

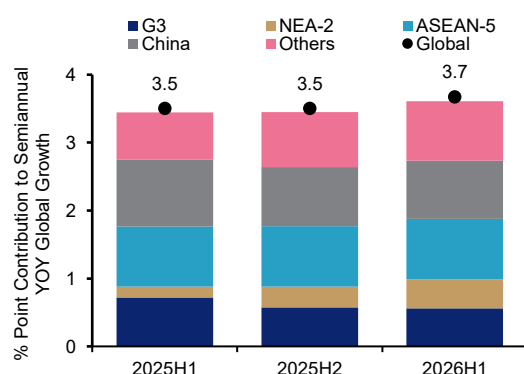
2 The International Economy

2.1 Recent Developments

The global economy remained resilient despite the energy shock, supported by the technology upcycle

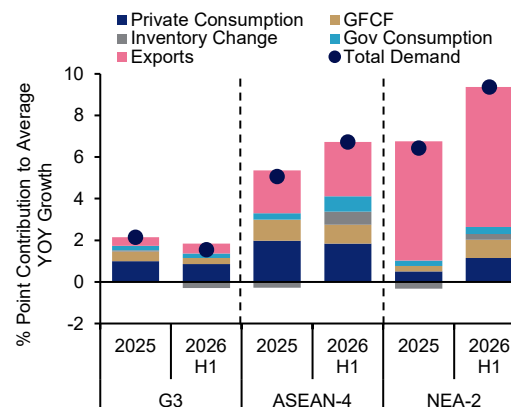
Global activity has held up better than expected despite the energy shock. Growth in H1 2026 rose to 3.7% y-o-y, from 3.5% in H2 2025, underpinned by firm outturns across most economies (**Chart 2.1**). Sustained AI-related demand lifted production and exports across Asia with the adjacent buildout of data centres providing an additional fillip to growth (**Chart 2.2**). At the same time, the drag from the energy shock remained contained, as alternative supplies, inventory drawdowns and softer oil demand, coupled with fiscal subsidies, helped cushion the impact of disrupted energy flows.

Chart 2.1: Breakdown of Global Growth



Source: Haver Analytics and EPG, MAS estimates

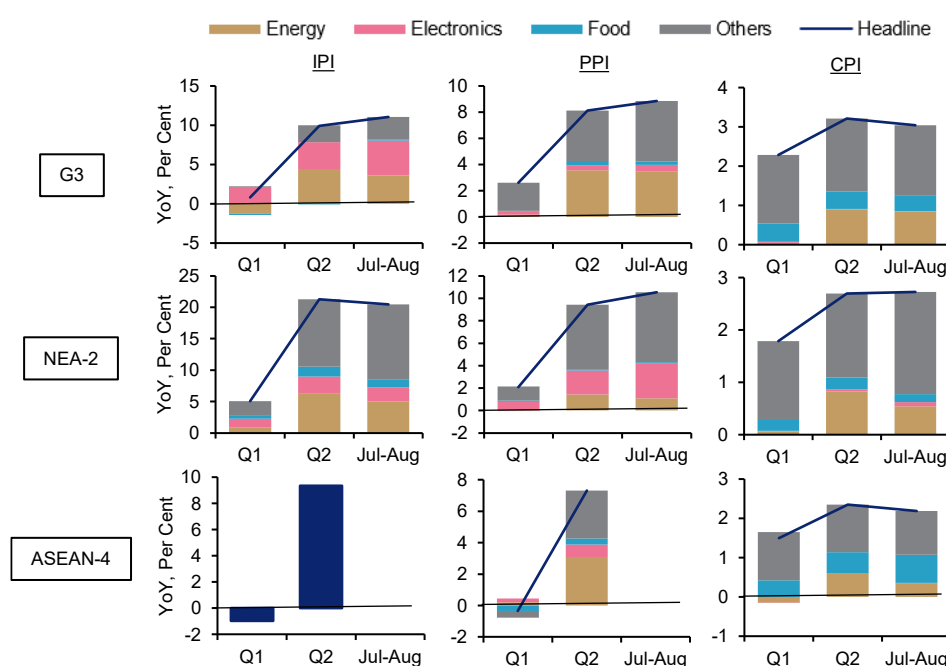
Chart 2.2: Decomposition of Total Demand in Key Regions



Source: Haver Analytics and EPG, MAS estimates

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

Headline inflation remained elevated relative to pre-shock levels, but has moderated from the highs seen earlier this year. While rising energy and electronics prices continued to lift upstream costs, their pass-through to consumer prices has been contained, with the pick-up in the overall CPI inflation showing signs of levelling off in recent months (**Chart 2.3**).

Chart 2.3: IPI, PPI and CPI Inflation Across Economies

Source: Haver Analytics and EPG, MAS estimates

Note: ASEAN-4 IPI and PPI data are available up to Q2 only.

2.2 Outlook

Global growth should continue to be underpinned by the technology boom

Compared with the *July Review*, the baseline forecast for the global economy has been revised up to 3.4% for 2026, and to 3.1% for 2027. The upward revisions mainly reflect stronger-than-expected activity in H1 2026 while the projected trajectory for the period ahead is broadly unchanged.

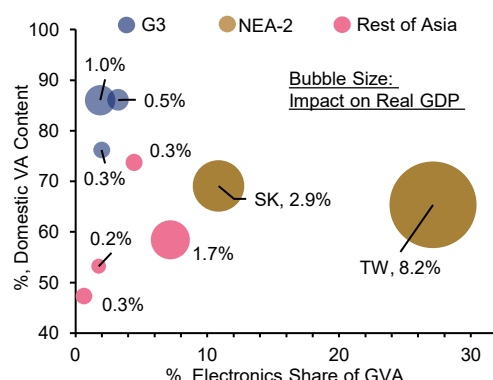
The global AI investment cycle is expected to remain a key growth support even as AI-driven growth moderates from the exceptional rate recorded thus far. Capital expenditure expectations for US hyperscalers have been revised higher since the *July Review*, arising from increased computing and data-centre demand through 2027. Concomitantly, semiconductor production is expected to remain at elevated levels in the coming quarters, and could rise further as new capacity comes on stream.

However, the gains from the AI boom will remain highly uneven across economies. Input-output estimates suggest that US hyperscaler investment can generate sizeable spillovers to some Asian economies. Notably, the spillovers to the NEA-2 economies are significant, owing to greater domestic value-added content of electronics production and the larger size of the electronics sector in these two economies (Chart 2.4).

In addition to boosting production, the AI boom is expected to generate considerable income gains through favourable terms-of-trade effects, cushioning the impact of higher energy prices at the margins. Similarly, the NEA-2 economies have benefited the most in this respect (Chart 2.5). Their income gains from firm export earnings have more than offset the drag from

higher energy import costs. The resulting increase in tax revenues is expected to bolster fiscal capacity, enabling governments to provide targeted and temporary support to vulnerable groups affected by higher energy prices.

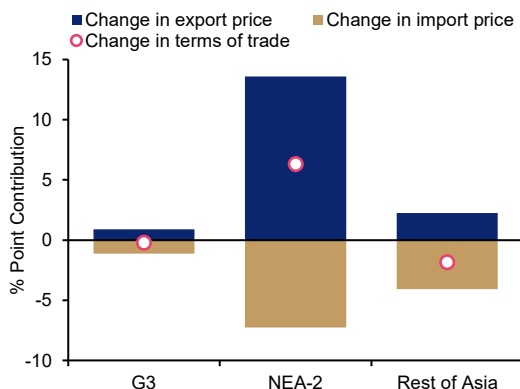
Chart 2.4: GDP Growth Impact Arising from US Hyperscaler Capex



Source: ADB MRIO and EPG, MAS estimates

Note: The bubble size is proportionate to the increase in real value-added arising from the expected expansion in US AI-related investment (US\$750 billion) in 2026. Domestic VA content is the share of induced output retained as domestic value-added, after netting out domestic intermediate transactions; the remainder accrues to imported inputs. Rest of Asia comprise China, Malaysia, Thailand and Philippines.

Chart 2.5: Terms-of-trade Effects Since the Energy Shock



Source: CEIC and EPG, MAS estimates

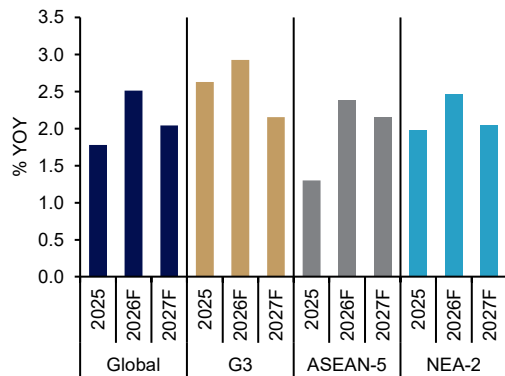
Note: Estimated terms-of-trade effects are based on changes in export and import prices between the Q4 2025 and Q2 2026 averages, weighted by 2025 goods exports and imports as shares of GDP. Rest of Asia comprise India, Malaysia, Indonesia, Thailand and Philippines.

Headline inflation is expected to rise in the near term as energy cost pressures continue to pass through

The lower-than-expected inflation prints in recent months have prompted a downward revision to the global inflation outlook (Chart 2.6). Global inflation is now projected at 2.5% in 2026 and 2.0% in 2027, compared with 2.7% and 2.2%, respectively, in the July *Review*. The relatively benign outturns reflect in part the delayed transmission of upstream costs. Pass-through from the energy shock has remained limited at the consumer level, dampened by subsidies, administered pricing, and other stabilisation measures.

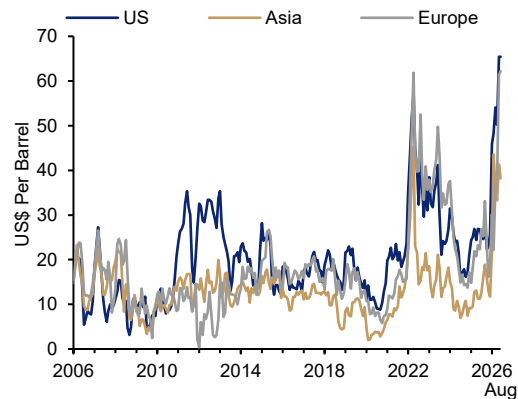
As such, the energy shock pass-through remains incomplete, with global headline inflation expected to edge higher in the coming months before gradually easing in 2027. While refining margins have retreated from their July 2026 peak, they remain elevated relative to historical norms (Chart 2.7). EPG's estimates suggest that up to one-third of the overall energy shock has yet to feed through to consumer prices, and will continue to do so over the coming quarters. The specific timing and extent of pass-through will vary across economies, reflecting differences in domestic pricing regimes and policy measures.

Chart 2.6: Headline Inflation



Source: Haver Analytics and EPG, MAS estimates

Chart 2.7: Oil Refining Margins



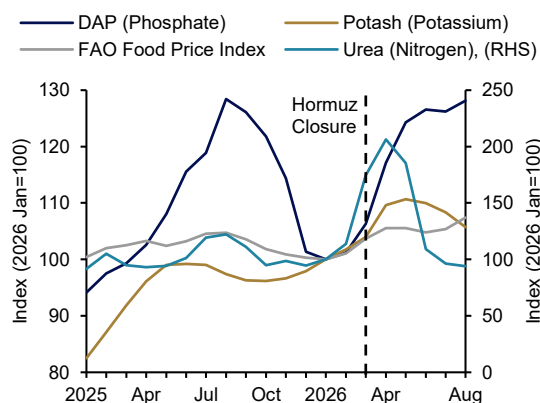
Source: CEIC, Haver Analytics and EPG, MAS estimates

Note: US series uses WTI, RBOB and ULSD; Asia and Europe use comparable regional benchmarks.

Food cost pressures could become more prominent in 2027, although the baseline assumes that weather-related production disruptions remain contained. International food prices have risen, but global grain inventories remain relatively comfortable, suggesting that broad-based supply scarcity has yet to emerge. Fertiliser price developments have become increasingly uneven. Urea prices have fallen back below pre-shock levels, while phosphate prices have continued to rise (Chart 2.8). Earlier increases in input costs could feed into food prices with a lag, as fertiliser purchased at elevated prices is used for the 2026/27 crop cycle.

Overall, the inflation path reflects a gradual and uneven transmission of earlier cost pressures rather than a renewed broadening of underlying inflation. Refined product prices remain the principal near-term source of cost pressure. The pass-through of earlier increases in agricultural input costs is also expected to continue, although the impact could be smaller and more delayed, occurring primarily over 2027, barring widespread weather-related crop losses or restrictive trade responses.

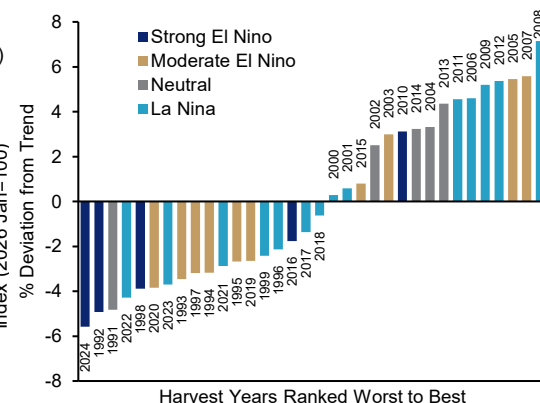
Chart 2.8: Fertiliser and Food Prices



Source: World Bank, FAO

Note: Gulf countries supply 34% of global urea trade and 18% of phosphate fertilisers, but almost no potash.

Chart 2.9: Asia's Rice Harvest Cluster in El Niño Years



Source: FAO, NOAA and EPG, MAS estimates

Note: Deviation estimated as actual rice yield relative to each economy's fitted linear trend. Bars are output-weighted across the six exposed producers: Thailand, Philippines, Vietnam, Cambodia, Myanmar and Pakistan.

The balance of risks is tilted towards higher inflation

Inflation risks remain skewed to the upside, reflecting the elevated likelihood of renewed supply shocks. The sporadic escalations in the Middle East conflict could produce a more severe energy shock than assumed in the baseline. Lower inventories and limited spare refining capacity have left markets more sensitive to further disruptions to shipping routes or energy infrastructure. Crude oil and refined product prices could therefore rise sharply, with the effects spreading through transport, utility and production costs.

Inflationary pressures from elevated energy costs could be compounded by higher food prices if adverse weather disrupts harvests in the coming months. El Niño-related heatwaves and rainfall deficits can significantly depress crop yields and disrupt planting cycles (Chart 2.9). The inflationary impact would be larger if the weather phenomenon affected major producing regions, available stocks and water buffers proved insufficient, and/or food-exporting economies imposed trade restrictions to protect domestic supply.

In comparison, downside risks from an AI cycle downturn appear less immediate, in view of sustained strong chip orders to meet robust capex demand. A materially weaker growth outcome would likely require a financial shock that emanates from a sharp reassessment of expected returns across the AI ecosystem. One plausible scenario is an AI infrastructure credit shock, where weaker-than-expected AI monetisation leads hyperscalers to curtail capex, prompting a repricing of debt-financed AI investments. The resulting tightening in financing conditions could delay projects across the AI supply chain, triggering a self-reinforcing downturn in investment and global growth.