

INTERNATIONAL MONETARY FUND

REGIONAL ECONOMIC OUTLOOK

ASIA AND PACIFIC

Navigating Trade Headwinds and
Rebalancing Growth

2025
OCT



Cataloging-in-Publication Data
IMF Library

Names: International Monetary Fund, publisher.

Title: Regional economic outlook. Asia and Pacific : navigating trade headwinds and rebalancing growth.

Other titles: Asia and Pacific : navigating trade headwinds and rebalancing growth. |

Navigating trade headwinds and rebalancing growth. | Regional economic outlook: Asia and Pacific.

Description: Washington, DC : International Monetary Fund, 2025. | Oct. 2025. | Includes bibliographical references.

Identifiers: ISBN:

9798229025881 (paper)

9798229025997 (ePub)

9798229026031 (Web PDF)

Subjects: LCSH: Economic forecasting—Asia. | Economic forecasting—Pacific Area. | Asia—Economic conditions. | Pacific Area—Economic conditions. | Economic development—Asia. | Economic development—Pacific Area.

Classification: LCC HC412.R44 2025

The *Regional Economic Outlook: Asia and Pacific* is published once a year, in the fall, to review developments in the Asia and the Pacific region. Both projections and policy considerations are those of the IMF staff and do not necessarily represent the views of the IMF, its Executive Board, or IMF Management.



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Acknowledgments

The *Regional Economic Outlook: Asia and the Pacific* was prepared by a team led by Li Cui and Andrea Pescatori, under the overall direction of Krishna Srinivasan and Thomas Helbling. Chapter 1 was prepared by Sakai Ando, Natalija Novta (lead), and Yuanyang Zhang (co-lead), with contributions from Sofia Felici, Adam Jakubik, Anne Oeking, Anoulat Sinthavy, Haruki Seitani, Yuting Wei, and Ying Xu. Chapter 2 was prepared by Chikako Baba (co-lead), Rahul Giri (co-lead), Michael Green, Ashique Habib, Sun Young Park, Weining Xin, and Xinrui Zhou, under the guidance of Andrea Pescatori. Chapter 3 was prepared by Rahul Giri (lead), Natalija Novta, Anne Oeking, Akshat Singh, Jeongwon Son, and Ying Xu, with contributions from Fei Han, Monica Petrescu and Tatjana Schulze, under the guidance of Li Cui. Outstanding research assistance was provided by Julia Estefania Flores, Vyshnavi Thumbala Saikrishnan, Ruihua Yang, Arthur Xie and Sofia Felici. Paige Brewer and Guli Gamwalla-Khadivi assisted with the preparation of the report. Cheryl Toksoz and Nokuthula Nkhoma of the IMF's Communications Department edited the volume and coordinated its publication and release. The report is based on data available as of September 29, 2025 or unless otherwise indicated, and includes comments from other IMF departments.

Definitions and Country Groupings

In this Regional Economic Outlook: Asia and Pacific, the following groupings are employed:

- “ASEAN” or “ASEAN-10” refers to Brunei Darussalam, Cambodia, Indonesia, Lao P.D.R., Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam, unless otherwise specified.
- “ASEAN-5” refers to Indonesia, Malaysia, the Philippines, Singapore, and Thailand.
- “Advanced Asia” refers to Australia, Hong Kong SAR, Japan, Korea, New Zealand, Singapore, and Taiwan Province of China, unless otherwise noted.
- “Emerging Asia” refers to China, India, Indonesia, Malaysia, the Philippines, Thailand, and Vietnam, unless otherwise noted.
- “Asia” refers to ASEAN, advanced Asia, Bangladesh, Bhutan, China, India, Maldives, Nepal, and Sri Lanka, and other Asian economies.
- “Regional Economic Outlook 14” represents the major 14 economies in Asia, including Australia, China, Hong Kong SAR, India, Indonesia, Japan, Korea, Malaysia, New Zealand, the Philippines, Singapore, Thailand, Taiwan POC, and Vietnam.
- International Organization for Standardization (ISO) country codes for Asia Pacific:

Australia	AUS	Bangladesh	BGD	Bhutan	BTN
Brunei Darussalam	BRN	Cambodia	KHM	China	CHN
Fiji	FJI	Hong Kong SAR	HKG	India	IND
Indonesia	IDN	Japan	JPN	Kiribati	KIR
Korea	KOR	Lao PDR	LAO	Macao SAR	MAC
Malaysia	MYS	Maldives	MDV	Marshall Islands	MHL
Micronesia	FSM	Mongolia	MGN	Myanmar	MMR
Nauru	NRU	Nepal	NPL	New Zealand	NZL
Palau	PLW	Papua New Guinea	PNG	Philippines	PHL
Samoa	WSM	Singapore	SGP	Sri Lanka	LKA
Solomon Islands	SLB	Taiwan POC	TWN	Thailand	THA
Timor-Leste	TLS	Tonga	TON	Tuvalu	TUV
Vanuatu	VUT	Vietnam	VNM		

The following conventions are used:

- In figures and tables, shaded areas show IMF projections.
- “Basis points” refer to hundredths of 1 percentage point (for example, 25 basis points are equivalent to ¼ of 1 percentage point).
- “Billion” means a thousand million; “trillion” means a thousand billion.

As used in this report, the term “country” does not in all cases refer to a territorial entity that is a state as understood by international law and practice. As used here, the term also covers some territorial entities that are not states but for which statistical data are maintained on a separate and independent basis.

Executive Summary

Economies in the Asia-Pacific region have shown resilience amid external and domestic challenges so far in 2025, posting stronger-than-expected economic growth in the first half of the year. Nevertheless, higher US tariffs and increasing protectionism will likely reduce demand for Asian exports and eventually weigh on growth in the near-term. Domestically, slowing growth trends and social tensions pose additional challenges. Amid these forces, reforms to make economic growth more resilient and sustainable will be critical.

Regional economic growth in the first half of 2025 benefitted from strong exports, partly due to frontloading in expectation of higher tariffs, and a buoyant tech cycle. Monetary and fiscal policy easing further supported domestic demand in the region, amid globally accommodative financial conditions and US dollar depreciation.

Despite a stronger-than-expected outcome in the first half of the year, Asia's GDP growth is expected to moderate somewhat in the second half, resulting in modestly lower annual growth of 4.5 percent in 2025 compared to 4.6 percent in 2024. Regional growth is projected to slow further to 4.1 percent in 2026, given the building negative effects of higher US tariffs and headwinds to medium-term potential growth. Risks to the regional outlook are tilted to the downside. While tariffs are lower than announced in April 2025 and tentative new trade deals are emerging, the full negative effect of the tariff increases is uncertain and the intensification of trade tensions continues to be a major downside risk for the region. While trade policy uncertainty has declined somewhat compared to April, it remains high and could weigh on investment and sentiment more than expected. Tighter financial conditions due to domestic or global developments could amplify trade shocks and compound vulnerabilities, and economic vulnerabilities could amplify social tensions. On the upside, the current AI-driven investment boom could deliver a stronger-than-expected boost to exports, investment, and productivity in the region. Further policy support could cushion the shocks more than expected and lift growth prospects. A reduction in geopolitical tensions would help reduce uncertainties and lift investment and productivity.

The external challenges have reinforced recent internal challenges in the region. Domestic demand, particularly consumption, remains below pre-pandemic trends in many countries. Persistent weaknesses in the service sector, property sector downturns, and sluggish consumer sentiment have contributed to a soft post-pandemic recovery in jobs and income growth, dampening consumption. Institutional constraints in the region, including limited scope for fiscal support because of high debt, inadequate social safety nets, or inefficiencies stemming from the financial structure, have hindered a broad-based recovery of domestic demand. In addition, while trade openness has supported growth in the manufacturing sector, broad-based productivity gains have stalled in recent years, along with a rise in capital misallocation.

These challenges underscore the need for Asian economies to make growth resilient and sustainable, by boosting domestic demand, particularly consumption, and reinvigorating productivity growth. In the near term, targeted fiscal and monetary policy should be used to smooth the impact of trade shocks and provide temporary support. At the same time, structural reforms are essential for enhancing the medium-term growth potential and rebalancing the economies. Such reforms should include measures to support the services sector; strengthen the efficiency of financial intermediation; reduce incentives for capital misallocation; and mitigate the impact of population aging. Meanwhile, greater intraregional trade and financial integration will enhance growth resilience and support financial development. Policy tools should also be upgraded. Fiscal reforms would help manage large spending pressures and prepare for future shocks. Emerging challenges and opportunities in artificial intelligence (AI) will need to be monitored and may call for refinement in regulatory frameworks.

1. Outlook for Asia and the Pacific¹

The Asia and the Pacific region remains the fastest growing region in the world, projected to contribute about 60 percent of global growth in 2025, despite external and domestic headwinds. Regional growth is projected to hold steady at 4.5 percent relative to 2024, and to decrease to 4.1 in 2026. This deceleration is smaller than predicted in April 2025, largely because of a lower increase in US effective tariff rates compared to announcements at the time. The steady growth in 2025 is supported by exports, the technology cycle, and policy easing, amid globally accommodative financial conditions. Despite the resilience, growth still faces challenges, given the less favorable external environment ahead and headwinds to medium-term potential growth. To safeguard resilient and sustainable growth, Asian policymakers will need to address both the near-term risks and the medium-term structural challenges, with a focus on strengthening domestic demand.

1.1 Recent Developments: Resilience amid Uncertainty

A Sobering Economic and Socio-Political Backdrop

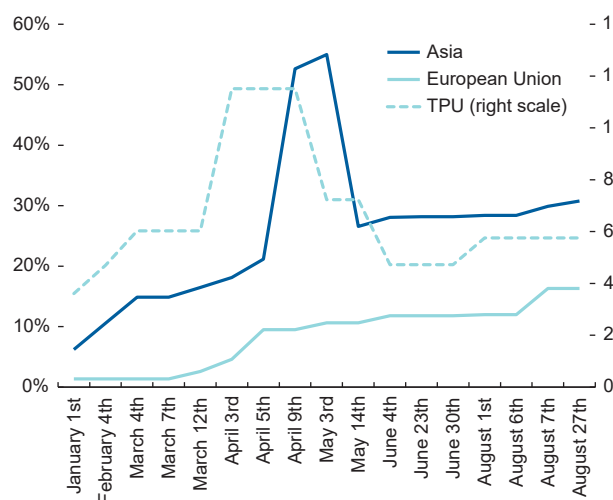
The Asia-Pacific region faces a challenging outlook, notably from sharply higher US tariffs and increased trade policy uncertainty. The sweeping US tariff increases announced on April 2, 2025—underpinning the highest effective US tariff rate in a century, with some of the steepest increases aimed at Asia—and the policy

Figure 1.1. Domestic and External Pressures

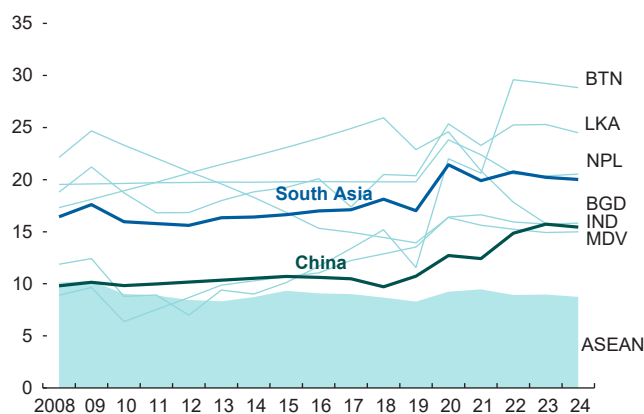
Uncertainty soared amid tariff announcements...

... and added to internal socio-political pressures

1. US Effective Tariffs and Trade Uncertainty
(Percent; index, right scale)



2. Youth Unemployment: Emerging and Developing Asia
(Percent)



Sources: World Trade Organization, International Labor Organization; Caldara and others (2020); and IMF staff calculations.

Note: The effective tariffs rates are weighted by US import value by country. Asia includes Australia, Bangladesh, Bhutan, Brunei Darussalam, Cambodia, China, Fiji, Hong Kong, China, India, Indonesia, Japan, Korea, Lao PDR, Macao, China, Malaysia, Papua New Guinea, the Philippines, Samoa, Singapore, Solomon Islands, Sri Lanka, Thailand, Timor-Leste, Tonga, Vanuatu, and Vietnam. The Trade Policy Uncertainty (TPU) index counts the monthly frequency of articles discussing trade policy uncertainty (as a share of the total number of news articles), normalized to 100 for a one percent article share. For Panel 2, "ASEAN" includes Indonesia, Malaysia, the Philippines, Thailand, and Vietnam.

¹ The authors of this chapter are Sakai Ando, Natalija Novta (lead), and Yuanyang Zhang (co-lead), with contributions from Sofia Felici, Adam Jakubik, Anne Oeking, Anoulat Sinthavy, Haruki Seitani, Yuting Wei, and Ying Xu, with outstanding research support from Sofia Felici, Vyshnavi Thumbala Saikrishnan, and Ruihua Yang and under the guidance of Li Cui and Andrea Pescatori.

actions that ensued, are redefining the geoeconomic landscape and reshaping patterns in global trade and foreign direct investment (FDI). Given the region's deep integration into global value chains, and the rising exposure to United States demand in recent years, the Asia Pacific region is particularly vulnerable to such shifts in trade policy shocks. Some of the tariff shocks turned out to be smaller than expected in April, as some tariff increases were paused or reduced amid negotiations, and a number of preliminary trade agreements between the United States and countries in the region have been reached. Nevertheless, tariffs for some other countries increased markedly in August, and the level of trade policy uncertainty continues to be high (see Figure 1.1, panel 1).

These global conditions are placing additional pressure on a region that has been experiencing slowing growth and increased social tensions in recent years. Subdued productivity growth and population aging have tempered potential growth in several countries in the region. Moreover, after benefiting from spectacular growth in China and integration in global value chains, countries in the region now face spillovers from weakened demand in China due to property sector adjustment and weak consumption. Moreover, deflationary pressures in China and the attendant decline in its export prices have had negative spillovers for some countries in the region, notably in the Association of Southeast Asian Nations (ASEAN) region. More recently, rising youth unemployment and dissatisfaction with political leadership have undermined sentiment and fueled social strains in several countries (see Figure 1.1, panel 2). As a result, economic growth decelerated to a rate in the current decade so far that is about 1.8 percentage points below that of average in the 2010s—0.9 in advanced Asia and 2.3 in emerging Asia. Despite the challenges, Asia has remained the fastest growth region in the world, contributing about 60 percent of global growth in 2024.

Notwithstanding the sobering backdrop, growth in Asia-Pacific was more resilient than expected in the first half of 2025. The resilience of growth in 2025H1 was supported by strong exports, in part reflecting frontloading ahead of higher US tariffs, and policy easing. Across most countries in the region, growth outturns in the first half of 2025 exceeded expectations relative to the April 2025 *World Economic Outlook*. Anticipation of US tariffs spurred a surge in exports early this year which, after temporary disruptions in April, kept net exports a key driver of growth. At the same time, monetary easing across most Asian economies coupled with looser fiscal policy in some countries, helped sustain domestic demand and cushion the trade shock (see Figure 1.2).

While exports to the United States slowed mid-year, consistent with a possible fading of frontloading, Asian exports overall have remained strong. After accelerating from 2024 through early 2025, Asian shipments to the United States lost momentum in Q2 but exports to the region and elsewhere remain robust (Figure 1.3, panels 1 and 2). Export prices—excluding China—have largely stayed firm, suggesting that most exporters have not cut prices in response to tariffs, with exceptions in some sectors such as Japanese car exporters (Figure 1.3, panel 3). Purchasing Manager's Index (PMI) new export orders mostly remain subdued since April, reflecting exporters' cautious outlook amid uncertainty (Figure 1.3, panel 4). The impact of the tariffs will continue to be felt in the region, with recent ones—like the increase on India in August 2025—requiring time to assess their full impact.

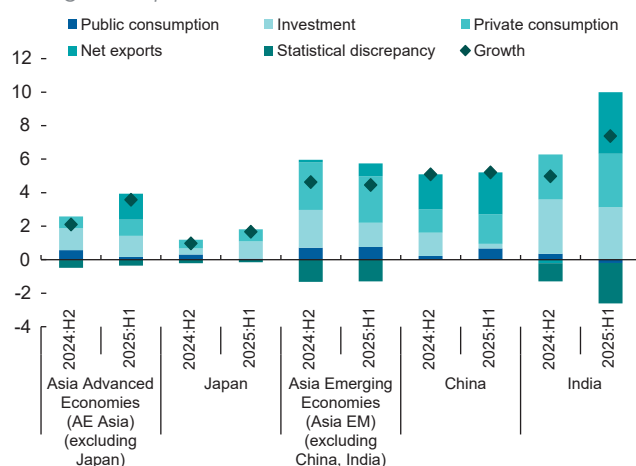
Trade friction with the United States and the strong artificial intelligence (AI)-driven tech cycle have contributed to rising intra-regional trade. China's exports to the United States, as a share of its total exports, have continued to decline, furthering the trend of diversification since 2018, while the share to Asian trade partners has increased, largely reflecting a redirection of intermediate goods to ASEAN for further processing. Similar to the 2018 tariffs episode, there is little evidence that plain trade rerouting is driving these shifts (Schulze and Xin 2025). The increase in intraregional trade has also been supported by Asian advanced economies—particularly Korea, Japan, and Taiwan POC, whose exports have been benefited from the AI-related global investment boom (October 2025 *World Economic Outlook*, Chapter 1) and related demand for tech products. Other Asian emerging markets, particularly in the ASEAN, have also increased their export shares to both

Figure 1.2. Macroeconomic Conditions

Growth has been buoyed by net exports...

1. Contributions to GDP Growth

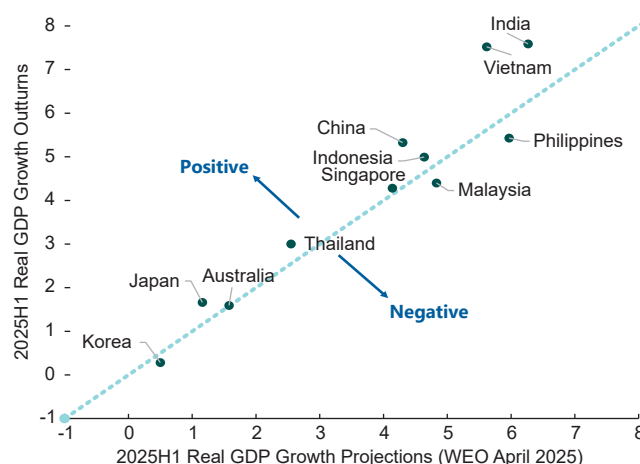
(YoY growth; percent)



... and exceeded expectations in 2025H1

2. Growth Surprises

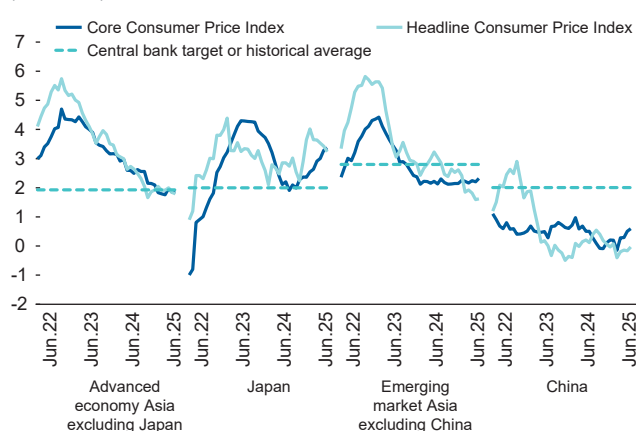
(Percent)



But inflation remains below target in emerging markets...

3. Headline and Core Inflation

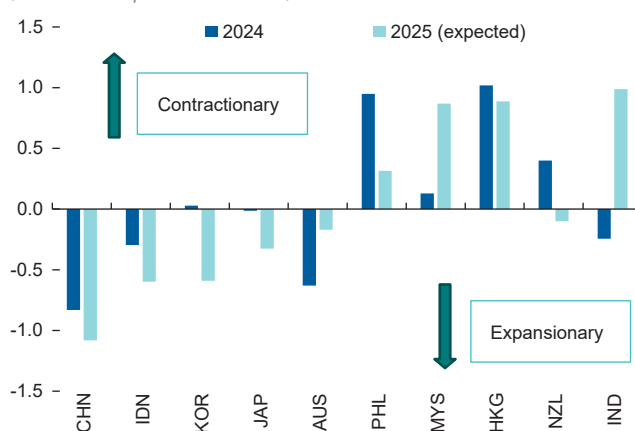
(Percent)



... prompting some countries to introduce fiscal support

4. Fiscal Impulse

(Percent of potential GDP)



Sources: Haver Analytics; WTO; and IMF staff calculations.

Note: For panel 1, AE Asia includes: AUS, HKG, KOR, NZL, SGP, and TWN. EM Asia includes: IDN, MYS, PHL, and THA. Data is not seasonally adjusted, except for China. For panel 3, Core Consumer Price Index (Core CPI) definitions vary slightly across economies.

Historical average is used for HKG, CHN, MYS, VNM, otherwise inflation target (or midpoint of target range) is used. For panel 4, the fiscal impulse is calculated based on the difference in the general government cyclically adjusted primary balance as percent of potential fiscal year GDP relative to the year before.

China and other Asian economies in 2025, likely facilitated by free-trade agreements and infrastructure connectivity projects. FDI into ASEAN economies has stayed strong and announcements of future investment suggest that companies continue to pursue supply chain diversification in the region (see Figure 1.3, panels 5 and 6).

Domestic Demand Has Remained Soft in Most of the Region despite Macro Policy Support...

Despite some improvements, domestic demand has remained soft in many Asian economies. Contributions to growth in 2025H1 from domestic demand have been steady or declining, with the exception of Japan (see Figure 1.2, panel 1). Despite recent improvements, retail sales growth generally remains below pre-pandemic

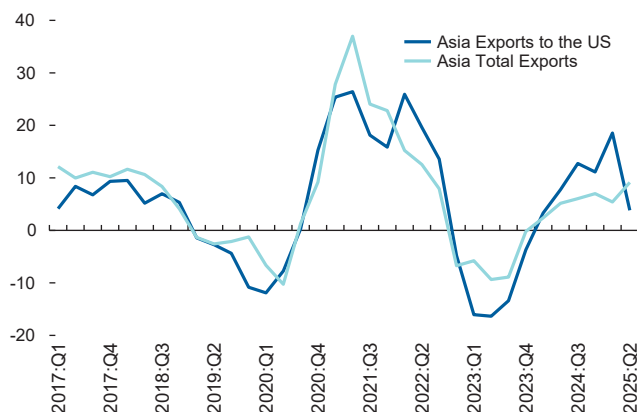
Figure 1.3. External Developments

Asian exports stayed solid despite waning frontloading...

... supported also by growing intraregional trade

1. Asia Exports

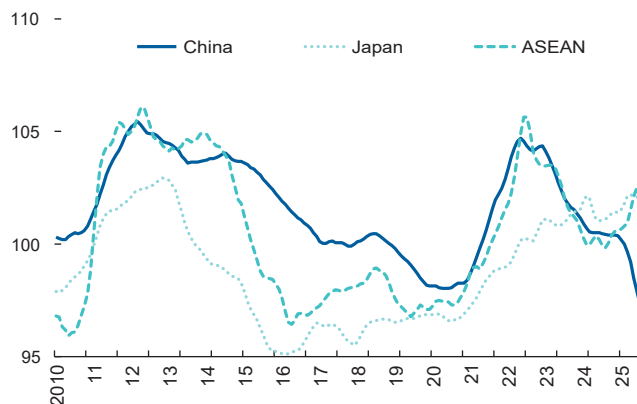
(YoY growth; percent)



Import prices from Asia mostly held up despite tariffs...

3. US Import Prices by Area

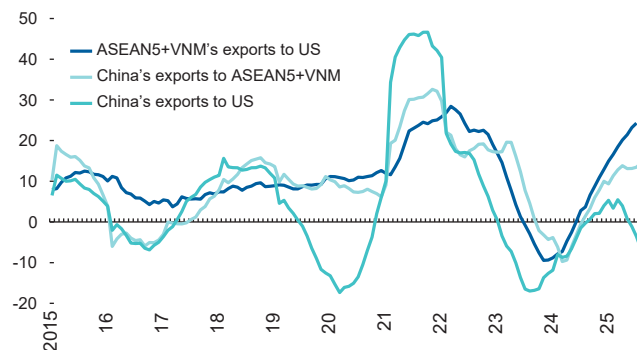
(Index, Dec 2003 = 100, 3-month moving average)



Supply chain reconfiguration continues...

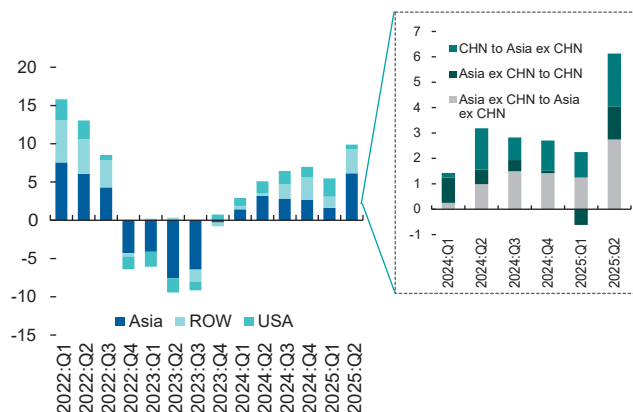
5. Supply Chain Trade

(YoY growth, percent, 12-month moving average)



2. Regional Economic Outlook 14: Strength in Regional Trade

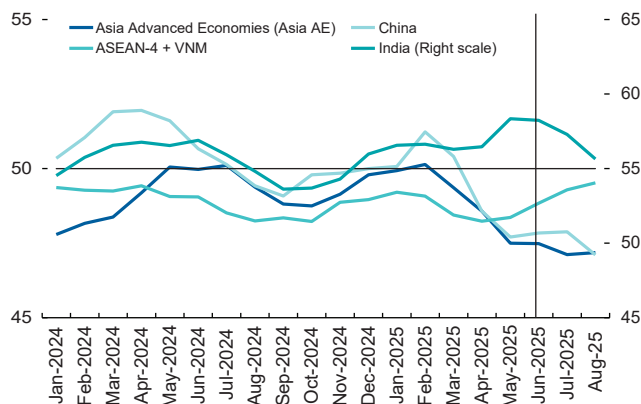
(Percent)



... but exporters are cautious about new orders

4. Manufacturing PMI: New Export Orders

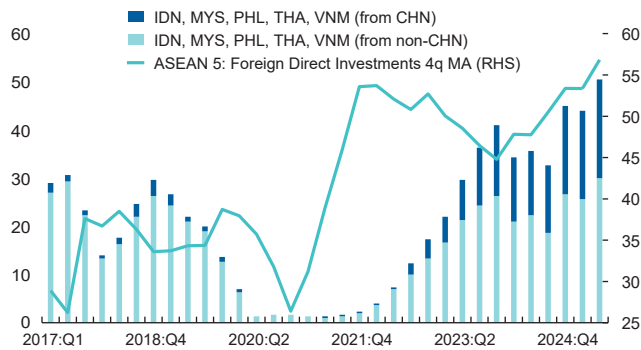
(Index, 50 = no change, 3-month moving average)



... bolstered by continued FDI in the region

6. FDI Announcements

(Number of announcements; Right scale - NSA, \$ billions)



Sources: Haver Analytics; Trade Data Monitor, WTO; Cross-border Orbis Data and IMF staff calculations.

Notes: For panel 1, US imports exclude pharmaceuticals. For panel 2, year-over-year contributions to regional export growth by destination for the 14 major economies in Asia Pacific are shown, with an additional focus on within APD trade. For panel 3, US import price from Japan is indexed as 2000=100. For panel 4, ASEAN-4 includes IDN, MYS, PHL, and THA. Asia AE includes AUS, KOR, JPN, and TWN POC. For panel 5, ASEAN5 includes IDN, MYS, PHL, THA, and SGP. For panel 6, the chart shows announcements of FDI projects in Indonesia, Malaysia, the Philippines, Thailand, and Vietnam from China and from all other origin countries.

average, reflecting weak consumer confidence (see Figure 1.4, panel 1). Soft domestic demand and negative output gaps have contributed to inflation being below target in many Asian emerging markets (see Figure 1.2, panel 3), with some exceptions (for example, India).

Monetary and fiscal policies have been eased in many countries. In response to tariffs or to support demand more broadly, some countries (for example China, Korea, Indonesia) introduced fiscal stimulus measures. For most countries, the 2025 fiscal impulse is more expansionary than in 2024 (see Figure 1.2, panel 4). In some cases, automatic stabilizers help cushion cyclical fluctuations (for example Australia), while in some others the fiscal impulse is contractionary to offset previous increases in spending (for example, Hong Kong SAR). Most Asian economies have also eased monetary policy in response to low inflation. Policy easing helped offset some of the headwinds from the uncertain trade environment and supported income and growth. With inflation above target and wage growth strengthening, the Bank of Japan (BOJ) is gradually raising its policy rate, with the most recent hike in January.

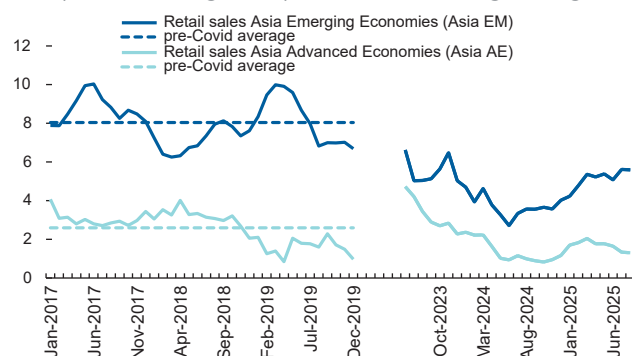
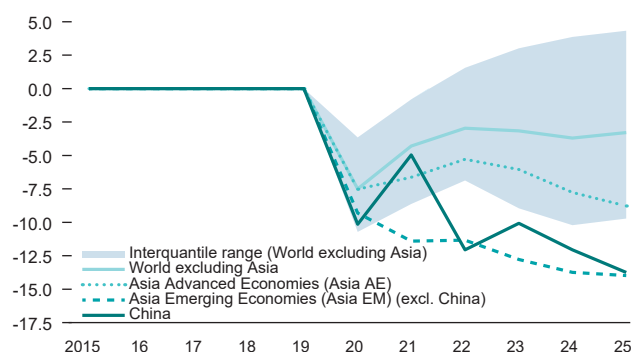
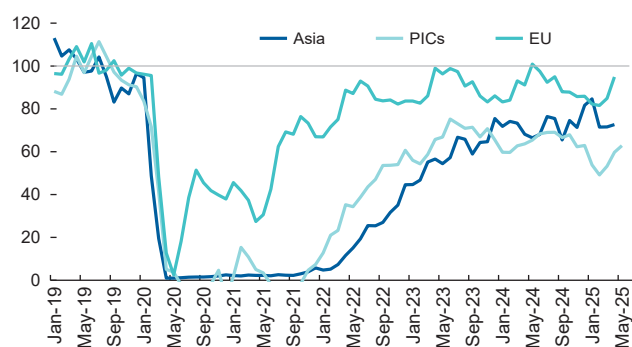
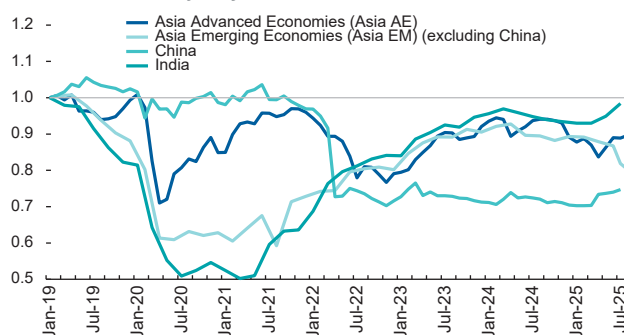
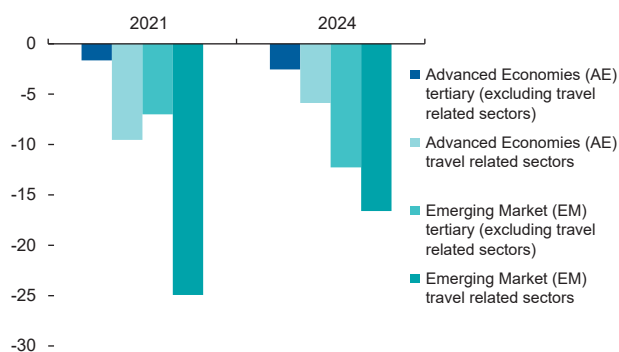
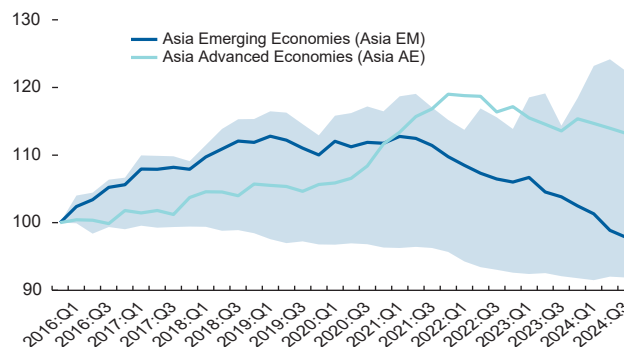
... Reflecting a Combination of Cyclical and Structural Factors

In large emerging markets in Asia, private consumption is still firmly below the pre-pandemic trends. Persistent weaknesses in the service sector, particularly trade, transport and accommodation, have been a headwind to job and income growth (see Figure 1.4, panels 3 and 4). Tourist arrivals in Asian economies have recovered more slowly than in other regions and are still persistently below the 2015–19 trend (see Figure 1.4, panel 5). The recovery has been held back by several factors, including fewer Chinese tourists (for example, in the Philippines, Thailand, Cambodia, Palau) and country-specific shocks (for example, earthquake and liquidation of the national airline in Vanuatu). High household debt and a downturn in the housing cycle have also dampened consumer demand and construction activities in some countries (for example, Thailand, New Zealand, China, Cambodia) (see Figure 1.4, panel 6). In some countries (for example, Australia, New Zealand), tight credit conditions have contributed to demand weakness. Institutional and structural challenges in the region—such as limited scope for fiscal support because of high public debt, inadequate social safety nets, and inefficiencies in financial intermediation (see Chapter 3)—have contributed to the slow post-pandemic recovery of domestic demand.

Asian Financial Conditions Eased, Aided by a Weak Dollar

Financial conditions have broadly eased. Despite geopolitical tensions in the Middle East and following a brief but sharp tightening in April because of trade policy uncertainty, financial conditions have eased in Asia and globally in 2025 (October 2025 *Global Financial Stability Report*). As elsewhere, the easing reflected lower corporate spreads and, to different degrees, buoyant equity markets and a weaker US dollar. Unlike in advanced economies, the easing in Asian emerging markets also reflected declines in 10-year government bond yields (see Figure 1.5, panels 1 and 2). The latter was also led by decreasing term premia in Asian emerging market economies. The decrease started in 2023, driven primarily by domestic factors such as soft inflation, defying trends in other markets (see Figure 1.5, panel 3). The decline in corporate bond spreads has partly reflected inflows into emerging markets bonds (see below). Asian equities were mixed, with pockets of somewhat stretched asset valuations as well as pockets of potential undervaluation relative to historical trends (for example in some ASEAN countries), based on forward price-to-earnings ratio. Market volatility measures have generally declined, notwithstanding policy uncertainty remaining elevated.

While generally appreciating against the US dollar, real exchange rate performance in Asia diverged in 2025. Currencies in advanced Asia generally appreciated against the dollar but, except for the Japanese yen, remained broadly stable in real effective terms, given broader dollar weakness (see Figure 1.5, panels 4 and 6). Some emerging market currencies in the region appreciated against the dollar but depreciated in nominal and real effective terms, reflecting soft domestic cyclical conditions and a relatively more accommodative domestic monetary policy stance. Since the Chinese renminbi has remained relatively stable against the US dollar in 2025, movements of other Asian currencies against the renminbi have been similar to those against the US dollar. Portfolio inflows to Asian emerging markets have resumed in recent months with the weaker dollar, recovering some of the losses in early 2025.

Figure 1.4. Domestic Demand*Retail sales growth is still below pre-COVID averages...***1. Retail Sales***(YoY percent change, simple 3-month moving average)**Consumption weakness is longer and deeper in Asia***3. Real Private Consumption Deviation from Trend**
(Percentage points)*Tourism recovered slowly and remains below trend...***5. Tourist Arrivals***(Index, pre-pandemic trend=100)**... and consumer confidence is weak***2. Consumer Confidence***(Index, seasonally adjusted, 2019 Jan=1)**... with timid recovery in services hindering job growth***4. Service Sector Real Gross Value Added, Deviation from Pre-pandemic Trend**
(Percentage points)*... and housing downturn further weighing on demand***6. Real Housing Prices***(Index, 2016Q1=100, weighted average)*

Sources: Haver Analytics; World Economic Outlook Database, Tourism Tracker Database; and IMF staff calculations.

Note: AE = advanced economy; EM= emerging market. For Panel 1, Asia AE: AUS, JPN, KOR, NZL, SGP, and TWN. Asia EM: CHN, IDN, IND, MYS, and VNM. In panel 2, Asia AE: AUS, JPN; EM (excluding China): IND, IDN, THA. Panel 3 shows medians for country aggregates, and the 25th/75th percentile for the world distribution excluding Asia. For Panel 3 and 4, pre-pandemic trend is based on 2015–19, and charts show cumulative changes. In panel 4, travel related sectors include wholesale and retail trade, accommodation, and transportation sectors. Data for Japan and India are until 2023. For panel 5, Asia includes 17 countries that are not Pacific Island Countries (PICs). PICs include Fiji, Palau, Samoa, Solomon Islands, Tonga, Tuvalu, Vanuatu, and Kiribati. In panel 6, the shaded area represents the max-min range for CHN, IDN, IND, MYS, PHL, and THA. Values are weighted by countries' GDP.

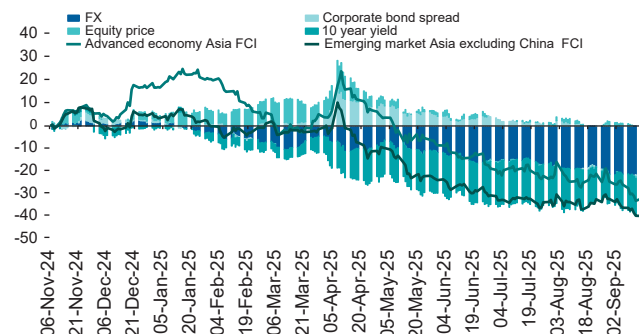
Figure 1.5. Financial Conditions, Exchange Rates, and Capital Flows

After brief turbulence, financial conditions eased...

... with lower rates contributing more to easing in Asia

1. Financial Conditions Index Decomposition for Emerging Market Asia excluding China

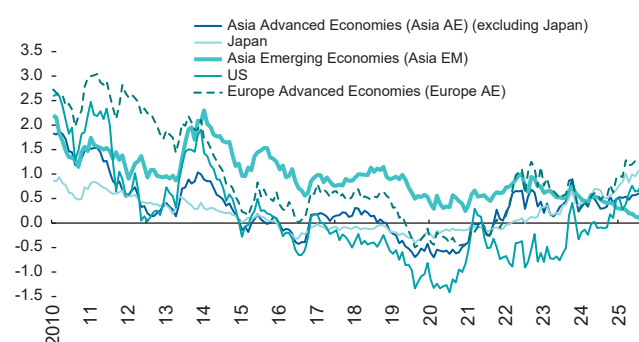
(+: tighter conditions, -: looser conditions)



Term premia compressed in EMs, while rising elsewhere

3. Term Premium, 10-year Government Bonds

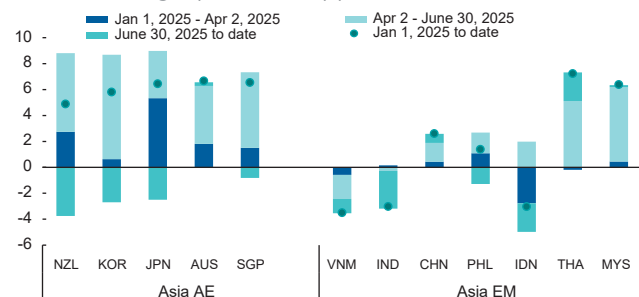
(Percent)



Asian currencies mostly appreciated against the dollar...

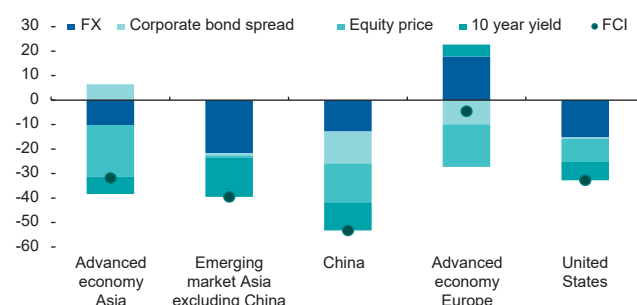
5. Exchange Rates against the US Dollar

(Percent change, positive = appreciation)



2. Financial Conditions across the World

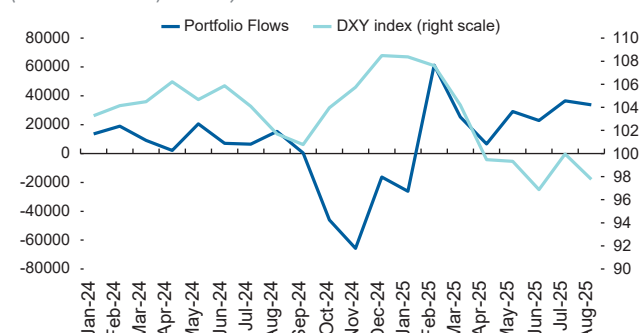
(+: tighter conditions, -: looser conditions)



Portfolio flows resumed, aided by a weak U.S. dollar

4. US Dollar and Capital Flows to Emerging Market Asia

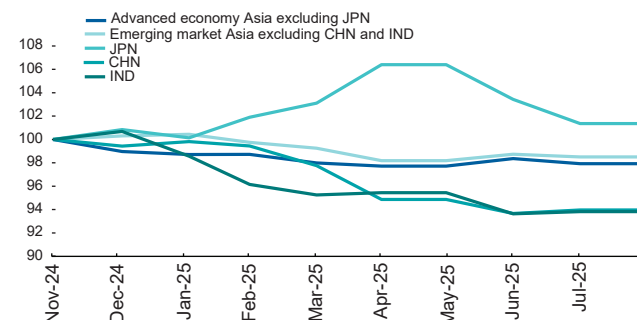
(USD millions; Index)



... but not against other trading partners

6. Real Effective Exchange Rates

(November 2024 = 100)



Sources: Bloomberg Finance L.P. Institute of International Finance and IMF staff calculations.

Note: Construct individual country-level cumulative changes in Financial Condition Index (FCI) taking stock market capitalization as weights. Domestic currency appreciation (NEER), an increase in 10-year yields and spreads, and lower equity prices contribute to tighter financial conditions. The FCI captures the cumulative change in financial variables normalized by the standard deviation of daily changes. The data is as of September 15, 2025, and is cumulative since November 6, 2024. AE Asia includes HKG, SGP, and KOR; EM Asia includes IDN, IND, MYS, PHL, and THA. AE Europe includes Austria, France, Germany, Italy, and Spain. For panel 4, all countries include equity, and debt flows with the exception of MYS, LKA, PHL, and VNM where debt data is unavailable. EM Asia includes CHN, IND, IDN, MYS, LKA, PHL, THA, and VNM. For panel 5, exchange rate data as of September 22, 2025. For panel 6, REER, data as of August 17, 2025 Data labels in the figure and Note use International Organization for Standardization (ISO) country codes. AE = advanced economy; EM = emerging market.

1.2 Outlook and Risks

Trade Policy Shifts and Persistent policy Uncertainty Cloud Asia's Prospects

Growth in Asia is expected to hold broadly steady in 2025 and moderate noticeably in 2026, given building negative effects of higher US tariffs and headwinds to medium-term potential growth. Reflecting the higher tariffs and higher trade policy uncertainty, GDP growth forecasts for most Asian countries in 2025 and 2026 are below those of October 2024—China and India being notable exceptions. Empirical analysis (see Box 1.1) shows that a one-standard-deviation increase in US trade policy uncertainty reduces investment in Asia by about 1 percent in the near term—with effects about twice as large in emerging market economies. So far, this drag has been partly offset by the AI-driven investment boom, which is expected to continue both this and next year. Relative to the April 2025 reference scenario, the current growth forecasts for 2025-26 are higher, as effective tariffs turned out lower than the initial tariff announcements for most economies. As noted in previous *Asia Pacific Regional Economic Outlooks*, headwinds to the medium-term growth potential, including from rapid population aging, are expected to influence growth outcomes to greater extent. Nevertheless, as in recent years, Asia is projected to continue to contribute around 60 percent of global growth in 2025 and 2026. Inflation is expected to stay soft in 2025 in most emerging markets and move closer to targets in 2026.

The overall balance of risks remains tilted to the downside, with further escalation of trade tensions being a key concern. While effective US tariffs on Asian economies are lower than initially announced, US agreements with some Asian countries are still under negotiation, with the possibility of higher tariffs. Prospects for supply chain diversification are subject to uncertainty, given recent ongoing trade policy shifts. A high share of Chinese value added embedded in regional exports (see Figure 1.6, panel 1) leaves many countries exposed to potential “transshipment” tariffs. Higher tariffs and still-elevated trade policy uncertainty and renewed escalation of tensions could further dampen confidence and investment. In Asia, the decline in China's export prices may risk negative spillovers to regional economies, especially in ASEAN (see Figure 1.6, panel 2).

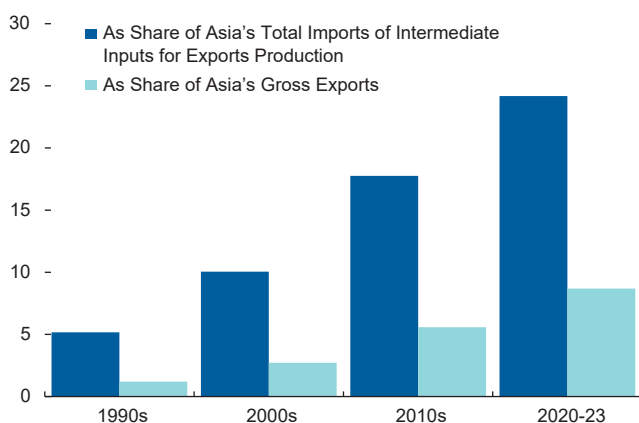
Figure 1.6. Spillovers from China

Rising share of Chinese value added in regional exports

Decline in China's export prices may affect some countries

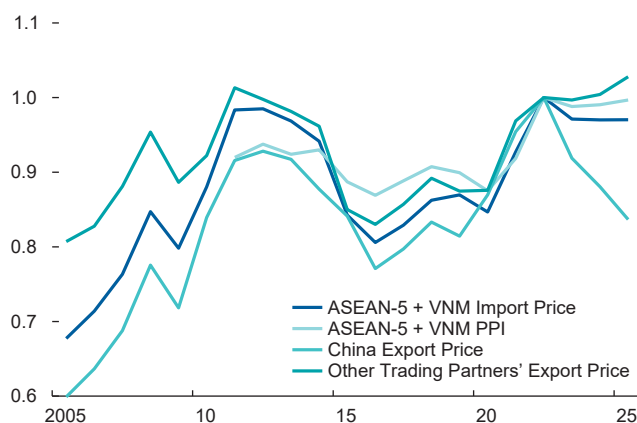
1. Asia's Imports of Intermediate Inputs from China for Exports Production

(Percentage points)



2. China's Export versus. ASEAN Import Prices and PPI

(Index 2022 = 1)



Sources: World Economic Outlook Database, Eora Global Supply Chain Database and Aslam, Novta and Rodrigues-Bastos (2017); and IMF staff calculations.

Note: For Panel 1, see October 2024 *Asia-Pacific Regional Economic Outlook* for more details. For Panel 2, other main trading partners include the United States, Hong Kong, Japan, Taiwan POC, India, Australia, Germany, France, Italy, United Kingdom, and Switzerland.

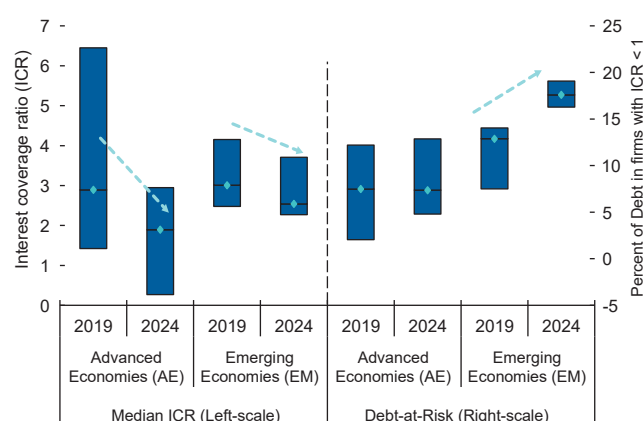
Tighter financial conditions could amplify the impact of trade and demand shocks... While financial conditions in Asia remain accommodative, they could reverse if trade policy uncertainty or geopolitical tensions intensify, or if there is a correction in investor optimism about AI prospects (Figure 1.7, panel 3). A sharp risk-off event in global financial markets could raise external borrowing costs, especially for frontier economies in the region, and put pressure on weaker currencies. In emerging market economies, a reversal of recent term-premium declines or a repricing of inflation expectations could raise yields and worsen debt dynamics (see Box 1.2).

... and increase debt vulnerabilities. A combination of rising debt-service costs and soft domestic demand could create a negative macro-financial feedback loop and further increase debt burdens (see Figure 1.8, panel 4). Easy financial conditions have benefited the corporate sector, including the low productivity

Figure 1.7. Risks

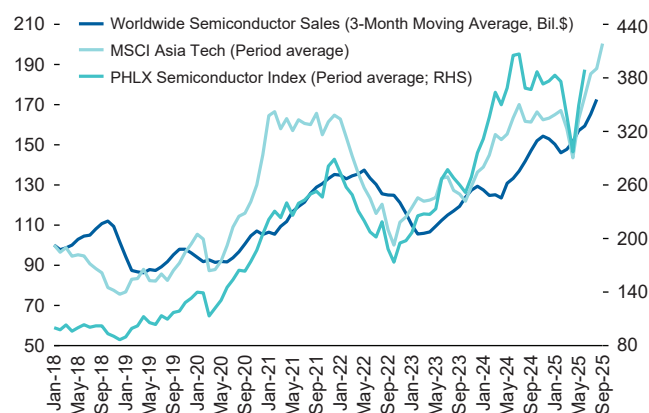
Corporate debt-at-risk has increased...

1. Asia: Corporate Debt Servicing Capacity
(Year-over-year)



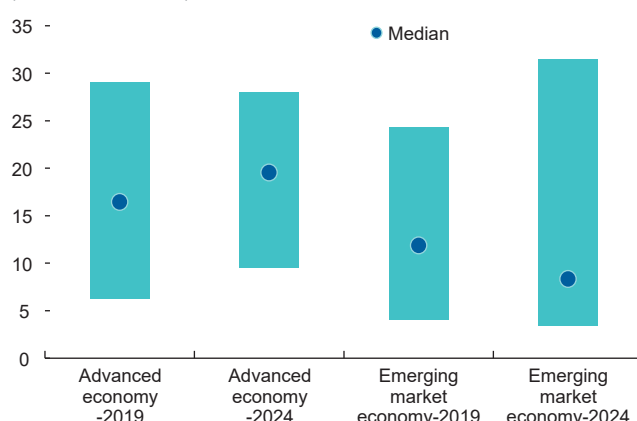
Stretched AI asset valuations pose downside risks...

3. Tech Cycle
(Index)



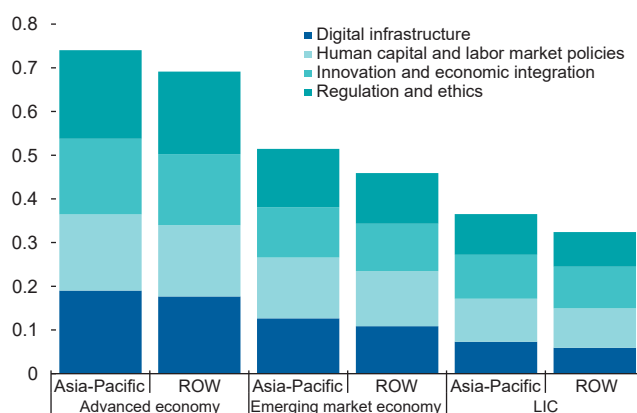
... and some countries face external debt pressures

2. Asia: External Debt of Non-Government and Non-Bank Sectors
(Percent of GDP)



... but AI adoption may also boost productivity over time

4. Artificial Intelligence Preparedness
(Index, average within each group)



Source: Cazzaniga and others (2024), S&P Capital IQ, World Economic Outlook Database, Quarterly External Debt Statistics, Global Financial Stability Report, Haver Analytics; and IMF staff calculations.

Note: For Panel 1, Debt-at-Risk shows the share of total debt held by firms with an Interest Coverage Ratio (ICR) below 1. Median ICR represents the distribution of median value across countries. Firm-level ICR is calculated using the four-quarter average. Underlying variables and calculated ICR are winsorized at 5%. Financial sector excluded; real estate sector included. For panel 2, the chart shows the median, and the minimum-maximum range for each group. For panel 4, ROW = rest of the world. AE = advanced economy; APD = Asia and Pacific Department; EM = emerging market; LIC = low-income country; PPP = public-private partnership; ROW = rest of the world.

“zombie firms” (see Chapter 3). Even so, corporate debt-at-risk in Asian emerging markets has climbed (see Figure 1.7, panel 1), driven by weak demand and property sector issues. Several ASEAN countries face increased external debt exposure (see Figure 1.7, panel 2), and rollover risks and balance sheet distress may arise from external tightening. Meanwhile, rapid population aging adds to long-term fiscal pressures across much of the region.

Economic or debt pressures could amplify socio-political challenges in the region. Weak growth, income gaps, and governance issues have led to demands for greater transparency of public services and more economic opportunities, with rising discontent and protests across the region in recent months. A severe downturn would heighten these tensions and disproportionately impact vulnerable groups that lack adequate access to social safety nets. A decline in international aid from some partners, and climate shocks, could impact smaller, low-income countries, particularly Pacific island countries, hindering growth and public finances.

There are also upside risks to the baseline projections. A stronger-than-expected AI cycle could lead to higher investment and exports, particularly in countries with strong exposure to the tech cycle. The adoption of AI could raise productivity more than projected, especially as the region demonstrates above average AI preparedness (see Figure 1.7, panel 4). Countries may also provide additional macroeconomic policy support to buttress domestic demand or implement more productivity-enhancing structural reforms, including, but not limited to further trade and financial integration, which could boost regional growth. Moreover, a reduction in geopolitical or trade tensions would help reduce uncertainty and boost investment and productivity. Box 1.3 quantifies the impact of selected risks around the baseline using the Fund’s Global Integrated Monetary and Fiscal (GIMF) model, providing a model-based illustration of potential downside and upside scenarios—including higher or lower tariffs and higher productivity growth due to faster AI adoption.

Country Groups

Advanced Economies

Growth in advanced Asia is forecast at 1.6 percent in 2025, broadly unchanged from 2024, and though with heterogeneity across countries.

- *Japan’s* growth is projected to increase to 1.1 percent in 2025, from 0.1 percent in 2024, reflecting strong private consumption and investment, and the recent rise in real wage growth expected to support consumption in the second half of the year. The forecast for 2025 is 0.5 percentage points higher than in the April 2025 *World Economic Outlook*, reflecting greater-than-expected resilience of domestic and external demand in the first half of the year. Growth in 2026 is projected to moderate to 0.6 percent.
- *Australia and New Zealand* are also strengthening relative to 2024, with private domestic demand expected to accelerate in 2025 and 2026 as monetary policy continues to ease. In 2025, GDP growth is projected at 1.8 percent in Australia and 0.8 in New Zealand, up from 1.0 and –0.6 percent in 2024 for the respective countries.
- In other Asian advanced economies, GDP growth is slowing relative to 2024 and revised down relative to October 2024. In *Korea*, GDP is expected to grow at 0.9 percent in 2025, down from 2.0 percent in 2024, and lower than the April 2025 forecast because of prolonged political and trade policy uncertainties in the first half of the year.
- *Inflation in advanced Asia* is forecast at 2.5 percent in 2025, slightly down from 2.6 percent in 2024, and projected to decline further towards central bank targets in 2026 with a projection of 2.1 percent. In *Japan*, inflation is projected at 3.3 percent in 2025, with an expected decline to 2.1 percent in 2026. In most other AEs, inflation softened in 2025.

Emerging Market Economies

Growth in Emerging Asia is projected to slow to 5.2 percent in 2025, from 5.3 percent in 2024, largely because of higher tariffs and trade policy uncertainty.

- *China's* growth is expected to moderate to 4.8 percent in 2025, from 5.0 percent in 2024. The 2025 forecast has been revised up relative to April 2025, thanks to stronger exports and the impact of increased fiscal stimulus. The lift from export frontloading in early 2025 is expected to be followed by a payback in late 2025 and early 2026, with growth projected to moderate to 4.2 percent in 2026.
- *India* economy is projected to expand at 6.6 percent this year, slightly up from 6.5 percent in 2024. The forecast has improved since April 2025 as strong Q2 growth and the goods and services tax (GST) reform are expected to outweigh the negative effects of higher US tariffs on demand for Indian goods. Growth is expected to moderate to 6.2 percent in 2026.
- Growth in countries of the *ASEAN* is expected to slow to 4.3 percent in 2025 from 4.8 percent in 2024. This is an upward revision of 0.3 percentage points relative to the April 2025 forecast, thanks to lower effective tariffs, stronger demand from trading partners and easier financial conditions.
- *Disinflation in emerging Asia* is expected to continue in 2025, with a forecast of 1.6 percent, down from 2 percent in 2024, driven by soft domestic demand and weakness in services inflation. Inflation is expected to go back to 2 percent in 2026, moving toward central bank targets in most countries. In *China*, inflation is forecast at 0 percent in 2025, down from 0.2 in 2024. Weak domestic demand has contributed to low inflation in China, though 2026 inflation is projected at 0.7 with a recovery in domestic demand.

Frontier Economies and Small States

GDP growth in frontier economies and small states is moderating, largely because of tariff-related external demand shocks.

- In *Bangladesh*, growth in FY2025 is projected at 3.8 percent, which is a downward revision relative to October 2024 as a result of political uncertainty, tighter policy stance and subdued investment. In *Mongolia*, 2025 GDP growth is forecast at 5.5 percent, a strengthening relative to 2024 because of a strong rebound in agriculture, but still lower than projected in October 2024. In *Nepal*, 2025:H1 GDP growth strengthened relative to 2024 and is projected at 4.3 percent, owing to stronger-than-expected recovery post-floods, but still lower than projected in October 2024 because of subdued domestic demand.
- In *Pacific Island Countries* 2025 GDP growth (simple average) is projected to moderate to 2.9 percent from 3.6 percent in 2024, which is a small downgrade relative to the forecasts in October 2024 and April 2025 *World Economic Outlook of the* mainly because of idiosyncratic factors.

1.3 Policies

The evolving global environment underscores the urgent need for policies to make growth more resilient and sustainable. Domestic demand, particularly consumption, has remained soft, making the region more susceptible to changes in global demand and trade policies. In addition, while trade openness has supported growth in the manufacturing sector, broad-based productivity gains have stalled in recent years, along with a rise in capital misallocation. Both macro-policy support and structural reforms are needed to help Asian countries navigate the challenging global environment.

Macro Policies Should Focus on Absorbing Shocks and Reducing Uncertainty...

- **Monetary policy easing is appropriate in countries with inflation below target.** Additional easing may be expected in many countries to bring inflation back to target and ensure that inflation expectations are well anchored (see Figure 1.8, panel 1). The weakening US dollar has helped reduce capital outflow pressures for countries in the region, providing additional room for policy rate cuts where needed. In Japan, gradual normalization of monetary policy can support inflation's convergence toward the 2 percent target if the baseline forecast materializes. Exchange rate flexibility should be the first line of defense in case of shocks, though judicious use of foreign exchange (FX) intervention—if needed to maintain stability—could be pursued in line with the Fund's integrated policy framework.

- In some countries, temporary and targeted fiscal measures could support demand and help vulnerable groups affected by the tariff shock.** The near-term fiscal stance should be calibrated to individual country circumstances. China, Korea, and Vietnam have introduced sizable fiscal packages to support demand and fund priority programs announced before the tariff shock. In countries with high public debt, expansionary fiscal policy needs to be balanced with medium-term consolidation efforts to preserve debt sustainability. Improving the adequacy and coverage of social safety nets in Asia, especially for the population in the bottom 20 percent of the income distribution, which has a high propensity to consume, could help support domestic demand (see Figure 1.8, panels 2-4).

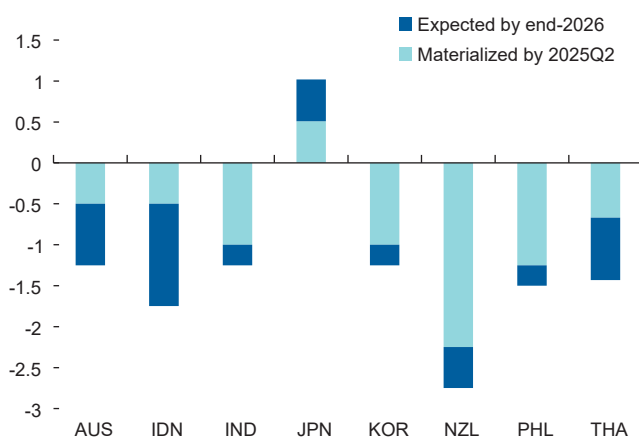
Figure 1.8. Monetary and Fiscal Policy, and Structural Reforms

Monetary policy is expected to ease in most countries...

... in addition to near-term fiscal support

1. Cumulative Policy Rate Changes since Peak

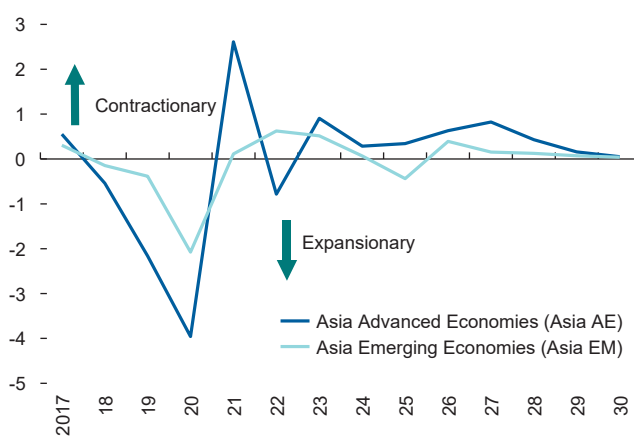
(Percentage Points, quarterly average)



Improving social safety nets could help support demand

2. Fiscal Impulse over Time

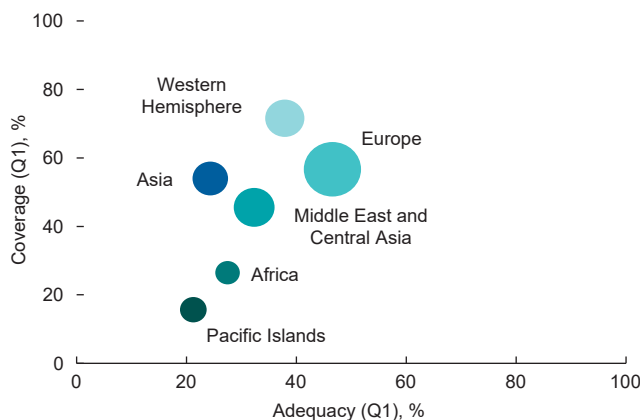
(Percent of potential GDP, simple average)



Fiscal support to be balanced with consolidation needs

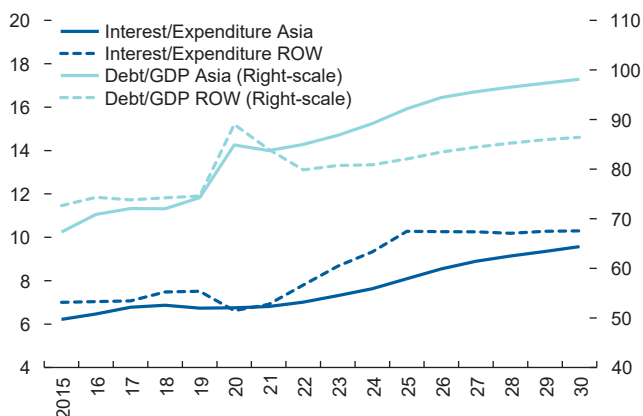
3. Social Safety Nets in Asia

(Percent)



4. Public Debt and Interest Expenses Over Time

(Percent, PPP GDP weighted average)



Sources: Bloomberg Finance L.P., Haver Analytics, World Economic Outlook Database, World Bank ASPIRE Database, CPIS, CDIS, DOTS; and IMF staff calculations.

Notes: For panel 1 Japan data shows the cumulative policy rate changes since trough. "Materialized" reflects cumulative policy rate changes from the peak through 2025:Q2. "Expected" represents staff projections for cumulative policy rate changes from 2025:Q3 until end-2026, except for THA (Bloomberg). For panel 2, The fiscal impulse measures the difference in the general government cyclically adjusted primary balance as percent of potential fiscal year GDP relative to the previous year. For panel 3, Simple averages of a sample of 94 countries. Data refers to the most recent year available. Bubble size represents the difference between poverty pre and post transfers. Adequacy refers to the size of transfer. For panel 4, APD sample includes 38 economies, and the ROW sample includes 158 countries.

... While Structural Reforms Are Needed to Create New Opportunities

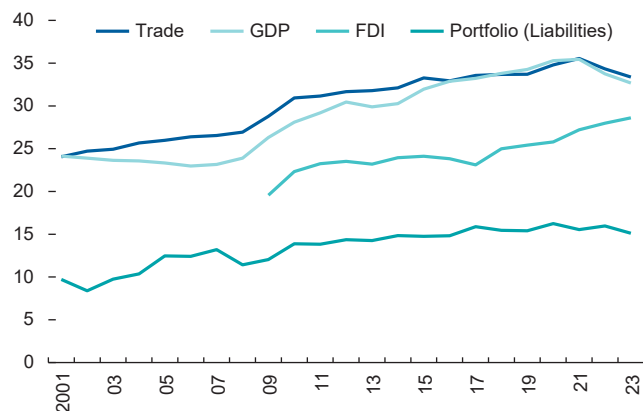
Countries in Asia would benefit from promptly addressing structural impediments to growth. The challenging global environment offers a chance to accelerate reforms to address economic imbalances, boost productivity, and enhance resilience.

- **Structural policies to support continued expansion of the service sector are essential for economic rebalancing.** The structural transformation towards services has slowed in recent years, partly affected by the COVID-19 pandemic, limiting job and income recovery. Continued international integration could boost tradable services, such as education and training that are important for labor to adapt to new technologies (November 2024 *Regional Economic Outlook: Asia and the Pacific*). As credit allocation historically favored manufacturing and real estate, reforms to improve financial intermediation and capital market development are essential to channel credit into more productive service sectors.
- **Financial reforms would boost returns on investment and lift growth.** The decline in productivity growth in recent years has been associated with rising capital misallocation. Diversifying the financial structure, including through capital market development, would help relax financial constraints that may stem from insufficient scale of financing or inadequate financial instruments, and support productive firms and innovation (see Chapter 3). Both private and public debts have risen since the pandemic and evergreening corporate borrowing has increased, weighing on growth and productivity. While macroprudential intervention in real estate and other high-risk credit segments should be used to contain systemic risks, dedicated strategies will help reduce risks from high debt morphing into debt overhangs. Thailand and Korea have introduced measures to tackle household debt. The Chinese authorities have taken steps to refinance developer and Local Government Financing Vehicles (LGFV) debt, but more is needed to restructure non-viable entities.
- **Fiscal reforms are essential to manage large spending pressures and prepare for future shocks.** This requires upgrading medium-term frameworks to anchor budgets and help build transparency while allowing more gradual fiscal adjustment in some countries. It also calls for expanding fiscal coverage to include public banks, SOEs, and subnational governments, given substantial policy support delivered through these entities in Asia. Developing a broader view of the public balance sheet would help better design policies and assess and manage vulnerabilities (IMF 2024). In small and low-income states, the potential decline in international aid flows calls for renewed efforts to mobilize domestic revenues, and where needed, reprioritize spending.
- **Labor market policy reform is needed to mitigate demographic pressures that will intensify in many Asian countries.** Projections indicate rapidly diminishing labor supply over the medium to long term because of aging in major Asian economies such as China, Japan, and Korea, which will dampen potential growth (October 2024 *Regional Economic Outlook: Asia and the Pacific*, Analytical Note). On the demand side, ageing and population decline is expected to curb consumption, with a shift in the composition of consumption toward more old-age services (for example, health) and away from young-age services (for example, education). Policies to increase labor force participation, enhance employee training, and integrate foreign workers could help manage the gradual transition.
- **Advances in AI can lift potential growth but also pose new socio-economic challenges.** These advances offer opportunities to boost productivity growth and offset the negative impact from aging in Asia. However, AI adoption could also increase inequality, exacerbate productivity gaps between large firms that lead in AI adoption and SMEs, and displace workers (IMF 2025). Policies to support AI integration and adoption in SMEs and increase labor market capacity to adapt to AI, including through reskilling, job switching, and strengthening social safety nets, would help to address these challenges.

Greater Regional Trade and Financial Integration Could Further Boost Growth

Further regional trade integration through lower barriers to trade and investments could yield substantial dividends. Asia-Pacific economies tend to maintain more extensive non-tariff barriers, possibly reflecting fractured and shallow trade agreements. Removing intra-regional barriers to trade—even unilaterally—would have positive effects on competition, productivity and growth (see Chapter 2). Coupled with stronger

Figure 1.9. Asia's Share in Global GDP, Trade, FDI and FPI
(Percent)



Sources: CPIS; CDIS; Dot; World Economic Outlook Database; and IMF staff calculations

Note: FDI = Foreign direct investment, FPI = Foreign portfolio investment.

regional demand, it will enable economies to diversify export markets and reduce costs, offsetting some of the headwinds from the tariff shocks. In addition, lowering FDI restrictions and enhancing competitiveness can help attract shifting supply chains.

Deeper regional financial integration could help reduce vulnerabilities to global financial shocks and support financial development. While advanced economies in Asia are well integrated into global financial markets, Asian emerging markets are mostly integrated through cross-border banking and could benefit from further linkages, including FDI and capital markets (see Figure 1.9) (Alonso and others, forthcoming). Further financial integration could improve access to finance and boost productivity, which is crucial at the current juncture, but reforms need to be carefully sequenced to minimize potential amplification of common shocks.

Box 1.1. The Impact of Trade Policy Uncertainty on Trade and Investment

Trade policy uncertainty (TPU) surged to historical highs in 2025 and remains elevated. It peaked in April after the announcement of new US tariffs on strategic sectors (see Figure 1.1, panel 1). Although these measures were later paused, TPU has stayed high across various indicators. Persistent uncertainty makes assessing its impact especially relevant for Asia-Pacific economies.

Uncertainty can affect economic activity through different channels. The real options channel suggests that when firms face heightened uncertainty about the policy environment, they postpone irreversible investments until clarity returns (Bernanke 1983; Pindyck 1991; Dixit and Pindyck 1994), implying a transitory decline in investment. By contrast, the risk premium channel emphasizes that uncertainty raises the required return on investment, increasing discount rates and lowering firm valuations (Cochrane 2005). This raises the cost of capital and can result in a more persistent reduction in investment, particularly for marginal projects.

This box quantifies the short-term effects of TPU on investment, exports, and exchange rates. To capture the relevant uncertainty for the region, the analysis employs a new bilateral TPU index based on text analysis of news reports. Unlike measures derived from corporate earnings calls—which are limited to economies with large capital markets—this approach allows coverage of smaller Asia-Pacific economies. The index focuses specifically on trade with the United States, Asia’s key final demand partner, and shows especially pronounced spikes, with the average TPU shock across the region reaching five standard deviations. While the new measure co-moves with existing TPU indicators at the regional level, it is particularly effective in capturing country-level variation.

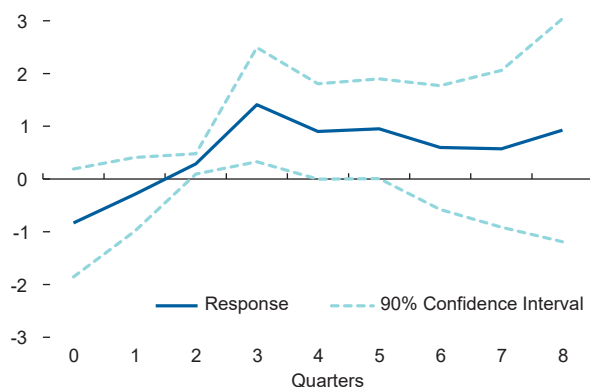
Empirical estimates confirm that TPU has significant effects on investment¹. Based on a panel of Asia-Pacific economies from January 1995 to April 2025, a one standard deviation increase in TPU leads to a 1 percent decline in investment within the same quarter. The effect is statistically significant for up to three quarters, consistent with the real options mechanism. Applying the recent shock size of five standard deviations implies a temporary 5 percent decline in investment. The effect is stronger in emerging markets—about twice as large as in advanced economies—possibly reflecting more limited ability to hedge or manage uncertainty (see Figure 1.1.1 and Figure 1.1.2).

By contrast, the short-term effect on exports is limited. This is not inconsistent with theory, as the TPU index captures increases in uncertainty (the second moment) rather than changes in average tariffs (the first moment). Over longer horizons—about 40 months—the decline in investment translates into weaker export capacity, pointing to indirect but meaningful spillovers from TPU to trade performance (see Figure 1.1.3).

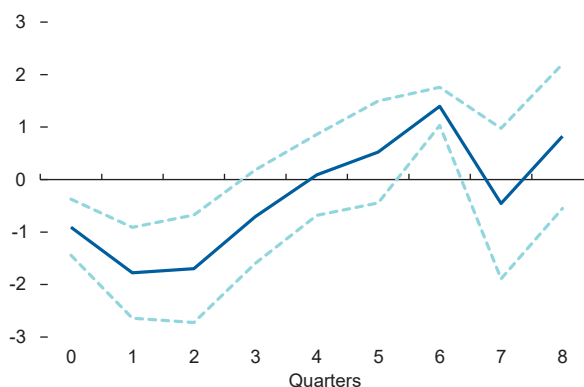
There is no evidence of trade frontloading in response to TPU spikes. Likewise, there is no systematic impact on the US dollar–bilateral and effective exchange rate measures show no material movement around TPU episodes. Imports from the United States into Asia-Pacific economies also, typically, remain broadly stable. These patterns suggest that the primary macroeconomic effects of TPU operate through domestic investment responses rather than immediate adjustments in trade flows or exchange rates.

The authors of this box are Sakai Ando, Sofia Felici, Adam Jakubik, Andrea Pescatori, and Yuting Wei.

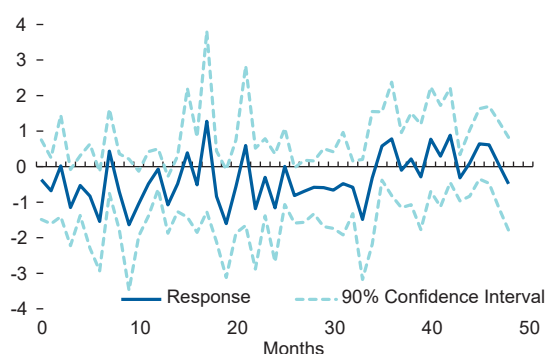
¹ The analysis uses a panel local projections framework covering 16 Asia-Pacific economies from January 1995 to April 2025. The dependent variables are the log differences of bilateral imports (monthly frequency), investment, and household consumption (quarterly frequency). All specifications include partner-country and time fixed effects. Figures report the percent response to a one-standard-deviation TPU shock, with dashed lines indicating 90 percent confidence intervals based on country-clustered standard errors.

Box 1.1. (continued)**Figure 1.1.1****Impulse Response Of Asia AE's Real Investments To TPU***(percentage points, response to one standard deviation)*

Sources: World Economic Outlook; and IMF staff estimates.
 Note: Asia AEs include Australia, Japan, Korea, New Zealand, and Singapore. AE = advanced economy; EM = emerging market; TPU = trade policy uncertainty.

Figure 1.1.2**Impulse Response Of Asia EM's Real Investments To TPU***(percentage points, response to one standard deviation)*

Sources: World Economic Outlook; and IMF staff estimates.
 Note: Asia EMs include Brunei, Cambodia, China, India, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Thailand, and Vietnam. AE = advanced economy; EM = emerging market; TPU = trade policy uncertainty.

Figure 1.1.3**Impulse Response Of Asia's Exports To US To TPU***(percentage points, response to one standard deviation)*

Sources: World Economic Outlook; and IMF staff estimates.

Historical evidence shows that spikes in TPU have a clear negative impact on investment, with potentially longer lasting effects if uncertainty persists. Policymakers should remain alert to these risks, while recognizing that timely macroeconomic support and structural policies can help offset some of the drag. The overall impact will also hinge on the evolution of tariff measures themselves, which vary across countries and sectors, implying heterogeneous outcomes and the need for tailored policy responses across Asia.

Box 1.2. Financial Spillovers to Asia Pacific¹

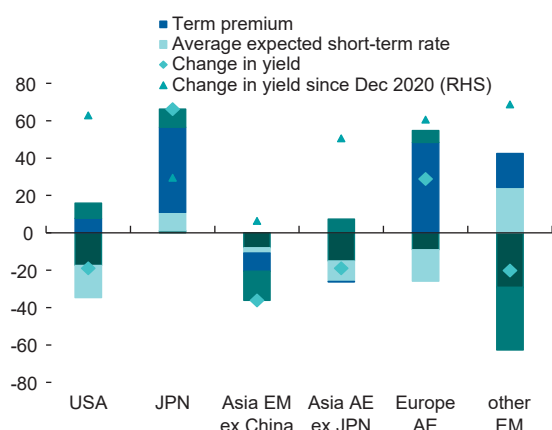
Globally and regionally, government bond yields of major economies have trended upwards since the pandemic, with a few seeing significant increases in recent months (see Figure 1.1.2). Such moves have raised questions about spillovers to Asian markets, as external tightening of financing conditions in the past tended to have negative impacts on the region. More specifically, global long-term rates could affect local borrowing costs, investor risk appetite, and exchange rates. When global investors require more compensation to hold long bonds, financing tends to get tighter. We look at these spillovers to judge how exposed Asian markets are today and whether policy buffers are well placed.

It is important to differentiate factors driving up the yields of major global economies. A decomposition of the long-term yields into two key elements, term premia and the expected policy path, shows that the recent change has been due not only to expected changes in policy rates, but also to an increase in term premia. The latter could reflect heightened uncertainty around the policy outlook, increased fiscal issuance, and shifts in global risk appetite, which affect different countries to varying degrees.² We examine the spillover of global yields into regional markets, distinguishing these two channels. Our main findings:

- Global rates affect Asia's long-term rates. Heightened global term premia have put upward pressure on regional term premia. But lower expected external policy rates—particularly in the US—and country-specific conditions—local inflation prospects, foreign exchange (FX) volatility, and domestic policy rates—have provided an offsetting force (see Figure 1.2.2).

Figure 1.2.1

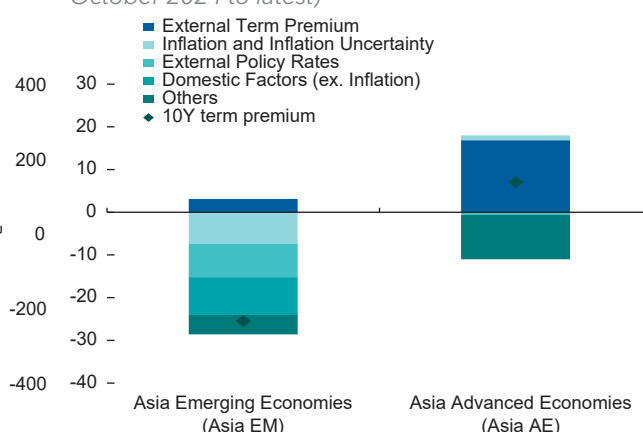
Changes in Long-term Yield Decomposition
(Basis points from Oct. 2024 to Aug. 2025)



Sources: Haver Analytics; IMF, World Economic Outlook Database, Refinitiv Eikon; and IMF staff calculations. Notes: Asia EMs include India, Indonesia, Malaysia, and Thailand. Asia AEs include Australia, New Zealand, and Korea, based on a simple country average. Solid color represents change from October 2024 to March 2025, patterns represent change from March 2025 to August 2025. Based on 10-year maturities. Decomposition based on a Gaussian Dynamic Term Structure Model. AE = advanced economy; EM = emerging market.

Figure 1.2.2

Term Premium Decomposition in Asia-Pacific
(average year-over-year percentage point change, October 2024 to latest)



Sources: Haver Analytics; CEIC; IMF, World Economic Outlook Database, Refinitiv Eikon; and IMF staff calculations. Notes: EMs include India, Indonesia, Malaysia, and Thailand. AEs include Australia, Korea, and New Zealand. Estimated by a linear regression of individual countries' 10-year term premia on global and local factors over November 2002 to June 2025. Global factors are proxied using 10-year term premia and policy rates from the United States and Japan, the latter purged of the US impact. Other factors include time trends and residuals. AE = advanced economy; EM = emerging market.

¹ The authors of this box are Anne Oeking, Anoulath Sinthavy, Haruki Seitani, and Ying Xu.

² Following standard asset-pricing theory (Cochrane 2005), long-term yields can be decomposed into expected short rates and a term premium—the compensation investors require for bearing duration risk.

Box 1.2. (continued)

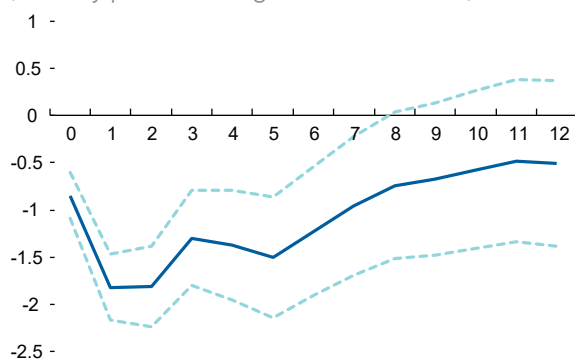
- On equities and FX market, we show that when global investors mark up the expected path of policy rates (risk-neutral long rates), Asian equities often rise, and currencies strengthen—consistent with better global growth expectations. By contrast, when global investors demand more compensation for holding duration (a higher term premium), equities soften, and currencies tend to weaken (see Figures 1.2.3 and 1.2.4).
- Across the board, the spillovers into real activity and inflation are modest over the horizons we study, suggesting that recent waves have been absorbed mainly within financial markets rather than spilling heavily into the real economy.

The region has been mostly shielded from global financial spillovers in the past few months. This has been supported by domestic cyclical conditions but also reflects deeper local-currency bond markets and stronger domestic policy frameworks that have anchored inflation expectations and curbed FX market volatility.³ Still, Asia is not immune to sharp global repricing. Policies should focus on keeping domestic anchors strong, continuing to build market depth so shocks are absorbed rather than amplified, and maintaining FX/liquidity buffers to manage bouts of volatility.

Figure 1.2.3

Effects of global term premium shock on regional stock prices

(Monthly percent change to a 1 S.D. shock)

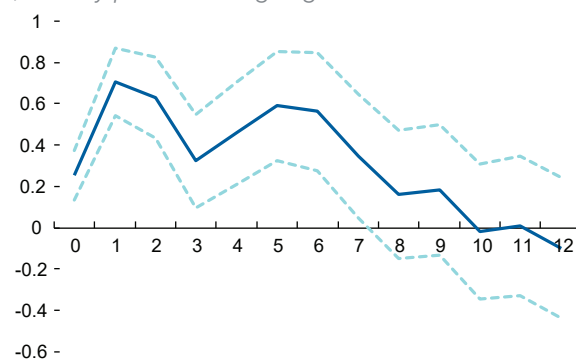


Sources: Haver Analytics; IMF, World Economic Outlook Database, Refinitiv Eikon; and IMF staff calculations.
Note: Estimated by panel local projections with country-fixed effects using individual countries' lagged macro-financial variables and global PMI as controls. The data cover eight countries (Australia, China, India, Indonesia, Korea, Malaysia, New Zealand, Thailand) over August 2005–April 2025. S.D. = standard deviation.

Figure 1.2.4

Effects of global term premium shock on regional exchange rates

(Monthly percent change against USD to a 1 S.D. shock)



Sources: Haver Analytics; IMF, World Economic Outlook Database, Refinitiv Eikon; and IMF staff calculations.
Notes: Estimated by panel local projections with country-fixed effects using individual countries' lagged macro-financial variables and global PMI as controls. The data cover eight countries (Australia, China, India, Indonesia, Korea, Malaysia, New Zealand, Thailand) over August 2005–April 2025. Positive values refer to local currency depreciation. S.D. = standard deviation.

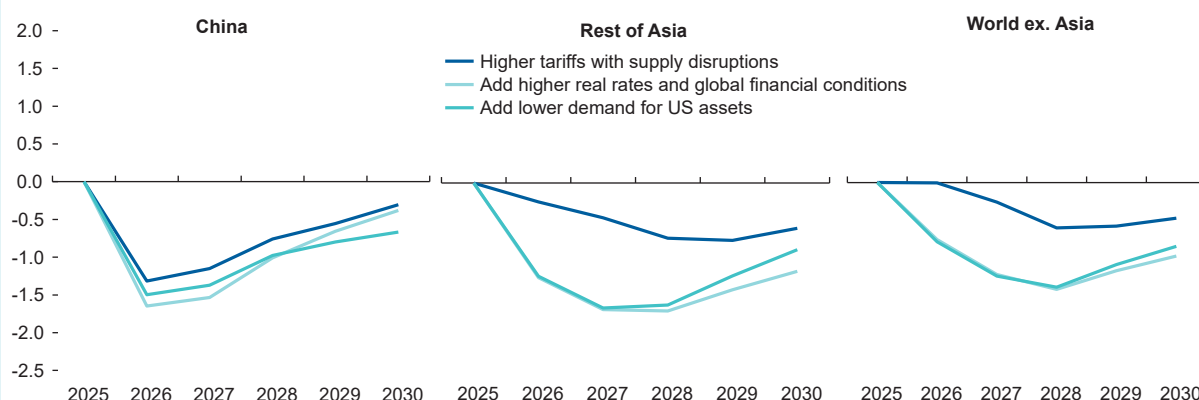
³ For example, regional local-currency bond markets have been expanding even as foreign investors pull back, and broader financial development has continued to advance. On average across regional EMs, local-currency government debt increased from 26.5 to 44 percent of GDP over the past decade, while foreign holdings of local-currency government bonds dropped from a peak of around 20 percent in 2011 to around 10 percent now.

Box 1.3. Risk Assessment: A Scenario Analysis for Asia¹

To assess risks around the baseline, the *Regional Economic Outlook* employs the Fund's Global Integrated Monetary and Fiscal (GIMF) model to simulate two multi-layered scenarios—a downside (Scenario A) and an upside (Scenario B)—drawing on the global analysis in Box 1.2 of the October 2025 *World Economic Outlook*. In both cases, monetary policy reacts endogenously, with most regions assumed to have flexible exchange rates, while in Scenario A China's exchange rate is managed through capital flow measures.

Scenario A (Downside). The scenario assumes an additional permanent increase of US tariffs—by 10 percentage points on average, and by 30 percentage points on imports from China—without retaliation. Global supply chains are temporarily disrupted, lowering world total factor productivity by about 1 percent in 2026–27. Sovereign yields rise by 100 basis points through higher term premia (except in China), while corporate spreads widen, more markedly in emerging markets. Finally, reduced foreign demand for US assets raises US risk premia.

Figure 1.3.1. Downside Scenarios
(GDP, percent deviation from baseline)



Source: IMF staff estimates.

Note: The scenarios are cumulative; each layer builds on the previous one. The vertical scale is consistent across all three panels. Rest of Asia refers to Asia excluding China.

In scenario A higher tariffs reduce global goods demand, the impact on Asia is felt mostly in China—because of higher tariffs—where output drops by –1.3 percentage points relative to baseline after one year (Figure 1.3.1). In the Rest of Asia, output declines more modestly by –0.3 percent in 2026, but the downturn deepens over time, reaching a trough of –0.8 percent in 2029. A more moderate pattern is observed outside Asia, with output declining by up to –0.6 percent, on average, over the 2028–2030 period.

Global tighter financial conditions amplify the effects of tariffs shocks across the region, particularly in emerging Asia, reflecting both a sharper widening of corporate spreads and investment compression from higher interest rates. GDP in the Rest of Asia declines by up to 1.7 percent in 2027–28, while China's contraction reaches 1.6 percent already in 2026.

¹ The authors of this box are Sofia Felici and Andrea Pescatori.

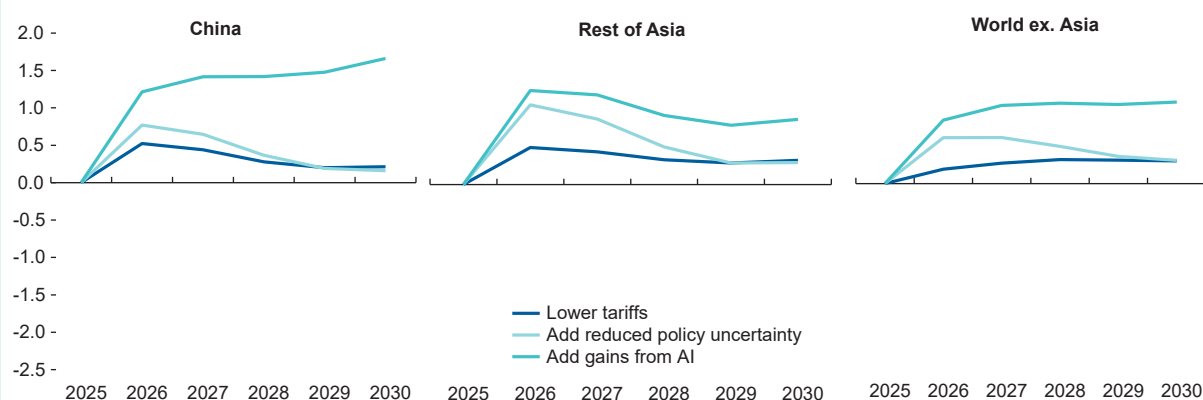
Box 1.3. (continued)

Finally, a depreciation of the US dollar tends to benefit EM Asia as their currencies are generally less flexible against the dollar than other EM currencies, and, thus, would depreciate against other regions, supporting external demand and partially offsetting the drag from higher interest real rates.

Scenario B (Upside): This scenario assumes that tariffs imposed since January 2025 are permanently removed. Imports from China see the largest decrease in effective tariff rates (about 22 percentage points), followed by Japan, Europe, and emerging Asia (10-20 percentage points). Trade policy uncertainty declines. AI provides higher-than-expected boost to productivity (TFP +0.8 percent over 10 years).

Figure 1.3.2. Upside Scenarios

(GDP, percent deviation from baseline)



Source: IMF staff estimates.

Note: The scenarios are cumulative; each layer builds on the previous one. The vertical scale is consistent across all three panels. Rest of Asia refers to Asia excluding China.

In scenario B, lower tariffs have an opposite effect to the one in scenario A, thereby supporting economic activity across the regions. China and the Rest of Asia see a GDP increase of 0.5 percentage points above the baseline (Figure 1.3.2). The reduction in trade policy uncertainty further benefits these countries, driven by a more favorable environment for investment. This effect is particularly strong in the Rest of Asia, where GDP rises by 1.1 percentage points above the baseline in 2026. When compounded with faster AI-driven productivity growth, the impact on Asian economies is amplified. Output in China increases by 1.2 and in 2026, with the effect peaking after four years, driven by productivity gains, as both countries are well positioned to benefit from the AI boom. For the Rest of Asia, output is boosted by 1.3 percent in 2026, before the impact gradually waning. Outside Asia, the positive effects of tariff removal and productivity gains are also present, with output remaining steadily above +1.1 percent, on average, over the 2027-2030 period.

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Annex Table 1.1. Asia: Real GDP

(Percent; year-over-year change)

	Actuals and Latest Projections			Difference from April 2025 WEO		
	2024	2025	2026	2024	2025	2026
Asia	4.6	4.5	4.1	0.0	0.6	0.1
Advanced Economies (AEs)	1.6	1.6	1.4	0.1	0.3	0.1
Australia	1.0	1.8	2.1	0.0	0.2	0.1
New Zealand	−0.6	0.8	2.2	−0.1	−0.5	−0.5
Japan	0.1	1.1	0.6	0.0	0.5	0.1
Hong Kong SAR	2.5	2.4	2.1	0.0	0.9	0.3
Korea	2.0	0.9	1.8	0.0	−0.1	0.4
Taiwan Province of China ¹	4.8	3.7	2.1	0.5	0.8	−0.4
Singapore	4.4	2.2	1.8	0.0	0.2	−0.1
Macao SAR	8.8	2.6	2.8	0.0	−1.0	−0.7
Emerging Markets and Developing Economies (EMDEs)	5.3	5.2	4.7	0.0	0.6	0.1
Bangladesh	4.2	3.8	4.9	0.0	0.0	−1.6
Brunei Darussalam	4.1	1.8	2.4	0.1	−0.7	−0.2
Cambodia	6.0	4.8	4.0	0.0	0.8	0.6
China	5.0	4.8	4.2	0.0	0.8	0.2
India ²	6.5	6.6	6.2	0.0	0.4	−0.1
Indonesia	5.0	4.9	4.9	0.0	0.2	0.3
Lao P.D.R.	4.3	3.5	2.5	0.0	1.0	0.6
Malaysia	5.1	4.5	4.0	0.0	0.4	0.2
Myanmar	−1.1	−2.7	3.0	0.0	−4.6	0.9
Mongolia	5.1	5.5	5.5	0.3	−0.5	−0.4
Nepal	3.7	4.3	5.2	0.6	0.3	−0.3
Philippines	5.7	5.4	5.7	0.0	0.0	0.0
Sri Lanka	–	–	–	–	–	–
Thailand	2.5	2.0	1.6	0.0	0.2	0.0
Vietnam	7.1	6.5	5.6	0.0	1.3	1.5
Pacific Island Countries³	3.6	2.9	2.9	0.0	−0.2	0.2
Fiji	3.5	3.2	3.1	−0.1	0.6	0.3
Kiribati	5.3	3.9	3.2	0.0	0.0	0.0
Marshall Islands	3.0	2.5	4.1	0.2	0.0	0.0
Micronesia	0.7	1.0	1.4	0.0	−0.1	−0.1
Nauru	1.6	2.1	1.9	−0.2	0.2	0.3
Palau	12.0	4.5	3.3	4.9	−1.2	−0.2
Papua New Guinea	3.8	4.7	3.5	0.0	0.2	0.0

	Actuals and Latest Projections			Difference from April 2025 WEO		
	2024	2025	2026	2024	2025	2026
Samoa	4.6	2.7	3.2	−4.9	−2.7	0.7
Solomon Islands	2.5	2.7	2.8	0.0	0.0	0.0
Tonga ⁴	2.1	2.7	2.3	0.0	0.0	0.0
Tuvalu	3.1	3.0	2.6	−0.2	0.2	0.3
Vanuatu	0.9	1.7	2.8	0.1	0.3	0.7
ASEAN⁵	4.8	4.3	4.3	0.0	0.3	0.4
ASEAN-5⁶	4.6	4.2	4.1	0.0	0.2	0.1
EMDEs excluding China and India	4.8	4.4	4.5	0.0	0.2	0.1

Sources: IMF, World Economic Outlook database; and IMF staff estimates and projections.

Note: AE = advanced economy; ASEAN = Association of Southeast Asian Nations; EMDE = emerging market and developing economy.

^{1/} Taiwan Province of China forecast data source is Consensus Forecast

^{2/} India's data are reported on a fiscal year basis. Its fiscal year starts from April 1 and ends on March 31.

^{3/} Pacific island countries aggregate is calculated using simple average, all other aggregates are calculated using weighted average.

^{4/} Tonga's data are reported on a fiscal year basis. Its fiscal year starts from July 1 and ends June 30.

^{5/} ASEAN comprises Brunei Darussalam, Cambodia, Indonesia, Lao P.D.R., Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam.

^{6/} ASEAN-5 comprises Indonesia, Malaysia, Philippines, Singapore, and Thailand.