

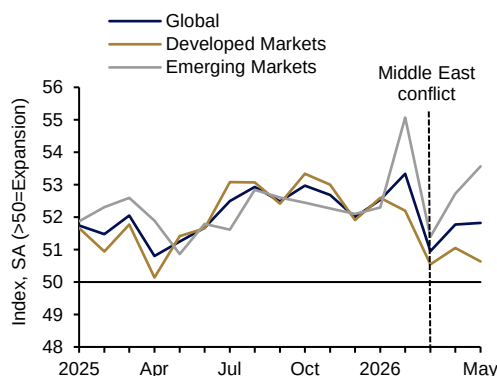
2 The International Economy

2.1 Recent Developments

The global economy weathered the initial energy shock and attendant rise in price pressures,...

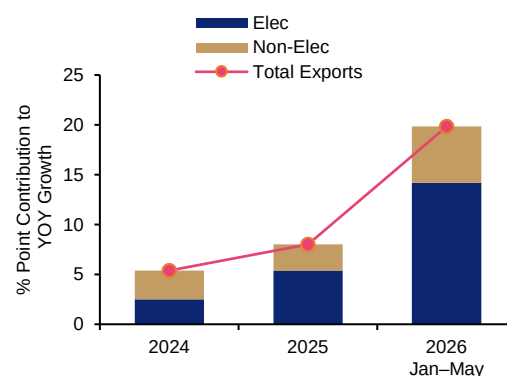
Global economic activity demonstrated some degree of resilience after the unprecedented energy supply disruption wrought by the blockade in the Strait of Hormuz. On the supply side, alternative sources of crude and inventory drawdowns helped offset part of the shortfall. At the same time, some fiscal support measures facilitated the adjustment of corporates and households to higher energy costs. Tighter financial conditions primarily through higher government bond yields also restrained aggregate demand. Against this backdrop, energy markets have been able to rebalance at less elevated price levels than initially feared, limiting the overall drag on growth. Composite PMI readings for the global economy, developed markets and emerging markets all rose in Apr–May following the pullback in March (**Chart 2.1**), while retail sales remained broadly stable.

Chart 2.1: Global Composite Purchasing Manager Indices (PMI)



Source: S&P Global

Chart 2.2: Contribution to Growth in Asia's Exports



Source: Haver Analytics and EPG, MAS estimates

Note: Asia here refers to China, Japan, NEA-2, ASEAN-5 and India.

However, global energy prices remain above pre-conflict levels and have fed through quickly into headline inflation prints, reflecting the immediate and direct pass-through to fuel prices. There are also incipient signs of indirect effects, as costlier energy inputs have begun to filter into producer prices of some products including chemicals, plastics and fertilisers, creating upstream cost pressures that could pass through more fully to consumer prices eventually. That said, excluding energy-related items, CPI inflation for the broader range of goods and services has remained largely stable to date, and second-round effects on wages and broader price-setting behaviour appear limited.

... and was boosted by continued momentum in the global technology cycle

At the same time, the ongoing boom in the global technology sector has bolstered growth. Demand for semiconductors and other electronics products remained robust, underpinned by firm AI-related investment, particularly in the US. This has provided an important source of support for manufacturing activity and exports in Asia, helping to offset softer growth in non-tech sectors and contributing to the firmness in global trade. Asia's overall exports rose by 20% y-o-y in Jan–May 2026, reflecting mainly tech exports which surged by 46%. The latter contributed to around 70% of Asia's total export growth, up from 60% a year ago, underscoring the tech sector's increasingly important role undergirding regional export performance (Chart 2.2).

2.2 Outlook

The outlook for global growth has improved modestly, underpinned by stronger AI-related demand

Compared with the April *Review*, the baseline forecast for 2026 growth has been revised up slightly to 3.1%, while the 2027 forecast is unchanged at 3.0%. The modest upgrade however masks uneven outcomes across regions, with stronger growth in the NEA-2 economies accounting for virtually all of the upward revision.

Regional economies with deep integration into the tech supply chain, particularly Taiwan and South Korea, will continue to benefit from strong investment in data centres, semiconductor infrastructure and AI technologies (Chart 2.3). However, within the NEA-2 economies, the gains remain concentrated in technology-related industries, while other export sectors have been comparatively subdued (Chart 2.4). At the same time, growth elsewhere in Asia is expected to remain around or slightly below trend, reflecting weaker exposure to AI-related demand and idiosyncratic domestic structural headwinds.

Chart 2.3: Growth Performance and Degree of AI Supply Chain Integration

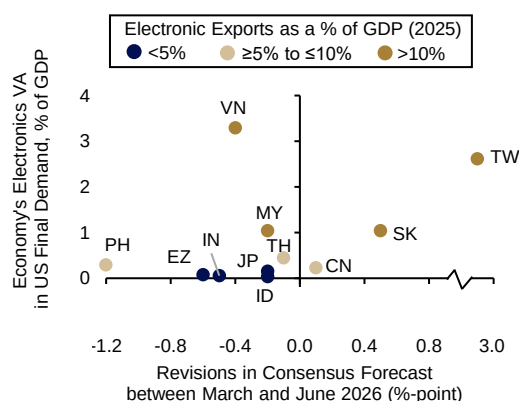
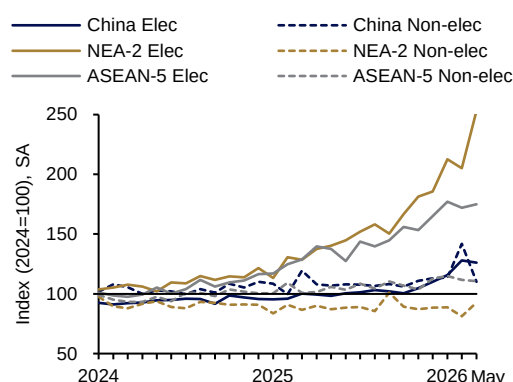


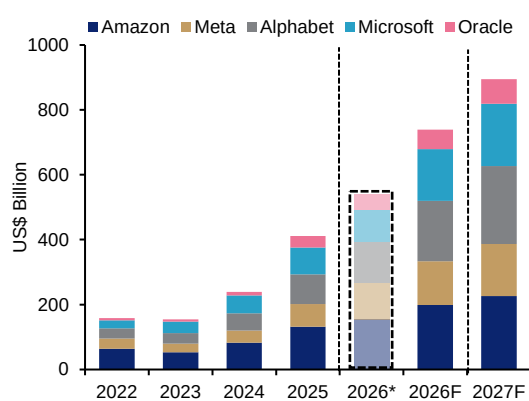
Chart 2.4: Asia Electronic and Non-Electronic Exports



Source: OECD TiVA, Consensus Economics, Source: Haver Analytics and EPG, MAS estimates
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The AI boom appears likely to gain further momentum, supported by hyperscaler investment as compute-intensive agentic AI applications spread across more industries worldwide. At the point of Q4 2025 earnings calls, analysts were expecting the five largest US hyperscalers to increase capital expenditure by 30% in 2026. Since then, this projection has been revised up: capex this year is now expected to be nearly double its 2025 level (**Chart 2.5**). This will translate into even stronger demand for semiconductors, memory chips and other AI-related hardware, supporting exports and manufacturing activity in economies with a strong IT nexus. Indeed, US imports of AI hardware from Asia have continued to hold up, underscoring resilient underlying demand (**Chart 2.6**). As such, regional headline economic growth is likely to remain narrowly driven by the electronics sector, although the sheer scale of demand for the electronics sector could still impart a discernible growth impulse to the rest of the economy.

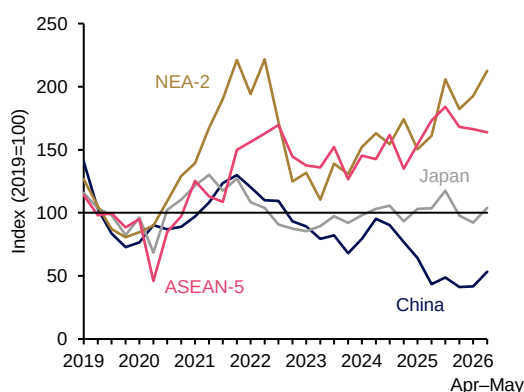
Chart 2.5: US Hyperscalers' Capex



Source: Bloomberg

Note: 2026* refers to the hyperscalers' capex projections for 2026 as of the 4Q25 earnings period. 2026F and 2027F are based on consensus estimates following 1Q26 earnings announcement.

Chart 2.6: US' AI Hardware Import Volumes from Asia



Source: US ITC and EPG, MAS estimates

Note: AI hardware includes the following NAICS components: 3344 (semiconductors), 3341 (computer equipment), 3334 (HVAC & commercial refrigeration equipment).

However, still-elevated energy prices and continued trade policy uncertainty will continue to weigh on growth somewhat

Energy prices are expected to remain higher than pre-conflict levels. While the risk of a severe supply disruption has receded, lingering concerns over the durability of the ceasefire is likely to sustain a geopolitical premium in the pricing of energy products. In addition, damaged energy infrastructure in the Middle East could take time to be restored, slowing the recovery in production capacity. Precautionary demand for crude oil is also likely to remain firm as countries rebuild depleted reserves, limiting the pace of decline in prices. This suggests that the terms-of-trade shock faced by net energy-importing economies could persist well beyond the initial disruption and continue to weigh on real incomes, corporate profitability and investment. In turn, this is likely to exert a sustained albeit moderate drag on growth.

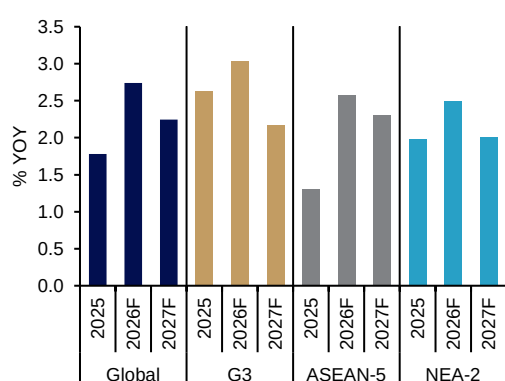
US trade policy remains a source of uncertainty for the global outlook. The Trump administration announced tariffs of 10–12.5% on imports from 60 trading partners, following USTR investigations into forced-labour enforcement. The measures, effective from 24 July, broadly replace the temporary 10% global tariff introduced after the suspension of the earlier IEEPA tariffs. There is also the risk of further sectoral tariffs on the basis of national security.

As the new tariffs largely preserve previous rates, their immediate impact on global growth is likely to be limited. However, continued uncertainty over their scope and possible further measures could weigh at the margins on trade, investment and business confidence in the coming quarters.

Headline inflation is projected to peak in late 2026, accompanied by firming core price pressures

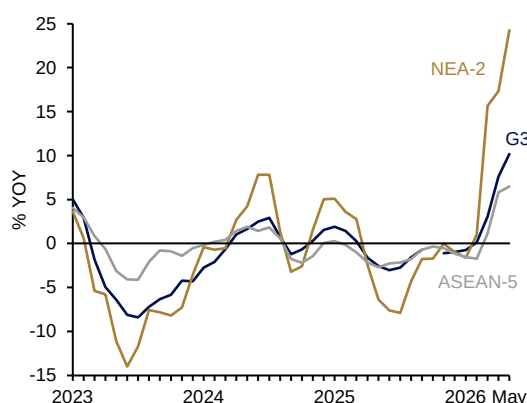
Global inflation is expected to pick up from 1.8% in 2025 to average 2.7% in 2026, before moderating to 2.2% in 2027 (Chart 2.7). Compared to the April *Review*, the 2026 inflation forecast remains unchanged while the 0.2%-point upward revision to the 2027 projection reflects stronger direct effects of the energy supply shock and the pass-through of the associated cost increases to downstream production. Notably, import price pressures have risen markedly in recent months since the outbreak of the Middle East conflict, particularly among net energy-importing economies (Chart 2.8). Some of these upstream cost pressures have yet to be fully reflected in consumer prices and could continue to pass through over the coming months.

Chart 2.7: Headline Inflation



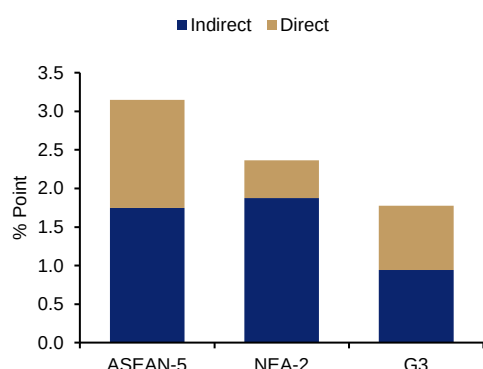
Source: Haver Analytics and EPG, MAS estimates

Chart 2.8: Import Price Inflation



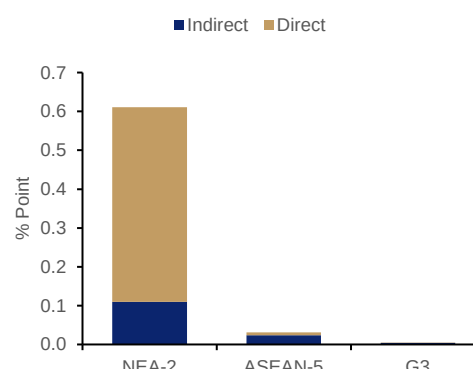
Source: CEIC and EPG, MAS estimates

Simulations using inter-country input-output tables suggest that such upstream cost shocks can generate sizeable cost-push pressures in the consumer basket (Chart 2.9). These indirect effects arise as higher energy input prices raise production costs for downstream industries and these are passed on to higher prices of non-energy goods and services faced by consumers. In most economies, the indirect effects are more pronounced than the direct channel, indicating the primacy of hydrocarbon inputs in the production structure of many industries. The estimated pass-through is also larger in several Asian economies, likely reflecting their greater exposure to affected upstream inputs in energy-intensive production networks.

Chart 2.9: Simulated Impact of Upstream Cost Shocks on Consumer Prices

Source: OECD ICIO tables, BIS and EPG, MAS estimates

Note: The Leontief price framework traces cost pass-through through global production networks. The simulation assumes global price shocks of 60% for oil and gas, 57% for refined fuels, 31% for chemicals and 20% for plastics, calibrated to observed peak percentage increases of the respective input prices since February. Consumer price effects are weighted using ICIO household consumption shares; direct effects arise from the shocked industries, while indirect effects reflect spillovers to other sectors.

Chart 2.10: Estimated Consumer Price Impact of a Simulated Electronics Cost Shock in Taiwan and South Korea

Source: OECD ICIO tables and EPG, MAS estimates

Note: EPG assumes a 20% price increase in the electronics sectors of Taiwan and South Korea, while holding prices in all other sectors and economies unchanged. The shock size is calibrated to South Korea's PPI for electronic and optical equipment, which has risen by around 20% since Q3 2025. Taiwan and South Korea are selected for their upstream roles in the electronics global value chain, particularly in semiconductors and key electronic components, allowing the simulation to trace how higher input costs cascade downstream through global production networks.

Beyond the impact of the energy shock, global inflation will be lifted by two other factors. First, inflationary pressures could also emanate from “chipflation”, where the sustained strength in global chip demand continues to drive up electronic component prices. That said, simulations of an increase in electronics prices in the NEA-2 economies suggest that the impact of “chipflation” on regional inflation should be smaller than the energy shock, given the latter's broader and more direct household impact (**Chart 2.10**). **Second,** weather-related disruptions could push food prices higher into 2027, with the National Oceanic and Atmospheric Administration (NOAA) estimating a 63% likelihood of a severe El Niño event this year. While El Niño's impact on food inflation will vary considerably across economies, the ability to absorb the shock will also depend on country-specific buffers—those with ample food stockpiles and fiscal space will be better positioned to manage the resulting price pressures.

Cost pressures in energy, electronics, and agriculture will keep headline inflation elevated, and the resulting rise in input costs should also begin feeding more strongly into core inflation in the months ahead. Core inflation will pick up more gradually compared to headline inflation, as elevated input costs work their way through production networks and filter into a broader range of goods and services. Nevertheless, a strong second-round impulse—characterised by a broad-based wage-price spiral—seems unlikely, given that growth in most economies is running at or below trend and labour markets remain broadly balanced across most economies.

The balance of risks is skewed towards higher inflation, but the accompanying growth outturn would depend on whether the shock is demand- or supply-driven

Global macroeconomic conditions are generally resilient, with growth holding up even as inflation risks remain elevated. The balance of risks is tilted toward higher inflation with downside growth risks contained.

In a positive demand-driven scenario, inflation could exceed the baseline, supported by a robust recovery in aggregate demand amid a durable truce in the Middle East. While energy prices may ease further, residual geopolitical premia are likely to keep them above pre-crisis levels. As confidence in the durability of final demand strengthens, firms are likely to pass through cost increases more fully and rapidly. With growth and inflation moving in tandem, the case for less accommodative monetary policy becomes clearer, while fiscal policy could remain broadly neutral.

In contrast, a renewed supply shock stemming from a sustained re-escalation of tensions in the Middle East would re-intensify concerns over energy supply, particularly as buffers have been eroded. Oil prices could rise more sharply, amplifying inflationary pressures and presenting a sharper trade-off between growth and inflation for central banks. Fiscal space may also be constrained by the rising cost of subsidies and mitigating measures. In this environment, emerging market economies with limited energy and foreign exchange buffers, as well as tighter fiscal positions, may face increased market scrutiny, with tighter financial conditions posing an additional drag on growth.¹

There also remains the risk of a correction in the global tech cycle

Current valuations in the AI sector could prove overly optimistic if earnings fail to meet investor expectations. This could prompt a broader reassessment of the prospects of firms across the AI ecosystem, triggering sharp capital outflows and asset price declines, with losses potentially amplified by leveraged positions. The resulting tightening in financial conditions could derail AI-related capital expenditure, removing an important source of growth for economies integrated into global technology supply chains. Even economies with limited direct exposure to the AI supply chain could be affected through broader financial market stress, exchange rate volatility, and weaker external demand. However, given the continued strength of AI-related earnings guidance and the long investment horizons of major hyperscalers, strong growth conditions in the sector could be sustained before fundamentals are fully tested.

¹ For a broader discussion of how fiscal policy, financial frictions, and exchange rate buffers condition policy trade-offs in open economies, see Dmitry Mukhin, "Exchange Rate Policy Beyond the Trilemma", *MAS Economic Essay*, July 2026.