

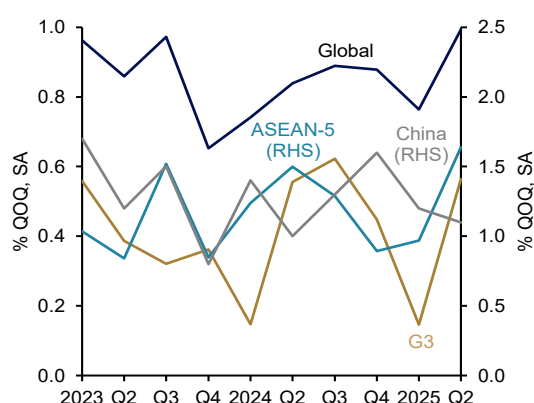
2 The International Economy

2.1 Global Growth

Global growth picked up in Q2, supported by continued front-loading activities and AI-related investments

The global economy surprised on the upside in Q2, underpinned by continued front-loading activities, strong AI-related investment and accommodative financial conditions. Global GDP growth rose to 1.0% q-o-q SA in Q2 from 0.8% in Q1, bringing H1 growth to 3.5% y-o-y (**Chart 2.1**). Exports from Asia to both the US and the rest of the world generally remained robust in the run-up to the reciprocal tariff announcements in early Q3 (**Chart 2.2**). The step-up in AI-related investment also provided an additional impetus for exports. Meanwhile, global financial conditions turned supportive, with investors shrugging off mounting tariffs, and focusing instead on the likely US monetary policy easing in the coming quarters. Financing conditions in the region also benefited from domestic monetary easing, as the ASEAN-5 central banks cut rates this year and boosted liquidity in the banking system.

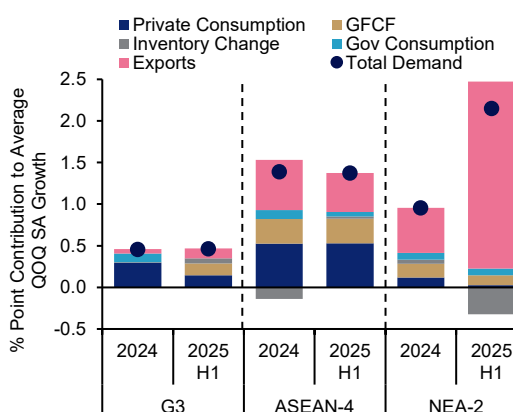
Chart 2.1: GDP Growth



Source: Haver Analytics and EPG, MAS estimates

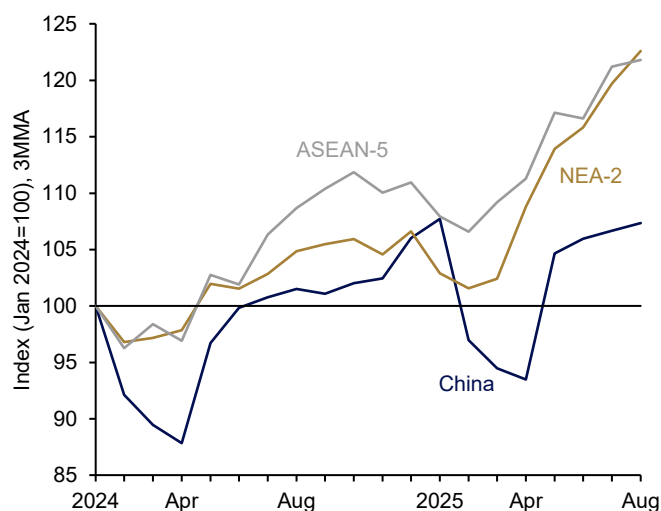
Note: ASEAN-5 economies comprise Malaysia, Indonesia, the Philippines, Thailand and Vietnam.

Chart 2.2: Decomposition of Total Demand in Key Regions



Source: Haver Analytics and EPG, MAS estimates

Note: ASEAN-4 economies comprise Malaysia, Indonesia, the Philippines, and Thailand.

Chart 2.3: Total Goods Exports of Asian Economies

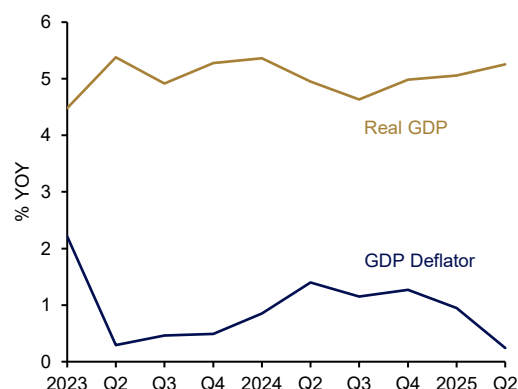
Source: Haver Analytics and EPG, MAS estimates

High-frequency indicators show overall growth momentum still holding up into Q3, but there are tentative signs of softening. Final domestic demand in advanced economies has continued to grow steadily, albeit at a reduced pace from last year. In the US, private consumption has pared back some of its weakness with recovery in Jul–Aug. Meanwhile, domestic demand in China softened as consumers and corporates pulled back their spending. August data also showed nascent signs of moderation in export growth in China, Malaysia, the Philippines and Thailand, following strong expansion in prior months (**Chart 2.3**).

Robust real activity belies a “slow burn” dynamic that is unfolding in response to the tariff shock

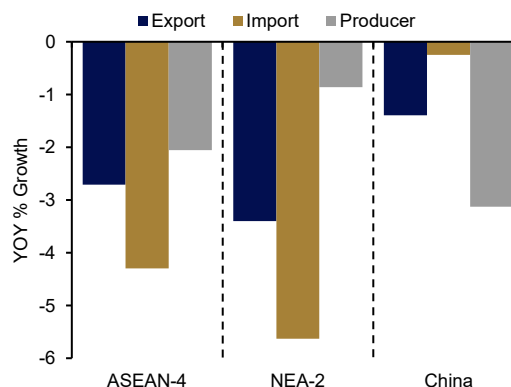
Beneath this creditable performance, a slow-moving but persistent dynamic is unfolding in response to the tariff shock. The transmission entails an adjustment of price-related variables, as firms reduce prices and wages amid heightened trade policy uncertainty and increased competition arising from export diversion. These price adjustments have been particularly pronounced in Asia, where broad-based price weakness has emerged even as real GDP growth stayed relatively resilient (**Chart 2.4**). Export prices have eased, likely reflecting some tariff burden borne by exporters and intensified competition in third-country markets amid trade diversion effects. Moreover, regional currency appreciation against the US\$ has translated into lower export prices in domestic currency terms. Import prices have also been subject to similar competitive and exchange rate dynamics. These external disinflationary impulses are cascading to the domestic sectors and weighing on producer prices as well (**Chart 2.5**).

Beyond the initial price cuts, firms may eventually scale back production to ensure their financial sustainability. However, the adjustment to quantities will likely be gradual as the downward pressure on profits is currently cushioned by the general weakness in costs. Global production networks have also demonstrated greater flexibility and adaptability than anticipated to the tariff shock. In addition, US non-financial corporates have built up financial buffers in the post-pandemic period, which can help cushion the shock. More broadly, lower import prices at the aggregate level would also support the overall terms of trade in some countries.

Chart 2.4: Asia-9 Real GDP Growth vs GDP Deflator

Source: Haver Analytics and EPG, MAS estimates

Note: Asia-9 economies comprise China, India, Indonesia, Malaysia, the Philippines, South Korea, Taiwan, Thailand and Vietnam.

Chart 2.5: Price Indices in Q2 2025

Source: Haver Analytics and EPG, MAS estimates

Note: ASEAN-4 economies comprise Malaysia, the Philippines, Thailand and Vietnam.

Global growth for 2025 has been revised higher but is expected to moderate in 2026, as tariff restrictions weigh on demand more discernibly

In view of the stronger-than-expected growth thus far, EPG has revised up its 2025 global growth forecast to 3.3% from 2.8% in the July *Review*. This reflects the front-loading induced surge in activity in H1 amid the evolving timelines of tariff implementation. Robust AI-related activities also provided a discernible uplift, as overall H1 growth rose to 3.5% y-o-y, the fastest pace since the post-pandemic rebound. High-frequency indicators show growth momentum still holding up into Q3. However, the above-trend expansion is expected to ease in the latter part of H2 as front-loading dissipates.

In 2026, growth is expected to moderate from an elevated base, as the drag from trade restrictions becomes more pronounced. The full impact of tariff implementation is expected to materialise in the months ahead.¹ The inventories that were previously accumulated before tariff implementation will be depleted, resulting in a more discernible pass-through of tariffs to costs and prices. Further, the full effect of tariffs has been delayed as the effective rates have lagged the rates based on official announcements, mainly due to implementation challenges.² However, the effective rates are expected to catch up eventually and continue to rise.

Moreover, incipient signs of labour market weakness have emerged that will weigh on domestic demand. In the US, elevated policy uncertainty has led to lower hiring rates as firms remain cautious. Tariff hikes have also contributed to sharp corrections in payroll gains since May in the tradable sectors, such as manufacturing and wholesale trade. Within Asia, Indonesia has seen a notable rise in layoffs this year, while Thailand's labour market has shown signs of gradual softening, with total employment growth contracting slightly in July, led by the non-agriculture sectors. In China, the domestic sectors have remained weak overall,

¹ With tariff outcomes remaining fluid, the baseline analysis does not include the 10 October announcement of the US tariff increase on Chinese imports. Nevertheless, such continuing trade tensions clearly add to the downside risks identified.

² Azzimonti, Marina. "Why Predicted and Actual Tariff Rates Diverged in May 2025", *Federal Reserve Bank of Richmond*, August 2025.

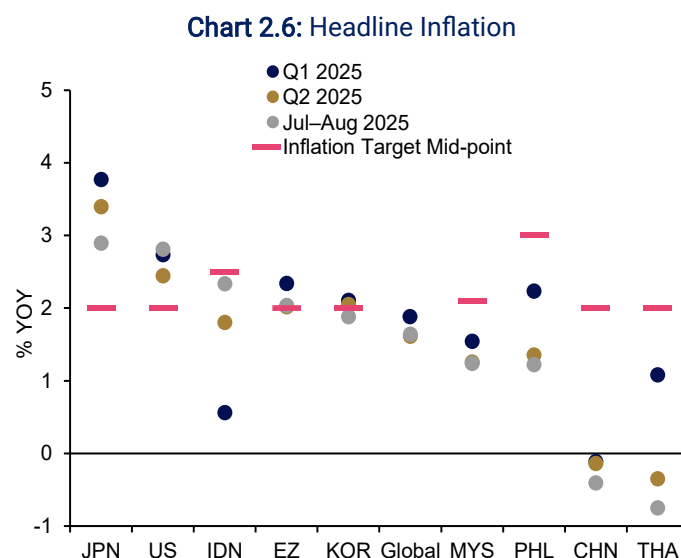
as the housing market faced renewed downward pressures and corporates pulled back capital expenditure amid the “anti-involution” campaign.

While the “slow burn” dynamic of the tariff shock is expected to continue, the balance of risks to global growth remains tilted to the downside. A sharp retrenchment of real activity could ensue, compounded by disorderly tightening in financial conditions due to heightened risk aversion. A severe pullback in external demand from further trade frictions (such as a broadening of sectoral tariffs to electronic products or a re-escalation of trade tensions between China and the US) could significantly weigh on the region’s exports. Beyond tariffs, the narrow concentration of private investment on building data centres and scaling AI-related infrastructure raises doubts about the durability of the investment strength. If such risks materialise, companies may have to resort to more significant production cuts and layoffs to ensure financial viability.

2.2 Global Inflation

Price adjustments amid heightened competition and trade policy uncertainty have led to disinflationary pressures globally

Amid the general weakness in costs, global inflation eased to 1.6% y-o-y in Q2 2025 and held steady in Jul–Aug. Price pressures were subdued in most economies, with inflation either at or significantly below their central bank targets (**Chart 2.6**). Within Asia, the muted inflation environment in the ASEAN-5 reflected a confluence of extended administrative price subsidies for energy consumption, easing food inflation on the back of improved supply conditions and the tariff-induced nominal price adjustments. Meanwhile, China’s deflationary spell has persisted amid its structural challenge of excess capacity. In the Eurozone, headline inflation fell to around 2% in recent months as services disinflation progressed alongside the softening in energy prices.



Source: Haver Analytics and EPG, MAS estimates

Note: Malaysia’s inflation target is proxied by its 2010–19 average inflation of 2.1%. Global CPI is aggregated using weights based on import sources of goods and services in Singapore’s CPI basket.

The US and Japan were the notable outliers with inflation readings exceeding their central bank targets. Inflation in the US has been on an uptrend since the tariff shock in April. The pass-through of tariffs has been staggered and also shown signs of affecting prices of products with low import content more recently. Meanwhile, in Japan, inflation is now driven more by domestic factors, as rising labour costs are passed on to consumers and higher food prices spill over into service sectors such as restaurants.

Global inflation is expected to remain broadly stable as weak price dynamics persist

Overall, global inflation is forecast to average 1.9% in 2025 and remain broadly stable in 2026. Weak price dynamics in the Eurozone and most of Asia are expected to continue for the rest of 2025 and in 2026. Other than the disinflationary demand-side impact from the tariff shock, China's deflation and the weak US\$, global oil prices are also forecast to fall further next year on the back of planned supply increases by OPEC+ countries. In addition, food inflation is expected to decline next year, amid ample grain supplies and the easing of rice export restrictions from India.

The US and Japan will probably continue to be the exceptions to these disinflationary pressures. In the US, the pass-through of tariffs to consumer prices is expected to strengthen with the run-down of stockpiles that were accumulated at lower import prices and the catch-up of effective tariff rates to announced rates. In Japan, rising labour costs and more active cost pass-through by firms are likely to sustain upward pressures on consumer prices.