation averaging 0.97%. This was attributed to declining energy and raw food prices. Inflation remained below the central bank target range of 1%–3%. The central bank cut its policy rate from 2.00% to 1.75% on 30 April and again

Figure 3.4.31 Inflation and Policy Interest Rate

Headline inflation in H1 2025 was subdued, while the central bank resumed monetary easing cutting the policy rate to 1.50%.



Source: CEIC Data Company.

to 1.50% on 13 August to accommodate growth and cushion increased downside risks, particularly the impact of higher US tariffs (Figure 3.4.31).

Prospects

The economy is projected to slow in H2 2025 and in 2026 as US tariff hikes reduce exports, weaken private consumption, and reduce private investment (Table 3.4.5). Real GDP growth this year is revised down from the *ADO April 2025* 2.8% forecast to 2.0%. Economic growth is expected to slow further to 1.6% in 2026, down from the previously forecast 2.9% (Figure 3.4.32).

Merchandise exports will likely decelerate in the coming months as front-loading shipments to the US in H1 2025 ends. The 19% US tariff on export goods will slow exports, particularly electrical equipment, machinery, metals, processed food, and vehicles. Small-scale businesses may find it difficult to adjust to the tariffs compared to their US counterparts which often benefit from larger operations and lower production costs.

Table 3.4.5 Selected Economic Indicators in Thailand, %

US tariff hikes will significantly impact economic growth, while domestic structural issues will add pressure on the economy.

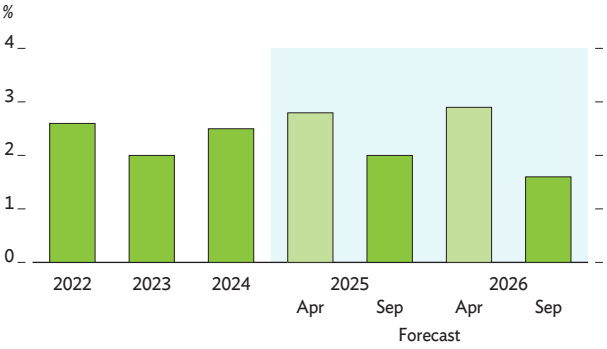
	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	2.5	2.8	2.0	2.9	1.6
Inflation	0.4	1.0	0.5	1.1	0.8

GDP = gross domestic product.

Sources: Office of the National Economic and Social Development Council; Asian Development Bank estimates.

Figure 3.4.32 Gross Domestic Product Growth

The growth forecast is revised down from 2.8% to 2.0%.



Source: *Asian Development Outlook* database.

A slow recovery of international tourist arrivals together with a weakened global economy will dampen the tourism sector. International tourist arrival forecasts have been revised down from 39.5 million in April to 34.0 million, primarily due to fewer inbound tourists from the PRC. Increased competition from other regional destinations is another factor contributing to the projected slowdown. Many countries in the region are spending heavily to attract international visitors by developing tourism infrastructure and offering competitive costs. Weakened currencies in some countries also makes them more affordable to international tourists.

Private consumption growth is revised down from the *ADO April 2025* forecast due to declining income, weak consumer confidence, and a drop in farm incomes from lower agricultural prices. The impact of US tariff hikes and sluggish tourism will likely affect employment and income. Persistent high household debt will continue to limit household purchasing power. Private consumption in H2 2025 may benefit from the government's domestic tourism stimulus program. The impact, however, may be limited due to registration issues.

Private investment will likely slow amid external and domestic headwinds. On the positive side, private investment should flow into new industries

such as smart electronics and data centers given the rising value of promotion certificates issued by the Board of Investment in 2024. Fiscal stimulus measures, particularly for infrastructure, could also encourage private investment. Nonetheless, private investment in H2 2025 and in 2026 will be hurt by the US tariff hikes, concerns over domestic political stability, and a weakness in services stemming from the slow tourism recovery.

Public expenditure will continue to support growth this year and next. Spending will likely maintain its momentum throughout the forecast period. The reallocation of funds from the cash handout program to infrastructure investment could lead to higher public spending and have a more pronounced impact on economic growth. However, domestic political uncertainties are raising concerns over policy continuation and delays in government spending.

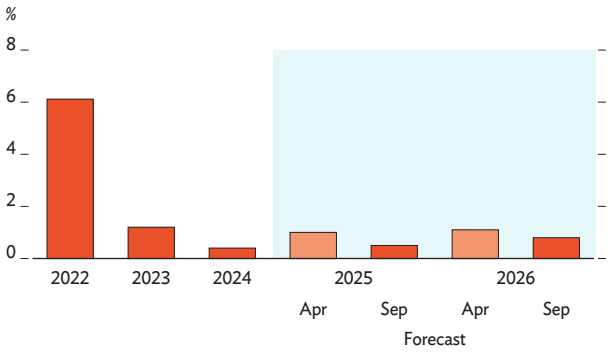
Agriculture is projected to grow by a moderate 2.0% in 2025 and 2.2% in 2026. The growth is attributed to La Niña conditions, which began in late 2024, resulting in consistent rainfall. As a result, water levels in reservoirs and natural sources rose, helping create favorable weather for farming which boosted crop and livestock growth. Farmers will likely expand areas under cultivation. However, farm income will likely continue to contract due to falling agricultural prices. High production costs, the global economic slowdown, and US tariff hikes could impact global supply chains and the country's agricultural exports.

Industrial production has been downgraded from the *ADO April 2025* forecast in line with declining merchandise exports, sluggish investment, and concerns over household debt and business confidence. Manufacturing is projected to slow in both export and domestic sectors. Automotive production, especially passenger cars and pickup trucks, should fall in line with lower domestic car sales and exports. The services outlook for 2025 and 2026 is also revised down, attributed to the global economic slowdown, subdued consumer spending, and the fall in international tourist arrivals.

Headline inflation is projected to remain low in 2025 and 2026. Reduced prices in energy and food, along with continued government subsidies for electricity and retail fuel will dampen price pressures. The headline inflation forecast for 2025 has been adjusted down from the 1.0% projected in *ADO April 2025* to 0.5%. Headline inflation is expected to be 0.8% in 2026, down from the 1.1% projected earlier (Figure 3.4.33).

Figure 3.4.33 Inflation

Inflation is forecast to remain subdued this year and next.



Source: *Asian Development Outlook* database.

Risks to the outlook remain on the downside. A larger-than-expected impact of US tariffs, slower-than-anticipated recovery in tourism, and increased geopolitical tensions could slow economic growth below the forecast. Domestic economic fragility, including political uncertainties and high household debt, heighten the risk of a slowdown in domestic demand.

Viet Nam

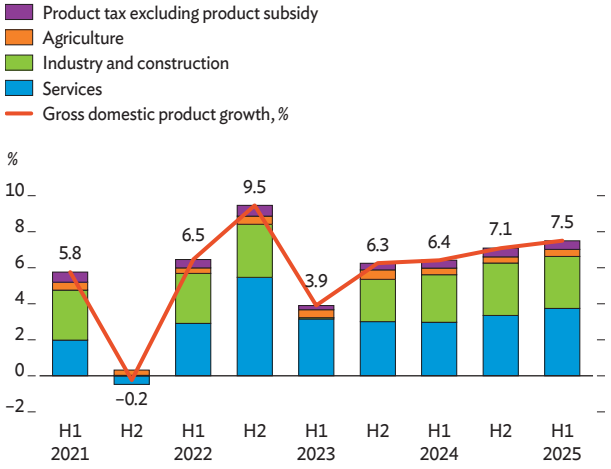
Economic growth in the first half (H1) of 2025 was fueled by expansionary policies and an export surge ahead of United States (US) tariff hikes. The tariff impact will likely slow growth in H2 2025. Although the domestic economy will likely remain resilient, growth should moderate from the strong first half 2025 performance. Overall, the growth forecast for 2025 has been revised slightly higher than *ADO April 2025*, but lower for 2026. Several downside risks to the outlook arise from both global uncertainties and domestic factors.

Updated Assessment

Despite significant global challenges, the economy performed remarkably well in H1 2025. Growth accelerated by an impressive 7.5% year on year from 6.4% in H1 2024, its strongest first half performance since 2010 (Figure 3.4.34). Industry and construction

Figure 3.4.34 Supply-Side Contributions to Growth

The economy was robust in H1 2025.



H = half.

Source: National Statistics Office, Ministry of Finance.

grew by a strong 8.3% in H1 2025 compared to 7.5% in H1 2024. A surge in new orders to front-load exports ahead of US reciprocal tariffs drove manufacturing up by 10.1%. Although public investment remained below the annual plan, actual disbursements helped drive construction up by 9.6% compared with 7.3% in H1 2024. Fiscal growth and the recovery of tourism and its associated industries led services up by 8.1%. Agriculture grew by a stronger 3.8%, resilient against external uncertainties and helped by price stability.

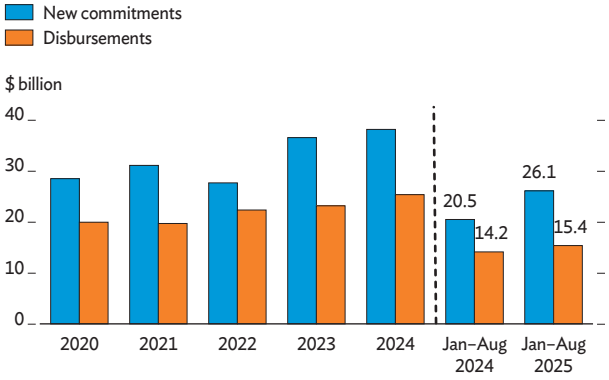
On the demand side, strong trade growth and a surge in foreign direct investment (FDI) disbursements helped drive the economy in H1 2025. Gross capital formation rose by 8.0%, driven by a 42.3% year on year jump in public investment in H1 2025, reaching 30% of the annual target. Monetary and fiscal stimulus further boosted domestic demand, with final consumption increasing by 8.0% compared to 5.8% a year earlier.

A surge in orders ahead of US reciprocal tariffs drove trade up in the first 8 months of 2025. Exports rose 14.8% to about $306 billion through August 2025. Main markets showing the fastest growth year on year for the period included the US (26.4%), the Republic of Korea (11.8%), the People's Republic of China (9.2%), and Japan (9%). Manufactured goods remained dominant, accounting for 88.6%, a 15.6% increase year on year. FDI businesses accounted for almost 75% of export volume. Meanwhile, imports climbed by 17.9% to about $292 billion, mainly in electronics, computers, and components. The trade surplus reached about $14 billion, lower than the $18.8 billion surplus in the same period in 2024.

Inward FDI remained strong, supporting industry (Figure 3.4.35). For the first 8 months of 2025, FDI disbursements rose 8.8% year on year to $15.4 billion—the highest 8-month level in 5 years. Disbursement on manufacturing accounted for 81% and disbursement on industrial real estate 8%. Total FDI pledges reached $26.1 billion, a 27.3% increase from the previous year. However, 58% of these pledges originated from capital adjustments to existing FDI projects and share purchases, while newly registered investments actually decreased by 8.1% in value. These trends reflect continued global trade uncertainty, creating hesitation among existing and potential foreign investors.

Figure 3.4.35 Foreign Direct Investment

FDI inflows remained robust through August 2025.

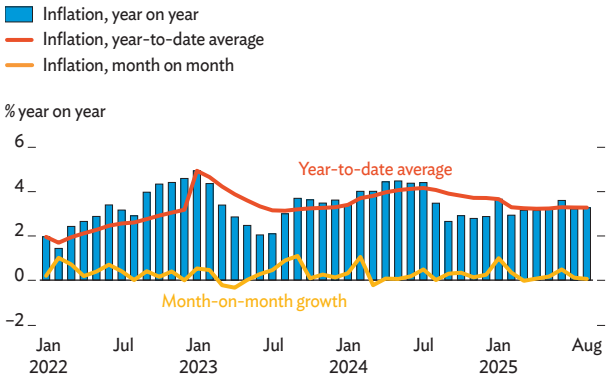


Source: National Statistics Office, Ministry of Finance.

Inflation remained within government targets for the first 8 months of 2025 (Figure 3.4.36). Inflation averaged 3.3%, lower than the 4.0% the previous year and within the government's target range. Food prices remained relatively stable, while rents and utility prices rose, reflecting an electricity tariff increase. Notably, headline inflation year on year in August eased to 3.2% from 3.5% a year earlier, driven by lower transport costs. In contrast, average core inflation rose by 3.2% in the first eight months on persistent price pressures from higher rents and construction material prices.

Figure 3.4.36 Monthly Inflation

Inflation remained under control during the first 8 months of 2025.



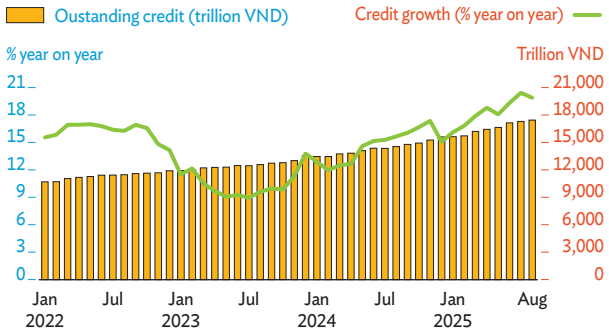
Sources: National Statistics Office; Ministry of Finance.

The State Bank of Viet Nam (SBV), the central bank, maintained its accommodative monetary policy. SBV has kept its policy rate at 4.5% since 2023, while injecting liquidity through open market operations to maintain ample market liquidity. By the end of August 2025, credit had increased by 11.8% compared to end-2024 and 19.9% over the same period last year, thus increasing demand for mobilizing capital (Figure 3.4.37). By end-August 2025, the currency had depreciated by 3.7% against the US dollar since end-2024, despite the dollar weakening against other major currencies. The decline added inflationary pressure to foreign debt repayments along with corporate foreign currency fundraising.

The corporate bond market grew strongly in the first 8 months of 2025. Total issuance was estimated at around VND374 trillion (about $14.4 billion) up 43% year on year. Issuers took advantage of low-interest rates to accelerate offerings, with the average coupon rate on new issuance at 6.9%, down from 7.5% in 2024. The main issuers remained credit institutions, accounting for about 74% of total issuance. Real estate developers increased issuance by 30% year on year, supported by recent legal reforms that eased bottlenecks in land valuation and site clearance.

Figure 3.4.37 Credit Growth

Credit expanded strongly in the first 8 months of 2025, supporting economic growth.



VND = Viet Nam dong.

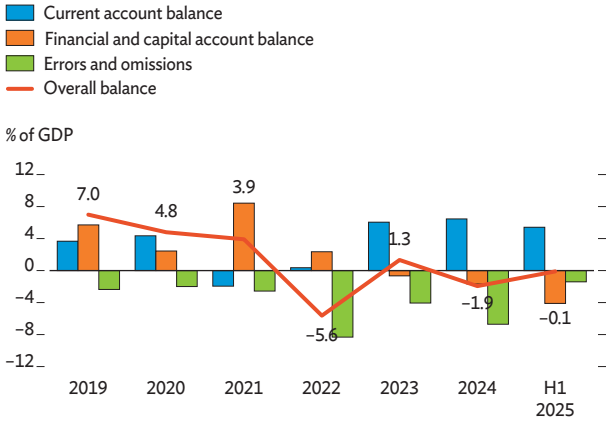
Sources: State Bank of Viet Nam; Asian Development Bank estimates.

Faster merchandise import growth relative to exports narrowed the trade surplus in H1 2025. The merchandise trade balance was estimated at 7.6% of GDP in H1 2025, down from 9.5% a year earlier. However, robust remittance inflows lifted the current account surplus to 5.4% of GDP in H1 2025, up from 4.6% in H1 2024. High global interest rates continued to weigh on capital flows, expanding the financial and capital account deficit to an estimated 4.1% of GDP compared to 2.2% in H1 2024. Despite the larger current account surplus, the wider financial and capital account deficit left a small balance-of-payments shortfall, estimated at 0.1% of GDP in H1 2025. (Figure 3.4.38). By end-June 2025, foreign exchange reserves were estimated to cover 2.5 months of imports, down from 2.8 months at end-2024.

The State budget performed well in the first 8 months of 2025. This was supported by tax reforms and a recovery in domestic production and exports. Budget revenue was estimated at VND1,740 trillion (approximately $67 billion), or 88.5% of the annual

Figure 3.4.38 Balance of Payments Indicators

The balance of payments registered a slight deficit in H1 2025.



GDP = gross domestic product, H = half.

Sources: State Bank of Viet Nam; Asian Development Bank estimates.

plan, up 28.5% year over year. Budget expenditure in the first 8 months increased by a sharp 31.5%. Notably, capital expenditure increased by 49.4% on accelerated efforts to disburse public investment. As of end-August, approximately 46.3% of the annual public investment plan had been disbursed, higher than end-August 2024. For H1 2025, the on-budget surplus was 3.9% of GDP, down from 4.1% the same period last year, reflecting more proactive fiscal execution.

Prospects

The economy should remain resilient in 2025–2026, supported by expansionary monetary and fiscal policies. US reciprocal tariffs effective on 7 August 2025—20% on imports and 40% on transshipped goods—risk near-term growth, while policy stimulus should mitigate the impact. The 2025 growth forecast is revised up to 6.7% and revised down to 6.0% in 2026 (from 6.6% and 6.5% respectively in *ADO April 2025*), while inflation projections are slightly below April forecasts (Table 3.4.6).

Table 3.4.6 Selected Economic Indicators in Viet Nam, %

Growth forecasts were revised up for 2025 and down for 2026, while inflation was revised down for both years.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	7.1	6.6	6.7	6.5	6.0
Inflation	3.7	4.0	3.9	4.2	3.8

GDP = gross domestic product.

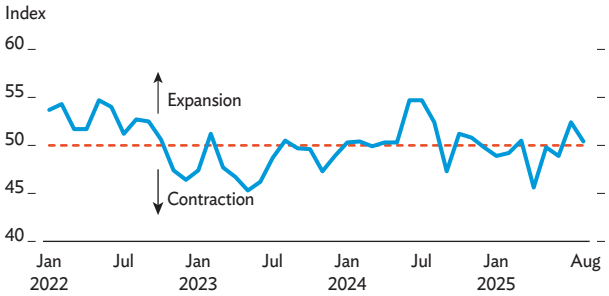
Sources: National Statistics Office; Asian Development Bank estimates.

Industrial output is forecast to grow by 7.7% in 2025 from higher manufactured exports, but may face headwinds from higher US tariffs. Viet Nam's industrial production index increased strongly in the first 8 months of 2025. The surge was driven largely by firms ramping up production and exports to preempt the new US tariffs, creating a short-term spike in output.

The Purchasing Managers' Index has indicated a slowdown in manufacturing since December 2024. A brief rebound occurred in July 2025, but the index softened again to nearly neutral in August (Figure 3.4.39). August orders decreased after a brief increase in July, while the uncertain global outlook will likely keep industrial production tight during H2 2025 with reciprocal tariffs in effect. However, construction should gain momentum on the government's accelerated rollout of major infrastructure projects.

Figure 3.4.39 Purchasing Managers' Index

The index fell during H1 2025, rebounded sharply in July, but returned to neutral in August.



H = half.

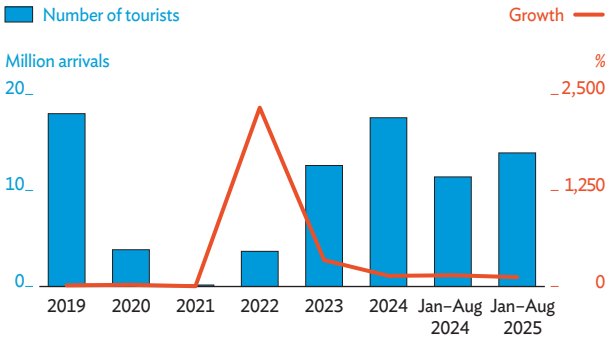
Note: A purchasing managers' index <50 signals deterioration, >50 improvement.

Source: IHS Markit.

Services growth should remain resilient, expanding by 7.4%. Services will gain from continued growth in finance and banking, logistics and transportation, communications, retail, and, notably, tourism and related industries. In the first 8 months of 2025, there were 13.9 million international arrivals, a 21.7% increase over the same period in 2024 (Figure 3.4.40).

Figure 3.4.40 International Tourism

Tourism has been recovering gradually to pre-pandemic levels.



Sources: National Statistics Office; Ministry of Finance.

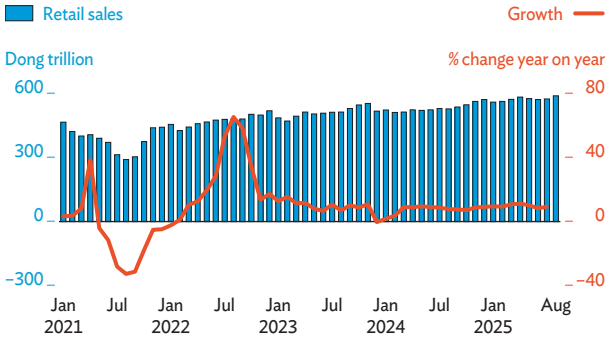
Agriculture will likely grow by 3.4% in 2025. Rising global demand for high-quality, sustainable food and wider adoption of smart farming technologies will drive the sector. However, it remains exposed

to climate risk, fragmented land holdings, limited technological access for smallholders, and volatile global commodity prices.

Domestic consumption has been buoyed by accommodative monetary and fiscal policies. Retail sales grew by 9.4% year on year in the first 8 months of 2025, driven by a continuing 2% value-added tax reduction, lower environmental taxes on fuel, corporate income tax restructuring for small and medium-sized enterprises, and sweeping administrative and other tax reforms that reduced costs (Figure 3.4.41). In real terms, retail sales increased by 7.2%, below the 8.0% growth from a year ago. Expanding retail networks, increased e-commerce penetration, and a rebound in tourism-related services will strengthen domestic demand. However, weaker manufacturing and exports from US tariffs may curb demand for logistics, finance, and business services in H2 2025. If trade tensions persist, investment could slow, constraining growth in high-value service industries in 2026.

Figure 3.4.41 Retail Sales

Retail sales remained robust in the first 8 months of the year on resilient domestic demand.



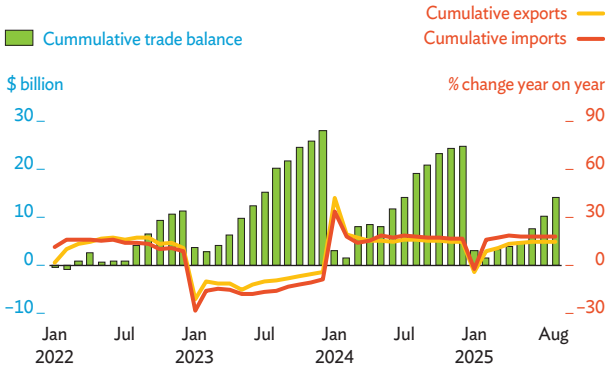
Sources: National Statistics Office; Ministry of Finance.

Effective public investment is critical to sustain growth and reduce infrastructure bottlenecks. With public debt less than 34% of GDP—well below the 60% statutory limit—there remains ample fiscal space for stimulus measures. Sweeping institutional reforms should streamline the regulatory environment, enhance disbursement efficiency and invigorate the domestic economy. As reforms take hold, private investment and consumption are expected to rise. However, persistent capacity constraints in project planning, execution, and management across all levels continue to affect timely disbursements.

Tariff uncertainty unsettles FDI and trade. Exports to the US will likely slow significantly after front-loading and effectivity of the new 20% tariffs, with export-oriented manufacturers likely to delay or scale back plans. Trade flows will also adjust as firms reconfigure supply chains and pricing. Imports in August began to slow, declining by 0.8% compared to July. Nonetheless, exports rose by 14.8% and imports by 17.9% in the first 8 months of 2025 (Figure 3.4.42). For the rest of the year, tariffs will pressure trade and investment, underscoring a need for structural shifts toward a more balanced growth model with stronger domestic demand and more diversified export markets to mitigate tariff-related shocks.

Figure 3.4.42 Trade Growth

Imports and exports continued to grow, though momentum slowed following the 20% reciprocal US tariffs.



Sources: National Statistics Office; Ministry of Finance.

With a favorable fiscal position, the government can stimulate growth through targeted tax cuts, lower business compliance costs, and increased social spending for low-income households. Coordinating structural reforms to improve the business climate and labor productivity would maximize their impact. The fiscal deficit is projected to reach 3.8% of GDP for 2025.

The central bank continues policies to support growth. With credit growth likely to reach or exceed the 16% target for 2025 and the SBV's more flexible approach to credit growth management, bank lending should grow further toward the end of 2025. However, there remain concerns over asset quality, loan portfolio risk, and potential inflationary pressures. In the near term, rising nonperforming loans and declining bank profitability will limit space for further monetary easing.

Stronger coordination between fiscal and monetary policies will help support growth. This will help avoid overburdening monetary tools and preserve macro-financial stability. Over the longer term, wide-ranging regulatory reforms must tackle structural challenges—including climate resilience, private competitiveness, restructuring state-owned enterprises, tax modernization, and the digital transformation. This is vital for a more balanced growth model.

Inflation is projected to be 3.9% in 2025, easing slightly to 3.8% in 2026. The decline in global energy prices has helped lower transportation costs, which account for a significant share of the consumer price basket. However, persistent upward adjustments in government healthcare, education costs, and electricity tariffs continue to exert inflationary pressure. Accelerated public investment and high credit growth could drive up prices of materials and services. Currency depreciation may further add to inflation through higher import costs.

The government is ramping up fiscal and monetary stimuli to increase its growth targets to 8.3%–8.5% in 2025, aiming for double-digit growth in the coming years. These target increases come despite mounting headwinds from reciprocal tariffs and escalating global and regional geopolitical tensions. Strong H1 2025 growth was driven by expansionary policies and a surge in export orders ahead of new tariffs. To sustain growth, emerging risks and structural constraints must be addressed effectively.

Risks to the outlook stem from both external and domestic sources. Should the global economic environment deteriorate more than expected from a slowdown among major trading partners and increased financial market volatility, economic headwinds would rise, particularly through weaker exports and investment inflows. Uncertainty over the details on applying transshipment reciprocal tariffs could reduce trade and investment growth. Domestically, while public investment reforms have helped, rising financial vulnerabilities and delays in policy coordination could limit the effectiveness of stimulus measures.

Other Economies

Brunei Darussalam

In the first quarter (Q1) of 2025, the economy contracted by 1.8% for the second straight quarter, with significant declines across all major sectors. Agriculture, forestry, and fisheries dropped by 11.7%, while services slipped by 0.6%. Industry, the largest sector, fell by 2.5%, less than the 5.2% contraction in Q4 2024 as oil and gas grew by 0.5% and food and beverage manufacturing rose 8.9%. However, liquefied natural gas (LNG) and methanol output fell by 8.0% due largely to maintenance issues. On the demand side, gross investment declined by 13.2%, and household spending decreased by 3.0%. Government expenditure increased by 0.8% to stimulate economic activity.

The GDP forecast for 2025 has been revised down to 1.0% on weaker global oil demand caused by increased global uncertainties (Table 3.4.7). United States (US) tariffs on Australia, Japan, and the People's Republic of China—the country's main trading partners—significantly affected the oil sector and exports overall. As industrial production slows globally, demand for the country's goods, which account for approximately 70% of GDP, has declined sharply, particularly for essential products such as crude oil, LNG, and petrochemicals. This should reduce the 2025 current account surplus, while persistent weakness in oil exports will likely keep the government budget in deficit, further constraining new public investment or infrastructure spending in the near term.

Growth is expected to accelerate to 1.5% in 2026 as oil and gas output benefits from new wells and extraction technology improvements. Once

Table 3.4.7 Selected Economic Indicators in Brunei Darussalam, %

GDP growth forecasts are revised downward, while inflation forecast is lowered for 2025 and increased for 2026.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	4.2	2.5	1.0	2.0	1.5
Inflation	−0.4	0.5	−0.3	−0.2	0.5

GDP = gross domestic product.
Sources: CEIC Data Company; Asian Development Bank estimates.

maintenance is complete, LNG production is expected to rebound, supporting growth overall. Initiatives to broaden the economic base—such as opening a marine maintenance and decommissioning yard in late 2025 and expanding Brunei Darussalam's Muara Port—should further reinforce growth in non-oil sectors, building a base for future economic momentum.

Deflation continued in the first half (H1) of 2025. Weak consumer demand on a low base kept inflation in negative territory, reaching –0.4% for H1 2025. This was primarily due to a 0.7% year on year price decline for food and non-alcoholic beverages. The most pronounced decreases were in meat (–3.2%) and milk and dairy products (–2.6%). Prices of most nonfood items had modest declines.

Deflation will likely persist through 2025 but reverse in 2026 as domestic demand begins to accelerate. Deflation in 2025 will likely be driven by weak domestic demand and declining global food commodity prices. The World Bank forecasts that all components of the global food price index will decrease in 2025. As a net importer of food with a fixed exchange rate—these global declines will largely transfer to domestic food prices. A projected rebound in consumer spending and uptick in private investment in 2026 should drive overall demand higher, placing upward pressure on prices and helping inflation return positive. In addition, an anticipated increase in global food prices will likely further support the return of inflation in 2026.

Risks to the forecast are mainly on the downside. The external outlook remains highly uncertain, and growth among the country's trading partners could be weaker than expected, further hurting exports.

Cambodia

Cambodia's growth forecast is revised down for this year and next (Table 3.4.8). The economy performed well in the first half (H1) of 2025, but H2 is expected to weaken due to border tensions with Thailand and the lingering effects of United States (US) trade policy uncertainty. Inflation projections have been lowered due to slower-than-expected food price increases and declining fuel costs.

Table 3.4.8 Selected Economic Indicators in Cambodia, %

Growth and inflation projections are revised down.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	6.0	6.1	4.9	6.2	5.0
Inflation	0.8	3.7	2.0	2.4	2.0

GDP = gross domestic product.

Sources: Ministry of Economy and Finance; National Institute of Statistics; Asian Development Bank estimates.

Industry remains the primary driver of growth, with expansion projected to moderate to 7.9% in 2025 before rising to 8.3% in 2026. Garment exports surged 22.2% year on year in H1 2025, driven partly by US buyers stocking up in anticipation of higher tariffs on Cambodian imports. However, garment manufacturing will likely remain strong given the less onerous 19% US tariff effective 7 August 2025, despite importers' caution due to continued trade policy uncertainty. Non-garment exports grew by 8.8%, led by insulated wire and optical cables, wood-based articles, and bicycles.

Services growth is expected to slow to 2.8% in 2025 and 2.6% in 2026. Tourism continued to recover in H1 2025, with a surge in arrivals from the People's Republic of China. However, border tensions will likely dampen tourism receipts from Thailand and impact broader services in H2 and beyond. Arrivals from Thailand decreased by 61.1% year on year in June 2025. While Thailand's tourists tend to spend less per visit as short-stay, land-based visitors, they accounted for over two million arrivals in 2024 (32.0% of the total).

Agriculture continues to grow steadily. The sector is projected to expand by 1.1% in 2025 and 2026, supported by export demand. The slight increase in the forecast comes from the expected contribution of returning migrants from Thailand in H2 2025. Agricultural exports increased 14.1% year on year in H1 2025, reaching $1.9 billion. Growth was driven by exports of cashew nuts and milled rice, offsetting declines in cassava and rubber shipments.

Inflation is moderating on lower-than-expected food cost increases and falling fuel prices. Year-on-year inflation decelerated from 6.0% in January

to 1.6% in June, largely from lower increases in food and dining costs. Falling fuel prices also helped offset upward price pressures in other areas. On a 12-month moving average basis, the inflation rate rose to 2.4% in June and should stabilize at around 2.0% in both 2025 and 2026.

The budget deficit will widen in 2025 due to higher spending and increased external borrowing. The 2024 budget deficit narrowed to 1.9% of GDP, with both revenues and expenditures below 2023 levels. For 2025, the deficit is expected to rise to $1.5 billion (3.1% of GDP), driven by a higher $9.1 billion expenditure. To finance the gap, the government will borrow $1.4 billion externally and $0.1 billion domestically. Defense and socio-economic outlays will likely rise in H2 2025 from continued border tensions and displaced communities and workers. The 2026–2028 Fiscal Framework aims to gradually reduce the deficit to an average of 2.2% of GDP, with sufficient flexibility to support livelihoods, macroeconomic stability, and growth.

The merchandise trade deficit widened in H1 2025 as imports outpaced exports. Imports rose by 18.0% led by sharp increases in construction materials and equipment, vehicles, consumer durables, and garment inputs. Exports increased by 16.2% driven by a rise in garment exports.

Foreign investment remains resilient. Foreign direct investment inflows rose 6.1% year on year in the first quarter of 2025 to $1.0 billion. Gross international reserves increased to $24.8 billion by mid-2025, up from $22.5 billion at end-2024, sufficient to cover 7.8 months of imports.

The outlook is subject to significant downside risks. These include weaker-than-expected growth in major advanced economies, prolonged border tensions with Thailand, continued global trade policy uncertainty, and large outstanding private debt.

Lao People's Democratic Republic

Growth prospects are weighed down by debt vulnerabilities, weak demand, and tariffs, though easing inflation provides some relief. The GDP forecast is revised down from 3.9% to 3.7% for 2025 and from 4.0% to 3.8% for 2026 (Table 3.4.9). Growth will be driven primarily by industry and services, though performance will be uneven. Inflation forecasts are down from *ADO April 2025*, from 13.5% to 9.5% for 2025 and from 10.4% to 8.5% for 2026. There are still some risks, as trade tensions and fiscal constraints could slow recovery more than projected.

Table 3.4.9 Selected Economic Indicators in the Lao People's Democratic Republic, %

Growth and inflation forecasts have been revised down from April.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	4.0	3.9	3.7	4.0	3.8
Inflation	23.3	13.5	9.5	10.4	8.5

GDP = gross domestic product.
Source: Asian Development Bank estimates.

Agriculture will likely expand modestly with output projected to rise by 1.3% in 2025. Favorable weather in the first half (H1) of 2025 boosted soybean, sweet corn, and vegetable yields, which increased. However, rice production declined by 0.7% due to labor shortages and lingering input cost pressures. Cassava cultivation contracted sharply, given weaker demand from Thailand and the People's Republic of China (PRC), which compounded rural income losses. While food production appears resilient, export-oriented production remains vulnerable due to structural weaknesses.

Industry is forecast to grow by 3.6% in 2025 supported by energy and some gains in manufacturing. Electricity output increased by 3.2% in H1 2025 and will likely expand 6.5% for the year, driven by favorable rainfall and new capacity.

Services continue to be the main driver of growth and is forecast to expand by 4.5% in 2025. Tourism rebounded strongly with 2.3 million arrivals in H1 2025—55% of the 2025 target and up 11.9% year on year. Gains reflect better connectivity, targeted marketing, and steady inflows from the Lao PDR–PRC railway corridor. Arrivals from Europe increased by 24%, while those from the Republic of Korea fell 23%. The tourism recovery boosted retail, hospitality, and transportation, although services remain constrained by still-weak household purchasing power following years of high inflation and a depreciating currency.

Public finances remain tight. By mid-2025, external debt service and principal repayments reached $533 million, nearly 30% of the annual projection. Revenue improved, with collections 93% of the H1 target. However, fiscal space remains limited. The government has prioritized debt sustainability by restraining capital expenditure and slowing major projects. Investments are also constrained on account of the suspension of fast-tracked mining approvals through the 2021 pilot scheme and the suspension of potash exploration and mining projects in Vientiane Capital in July, due to serious environmental and safety concerns.

Inflationary pressures eased significantly in 2025. Headline inflation fell steadily to 5.0% in August from 11.1% in April, bringing the average to 11.0% for H1 2025—less than half the 24.7% in H1 2024. Food inflation decreased sharply to 3.1% from 24.3% in August 2024 on declining domestic food prices. Retail fuel costs fell by 0.6% in August, lowering transport costs across the economy. Nonfood inflation, however, remains high, with housing, water, electricity, and fuel costs up 15.3% year on year in August 2025, healthcare and pharmaceuticals up by 13.6%, and household goods up 7.8%. Prices for imported goods rose moderately by 3.1% as the kip stabilized.

Downward inflation allowed for some monetary policy easing. The Bank of the Lao PDR cut its policy rate from 10.0% in March to 9.0% in August, its third decline this year. The exchange rate stabilized, with the kip appreciating 0.5% against the US dollar while depreciating 6.0% against the Thai baht. The gap between official and parallel market exchange rates narrowed from 6.8% in mid-2024 to 1.7% in mid-2025.

Foreign reserves rose to $2.7 billion in August 2025 from $2.1 billion in December 2024, providing 3.1 months of import cover and helping stabilize the exchange rate. Broad money grew 9.0% in H1 2025, below the government's 20% target, reflecting tighter liquidity conditions.

Myanmar

The economy still faces escalating conflict, persistent macroeconomic instability, recurring disasters triggered by natural hazards, and ongoing humanitarian crises. A devastating 7.7-magnitude earthquake struck central Myanmar in March this year, significantly disrupting key economic areas and worsening an already dire macroeconomic situation. Trade flows and business were severely disrupted from the widespread destruction of critical infrastructure, including transportation networks. Limited capacity, insufficient assistance, and intensifying conflicts leave reconstruction and the recovery of livelihoods a long-term challenge. The real GDP growth forecast for 2025 has thus fallen into a 3.0% contraction from the 1.1% growth in *ADO April 2025* (Table 3.4.10). A gradual business recovery along with earthquake reconstruction and rehabilitation should contribute to 2.0% growth in fiscal year 2026 (FY2026, ending 31 March 2027) despite a substantial United States (US) tariff increase.

Table 3.4.10 Selected Economic Indicators in Myanmar, %

Growth forecasts are revised down from April due to the devastating earthquake impact and ongoing instability.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	−0.7	1.1	−3.0	1.6	2.0
Inflation	27.8	29.3	30.0	20.0	23.0

GDP = gross domestic product.

Note: Years are fiscal years ending 31 March of the following year.

Sources: Central Bank of Myanmar; Asian Development Bank estimates.

Combined, continued instability and recurrent disasters constrains growth across the economy. Unfavorable business climate conditions and decreasing confidence from prolonged domestic instability coupled with the impact of earthquake-related disruptions and conflict continue to dampen the industrial outlook. Rising global and regional trade tensions constrained both demand and supply. The manufacturing purchasing managers' index has remained contractionary since January 2025 primarily due to weaker demand and supply chain disruptions. The earthquake destroyed over 3.7 million hectares of croplands, including irrigation systems, storage facilities, agricultural equipment, and inputs. Preliminary ADB findings suggest that approximately 22% of the population and 12% of agricultural GDP in the hardest-hit areas were adversely affected, significantly hurting agricultural productivity. The

risks from instability and natural hazards like flooding and landslides remain high, particularly during the monsoon season. Reduced consumer spending from substantial reductions in income and employment will likely slow services growth, particularly in travel and tourism, wholesale, and retail trade. Widespread security concerns, soaring inflation, and transportation disruptions also strain services.

Foreign investment remains subdued with no notable rebound in recent months. Foreign direct investment (FDI) commitments reached just $40.9 million in June 2025, down 72.4% compared to June 2024. Over 90% of the FDI commitments were in manufacturing. Bilateral trade with key partners increased by a modest 7.8% with Thailand and 4.3% with the People's Republic of China. The trade deficit is expected to decrease in line with *ADO April 2025* projections given ongoing import restrictions and subdued investment demand.

Higher inflation will likely persist through 2025. Earthquake disruptions, conflicts, ongoing local currency depreciation, and supply chain and logistics constraints drove up prices for both food and nonfood items. Food inflation remained high, averaging 17.0% in the first 4 months of FY2025, while nonfood inflation averaged 24.6%, slightly up from 24.1% the same period last year. Earthquake reconstruction resulted in higher costs for construction materials, with cement prices increasing by an average 82.6% in July 2025. With persistent supply constraints, higher demand for certain nonfood items such as household goods and medicine has driven prices up. Consequently, the inflation forecast has been revised up slightly to 30% for this fiscal year from the previous 29.3% projection in *ADO April 2025*. Inflation is projected to ease in FY2026 as supply chain constraints and domestic trade flows improve, along with a stabilizing exchange rate.

The economy continues to face downward risks due to armed conflict, political instability, trade disruptions, and the lasting earthquake effects. Recent global trade restrictions coupled with a more difficult external environment, including the 40% import tariff imposed by the US, could further damage already weak trade and investment.

Singapore

The economy grew by a strong 4.3% in the first half (H1) of 2025, up from 3.3% in H1 2024, driven by resilient external demand and a broad-based domestic expansion in the second quarter (Q2). GDP increased by 4.4% year on year in Q2 2025, higher than the 4.1% Q1 growth. Q2 growth was supported by a rebound in manufacturing, which grew by 5.0%. Transport, precision engineering, and electronics output all gained. Services also posted a solid 4.2% expansion driven by trade, transport, and storage, along with real estate. Construction growth accelerated to 5.5% from 3.3% in Q1 as both public and private projects advanced.

Demand grew faster in Q2 than Q1 supported by strong external demand. Net exports accelerated by 11.5% in Q2 2025, up from 5.9% in Q1. The strong export growth outpaced an increase in imports from front-loading ahead of higher United States (US) baseline 10% tariff which took effect in August. Domestically, consumption grew by 4.5% in Q2 2025, up from 0.3% in Q1, driven by strong private spending and a rebound in government expenditure. Domestic investment growth moderated to 4.2% in Q2, from 6.4% in Q1, on lower construction spending despite higher outlays on public transport equipment and intellectual property products.

Overall inflation remained subdued in the first 7 months on modest import and domestic cost pressures. In July, the Monetary Authority of Singapore (MAS) Core Inflation, which excludes private transport and accommodation, eased at 0.5% year on year due to lower retail and other goods prices and a larger decline in electricity and gas costs. Headline inflation slowed at 0.6% year on year. The headline inflation averaged 0.9% from January to July and core inflation 0.6%.

Economic growth will likely moderate in H2 2025 as expansion in outward-oriented sectors slows. Growth in wholesale trade, transportation, and storage should slow as the lift from front-loading wanes and global trade eases. Growth will continue to be supported by construction and financial services, benefiting from infrastructure spending and accommodative financial conditions. The strong H1

growth is expected to ease in the months ahead amid continued global policy uncertainty and the delayed effects of US tariffs. As a result, the full-year growth forecast for 2025 is revised down slightly to 2.5% from 2.6% in *ADO April 2025* (Table 3.4.11). The 2026 forecast has also been revised down from 2.4% to 1.4% as the US tariff impact will weigh more heavily next year.

Table 3.4.11 Selected Economic Indicators in Singapore, %

Growth and inflation forecasts have been revised down from April.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	4.4	2.6	2.5	2.4	1.4
Inflation	2.4	2.0	1.0	1.7	1.2

GDP = gross domestic product.

Sources: Ministry of Trade and Industry. Economic Survey of Singapore Second Quarter 2025; Asian Development Bank estimates.

Inflationary pressures should remain contained on easing commodity prices and a strong Singapore dollar. While ongoing trade conflicts could be inflationary, weaker global demand is likely to offset their impact on import prices. Domestically, larger government subsidies for essential services will continue to temper services inflation. The government projected that MAS Core Inflation and consumer price index (CPI)-All Items inflation would average 0.5%–1.5% in 2025, although uncertainties remain given elevated external risks. Thus, the inflation forecast has been revised down to 1.0% for 2025 and 1.2% for 2026.

Downside risks to the outlook continue from the uncertainty over US economic policies. A re-escalation of tariff hikes could heighten economic uncertainty, prompting businesses and households to reduce spending and hiring. Trade-related inflationary pressures add to the US monetary policy uncertainty. This could contribute to increased financial market volatility and destabilized capital flows, hindering financing and investment. Continued global geopolitical tensions could further disrupt energy supplies and potentially drive up related prices, slowing disinflation momentum.

Timor-Leste

Growth in 2025 will likely remain robust based on strong domestic demand bolstered by expansionary fiscal policy and credit growth. Although the growth forecast has been slightly revised down from *ADO April 2025* due to the base effect from the preliminary 4.1% growth rate in 2024, the economy should still expand by 3.8% this year. Improved budget execution from strengthened legal and regulatory frameworks for public finance and project implementation, along with higher public capital investment and government transfers, sustained credit growth, and steady remittance inflows will continue to support the economy in a low-inflation environment. The United States (US) imposition of a 10% tariff will likely have minimal impact on growth, given limited bilateral trade and the negligible exposure of domestic industries to US final demand.

Economic growth in 2026 is projected to moderate more sharply than the previous forecast. The government is prioritizing budget consolidation to align expenditure plans with the economy's absorptive and institutional implementation capacity. This should enhance both the execution and efficiency of public spending by adopting a program- and performance-based budgeting framework, while also curbing persistently excessive withdrawals from the Petroleum Fund. As part of the 2026 preliminary budget plan, recurrent expenditures will be reduced—especially transfers to state-owned enterprises—resulting in a decline in government spending compared to approved 2025 expenditure. Despite these cuts, the government intends to reallocate resources toward priority sectors—including health, education, food and nutrition security, and critical infrastructure. The fiscal deficit will likely narrow relative to the approved 2025 budget, creating a contractionary fiscal impulse. This tightening of fiscal policy will contribute to a more moderate 3.4% GDP growth in 2026 from 3.8% forecast in *ADO April 2025* (Table 3.4.12).

Inflation will likely slow further, below *ADO April 2025* projections. Average inflation declined sharply from 2.1% in December 2024 to just 0.3% in July 2025 due to easing food inflation, which fell from an average 4.3% to 0.9%, and subdued average price pressures in both tradable (0.2%) and non-tradable (0.5%) goods. Given the continued disinflationary trend, inflation forecasts for 2025 and 2026 have been revised

Table 3.4.12 Selected Economic Indicators in Timor-Leste, %

Growth and inflation are expected to be lower than forecast in April.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	4.1	4.0	3.8	3.8	3.4
Inflation	2.1	2.9	1.2	2.6	1.9

GDP = gross domestic product.

Sources: National Institute of Statistics of Timor-Leste; Asian Development Bank estimates.

down to 1.2% and 1.9%, respectively. These signal a more stable price environment, supported by weaker demand-side pressures and lower shipping costs.

The country's accession to ASEAN in October 2025 marks a pivotal milestone, offering significant opportunities for private sector development. As the 11th member of the regional bloc, Timor-Leste is expected to benefit from deeper economic integration. This will open new avenues for businesses, attract private investment, improve access to project financing, and facilitate trade, all of which collectively support long-term economic growth. To take full advantage of these opportunities, Timor-Leste should address its fundamental structural challenges and strengthen the private sector's role in contributing to economic growth. Realizing the potential benefits of ASEAN accession will require unwavering policy commitment and effective implementation of the reform policies. These include (i) enhancing domestic resource mobilization to reduce overdependence on the Petroleum Fund, (ii) improving fiscal spending efficiency to boost the productivity of public investments, (iii) reducing fiscal dominance to alleviate the crowding-out effect and create space for private sector expansion, (iv) scaling up investments in human capital and essential infrastructure, and (v) leveraging long-term development finance to promote private sector-led growth and economic diversification.

Several factors pose downside risks to the outlook. Downside risks include disasters triggered by natural hazards, adverse spillover effects from higher US tariffs and rising global trade uncertainty, as well as the slow execution of public service delivery and capital investment.

THE PACIFIC

Growth in the Pacific subregion is forecast higher in 2025 and lower in 2026 than the projections in *ADO April 2025*. The 2025 upward revision is largely driven by stronger resource-related output in Papua New Guinea (PNG), the subregion's largest economy. Inflation forecasts for 2025 and 2026 are adjusted down, primarily due to lower inflation in Fiji, the second-largest economy. Geopolitical and trade tensions continue to pose risks to both growth and inflation across the subregion.

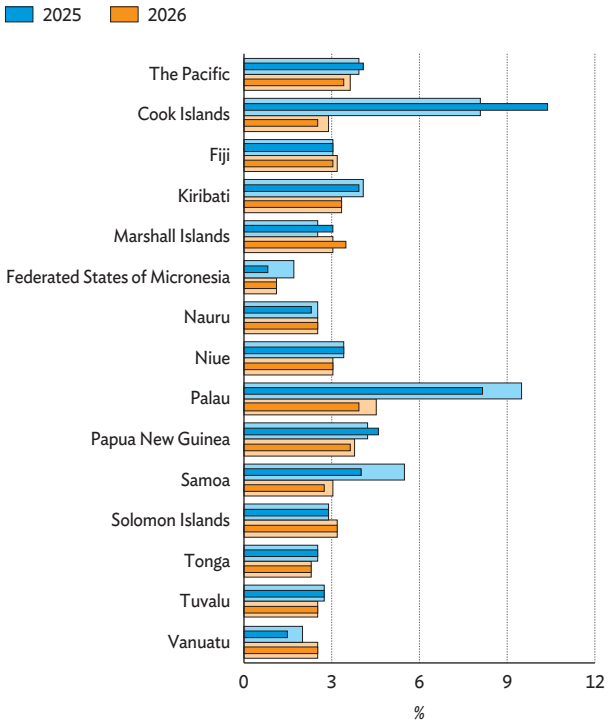
Subregional Assessment and Prospects

Growth in the Pacific is now projected to accelerate to 4.1% in 2025, up from the 3.9% forecast in *ADO April 2025* (Figure 3.5.1). The revision largely comes from increased output of minerals, liquefied natural gas, and cash crops in PNG. The growth forecast is also raised for the Marshall Islands in fiscal year (FY) 2025 (ends 30 September 2025) from the first full year of financial assistance under the country's renewed Compact of Free Association (COFA) with the United States (US). In the Cook Islands, growth in FY2025 (ended 30 June 2025) is estimated higher than *ADO April 2025* as tourism arrivals exceeded expectations.

Delayed public infrastructure projects and slower than expected tourism growth are among the factors dampening the 2025 outlook for other Pacific economies. In Nauru, growth in FY2025 (ended 30 June 2025) was lower than previously forecast due to delays in infrastructure projects related to the country's hosting of the Micronesian Games. Samoa's growth estimate was also lower than *ADO April 2025* projections on weaker visitor arrivals, reduced agriculture and fishing output, and disruptions from power outages during the second half (H2) of FY2025 (ended 30 June 2025). Meanwhile, constraints on implementing COFA-funded public expenditure

Figure 3.5.1 Gross Domestic Product Growth in the Pacific

The growth forecast for the subregion is revised up for 2025 and down for 2026, driven by prospects in larger economies.



Note: Lighter colored bars are *Asian Development Outlook April 2025* forecasts.

Source: *Asian Development Outlook* database.

The write-up on the Pacific was prepared by Emma Allen, Kayleen Calicdan, Sudyumna Dahal, Kaukab Naqvi, Katherine Passmore, Cara Tinio, and Isoa Wainiqolo of ADB's Pacific Department (PARD); and Prince Cruz, Ana Isabel Jimenez, Kelly Samof, and Jennifer Umlas, PARD consultants.

in the Federated States of Micronesia (FSM) and post-disaster reconstruction projects in Vanuatu reduced 2025 growth estimates (FY2025 ends 30 September 2025 for the FSM). In Palau, tourism recovery is lagging, while Kiribati's growth forecast is also adjusted down as public spending will be slightly below initial expectations.

The subregional growth projection for 2026 is reduced to 3.4% from the 3.6% forecast in *ADO April 2025*. PNG growth is expected to moderate as resource output eases from the elevated 2025 levels along with the risks associated with global trade and policy uncertainty. Slower global growth coupled with the indirect impact of US tariffs on Fiji's major trading partners also led to a downward revision of the country's 2026 growth forecast. The Palau economy will likely expand more slowly in 2026 than projected in *ADO April 2025* as the global economic slowdown is expected to reduce visitor arrivals from major source markets. The growth forecast for the Cook Islands is also revised downward, reflecting both the impact of the global slowdown and anticipated constraints in airline and hotel room capacity. Agricultural output is expected to remain subdued due to weather conditions in Samoa, reducing the FY2026 growth projection. However, growth forecasts for the Marshall Islands have been raised on stimulus from COFA-funded projects and increased domestic demand. Projections remain unchanged for the remaining Pacific economies.

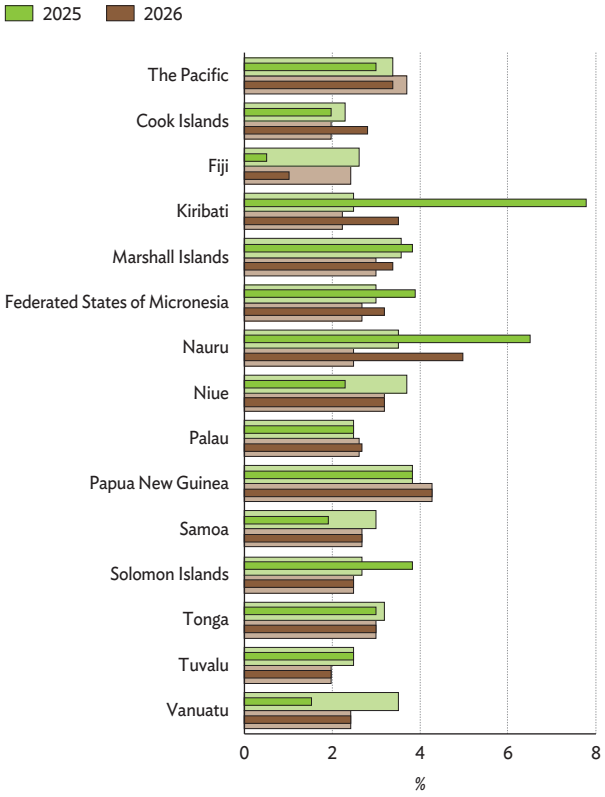
Capacity constraints and vulnerability to external shocks remain the main downside risks to growth. A limited local workforce and institutional constraints, particularly in the smaller island economies, continue to weigh on economic activity. Elections in some economies may also affect public infrastructure projects and public expenditure generally. Added to the ever-present exposure to natural hazards, growth prospects are also at risk from geopolitical and trade tensions. These could affect tourism, the cost of imported production inputs, and the value of sovereign wealth funds that many Pacific economies depend on to augment their limited fiscal space.

Inflation is projected to be 3.0% in 2025, down from the 3.4% forecast in *ADO April 2025* (Figure 3.5.2). In Fiji, 2025 inflation is expected to be below *ADO April 2025* projections as prices for transport, housing, and clothing have moderated. This is further supported by new cost-of-living measures introduced on 1 August 2025—including lower customs duties on selected food items and a reduced value-added tax rate. The inflation forecast for Vanuatu has also been revised down in 2025, driven by substantially lower food inflation and price declines in housing and utilities, communications, and clothing and footwear. Actual FY2025 inflation in the Cook Islands, Niue, Samoa, and Tonga was also lower than projected in *ADO April 2025*, as low food price inflation and minimal changes in utility and transport costs—linked to international fuel price movements—helped contain prices in these economies.

However, domestic factors have raised 2025 inflation forecasts in some economies. In Kiribati, early 2025 increases in fuel prices and electricity tariffs added significant upward price pressures. In Solomon Islands, bad weather drove domestic inflation

Figure 3.5.2 Inflation in the Pacific

Subregional inflation is revised down, but domestic factors exert price pressures in some economies.



Note: Lighter-colored bars are forecasts in *Asian Development Outlook April 2025*.

Source: *Asian Development Outlook* database.

higher, particularly for food and betel nut. In Nauru, supply bottlenecks caused by ship maintenance delays pushed FY2025 inflation above projections in *ADO April 2025*. Inflation forecasts for the Marshall Islands and the FSM are also adjusted up, with increased domestic demand driven by wage increases keeping inflation high.

The inflation projection for 2026 is revised down to 3.4% from 3.7% in *ADO April 2025*, but are up for several smaller economies. The lower subregional average mainly reflects a downward revision in Fiji's inflation outlook, driven by the cost-of-living measures introduced in August 2025 and easing international fuel prices. However, forecasts are revised up in the Cook Islands, where higher visitor spending and wage pressures from labor market constraints should push prices up, and in Nauru, where supply bottlenecks caused by ship maintenance delay will likely continue in the first quarter of FY2026. Inflation is also expected to be higher than *ADO April 2025* forecasts in Kiribati. Inflation forecasts for FY2026 are also adjusted up across the North Pacific. Price pressures from domestic demand should continue in the Marshall Islands and the FSM, while in Palau, expected inflation in the US—a key supplier of imports—may pass through to consumer prices.

International geopolitical and trade tensions continue to weigh on the inflation outlook, with potential disruptions to global supply chains. Extreme climate events could also trigger supply bottlenecks, adding to price pressures. Although international commodity prices are currently moderating, the volatility remains a significant risk with serious inflationary impact across the Pacific. Also, wage pressures from tight labor markets are contributing to rising inflation pressures in some economies.

Fiji

The growth forecast for 2025 remains unchanged, while the outlook for 2026 has been revised down (Table 3.5.1). *ADO April 2025* projected a slight slowdown in visitor arrivals following a record year in 2024. However, arrivals are now projected to remain at 2024 levels. The downward revision for 2026 is due to reduced expectations for global growth and possible indirect effects from the United States (US) tariff policy on Fiji's key trading partners. On the upside, increased private investment in construction, particularly new and refurbished hotels, should expand hotel inventory and support 2026 growth.

Table 3.5.1 Selected Economic Indicators in Fiji, %

Growth forecasts remain unchanged, but the inflation projection for 2025 has been reduced.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	3.5	3.0	3.0	3.2	3.0
Inflation	4.5	2.6	0.5	2.4	1.0

GDP = gross domestic product.
Source: Asian Development Bank estimates.

Visitor arrivals declined marginally, while growth in transit passengers and average spending rose. The first 7 months saw visitor arrivals decline by a marginal 0.4% compared to the same period in 2024, with slightly lower arrivals from Australia, New Zealand, and the Asian market. However, the slowdown was offset by a pick-up in domestic tourism in the first quarter, with room occupancy increasing, particularly in Suva and Coral Coast. Tourism earnings rose by 2.3% in the first half (H1) of 2025, led by an estimated 10% increase in visitor day spending. Transit passengers continued to grow strongly, increasing by 18.0% year on year in the first 7 months of 2025, as new routes to the US began.

Overall, industrial output has been positive. Gold production, including gold concentrate, rose by 14.7% in the first 7 months of the year. Mahogany production more than doubled (up by 101.3%), with wood chips (9.7%) and sawn timber (26%) also growing strongly, supported by good weather and higher external demand. Mahogany exports rose by 8.3% year on year while wood chip exports more than tripled to F$22.2 million in H1 2025. However, cane throughput and sugar production fell during the first 11 weeks of crushing (ended 18 August 2025) compared to the same period in 2024 due to frequent mill breakdowns and long wait times which negatively impacted cane quality and juice extraction efficiency.

Consumption remains robust, supported by strong remittance inflows and growth in lending. Remittances rose by 11.5% to F$692.6 million in

H1 2025, while new consumer lending surged by 35.1% year on year to July. This supported strong growth in value-added tax collections in H1 2025, which increased by 5.4%, new vehicle registrations by 22.0%, and electricity use by 1.8%—all suggesting continued growth in aggregate demand. Investment also remained strong, driven by a 6.7% increase in construction work completed and 10.3% growth in imports of investment goods such as machinery and transport equipment. Moderation is expected in the coming months, however, due to slow 1.4% growth in new investment-related lending in the first 7 months of the year, particularly in real estate and new buildings.

The government had a relatively good fiscal year 2025 (FY2025, ended 31 July 2025). The 8.5% growth in public spending outpaced the 8.0% growth in revenue, leaving the budget with a deficit of 3.6% of GDP—lower than the 4.5% of GDP initially projected, but slightly above the 3.4% budget deficit in FY2024. For FY2026, a 6.0% of GDP fiscal deficit is targeted, with expenditure expected to rise by 8.8% to counter the projected global economic slowdown. The government also aims to speed up public service delivery, raise civil service salaries and social welfare assistance, address the national HIV crisis, and invest in major water and health infrastructure upgrades. Public debt is nevertheless projected to remain below 80% of GDP.

Inflation forecasts for 2025 and 2026 are revised down. In the first 8 months of 2025, inflation was 1.1% on lower prices for transport, housing and clothing. Inflation is projected to ease further this year on new fiscal measures such as the value-added tax rate reduction from 15.0% to 12.5%, bus fare subsidies, and lower custom duties on selected food items starting on 1 August 2025. In 2026, moderate inflation is again projected as fiscal reforms continue into H1 2026 together with the downward trend in Brent crude oil prices.

Risks to the outlook remain with new investment likely to bolster resilience. The country remains exposed to large shocks due to limited fiscal buffers and climate risk, but ongoing reforms and new investments in water security and coastal protection should improve resilience.

Papua New Guinea

The growth forecast for 2025 has been revised up, while inflation projections remain unchanged (Table 3.5.2). Mining output in the first half (H1) of 2025 was stronger than expected in *ADO April 2025*, driven by high precious metal prices and mine upgrades in Lihir and K92, for example. The Porgera mine had its highest half-year gold output since reopening in 2023, while the Ok Tedi and K92 mines also had robust H1 output. In addition, while hydrocarbon prices and crude oil production moderated during H1, liquefied natural gas (LNG) production remained strong due to the Angore gas field coming onstream. LNG output grew by 7% year on year in H1 2025, its highest growth since 2020.

Table 3.5.2 Selected Economic Indicators in Papua New Guinea, %

Stronger resource output should boost growth in 2025 while inflation forecasts remain unchanged.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	4.0	4.2	4.6	3.8	3.6
Inflation	0.6	3.8	3.8	4.3	4.3

GDP = gross domestic product.
Source: Asian Development Bank estimates.

The impact of reciprocal tariffs announced by the US has thus far been milder than expected. The US-imposed base 10% tariff on the country's products was lower than most others in Asia and the Pacific, even as it rose to 15% starting September. Major trading partners either were assigned lower rates or sought to negotiate lower tariffs with the US compared to those announced in April. For example, Australia has a 10% rate while Japan and the European Union negotiated lower levels than those announced in April. This resulted in a somewhat more favorable external environment compared to April.

The non-resource sector outperformed the April forecast, supported by higher agricultural commodity prices in H1 2025 and increased foreign exchange availability. Export earnings from palm oil, coffee, cocoa, copra, and other cash crops will likely

continue to increase in H2 2025, further supporting household incomes. Foreign exchange availability—which businesses cite as a major constraint—significantly improved this year. Recent reports show that some foreign exchange orders are now filled the day they are received rather than the 4-week delay last year. Recent business survey data suggest that private sector confidence increased in 2025. In addition, base effects will support 2025 growth, as the *ADO April 2025* growth estimate for 2024 is revised down due to weaker public capital spending and lower mining output, making 2025 projections appear more robust by comparison. The 2026 downward growth revision comes from risks associated with global trade and policy uncertainty. Also, the resource output will likely moderate from the elevated 2025 levels, denting the country's commodity exports, which will weigh down 2026 growth.

Fiscal consolidation should continue as forecast in *ADO April 2025* but with some adjustments. Government revenue growth in 2025 will likely slow, reflecting shortfalls in tax revenue from the PNG LNG project and from other non-tax revenues. The shortfall from PNG LNG project is estimated to be around 7%–11% of 2024 government receipts. Nevertheless, revenue growth is projected to outpace expenditure growth from stronger mining revenue, reducing the fiscal deficit to 2.6% of GDP in 2025 and 1.2% in 2026. Thus, public debt is expected to decline to 50.5% of GDP in 2025 and to 48.9% in 2026. With these trends, the sovereign bond risk premium as measured by the G-spread narrowed further in H1 2025 and should remain stable through 2025. However, the lower share of capital spending will likely continue in 2025 and 2026, which will drag down growth, especially given the country's substantial development needs.

Inflation forecasts remain unchanged in 2025 and 2026 while the upward and downward pressures continue. Food, fruit, and vegetables prices increased during H1 2025. The further depreciation of the Kina in H1 2025 also contributed to imported inflation as the average yearly imported inflation remained elevated at 4.3% in the second quarter (Q2) of 2025. Downward pressure from alcoholic beverages, tobacco and betel nuts reversed their earlier increases, contracting by 14.5% quarter on quarter in Q2 2025, underscoring persistent volatility. Also, the zero-rated goods and services tax on essential items, effective July 2025, should help counter inflationary pressures until they expire in mid-2026.

The outlook faces both downside and upside risks. As the country celebrates its 50th independence anniversary in 2025, deteriorating law and order and severe development challenges weigh on the outlook. The country's imminent "grey listing" by the Financial Action Task Force could increase problems for banks maintaining correspondent bank relationships, while also damaging market perception. The further deterioration of the external and trade environment could pose additional headwinds. On the upside, the expected final investment decision and start of the multibillion-dollar Papua LNG project, along with other resource projects, could provide a substantial boost to economic activity (The ADB forecast does not yet include the potential impact of these proposed resource projects).

Solomon Islands

Growth forecasts for 2025 and 2026 remain unchanged (Table 3.5.3). Fishing did not do as well as anticipated, but was offset by stronger than expected mining output. Gold production was up by 87% in the first 7 months of 2025 compared to the same period in 2024. However, logging output over the period fell by an estimated 17% as the industry continues to stagnate. The fish catch also dropped 10% mainly due to lower volumes caught by longline vessels.

Table 3.5.3 Selected Economic Indicators in Solomon Islands, %

GDP forecasts remain unchanged, but the inflation forecast for 2025 is raised on higher prices for domestic goods.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	2.5	2.9	2.9	3.2	3.2
Inflation	4.2	2.7	3.8	2.5	2.5

GDP = gross domestic product.

Sources: Solomon Islands National Statistics Office; Asian Development Bank estimates.

Strong mining output continues to fuel export growth. Merchandise exports grew by 38% in the first half (H1) of 2025 with mineral exports up by more than 70%, offsetting a 10% decline in log and timber exports and a 12% drop in fish exports. Merchandise imports by contrast increased by only 16%, with mineral fuels and machinery and transport equipment increasing less than 10%. Foreign reserves increased by 8% from end-June 2024 to SI$6 billion at end-June 2025, enough to cover 11 months of goods and services imports.

The budget deficit will widen as forecast. Revenue targets in the 2025 budget—focused on "Accelerating Accountable and Transformative Investments"—remain largely on track. Goods and services tax revenue gained from an increase in customs excise duties, while non-tax revenue declined as proceeds from fishing license fees fell. Expenditure in H1 has fallen behind, particularly the development budget, although this follows annual expenditure trends. In May 2025, the government survived a no-confidence motion, providing political stability ahead of the Pacific Islands Forum leaders meeting hosted in Honiara in September 2025.

As expected, public debt continued to rise. Public debt in H1 2025 rose by 16.4% to reach 25.8% of GDP, largely due to new loan disbursements from development partner-funded infrastructure investments. Debt servicing costs remain below 1% of GDP, however, indicating manageable repayment levels.

The impact of the 10% tariff imposed by the United States in April 2025 on imports from Solomon Islands should remain negligible. As discussed in *ADO April 2025*, the United States is not a major trading partner of Solomon Islands. However, the flow-on impact from reciprocal tariffs on Solomon Islands' major trading partners remains a significant downside risk to the outlook.

The inflation forecast for 2025 is revised up, but remains unchanged for 2026. Although 2025 inflation eased as expected in *ADO April 2025*, it will likely be higher than initially expected for the year. Average inflation for the first 7 months of 2025 was 3.4%, within the central bank's 2%–5% desired range. This reflected lower imported inflation, especially for food, transport, and housing utilities. However, rising domestic inflation for food and betel nut will likely lead to inflation above the *ADO April 2025* forecast. In July 2025, domestic food inflation spiked to 14.8% from –2.9% in February due to supply constraints from bad weather. With the average price of betel nut 75% higher in the first 7 months of 2025, inflation for alcoholic beverages, tobacco, and narcotics rose by 13.4% over the same period.

In September 2025, the central bank shifted to an expansionary monetary policy for the coming 6 months. The central bank says that the shift will "support growth while containing inflation within the desired range." Inflation is expected to ease slightly in 2026 as global commodity prices continue to decline. The central bank will closely follow the situation and stands ready to adjust policy in response to any shocks.

Vanuatu

The *ADO April 2025* GDP growth forecast for this year was revised down due to delays in recovery and reconstruction from the December 2024 earthquake (Table 3.5.4). Tight fiscal space and logistical challenges have contributed to delays in reconstruction. Uncertainty over the start of insurance payouts has also reportedly delayed reconstruction in the Port Vila Central Business District into 2026 and 2027. Gross domestic insurance claims surged to Vt5 billion in December 2024 from just Vt38 million in September due to the massive damage from the earthquake. The growth forecast for 2026 remains

Table 3.5.4 Selected Economic Indicators in Vanuatu, %

GDP growth and inflation forecasts for 2025 are revised down as slower economic recovery reduces demand. Forecasts for 2026 remain unchanged.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	1.0	2.0	1.5	2.5	2.5
Inflation	1.1	3.5	1.5	2.4	2.4

GDP = gross domestic product.

Sources: Vanuatu Bureau of Statistics; Asian Development Bank estimates.

unchanged, however, with recovery and reconstruction expected to accelerate and outweigh downside risks to the outlook.

Air arrivals have surged but there were fewer arrivals by cruise ships. Arrivals by air rose by 83% in the first 7 months of 2025. Visitors from Australia increased by 120% following the entry of a budget airline while those from New Caledonia leapt by 288% after flights resumed. This helped offset the 45% drop in arrivals by cruise ship, which stemmed from lack of access to the Port Vila port due to earthquake-induced landslide. An interim arrangement allowed cruise ships to resume stops in Port Vila in August. The impact of United States tariffs on Vanuatu's main trading partners and source tourist markets continues as a downside risk to the growth forecast.

Businesses, still recovering from the pandemic effects, were heavily affected by the earthquake, especially those catering to tourists. A survey conducted from March to April 2025 by the Vanuatu Chamber of Commerce and Industry found that occupancy rates fell to 27% in February, while 61% of tour operators had more than half of their pre-earthquake reservations cancelled. Although most of the businesses surveyed did not relocate, weaker tourist traffic led to estimated revenue losses of 35% for large businesses and 54% for sole traders in the first half (H1) of 2025. Nonetheless, around 48% of proprietors planned to invest in their businesses over the coming 12 months—suggesting cautious optimism over the recovery—while 47% had no plans to invest in the near-term. Businesses cited key challenges for a tourism recovery, including the lack of government support and domestic and international connectivity issues.

Passage of the 2025 budget was delayed until March as Parliament was formed following the January 2025 elections. With the rollover of unused 2024 funds, the 2025 budget targets a 34% increase in expenditure. Current expenditure is projected to increase by 39% mainly due to an 87% increase in the use of goods and services and a 27% increase in wages and salaries. Higher spending will be mainly financed by an 86% increase in grants, a portion of which will cover 58% of the Vt12.3 billion goods and services budget. This includes projects on urban resilience, climate change adaptation, renewable energy, transportation, education, and health. With overall revenue expected to rise by just 19%, the fiscal deficit is expected to widen from 0.3% of GDP in 2024 to 6.1% in 2025.

Implementing the expansionary 2025 budget may be challenging. Capital expenditure for 2025 is planned at Vt12.2 billion, 16% higher than in 2024. Although project implementation should accelerate in H2 2025, only 19% had been disbursed by June. In 2024, Vt9.8 billion (41%) of the Vt23.7 billion capital expenditure budgeted was spent.

The inflation forecast for 2025 is revised down from *ADO April 2025*. Consumer prices fell by 0.2% from a year earlier in H1 2025. With deflation during the last two quarters of 2024, full year inflation for the year was just 1.1%, significantly below the 4.8% estimate in *ADO April 2025*. Price decreases during H1 2025 came mainly from lower prices of housing utilities (–3.9%), communications (–3.8%), and clothing and footwear (–2.8%). Inflation for food and nonalcoholic beverages—44.5% of the inflation basket—was 0.6%, down from 6.7% in H1 2024 but a reversal from –2.8% in H2 2024. Price growth is expected to pick up in H2 2025 but full-year inflation will likely stay within the central bank target of 0% to 4%.

Monetary policy will likely continue to support economic recovery. In June 2025, the central bank maintained the policy interest rate at 2.75%, last raised by 50 basis points in September 2024. The interest rate and other policy instruments will likely remain unchanged following the September 2025 monetary policy meeting. The *ADO April 2025* inflation forecast for 2026 remains unchanged, up from 2025 in line with the expected economic recovery. In June 2025, official foreign reserves were equivalent to 8.0 months of imports, above the central bank's 4.0-month minimum threshold.

Central Pacific Economies

Growth forecasts for Nauru and Kiribati are adjusted down from *ADO April 2025* and unchanged for Tuvalu. Stimulus from public infrastructure projects is projected to continue to drive growth across all three economies, but the slower project rollout in Nauru led the forecast down, while the Kiribati economy will likely show slower than

expected growth this year. Although Tuvalu growth forecasts remain unchanged, an ongoing dengue outbreak weighs on the outlook. Inflation should rise in Kiribati on higher prices for fuel and utilities, in Nauru due to shipping delays, and in Tuvalu on higher wages and limited labor supply. International commodity price volatility and supply chain disruptions are among the risks to Central Pacific growth and inflation.

Kiribati

More moderate growth is now forecast for 2025 (Table 3.5.5). Growth in 2024 is now estimated to be 5.3%, slightly below the 5.8% estimated in *ADO April 2025*. Moderate expansion will continue in 2025, but somewhat below the April forecast, due to slower than expected public spending. The 2026 projection remains unchanged as capital spending, especially on infrastructure, continues to drive growth. Phase two of a hospital upgrade and healthcare service improvements in Betio, a major urban center, began in July. Construction on renewable energy projects will likely begin in 2026, alongside ongoing efforts to improve transport links to the outer islands.

Table 3.5.5 Selected Economic Indicators in Kiribati, %

Significantly higher inflation is forecast for 2025 driven by domestic policy adjustments affecting fuel and electricity costs.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	5.3	4.1	3.9	3.3	3.3
Inflation	2.5	2.5	7.8	2.2	3.5

GDP = gross domestic product.

Sources: International Monetary Fund Article IV Staff Report; Asian Development Bank estimates.

Public spending on social protection has helped alleviate poverty. A recent report by the Pacific Community shows that over 19,000 i-Kiribati were lifted out of absolute poverty since 2020. This reduced the national poverty rate from 21.9% in 2019–2020 to 5.5% in 2023–2024 as more people in both urban and rural areas could afford their basic needs. Social protection programs, funded largely by higher fishing revenue, improved welfare especially among lower-income households.

Fiscal deficits are likely in the near term. The 2025 budget targets lower government expenditure, driven largely by a budgeted freeze on public wages and reduced subsidies to state-owned enterprises and unemployment benefits. However, expenditure continues to outpace revenue, even with increased grants from development partners. A deficit equivalent to 15.0% of GDP is now projected for 2025 compared to the small surplus expected in *ADO April 2025*, with a larger 17.0% of GDP deficit in 2026. Drawdowns from cash reserves and the Revenue Equalization Reserve Fund will cover the shortfall. As of June 2025, the value of the Revenue Equalization Reserve Fund was A$1.7 billion, equivalent to 356.6% of 2024 GDP.

Significant downside risks remain. The economy is highly volatile due to its remoteness, limited natural resources, and high service delivery costs. Geopolitical tensions may raise international commodity prices or disrupt supply chains, increasing import costs. While the United States (US) is not a major trading partner, and its 10% reciprocal tariff is not seen to directly impact Kiribati exports, shifts in global trade could affect growth prospects among the country's main trading partners and heighten commodity and financial market volatility. Weak financial market performance in 2025 may limit reserve fund withdrawals in 2026, leading to fiscal tightening, reduced public investment and slower economic growth. The country also remains acutely vulnerable to climate change and disasters.

Inflation projections are revised up as domestic factors pushed up prices in 2025. Earlier in the year, the state-owned Kiribati Oil Company began shifting toward market-based pricing as no subsidy was provided in the 2025 budget. Although international oil prices were much lower year on year in the first half (H1) of 2025, local fuel prices increased by 64%. At the same time, the Public Utilities Board increased electricity tariffs by 50% to improve its financial sustainability as well as accommodate the increased fuel costs. Inflation will likely ease in 2026, albeit higher than projected in *ADO April 2025*, as the impact of the one-time adjustment dissipates and in line with expected external price trends. International commodity price volatility and supply chain disruptions remain the main downside risks to the outlook.

Nauru

The *ADO April 2025* growth forecast is down slightly for the year as investment was lower than expected (Table 3.5.6). Capital expenditure declined by 11% in fiscal year 2025 (FY2025, ended 30 June 2025) in sharp contrast to the 54% expansion in FY2024. Delays in construction of a new stadium and other facilities pushed back the Micronesian Games from July 2026 to January 2028. For FY2026, budget passage was delayed from June to September for the second consecutive year, slowing capital spending in the first quarter (Q1) of FY2026. The GDP growth forecast for FY2026 remains unchanged as capital spending is projected to expand by 16%.

Table 3.5.6 Selected Economic Indicators in Nauru, %

GDP forecast for 2025 is revised down on lower infrastructure spending, while inflation forecasts are higher due to shipping delays.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	1.8	2.5	2.3	2.5	2.5
Inflation	11.6	3.5	6.5	2.5	5.0

GDP = gross domestic product.

Note: Years are fiscal years ending on 30 June of that year.

Sources: International Monetary Fund; Asian Development Bank estimates.

Government recurrent spending buoyed the economy in FY2025. After six supplementary appropriations, recurrent expenditure was 18% higher than in FY2024 on a 33% jump in government operations with wages and salaries up 14%. Total spending rose while revenues fell, leaving the fiscal surplus down to the equivalent of 2.3% of GDP in FY2025 from 28.1% in FY2024.

The Regional Processing Centre (RPC) continued to contribute to the economy. A year after it was fully reactivated, RPC-related revenue accounted for 63% of total revenue in FY2025, up from 60% in FY2024. RPC-related revenue remained relatively unchanged from last year while other major revenue items declined. Grants fell by 33%, fishing license fees by 16%, and taxes by 8%.

The 2026 budget will likely expand further. Total revenue is projected to increase by 10% in FY2026 largely due to a 49% increase in grants, while domestic revenue is expected to increase by 6% with higher RPC-revenues. With overall spending projected to rise by 3%, the fiscal surplus is seen to increase to the equivalent of 10.7% of GDP. The budget will likely expand further with the August signing of an agreement with Australia for resettling non-citizens in Nauru. The deal includes an upfront payment of some A$400 million, followed by an annual payment of around A$70 million to resettle several hundred people. In August, the government also signed an agreement with a company from the People's Republic of China, reportedly valued at A$1 billion, to examine proposed projects in energy, phosphate, fisheries, and agriculture. These agreements are an upside risk to the medium-term outlook (The ADB forecast does not yet include the potential impact of these agreements).

The government introduced reforms to attract foreign investment. The passage of the Foreign Investment Act in April 2025 should improve the investment climate. One of the first foreign investors under the law is a United Arab Emirates-based company, which signed an agreement with the government in June 2025 to manage and deliver health services. Granting "citizenship by investment" visas also started in August 2025. Revenue under the scheme will go toward climate-resilient projects.

Inflation forecasts for FY2025 and FY2026 have been raised, largely due to the impact of shipping delays. Vessel maintenance and mechanical issues led to delays in goods shipments, pushing inflation up during H2 FY2025. To reduce the backlog, the Nauru Shipping Line chartered dedicated vessels. Australia donated 20 tons of rice in April 2025 and another 20 tons in June to reduce food shortages created by the delays. In August 2025, the government received its second shipping vessel acquired with help from the People's Republic of China. Twice the size of the current ship, it will provide faster and more reliable service directly from Australia.

Tuvalu

Economic growth will likely continue in 2025 despite ongoing risks (Table 3.5.7). The economy is projected to grow, supported by increased public spending and infrastructure investments in climate resilience, digital connectivity, renewable energy, and maritime transport. Key projects include the second

Table 3.5.7 Selected Economic Indicators in Tuvalu, %

Growth is expected to continue in 2025, supported by public spending and investments in climate resilience, connectivity, and transport.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	3.3	2.7	2.7	2.5	2.5
Inflation	1.2	2.5	2.5	2.0	2.0

GDP = gross domestic product.

Sources: Tuvalu Central Statistics Division; Tuvalu Ministry of Finance and Economic Development; Asian Development Bank estimates.

phase of the Tuvalu Coastal Adaptation Project, an international subsea telecommunications cable, satellite internet services, and commissioning of a solar energy facility in Funafuti with distribution and storage upgrades on the outer islands. The Funafuti Port rehabilitation, completion of boat harbors in Nui and Nukulaelae, and ongoing construction in Niutao are expected to enhance interisland connectivity. Downside risks include an ongoing dengue outbreak and refueling issues at Funafuti airport, limiting capacity from sole air service provider Fiji Airways. The addition of a fifth weekly flight starting in August 2025 will help. Growth is projected to stabilize in 2026, yet still constrained by capacity limits, rising emigration, and vulnerability to climate and other natural hazards.

The inflation projection for 2026 remains unchanged. Average annual inflation fell to 0.5% in Q1 2025—down from 1.2% in Q4 2024 and 5.1% in Q1 2024—on lower global prices for imports. However, domestic price pressures persist due to wage increases and labor shortages. Risks to the inflation outlook include supply chain disruptions from climate shocks and tight labor market conditions.

Tuvalu's fiscal position strengthened in FY2025 (ended 30 June 2025) and will likely remain stable in FY2026. Domestic revenue rose by 5.3% in FY2025 compared to 2023 on a 7.9% increase in tax collection and fishing license revenue (2023 is used as reference since 2024 had only a half-year budget). Operating expenses fell by 12.4%, largely due to a 24.8% reduction in spending on goods and services and a 4.2% decline in costs under the Tuvalu Overseas Medical Treatment Scheme, leading to a fiscal surplus of 15% of GDP in FY2025. The FY2026 budget is in line with the Medium Term Fiscal Strategy goal of keeping the fiscal deficit below 10% of GDP, as strong domestic revenue growth should compensate for increased spending. Domestic revenue is projected to increase 29.5%, driven by a 38.4% increase in fishing license receipts linked to expected disbursements under the US Treaty on Fisheries and more vessels. Although budget support is projected to decline by 15.4%, it includes a $7 million budget support grant to strengthen fiscal management, transparency, and climate resilience.

Downside risks to the outlook remain from climate-related events, project delays, limited fiscal space, and a small workforce. Around 90% of the population—approximately 8,750 people—applied for one of the 280 annual visas offered under the Australia-Tuvalu Falepili Union, which offers migration as a response to escalating climate risk. Heavy reliance on fishing licenses, internet domain revenue, and official development assistance leaves the economy vulnerable to global economic uncertainty.

North Pacific Economies

Growth projections are revised up for the Marshall Islands and down for the Federated States of Micronesia (FSM) and Palau. Although financial assistance under renewed agreements with the United States (US) began across the North Pacific, use in the FSM's larger states depends highly on capacity constraints. In Palau, tourism is recovering more slowly than anticipated in *ADO April 2025*. Adjustments to inflation projections broadly reflect international commodity price trends.

Marshall Islands

Growth forecasts have been revised up (Table 3.5.8). The economy is now estimated to have grown by 3.0% in fiscal year (FY) 2024 (ended 30 September 2024 for all three North Pacific economies), significantly higher than *ADO April 2025* estimates. Updated data show that fisheries output was stronger, driving the economy along with a rise in visitor arrivals and construction. Momentum from government spending and capital investment—driven by strong financial support from development partners and the renewed Compact of Free Association (COFA) with the US—should continue over the forecast period. Coupled

Table 3.5.8 Selected Economic Indicators in the Marshall Islands, %

Growth and inflation projections are revised up over the forecast period.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	3.0	2.5	3.0	3.0	3.5
Inflation	5.7	3.6	3.8	3.0	3.4

GDP = gross domestic product.

Note: Years are fiscal year ending on 30 September of that year.

Sources: Graduate School USA Economic Monitoring and Analysis Program; Asian Development Bank estimates.

with increased household consumption from wage hikes under the Minimum Wage (Amendment) Act 2024, growth forecasts have been raised for FY2025 and FY2026. The start of the Universal Basic Income and Extraordinary Needs Distribution (END) schemes expected in FY2026 should further boost domestic demand.

Inflation projections were also revised up. Inflation is now estimated at 5.7% for FY2024, higher than reported in *ADO April 2025*. Although still expected to moderate over the forecast period on international commodity price trends, projections are revised higher as minimum wage increases and the Universal Basic Income and END payments add price pressures over the forecast horizon.

Additional measures could further increase household consumption in the near term, raising both growth and inflation. The government is taking steps to implement its revised tax policy under the Income Tax (Amendment) Act 2024. These measures, together with the full roll-out of the END scheme in areas subject to conditions for payment, will likely increase household spending, contributing to higher output as well as upward pressure on prices.

Other than higher household consumption, risks to the growth outlook are skewed toward the downside. Local capacity constraints exacerbated by out-migration, the subsequent need to import foreign expertise, and unexpected global price volatility could affect the cost and speed of infrastructure projects. Global price volatility also remains a key risk to the inflation outlook along with possible supply chain disruptions from continuing geopolitical tensions.

The fiscal position should remain in surplus with debt continuing to fall. With COFA assistance significantly boosting government resources, a fiscal surplus equivalent to 2.8% of GDP is projected for both FY2025 and FY2026 even with higher spending planned. The additional assistance will also help the government manage public debt, likely equivalent to 16.0% of GDP at the end of FY2025, down from 18.0% in FY2024. The International Monetary Fund's latest debt sustainability analysis assesses the country's risk of debt distress as "moderate," an upgrade from the "high" rating in 2023.

Federated States of Micronesia

The growth forecast is adjusted down for FY2025 and unchanged for FY2026 (Table 3.5.9). Although FY2025 was the first full fiscal year of grants under the renewed COFA, their use in the larger states of Chuuk and Pohnpei has been slower than expected in April because of the lack of sufficient project management staff and the need to meet COFA accountability and reporting requirements. Economic expansion this year will likely be driven by construction funded primarily by unspent previous COFA grants, COFA-supported public spending in the smaller states of Kosrae and Yap, and the impact of public wage increases in Chuuk and Kosrae. As absorptive capacity improves in the larger states, they will be better positioned to leverage COFA grants in FY2026, thus supporting stronger growth. Nonetheless, continued out-migration undermines capacity development, potentially limiting the effective use of larger COFA resources.

Table 3.5.9 Selected Economic Indicators in the Federated States of Micronesia, %

More muted growth is likely in 2025 as larger states face capacity and compliance constraints to fully harness additional United States financial assistance.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	1.7	1.7	0.8	1.1	1.1
Inflation	5.4	3.0	3.9	2.7	3.2

GDP = gross domestic product.

Note: Years are fiscal year ending on 30 September of that year.

Sources: Graduate School USA Economic Monitoring and Analysis Program; Asian Development Bank estimates.

Inflation forecasts are adjusted up. Inflation for FY2024 is now estimated at 5.4%, higher than reported in *ADO April 2025*. It should still moderate with easing international commodity prices. However, projections for FY2025 and FY2026 are adjusted up to align with revised assumptions regarding inflation in the US, a key supplier of imports, especially food. Increased domestic demand from public wage hikes should continue adding some upward price pressures. Inflation, however, will remain vulnerable to supply chain disruptions and potential global price volatility.

The fiscal position will likely return to surplus from renewed COFA assistance. After deficits averaging 0.8% of GDP during the past 2 fiscal years, renewed COFA financial assistance should lead to fiscal surpluses of about 1.0% of GDP in both FY2025 and FY2026. Public debt is expected to remain stable at about 10% of GDP over the period.

Palau

Growth forecasts have been revised down (Table 3.5.10). Despite the slower-than-expected recovery in tourism, the economy received a short boost from the Pacific Mini Games hosted in July with over 1,500 participants. Construction related to the games, along with other ongoing infrastructure projects, supported growth. Nevertheless, overall growth remains below earlier forecasts.

Table 3.5.10 Selected Economic Indicators in Palau, %

Growth forecasts are revised down for both years with inflation slightly higher in 2026.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	6.6	9.5	8.2	4.5	3.9
Inflation	3.7	2.5	2.5	2.6	2.7

GDP = gross domestic product.

Note: Years are fiscal year ending on 30 September of that year.

Sources: Graduate School USA Economic Monitoring and Analysis Program; Palau Ministry of Finance; Asian Development Bank estimates.

Tourism has shown signs of recovery. Arrivals increased by 25.9% from October 2024 to July 2025 compared to a year earlier. The People's Republic of China remained Palau's largest source market, accounting for 31.1% of total arrivals, followed by Taipei,China (20.5%). Direct flights from Brisbane launched in November 2024 also helped to increase arrivals from Australia. Ticket sales for direct flights from Japan began in May, with services scheduled to start in October 2025. Government-led marketing for the Narita-Koror route should significantly boost arrivals from Japan in the near-term.

Despite these positive trends, economic recovery remains below expectations. Looking ahead, FY2026 growth prospects remain subdued as US tariffs on key tourism markets like the People's Republic of China, Japan, and Australia may indirectly dampen outbound travel and slow potential economic performance.

The inflation forecast for FY2025 remains unchanged. In the first 3 quarters of FY2025, consumer prices increased a slight 0.6% compared to the same period last year. While prices of imported goods remained broadly stable, domestic prices rose slightly. The subdued inflation was helped by reductions in transport costs (–3.2%) and utility prices (–1.5%), which helped offset price increases in hotels and restaurants (12.7%), communications (5.3%), and food and non-alcoholic beverages (1.8%). Inflation is projected to rise to 2.7% in FY2026, primarily on higher inflation in the US—Palau's main source of imports.

Fiscal surpluses will likely continue, supported by increased public revenues and prudently managed expenditure. The continued tourism recovery and renewed COFA support should provide adequate fiscal space. In addition, institutional reforms on fiscal consolidation and debt management will upgrade expenditure oversight and better implement the 2023 Compact Review Agreement. The government also plans to prepay high-interest loans. Together, these initiatives will likely help fiscal sustainability and maintain surpluses over the medium term.

South Pacific Economies

Growth prospects vary across the South Pacific. Tourism trends continue to dominate the growth outlook for the Cook Islands, while disruptions from power outages and lower agriculture and fisheries output dampen economic prospects in Samoa. Tourism and construction, particularly public infrastructure, remain key growth drivers in Niue and Tonga. Inflation continues to moderate in South Pacific economies, but upward price pressures are likely in the near term, mostly from higher tourism spending and domestic wages.

Cook Islands

Growth exceeded expectations as tourism outperformed projections (Table 3.5.11). The record 175,757 international arrivals in fiscal year (FY) 2025 (ended 30 June for all four South Pacific economies) were 5.4% above the pre-pandemic peak and 7.5% higher than in FY2024. New Zealand remained the main source market, while Australia's share rose sharply with the introduction of Jetstar Airways flights from Sydney. Recent data also show continued strong growth both in business activity and employment. Growth will likely continue in FY2026, although the forecast is revised down somewhat. Continued constraints on airline services and accommodation may limit further growth in new arrivals while skilled labor shortages could delay capital projects. The peak tourism season at the start of the fiscal year was boosted by the country's 60th anniversary of self-governance. Along with many visiting overseas citizens, the celebrations attracted about 1,000 visitors from the outer islands to Rarotonga, spurring trade and other tourism-related business. Beyond tourism, the country is exploring seabed mining as an alternative source of future growth.

Table 3.5.11 Selected Economic Indicators in the Cook Islands, %

Growth in 2025 exceeded the April forecast on higher tourism and should remain positive next year.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	14.0	8.1	10.4	2.9	2.5
Inflation	4.6	2.3	2.0	2.0	2.8

GDP = gross domestic product.

Note: Years are fiscal years ending on 30 June of that year.

Sources: Cook Islands Statistics Office; Asian Development Bank estimates.

Inflation was below the FY2025 forecast while the FY2026 projection has been raised. Lower price increases in food and non-alcoholic beverages, transport, and catering, combined with a decline in housing, utilities, and household maintenance costs, contributed to inflation in FY2025. The FY2026 projection was raised as one major import firm increased freight costs by one-third in the second quarter as its operating, compliance, and fuel costs rose, and to ensure ship reliability and service standards. Other importers will likely follow suit. Further price increases came from higher imported food costs from New Zealand. Diesel and minimum wage hikes (due to labor constraints) also contributed to the higher projection.

The FY2025 fiscal balance reversed from a projected deficit to surplus equivalent to 1.3% of GDP. Significant underspending in both capital and operating expenditure offset a revenue shortfall. A 5.4% of GDP surplus is projected for FY2026. Cash reserves will likely remain above the government's 3-month threshold in both FY2025 and FY2026. Public debt was estimated at 29.4% of GDP at the end of FY2025, down from 33.2% of GDP in FY2024, due to early repayments and favorable currency movements. The government medium-term debt strategy targets a 30:70 foreign-to-domestic debt ratio, with the 28% foreign and 72% domestic debt projected for FY2026 also reducing exchange rate risk.

Risks to the outlook remain, with sustainable tourism investment to bolster resilience. The economy remains vulnerable due to limited fiscal buffers and climate-related shocks. However, ongoing reforms, fresh investments in sustainable tourism, and efforts to diversify the economy should strengthen its long-term adaptive capacity.

Niue

Growth forecasts remain unchanged (Table 3.5.12). Tourism and construction should remain the key drivers of growth in the near-term, with growth likely moderating through FY2026. Tourist arrivals will likely increase further following the twice-weekly

Table 3.5.12 Selected Economic Indicators in Niue, %

Growth projections remain, while the inflation forecast for 2025 was revised down as import prices were lower than expected.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	8.7	3.4	3.4	3.0	3.0
Inflation	5.4	3.7	2.3	3.2	3.2

GDP = gross domestic product.
Note: Years are fiscal years ending on 30 June of that year.
Sources: Niue Statistics Office; Asian Development Bank estimates.

Table 3.5.13 Selected Economic Indicators in Samoa, %

Growth is revised down in the forecast period, partly driven by disruptions to agriculture and power supply.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	4.6	5.5	4.0	3.0	2.7
Inflation	3.6	3.0	1.9	2.7	2.7

GDP = gross domestic product.
Note: Years are fiscal years ending on 30 June of that year.
Sources: Samoa Bureau of Statistics; Asian Development Bank estimates.

Air New Zealand flights which began in May 2025. Construction will be fueled by major projects, including ongoing renewable energy infrastructure and a new government building planned to house the Niue High Court and the Department of Justice.

FY2025 inflation was below April projections. Imported prices rose by 2.0% over the period, half the rate earlier projected, due to lower prices of selected food and clothing and footwear items. Inflation will likely increase in FY2026, driven by capacity constraints in tourism and wage pressures.

The government likely achieved its balanced budget policy in FY2025 and is projected to do so again in FY2026. Despite a 19.5% shortfall in revenue compared with the *ADO April 2025* forecast, expenditure declined by a similar margin. The transition to renewable energy should lower fuel import costs and subsidies as reliance on diesel power generation declines. While the government budgeted an 18% increase in FY2026 expenditure, capacity constraints will likely keep spending below target.

Downside risks to the outlook persist with limited labor capacity and institutional constraints continuing to weigh down growth. The economy remains vulnerable to external shocks and climate-related events. Reliance on development assistance and a narrow economic base heighten these risks.

Samoa

Growth in FY2025 was lower than the *ADO April 2025* forecast (Table 3.5.13). Although hosting the October 2024 Commonwealth Heads of Government Meeting provided a boost to tourism in H1 FY2025, visitor arrivals grew by 2.8% year on year in FY2025, significantly down from the 40.9% growth in FY2024. This led to more modest growth in transport, along with accommodation and restaurants. Output of the agriculture and fishing sector was limited by high rainfall, with the closure of a major fisheries operator further hurting the sector. As anticipated in *ADO April 2025*, widespread power outages on Upolu, Samoa's main island (officially declared a state of emergency in March) disrupted manufacturing and services. A dengue outbreak followed in April, requiring a coordinated national response.

The FY2026 growth projection is adjusted down. As expected, visitor arrivals will likely ease, while drier weather conditions could slow agricultural and fishing output, with fishing already hurt from the FY2025 operations closure. Construction remains a key growth driver, though project rollout could be delayed due to the transition to a new government following the August 2025 snap elections. However, the energy crisis was eased in April 2025 with rented generators restoring power supply and normal economic activities resuming. The government is now taking steps to strengthen grid infrastructure, expand generation capacity, and improve the policy framework to encourage private sector participation in decarbonization.

Inflation was lower than FY2025 projections, but the FY2026 forecast remains unchanged. In FY2025, food inflation dropped to 4.0% from 7.9% in FY2024 as imported food prices grew much slower than locally produced food. Utilities costs were lower by 0.5% and transport costs by 3.2%, the second consecutive fiscal year both declined along with international fuel prices. Inflation in FY2026 is forecast to pick up to 2.7% as projected in *ADO April 2025* due

to weather-related disruptions to local staple food supplies, which will likely push up food prices. While international commodity prices are still projected to fall, the inflation outlook remains vulnerable to supply disruptions from geopolitical tensions.

There was a fiscal surplus equivalent to 4.9% of GDP in FY2025. Domestic revenue was 4.7% higher year on year on higher tax collections. Even with lower grant inflows, fiscal resources were more than enough to fund a 5.1% higher year on year expenditure. Public debt totaled the equivalent of 20.7% of GDP in FY2025, lower than 23.5% the previous year. Following parliament's rejection of the proposed FY2026 national budget, the government is in caretaker mode—using 25% of the FY2025 budget until the new government passes a FY2026 budget.

Both domestic and external factors pose downside risks to the outlook. Policy shifts from changing governments could slow public infrastructure projects as well as fiscal spending generally. Externally, instability related to ongoing geopolitical and trade tensions could seriously affect tourism.

Tonga

The *ADO April 2025* economic growth forecast for FY2025 remains unchanged (Table 3.5.14). The FY2025 recovery came from growth in construction, public services, tourism, and agriculture. Reconstruction spending fueled a 25% growth in capital expenditure. Major infrastructure projects—such as the Nuku'alofa Port Upgrade and road maintenance programs—continued and remains critical for trade logistics and economic resilience.

Table 3.5.14 Selected Economic Indicators in Tonga, %

Growth forecasts are unchanged, as economic recovery remains supported by reconstruction and tourism activity.

	2024	2025		2026	
		Apr	Sep	Apr	Sep
GDP growth	1.4	2.5	2.5	2.3	2.3
Inflation	8.0	3.2	3.0	3.0	3.0

GDP = gross domestic product.

Note: Years are fiscal years ending on 30 June of that year.

Sources: Tonga Statistics Department; Asian Development Bank estimates.

Following the El Niño damage last year, agriculture showed signs of recovery. The volume of locally marketed agricultural products rose by 6% in the first 3 quarters of FY2025 over the same period in FY2024, led by coconut (up by 10%), watermelon (67%), and vegetables (21%). By value, agricultural products surged by 45% to T$6.4 million, led by root crops (up by 42%), coconuts (81%), and vegetables (46%). Further, agricultural export volumes and receipts rose by 10% in FY2025.

Services grew due to higher remittances and tourism receipts. Remittances increased by 4% to T$541 million in FY2025 (the equivalent of 43% of GDP). Tourism receipts increased by 22% to T$178 million (14% of GDP), due to a 9% increase in arrivals via air and by yacht, which reached 66,900 in FY2025. However, arrivals by cruise ships fell by 41% to 12,700. Around 40% of visitors arrived from New Zealand, with 20% from Australia. Total reserves reached T$925 million in June 2025 (equivalent to 10.6 months of imports), nearly unchanged from a year earlier.

The outlook for FY2026 remains unchanged from *ADO April 2025* as growth in construction continues as planned. Under the FY2026 budget, capital expenditure is projected to rise by 7%, including investment for developing a bridge over the Fanga'uta Lagoon. Current expenditure is also expected to rise by 11%, up from 7% in FY2025. With spending expected to rise faster than revenues, the fiscal surplus will narrow to the equivalent of 4.2% of GDP in FY2026 from 6.2% in FY2025. The FY2026 budget also includes a new domestic bond market policy to stimulate private investment by offering low-interest (2%–3%) business loans.

Inflation in FY2025 was slightly below *ADO April 2025* projections. Consumer price growth moderated from 8.0% in FY2024 to 3.0% in FY2025, based on a new inflation basket (see Box). The decline was largely driven by a sharp decline in the growth of food prices, which fell from 10.6% in FY2024 to 2.5% in FY2025. The fall in housing utility costs persisted at –5.4% due to lower fuel prices. Inflation for locally produced goods fell dramatically, from 12.4% to 3.3%, while inflation for imported goods eased from 3.6% to 2.6%.

Box Rebased Inflation Basket

The Consumer Price Index (CPI) was rebased in 2025 from 2018 to 2021. The new basket updates household spending patterns based on the 2021 Household Income and Expenditure Survey, with the basket expanding from 137 to 161 items. Notable additions include green coconuts, cheese, mobile phones, and motor vehicles, while items with minimal expenditure shares, such as turkey tails and domestic call bundles, were excluded.

CPI weights were also adjusted to capture shifts in household consumption. Food and non-alcoholic beverages increased from 39.8% of the CPI basket to 42.6%, while restaurants and accommodation services increased significantly from 3.1% to 15.0%, highlighting growing expenditure on food consumed away from home. In contrast, transport decreased from 16.4% to 13.2%, alcoholic beverages, tobacco, and narcotics from 11.6% to 5.6% and housing and utilities from 10.8% to 6.6%. The weight of imported goods in the CPI basket declined from 55.1% to 51.4%.

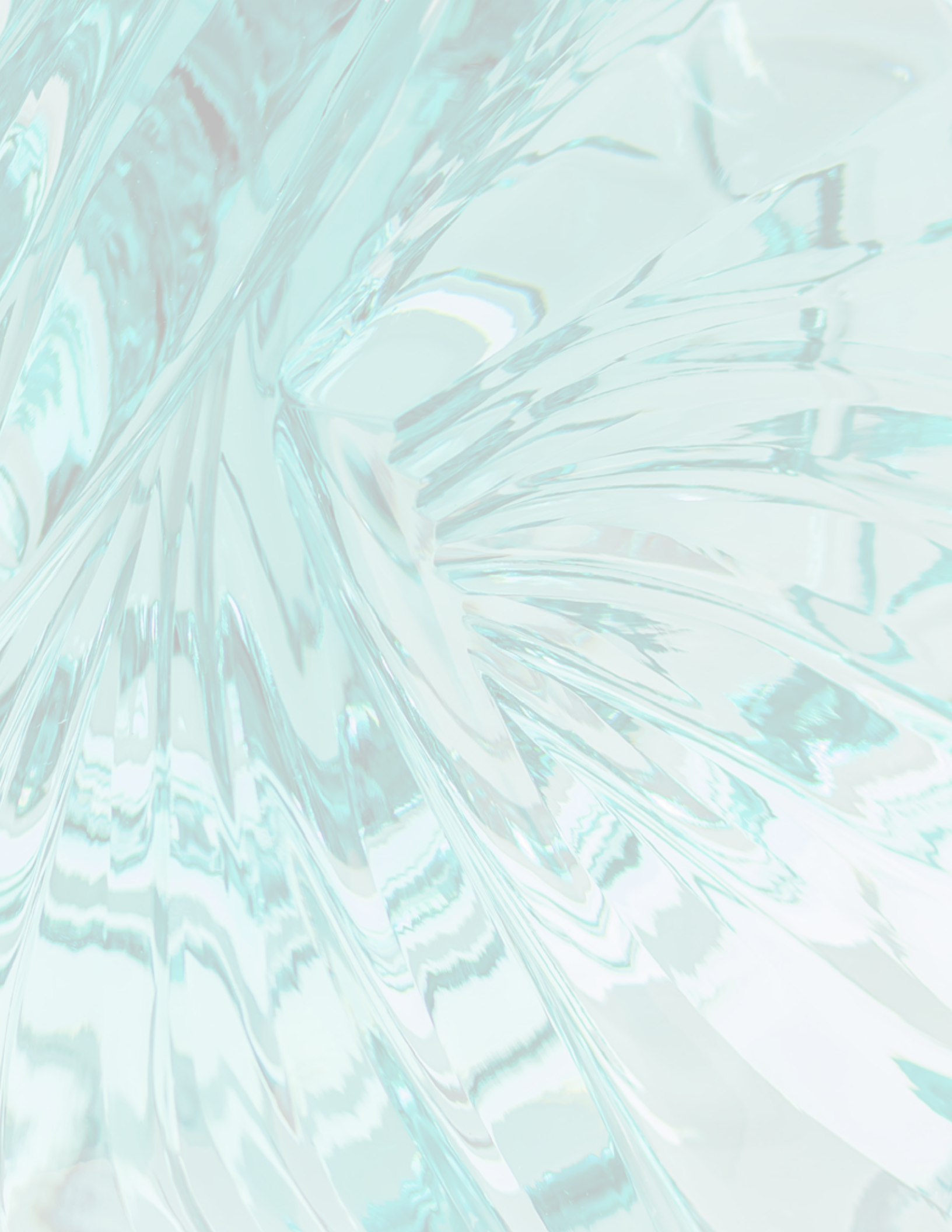
The updated CPI basket led to higher inflation estimates for previous years. For instance, inflation in FY2023 was revised from 10.2% to 12.6%, while in FY2024, it was raised from 4.6% to 8.0%.

Source: Tonga Statistics Department.

The inflation forecast for FY2026 remains unchanged, still below the central bank's 5% reference rate. The central bank shifted from an accommodative to neutral stance in August 2025, citing sufficient reserves and stable financial markets. It is also intensifying efforts to strengthen transmitting monetary policy using a more up to date framework that promotes economic stability.

Downside risks to the outlook include limited fiscal space and greater difficulty in obtaining reconstruction funding. The risk of debt distress remains high, with debt servicing projected at T$69.8 million, equivalent to 17% of domestic revenue—73% of which is in foreign currency. Public debt as of June 2025 stood at T$428.9 million (equivalent to 34% of GDP), down by 3.3 percentage-points from last year. Labor shortages, the potential decline in visitor arrivals by air, and heightened global uncertainty from geopolitical tensions and trade disruptions could further dampen growth. There are also rising political risks ahead of November 2025 parliamentary elections.

Problems with domestic air travel could drag down growth and push up inflation in FY2026. The national carrier, Lulutai Airlines, was grounded for 3 days in July 2025 due to safety issues and operational compliance. The suspension significantly disrupted domestic air connectivity. Any further disruptions and a need for recapitalization could weaken growth and add to fiscal strain.



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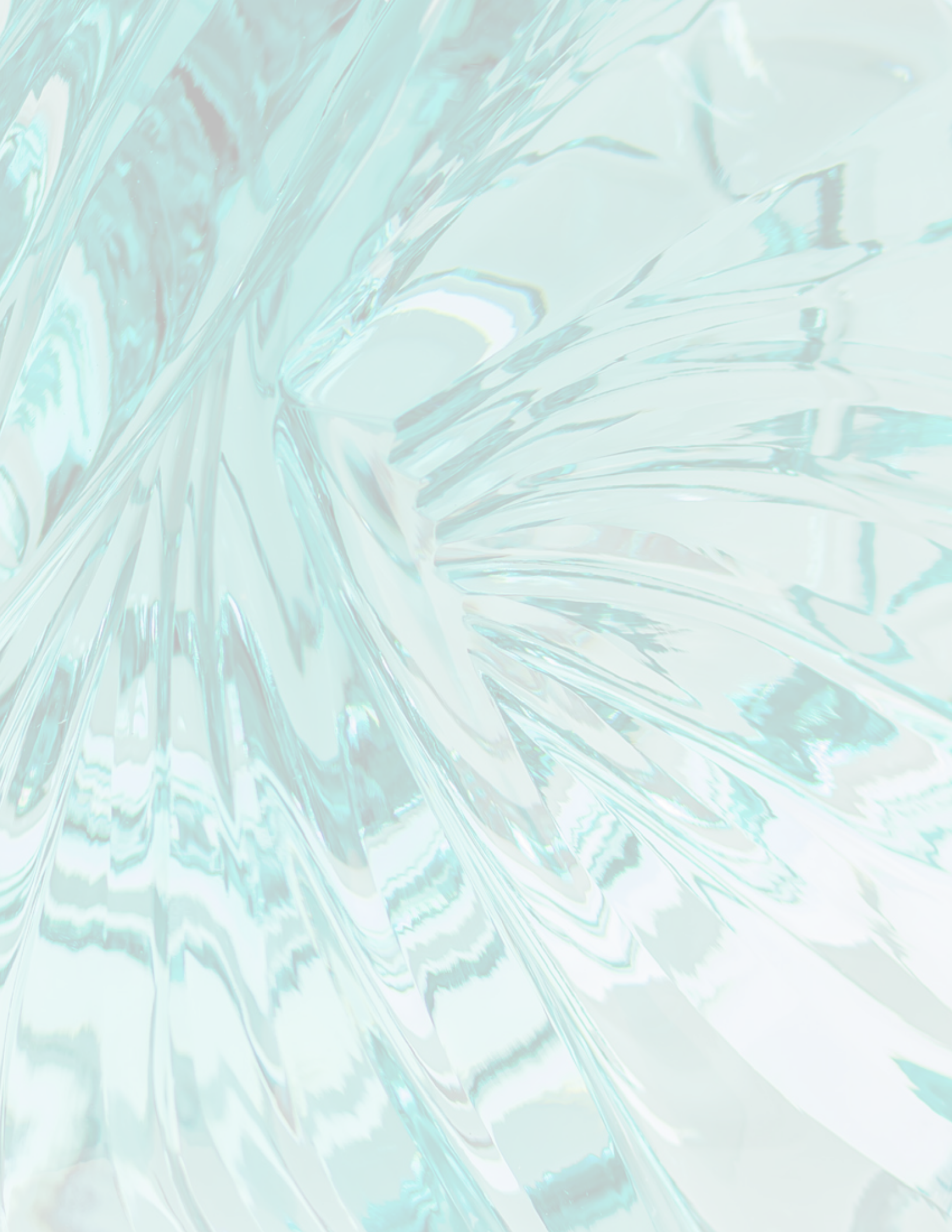
STATISTICAL APPENDIX



STATISTICAL NOTES AND TABLES

This statistical appendix presents economic indicators for the 46 developing member economies in the Asian Development Bank (ADB) in two tables: gross domestic product (GDP) growth and inflation. The economies are grouped into five subregions: the Caucasus and Central Asia, East Asia, South Asia, Southeast Asia, and the Pacific. The tables contain forecasts for 2025–2026 and historical data for GDP and inflation from 2022.

The data are standardized to the degree possible to allow comparability over time and across economies, but differences in statistical methodology, definitions, coverage, and practice make full comparability impossible. National income accounts are based on the United Nations System of National Accounts. Historical data are variously based on official sources, statistical publications and databases, and documents from ADB, the International Monetary Fund, and the World Bank. Projections for 2025 and 2026 are generally ADB estimates based on quarterly or monthly data as available, though some projections are from governments.

Most economies report by calendar year. The following report all variables by fiscal year: Afghanistan, Bangladesh, Bhutan, India, Nepal, and Pakistan in South Asia; Myanmar in Southeast Asia; and the Cook Islands, the Marshall Islands, the Federated States of Micronesia, Nauru, Palau, Samoa, and Tonga in the Pacific.

Regional and subregional averages are provided in the two tables. Averages are weighted by purchasing power parity (PPP) GDP in current international dollars. PPP GDP data for 2022–2023 were obtained from the IMF World Economic Outlook Database, October 2024 edition. Weights for 2023 are carried over to 2026.

The following paragraphs discuss the two tables in greater detail.

Table A1: Gross Domestic Product Growth Rate, % per year. The table shows annual growth rates of GDP valued at constant market prices, factor costs, or basic prices. GDP at market prices is the aggregate value added by all resident producers at producers' prices, including taxes less subsidies on imports plus all nondeductible value-added or similar taxes. Most economies use constant market price valuation. Pakistan uses constant factor costs, and Fiji basic prices.

Table A2: Inflation, % per year. Data on inflation rates are period averages. Inflation rates are based on consumer price indexes. The consumer price indexes of the following economies are for a given city only: Cambodia is for Phnom Penh, the Marshall Islands for Majuro, and Sri Lanka for Colombo.

Table A1 Gross Domestic Product Growth Rate, % per Year

	2022	2023	2024	2025		2026	
				Apr	Sep	Apr	Sep
Developing Asia	**4.5**	**5.5**	**5.1**	**4.9**	**4.8**	**4.7**	**4.5**
Developing Asia excluding the PRC	**5.8**	**5.6**	**5.1**	**5.0**	**4.9**	**5.1**	**4.8**
Caucasus and Central Asia	**5.2**	**5.4**	**5.7**	**5.4**	**5.5**	**5.0**	**4.9**
Armenia	12.6	8.3	5.9	5.0	5.0	4.7	4.7
Azerbaijan	4.7	1.4	4.1	3.4	2.4	3.3	2.0
Georgia	11.0	7.8	9.4	6.0	7.0	5.0	5.0
Kazakhstan	3.2	5.1	5.0	4.9	5.3	4.1	4.3
Kyrgyz Republic	9.0	9.0	9.0	8.5	8.3	8.6	8.4
Tajikistan	8.0	8.3	8.4	7.4	7.4	6.8	6.8
Turkmenistan	6.2	6.3	6.3	6.5	6.3	6.0	6.0
Uzbekistan	5.7	6.3	6.0	6.6	6.6	6.7	6.7
East Asia	**3.0**	**4.9**	**4.7**	**4.4**	**4.4**	**4.0**	**3.9**
People's Republic of China	3.1	5.4	5.0	4.7	4.7	4.3	4.3
Hong Kong, China	–3.7	3.2	2.5	2.3	2.2	2.5	2.0
Republic of Korea	2.7	1.6	2.0	1.5	0.8	1.9	1.6
Mongolia	5.0	7.4	5.1	6.6	5.7	5.9	5.7
Taipei,China	2.7	1.1	4.8	3.3	5.1	3.0	2.3
South Asia	**7.0**	**7.8**	**5.9**	**6.0**	**5.9**	**6.2**	**6.0**
Afghanistan	–20.7	–6.2	2.3	2.6	1.8	2.2	1.7
Bangladesh	7.1	5.8	4.2	3.9	4.0	5.1	5.0
Bhutan	5.2	4.6	7.5	8.5	8.1	6.0	6.0
India	7.6	9.2	6.5	6.7	6.5	6.8	6.5
Maldives	13.8	4.9	3.3	5.0	5.0	4.8	4.9
Nepal	5.6	2.0	3.7	4.4	4.6	5.1	3.0
Pakistan	6.2	–0.2	2.5	2.5	2.7	3.0	3.0
Sri Lanka	–7.3	–2.3	5.0	3.9	3.9	3.4	3.3
Southeast Asia	**5.7**	**4.1**	**4.8**	**4.7**	**4.3**	**4.7**	**4.3**
Brunei Darussalam	–1.6	1.1	4.2	2.5	1.0	2.0	1.5
Cambodia	5.1	5.0	6.0	6.1	4.9	6.2	5.0
Indonesia	5.3	5.0	5.0	5.0	4.9	5.1	5.0
Lao People's Democratic Republic	2.5	3.7	4.0	3.9	3.7	4.0	3.8
Malaysia	8.9	3.6	5.1	4.9	4.3	4.8	4.2
Myanmar	2.0	0.8	–0.7	1.1	–3.0	1.6	2.0
Philippines	7.6	5.5	5.7	6.0	5.6	6.1	5.7
Singapore	4.1	1.8	4.4	2.6	2.5	2.4	1.4
Thailand	2.6	2.0	2.5	2.8	2.0	2.9	1.6
Timor-Leste	4.0	2.4	4.1	4.0	3.8	3.8	3.4
Viet Nam	8.0	5.1	7.1	6.6	6.7	6.5	6.0
The Pacific	**7.9**	**5.3**	**3.8**	**3.9**	**4.1**	**3.6**	**3.4**
Cook Islands	10.9	14.0	14.0	8.1	10.4	2.9	2.5
Fiji	17.7	9.4	3.5	3.0	3.0	3.2	3.0
Kiribati	4.6	2.7	5.3	4.1	3.9	3.3	3.3
Marshall Islands	–1.1	–4.0	3.0	2.5	3.0	3.0	3.5
Federated States of Micronesia	–3.0	0.4	1.7	1.7	0.8	1.1	1.1
Nauru	3.0	0.6	1.8	2.5	2.3	2.5	2.5
Niue	0.1	6.1	8.7	3.4	3.4	3.0	3.0
Palau	–1.1	1.5	6.6	9.5	8.2	4.5	3.9
Papua New Guinea	5.7	3.8	4.0	4.2	4.6	3.8	3.6
Samoa	2.3	15.2	4.6	5.5	4.0	3.0	2.7
Solomon Islands	2.4	3.0	2.5	2.9	2.9	3.2	3.2
Tonga	–2.3	2.1	1.4	2.5	2.5	2.3	2.3
Tuvalu	0.7	3.7	3.3	2.7	2.7	2.5	2.5
Vanuatu	5.6	5.8	1.0	2.0	1.5	2.5	2.5

ADB = Asian Development Bank, PRC = People's Republic of China.

Notes: 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.

Source: *Asian Development Outlook* database.

Table A2 Inflation, % per Year

	2022	2023	2024	2025		2026	
				Apr	Sep	Apr	Sep
Developing Asia	**4.4**	**3.3**	**2.6**	**2.3**	**1.7**	**2.2**	**2.1**
Developing Asia excluding the PRC	**6.7**	**6.2**	**4.8**	**4.0**	**3.3**	**3.7**	**3.7**
Caucasus and Central Asia	**12.3**	**10.2**	**6.8**	**6.9**	**7.7**	**5.9**	**6.6**
Armenia	8.6	2.0	0.3	3.0	3.5	2.8	2.8
Azerbaijan	13.9	8.8	2.2	4.2	4.2	3.5	3.5
Georgia	11.9	2.5	1.1	4.0	4.0	3.5	3.5
Kazakhstan	15.0	14.5	8.7	8.2	10.5	6.5	8.4
Kyrgyz Republic	13.9	10.8	5.0	6.0	7.0	7.8	8.0
Tajikistan	4.2	3.8	3.6	5.0	4.5	5.8	5.2
Turkmenistan	3.0	1.3	5.5	6.0	4.0	6.0	5.0
Uzbekistan	11.4	10.0	9.4	8.0	8.0	7.0	7.0
East Asia	**2.3**	**0.6**	**0.5**	**0.6**	**0.3**	**0.9**	**0.6**
People's Republic of China	2.0	0.2	0.2	0.4	0.0	0.7	0.4
Hong Kong, China	1.9	2.1	1.7	1.9	1.6	2.0	1.6
Republic of Korea	5.1	3.6	2.3	1.9	1.9	1.9	1.9
Mongolia	15.1	10.4	6.2	9.1	8.6	7.0	7.2
Taipei,China	2.9	2.5	2.2	2.0	1.8	1.8	1.5
South Asia	**7.9**	**7.9**	**6.5**	**4.9**	**3.7**	**4.5**	**4.7**
Afghanistan	7.8	10.6	–7.7	–5.3	–4.2	5.0	1.0
Bangladesh	6.2	9.0	9.7	10.2	10.0	8.0	8.0
Bhutan	5.6	4.2	2.8	3.4	3.2	3.5	3.7
India	6.7	5.4	4.6	4.3	3.1	4.0	4.2
Maldives	2.3	2.9	1.4	4.7	4.5	2.2	3.5
Nepal	6.3	7.7	5.4	5.2	4.1	5.0	4.5
Pakistan	12.2	29.2	23.4	6.0	4.5	5.8	6.0
Sri Lanka	46.4	17.4	1.2	3.1	0.5	4.5	4.5
Southeast Asia	**5.2**	**4.2**	**3.0**	**3.0**	**2.5**	**2.8**	**2.7**
Brunei Darussalam	3.7	0.4	–0.4	0.5	–0.3	–0.2	0.5
Cambodia	5.3	2.1	0.8	3.7	2.0	2.4	2.0
Indonesia	4.1	3.7	2.3	2.0	1.7	2.0	2.0
Lao People's Democratic Republic	23.0	31.2	23.3	13.5	9.5	10.4	8.5
Malaysia	3.4	2.5	1.8	2.5	1.8	2.5	2.2
Myanmar	27.2	27.5	27.8	29.3	30.0	20.0	23.0
Philippines	5.8	6.0	3.2	3.0	1.8	3.0	3.0
Singapore	6.1	4.8	2.4	2.0	1.0	1.7	1.2
Thailand	6.1	1.2	0.4	1.0	0.5	1.1	0.8
Timor-Leste	7.0	8.4	2.1	2.9	1.2	2.6	1.9
Viet Nam	3.2	3.3	3.7	4.0	3.9	4.2	3.8
The Pacific	**5.2**	**3.1**	**1.9**	**3.4**	**3.0**	**3.7**	**3.4**
Cook Islands	3.6	13.2	4.6	2.3	2.0	2.0	2.8
Fiji	4.3	2.4	4.5	2.6	0.5	2.4	1.0
Kiribati	5.3	9.3	2.5	2.5	7.8	2.2	3.5
Marshall Islands	2.8	7.4	5.7	3.6	3.8	3.0	3.4
Federated States of Micronesia	5.0	6.2	5.4	3.0	3.9	2.7	3.2
Nauru	1.5	5.2	11.6	3.5	6.5	2.5	5.0
Niue	4.5	5.1	5.4	3.7	2.3	3.2	3.2
Palau	13.2	12.4	3.7	2.5	2.5	2.6	2.7
Papua New Guinea	5.3	2.3	0.6	3.8	3.8	4.3	4.3
Samoa	8.8	12.0	3.6	3.0	1.9	2.7	2.7
Solomon Islands	5.4	5.1	4.2	2.7	3.8	2.5	2.5
Tonga	6.8	12.6	8.0	3.2	3.0	3.0	3.0
Tuvalu	12.2	7.2	1.2	2.5	2.5	2.0	2.0
Vanuatu	6.7	11.2	1.1	3.5	1.5	2.4	2.4

ADB = Asian Development Bank, PRC = People's Republic of China.

Notes: 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.

Source: *Asian Development Outlook* database.

Asian Development Outlook September 2025

Growth Slows as a New Global Trade Environment Takes Shape

As a new global trade environment emerges, growth in Asia and the Pacific is set to slow slightly. The region's outlook will be shaped by offsetting factors. Higher US tariffs and elevated trade policy uncertainty will weigh on economic activity. Robust domestic demand, electronics and AI-driven exports, and policy support will help cushion external headwinds. Inflation will continue to moderate, as energy and food prices ease further. Downside risks stem from renewed tariff hikes, geopolitical tensions, further deterioration in the PRC's property market, and financial market volatility. Policymakers should intensify efforts to bolster resilience, relying on sound macroeconomic policies and fostering regional cooperation and integration.

About the Asian Development Bank

ADB is a leading multilateral development bank supporting inclusive, resilient, and sustainable growth across Asia and the Pacific. Working with its members and partners to solve complex challenges together, ADB harnesses innovative financial tools and strategic partnerships to transform lives, build quality infrastructure, and safeguard our planet. Founded in 1966, ADB is owned by 69 members—50 from the region.

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