ASIAN DEVELOPMENT OUTLOOK

APRIL 2026

THE MIDDLE EAST CONFLICT CHALLENGES RESILIENCE IN ASIA AND THE PACIFIC

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Notes:
In this publication, “$” refers to United States dollars.
ADB recognizes “Brunei” as Brunei Darussalam; “China” as the People’s Republic of China; “Hong Kong” as Hong Kong, China; “Korea” as the Republic of Korea; “Laos” as the Lao People’s Democratic Republic; and “USA” as the United States.

Cover design by Anthony Victoria.

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FOREWORD

Developing Asia and the Pacific's economic ascent faces a formidable test. The conflict in the Middle East has injected new uncertainty into an already fragile global landscape, disrupting trade and energy markets. While the region's direct exposure is limited, it remains vulnerable to rising prices for energy and other commodities, which fan inflation and tighten financial conditions.

The impacts are subject to extreme uncertainty and will depend on the length of the conflict. Disruptions caused by damaged infrastructure will have persistent effects, with delayed impacts on supply chains compounding the initial shock. Higher fertilizer prices, in particular, could disrupt agricultural output and create food insecurity. *Asian Development Outlook (ADO) April 2026* estimates that growth in the region could slow substantially in the case of a prolonged conflict or further escalation. Fortunately, the region enters this period from a position of strength, and its proven ability to adapt offers a crucial buffer. Still, leaders must be prepared for downside risks and ready to act.

Sound policy is key. Targeted, temporary support can shield vulnerable households and businesses from rising energy costs without derailing long-term fiscal health. Clear monetary policy is essential to keep inflation expectations in check. Maintaining investment in education, infrastructure, and digital connectivity will help sustain growth even as external pressures mount.

Now is the time to deepen regional cooperation. Stronger energy connections, more resilient supply chains, and streamlined trade can help insulate economies from global shocks while unlocking opportunities for private enterprise and job creation across the region. Joint efforts to secure food and fuel supplies and to mobilize modern, clean energy investment will reduce vulnerability to future price spikes and build energy security and long-term resilience.

The Asian Development Bank stands ready to support the region through this period of uncertainty. Drawing on our full range of financial instruments—from crisis response tools to trade finance—we will provide financing, policy advice, and expertise to help countries manage risks while advancing reforms that promote inclusive, sustainable growth. With sound economic management and stronger regional cooperation, Asia and the Pacific can weather the current storm and continue building a more stable and prosperous future. This report aims to inform that journey and empower policymakers and partners to move forward with confidence.

Masato Kanda

MASATO KANDA
President
Asian Development Bank

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DEFINITIONS AND ASSUMPTIONS

The economies discussed in *Asian Development Outlook April 2026* are classified by major analytic or geographic group. For the purposes of this report, the following apply:

- **Asia and the Pacific** includes all the 50 Asian Development Bank (ADB) regional member economies.
    - **Developing Asia and the Pacific** comprises the 43 members of the Asian Development Bank listed below by geographic group.
        - **Caucasus and Central and West Asia** comprises Armenia, Azerbaijan, Georgia, Kazakhstan, the Kyrgyz Republic, Tajikistan, Türkiye, Turkmenistan, and Uzbekistan.
        - **Developing East Asia** comprises the People's Republic of China and Mongolia.
        - **South Asia** comprises Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka.
        - **Developing Southeast Asia** comprises Brunei Darussalam, Cambodia, Indonesia, the Lao People's Democratic Republic, Malaysia, Myanmar, the Philippines, Thailand, Timor-Leste, and Viet Nam.
        - **The Pacific** comprises the Cook Islands, Fiji, Kiribati, the Marshall Islands, the Federated States of Micronesia, Nauru, Niue, Palau, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu.
    - **Advanced Asia and the Pacific** comprises seven regional members of the Asian Development Bank: Australia; Hong Kong, China; Japan; the Republic of Korea; New Zealand, Singapore; and Taipei,China.
- **Association of Southeast Asian Nations** (ASEAN) comprises Brunei Darussalam, Cambodia, Indonesia, the Lao People's Democratic Republic, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Viet Nam. ASEAN 4 comprises Indonesia, Malaysia, the Philippines, and Thailand.

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

A number of assumptions have been made for the projections in *Asian Development Outlook April 2026*. The policies of domestic authorities are maintained. Real effective exchange rates remain constant at their average from 10 February to 31 March 2026. The average price of oil is $72/barrel in 2026 and $63/barrel in 2027. The US federal funds rate averages 3.64% in 2026 and 3.50% in 2027, and the European Central Bank's deposit facility rate averages 2.00% in 2026 and 1.67% in 2027.

All data in *Asian Development Outlook April 2026* were accessed from 10 February to 18 March 2026.

ABBREVIATIONS

AAP	advanced Asia and the Pacific
ADB	Asian Development Bank
AI	artificial intelligence
BOI	Board of Investment
CIT	corporate income tax (Papua New Guinea)
CNY	Chinese yuan
COFA	Compact of Free Association
CPI	consumer price index
CTF	Compact Trust Fund
DAP	developing Asia and the Pacific
EDL	Électricité du Laos (Lao People’s Democratic Republic)
END	Extraordinary Needs Distribution (Marshall Islands)
EPC	Electric Power Corporation (Samoa)
EU	European Union
FDI	foreign direct investment
FSM	Federated States of Micronesia
FY	fiscal year
GDP	gross domestic product
GST	goods and services tax
GVC	global value chain
H	half
ICT	information and communication technology
IDP	Infrastructure Development Plan (Federated States of Micronesia)
IEA	International Energy Agency
IMF	International Monetary Fund
IPO	initial public offering
kWh	kilowatt-hour
KZT	Kazakhstani tenge
Lao PDR	Lao People’s Democratic Republic
LED	log export duty (Papua New Guinea)
LNG	liquefied natural gas
M2	broad money
MSME	micro, small, and medium-sized enterprise
MW	megawatt
NCD	noncommunicable disease
NDC	nationally determined contribution
NEER	nominal effective exchange rate
NPL	nonperforming loan
NRW	nonrevenue water (Cook Islands)
nsa	not seasonally adjusted
NTF	Nauru Intergenerational Trust Fund
O&M	operation and maintenance (Tuvalu)
OPEC+	Organization of the Petroleum Exporting Countries and partners

PBOC	People's Bank of China
PMI	purchasing managers' index
PNG	Papua New Guinea
PPP	public–private partnership
PRC	People's Republic of China
PRs	Pakistan rupees
Q	quarter
qoq	quarter on quarter
RBI	Reserve Bank of India
RPC	Regional Processing Centre (Nauru)
RUB	Russian ruble
sa	seasonally adjusted
SOE	state-owned enterprise
TFP	total factor productivity
TL	Turkish lira
UBI	Universal Basic Income (Marshall Islands)
US	United States
VAT	value-added tax
yoy	year on year

ADO APRIL 2026
HIGHLIGHTS

The conflict in the Middle East has amplified global geopolitical risks. Under an early stabilization scenario, economic growth in developing Asia and the Pacific is projected to moderate to 5.1% in both 2026 and 2027. Higher energy prices will raise production costs and consumer prices, while export growth will normalize following last year's front-loading ahead of US tariff increases.

However, incoming evidence since this report's key assumptions were finalized on 10 March points to a higher likelihood of prolonged disruptions from the conflict keeping energy prices elevated, raising inflation and weighing further on growth across the region. This report explores alternative scenarios for the duration and severity of the conflict, along with their implications for developing Asia and the Pacific.

Additional risks cloud the outlook. An abrupt tightening in global financial conditions could raise borrowing costs. New tariff increases and trade policy uncertainty could also disrupt global supply chains and weaken external demand.

Albert F. Park
Chief Economist
Asian Development Bank

The Middle East Conflict Challenges Resilience in Asia and the Pacific

- **The conflict in the Middle East has reintroduced geopolitical tensions and energy market disruptions as central drivers of the global macroeconomic outlook.** The conflict escalated on 28 February 2026, disrupting energy production facilities and key commodity transport routes. Within two weeks, the Brent oil price had spiked to over $100/barrel, up by about 70% since the start of the year, with the Oman benchmark—which is more relevant for Asia—rising even more sharply. While developing Asia and the Pacific (DAP) has only modest direct trade exposure to Middle Eastern economies, it is highly vulnerable to spillovers transmitted through global energy markets, trade and transport networks, and financial conditions.

- **The 2026 conflict impacts developing Asia and the Pacific beyond higher energy prices.** Economies in the Middle East are major suppliers of fertilizers and related inputs, including urea and ammonia, much of which transits through the Strait of Hormuz, a critical waterway for commodity exports. Disruptions to production and transport have already tightened these markets, pushing up prices. This raises agricultural production costs and can feed through with a lag into food prices. Semiconductor output could also be affected, as the conflict impacts shipments of helium, sulfur, and petrochemical products, which are key inputs for chip manufacturing. The conflict also disrupts aviation links between Asia and Europe, which will weigh on tourism-dependent economies, while remittance inflows from the Middle East could slow. Additionally, steep stock market declines could weigh on confidence and consumption.

- **Regional financial conditions have tightened since the Middle East conflict escalated on 28 February 2026.** After remaining broadly stable in January–February, financial markets weakened as volatility increased and risk sentiment deteriorated. Equity prices declined, risk premiums widened, bond yields rose, and most regional currencies depreciated against the US dollar. Net portfolio flows turned negative, but outflows were broadly contained. Global and regional financial conditions could tighten further if the conflict worsens, exacerbating debt vulnerability in highly leveraged economies and weighing on investment and external demand.

- **The key assumptions for this report, finalized on 10 March under exceptionally high uncertainty, envisaged the conflict lasting around 1 month, with disruptions gradually easing thereafter.** This early stabilization scenario does not anticipate a prolonged interruption to Gulf energy production or shipping through the Strait of Hormuz. Oil and gas prices peak in March 2026, then normalize gradually and converge toward pre-conflict levels toward year-end. Under these assumptions, the crisis raises inflation across DAP and dampens gross domestic product (GDP) growth in energy-importing economies this year, but does not materially undermine the region's resilience.

- **Incoming evidence since 10 March points to a higher likelihood of more persistent disruptions than under the early stabilization scenario.** Military actions, including against energy infrastructure, continued into early April. Damage to such facilities or a long closure of the Strait of Hormuz could curb exports of energy and other commodities from the Middle East for a significant period, with longer-lasting effects on prices.

- **Under the early stabilization scenario, growth in developing Asia and the Pacific is forecast to moderate to 5.1% in both 2026 and 2027.** However, alternative assumptions suggest that it would fall to 4.7% in 2026 and 4.8% in 2027 if disruptions in the Middle East last through the third quarter of 2026. These projections remain subject to an exceptionally high degree of uncertainty. The region entered this challenging environment with solid momentum, as growth strengthened to 5.4%

in 2025 on resilient domestic demand. Economic activity over the forecast horizon will continue to be supported by steady labor markets, higher public infrastructure spending, and accommodative policy. The conflict will weigh on growth mainly through higher production costs and consumer prices, as well as weaker external demand from trade and tourism. The fading boost from earlier export front-loading will add to these headwinds.

- **Renewed trade uncertainty will also weigh on the outlook.** In February 2026, the US replaced many tariffs introduced in 2025 on specific economies with a flat 10% global tariff valid for 150 days, while signaling a possible increase to 15% and other measures singling out particular products and economies. Export front-loading could reemerge and support growth in the short term, but elevated uncertainty and renewed trade tensions will dampen regional investment.

- **Growth is set to moderate across all subregions in developing Asia and the Pacific.** In the People's Republic of China (PRC), private consumption will remain subdued in line with modest household income growth, while continued property market weakness and slower export expansion are also expected to weigh on activity. Growth in India will ease but remain robust, bolstered by resilient consumption, recent trade agreements, and ongoing structural reforms. Activity is expected to moderate in the Caucasus and Central and West Asia, as oil output plateaus in Kazakhstan and growth in Türkiye remains steady driven by robust domestic demand. In the Pacific, growth will decelerate as tourism slows and hydrocarbon output flattens. Developing Southeast Asia is forecast to maintain broadly steady growth, supported by resilient domestic demand and infrastructure spending, though weaker global trade and fading export front-loading effects will weigh on some economies.

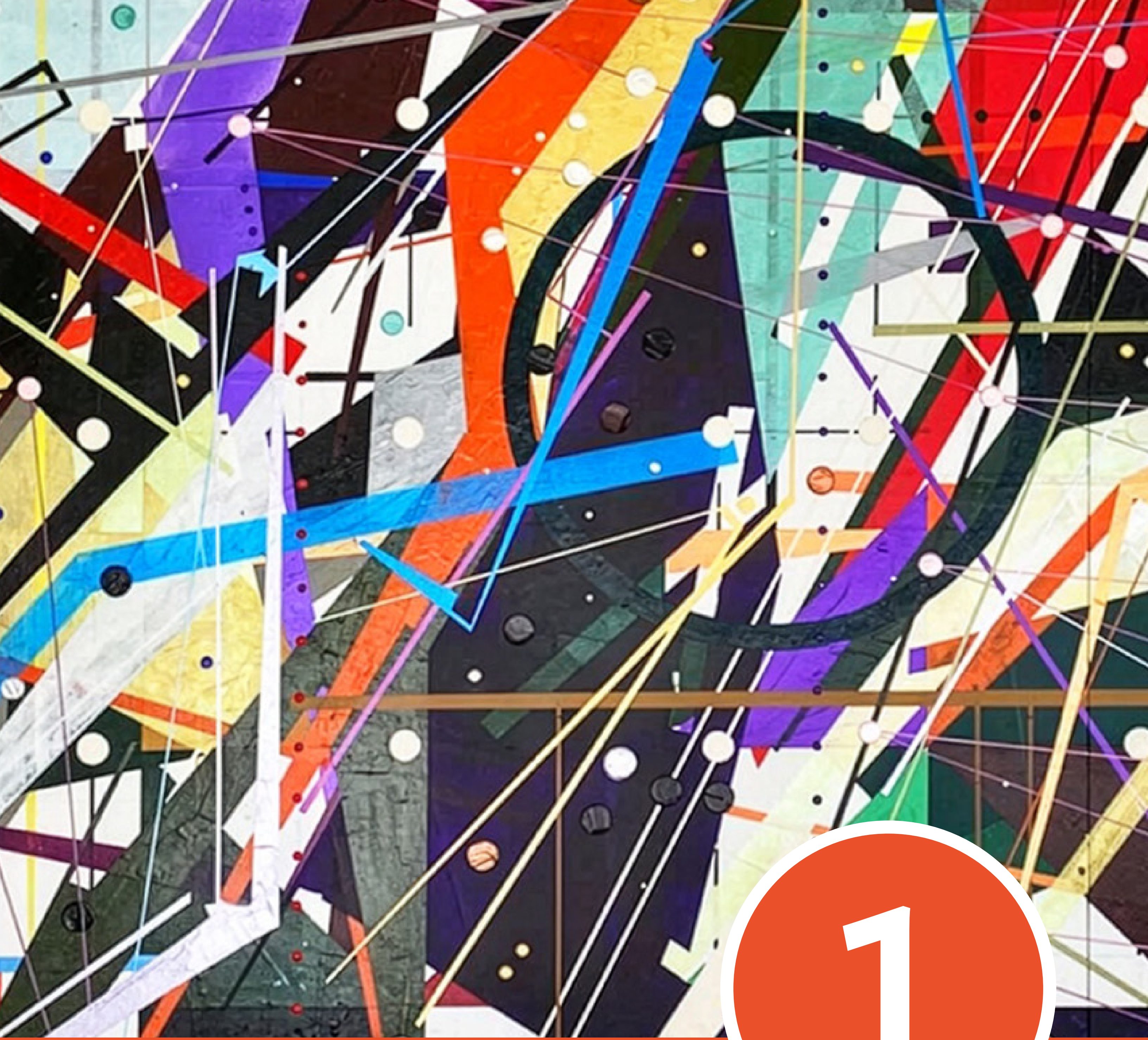
- **Under the early stabilization scenario, inflation is projected at 3.6% in 2026 and 3.4% in 2027, but alternative assumptions suggest that it would rise to 5.6% in 2026 if tensions in the Middle East last through the third quarter of this year.** In the PRC, inflation is forecast to increase modestly reflecting higher food prices and as measures to curb excessive competition among producers gain traction. In South Asia, upward pressure on prices will come from food and energy inflation. Stronger domestic demand in developing Southeast Asia and higher energy prices in the Pacific are expected to push inflation higher in these subregions. In contrast, price pressure in the Caucasus and Central and West Asia is projected to continue to ease as monetary conditions remain tight in some economies and inflation in Türkiye decelerates further.

- **A severe conflict escalation poses significant risks to the outlook.** This report quantifies potential impacts from a scenario in which disruptions to Gulf energy production and transport routes are substantially broader than observed in March and early April. In this scenario, energy prices spike further and remain elevated through the first quarter of 2027, with Brent oil reaching $155/barrel in the second quarter of 2026. Higher energy and transport costs would intensify inflationary pressures, erode real incomes, and weigh more heavily on growth across DAP. Regional growth would be 1.3 percentage points lower over 2026-27 than projected under the early stabilization scenario, while inflation would be 3.2 percentage points higher. Supply chain disruptions and sharply deteriorating financial conditions could further amplify the effects.

GDP Growth Rate and Inflation, % per year

	GDP Growth				Inflation			
	2024	2025	2026	2027	2024	2025	2026	2027
Developing Asia and the Pacific (DAP)	**5.3**	**5.4**	**5.1**	**5.1**	**5.3**	**3.0**	**3.6**	**3.4**
DAP excluding the People's Republic of China	**5.6**	**5.9**	**5.5**	**5.8**	**10.5**	**6.1**	**6.8**	**5.8**
Caucasus and Central and West Asia	**4.3**	**4.6**	**4.2**	**4.4**	**41.1**	**25.6**	**20.6**	**16.3**
Armenia	5.9	7.2	5.5	5.7	0.3	3.3	3.8	3.2
Azerbaijan	4.1	1.4	2.0	1.8	2.2	5.6	5.7	4.9
Georgia	9.7	7.5	5.5	5.2	1.1	3.9	3.8	3.3
Kazakhstan	5.0	6.5	4.8	4.5	8.7	11.4	10.4	9.5
Kyrgyz Republic	11.5	11.1	8.9	8.4	5.0	8.2	10.3	8.5
Tajikistan	8.4	8.4	7.3	6.8	3.6	3.5	4.0	4.5
Türkiye	3.3	3.6	3.6	4.0	60.0	35.2	27.7	21.5
Turkmenistan	6.3	6.3	6.5	6.2	5.5	5.5	6.0	6.0
Uzbekistan	6.7	7.7	6.7	6.8	9.8	7.3	6.5	5.0
Developing East Asia	**5.0**	**5.0**	**4.6**	**4.5**	**0.2**	**0.0**	**0.6**	**1.0**
People's Republic of China	5.0	5.0	4.6	4.5	0.2	0.0	0.6	1.0
Mongolia	5.1	6.8	5.7	6.0	6.2	8.6	7.8	6.8
South Asia	**6.4**	**6.8**	**6.3**	**6.8**	**6.4**	**2.9**	**5.0**	**4.6**
Afghanistan	2.3	1.9	2.3	2.8	−7.7	−4.2	4.6	3.2
Bangladesh	4.2	3.5	4.0	4.7	9.7	10.0	9.0	8.5
Bhutan	7.5	8.5	6.9	7.2	2.8	3.5	3.9	3.2
India	7.1	7.6	6.9	7.3	4.6	2.1	4.5	4.0
Maldives	3.5	5.4	1.0	3.0	1.4	4.0	5.0	4.0
Nepal	3.7	4.6	2.7	5.0	5.4	4.1	3.7	4.5
Pakistan	2.6	3.1	3.5	4.5	23.4	4.5	6.4	6.5
Sri Lanka	5.0	5.0	4.0	4.2	1.2	−0.5	5.2	4.0
ASEAN	**5.0**	**4.8**	**4.6**	**4.6**	**3.0**	**2.2**	**3.1**	**2.8**
Developing Southeast Asia	**4.9**	**4.8**	**4.7**	**4.8**	**3.0**	**2.3**	**3.2**	**2.8**
Brunei Darussalam	4.1	0.7	1.6	1.9	−0.4	−0.3	0.9	0.4
Cambodia	6.0	5.2	4.5	5.0	0.8	2.5	2.8	2.5
Indonesia	5.0	5.1	5.2	5.2	2.3	1.9	2.5	2.5
Lao People's Democratic Republic	4.0	4.4	4.0	4.5	23.1	7.7	9.8	6.7
Malaysia	5.1	5.2	4.6	4.5	1.8	1.4	1.8	1.9
Myanmar	−0.7	−2.2	2.4	2.7	29.6	25.2	24.0	16.0
Philippines	5.7	4.4	4.4	5.5	3.2	1.7	4.0	3.5
Thailand	2.9	2.4	1.8	2.0	0.4	−0.1	1.3	1.0
Timor-Leste	4.3	3.9	3.8	4.1	2.1	0.5	1.7	2.0
Viet Nam	7.1	8.0	7.2	7.0	3.6	3.3	4.0	3.8
The Pacific	**3.9**	**4.2**	**3.4**	**3.2**	**1.7**	**3.0**	**4.2**	**3.5**
Cook Islands	15.1	4.0	2.7	3.0	4.6	2.0	3.5	3.3
Fiji	3.5	3.0	2.9	2.7	3.9	−1.4	3.3	1.9
Kiribati	4.6	4.3	3.1	2.6	2.6	6.5	5.3	4.2
Marshall Islands	2.5	3.0	3.7	2.8	5.7	5.6	5.7	4.0
Federated States of Micronesia	2.3	1.1	1.0	1.0	5.4	3.9	3.5	3.0
Nauru	1.6	2.1	2.5	2.5	9.3	6.1	4.5	4.0
Niue	8.7	2.7	2.5	2.5	5.4	2.3	3.4	2.8
Palau	12.0	6.9	6.0	3.7	3.7	0.2	2.8	2.4
Papua New Guinea	3.9	4.7	3.6	3.4	0.6	4.4	4.6	4.0
Samoa	4.8	4.2	3.2	3.0	3.6	1.9	1.8	4.0
Solomon Islands	3.0	3.6	3.0	3.4	4.2	3.4	4.5	2.8
Tonga	1.8	2.5	2.3	2.3	8.0	2.9	3.8	2.7
Tuvalu	3.1	2.7	2.5	2.4	0.4	2.8	3.1	1.0
Vanuatu	3.8	3.8	4.7	3.9	1.2	0.7	2.0	2.7

ASEAN = Association of Southeast Asian Nations, GDP = gross domestic product.
Notes: ASEAN comprises Brunei Darussalam, Cambodia, Indonesia, the Lao People's Democratic Republic, Malaysia, Myanmar, the Philippines, Singapore, Thailand, Timor-Leste, and Viet Nam. ADB placed on hold its regular assistance in Afghanistan effective 15 August 2021. Effective 1 February 2021, ADB placed a temporary hold on sovereign project disbursements and new contracts in Myanmar.
Source: *Asian Development Outlook* database.



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THE MIDDLE EAST CONFLICT CHALLENGES RESILIENCE IN ASIA AND THE PACIFIC

THE MIDDLE EAST CONFLICT CHALLENGES RESILIENCE IN ASIA AND THE PACIFIC

The conflict in the Middle East has negatively affected the economic outlook for developing Asia and the Pacific. *As a major net importer of crude oil, refined oil products, and natural gas, the region is highly exposed to adverse spillovers from the conflict. These are already materializing, mainly through higher prices of energy and other commodities, disrupted shipping routes, and tighter financial conditions.*

The key assumptions for this report, finalized on 10 March under exceptionally high uncertainty, envisaged the conflict lasting around 1 month, with disruptions gradually easing thereafter. *Under this early stabilization scenario, regional growth is forecast to moderate only slightly, to 5.1% in both 2026 and 2027 from 5.4% in 2025, reflecting the region's still-resilient domestic demand. At the same time, incoming evidence points to more persistent disruptions. As of early-April, military activity in the Middle East was continuing. Traffic through the Strait of Hormuz, a crucial waterway through which the vast majority of commodity exports from the Middle East are transported, was still close to zero. Critical energy infrastructure was damaged, with reconstruction potentially taking years.*

Against this backdrop, the Middle East conflict could affect growth and inflation in developing Asia and the Pacific more severely than this report's early stabilization scenario forecasts suggest. *Illustrative analyses indicate that, in a severe-crisis scenario in which energy prices rise significantly above their March 2026 levels and stay elevated through the first quarter of 2027, regional growth could be 1.3 percentage points lower and inflation 3.2 percentage points higher over 2026-2027. Additional risks stem from lagged effects of higher fertilizer prices on agricultural production and food inflation, as well as heightened financial market volatility, which could exacerbate vulnerabilities in highly leveraged and externally dependent economies.*

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

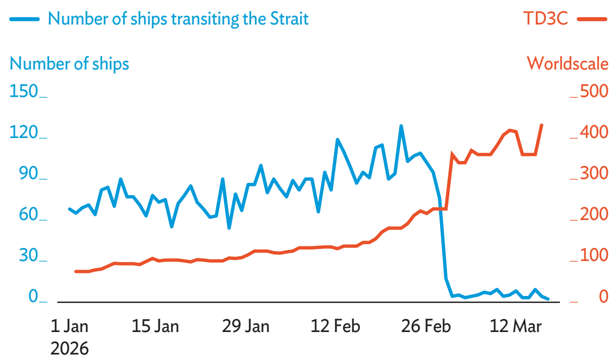
Resilient Growth Despite Trade and Geopolitical Shocks

The conflict in the Middle East has added new uncertainty to the regional outlook. On 28 February 2026, geopolitical tensions escalated into a new conflict in the Middle East, disrupting energy production facilities and the key global energy transport route through the Strait of Hormuz (Figure 1.1.1). The Brent crude oil price climbed from the low $70s just before the beginning of military actions to an intraday high of nearly $120 per barrel at the peak of market tensions. It later settled at just above $100 until this report's data cut-off in March (Figure 1.1.2, panel A). Dubai and especially Oman benchmarks increased by much more, indicating that markets priced a particularly acute disruption to Gulf-linked physical supply. For Asian importers, this implies that the effective cost of crude oil has risen by more than Brent alone would suggest. Natural gas markets reacted similarly strongly (Figure 1.1.2, panel B).

Developing Asia and the Pacific (DAP) is highly exposed. While the region's direct trade links to Middle East economies are moderate, exposure comes from spillovers through energy prices, shipping, aviation, and financial markets because of its heavy

Figure 1.1.1 Number of Ships Transiting the Strait of Hormuz and Oil Shipping Costs to Asia

Ship traffic through the Strait of Hormuz collapsed while freight costs rose as markets priced in higher disruption risk.



PRC = People's Republic of China, VLCC = very large crude carrier.

Notes: Conflict in the region brings reports of global positioning system jamming, automatic identification system spoofing, and vessels going dark, so data on the number of ships passing through the Strait of Hormuz since 1 March may not be accurate. TD3C is the Baltic Exchange spot freight route assessed for a VLCC carrying 270,000 tons of crude from Ras Tanura, Saudi Arabia to Ningbo, PRC. Freight rates are quoted in Worldscale, a tanker freight pricing system that expresses rates as a percentage of a published base rate for a given route and tanker size. The data refer to forward freight rates for March 2026. Last observation 18 March 2026.

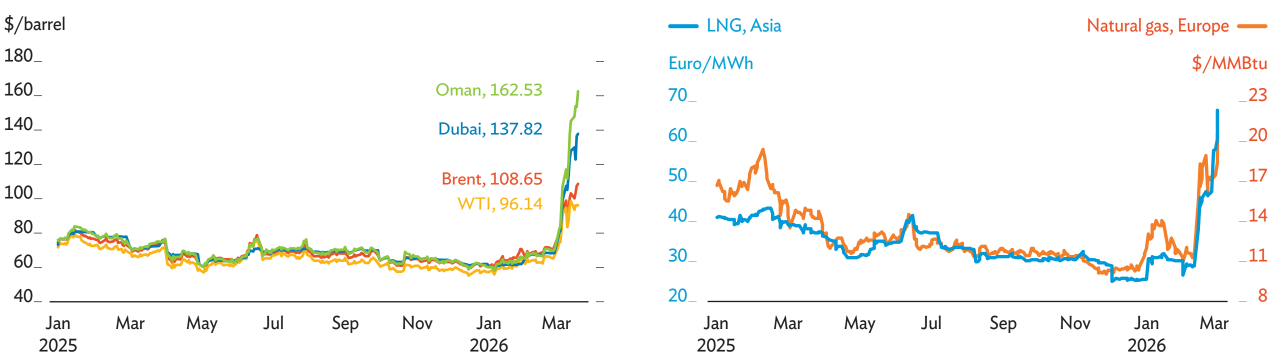
Sources: IMF Portwatch; Bloomberg.

Figure 1.1.2 Brent Crude Oil and Natural Gas Prices

Benchmark oil and natural gas prices soared after the escalation of the conflict.

A. Crude Oil Front Month Futures Prices

B. Natural Gas Front Month Futures Prices



LNG = liquefied natural gas, MMBtu = million British thermal unit, MWh =megawatt-hour, WTI = West Texas Intermediate.

Notes: Close-of-day prices. Last observation is 19 March 2026. Europe's natural gas benchmark is the Dutch Title Transfer Facility (TTF), while Asia's LNG benchmark is the Japan–Korea Marker (JKM).

Source: Bloomberg.

reliance on imported hydrocarbons from the Gulf and its central role in global trade networks. The risk is especially important because the Strait of Hormuz is a critical transportation chokepoint. In 2024 and early 2025, the strait carried more than 25% of global seaborne oil trade and about 20% of global oil consumption and LNG trade, with more than 80% of it ultimately destined for Asian markets. As the conflict escalated, damage to energy infrastructure and disruption to transport routes have therefore raised concerns about not only oil supply, but also freight costs, delivery times, and broader confidence effects.

Growth Was Resilient as Inflation Cooled in 2025

DAP enters challenging times from a position of strength, with growth remaining robust and edging up slightly to 5.4% in 2025 from 5.3% in 2024 (Box 1.1.1). Robust private consumption last year offset low contributions to gross domestic product (GDP) growth from weak investment and net exports. Exports benefited from strong global demand for artificial intelligence (AI) products, front-loaded shipments ahead of United States (US) tariff increases, and export market diversification. However, faster growth in imports of capital goods and components curtailed net export gains. Investment weakened, dented by property market strains in the People's Republic of China (PRC) and heightened trade uncertainty. Fiscal stimulus supported consumption in the PRC, as did tax cuts in India. Subregional growth patterns diverged. Growth in South Asia accelerated sharply from 6.4% in 2024 to 6.8% in 2025 on strong consumption in India. Developing East Asia grew steadily by 5%, as strong exports and resilient consumption offset persistent investment weakness in the PRC. Growth in the Caucasus and Central and West Asia picked up from 4.2% to 4.6%, aided by earthquake reconstruction in Türkiye, and in the Pacific from 3.9% to 4.2% on a mining-led rebound in Papua New Guinea. In contrast, growth in developing Southeast Asia eased slightly to 4.8%, reflecting various constraints on domestic demand across economies (Figure 1.1.3).

Box 1.1.1 Updated Economy Groups in Asian Development Outlook

This edition of the *Asian Development Outlook (ADO)* introduces a revised classification of economies to better reflect their level of development. *ADO* economy groups have remained unchanged for more than 2 decades, despite several economies having long since graduated from developing status. Regional ADB member economies are now organized into two groups: advanced Asia and the Pacific (AAP) and developing Asia and the Pacific (DAP). AAP comprises economies classified as advanced by the International Monetary Fund and as high-income by the World Bank: Australia; Hong Kong, China; Japan; the Republic of Korea; New Zealand; Singapore; and Taipei,China. DAP includes all remaining regional member economies. AAP and DAP aggregate to Asia and the Pacific, but DAP is the default meaning of "the region" or "regional economies" in ADO.

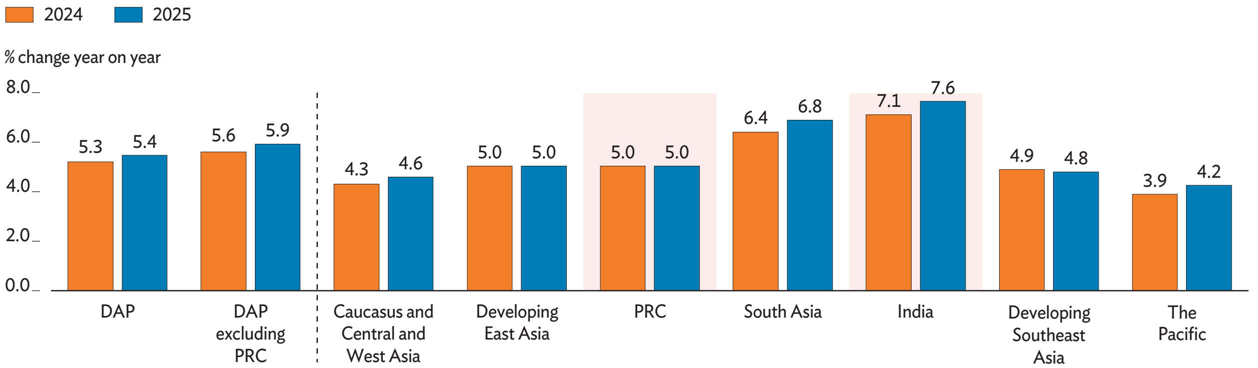
Subregions have been updated to reflect the revised classification of economies and the inclusion of Türkiye. ADO now covers Türkiye, which joined the bank in 1991 as a nonregional member and now, as ADB's newest regional member, is eligible for loans using ADB ordinary capital resources and full participation in ADB operations (ADB 2025). With Türkiye's inclusion, the Caucasus and Central Asia subregion has been renamed the Caucasus and Central and West Asia (CCWA). Under the revised structure, developing East Asia—formerly East Asia—only comprises the People's Republic of China (PRC) and Mongolia, while developing Southeast Asia—formerly Southeast Asia—now excludes Singapore. The composition of the South Asia and Pacific subregions is unchanged.

DAP is the primary focus of ADO, with AAP resituated in the broader global context. Developments in AAP are discussed insofar as they influence the regional outlook. The annex to Part 1 provides more detailed analysis of AAP economies, alongside developments in the United States, the euro area, and global oil markets. The main report presents data using the revised classification, while statistics based on the old groupings are reported in the statistical appendix.

Reference:
ADB. 2025. ADB Welcomes Türkiye as Regional Member. News release. 6 May.

Figure 1.1.3 Annual GDP Growth, Developing Asia and the Pacific

Regional growth picked up in 2025, except in developing East Asia and developing Southeast Asia.



PRC = People's Republic of China, DAP = developing Asia and the Pacific.

Notes: DAP covers the 43 developing member economies of the Asian Development Bank. Data for India are for fiscal years, from 1 April to 31 March of the following year. Box 1.1.1 has detailed discussion of the revised classification of regional member economies introduced in this report.

Source: *Asian Development Outlook 2026* database.

Growth eased slightly in the second half (H2) of last year as trade lost momentum. Regional GDP growth slowed from 5.5% year on year in H1 to 5.4% in H2, as growth in the PRC decelerated from 5.3% to 4.7%. This moderation was driven by a significant decline in the contribution of net exports, despite robust electronics gross exports (Figure 1.1.4, panel A). Net exports also weighed on growth in other economies. In Thailand, their contribution turned slightly negative in H2, while in Malaysia it remained negative as imports of components for export-oriented production accelerated. In Türkiye, the drag from net exports worsened in H2 as fuel exports decreased. Bucking this trend, Indonesia and the Philippines saw stronger net export contributions, underpinned by solid global demand for electronics and rising exports to markets other than the US. In India, higher exports of goods and services offset rising imports, leaving the contribution of net exports to growth broadly neutral.

Consumption growth remained robust in the second half of 2025. Buoyant private consumption lifted India's growth rate from 6.9% in H1 to 8.1% in H2. Meanwhile, consumption growth declined somewhat in the PRC amid subdued consumer confidence, fading impact from earlier policy support, and negative wealth effects from falling house prices. Consumption growth strengthened in Indonesia, partly supported by higher government spending, and in Malaysia and Türkiye, reflecting stronger labor markets and government income support. In contrast, consumption growth in the Philippines fell markedly, dragged down by extreme weather events, adjustments to government spending, and the fading effects of an earlier election boost.

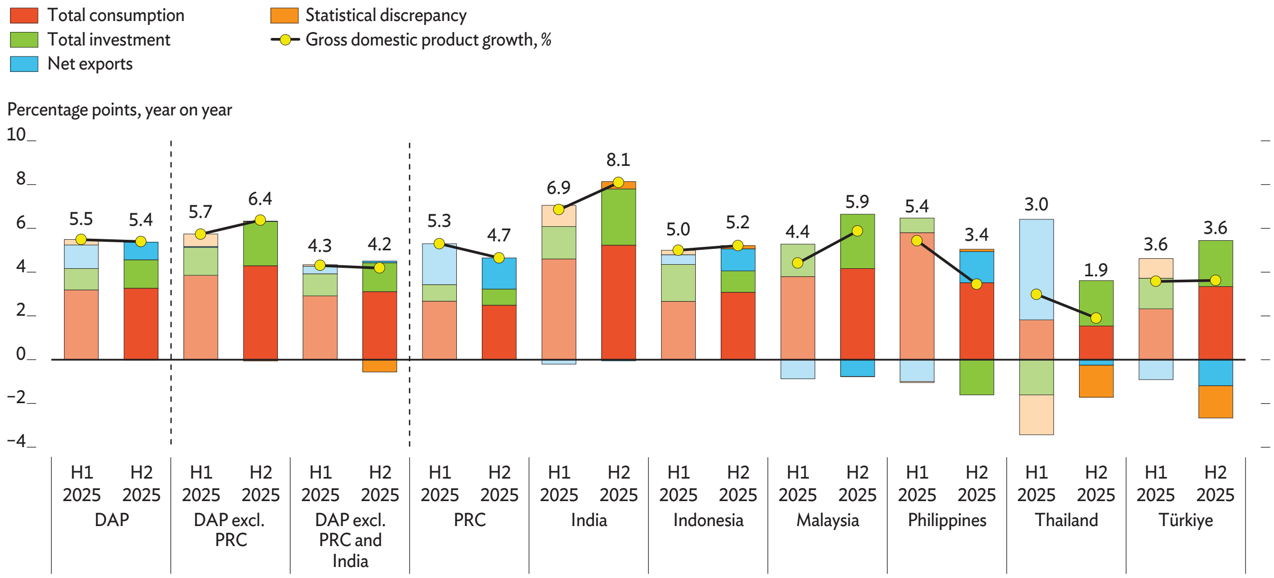
Regional investment was strong in H2 2025, with significant variation across economies and sectors. Surging public and private investment in India drove the regional performance, but domestic constraints and large inventory fluctuations affected capital formation in several economies (Figure 1.1.5, panel A). In Indonesia, investment growth moderated as inventory depletion offset increases in public infrastructure spending and private construction. In the Philippines, investment declined sharply under stricter fiscal controls, delayed public spending, and disruptive weather. Meanwhile, fixed asset investment in the PRC contracted by 12% in H2 as the property market continued to cool and business confidence weakened (Figure 1.1.5, panel B). By contrast, investment picked up in Malaysia and Thailand on inventory accumulation. The boom in global demand for AI infrastructure and products also supported IT investment across the region.

Services drove regional growth in 2025, with activity accelerating in the H2 (Figure 1.1.4, panel B). India led the region, with Indonesia, Malaysia, and Türkiye also recording healthy expansions. In contrast, growth in services moderated in the Philippines and Thailand, where weakness in real estate and tourism dampened performance. In

Figure 1.1.4 Contributions to GDP Growth in 2025, First Half vs Second Half

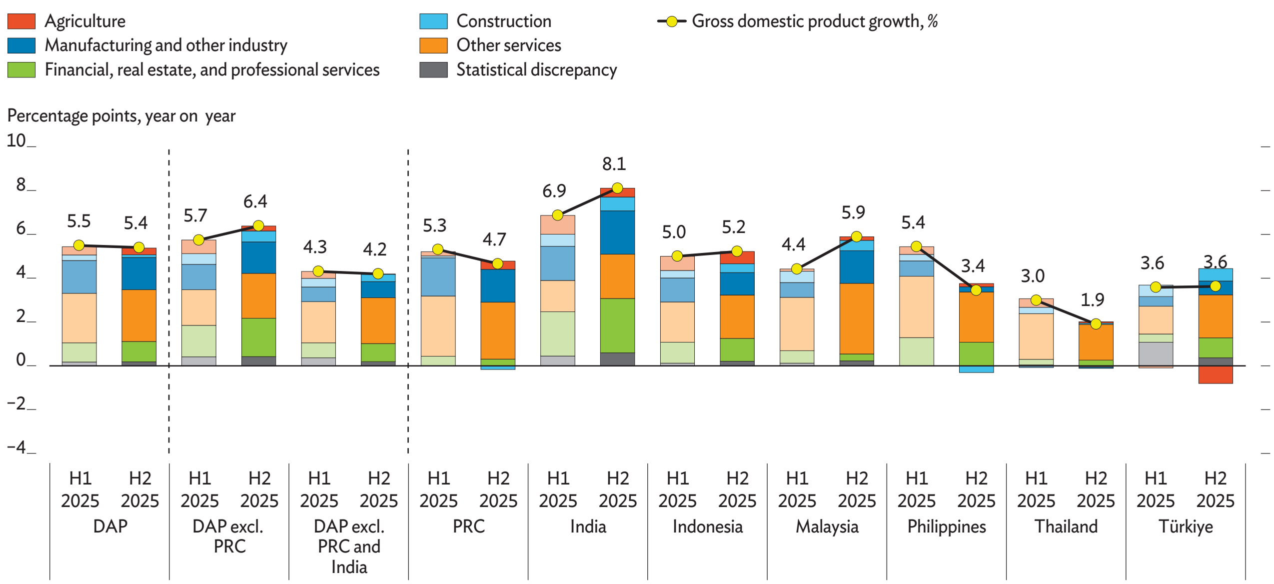
A. Demand-Side

Growth in developing Asia and the Pacific moderated slightly in H2 2025 as the trade impulse waned.



B. Supply-Side

Manufacturing and other industries showed mixed performance across economies in H2 2025, while services expanded rapidly outside of the PRC.



PRC = People's Republic of China, DAP = developing Asia and the Pacific, GDP = gross domestic product, H = half.

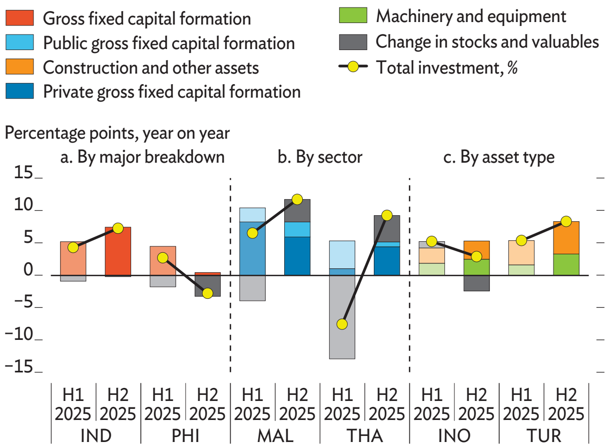
Notes: DAP economies included in this analysis are the PRC, India, Indonesia, Malaysia, the Philippines, Thailand, and Türkiye, which have quarterly GDP figures and supply- and demand-side data. These economies account for 89% of DAP GDP weighted by purchasing power parity. Totals may not sum precisely due to statistical discrepancies and chain-linking in panel A and in product taxes and subsidies in panel B. Data are for calendar years, not seasonally adjusted. For the PRC, the breakdown of supply-side contributions was estimated using sectoral shares from the 2023 ADB Multiregional Input–Output Table.

Sources: Asian Development Bank estimates using data from Haver Analytics; CEIC Data Company; official sources.

Figure 1.1.5 Investment Indicators, Developing Asia and the Pacific

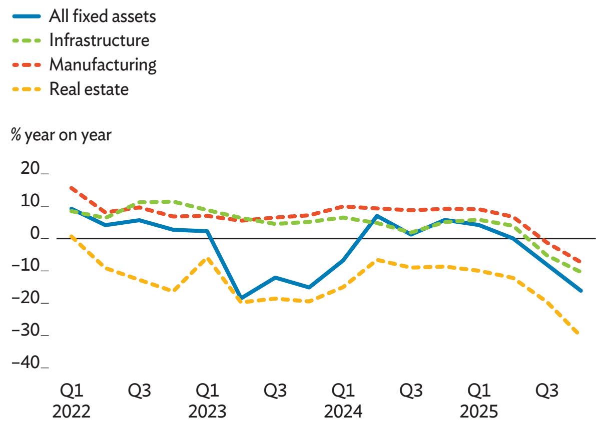
A. Contributions to Investment Growth, Selected Economies

Investment trends diverged in H2, with large swings in fixed investment and inventories in some economies.



B. Growth in Fixed Asset Investment, People's Republic of China

Contraction in fixed-asset investment deepened in H2.



H = half, IND = India, INO = Indonesia, MAL = Malaysia, PHI = Philippines, THA = Thailand, TUR = Türkiye.

Note: Data are for calendar years, not seasonally adjusted.

Sources: CEIC Data Company; Haver Analytics; official sources.

the PRC, services contributed slightly less to growth in H2 as a weak property market weighed on real estate activity and consumer sentiment.

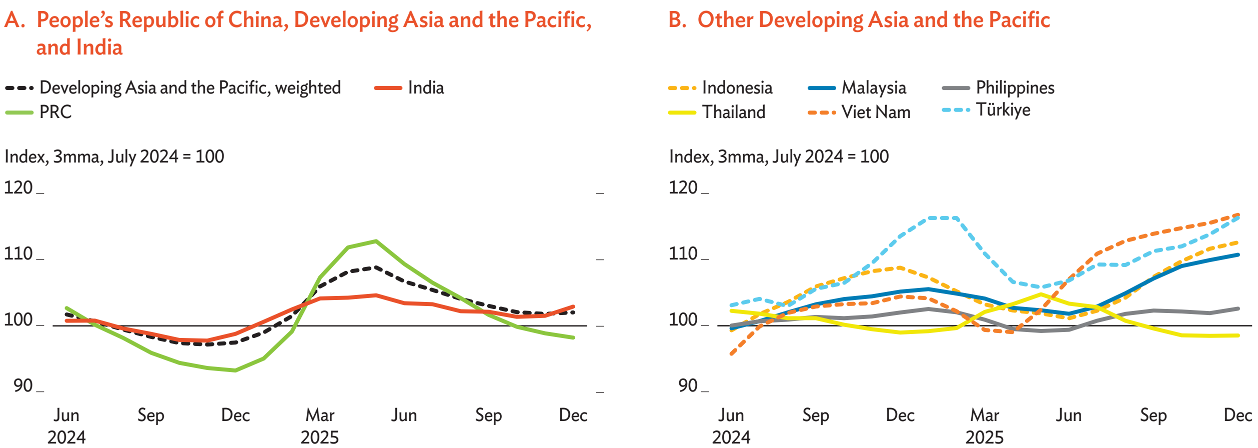
Industrial growth eased modestly in H2 2025 as construction contracted in the PRC and the Philippines. In the PRC, the property market slump continued to weigh on construction, while manufacturing growth slowed as authorities reined in excess industrial capacity and curbed aggressive competition. In contrast, industrial expansion in India strengthened early in 2025, eased midyear, and rebounded toward November–December on pharmaceuticals, electronics, and vehicles (Figure 1.1.6, panel A). Industrial growth picked up in H2 in several other regional economies (Figure 1.1.6, panel B). Viet Nam posted the strongest gains, driven by electronics, computers, and automobiles, while Malaysia benefited from stronger activity in key export-oriented industries, notably mining and electronics. Industrial production declined in Thailand, as late-year gains in automotive and electronic components were offset by weaker expansion in clothing, electrical equipment, and rubber. Agriculture posted steady growth over the year across most of the region except in Türkiye, where harvests contracted in H2 under erratic weather and rising prices for inputs such as diesel and fertilizer.

Leading indicators pointed to manufacturing acceleration in early 2026. The S&P Global Purchasing Managers' Index (PMI) for manufacturing was higher than 50, thus signaling improving activity, in six of the eight economies covered in February 2026 (Figure 1.1.7). Driven by stronger output, the PMI rebounded sharply in the Philippines and rose more moderately in the PRC, India, Indonesia, and Viet Nam. Higher new orders and employment also contributed to PMI gains in the PRC and India. In contrast, the PMI was below 50 in Malaysia and Türkiye as orders and output slipped.

Leading indicators for services likewise suggest strengthening growth. India's services PMI remained highly expansionary in February 2026, reflecting faster growth in new business intake and output. In the PRC, sharply rising new business inflow—partly aided by domestic promotional campaigns—lifted the services PMI. In the Philippines, the index fell below 50 in February as the effects of seasonal increases in remittances and tourism on services—including logistics and finance—faded. In Sri Lanka, the services PMI eased slightly in January but remained firmly in expansionary territory, underpinned by continued strength in trade, hospitality, and financial services.

Figure 1.1.6 Industrial Production

Industrial output growth moderated in the PRC and Thailand in H2 but picked up across many other regional economies.



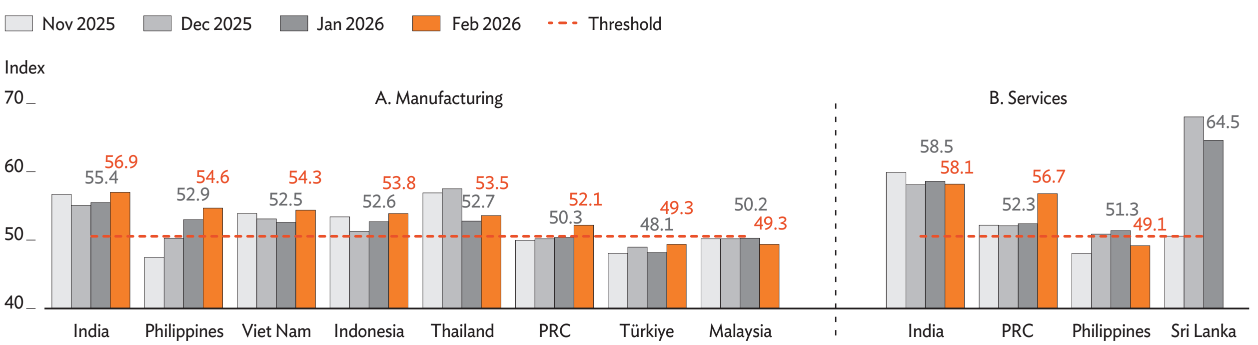
3mma = 3-month moving average, PRC = People's Republic of China.

Notes: The weighted industrial production index for developing Asia and the Pacific is constructed using GDP (PPP-adjusted) weights for economies with available monthly data and is presented as a 3-month moving average. Industrial production excludes construction. In the PRC, industrial production is measured by the index of industrial value added.

Source: CEIC Data Company.

Figure 1.1.7 Purchasing Managers' Index

Indexes pointed to improving economic activity in early 2026.



PRC = People's Republic of China.

Notes: Data are seasonally adjusted except for the services purchasing managers' indexes for the Philippines and Sri Lanka. Values above 50 indicate improvement, below 50 deterioration.

Source: CEIC Data Company.

Headline inflation eased gradually through most of 2025 before edging up toward year-end and in early 2026. After beginning the year above pre-pandemic levels, inflation declined steadily and stabilized from around midyear to October, as earlier price pressures unwound (Figure 1.1.8, panels A and B). Regional inflation fell from 4.5% in 2024 to 3.0% in 2025 with lower energy and food prices. Price pressures remained highly uneven across economies, with Türkiye recording the highest inflation rate in the region at 35.2% and the PRC the lowest at 0.0%. Better harvests, subdued consumer sentiment, intensified price competition in the PRC, and lagged effects from earlier monetary tightening helped contain prices. Core inflation remained broadly stable, near pre-pandemic levels, and accounted for more than two-thirds of headline inflation.

Inflation picked up modestly in late 2025 on rising food and energy prices. Food inflation, which had been negative from August to October 2025, turned positive in November and rose further in December

Figure 1.1.8 Contributions to Inflation by Aggregation

Inflation drivers varied across subregions over time.

Notes: Core inflation excludes food and energy. For some economies, core inflation is estimated as the residual of overall inflation after excluding food, nonalcoholic beverages, and energy. For lack of a more disaggregated breakdown, energy-related consumer prices in most economies include housing, water, and transport. Subregional averages are weighted using gross domestic product (GDP) adjusted for purchasing power parity and include the following economies, which account for 94% of GDP in developing Asia and the Pacific: Armenia, Georgia, Kazakhstan, and Türkiye in the Caucasus and Central and West Asia; Mongolia and the People's Republic of China in developing East Asia; India, Maldives, Nepal, Pakistan, and Sri Lanka in South Asia; Cambodia, Indonesia, the Lao People's Democratic Republic, Malaysia, the Philippines, and Thailand in developing Southeast Asia; and Fiji and Samoa in the Pacific.

Sources: Asian Development Bank estimates using data from Haver Analytics, CEIC Data Company, and official sources.

in line with global commodity trends. Despite peak harvest season, the benchmark Thai rice (5% broken) climbed to $424/ton in December, the highest since May 2025. This was driven by stronger export demand including from the PRC, domestic policy support, flood-related supply concerns, and Thai baht appreciation. Benchmark prices for US hard red winter wheat also increased in November and December on risks to Black Sea exports, adverse weather in the US and Russia, and expectations of higher PRC imports. In the PRC, fresh fruit and vegetable prices rose by an average of 2.6% in November and 16.4% in December. Brent crude oil prices fell for a third straight year in 2025, dropping from about $79/barrel in January to $62–$64 in December, for an average of $69 in 2025, as demand weakened and supply rose from outside of the OPEC+ alliance led by the Organization of the Petroleum Exporting Countries. Then, in early 2026, the conflict in the Middle East pushed prices sharply higher and made markets more sensitive to supply disruption risks.

Inflation firmed across the region in early 2026, with February data pointing to broader price pressures (Figure 1.1.8, panels C–F). The rise in South Asia primarily reflected higher prices for food, energy, gold (Box 1.1.2), and other precious metals, with India accounting for much of the increase. There, inflation averaged 3.0% year on year in January and February under the new consumer price index. Indonesia and the Philippines led inflation higher in developing Southeast Asia with higher food, housing, and utility costs. However, deflation persisted in Thailand as caps on electricity and fuel prices continued to hold down energy inflation. Developments in the Caucasus and Central and West Asia were driven by Türkiye, where tight monetary policy and base effects reduced inflation to 30.7% year on year—its lowest since November 2021—before February inflation ticked up to 31.5%, driven by high food and service costs. In the PRC, the consumer price index rose from 0.2% year on year in January 2026 to 1.3% in February, its highest in 3 years, as a demand surge in the Lunar New Year lifted prices for food, services, and travel.

Box 1.1.2 Gold at Record Highs: Safe-Haven Demand from Asia and the Pacific

Gold prices surged to record highs in early 2026 (box figure 1). Gold has long been regarded as a safe-haven asset—one that preserves value during periods of stress and uncertainty. This partly owes to its historical role as a store of value and its limited correlation with riskier financial assets. The recent surge unfolded against a backdrop of successive shocks, including the COVID-19 pandemic, geopolitical tensions, and rising trade policy uncertainty. Although gold prices eased following the outbreak of conflict in the Middle East, they remain close to historic highs.

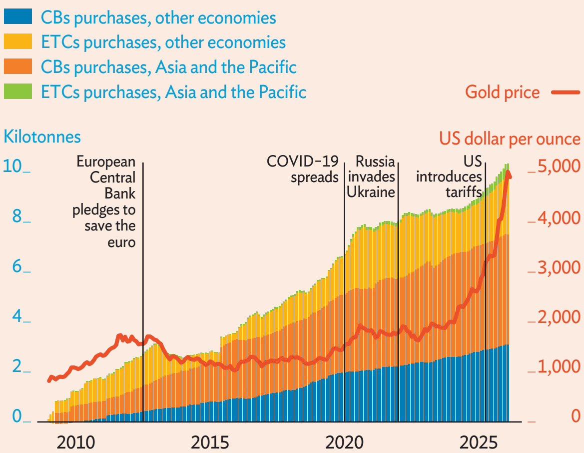
Central banks have purchased gold steadily following the 2008 Global Financial Crisis, while demand from gold-focused funds has been more cyclical. Most end-uses of gold, such as jewellery and technology, tend to adjust only gradually over short horizons and are therefore unlikely, by themselves, to explain sharp price swings. Central bank purchases have risen steadily since the Global Financial Crisis, likely reflecting a gradual rebalancing of reserve portfolios and a strategic shift toward greater diversification (box figure 1). By contrast, demand by gold-focused exchange-traded commodity (ETCs) funds has been more volatile and episodic, strengthening sharply during periods of heightened uncertainty and easing when tensions stabilized.

Gold-focused fund inflows from Asia and the Pacific accelerated markedly after the COVID-19 pandemic and displayed a close co-movement with the price of gold (box figure 2). While ETC demand from the region remains modest in absolute terms compared with that of other economies—primarily the United States (US) and Europe—the recent increase is striking. Around 0.4 kilotonnes were added in just over 2 years since January 2024, more than 3 times the cumulative inflows recorded over the previous 15 years, with the bulk of this increase occurring since early 2025. This rapid accumulation coincides with a very tight alignment between demand for gold from ETCs in Asia and the Pacific and prices over the same period. By contrast, ETC demand from other economies was more closely aligned with gold prices up to the COVID-19 pandemic, but this relationship significantly weakened thereafter. Over 2009 to 2025, the correlation between ETC demand

Box 1.1.2 *Continued*

1 Gold Price and Cumulative Purchases by Central Banks and Gold-Focused Investment Funds

The price of gold and gold-focused fund purchases have risen sharply since the pandemic.



CBs = Central banks; ETCs = Exchange-traded commodities; US = United States.

Notes: Purchases are cumulative since January 2009. A purchase of 604 tonnes that took place over a six-year period from 2009–2015 was announced by the People's Bank of China in June 2015 and is recorded for the same month. The sample goes from January 2009 to March 2026. Average for March 2026 is computed on the 1 March to 26 March period.

Sources: Gold World Council and ADB calculations.

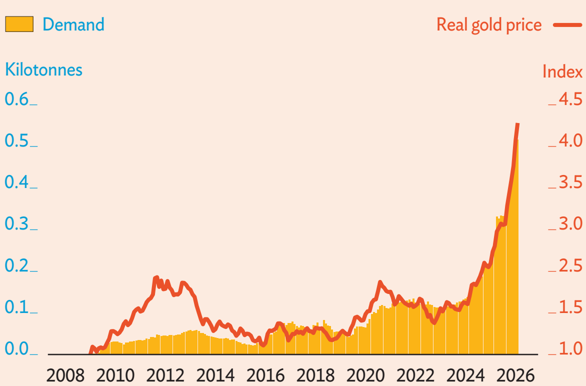
and gold prices is higher for Asia and the Pacific than for other economies, and this difference is particularly pronounced in the post–COVID-19 period, when the correlation rises to near unity for the region but falls sharply elsewhere (box table).

Investor demand for gold rises after uncertainty shocks only among funds domiciled in Asia, and this response has strengthened in recent years. Regression analysis and data on flows into gold-focused investment funds are used to examine how institutional investors' demand for gold responds to shocks in US trade policy uncertainty (TPU) and financial uncertainty, as measured by expected stock market volatility (VIX). In 2015–2020, TPU and VIX shocks left flows broadly unchanged across all funds (box figure 3). In 2021–2025, however, the same shocks triggered significant inflows into gold funds domiciled in Asia and the Pacific, with a one-standard-deviation increase in TPU and VIX raising flows by about 2.6 and 1.2 percentage points of fund assets, respectively, within 5 weeks. No comparable response is observed for funds domiciled outside the region. One possible explanation is that institutional investors in Asia and the Pacific hold sizable, only partially hedged US dollar–denominated asset positions, which can heighten exposure to exchange rate risk during periods of uncertainty and increase the appeal of diversifying into safe-haven assets such as gold, consistent with evidence in ADB (2024).

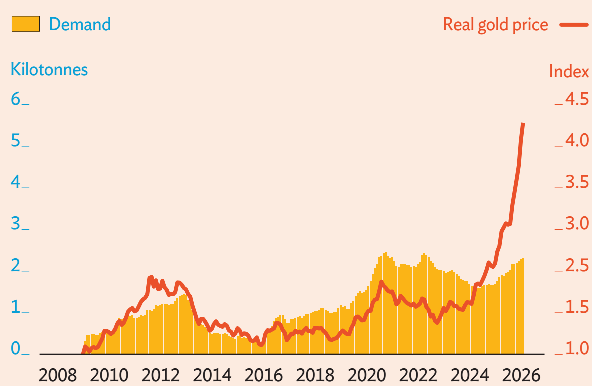
2 Retail Gold Price and Gold-Focused Fund Purchases

Gold demand in Asia and the Pacific has risen in tandem with the gold price in 2024 and 2025.

A. Asia and the Pacific



B. Other Economies



Notes: Purchases are cumulative since January 2009. The real gold price is the nominal price adjusted for the US consumer price index. The sample goes from January 2009 to February 2026.

Sources: World Gold Council, U.S. Bureau of Labor Statistics, Consumer Price Index for All Urban Consumers: All Items in U.S. City Average [CPIAUCSL], retrieved from FRED, Federal Reserve Bank of St. Louis, 26 March 2026, and ADB calculations.

Box 1.1.2 *Continued*

Correlation of Gold Purchases by Gold-Focused Funds and Real Gold Price

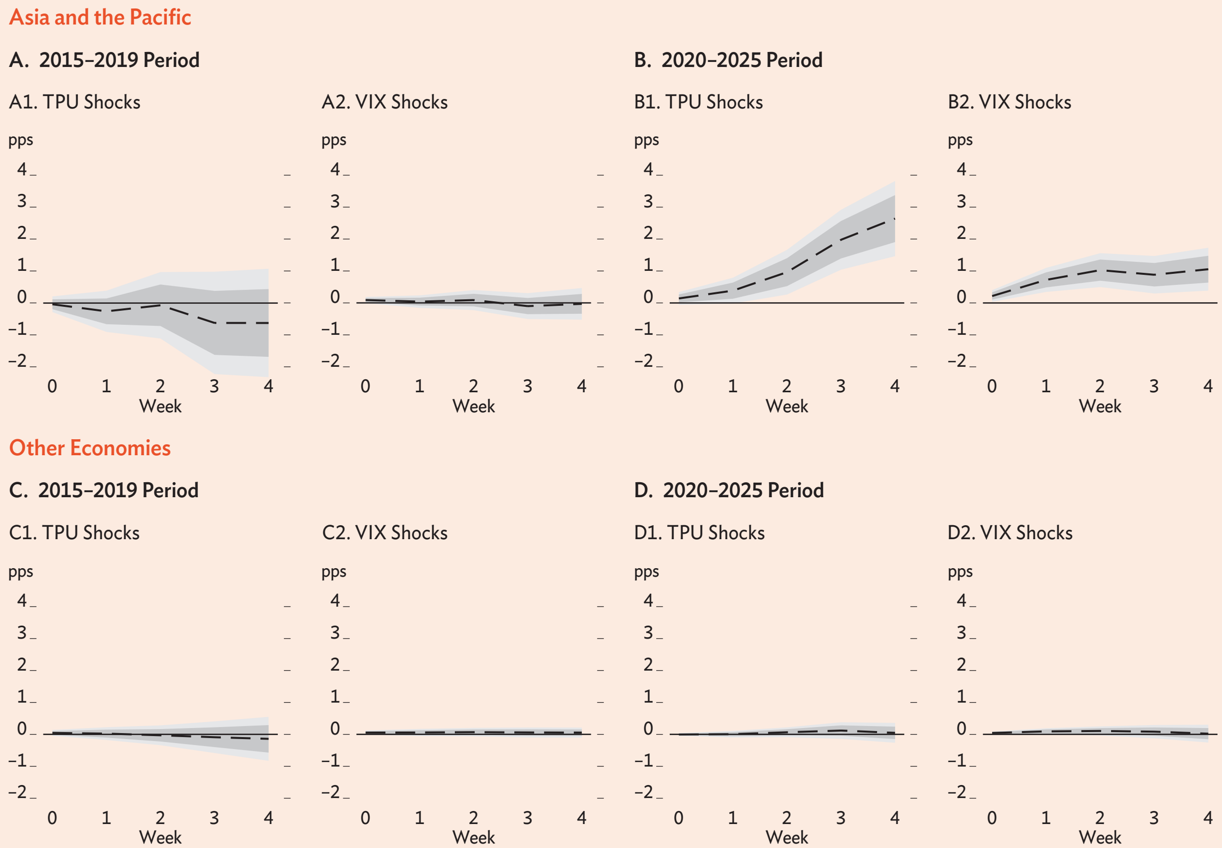
The correlation has broken down in non-regional economies.

	Asia and the Pacific	Other Economies
Full sample (January 2009 to February 2026)	0.89	0.61
Post-GFC period (January 2009 to December 2014)	0.77	0.92
Pre COVID-19 period (January 2015 to December 2019)	0.41	0.66
Post COVID-19 period (January 2020 to February 2026)	0.99	0.08

The real gold price is the nominal price adjusted for the US consumer price index.
Source: World Gold Council and ADB calculations.

3 Inflows into Gold-Focused Funds in Response to Uncertainty Shocks

Investors in Asia and the Pacific bought gold following uncertainty shocks since 2020.



pps = percentage points; TPU = Trade policy uncertainty; VIX = CBOE Volatility Index.

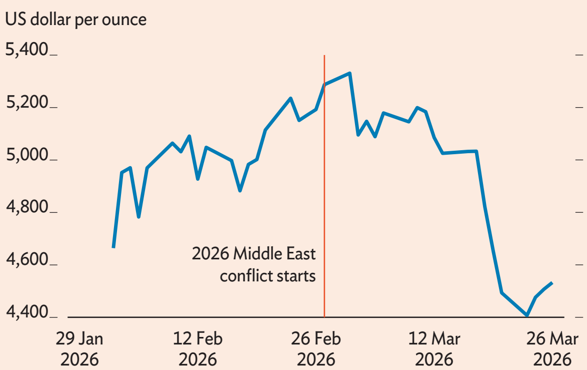
Notes: Dashed lines denote point estimates, light and dark grey areas are 67% and 90% confidence bands, respectively, obtained using two-way clustered standard errors (fund and time). The estimation employs the local projections method (Jorda 2005) over a 5-week horizon in a fund-week panel. The dependent variable is cumulative investors' allocations into mutual funds over the horizon considered divided by funds' initial assets. The main explanatory variables are the first difference of the US VIX and TPU indexes divided by their standard deviation and interacted with period dummies. Control variables include (i) lags of the first difference of the US TPU and VIX indexes; (ii) six monthly lags of the fund's net asset value percentage return and previous fund inflows; (iii) forward shocks, following the methodology of Teulings and Zubanov (2014) to account for TPU and VIX shocks occurring within the t+k horizon but not captured by the explanatory variables at time t; and (iv) the log of fund initial assets.

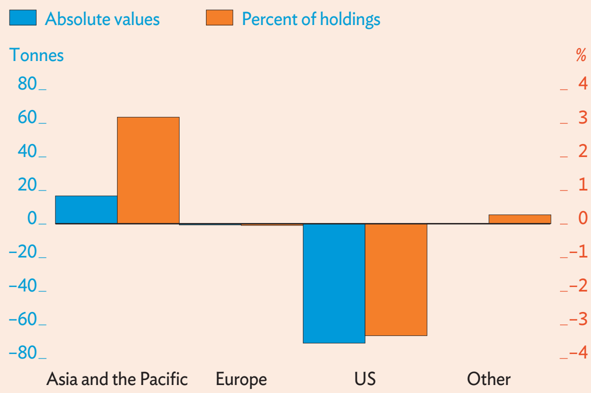
Sources: ADB calculations based on data from Emerging Portfolio Fund Research, D. Caldara et al. 2020. The Economic Effects of Trade Policy Uncertainty. Journal of Monetary Economics. 109. pp. 38–59; and Chicago Board Options Exchange. CBOE Volatility Index: VIX [VIXCLS]. Federal Reserve Bank of St. Louis (accessed 9 July 2025).

Box 1.1.2 *Continued*

4 Gold Price and Purchases by Gold-Focused Funds

Regional investors have continued to purchase gold during the 2026 Middle East conflict.





US = United States.
Source: World Gold Council and ADB calculations.

Investors in Asia and the Pacific continued to increase their exposure to gold during the 2026 conflict in the Middle East, despite falling prices. Following the outbreak of the conflict, gold prices eased, and investors in other economies—particularly the US—reduced holdings of gold through gold-focused funds (box figure 4). By contrast, investors in Asia and the Pacific continued to add to their positions, purchasing almost 20 tonnes of gold in the three weeks following the start of military activity—an increase of more than 3% relative to their holdings. This divergence suggests that investors in the region may place a more persistent weight on gold as a hedge against uncertainty. More broadly, the evidence points to a growing role for Asian investors in shaping gold demand at the margin—that is, in driving changes in demand during episodes of heightened uncertainty—with their response to uncertainty appearing to have strengthened over time.

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This box was written by Gabriele Ciminelli, Jiancong Liu and Alexander Raabe.

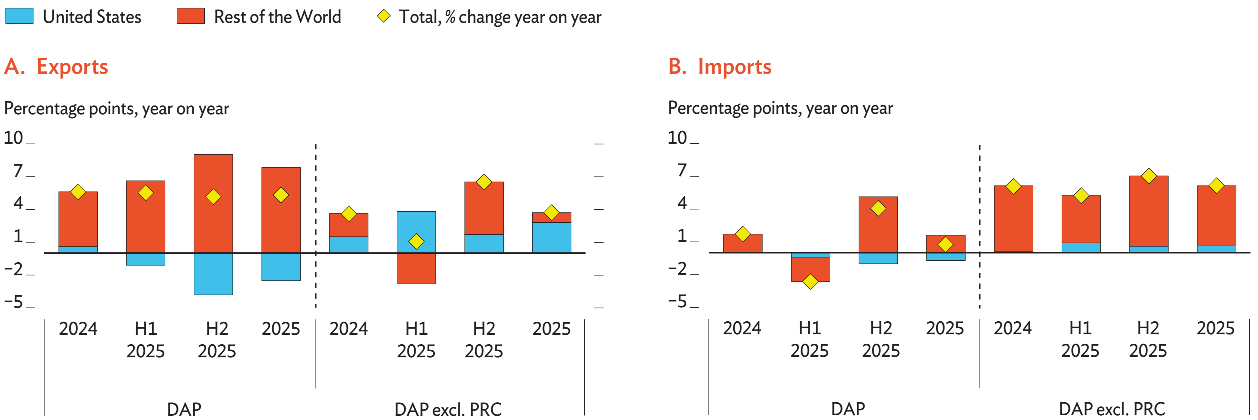
Navigating Trade Policy Shifts

Developing Asia and the Pacific (DAP) recorded solid growth in goods exports in 2025 despite external headwinds. Even as regional exports to the US contracted, nominal export growth remained at about 5%, supported by a sharp increase in exports to the rest of the world (Figure 1.1.9, panel A). This shift, which was particularly evident in the second half (H2) of the year, was driven largely by the PRC. Excluding the PRC, exports to the US increased in both halves of 2025, outpacing growth in exports to the rest of the world in H1 but falling behind In H2. Goods imports also expanded across the region by about 1%, mostly in H2, but their growth remained well below that of exports (Figure 1.1.9, panel B).

Exports of vehicles, electronics, and machinery recorded robust growth in the PRC, Indonesia, Malaysia, Thailand, and Türkiye (Figure 1.1.10).

Figure 1.1.9 Nominal Growth in Exports and Imports of Goods, by Major Destination and Origin

Goods export growth remained solid in 2025, significantly outpacing import growth.



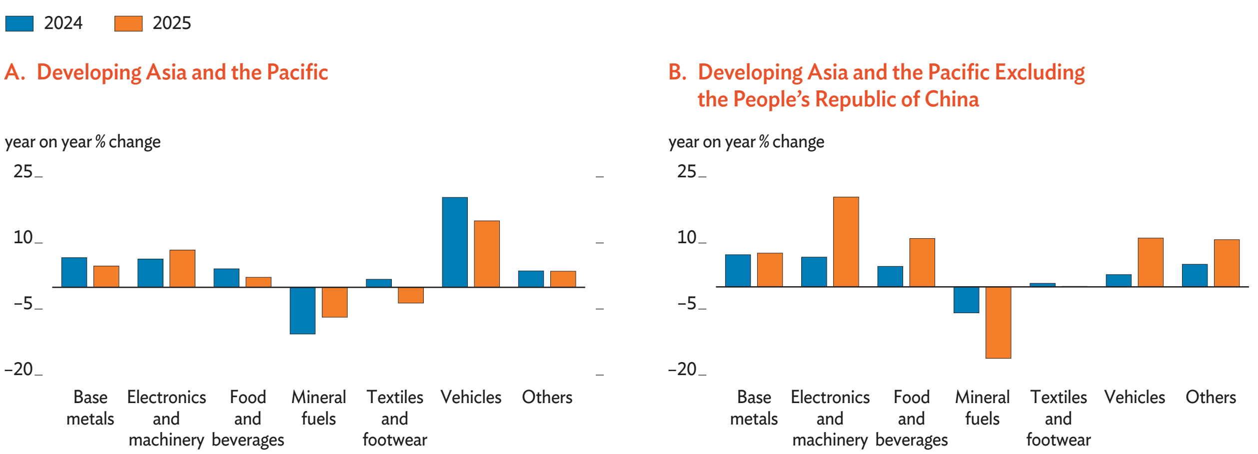
PRC = People's Republic of China, DAP = developing Asia and the Pacific, H = half.

Notes: DAP includes those economies with full year 2025 data: Armenia, Azerbaijan, Bangladesh, Brunei Darussalam, Cambodia, the PRC, Georgia, India, Indonesia, Kazakhstan, the Kyrgyz Republic, Malaysia, Mongolia, Nepal, Pakistan, the Philippines, Sri Lanka, Thailand, Türkiye, Uzbekistan, and Viet Nam. Subregional trends varied: strong in developing Southeast Asia, stable in developing East Asia, and South Asia rebounding in H2, after sharp contraction earlier in the year, as India's exports of petroleum stabilized and of ores and minerals recovered.

Sources: CEIC Data Company; US Census Bureau; Asian Development Bank estimates.

Figure 1.1.10 Nominal Growth in Exports of Goods by Sector

Vehicles posted strong export growth in 2025, as did electronics and machinery.



Note: Developing Asia and the Pacific includes economies with sector data for the full year 2025: Cambodia, the People's Republic of China, Georgia, Indonesia, Malaysia, Mongolia, Thailand, and Türkiye.

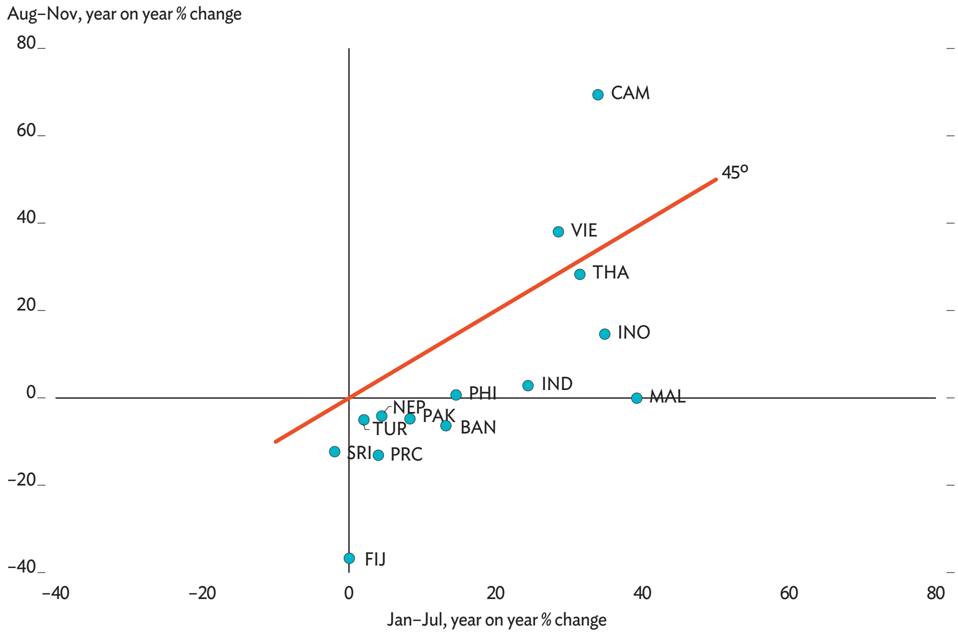
Sources: International Trade Centre Trade Map; Asian Development Bank estimates.

In the PRC and Türkiye, exports were driven by vehicles, for which demand strengthened in H2, especially for electric vehicles from the PRC and for autos from Türkiye for European markets. Meanwhile, DAP excluding the PRC benefited from continued participation in the semiconductor global value chain, as indicated by its strong exports of electronics and machinery.

Anticipation of higher tariffs prompted front-loading of exports to the US. Goods exports to the US were generally stronger in January–July than in August–November 2025 as shipments were advanced ahead of anticipated tariff hikes in August (Figure 1.1.11). Cambodia and Viet Nam were exceptions as US-bound exports strengthened later in the year, driven by garments from Cambodia, and by technology products, garments, and footwear from Viet Nam.

Figure 1.1.11 Growth in Goods Exports to the United States, January–July vs August–November 2025

Most economies in developing Asia and the Pacific front-loaded exports to the US ahead of expected tariff hikes.



BAN = Bangladesh, CAM = Cambodia, PRC = People's Republic of China, FIJ = Fiji, IND = India, INO = Indonesia, MAL = Malaysia, NEP = Nepal, PAK = Pakistan, PHI = Philippines, SRI = Sri Lanka, THA = Thailand, TUR = Türkiye, VIE - Viet Nam.

Sources: International Monetary Fund; Asian Development Bank estimates.

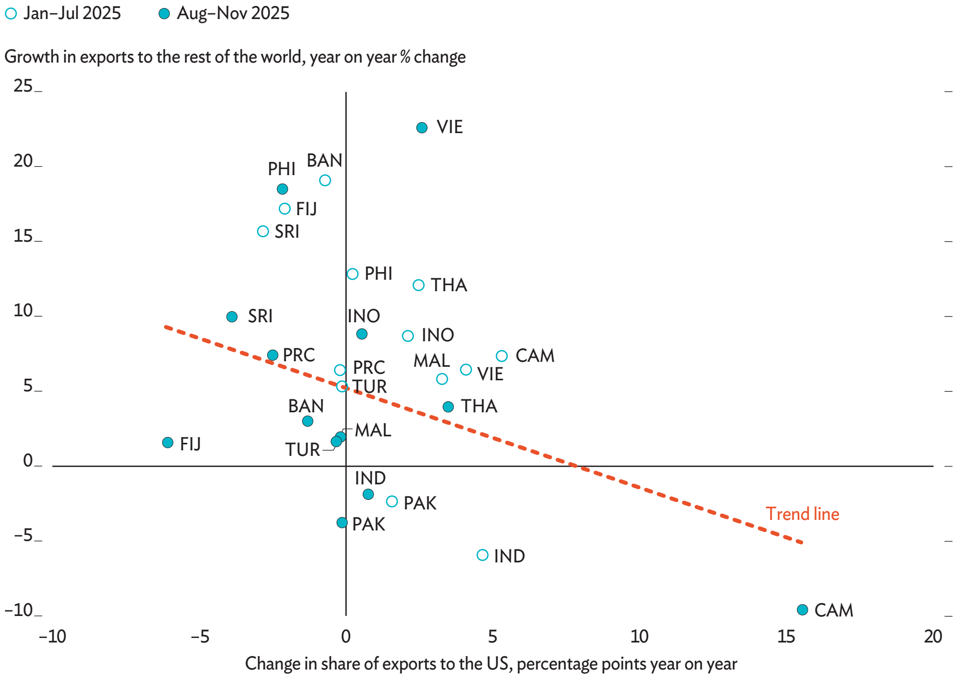
Export markets diversified following US tariff hikes. Ahead of anticipated US tariff increases in August, a number of DAP economies recorded rising shares of goods exports to the US alongside strong growth in exports to the rest of the world (Figure 1.1.12). After the tariffs took effect, exports to the US weakened for several economies while shipments to other markets strengthened. This reorientation was particularly evident in the Philippines and Viet Nam and, to a lesser extent, in the PRC and Indonesia. Cambodia diverged from this pattern, with increased reliance on the US as exports to the rest of the world declined. This may reflect its role in regional supply chains, given that over 50% of Cambodia's imports were sourced from the PRC and over 40% of its exports were directed to the US in 2025, shares that grew considerably relative to 2024.

Surging demand for advanced semiconductors underpinned exports from Asia and the Pacific, with gains uneven across economies. Semiconductor hubs in advanced Asia and the Pacific—Hong Kong, China; the Republic of Korea; Singapore; and Taipei,China—have been at the forefront of the artificial intelligence boom, reflecting an uneven diffusion of AI-related capabilities across the region, with advanced Asia and the Pacific ahead of DAP—an issue examined further in the Special Topic of this report. Several DAP economies, including the PRC, Indonesia, Malaysia, and Thailand, have benefited through their integration into the semiconductor value chain, displaying healthy rates of exports growth (Figure 1.1.13). Economies with weaker links to this value chain saw more moderate and varied export growth outcomes. Semiconductor-driven growth is expected to continue supporting exports in some economies into 2026, but the broader trade outlook in the near term is uneven due to high tariffs and moderating external demand.

Even after recent changes in US tariff policy, the US effective tariff rate on DAP remains higher than for the rest of the world. On 20 February 2026, the US Supreme Court ruled that the International Emergency Economic Powers Act did not authorize the tariffs introduced in 2025, rendering them invalid. In response, the US administration introduced a 10% global tariff under Section 122 of the Trade Act of 1974, enforceable for up to 150 days (Figure 1.1.14).

Figure 1.1.12 Growth in Exports of Goods to Markets Other than the United States, 2025

Following US tariff hikes in August 2025, exports shifted toward other markets.

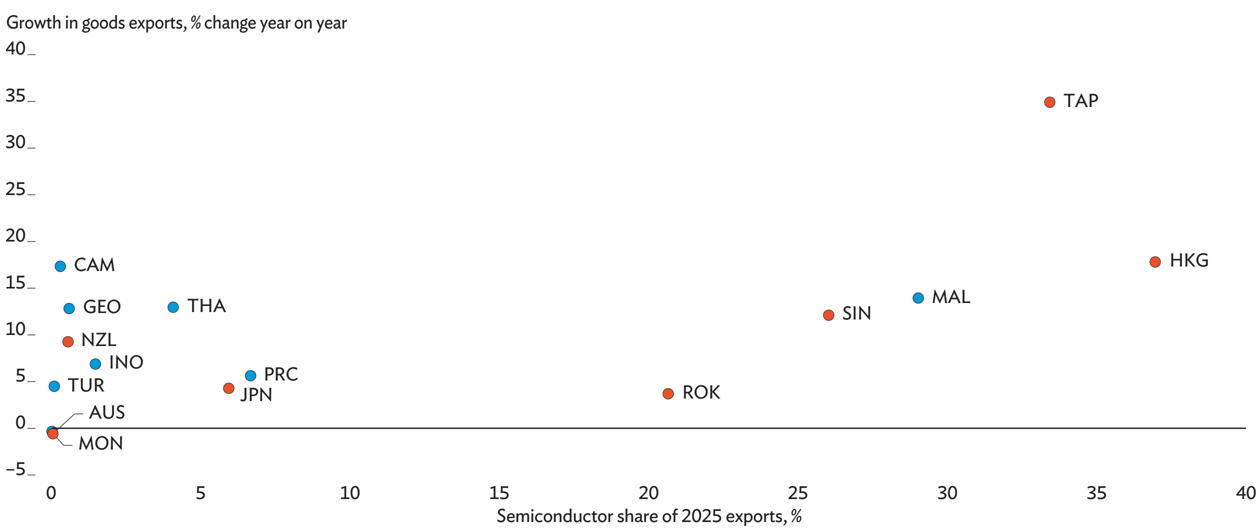


BAN = Bangladesh, CAM = Cambodia, PRC = People's Republic of China, FIJ = Fiji, IND = India, INO = Indonesia, MAL = Malaysia, PAK = Pakistan, PHI = Philippines, SRI = Sri Lanka, THA = Thailand, TUR = Türkiye, VIE = Viet Nam.

Sources: International Monetary Fund; Asian Development Bank estimates.

Figure 1.1.13 Semiconductor Exposure and Growth in Goods Exports from 2024 to 2025

Economies in the semiconductor value chain experienced higher export growth in 2025.



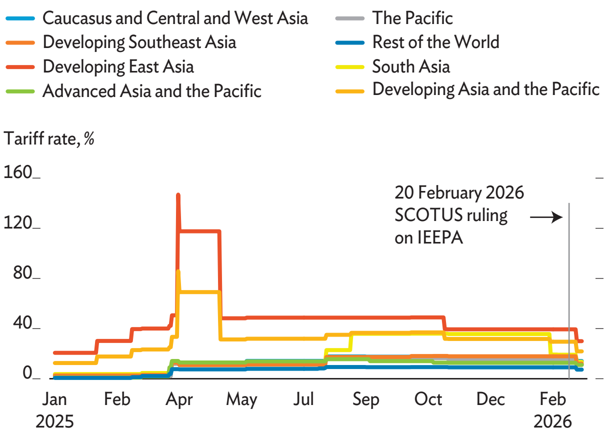
AUS = Australia; CAM = Cambodia; PRC = People's Republic of China; GEO = Georgia; HKG = Hong Kong, China; INO = Indonesia; JPN = Japan; ROK = Republic of Korea; MAL = Malaysia; MON = Mongolia; NZL = New Zealand; SIN = Singapore; TAP = Taipei,China; THA = Thailand; TUR = Türkiye.

Notes: Color red dots for economies in advanced Asia and the Pacific, color blue for developing Asia and the Pacific. Semiconductor exports include Harmonized System Code HS 8541 (diodes, transistors, and similar semiconductor devices) and HS 8542 (electronic integrated circuits). Export values are from ITC Trade Map (January 2024–November 2025).

Sources: Asian Development Bank estimates; International Trade Centre Trade Map; CEIC Data Company.

Figure 1.1.14 United States Effective Tariff Rates

Developing Asia and the Pacific continues to face higher US tariffs than the rest of the world.



IEEPA = International Emergency Economic Powers Act, SCOTUS = Supreme Court of the United States.

Notes: Values are effective, trade-weighted tariff rates. They may differ from published statutory tariff rates because multiple tariffs can apply to the same product under different trade actions, and because the estimates reflect product and trade weights. Rates exclude tariffs that are not officially specified (such as on branded drugs and semiconductors), applied only to the metal content of certain products, or applied to transshipped goods. Tariffs specified at a level more detailed than the Harmonized System (HS) 6-digit classification are assumed to apply to all goods within the corresponding HS 6-digit code. Trade weights are based on 2023 data.

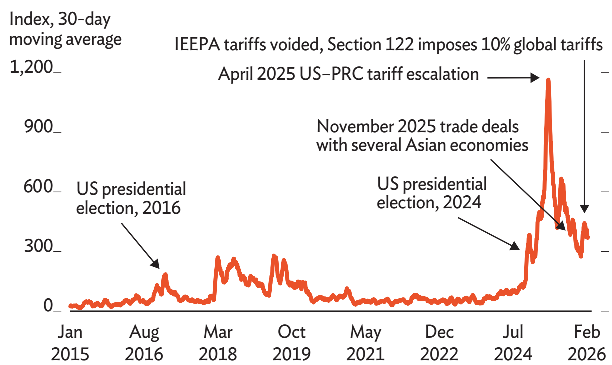
Sources: Asian Development Bank estimates based on World Trade Organization. Observatory of Economic Complexity; Integrated Database and Consolidated Tariff Schedules (both accessed on 10 November 2025); and official US government sources.

The administration signaled that the rate could be raised to 15%, which would increase the effective tariff rate on DAP by about 3 percentage points. Section 301 investigations were initiated and could result in new economy- or product-specific tariffs. Under the current 10% global tariff, developing East Asia faces the highest effective tariff rate within DAP, largely reflecting duties on the PRC. Rates dropped from a peak of 147% in April 2025 to 30% in February 2026, but remain well above the pre-2025 level of 21%. Other subregions have also seen declines to rates higher than at the start of 2025.

The US court ruling could boost regional exports in the short term, but trade policy uncertainty continues to weigh on the outlook. Lower effective tariff rates after 20 February and the expectation of renewed tariff increases may trigger some front-loading of exports. However, the effect is likely to be smaller than that of last year's larger tariff hikes. Trade policy uncertainty, already elevated, rose again in early 2026 following the introduction of tariffs on high-end semiconductors in January and the US Supreme Court's ruling in February (Figure 1.1.15). Targeted tariff increases would further weigh on regional exports, adding to an already challenging external environment. Rising geopolitical tensions in the Middle East introduce additional risks through higher energy prices, transport disruption, and supply chain delay, with the magnitude of these effects depending on the conflict's duration. As a result, the near-term trade outlook remains fragile, and any gains from lower tariffs are likely to be uneven and sensitive to further policy developments.

Figure 1.1.15 Trade Policy Uncertainty Index

Trade policy uncertainty rose again in February 2026 following new tariff announcements.



PRC = People's Republic of China, IEEPA = International Emergency Economic Powers Act, US = United States.

Note: The 30-day moving average of the trade policy uncertainty index measures the frequency of articles discussing trade policy uncertainty in seven newspapers, six in the US and one in the United Kingdom.

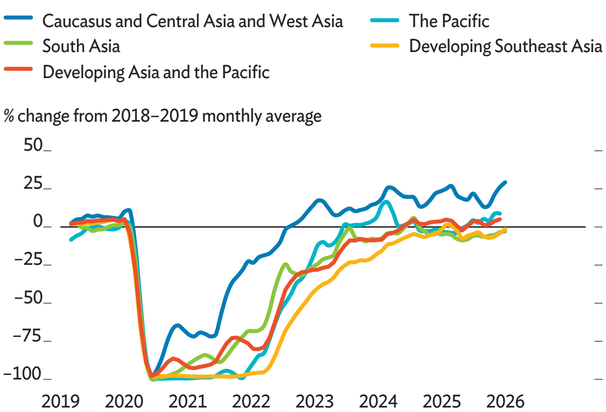
Source: Caldara, D. et al. 2020. The Economic Effects of Trade Policy Uncertainty. *Journal of Monetary Economics*. 109. Data downloaded from https://www.matteoiacoviello.com/tpu.htm on March 18 2026.

Tourism Recovery Gathered Pace

Tourism in DAP continued to recover in 2025, surpassing pre-pandemic levels. Visitor arrivals rose by 2% in January–November over the same period in 2024 (Figure 1.1.16). The strongest rebound occurred in the Caucasus and Central and West Asia. This was led by record visitor numbers in Türkiye, supported by global tourism branding campaigns, and in Georgia, which benefitted from investment in hospitality, infrastructure, and regional connectivity. The Pacific enjoyed steady growth as Fiji posted record arrivals following policy reform and improved air connectivity. In contrast, arrivals in South Asia and developing Southeast Asia remained below pre-pandemic levels. In South Asia, record tourism in Maldives and Sri Lanka was insufficient to offset declines in India. In developing Southeast Asia, stronger arrivals in Viet Nam following relaxed visa policies were offset by weaker tourism in Thailand and Cambodia as border tensions between them reemerged.

Figure 1.1.16 International Tourist Arrivals

Tourist arrivals in developing Asia and the Pacific were above pre-pandemic levels in 2025.



Note: The Caucasus and Central and West Asia comprises Armenia, Georgia, and Türkiye. The Pacific comprises the Cook Islands, Fiji, Palau, Samoa, and Vanuatu. South Asia comprises India, Maldives, Nepal, and Sri Lanka. Developing Southeast Asia comprises Cambodia, Indonesia, Malaysia, Myanmar, the Philippines, Thailand, and Viet Nam; Advanced Asia and the Pacific comprises Hong Kong, China; Japan; the Republic of Korea; Singapore; and Taipei,China.

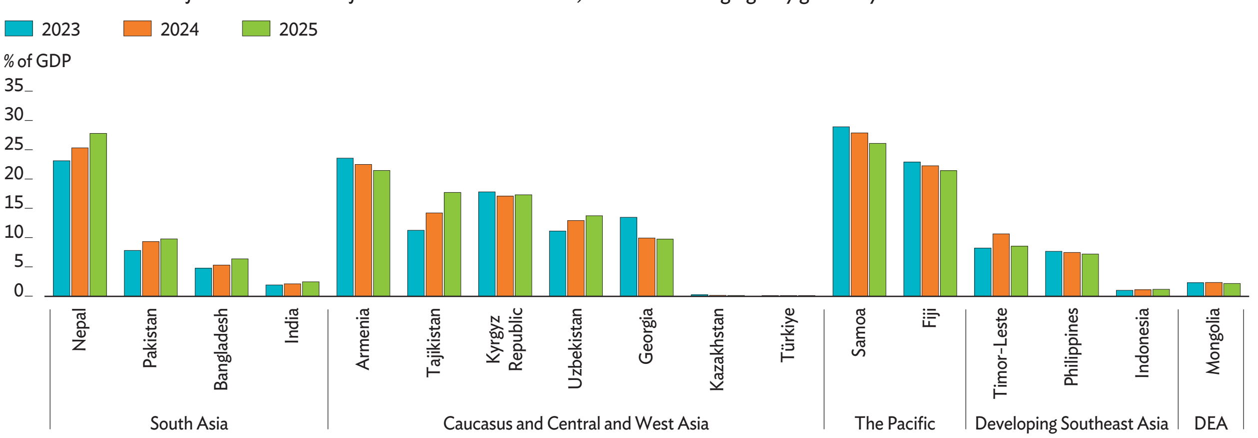
Sources: CEIC Data Company; official sources.

Remittance Trends Uneven Across the Region

Recent developments point to diverging remittance dynamics across economies in 2025 (Figure 1.1.17). Remittances account for more than 2% of GDP in several regional economies, underscoring the central role overseas workers play in supporting household income and domestic demand. Inflows showed uneven trends across DAP in 2025. Remittances continued to rise in South Asia, particularly in Nepal, where in 2025 they exceeded one-quarter of GDP. In the Caucasus and Central and West Asia, remittances as a share of GDP continued to decline in Armenia as inflow normalized following a surge linked to the Russian invasion of Ukraine, and in Georgia with lower transfers from Russia following migrant departures and ruble depreciation. The share remained broadly stable in the Kyrgyz Republic, while it increased in Tajikistan with stronger transfers from migrant workers—mostly in Russia—and in Uzbekistan owing to robust growth in remittance inflow supported by currency appreciation in partner economies and rising labor migration. Remittances remained a small share of GDP in Kazakhstan and Türkiye. The share decreased in Fiji, the Philippines, and Samoa, notwithstanding increases in absolute terms.

Figure 1.1.17 Remittances to Selected Economies in Developing Asia and the Pacific

Remittances account for a sizable share of GDP in several economies, with levels changing only gradually in most economies.



DEA = developing East Asia, GDP = gross domestic product.

Note: In Türkiye, remittances as a share of GDP is 0.02% in 2023, 0.008% in 2024, and 0.004% in 2025.

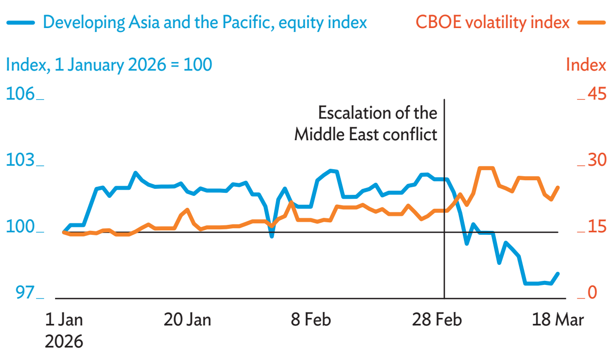
Sources: Official sources; CEIC Data Company; *World Economic Outlook October 2025* Database.

Rising Geopolitical Tensions Take Toll on Regional Financial Markets

Financial conditions in DAP weakened following escalation of the conflict in the Middle East. Despite rising global uncertainty, regional financial markets remained broadly stable in the first 2 months of 2026, supported by declining short-term interest rates and economic growth exceeding expectations across many regional economies in the fourth quarter of 2025 (Figure 1.1.18). However, after the conflict escalated on 28 February, market volatility rose sharply and financial conditions tightened, with declining equity prices, widening risk premiums, higher bond yields, currency depreciation against the US dollar, and net portfolio outflows.

Figure 1.1.18 Volatility Index and Regional Stock Market Fluctuation

Rising volatility subdued investor sentiment and weighed on regional equity markets following escalation in the Middle East conflict.



CBOE = Chicago Board Options Exchange.

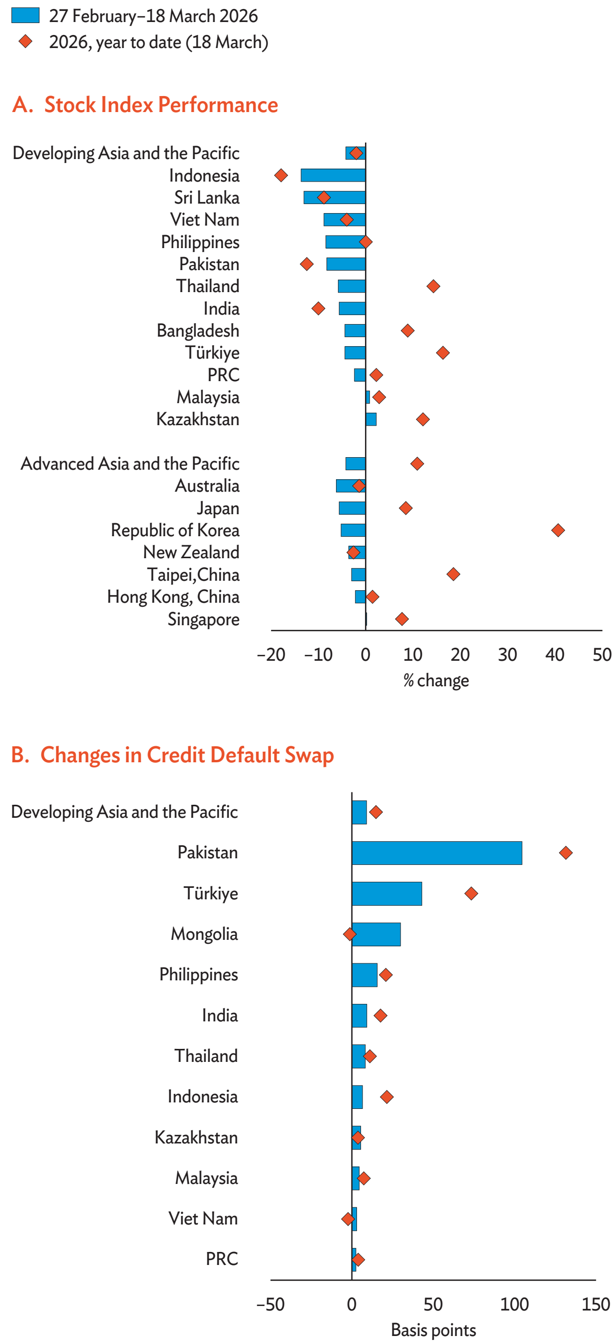
Note: The developing Asia and the Pacific equity index is weighted by 2025 market capitalization and comprises Bangladesh, the People's Republic of China, India, Indonesia, Kazakhstan, Malaysia, Pakistan, the Philippines, Sri Lanka, Thailand, Türkiye, and Viet Nam.

Source: Bloomberg.

While equity markets declined and risk premiums widened, the magnitude of impact varied across economies. As a large net importer of energy, the region was hit by worsening uncertainty and deteriorating risk sentiment stemming from the conflict. From 27 February to 18 March, regional equity markets fell by 4.2% on a market capitalization–weighted basis, while risk premiums—as proxied by credit default swap spreads—rose by an average of 9.0 basis points on a GDP-weighted basis (Figure 1.1.19). The magnitude of the equity losses

Figure 1.1.19 Equity Markets and Credit Default Swap Spreads

Regional equity markets retreated and credit default swap spreads widened in response to the Middle East conflict.



PRC = People's Republic of China.

Notes: Equity indexes are in local currency terms. The average return in developing Asia and the Pacific is weighted using market capitalization, and the average change in the credit default swap is weighted by gross domestic product, purchasing power parity.

Source: Bloomberg.

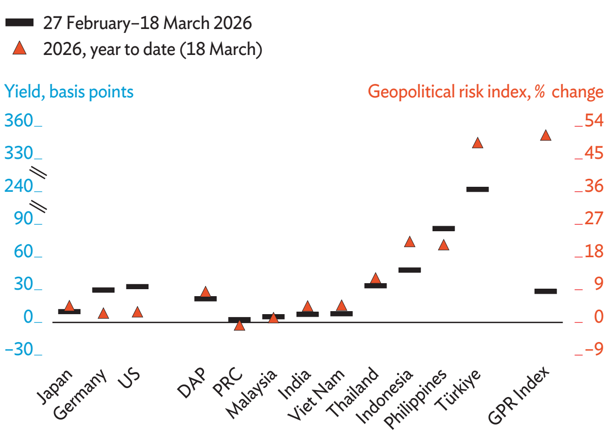
and rises in risk premiums across regional markets varied reflecting domestic factors. Indonesian equities posted a relatively large retreat, partly driven by the revision of its credit rating outlook by Fitch Ratings from stable to negative in early March and fiscal risk concerns as its fiscal deficit is near the 3% of GDP ceiling. At the other extreme, Kazakhstan—an oil-exporting economy—was largely unaffected. Pakistan recorded the second-largest equity losses and the highest rise in risk premiums since the start of the year, partly reflecting uncertainty surrounding delays affecting an International Monetary Fund staff-level agreement caused by fiscal discrepancies identified in March. Among economies in advanced Asia and the Pacific, Australia recorded a relatively large equity loss after its central bank hiked the policy rate on 17 March and as the Middle East conflict raised inflation risk.

As geopolitical tensions intensified, benchmark bond yields increased. A widely used measure of geopolitical risk rose by over 8.5% in the 18 days following the start of the conflict (Figure 1.1.20). Consistent with this deterioration in global risk sentiment and the inflationary implications of higher oil prices, yields rose across all regional economies with available data. Yields rose most sharply in Türkiye, also reflecting ongoing monetary policy tightening and persistently high inflation. The Philippines too recorded a notable increase in its 10-year government bond yield, as a historically weak peso amplified inflationary pressure stemming from higher oil prices. Moderate increases were observed in Indonesia, Thailand, and Viet Nam. By contrast, yields in the PRC remained broadly stable, reflecting weaker domestic demand and accommodative monetary conditions.

Following escalation, most regional currencies depreciated against the US dollar, and portfolio flows turned negative. On a GDP-weighted basis, currencies in the region depreciated by 0.9% between 27 February and 18 March, as risk aversion benefited the US dollar (Figure 1.1.21). The Thai baht weakened

Figure 1.1.20 Changes in 10-Year Government Bond Yield and the Geopolitical Risk Index

Yields rose in all regional markets in the wake of conflict escalation in the Middle East, reflecting the inflationary implications of higher oil prices and higher global risk aversion.



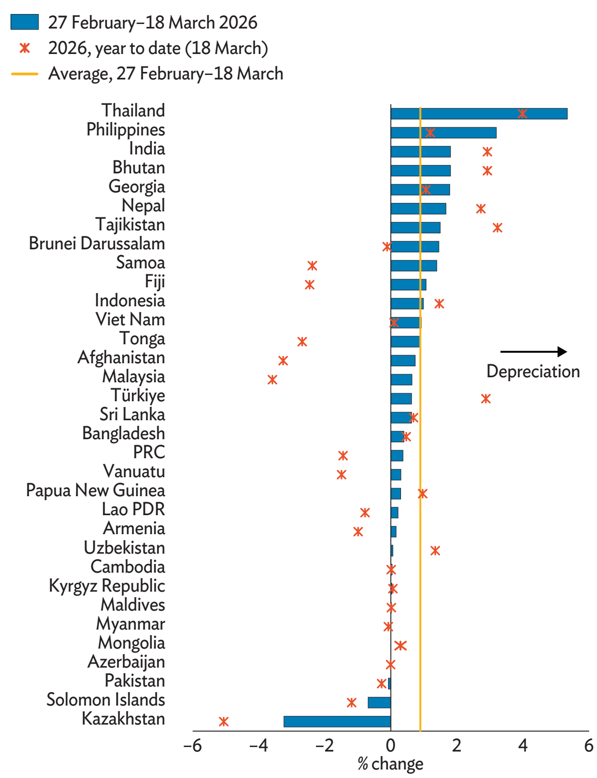
PRC = People's Republic of China, DAP = developing Asia and the Pacific, US = United States.

Notes: The average change in yield for developing Asia and the Pacific is weighted by gross domestic product, purchasing power parity. Developing Asia and the Pacific includes the People's Republic of China, India, Indonesia, Malaysia, the Philippines, Thailand, Türkiye, and Viet Nam. The geopolitical risk index is as of 16 March 2026.

Sources: Bloomberg; Caldara, D., and M. Iacoviello. 2022. Measuring Geopolitical Risk. *American Economic Review* 112(4) (Data downloaded from https://www.matteoiacoviello.com/gpr.htm on 17 March 2026).

Figure 1.1.21 Exchange Rate Movement

Most regional currencies weakened against the US dollar following escalation in the Middle East.



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

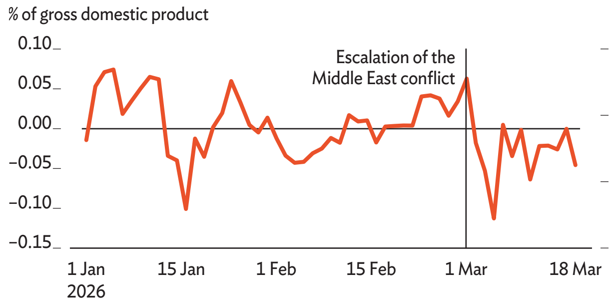
Note: Average exchange rate change is weighted by gross domestic product, purchasing power parity.

Source: Bloomberg.

the most, reflecting a widening interest rate differential with the US following a Bank of Thailand policy rate cut of 25 basis points in late February, as well as risk exposure to oil prices and tourism. Portfolio flows turned negative across the region, but their magnitude and volatility remained within recent ranges, suggesting no broad sell-off by foreign investors (Figure 1.1.22). Related to this, with a focus on the bond market, Box 1.1.3 suggests that factors beyond yield differentials are important for attracting foreign capital to DAP. The resilience of capital flows likely reflects continued confidence in the region's economic fundamentals and the expectation that the spike in oil prices will be temporary.

Figure 1.1.22 Developing Asia and the Pacific's Daily Net Portfolio Flows

Portfolio flows became more volatile following the escalation of the Middle East conflict but remained within recent ranges.



Notes: Net portfolio (equity and debt) flows are calculated using a 3-day centered moving average and expressed as a percentage of gross domestic product. Contributions are weighted using nominal gross domestic product in the second quarter of 2025 for the following economies: the People's Republic of China, India, Indonesia, Malaysia, Pakistan, the Philippines, Sri Lanka, Thailand, Türkiye, and Viet Nam.

Source: Institute of International Finance.

Box 1.1.3 Investor Demand Beyond Yield in Developing Asia and the Pacific

Emerging market capital inflows have historically been supported by abundant global liquidity and low yields in advanced economies. These conditions and others were in play in the aftermath of the 2008–2009 global financial crisis, when substantial foreign capital flowed into emerging markets (Ahmed and Zlate 2014). More recently, global investors have reassessed their portfolio allocations as bond yields in advanced economies have normalized. With higher returns now available in advanced markets, the need to seek higher yields in emerging economies has decreased. As a result, investment in emerging market bonds may increasingly reflect considerations beyond the yield, including diversification, currency exposure, and local growth prospects.

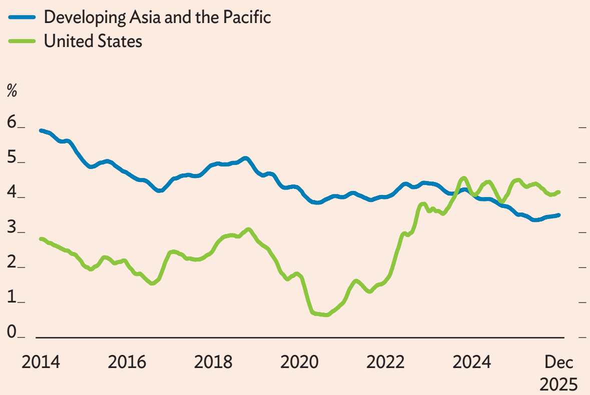
The gap between bond yields in developing Asia and the Pacific (DAP) and the United States (US) has narrowed since September 2020, reflecting differences in inflation dynamics and monetary policy cycles. Following the pandemic, inflation rose more sharply and remained elevated for longer in the US and other advanced economies than in DAP. As a result, the US Federal Reserve embarked on an aggressive tightening cycle in March 2022, while central banks in DAP generally raised policy rates by less and, in some cases, began easing earlier. In mid-2021 the average policy rate in DAP, weighted by gross domestic product, was about 3.1 percentage points higher than in the US, but the gap then narrowed given the Fed's sharp tightening. By early 2026, it reached around zero. Likewise, US bond yields increased more strongly, leading to a rapid compression of the yield differential between DAP and the US. DAP yields eventually fell below those of the US in August 2023 (box figure 1).

A narrowing yield differential has not caused a sustained decline in portfolio flows into DAP, pointing to a shift in investor behavior. Even after both nominal and real yield differentials turned negative in mid-2023, the region continued to attract bond inflows (box figure 2). This suggests that factors beyond yield—such as portfolio diversification, currency exposure, and domestic growth prospects—may be playing more prominent roles. Empirical evidence is consistent with this interpretation. Panel regression results show a negative relationship between the DAP–US yield differential and net bond inflows from August 2023 (box figure 3).

Box 1.1.3 *Continued*

1 10-year Government Bond Yield in Developing Asia and the Pacific vs. the United States

The yield differential started to narrow after the pandemic as inflation dynamics and monetary policy cycles differed.

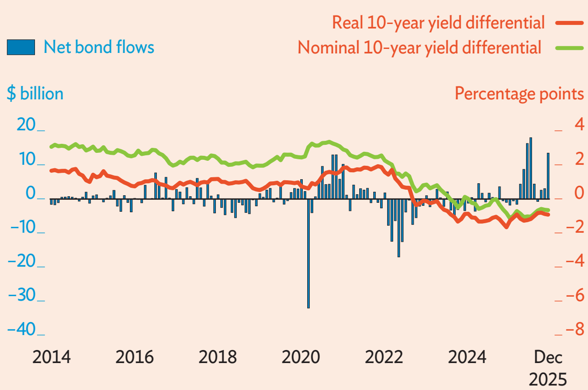


Notes: Developing Asia and the Pacific includes the People's Republic of China, India, Indonesia, Malaysia, the Philippines, Thailand, and Viet Nam. The yield in developing Asia and the Pacific is an aggregate weighted by gross domestic product (on a purchasing power parity basis). Yields are smoothened using a 90-day centered moving average.

Sources: Bloomberg and CEIC Data Company.

2 Yield Differential and Monthly Bond Portfolio Flows into Developing Asia and the Pacific

Although the yield differential between DAP and the US turned negative, DAP bond markets did not suffer sustained outflows.



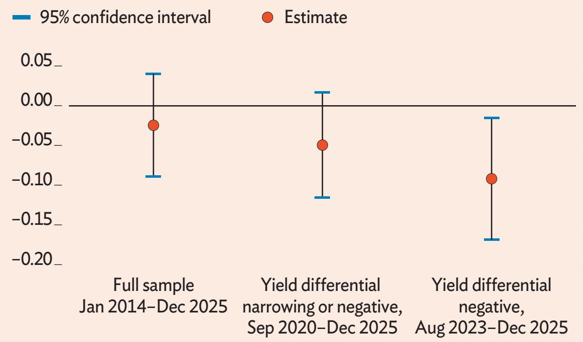
DAP = developing Asia and the Pacific, US = United States.

Notes: DAP includes the People's Republic of China (PRC), India, Indonesia, Malaysia, the Philippines, Thailand, and Viet Nam. The DAP yield is an aggregate, weighted by gross domestic product (on a purchasing power parity basis). The 10-year government bond yield differential is calculated as the difference between the GDP-weighted average yield for DAP and the US yield. For the US, the generic inflation-indexed 10-year government bond yield is used. For Thailand, 10-year zero-coupon inflation swap rate is used. Where long-term inflation expectations are unavailable, expected inflation is proxied using central bank targets for the PRC, India, Indonesia, the Philippines, and Viet Nam, and inflation expectations 1 year ahead for Singapore and Malaysia.

Source: Bloomberg; CEIC Data Company; and official sources.

3 Correlation Between Yield Differential and Bond Market Flows in Developing Asia and the Pacific

The relationship between the DAP–US yield differential and bond flows into DAP became statistically significant and negative since August 2023.



DAP = developing Asia and the Pacific, US = United States.

Notes: Dots denote coefficient estimates from regressions of the DAP–US bond yield differential on monthly bond flows for seven DAP economies: the People's Republic of China, India, Indonesia, Malaysia, the Philippines, Thailand, and Viet Nam. Estimates are based on panel fixed-effects regressions with month and market fixed effects, controlling for gross domestic product growth, fiscal balance, and inflation.

Source: Asian Development Bank estimates.

Persistent fiscal deficits in advanced economies have increased bond issuance, keeping supply elevated and putting upward pressure on risk premia. While debt ratios have declined from pandemic peaks, fiscal deficits in the US and other advanced economies remain larger than in DAP. Continued borrowing to finance fiscal spending could also raise debt sustainability concerns and widen risk premia on government bonds.

DAP has continued to attract global bond investors with solid fundamentals and more regional assets being included in global benchmark indexes. Ongoing financial market development and better governance have strengthened the investor base, reinforcing the region's role in global portfolios. This has helped to anchor demand for DAP bonds despite fluctuation and compression in bond yield differentials. The box table shows milestones in the inclusion and upgrading of regional assets in major global indexes, highlight their growing importance in global portfolios from 2018 to 2026.

Box 1.1.3 *Continued*

Major Global Indexes' Inclusion and Upgrading of Developing Asia and the Pacific's Markets

Growing inclusion of DAP capital markets in global benchmark indexes has anchored demand for DAP assets.

Year(s)	Market	Asset Class	Index	Status/Significance
2018–2019	People's Republic of China	Equity	MSCI EM Index	Initial inclusion of A-Shares (5% factor) in 2018 and weight increased to 20% inclusion factor in 2019
2019	People's Republic of China	Bonds	Bloomberg Global Aggregate Index	Phased inclusion of government and policy bank bonds
2021	People's Republic of China	Bonds	FTSE WGBI	Full 36-month phase-in completed, top-tier weight
2024–2025	India	Bonds	J.P. Morgan GBI-EM Index	Increasing to 10% max weight by March 2025
2025	India	Bonds	FTSE EMGBI	Scheduled inclusion since September 2025
2026	Viet Nam	Equity	FTSE Russell EM	Expected upgrade to secondary emerging market in September 2026
2026	Philippines	Bonds	J.P. Morgan GBI-EM	Under review for inclusion (expected H1 2026).

DAP = developing Asia and the Pacific, EM = emerging, EMGBI = emerging markets government bond index, FTSE = Financial Times Stock Exchange, GBI = government bond index, H1 = first half, MSCI = Morgan Stanley Capital International, Q = quarter, WGBI = world government bond index.

Sources: MSCI and FTSE.

Strong domestic fundamentals in DAP will keep the region's bond markets attractive to global investors. The strength of investor demand reflects strong economic growth, trade openness, well-functioning financial markets, and solid institutional frameworks (Asian Development Bank 2025). These factors are expected to continue supporting the resilience of investor demand, even in an environment of less-favorable yield differentials.

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Asian Development Bank. 2025. Capital Inflows to Emerging Market Economies: Global Factors and the Role of Fundamentals. Analytical chapter in Asian Development Bank. 2025. *Asian Development Outlook September 2025*.

This box was written by John Beirne, Shu Tian, and Mai Lin Villaruel.

Cautious Monetary Easing as External Price Pressures Reemerge

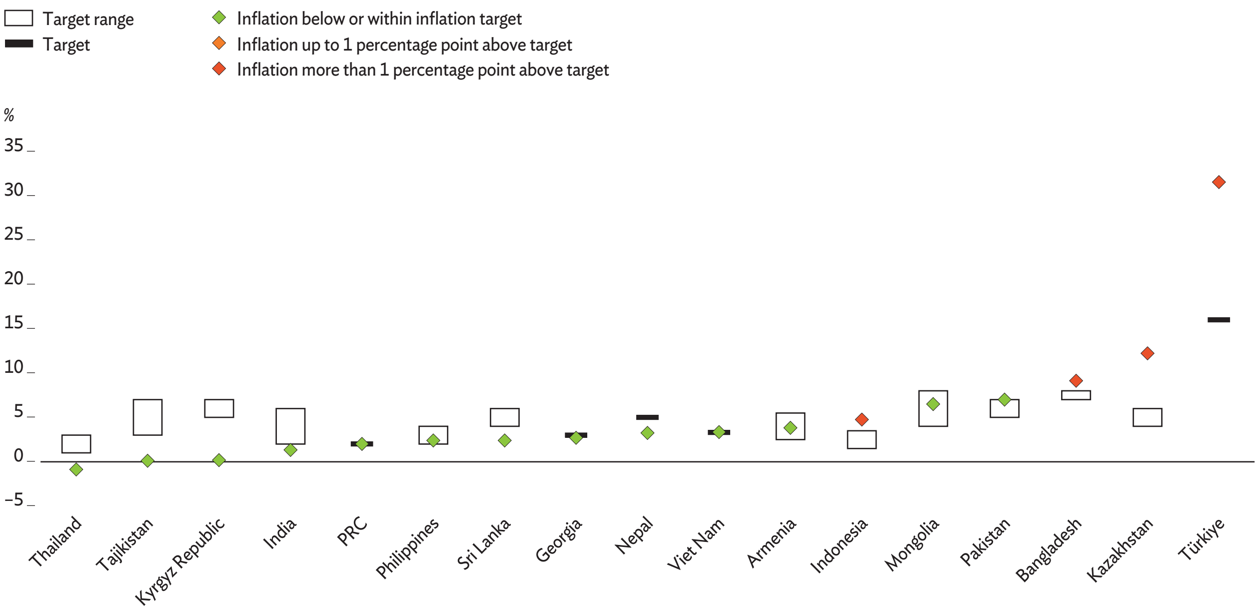
Headline inflation eased across most economies in DAP. Annual inflation has declined since the start of 2025 in 25 of the 38 DAP economies with available data. The latest data, from before the conflict in the Middle East escalated, show that 13 of the 17 economies with formal or de-facto inflation-targeting frameworks recorded inflation outcomes within or below their target ranges (Figure 1.1.23). Indonesia and Bangladesh were only marginally above target, while Kazakhstan and Türkiye continued to face elevated inflation. However, the escalation of conflict in the Middle East is likely to renew inflationary pressure through higher energy prices, countering regional disinflation in the near term.

Policy rate holds and cautious cuts dominated regional monetary policy. Improving inflation outcomes and weaker price pressures allowed many central banks to initiate or extend cautious easing. Bucking this trend, a small set of economies, mostly in the Caucasus and Central and West Asia, tightened monetary policy further as food price increases and imported inflation pressures kept inflation elevated. In these economies, cumulative rate hikes ranged from

50 basis points in Uzbekistan to 300 basis points in the Kyrgyz Republic. Türkiye followed a different policy sequence, cutting in early 2025, briefly hiking in April, and then resuming cuts to year-end. Overall, while rate increases tended to be larger than cuts, these moves were concentrated in a handful of economies; in most others, monetary authorities kept policy rates on hold or implemented modest cuts (Figure 1.1.24).

Figure 1.1.23 Latest Headline Inflation Rates Relative to Inflation Targets

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



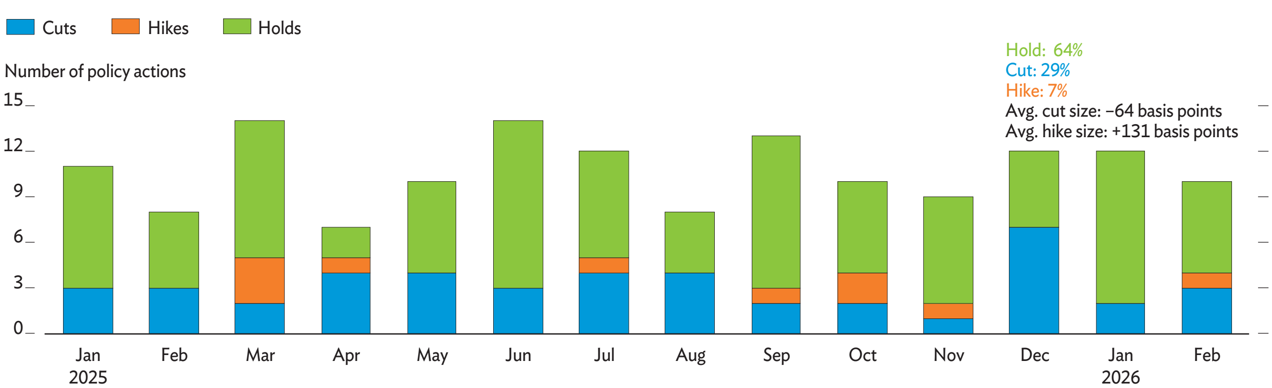
PRC = People's Republic of China.

Notes: Inflation up to 0.1 percentage points above target is considered within target. Latest inflation refers to December 2025 for India; January 2026 for Armenia, Kazakhstan, Sri Lanka, and Tajikistan; and February 2026 for the rest. The PRC maintains an annual consumer price index objective but is not an inflation-targeting economy. Bangladesh maintains an inflation objective but is not an inflation-targeting economy.

Source: CEIC Data Company and official sources.

Figure 1.1.24 Monetary Policy Decisions, 2025–2026

Holds and cuts have dominated central bank policy meeting decisions since January 2025.



Notes: Decisions are counted for each scheduled or unscheduled policy announcement since January 2025 in Armenia, Bangladesh, the People's Republic of China, Georgia, India, Kazakhstan, the Kyrgyz Republic, the Lao People's Democratic Republic, Malaysia, Mongolia, Nepal, Pakistan, Papua New Guinea, the Philippines, Sri Lanka, Tajikistan, Thailand, Türkiye, Uzbekistan, and Vanuatu.

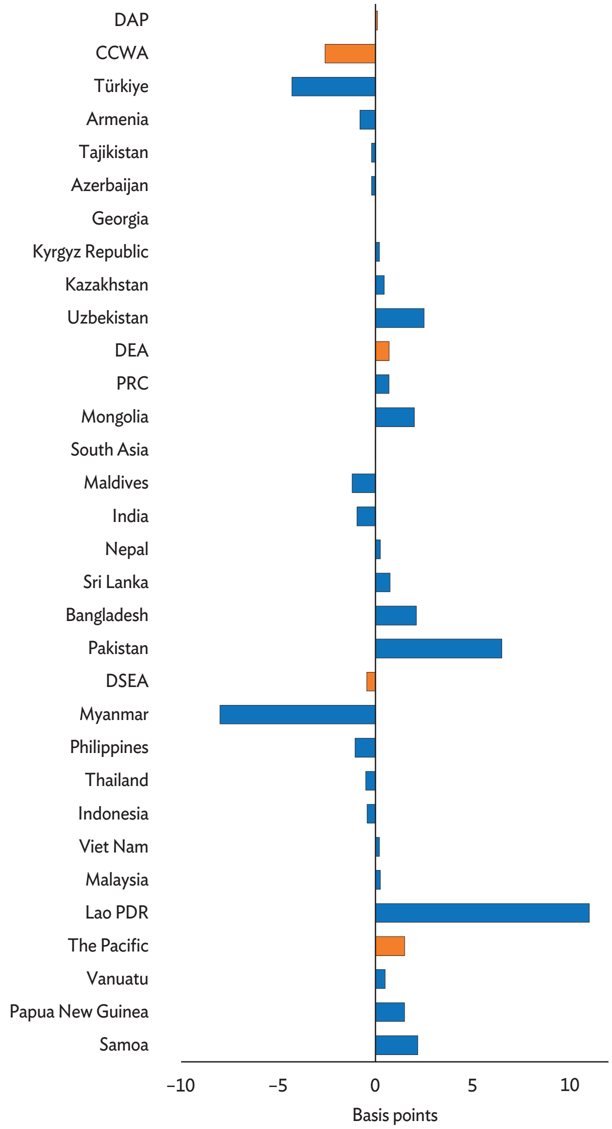
Source: Official central bank and monetary authority statements.

Real monetary conditions remained broadly stable in 2025, though with marked differences across DAP subregions. For the region as a whole, the implied ex-ante real policy rate—measured as a GDP-weighted average of nominal policy rates adjusted for inflation expectations—rose by 0.1 percentage points over the year, as falling inflation expectations slightly outpaced the decrease in nominal rates (Figure 1.1.25). This modest aggregate movement masks substantial variation across economies. The real policy rate remained broadly unchanged in South Asia, as moderate easing in India was offset by significant tightening in Bangladesh and Pakistan. Developing East Asia experienced moderate tightening, while the Pacific recorded a more pronounced increase. By contrast, the Caucasus and Central and West Asia recorded a large decline in its real policy rate, driven primarily by significantly easier conditions in Türkiye. Developing Southeast Asia also saw notable easing, reflecting declines in Indonesia, the Philippines, and Thailand.

Escalation of the conflict in the Middle East may partly reverse the region's recent disinflation. Higher energy prices, shipping and other transport disruption, and supply bottlenecks caused by the conflict could spill over into DAP and raise prices. Model-based estimates suggest that the impact in 2026 will be primarily on headline rather than core inflation (Figure 1.1.26) (Box 1.3.1). Under the assumption of an early stabilization for the Middle East conflict, simulations indicate that headline inflation could rise by almost 0.8 percentage points in the region overall, reflecting direct pass-through of higher oil and gas prices, with a more moderate and gradual impact on core inflation. The magnitude of effects would differ across subregions. Economies in the Caucasus and Central and West Asia and in South Asia are projected to face the largest increases in headline inflation, in particular Bangladesh, India, Pakistan, Sri Lanka, and Türkiye. By contrast, inflationary effects in developing East Asia are expected to be more contained, while developing Southeast Asia and the Pacific are likely to experience intermediate increases. Overall, the predominance of headline over core pressures suggests that the initial inflationary impulse will largely reflect external cost shocks, though second-round effects on core inflation could emerge if higher energy and transport costs persist.

Figure 1.1.25 Change in Implied Ex-ante Real Policy Rates at Year-End, 2024 to 2025

Regional real monetary conditions remained broadly stable on average in 2025, but this masked substantial differences across economies.



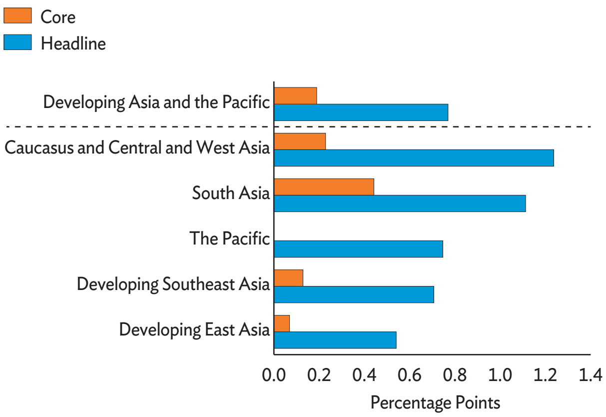
CCWA = Caucasus and Central and West Asia, PRC = People's Republic of China, DAP = developing Asia and the Pacific, DEA = developing East Asia, DSEA = developing Southeast Asia, Lao PDR = Lao People's Democratic Republic.

Notes: The change in the implied ex-ante real policy rate is the difference between the ex-ante real policy rate in 2025 (end-2025 policy rate minus 2026 average inflation rate forecast by *Asian Development Outlook September 2025* or, for Türkiye, by the International Monetary Fund's World Economic Outlook in October 2025) and the ex-ante real policy rate in 2024 (end-2024 policy rate minus 2025 average inflation rate forecast a year earlier). Regional and subregional averages were calculated as the GDP-weighted mean change in implied ex-ante real policy rates in included economies. This measure combines year-end policy rates with full-year average inflation forecasts and is therefore an indicative proxy for real monetary conditions.

Sources: CEIC Data Company; *Asian Development Outlook September 2024* and *2025*; International Monetary Fund. World Economic Outlook Database.

Figure 1.1.26 Simulated Impact of the Conflict in the Middle East on 2026 Inflation

The conflict is likely to exert significant pressure on inflation rates this year.



Notes: Simulated impacts are presented as deviations with respect to a pre-conflict scenario incorporating information up to 20 February 2026. Simulations do not take into account discretionary policy responses, global supply adjustments, heightened uncertainty effects, or remittance and tourism spillover. Results include proxied economies that are not directly modeled in the system. Refer to Box 1.3.1 in this report for more details.

Source: Asian Development Bank estimates using Global Economic Model of Oxford Economics.

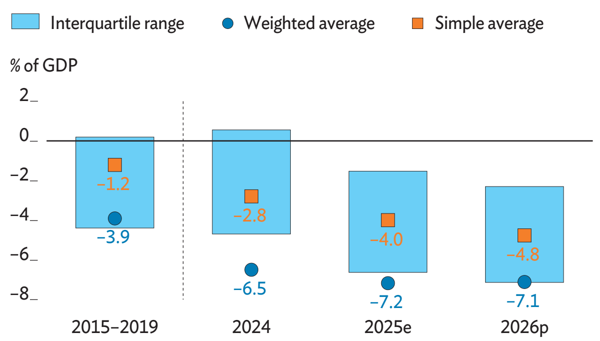
Initial inflationary effects from the conflict may trigger a measured monetary policy response in the region. Because the initial rise in inflation is expected to be driven mainly by higher energy costs, central banks may tolerate part of the increase in headline inflation and respond more decisively only if core inflation or inflation expectations strengthen. Pressure on regional central banks to raise policy rates is constrained by the expectation that monetary policy in the United States will not tighten in response to the shock. Policy tightening may nonetheless occur in some regional economies, particularly where exchange rate pressure intensifies. However, if rate increases do not fully match the rise in headline inflation, short-term real policy rates will decline, partly cushioning the impact on domestic demand. At the same time, this effect may be offset by tighter overall financial conditions as heightened risk aversion raises long-term yields, widens risk premiums, and dampens capital flows.

Fiscal Vulnerability Worsened in Some Economies

Fiscal deficits widened across most of the region in 2025. The GDP-weighted regional fiscal deficit deteriorated from the equivalent of 6.5% of GDP in 2024 to 7.2% in 2025, further above the pre-pandemic average of 3.9% (Figure 1.1.27). Deficits widened sharply in the Kyrgyz Republic, Tajikistan, and Timor-Leste to finance large public investment programs; in Vanuatu on reconstruction spending and the realization of contingent liabilities; in Azerbaijan and Nauru as revenue weakened; and in Samoa following a decline in grants. Fiscal deficits also widened, but less significantly, in Armenia, the PRC, and Thailand as governments continued to support domestic demand. In contrast, India, Malaysia, Nepal, and the Philippines reduced their deficits modestly with ongoing fiscal consolidation.

Figure 1.1.27 Regional Fiscal Balance

Fiscal deficits widened in most economies in 2025, further increasing the regional average fiscal deficit.



e = estimate, GDP = gross domestic product, p = projection.

Notes: Excluding Afghanistan, Niue, and the Cook Islands for lack of data. Regional weighted averages are GDP-weighted in nominal US dollars. The interquartile range is defined as encompassing the second and third quartiles.

Sources: Asian Development Bank. Asia Sovereign Debt Monitor; International Monetary Fund. World Economic Outlook (October 2025).

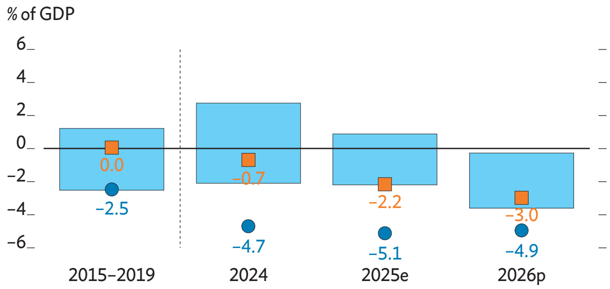
Primary deficits across the region remain larger than before the pandemic. The simple average of primary fiscal balances deteriorated from near balance in 2015–2019 to a deficit equal to 2.2% of GDP in 2025, projected to reach 3.0% in 2026. The weighted average primary deficit is substantially larger, estimated at 5.1% in 2025 and expected to narrow only slightly in 2026 (Figure 1.1.28, panel A). This reflects

Figure 1.1.28 Primary Balances

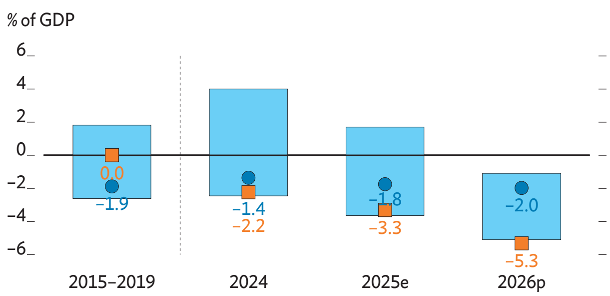
Primary deficits, still greater than before the pandemic, deepened across the region.

Interquartile range · Weighted average · Simple average

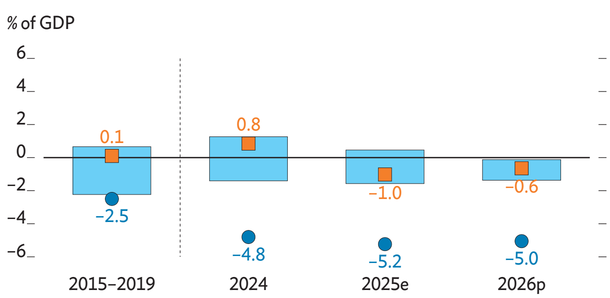
A. Developing Asia and the Pacific



B. Low-Income Countries in Developing Asia and the Pacific



C. Developing Asia and the Pacific Excluding Low-Income Countries



e = estimate, FSM = Federated States of Micronesia, GDP = gross domestic product, p = projection.

Notes: Low-income countries include those whose public debt is assessed through the Low-Income Country Debt Sustainability Framework of the International Monetary Fund and the World Bank, regardless of their World Bank classification based on income per capita: Bangladesh, Bhutan, Cambodia, Kiribati, the Kyrgyz Republic, the Lao People's Democratic Republic, Maldives, the Marshall Islands, the Federated States of Micronesia, Myanmar, Nepal, Papua New Guinea, Samoa, Solomon Islands, Tajikistan, Timor-Leste, Tonga, Tuvalu, Uzbekistan, and Vanuatu. Excludes Afghanistan, Niue, and the Cook Islands for lack of data. Regional weighted averages are GDP-weighted in nominal US dollars. The interquartile range is defined as encompassing the second and third quartiles.

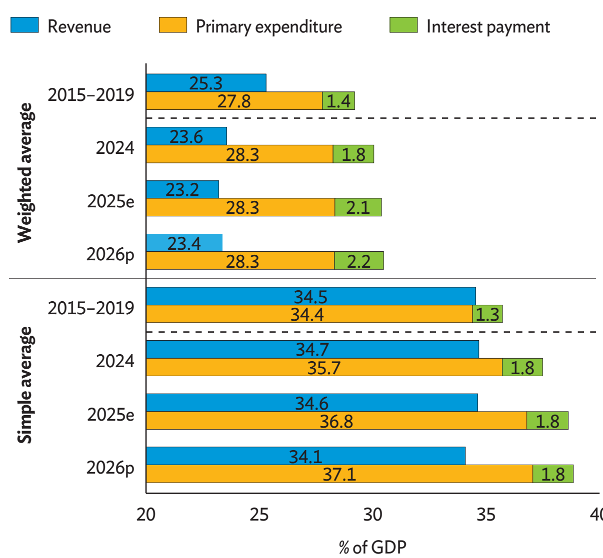
Sources: Asian Development Bank. Asia Sovereign Debt Monitor; International Monetary Fund. World Economic Outlook (October 2025).

persistent deficits in several large economies. Fiscal pressures are mounting more quickly in low-income countries, where the simple average of primary deficits is projected to widen to 5.3% of GDP in 2026 (Figure 1.1.28, panel B). Other countries' primary deficits trend broadly in line with those of the whole region (Figure 1.1.28, panel C).

The widening of primary deficits partly reflected declining revenue, and rising interest payments further deteriorated overall balances (Figure 1.1.29). Revenue in the region fell by an amount equal to about 0.4% of GDP in 2025. The ratio of revenue to GDP nevertheless increased in a third of regional economies. This largely reflected stronger activity and tax buoyancy, as well as the impact of adjustment programs supported by the International Monetary Fund in Pakistan, equal to 3.0% of GDP, and Sri Lanka, 1.3%. Primary spending in the region was unchanged from 2024 to 2025, while interest payments rose from 1.8% of GDP to 2.1%.

Figure 1.1.29 Revenue, Primary Expenditure, and Interest Payment

Fiscal expenditure increased more than revenue in 2025.



e = estimate, GDP = gross domestic product, p = projection.

Notes: Excludes Afghanistan, Niue, and the Cook Islands for lack of data. Regional weighted averages are GDP-weighted in nominal US dollars.

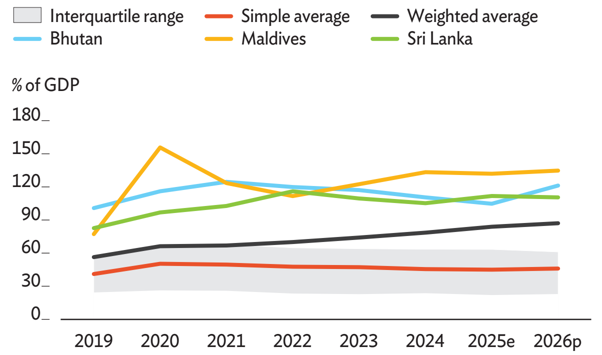
Sources: Asian Development Bank. Asia Sovereign Debt Monitor; International Monetary Fund. World Economic Outlook (October 2025).

Government debt ratios rose in few large economies, pushing up the regional average (Figure 1.1.30). Driven by increases in the PRC, Indonesia, Pakistan, the Philippines, and Thailand, aggregate regional debt rose to equal 84% of GDP. Strong economic growth helped contain ratios of debt to GDP in many economies, alongside rising inflation in some. Borrowing costs were favorable in most economies, including those undergoing adjustment: Bangladesh, Pakistan, and Sri Lanka. In contrast, borrowing costs increased in parts of the Caucasus and Central and West Asia on tighter monetary policy and a shift toward more expensive domestic borrowing.

The regional fiscal balance is projected to remain broadly unchanged in 2026, with debt sustainability risks still elevated. Fiscal deficits are expected to ease in most economies, but higher deficits in several larger ones will leave the aggregate regional balance broadly stable. Low-income economies are anticipated to face continued pressure from primary deficits and, some, debt vulnerability. Highly indebted economies, notably the Lao PDR and Maldives, rely on costly borrowing to close large financing gaps. In Maldives, the repayment of a critical sovereign obligation in early April 2026 has left fiscal and foreign reserve buffers extremely thin amid weakening tourism and rising oil prices. Unease about Bangladesh has prompted a negative outlook from rating agencies, and Moody's recently revised the sovereign outlook for Indonesia to negative on governance concerns. These economies may need fiscal consolidation and tighter fiscal policies.

Figure 1.1.30 Government Debt in Developing Asia and the Pacific

Debt increases in several large economies pushed the regional aggregate higher.



e = estimate, GDP = gross domestic product, p = projection.

Notes: Excludes Afghanistan, Niue, and the Cook Islands for lack of data. Regional weighted averages are GDP-weighted in nominal US dollars.

Sources: Asian Development Bank. Asia Sovereign Debt Monitor; International Monetary Fund. World Economic Outlook (October 2025).

Geopolitical Headwinds and Trade to Slow Regional Growth

This report's key assumptions, finalized on 10 March, anticipate an early stabilization in the Middle East, with energy prices declining from April 2026. Under such a scenario, the conflict would have a limited impact on growth in developing Asia and the Pacific (DAP) and a more pronounced effect on inflation (Box 1.2.1). At the same time, evidence through early April points to more persistent disruptions, with military activity continuing, commodity shipments through the crucial Strait of Hormuz close to zero, and damage to critical energy infrastructure. Against this backdrop, the risk that the Middle East conflict could have more severe effects on growth and inflation in developing Asia and the Pacific than in this report's early stabilization scenario looms large.

Box 1.2.1 Oil Supply Expectations and Their Impact on Inflation and Output in Developing Asia and the Pacific

Large and unexpected spikes in oil prices are among the most consequential shocks to the global economy. Irrespective of whether they stem from geopolitical tensions, shifting demand, or supply disruption, these fluctuations exert stagflationary pressures: weakening growth while raising inflation. Importantly, supply disruption is particularly damaging when expected to be persistent (Barsky and Kilian 2001; Kilian 2009). Expectations play a central role, prompting households and firms to adjust consumption, prices, and investment in anticipation of future constraints.

Movement in oil futures prices during unexpected events, such as disasters, can provide a useful proxy for supply shocks. Qureshi and Ahmad (2025) identify shocks using changes in oil futures triggered by major natural and technological disasters in key producers and exporters of crude oil. These movements offer a clean measure of shocks to oil supply expectations, isolating them from broader oil market fluctuations and avoiding typical reverse-causality concerns. Local projection techniques (Jordà 2005) are used to estimate the impacts of an oil supply expectation shock on industrial production and inflation in a sample of economies in developing Asia and the Pacific: Armenia, the People's Republic of China, India, Indonesia, Kazakhstan, Malaysia, Pakistan, the Philippines, Thailand, and Viet Nam. The sample spans both oil importers and exporters, with varying degrees of exchange rate flexibility and energy price regulation. The specification includes global and country-specific controls, along with country and year fixed effects.

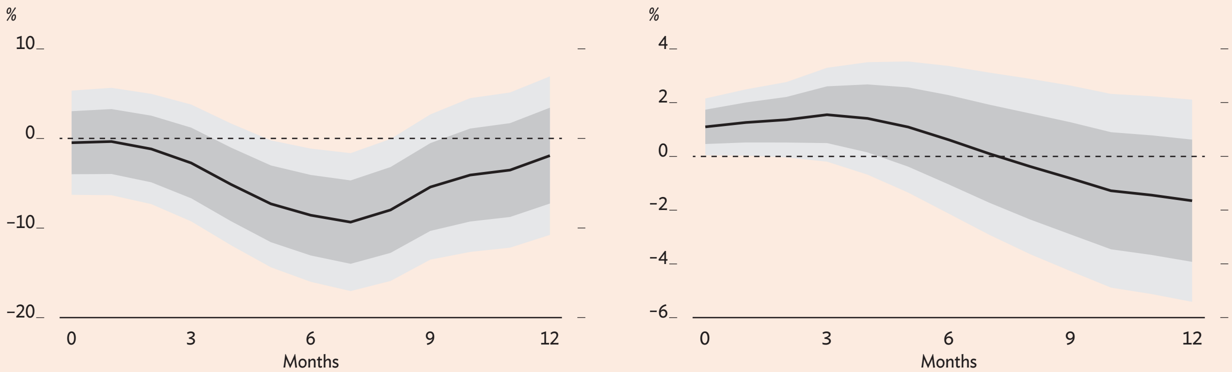
A shock to oil supply expectations causing a 10% rise in oil prices after adjusting for inflation reduces industrial production by almost 10% within 7 months on average. The gradual decline suggests that higher energy costs feed through supply chains before fully constraining activity. In contrast, consumer prices respond almost immediately, rising by almost 2% and peaking after 3 months (box figure). Together, these effects point to stagflation in response to oil supply shocks, with potentially larger effects in more oil-intensive economies.

Energy supply disruption caused by the Middle East conflict poses significant policy challenges in developing Asia and the Pacific. Inflation expectations that are well contained may limit the pass-through of oil price shocks to wages and broader prices. Otherwise, the risk of a wage–price spiral increases, potentially requiring monetary policy tightening (Baba and Lee 2022). Such tightening further constrains demand already

Box 1.2.1 *Continued*

Responses of Industrial Production and Consumer Prices to an Oil Supply Expectation Shock

Industrial production declines by almost 10% within 7 months from a 10% shock.



Notes: Solid black lines denote point estimates; light and dark grey shaded regions are, respectively, 90% and 68% confidence intervals. The oil supply expectation shock enters contemporaneously as an exogenous shock, with a unit increase corresponding to a 10% rise in the real oil price. Robust standard errors are used. Responses and standard errors are smoothed using a simple moving average.

Source: Qureshi and Ahmad (2025).

weakened by higher energy costs, thus compounding the negative effect on growth. Fiscal policy can mitigate the distributional impacts of such dynamics with measures to support vulnerable households. Such measures are most effective, however, when temporary and well targeted, as broad subsidies risk creating large fiscal costs without addressing underlying vulnerability.

In the medium term, economies in the region may need to enhance policy frameworks and structural resilience to better withstand such shocks. Reducing reliance on crude oil—through diversification of energy sources, efficiency gains in industry and services sectors, and deeper regional energy cooperation—can mitigate the impact of oil market disruption. Strengthening social protection systems will be critical to shield the most vulnerable. At the policy level, credible macroeconomic frameworks and robust institutions can enhance the capacity of economies to absorb external shocks. Improved macroeconomic surveillance is key, enabling authorities to calibrate short-term policy responses to safeguard stability, while advancing reform that builds shock resilience.

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This box was written by Irfan A. Qureshi and Ghufran Ahmad.

Heightened Risks to Commodity Markets

Under the assumed early stabilization scenario, set on 10 March, oil prices are expected to stay elevated in the near term amid heightened geopolitical tensions, before declining toward pre-conflict levels by year-end. The scenario assumes no significant damage to energy infrastructure and no prolonged disruptions to transport through the Strait of Hormuz. The Brent crude oil price, which averaged $64/barrel in the fourth quarter (Q4) of 2025 and $77 in Q1 2026, is forecast to settle at $80 in Q2 2026 before easing through the rest of the year as tensions gradually stabilize. Prices are expected to average around $68 in Q3 and $66 in Q4, bringing the 2026 annual average to $72/barrel. In 2027, prices are projected to decline to $63/barrel as the global oil surplus grows with the unwinding of production cuts by OPEC+, the alliance led by the Organization of the Petroleum Exporters, and as output increases from producers not in OPEC+.

Developments since 10 March, however, point to rising risks around the oil price path projected under the early stabilization scenario. The Strait of Hormuz saw virtually no transit through early April, while damage to energy infrastructure in the region continued. A higher oil price path poses significant risks to the region's economic outlook. Box 1.2.2 presents alternative scenarios in which disruptions to energy markets are assumed to last significantly longer than envisaged in the early stabilization scenario, with material effects on regional growth and inflation.

Box 1.2.2 Macroeconomic Implications of a Protracted Conflict in the Middle East for Asia and the Pacific: Risk Scenarios

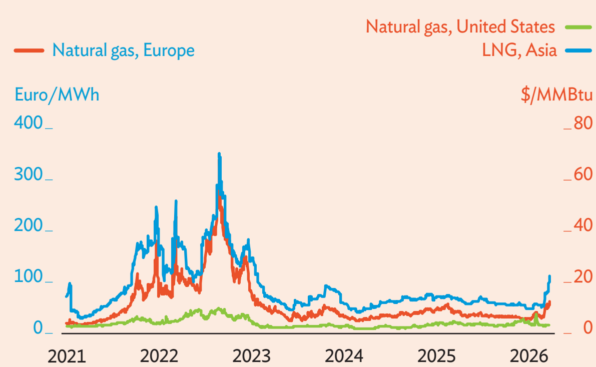
The conflict in the Middle East poses significant risks to the regional economic outlook. Since escalation in late February, oil and gas prices have risen sharply (box figure 1). The conflict affects both the production and the transport of fossil fuels. In particular, disruption to maritime traffic through the Strait of Hormuz—a critical chokepoint handling about 20% of globally traded oil and liquefied natural gas—has amplified price pressures. Economies in Asia and the Pacific are highly exposed, as many are net importers of hydrocarbons and rely heavily on supplies from the Middle East.[a] As a hub for global manufacturing and trade, the region is vulnerable as well to disrupted shipping lanes and aviation corridors linking Asia with Europe. Prolonged geopolitical tensions and resulting uncertainty could tighten global financial conditions, compounding these effects. While the early stabilization scenario projections in this report assume a short-lived conflict, sustained escalation poses substantial downward risks.

1 Benchmark Brent Crude Oil and Natural Gas Prices

Prices have soared since the escalation of conflict.

A. Brent Crude Oil Front Month Futures Prices

B. Natural Gas Front Month Futures Prices



LNG = liquefied natural gas, MMBtu = million British thermal units, MWh = megawatt-hour.

Notes: Close-of-day prices. Last observation 19 March 2026. Europe's natural gas benchmark is the Dutch Title Transfer Facility, while Asia's LNG benchmark is the Japan–Korea Marker.

Source: Bloomberg.

Box 1.2.2 *Continued*

Drawing on a recent ADB analysis, this box considers three escalation scenarios under which prolonged conflict could affect the regional outlook (ADB 2026). Reflecting different assumptions on conflict severity and intensity, the scenarios vary along three key dimensions: oil and gas prices, supply chain disruptions, and global financial conditions. Oil and gas prices are the primary transmission channel (box table). Under scenarios 1, 2, and 3, Brent crude is assumed to rise to $105, $130, and $155 per barrel, respectively, in the second quarter (Q2) of 2026. Prices remain elevated for longer under more severe scenarios, before gradually declining. To capture supply chain stress, the scenarios incorporate a shock to Asian and European production networks in Q2 2026. This is calibrated to be significant but not extreme, equal to about half the disruption observed at the peak of the COVID-19 pandemic. Global financial conditions are assumed to tighten to varying degrees. In the most severe scenario, the financial shock is comparable to roughly half of the tightening observed during the global financial crisis of 2008–2009.[b]

Impacts remain manageable under a contained scenario, but a more protracted conflict would generate materially larger losses in growth and stronger inflationary pressures. In developing Asia and the Pacific (DAP), cumulative growth losses in 2026–2027 amount to 0.3 percentage points (pps) in scenario 1 (S1), 0.7 pps in S2, and 1.3 pps in S3, broadly in line with effects on the world economy (box figure 2). Growth in advanced Asia and the Pacific is affected more strongly in 2026, reflecting greater exposure to international energy prices, although impacts ease in 2027 under scenarios with shorter duration. In contrast, inflation is more pronounced in DAP excluding the People's Republic of China because of the region's higher reliance on imported energy. Inflation in DAP rises by a cumulative 0.6 pps in S1, 1.2 pps in S2, and 3.2 pps in S3 over 2026–2027. Most economies suffer inflationary impacts in 2026 that moderate in 2027 as energy prices normalize. However, under prolonged conflict in S3, inflation is higher and more persistent, particularly in DAP economies excluding the People's Republic of China.

Although the energy price shock is assumed to be temporary, it generates broad and persistent stagflationary effects through supply, price, and financial channels. In the model, higher oil prices and supply disruption increase energy and producer prices, while supply-chain stress further raises transport costs, amplifying producer price inflation. Disrupted Gulf exports also push up fertilizer prices and food inflation. These price increases erode household real incomes and reduce consumption, weakening domestic demand and growth. Even as energy prices normalize, higher producer prices and supply-chain disruptions generate persistent inflationary pressures. These feed into core inflation and prompt monetary policy tightening, further dampening demand. Financial market corrections amplify stagflationary pressures, as wealth losses weigh on consumption, as do higher borrowing costs on investment.

Oil and Gas Price Assumptions under Different Scenarios

Energy prices peak at more than twice pre-conflict levels in the most adverse scenario.

	Oil price, Brent ($ per barrel)	Gas prices, Japan and Europe ($ per MMBtu)
Early stabilization scenario	$80 in Q2 2026, then slowly returning to pre-conflict from Q3 2026, averaging $63 in 2027	$18 in Q2 2026, then slowly returning to pre-conflict from Q3 2026, averaging $12 in 2027
Scenario 1 (S1)	$105 in Q2 2026 Early stabilization scenario from Q3 2026	$30 in Q2 2026 Early stabilization scenario from Q3 2026
Scenario 2 (S2)	$130 in Q2 2026 $120 in Q3 2026 Early stabilization scenario from Q4 2026	$40 in Q2 2026 $45 in Q3 2026 Early stabilization scenario from Q4 2026
Scenario 3 (S3)	$155 in Q2 2026 $140 from Q3 2026 to Q1 2027 Early stabilization scenario from Q2 2027	$55 in Q2 2026 $50 from Q3 2026 to Q1 2027 Early stabilization scenario from Q2 2027

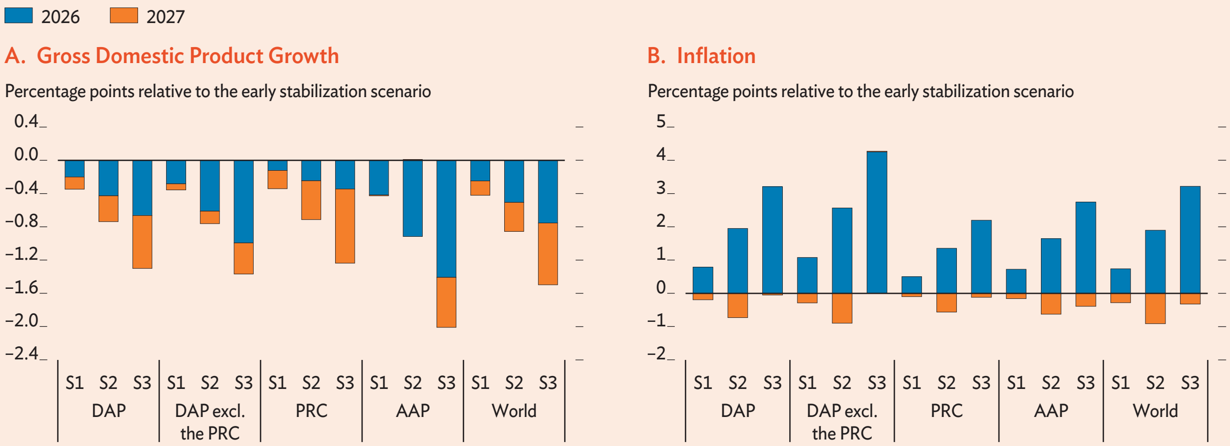
MMBtu = million British thermal units, Q = quarter.

Source: Asian Development Bank estimates.

Box 1.2.2 *Continued*

2 Estimated Impacts of the Middle East Conflict by Risk Scenario

GDP growth falls and inflation rises, with higher magnitudes as disruptions from the conflict intensify.



AAP = advanced Asia and the Pacific, PRC = People's Republic of China, DAP = developing Asia and the Pacific.
Source: Asian Development Bank estimates using Global Economic Model of Oxford Economics.

These model-based simulations should be interpreted with caution, as they are subject to several caveats. First, the analysis does not incorporate potential discretionary policy responses that may mitigate the impact of higher energy prices. Second, oil supply is determined within the model for many economies, but global supply may adjust more quickly in practice. Third, remittance- and tourism-dependent economies may face additional impacts not captured by the model. Fourth, some economies lack sufficient data to be modeled directly and are assumed to move in line with comparable economies. Finally, the model only partly reflects nonlinear financial market dynamics that could amplify shocks and their macroeconomic effects.

Policy should safeguard macroeconomic stability, manage energy consumption, and accelerate energy diversification. Immediate priorities are to contain inflationary pressures, stabilize financial conditions, and limit how much external shocks undermine confidence and domestic demand. Where support is needed, targeted and time-bound fiscal measures should be preferred to broad-based energy subsidies or price controls. Monetary policy should focus on targeted liquidity provision and anchoring inflation expectations through effective communication, rather than aggressive tightening. Governments should complement stabilization measures with efforts to reduce energy demand where feasible, notably by curtaining nonessential electricity use and transport fuel consumption. Strengthening efficiency standards and accelerating the adoption of renewable energy would diversify energy sources and reduce vulnerability to future external shocks.

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This box was written by Jaqueson Galimberti, Dennis Sorino, and Pilipinas Quising.

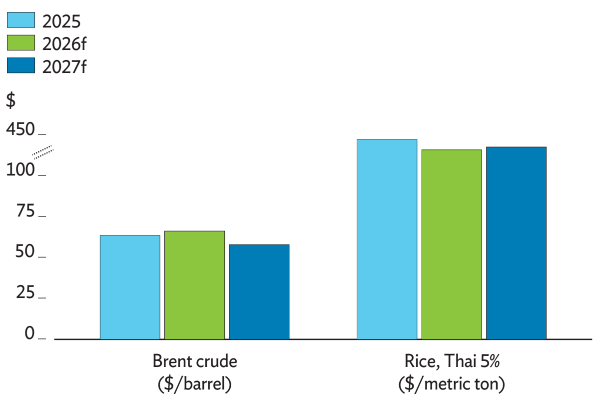
[a] The region is home to the world's four largest net importers of crude oil: the People's Republic of China, India, the Republic of Korea, and Japan (UN Comtrade. 2023 data, HS code 2709). However, exposure extends well beyond energy. Over half of Asia's seaborne imports of naphtha, a key feedstock for petrochemicals, are sourced from the Middle East (Richardson 2026). Disruption therefore risks spilling over to a wide range of manufacturing activities that rely on the timely delivery of chemical inputs, fertilizers, pharmaceutical ingredients, and semiconductor components.

[b] Additionally, oil and gas supply shocks are applied to Gulf economies with magnitudes based on estimates of the impact of intermittent closure of the Strait of Hormuz.

The conflict could also disrupt global markets for non-energy commodities sourced from the Gulf, with significant implications for food prices. Economies in the Middle East are major global suppliers of fertilizers and related inputs, including urea and ammonia, much of which transits through the Strait of Hormuz. Disruptions to production and transport have already tightened these markets, pushing up fertilizer prices. As fertilizers are a key input to agriculture, higher prices could raise agricultural production costs and reduce yields, feeding through with a lag into food prices. Under the early stabilization scenario, global rice prices are projected to decline in 2026 with improved supply conditions, but pressures resulting from a prolonged conflict could offset the expected easing and create broader upside risks to food inflation before conditions normalize in 2027 (Figure 1.2.1).

Figure 1.2.1 Commodity Prices

Global oil prices are expected to rise in 2026 due to the conflict in the Middle East, while rice prices are projected to remain low amid ample supply.



f = forecast.

Note: Rice price refers to Thai white rice 5% broken.

Sources: *Asian Development Outlook* database; World Bank Commodity Pink Sheet; Focus Economics.

Growth to Remain Resilient in Major Advanced Economies

Under the assumption of early stabilization in the Middle East conflict, growth is set to remain broadly stable in the United States (US) and slow in the euro area. In the US, growth is projected to edge up slightly to 2.3% in 2026, from 2.1% in 2025, before easing to 2.0% in 2027 (Table 1.2.1). Economic activity will be supported by strong investment in artificial intelligence. However, higher energy prices caused by the conflict may put upward pressure on inflation and weigh on real household incomes, partly dampening consumption and consumer confidence. Growth in the euro area is projected to slow significantly in 2026 before edging up slightly in 2027. Higher public spending on infrastructure and defense will support activity in 2026. However, subdued domestic demand will limit the pace of expansion, with private consumption growing only moderately as energy price increases will raise inflation and erode real incomes. The external environment will remain challenging as competition from foreign producers intensifies, global demand weakens, and uncertainty on trade and energy worsens.

Table 1.2.1 Early Stabilization Scenario Assumptions on the International Economy

Growth in the United States and the euro area is expected to stabilize, but global geopolitical tensions will spur inflation.

	2024	2025	2026	2027
	Actual		Forecast	
GDP growth, %				
United States	2.8	2.1	2.3	2.0
Euro area	0.9	1.4	1.1	1.2
Inflation, %				
United States	3.0	2.6	2.7	2.4
Euro area	2.4	2.1	2.6	2.3
Brent crude spot prices, average, $/barrel	81	69	72	63

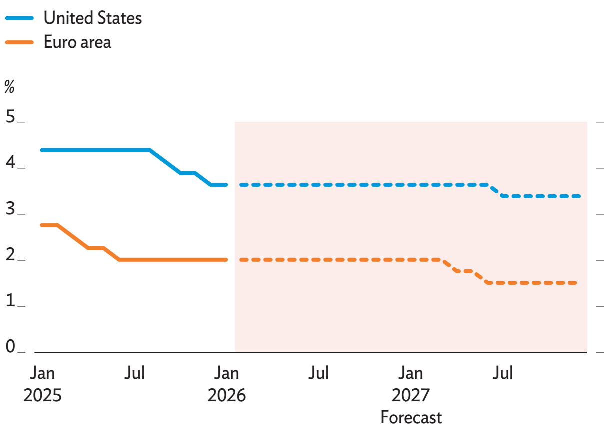
GDP = gross domestic product.

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

Inflation is projected to rise in the near term following the surge in energy prices caused by the conflict. In the US, the energy price shock is expected to raise inflation in 2026. However, these effects are anticipated to be temporary, with inflation gradually converging toward the target rate in 2027. Given persistent inflationary pressure, the US Federal Reserve is expected to keep policy rates on hold in 2026, before easing in 2027 with a 25-basis point reduction (Figure 1.2.2). In the euro area, headline inflation is also projected to accelerate as the conflict in the Middle East raises energy and transportation costs, which will feed through to broader consumer prices. Energy prices are anticipated to decline in 2027, but this will be partly offset by gradually strengthening wage growth, resulting in only a slight moderation in inflation. The European Central Bank is expected to keep its policy rate unchanged at 2% in 2026 before easing in 2027.

Figure 1.2.2 Central Bank Policy Rates in Major Advanced Economies

Monetary policy is expected to remain on hold in 2026, given higher energy prices and geopolitical uncertainty, before easing resumes.



Sources: Haver Analytics; Asian Development Bank estimate.

Slower Growth in Advanced Asia and the Pacific

Growth in advanced Asia and the Pacific is projected to slow to 2.2% in 2026 and 1.8% in 2027, from 2.5% in 2025, under the early stabilization scenario. Strong technology exports will only partly offset trade constraints and the fallout from the Middle East conflict (Table 1.2.2). Growth in Japan is projected to weaken markedly as the effects of export front-loading in 2025 fade and rising energy prices weigh on market sentiment. In contrast, despite higher energy prices and reduced confidence in the wake of the conflict, growth is expected to pick up in the Republic of Korea and remain strong in Taipei,China on sustained global demand for semiconductors. Growth in Singapore is projected to moderate, weighed down by subdued activity in consumer services amid trade and geopolitical uncertainties. In Hong Kong, China, slower growth in the People's Republic of China (PRC) and heightened geopolitical uncertainty are anticipated to constrain economic expansion. Economic activity is forecast to remain steady in Australia, supported by resilient domestic demand, and strengthen in New Zealand, reflecting earlier monetary easing.

Table 1.2.2 Economic Growth and Inflation in Advanced Asia and the Pacific, %

Growth is projected to moderate and inflation to rise across most economies.

	2024	2025	2026f	2027f
GDP Growth				
Advanced Asia and the Pacific	**1.5**	**2.5**	**2.2**	**1.8**
Australia	1.1	2.0	2.0	2.9
Hong Kong, China	2.6	3.5	2.6	3.0
Japan	–0.2	1.2	0.7	0.6
Republic of Korea	2.0	1.0	1.9	1.9
New Zealand	–0.3	0.2	1.9	2.8
Singapore	5.3	5.0	3.0	2.3
Taipei,China	5.3	8.7	7.6	4.0
Inflation				
Advanced Asia and the Pacific	**2.6**	**2.5**	**2.6**	**1.9**
Australia	3.2	2.9	5.1	2.6
Hong Kong, China	1.7	1.4	1.7	1.5
Japan	2.7	3.2	2.4	1.8
Republic of Korea	2.3	2.1	2.3	2.0
New Zealand	2.9	2.8	3.8	1.6
Singapore	2.4	0.9	1.6	1.7
Taipei,China	2.2	1.7	1.8	1.5

f = forecast, GDP = gross domestic product.

Source: *Asian Development Outlook* database.

Inflation in advanced Asia and the Pacific is forecast to increase this year on elevated energy prices under the early stabilization scenario. Higher petroleum prices from the conflict in the Middle East are expected to push up inflation in Australia; Hong Kong, China; the Republic of Korea; New Zealand; and Taipei,China. Singapore will see inflation rise over the forecast period, driven by increases in transport costs and electricity prices following a carbon tax hike. In contrast, although energy prices have risen, inflation in Japan is anticipated to moderate due to base effects and government cost-of-living measures, notably fuel and utility price subsidies and income tax support.

Slowing Regional Growth Despite Robust Domestic Demand

DAP faces a challenging external environment as the conflict in the Middle East lifts energy prices and uncertainty, raising production costs and weighing on confidence. The regional outlook crucially depends on how long tensions in the Middle East and ensuing disruptions to commodity markets will last. Key assumptions finalized on 10 March envisage an early stabilization scenario, with disruptions easing gradually from April onwards. Under these assumptions, the conflict would have only modest effects on growth in DAP, but risks are clearly tilted to the downside. Regional growth is forecast to moderate from 5.4% in 2025 to 5.1% in both 2026 and 2027 (Table 1.2.3). However, these projections are subject to a high degree of uncertainty. Incoming evidence since 10 March suggests that tensions may escalate further and last longer than in the early stabilization scenario. Risk scenario analysis suggests that growth would fall to 4.7% in 2026 and 4.8% in 2027 if disruptions last through the third quarter of 2026 (Box 1.2.2).

Against the backdrop of a deteriorating external environment, domestic demand will continue to support economic activity in DAP. Consumption is expected to remain largely resilient, particularly in South Asia and developing Southeast Asia, sustained by monetary policy easing, while increased public infrastructure investment in some economies will provide additional support to domestic demand.

Growth in the PRC is projected to slow, reflecting subdued private consumption and weaker external demand. GDP growth is expected to decline from 5.0% in 2025 to 4.6% in 2026 and 4.5% in 2027. The government's proactive fiscal stance and moderately accommodative monetary policy will cushion domestic demand, though subdued consumer sentiment and income expectations are anticipated to constrain growth in private consumption. Investment in high-technology and artificial intelligence will provide some support, but a prolonged downturn in the property sector will continue to weigh on activity. Export growth is expected to moderate from a high base as global demand weakens, though increased trade with markets outside the US will partly offset this slowdown.

In South Asia, growth will continue to be supported by strong domestic demand, though expected to moderate in 2026. GDP growth in the subregion is projected to ease from 6.8% in 2025 to 6.3% in 2026 before returning to 6.8% in 2027. Despite a worsening global economic and geopolitical environment, growth in India is forecast to remain robust at 6.9% in fiscal year (FY) 2026. Activity will be underpinned by strong domestic demand, supported by easing financing conditions, and lower US tariffs on Indian goods. Growth is projected to rise to 7.3% in FY2027, driven by domestic reforms, the effects of trade agreements with the European Union, and expected government salary increases. In Pakistan, growth is forecast to pick up as private investment strengthens on accommodative monetary policy and improved investor confidence following sovereign credit rating upgrades in 2025. In Bangladesh, growth is projected to rise over the forecast period supported by the new government's regulatory initiatives and benefits from ongoing financial sector reforms. In Bhutan, growth will remain robust in 2026 and 2027, driven by the construction of new hydropower plants. In Maldives, growth is projected to slow as a surge in fishing activity last year unwinds, the conflict in the Middle East dampens tourism revenue and raises energy costs, and dwindling fiscal and external resources constrain countercyclical policy response. Growth in Nepal and Sri Lanka is projected to slow in 2026, partly due to the impact of the Middle East conflict, before accelerating in 2027.

Table 1.2.3 GDP Growth in Developing Asia and the Pacific, %

Regional growth will moderate in 2026 and 2027, remaining stronger outside the People's Republic of China.

	2024	2025e	2026f	2027f
Developing Asia and the Pacific (DAP)	**5.3**	**5.4**	**5.1**	**5.1**
DAP excluding the People's Republic of China	**5.6**	**5.9**	**5.5**	**5.8**
Caucasus and Central and West Asia	**4.3**	**4.6**	**4.2**	**4.4**
Armenia	5.9	7.2	5.5	5.7
Azerbaijan	4.1	1.4	2.0	1.8
Georgia	9.7	7.5	5.5	5.2
Kazakhstan	5.0	6.5	4.8	4.5
Kyrgyz Republic	11.5	11.1	8.9	8.4
Tajikistan	8.4	8.4	7.3	6.8
Türkiye	3.3	3.6	3.6	4.0
Turkmenistan	6.3	6.3	6.5	6.2
Uzbekistan	6.7	7.7	6.7	6.8
Developing East Asia	**5.0**	**5.0**	**4.6**	**4.5**
People's Republic of China	5.0	5.0	4.6	4.5
Mongolia	5.1	6.8	5.7	6.0
South Asia	**6.4**	**6.8**	**6.3**	**6.8**
Afghanistan	2.3	1.9	2.3	2.8
Bangladesh	4.2	3.5	4.0	4.7
Bhutan	7.5	8.5	6.9	7.2
India	7.1	7.6	6.9	7.3
Maldives	3.5	5.4	1.0	3.0
Nepal	3.7	4.6	2.7	5.0
Pakistan	2.6	3.1	3.5	4.5
Sri Lanka	5.0	5.0	4.0	4.2
ASEAN	**5.0**	**4.8**	**4.6**	**4.6**
Developing Southeast Asia	**4.9**	**4.8**	**4.7**	**4.8**
Brunei Darussalam	4.1	0.7	1.6	1.9
Cambodia	6.0	5.2	4.5	5.0
Indonesia	5.0	5.1	5.2	5.2
Lao People's Democratic Republic	4.0	4.4	4.0	4.5
Malaysia	5.1	5.2	4.6	4.5
Myanmar	–0.7	–2.2	2.4	2.7
Philippines	5.7	4.4	4.4	5.5
Thailand	2.9	2.4	1.8	2.0
Timor-Leste	4.3	3.9	3.8	4.1
Viet Nam	7.1	8.0	7.2	7.0
The Pacific	**3.9**	**4.2**	**3.4**	**3.2**
Cook Islands	15.1	4.0	2.7	3.0
Fiji	3.5	3.0	2.9	2.7
Kiribati	4.6	4.3	3.1	2.6
Marshall Islands	2.5	3.0	3.7	2.8
Federated States of Micronesia	2.3	1.1	1.0	1.0
Nauru	1.6	2.1	2.5	2.5
Niue	8.7	2.7	2.5	2.5
Palau	12.0	6.9	6.0	3.7
Papua New Guinea	3.9	4.7	3.6	3.4
Samoa	4.8	4.2	3.2	3.0
Solomon Islands	3.0	3.6	3.0	3.4
Tonga	1.8	2.5	2.3	2.3
Tuvalu	3.1	2.7	2.5	2.4
Vanuatu	3.8	3.8	4.7	3.9

ASEAN = Association of Southeast Asian Nations, e = estimate, f = forecast, GDP = gross domestic product.

Note: ASEAN comprises Brunei Darussalam, Cambodia, Indonesia, the Lao People's Democratic Republic, Malaysia, Myanmar, the Philippines, Singapore, Thailand, Timor-Leste, and Viet Nam.

Source: *Asian Development Outlook* database.

The outlook for developing Southeast Asia remains solid, supported by robust domestic demand. Under the early stabilization scenario, subregional GDP growth is projected at 4.7% in 2026, rising slightly to 4.8% in 2027. However, a prolonged conflict in the Middle East would intensify downside risks, and growth prospects continue to vary across economies. In Indonesia, growth is expected to strengthen, supported by resilient domestic demand, yet a prolonged conflict in the Middle East may weigh on the outlook. Myanmar is projected to rebound from contraction in 2025 as disaster reconstruction supports activity, while normalization of hydrocarbon production will sustain growth in Brunei Darussalam. By contrast, growth in Malaysia, Thailand, and Viet Nam is forecast to moderate amid weaker global trade, fading effects from export front-loading, and the impact of the Middle East conflict, though technology exports will provide some cushion. In the Philippines, growth will remain subdued as inflationary pressures from elevated global commodity prices and heightened uncertainties over the Middle East conflict weigh on consumer spending and investor confidence. The ongoing border closure is expected to slow growth in Cambodia in 2026 before economic activity regains momentum in 2027 as tourism-related services recover. Timor-Leste's growth is forecast to remain stable in 2026 before accelerating in 2027, supported by strong domestic demand.

Several factors are projected to moderate growth in the Caucasus and Central and West Asia. Expansion is expected to decline from 4.6% in 2025 to 4.2% in 2026 and recover slightly to 4.4% in 2027. This reflects mainly a slowdown in Kazakhstan as oil output plateaus near capacity despite higher oil prices, and in Uzbekistan, where construction will moderate following rapid expansion last year. Growth in Georgia and Tajikistan is also projected to slow as weaker global demand weighs on exports. Growth in Türkiye—which accounts for 64% of subregional GDP—is anticipated to remain steady in 2026, driven by robust domestic demand, although the Middle East conflict may weigh on activity in the near term. Growth is expected to pick up in 2027, underpinned by higher spending on durable goods and construction

Growth in the Pacific is forecast to moderate largely due to broadly flat hydrocarbon output. Subregional expansion is expected to slow from 4.2% in 2025 to 3.4% in 2026 and 3.2% in 2027. This mainly reflects developments in Papua New Guinea—the subregion's largest economy—where growth is projected to ease to 3.6% in 2026 and 3.4% in 2027. Higher oil production in 2026, driven by recent price gains, will be offset by flat liquefied natural gas production operating near capacity and weaker non-resource sector activity, with overall hydrocarbon output expected to level off as prices normalize in 2027. Growth is also projected to moderate across much of the subregion. In the Cook Islands and Fiji, airline and hotel capacity and price competition from alternative destinations are expected to constrain tourism growth, while factors such as budget dynamics, local capacity, and project implementation cycles will affect the growth outlook across most of the Pacific. In contrast, Vanuatu is expected to see stronger growth in 2026 as reconstruction efforts continue following a December 2024 earthquake, while expansion in Solomon Islands is projected to pick up in 2027, largely driven by infrastructure-related stimulus.

Inflation Rising Gradually and Unevenly in the Region

Under the assumption of an early stabilization of the Middle East conflict, inflation in DAP is forecast to rise from 3.0% in 2025 to 3.6% in 2026, mainly on higher energy prices. The rate will then ease to 3.4% in 2027 as global commodity prices stabilize (Table 1.2.4). However, with disruptions now appearing more likely to last longer than assumed under the early stabilization scenario, upside risks to inflation have increased materially. Inflation impacts would be much more significant in the case of longer-lasting disruptions to energy and other commodity markets, including through higher fertilizer prices that raise agricultural production costs and feed into food prices. Scenario analysis suggests that inflation would rise to 5.6% in 2026 if tensions last through the third quarter of this year, before slowing to 2.8% in 2027, as energy prices decline (Box 1.2.2).

The increase in regional inflation will be driven mainly by the PRC and India, reflecting higher food prices and commodity prices. Inflation in Türkiye is expected to continue falling with tight monetary policy and energy subsidy reform, while remaining elevated. This will ease price pressure in the Caucasus and

Table 1.2.4 Inflation in Developing Asia and the Pacific, %

Regional inflation is expected to accelerate, with varying trends across subregions.

	2024	2025e	2026f	2027f
Developing Asia and the Pacific (DAP)	**5.3**	**3.0**	**3.6**	**3.4**
DAP excluding the People's Republic of China	**10.5**	**6.1**	**6.8**	**5.8**
Caucasus and Central and West Asia	**41.1**	**25.6**	**20.6**	**16.3**
Armenia	0.3	3.3	3.8	3.2
Azerbaijan	2.2	5.6	5.7	4.9
Georgia	1.1	3.9	3.8	3.3
Kazakhstan	8.7	11.4	10.4	9.5
Kyrgyz Republic	5.0	8.2	10.3	8.5
Tajikistan	3.6	3.5	4.0	4.5
Türkiye	60.0	35.2	27.7	21.5
Turkmenistan	5.5	5.5	6.0	6.0
Uzbekistan	9.8	7.3	6.5	5.0
Developing East Asia	**0.2**	**0.0**	**0.6**	**1.0**
People's Republic of China	0.2	0.0	0.6	1.0
Mongolia	6.2	8.6	7.8	6.8
South Asia	**6.4**	**2.9**	**5.0**	**4.6**
Afghanistan	−7.7	−4.2	4.6	3.2
Bangladesh	9.7	10.0	9.0	8.5
Bhutan	2.8	3.5	3.9	3.2
India	4.6	2.1	4.5	4.0
Maldives	1.4	4.0	5.0	4.0
Nepal	5.4	4.1	3.7	4.5
Pakistan	23.4	4.5	6.4	6.5
Sri Lanka	1.2	−0.5	5.2	4.0
ASEAN	**3.0**	**2.2**	**3.1**	**2.8**
Developing Southeast Asia	**3.0**	**2.3**	**3.2**	**2.8**
Brunei Darussalam	-0.4	-0.3	0.9	0.4
Cambodia	0.8	2.5	2.8	2.5
Indonesia	2.3	1.9	2.5	2.5
Lao People's Democratic Republlic	23.1	7.7	9.8	6.7
Malaysia	1.8	1.4	1.8	1.9
Myanmar	29.6	25.2	24.0	16.0
Philippines	3.2	1.7	4.0	3.5
Thailand	0.4	−0.1	1.3	1.0
Timor-Leste	2.1	0.5	1.7	2.0
Viet Nam	3.6	3.3	4.0	3.8
The Pacific	**1.7**	**3.0**	**4.2**	**3.5**
Cook Islands	4.6	2.0	3.5	3.3
Fiji	3.9	−1.4	3.3	1.9
Kiribati	2.6	6.5	5.3	4.2
Marshall Islands	5.7	5.6	5.7	4.0
Federated States of Micronesia	5.4	3.9	3.5	3.0
Nauru	9.3	6.1	4.5	4.0
Niue	5.4	2.3	3.4	2.8
Palau	3.7	0.2	2.8	2.4
Papua New Guinea	0.6	4.4	4.6	4.0
Samoa	3.6	1.9	1.8	4.0
Solomon Islands	4.2	3.4	4.5	2.8
Tonga	8.0	2.9	3.8	2.7
Tuvalu	0.4	2.8	3.1	1.0
Vanuatu	1.2	0.7	2.0	2.7

ASEAN = Association of Southeast Asian Nations, e = estimate, f = forecast.

Note: ASEAN comprises Brunei Darussalam, Cambodia, Indonesia, the Lao People's Democratic Republic, Malaysia, Myanmar, the Philippines, Singapore, Thailand, Timor-Leste, and Viet Nam.

Source: *Asian Development Outlook* database.

Central and West Asia and moderate the increase in regional inflation. Excluding Türkiye, average inflation in DAP under the early stabilization scenario is projected to increase from 1.4% in 2025 to 2.5% in both 2026 and 2027.

In the PRC, inflation is projected to increase gradually as authorities act against deflationary pressure. Headline inflation is expected to edge up from zero in 2025 to 0.6% in 2026 and further to 1.0% in 2027. The increase will be supported by policy measures to limit excessive competition among producers that include industry consolidation, capacity controls, and more selective subsidies. Rising pork prices and energy prices are anticipated to also push up inflation.

Inflation in South Asia is set to rise from 2.9% in 2025 to 5.0% in 2026, reflecting higher food and energy prices. It will then ease to 4.6% in 2027 as oil prices soften. In India, inflation is projected to more than double from 2.1% in FY2025 to 4.5% in FY2026 on a rebound in food prices from earlier declines, higher global oil prices, currency weakness, and rising precious metal prices, then ease to 4.0% in FY2027 on account of lower oil prices. Inflation is projected to increase in Pakistan on stronger economic activity, temporary disruption to wheat supplies, and higher oil and liquefied natural gas prices. In Bangladesh, inflation is expected to remain high in FY2026 and ease a little in FY2027 as the effects of external shocks diminish and domestic supply conditions improve. In Afghanistan, supply-chain disruptions with Pakistan are expected to push food prices higher, compounded by elevated global oil prices. Inflation in Bhutan will increase temporarily not only due to oil prices, but the introduction of a goods and services tax as well. Rising energy prices are also expected to add to inflationary pressures in Maldives, Nepal, and Sri Lanka in 2026.

In developing Southeast Asia, inflation is projected to rise from 2.3% in 2025 to 3.2% in 2026 as domestic demand strengthens. Consumer prices are forecast to edge up in most economies, with further upward pressures from higher energy and food production costs if the Middle East conflict is prolonged. In Indonesia, stronger domestic demand will also push inflation higher. In the Philippines, price pressure will rise on higher oil prices, electricity rate adjustments, and public transportation costs, while in Malaysia inflation will be shaped by tariff adjustments and the lagged effects of sales and services tax increases. In Thailand and Viet Nam, inflation is projected to rebound as rising energy prices combine with price pressure from improving domestic activity. Similarly, higher oil prices may amplify inflationary pressure in Cambodia, the Lao People's Democratic Republic, and Timor-Leste. In contrast, inflation will ease in Myanmar as price pressure is contained by improved domestic transport networks, currency appreciation, and better agricultural output. The subregional inflation rate will then ease to 2.8% in 2027 as global commodity prices stabilize.

Inflation in the Caucasus and Central and West Asia is forecast to decline significantly but remain elevated. Subregional inflation is expected to fall from 25.6% in 2025 to 20.6% in 2026 and 16.3% in 2027. This decrease will largely reflect developments in Türkiye, where tight monetary policy and domestic energy subsidy reform is expected to drive inflation down from 35.2% in 2025 to 21.5% in 2027. Tight or cautious monetary policy in Kazakhstan and Uzbekistan is anticipated to contain inflation. These trends are expected to offset higher inflation in the Kyrgyz Republic and Tajikistan fueled by utility price increases, and in Turkmenistan from currency fluctuation and external price pressure. Inflation in Azerbaijan is projected to rise in 2026 on higher import costs driven by elevated global hydrocarbon prices, then moderate in 2027.

Inflation in the Pacific is projected to increase on rising energy prices. In Papua New Guinea, upward pressure on prices is expected from currency depreciation, volatility in betel nut prices, higher fuel prices, and the discontinuation of goods and services tax exemptions for some essential items. External pressures are also expected to intensify, as the conflict in the Middle East adds to inflation through higher global fuel and import prices. In Fiji, inflation is forecast to rebound in 2026 following deflation in 2025, driven by elevated oil prices and higher prices for alcoholic beverages due to domestic supply constraints. Beyond oil prices, increases in import costs are anticipated to add to inflationary pressures in 2026, particularly in the smaller economies of the subregion. In Solomon Islands, stronger domestic demand is also expected to push inflation higher. In Samoa, inflation from higher oil prices will extend into early FY2027 (ending 30 June 2027). Inflation in the subregion is expected to ease in 2027 as global oil prices stabilize.

The Risk of Escalating Middle East Tensions Looms Large

The regional outlook critically depends on how the conflict in the Middle East evolves. Elevated energy prices, disruptions to transport routes, and tighter supply conditions have already emerged, but their persistence will depend on the duration of the conflict. Prolonged tensions could further damage energy infrastructure and disrupt the transport of energy and other crucial commodities for longer than anticipated. DAP is highly exposed as the world's largest energy-importing region and the main destination for hydrocarbons transiting the Strait of Hormuz, through which a large share of globally traded petroleum passes. Persistently high oil prices would negatively shock the terms of trade for most regional economies, raising inflation, eroding real incomes, and widening current account deficits. Elevated shipping insurance costs, rerouted aviation corridors, and logistics disruptions could further increase transport costs and slow trade. Long-lasting disruptions to global markets for non-energy commodities sourced from the Gulf, particularly fertilizers such as urea and ammonia, would further raise agricultural input costs. These pressures could feed into food prices over time, adding to inflation. Disruptions to key industrial inputs such as helium, sulfur, and petrochemical products could extend negative spillovers to manufacturing, including semiconductor supply chains.

Heightened geopolitical tensions in the Middle East have already contributed to tighter financial conditions. These could tighten further if uncertainty persists. Increased risk aversion may trigger further equity market declines, as well as wider risk premiums and lower capital flows to the region. Sustained currency depreciation would add to inflationary pressures and increase the burden of US dollar-denominated debt, particularly in economies with significant external financing needs. Tighter financial conditions would weigh on investment and domestic demand, amplifying the impact of higher energy and commodity prices. Box 1.2.2 quantifies the impacts of escalation in the Middle East conflict on growth and inflation in the region. In a severe escalation scenario, in which disruptions become very large and last through the first quarter of next year, regional growth would be around 1.3 percentage points lower over 2026–2027 and inflation about 3.2 percentage points higher than under the early stabilization scenario.

Trade Risks Further Cloud the Outlook

Trade tensions have eased since their 2025 peak, but risks remain from renewed tariff shocks. While recent bilateral agreements between the US and its major trading partners—notably the PRC, India, and Taipei,China—have reduced some tariff rates, the broader tariff regime remains unsettled. On 20 February 2026, the US Supreme Court rejected tariffs introduced under the International Emergency Economic Powers Act. This prompted the administration to introduce a 10% global tariff valid for 150 days, with indications that it could rise to 15%. At the same time, new investigations have been launched that could bring more permanent sector-specific duties, with the aim of restoring tariff rates broadly in line with those before the court ruling. In the near term, the fixed 150-day window may encourage export front-loading as firms accelerate shipments ahead of possible tariff increases. While this would temporarily lift trade and manufacturing activity, it risks weaker demand later if orders are pulled forward. Beyond that, further tariff hikes and persistently elevated trade policy uncertainty could weigh on export growth, disrupt regional supply chains, delay investment decisions, and tighten financial conditions.

A deeper PRC property downturn could also pose a downside risk to the regional outlook. Real estate activity continued to contract in late 2025, with full-year investment falling by 17.2% and home sales by floor area declining by 8.7%. In response, the government has prioritized property market stabilization and inventory reduction in 2026, reflecting a proactive approach to underpin recovery. While a swift rebound may not be imminent, these measures could gradually restore confidence. Should challenges persist, however, impacts may be felt through the construction sector and its suppliers, local government finances, and broader confidence channels. In a severe scenario, spillover to the region could occur, especially if financial stress on developers, local governments, or banks affects broader credit markets.

SPECIAL TOPIC

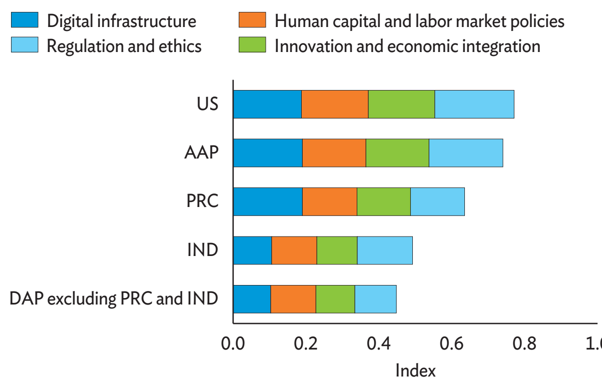
AI Readiness and Economic Impacts in Asia and the Pacific

Generative artificial intelligence (AI) has potential to transform economies and the nature of work, depending on how widely and effectively it is adopted. Advanced economies appear better positioned to realize early gains from the economic transformation driven by AI, due to prior investment in data infrastructure, computing capacity, and technological proficiency. Developing economies could also benefit through technological diffusion. However, realizing the long-term gains from AI will require systematic improvement in AI readiness across five dimensions: digital infrastructure, human capital, innovation capacity, institutional strength, and economic structure.

AI preparedness indicators reveal a wide gap between advanced and developing economies in Asia and the Pacific, with digital infrastructure emerging as a key constraint. Advanced Asia and the Pacific (AAP) economies—Australia; Hong Kong, China; Japan; the Republic of Korea (ROK); New Zealand; and Singapore—cluster near the global frontier, scoring an average of 0.19 on the digital infrastructure component of the AI Preparedness Index (AIPI) of Cazzaniga et al. (2024) (Figure 1.4.1).[1] Conversely, many developing Asia and the Pacific (DAP) economies—such as Cambodia, India, Myanmar, Papua New Guinea, and the Philippines—score below 0.11. Evidence suggests that this gap arises from binding constraints on computing capacity, digital connectivity, and data infrastructure, creating cascading barriers that prevent AI diffusion. Limited computational infrastructure restricts access to cloud-based services, thus constraining the use of proprietary or local data to train AI models, which, in turn, hinders the integration of AI into production workflows. As a result, adoption by firms remains low, slowing the pace and scale of technology diffusion and reducing productivity gains across the economy.

Figure 1.4.1 Artificial Intelligence Preparedness Index

Developing Asia and the Pacific lags advanced economies in AI preparedness.



AAP = advanced Asia and the Pacific, AI = artificial intelligence, AIPI = Artificial Intelligence Preparedness Index, PRC = People's Republic of China, DAP = developing Asia and the Pacific, IND = India, US = United States.

Note: To assess an economy's potential to adopt AI technologies, the AIPI collates several indicators across four components: digital infrastructure, human capital, innovation capacity, and legal and ethical frameworks. Each component of the AIPI is scored from 0.00 to 0.25, and individual scores are then added to construct the AIPI, which ranges from 0 to 1.

Source: Asian Development Bank estimates based on Cazzaniga M. et al. 2024. GenAI: Artificial Intelligence and the Future of Work. *IMF Staff Discussion Note* No. SDN2024/001. International Monetary Fund.

Human capital quality determines whether firms can effectively absorb and leverage AI to generate productivity gains, rather than simply operate it. The largest per-task productivity gains occur when workers possess complementary skills, enabling them to augment AI capabilities. DAP averages 0.13 on the

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1 The AIPI measures relative preparedness for AI adoption rather than actual usage or outcomes, with values for each component ranging from 0.00 to 0.25. See the note under Figure 1.4.1.

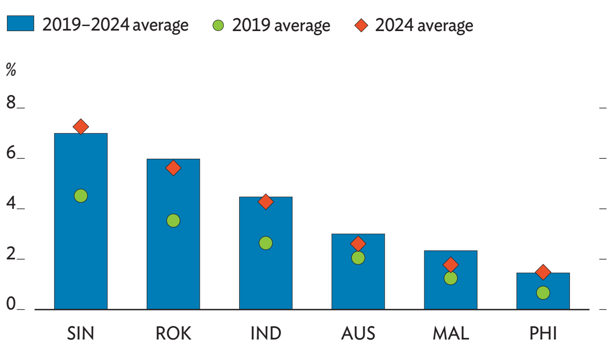
human capital and labor market policies component of the AIPI, compared with 0.17 in AAP, indicating a sizable gap. Job posting data reveals substantial variation in demand for AI-related competencies across economies in Asia and the Pacific. Advanced economies, such as Singapore and the ROK, exhibit higher and faster-growing demand than developing economies, including India, Malaysia, and the Philippines (Figure 1.4.2). These disparities point to differences in firm readiness and complementary organizational capabilities that shape how rapidly AI adoption translates into productivity gains (Adrjan et al. forthcoming).

Innovation ecosystems and economic integration create path-dependent advantages that drive persistent disparity in AI capabilities. These factors account for much of the cross-economy variation in AI preparedness, with DAP lagging AAP on the innovation and economic integration component of the AIPI, by 0.11 versus 0.17. Leading economies—including the People's Republic of China (PRC), Japan, and the ROK—combine strong government investment with substantial firm-level research and development, enabling AI development and deployment at scale. This supports not only adoption but also adaptation to local contexts, languages, and market conditions. In contrast, most developing economies in the region lack robust research infrastructure and innovation ecosystems, relying more heavily on technology transfer and lacking capacity to adapt AI applications (Asian Development Bank 2025; Arboleda-Muñoz, Chaparro-Banegas, and Roig-Tierno 2026). Integration into AI-related value chains further amplifies disparity. Trade in AI-enabling goods—such as electronics, computing equipment, and other digital hardware—accounts for a much larger share of total trade in Hong Kong, China; Singapore; and Taipei,China than in most DAP economies (Figure 1.4.3). Participation in these value chains facilitates technology spillover and accelerates AI adoption and diffusion.

Institutional quality shapes the pace and efficiency of AI adoption. Policy design matters: tax incentives and intellectual property protections can support startup investment and patenting

Figure 1.4.2 Share of Job Postings with Artifical Intelligence-related Skills by Economy

Demand for AI-related skills varies sharply across Asia and the Pacific.



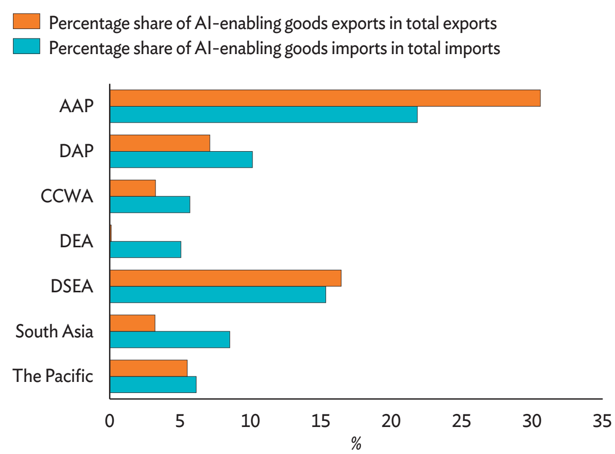
AI = artificial intelligence, AUS = Australia, IND = India, ROK = Republic of Korea, MAL = Malaysia, PHI = Philippines, SIN = Singapore.

Notes: Monthly demand for AI-related skills is calculated as the share of job postings that involve AI use or AI development in occupations classified as requiring intermediate or advanced digital skills. AI classifications are derived from text-based analysis of job posting content, identifying references to AI tools, systems, or development activities. For each economy and month, AI demand equals the number of AI-use and AI-develop postings divided by the total number of job postings requiring intermediate or advanced digital skills.

Source: Adrjan, P. et al. Forthcoming. *The Technification of Jobs: An LLM-Based Analysis of Digital Skills Demand in Asia-Pacific*.

Figure 1.4.3 Shares of AI-Enabling Goods in Exports and Imports across Asia and the Pacific

Participation in the trade of AI-enabling goods is uneven across the region.



AAP = advanced Asia and the Pacific, AI = artificial intelligence, CCWA = Caucasus and Central and West Asia, DAP = developing Asia and the Pacific, DEA = developing East Asia, DSEA = developing Southeast Asia.

Notes: DAP's subregional components are CCWA, DEA, DSEA, South Asia, and the Pacific. AI-enabling goods are defined based on the World Trade Organization's *World Trade Report 2025*, which identifies more than 100 products at the six-digit Harmonized System (HS6) level related to computing hardware, electronics, and other inputs essential for AI development and deployment. Export and import shares are calculated as the value of AI-enabling goods relative to each economy's total merchandise exports and imports.

Source: World Trade Organization.World Trade Report 2025: Making Trade and AI Work Together for the Benefit of All. World Trade Organization 2025.

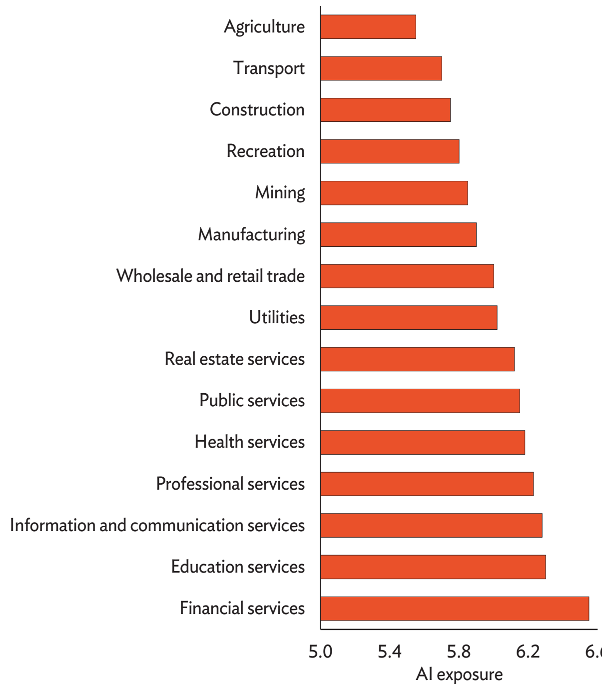
efficiency in AI development, while public ownership in strategic sectors could constrain innovation. Weak regulatory clarity and inconsistent enforcement create uncertainty and slow AI deployment and adoption even where technical capacity exists (Ernst and Mishra 2021). DAP's average score for the regulation and ethics component of the AIPI is 0.12, compared with AAP's 0.20, indicating a notable gap in these enabling conditions. Limited competition, low firm dynamism, and barriers to technology adoption further hinder AI diffusion beyond frontier firms. Gaps in data governance, privacy frameworks, and public procurement standards discourage investment and delay adoption. In contrast, transparent and credible AI governance and ethical frameworks can reduce uncertainty and support broader uptake across both the public and the private sectors.

Economic structure and task composition influence AI adoption. Sectors such as finance, education, information and communication, and professional services—where tasks are easier to enhance using AI—exhibit the highest exposure to generative AI (Figure 1.4.4). In contrast, agriculture, transport, and construction are less exposed, as core activities rely on physical and manual tasks that are more likely to be affected by developments in advanced robotics than by generative AI.[2] Economic structure in DAP is less conducive to AI deployment than in AAP, as it has a smaller share of services and a larger role for agriculture. As a result, near-term gains from AI adoption are likely to be more limited in DAP. At the same time, however, lower exposure to automatable tasks could mitigate short-term labor displacement and allow a more gradual adjustment as skills and capabilities evolve.

Potential AI effects on economic outcomes are assessed here by modeling sectoral productivity shocks from AI across economies under different scenarios. Sectoral productivity gains from AI are likely to result in different outcomes across sectors and economies. The extent to which productivity gains translate into improved aggregate economic performance depends on the exposure of different tasks to AI, the concentration of those tasks across sectors, the sectoral composition of the economy, and each economy's AI preparedness. To assess these dynamics, the analysis uses a multi-economy multi-sector dynamic general equilibrium model, with heterogeneous households, representative firms in each sector, a government, a central bank, and investment and trade links.[3] Scenarios vary by existing AI preparedness, its improvement through catch-up

Figure 1.4.4 Sectoral Exposure to Generative Artificial Intelligence

AI exposure is concentrated in services reliant on digital and analytical tasks.



Source: Gambacorta, L. et al. 2025. Artificial Intelligence and Growth in Advanced and Emerging Economies: Short-Run Impact. *BIS Working Papers* No. 1321. Bank for International Settlements.

2 Initial evidence suggests that AI can enhance the operational and technical capacity of robots in agriculture, particularly where labor shortages arise—e.g., because of population aging (OECD 2026).

3 The model consists of 12 sectors and 21 economies and regions. The sectors in the model are electricity distribution, gas extraction and utilities, petroleum refining, coal mining, crude oil extraction, other mining, agriculture and forestry, durable goods, nondurable goods, construction, transportation, and services. The regions in the model are Australia, Japan, the ROK, the US, Western Europe, and other advanced economies; Bangladesh, the PRC, India, Indonesia, Malaysia, Pakistan, the Philippines, Sri Lanka, Thailand, Viet Nam, and other Asian economies; Latin America; the Middle East and North Africa; the rest of Africa; and the rest of the world. More details of the model are available in McKibbin and Wilcoxen (1999, 2013).

effects, and the scale of AI adoption and diffusion within and across sectors (Table 1.4.1).[4] AI adoption paths are informed by the historical adoption rates of electricity (low adoption scenario), the internet and computers (medium), and mobile phones (high).[5]

Table 1.4.1 Scenario Design Assumptions

Alternative AI adoption and catch-up assumptions for the scenarios.

Scenario	Catch-Up to the Frontier	Degree of AI Adoption
1	No catch-up to the frontier, and AI preparedness remains at 2023 levels	Low
2		Medium
3		High
4	Gradual catch-up to the frontier by 2050, starting from 2023 AI preparedness levels	Low
5		Medium
6		High

AI = artificial intelligence.
Source: Asian Development Bank assumptions.

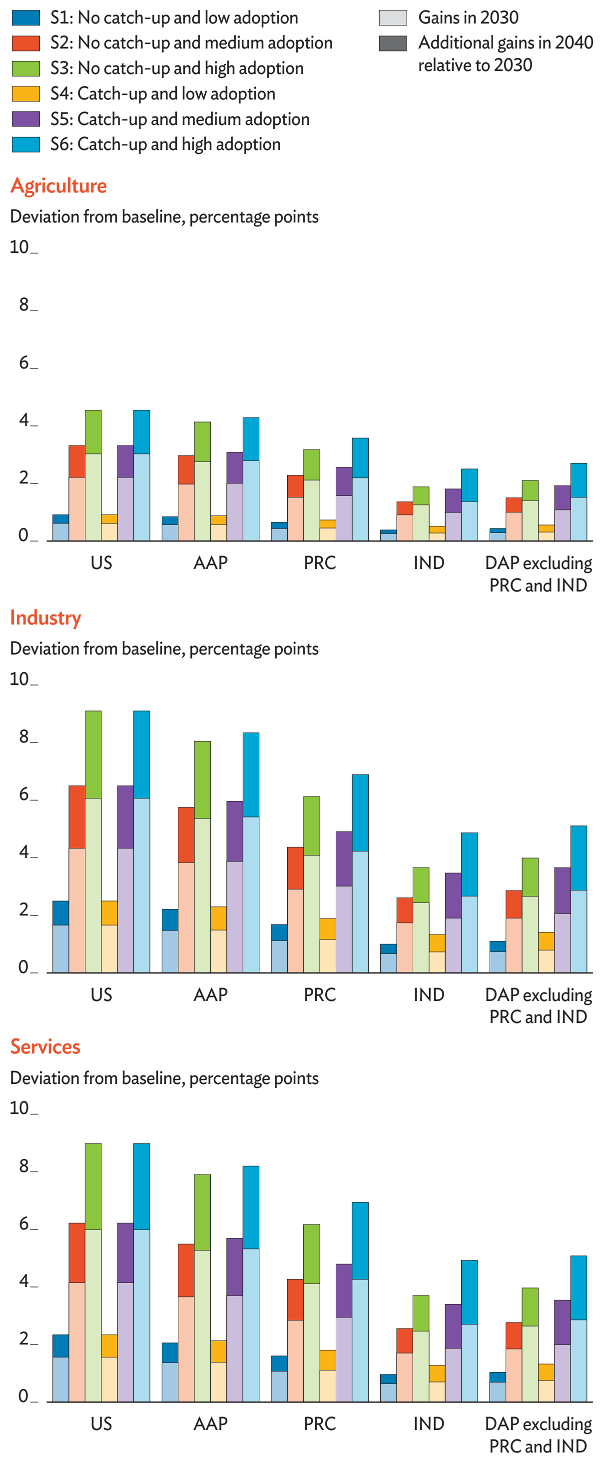
Sector- and economy-specific AI productivity gains are estimated based on task exposure, sectoral task composition, adoption rates, and preparedness. These are then introduced into the model as external productivity shocks, reflecting the nature of AI progress as largely independent of individual economy conditions. The estimates indicate that agriculture is subject to the lowest AI-driven productivity shocks at 0.1%–4.5%, versus industry at 0.3%–9.1% and services at 0.3% to 9.0% (Figure 1.4.5). Regardless of catch-up, overall productivity shocks for DAP, at 0.2%–6.9%,

4 The US is assumed to represent the AI preparedness frontier. While some economies, notably Denmark and Singapore, score marginally higher on the AIPI, the US is more commonly used as the reference frontier in studies exploring the economic impacts of AI. Thus, adopting the US as the benchmark facilitates comparability with existing literature and ensures consistency in the calibration of shocks and interpretation of results.

5 Filippucci et al. (2025) estimate potential sectoral productivity gains for 40 sectors under three large language model adoption scenarios: low, medium, and high. These estimates are mapped to 65 production sectors in 163 economies and regions in the Global Trade Analysis Project 12 Database. Economy- and sector-specific productivity gains are then scaled using each economy's AIPI score relative to the US. This approach allows sectoral productivity effects to vary across economies according to their AI preparedness and structural composition as of 2023.

Figure 1.4.5 Sectoral Productivity Shocks due to Artificial Intelligence Adoption and Diffusion

AI-driven productivity gains are uneven across sectors, with industry and services consistently benefiting more than agriculture across economies and scenarios.



AAP = advanced Asia and the Pacific, PRC = People's Republic of China, DAP = developing Asia and the Pacific, IND = India, S = scenario, US = United States.
Source: Asian Development Bank estimates.

remain below those of AAP and the US across all scenarios and sectors, due to their lower exposure. Among DAP economies, the PRC experiences the highest productivity gains within DAP, at 0.2%–6.9%. Productivity gains for India are close to those of the rest of DAP.

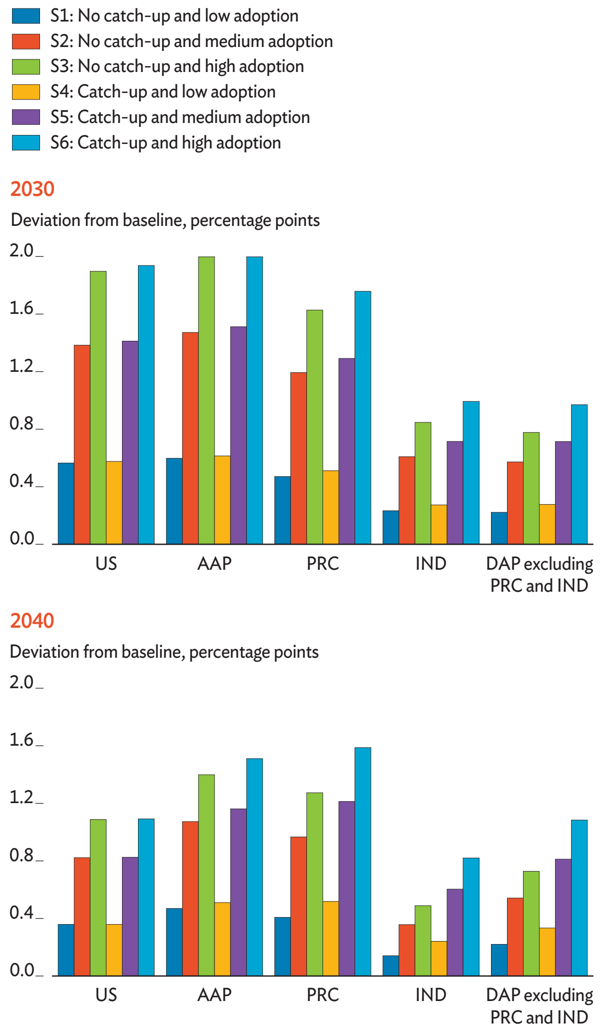
Simulation results suggest that gross domestic product (GDP) growth rises markedly more in advanced than in developing economies. The latter, however, have greater potential to benefit from catching up. Heterogeneous productivity shocks across sectors and economies affect sectoral output. This has different impacts on household incomes and employment, which affect consumption and saving patterns across economies. The income effects and the relative changes in sectoral output also affect the relative attractiveness of production sectors across economies for investment. These dynamics are reflected in significant differences in GDP growth. AAP and the US see growth increments of 0.6–2.1 percentage points (pps) by 2030 across scenarios, gradually easing to 0.4–1.5 pps by 2040 (Figure 1.4.6). In contrast, DAP experiences broadly stable impacts, ranging from 0.2–1.8 pps in 2030 to 0.1–1.6 pps in 2040. Additional gains from catch-up are modest in AAP but larger in DAP, at 0.0–0.4 pps. Within DAP, the PRC experiences larger gains than India and the rest of DAP.

Forward-looking investments shape growth impacts in developing economies, while exports play a larger role in advanced economies (Figure 1.4.7). Within DAP, the contribution of investment to GDP growth increases from 0.1 to 1.1 pps relative to the baseline. However, these gains are partly offset by higher imports of capital goods needed to support AI-related investment, particularly in the period to 2030. In AAP, exports are the main driver of growth by 2030, contributing 0.4–1.2 pps as global demand for AI-enabling goods increases. These gains moderate by 2040, as rising incomes strengthen the contributions of consumption and investment. While the relative importance of growth drivers changes over time, higher AI adoption and catch-up affect only the magnitude of their contributions, leaving the relative composition unchanged.

AI-driven sectoral output growth remains modest, with services emerging as the main driver, especially as developing economies catch up.

Figure 1.4.6 Variation in Gross Domestic Product Growth across Scenarios 1–6

AI-driven GDP gains peak earlier in advanced economies, while catch up sustains gains over time in developing economies.



AAP = advanced Asia and the Pacific, PRC = People's Republic of China, DAP = developing Asia and the Pacific, IND = India, S = scenario, US = United States.

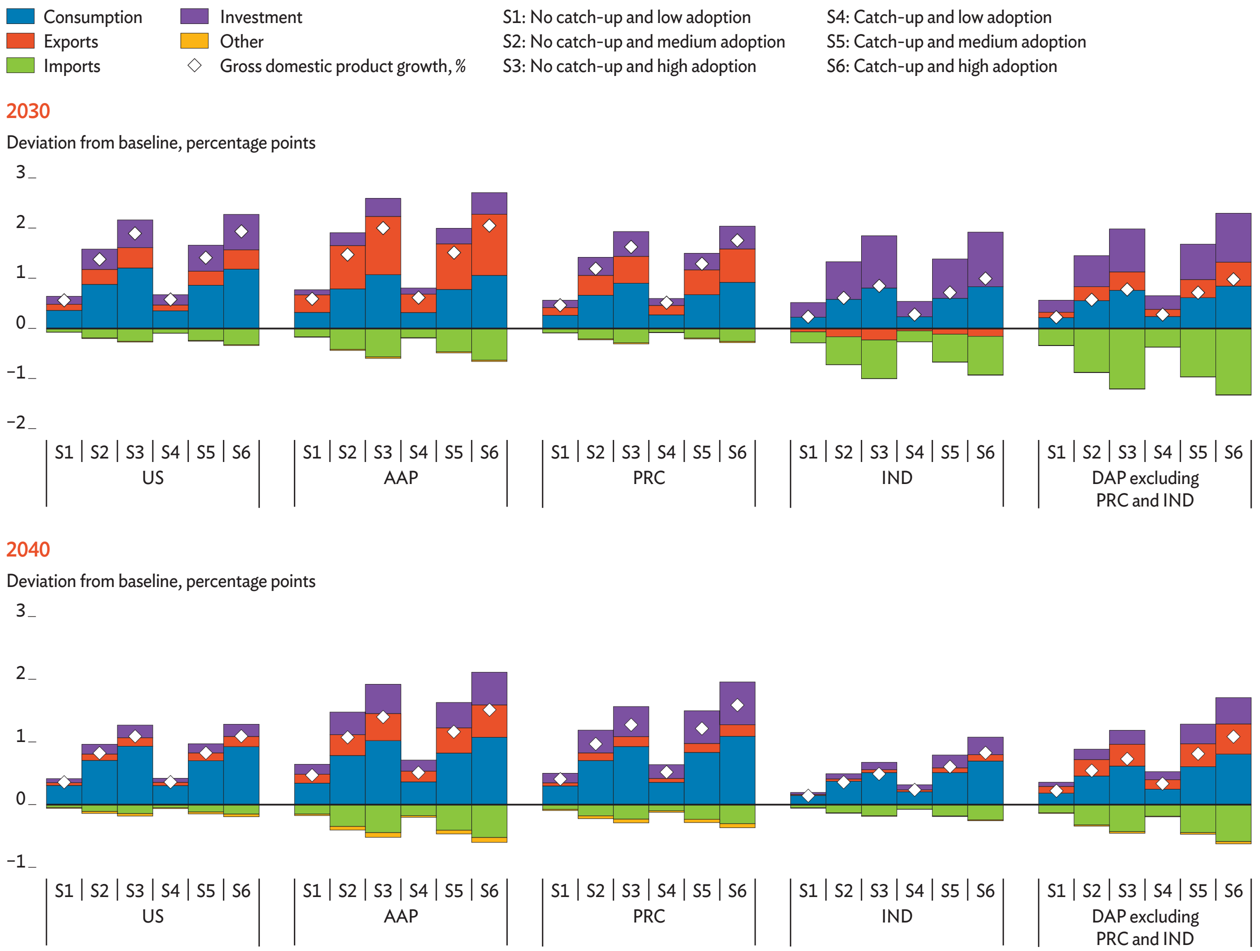
Notes: Simulation results from economic modeling are expressed relative to a model baseline of sectoral productivity growth that is a function of labor growth in a given economy and labor productivity growth in each of its sectors. The figure shows snapshots of dynamic results for 2030 and 2040.

Source: Asian Development Bank estimates using the G-Cubed model GGG12W_v195.

Sectoral output gains reflect AI-driven sectoral productivity improvements, but are moderated by production linkages and price adjustments. Agriculture contributes very little to output growth across time, scenarios and economies (Figure 1.4.8). In DAP, growth effects are smaller than in AAP but more persistent, with services displaying the largest average

Figure 1.4.7 Demand-Side Contributions to Gross Domestic Product Growth across Scenarios 1–6

Exports lead AI-driven growth in DAP, while investments are the dominant driver in AAP.



AAP = advanced Asia and the Pacific, PRC = People's Republic of China, DAP = developing Asia and the Pacific, GDP = gross domestic product, IND = India, S = scenario, US = United States.

Notes: Simulation results from economic modeling are expressed relative to a model baseline of sectoral productivity growth that is a function of labor growth in a given economy and labor productivity growth in each of its sectors. The figure shows snapshots of dynamic results for 2030 and 2040.

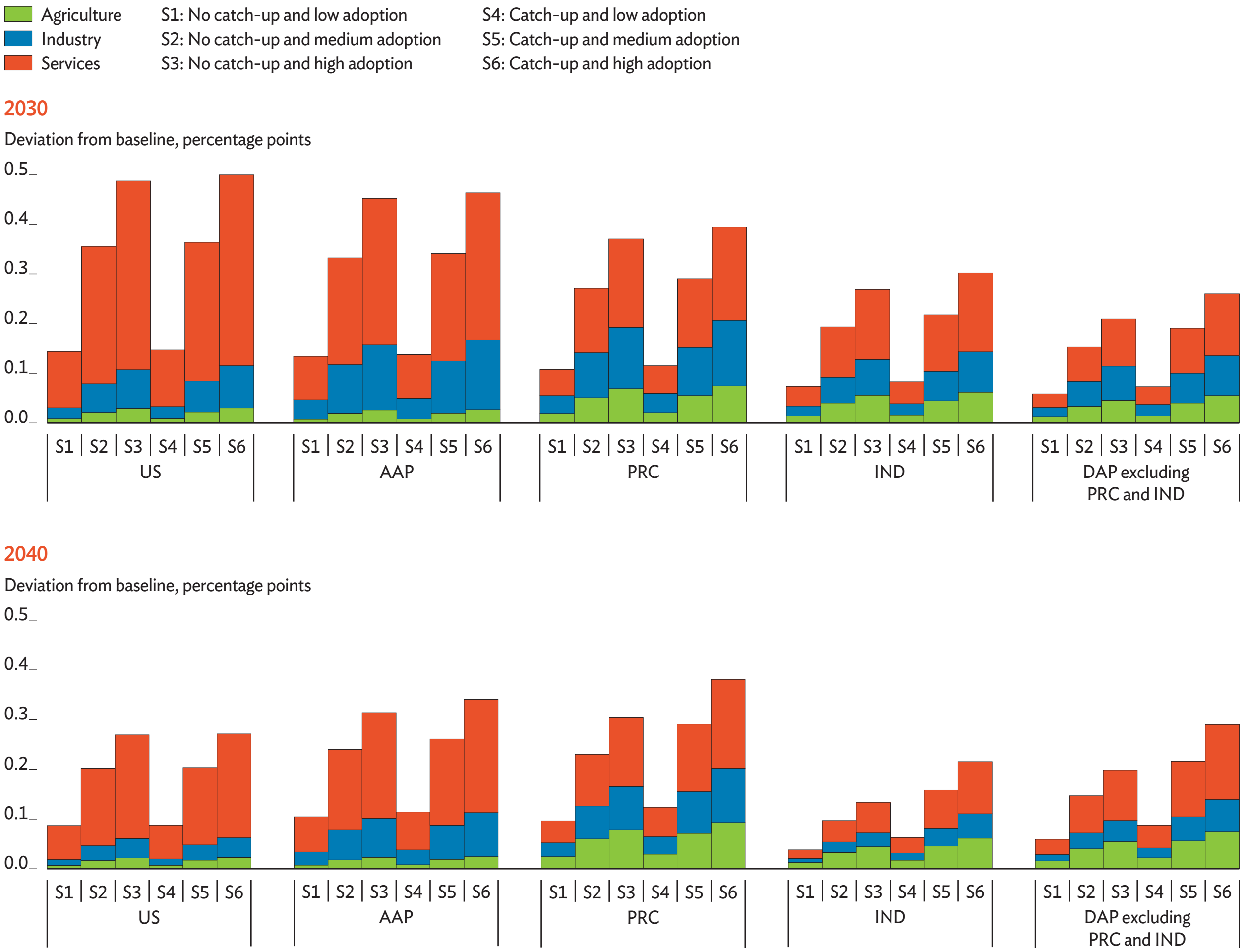
Source: Asian Development Bank estimates using the G-Cubed model GGG12W_v195.

contribution across all scenarios, at 0.08 pps by 2040, partly driven by catch-up gains. As in DAP, the boost in service productivity leads the growth in AAP, with the production of AI-enabling goods boosting the contribution of industry.

AI is more likely to accelerate services-led structural change in better-prepared economies while posing risks to employment in less-prepared economies. AI affects employment through both job creation and job displacement, and the balance differs widely across economies. Productivity gains raise output and labor demand in the sectors that benefit most from AI, but they also reduce the need for some workers and create transitional unemployment as workers move across sectors. In advanced economies, employment effects are concentrated in services, while adjustments elsewhere remain limited (Figure 1.4.9). In the PRC and India, AI can support temporary employment gains in agriculture and industry as these sectors expand initially. In the rest of DAP, weaker output gains mean that displacement effects dominate, with employment falling across sectors and workers facing a slower and more difficult adjustment process.

Figure 1.4.8 Sectoral Contributions to Output Growth across Scenarios 1–6

Services contribute the most to AI driven output growth, while agriculture contributes the least.



AAP = advanced Asia and the Pacific, PRC = People's Republic of China, DAP = developing Asia and the Pacific, IND = India, S = scenario, US = United States.

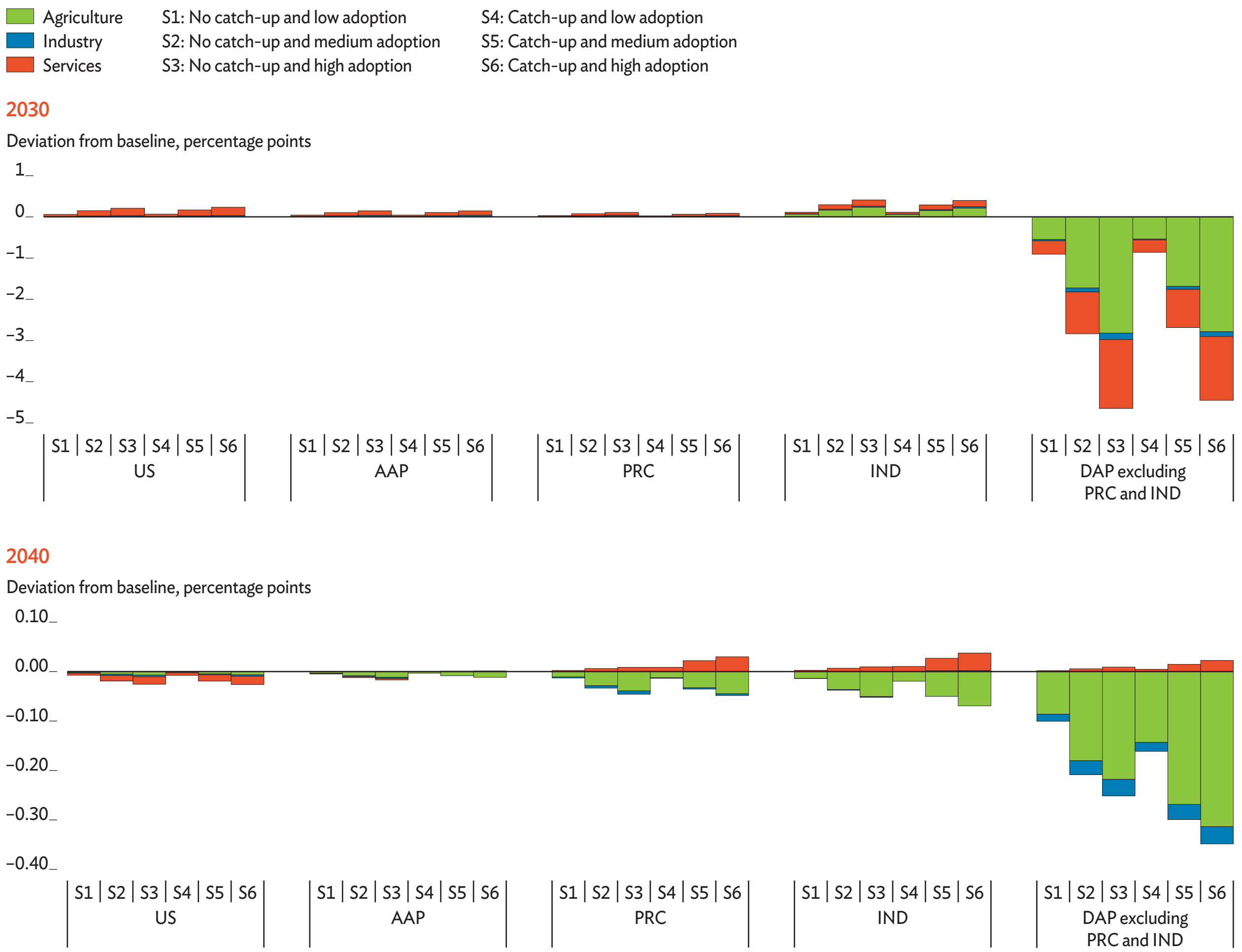
Notes: Simulation results from economic modeling are expressed relative to a model baseline of sectoral productivity growth that is a function of labor growth in a given economy and labor productivity growth in each of its sectors. The figure shows snapshots of dynamic results for 2030 and 2040.

Source: Asian Development Bank estimates using the G-Cubed model GGG12W_v195.

Policy reforms that strengthen AI readiness and adoption can mitigate short-term worker displacement and improve long-term economic outcomes. Policies to enhance digital infrastructure, human capital, innovation capacity, and institutional strength support faster and more effective AI adoption, benefiting DAP in the long run. Across sectors, services offer the greatest potential gains from AI, underscoring the need for forward-looking investment and targeted incentives to expand the sector and ease labor reallocation. At the same time, developing industries that produce AI-enabling goods, and enhancing their participation in global value chains, can boost industrial output and employment. Policies that promote AI-related skills and employability will help to reduce short-term unemployment risks. Strengthening social protection systems remains essential to support workers with limited opportunities for upskilling or reskilling.

Figure 1.4.9 Sectoral Contribution to Employment across Scenarios 1–6

AI adoption has mixed dynamic employment outcomes across economies.



AAP = advanced Asia and the Pacific, PRC = People's Republic of China, DAP = developing Asia and the Pacific, IND = India, S = scenario, US = United States.

Notes: Simulation results from economic modeling are expressed relative to a model baseline of sectoral productivity growth that is a function of labor growth in a given economy and labor productivity growth in each of its sectors. The figure shows snapshots of dynamic results for 2030 and 2040.

Source: Asian Development Bank estimates using the G-Cubed model GGG12W_v195.

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ANNEX

Steady Growth, Rising External Pressures

Growth is expected to remain robust in the United States (US), but weaken in the euro area. In the US, consumption will continue to drive growth, while accelerating investment in artificial intelligence (AI) underpins broader domestic economic activity this year and next. In the euro area, domestic demand is expected to support economic activity in 2026 and 2027, though subdued productivity growth and labor supply constraints will weigh on the pace of expansion. Meanwhile, the external environment is likely to remain challenging given uncertainty related to the Middle East conflict. In aggregate, the major advanced economies are expected to grow by 1.8% in 2026 and 1.6% in 2027 (Table A.1).

Table A.1 Early Stabilization Scenario Assumptions on the International Economy

Global geopolitical and trade headwinds will weigh on growth in advanced economies.

	2024	2025	2026	2027
	Actual		Forecast	
GDP growth, %				
Major advanced economies	2.0	1.8	1.8	1.6
United States	2.8	2.1	2.3	2.0
Euro area	0.9	1.4	1.1	1.2
Inflation, %				
Major advanced economies	2.7	2.4	2.7	2.4
United States	3.0	2.6	2.7	2.4
Euro area	2.4	2.1	2.6	2.3
Brent crude spot prices, average, $/barrel	81	69	72	63
Interest Rates, %				
United States federal funds rate, average	5.19	4.25	3.64	3.50
European Central Bank main policy rate, average	3.69	2.21	2.00	1.67

GDP = gross domestic product.

Note: Average rates are weighed by GDP purchasing power parity.

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

Major Advanced Economies

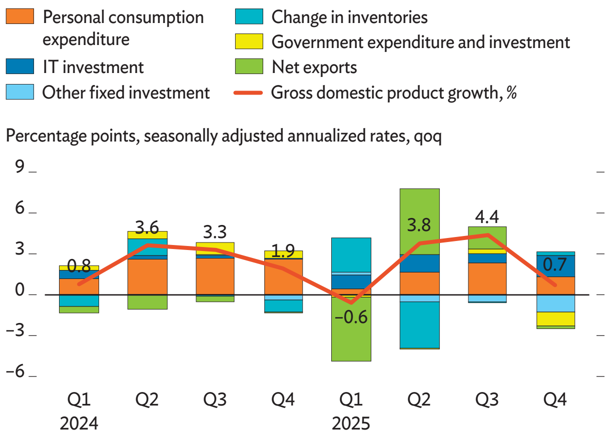
United States

Growth slowed in 2025 despite expanded IT investment. Gross domestic product (GDP) expansion slowed from 2.8% in 2024 to 2.1% as growth in personal consumption decelerated but continued to support activity. Investment remained an uneven driver, with IT investment driven up by sustained spending on equipment and software supporting AI, while other fixed investment was subdued, underscoring caution outside of the technology sector. Growth slowed sharply in the fourth quarter (Q4), from 4.4% in Q3 to 0.7% (Figure A.1), as a government shutdown contracted federal spending at an annualized rate of

This annex was written by Sabah Abdulla, John Beirne, Gabriele Ciminelli, Jaqueson Galimberti, Henry Ma, Madhavi Pundit, Melanie Grace Quintos, Pilipinas Quising, Nedelyn Magtibay-Ramos, Ed Kieran Reyes, Shiela Camingue-Romance, Dennis Sorino, Shu Tian, Michael Timbang, and Mai Lin Villaruel of the Economic Research and Development Impact Department (ERDI), ADB, Manila, and Emmanuel Alano and Jesson Pagaduan, ERDI consultants.

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

Growth slowed sharply in Q4 with a decline in government expenditure and lower investment outside the technology sector.



Q = quarter, qoq = quarter on quarter.

Notes: IT investment includes computers and peripheral equipment, software, and data centers. IT investment numbers are Asian Development Bank estimates.

Sources: Bureau of Economic Analysis; Haver Analytics; US Census Bureau; Asian Development Bank estimates.

16.7%, subtracting materially from headline growth. Private domestic demand nevertheless remained firm, supported by moderating consumption but strong IT investment, which added 1.5 percentage points to Q4 GDP.

Recent activity indicators point to continued expansion entering 2026. The Institute of Supply Management's ISM manufacturing index edged slightly lower from 52.6 in January to 52.4 in February, while the services index jumped from 53.8 to 56.1, its highest reading since July 2022, pushing the composite index to a 43-month high of 55.7 (Table A.2). Services were supported by a sharp rebound in new orders and strong business activity, alongside improving employment. Manufacturing conditions began to recover in early 2026, as industrial production rose by 0.7% in January followed by a further 0.2% gain in February. New orders rebounded and broad gains across sectors suggested firmer activity in the near term despite persistent uncertainty about demand, costs, and trade policy.

Table A.2 Business, Consumer, and Employment Indicators, United States

Recent activity and sentiment indicators point to moderate growth entering 2026.

	Annual Average			2025								2026	
	2023	2024	2025	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb
Business													
Composite PMI, 50 = no change	52.0▲	51.9▲	51.3▲	50.0↔	50.6▲	50.2▲	51.5▲	50.1▲	51.6▲	51.9▲	53.1▲	53.7▲	55.7▲
Manufacturing PMI, 50 = no change	47.1▼	48.2▼	48.9▼	48.6▼	49.0▼	48.4▼	48.9▼	48.9▼	48.8▼	48.0▼	47.9▼	52.6▲	52.4▲
Service PMI, 50 = no change	52.7▲	52.4▲	51.7▲	50.2▲	50.8▲	50.5▲	51.9▲	50.3▲	52.0▲	52.4▲	53.8▲	53.8▲	56.1▲
Industrial production index, 2017 = 100	100.8▼	100.1▼	101.3▲	101.0▼	101.5▲	101.9▲	101.6▼	101.7▲	101.2▼	101.4▲	101.7▲	102.4▲	102.6▲
Consumer													
Consumer confidence, 1985 = 100	105.4▲	104.5▼	96.1▼	98.4▲	95.2▼	98.7▲	97.8▼	95.6▼	95.5▼	92.9▼	94.2▲	89.0▼	91.2▲
Consumer sentiment, Q1 1966 = 100	65.4▲	72.5▲	57.6▼	52.2↔	60.7▲	61.7▲	58.2▼	55.1▼	53.6▼	51.0▼	52.9▲	56.4▲	56.6▲
Retail sales, $ billion	590.2▲	603.6	626.4▲	618.0▼	624.1▲	628.7▲	632.1▲	632.4▲	631.3▼	634.5▲	634.7▲	633.7▼	...
Employment													
Unemployment rate, %	3.6▼	4.0▲	...	4.3▲	4.1▼	4.3▲	4.3↔	4.4▲	...	4.5▲	4.4▼	4.3▼	4.4▲
Nonfarm payrolls, '000	210▼	122▼	10▼	13▼	–20▼	64▲	–70▼	76▲	–140▼	41▲	–17▼	126▲	–92▼
Job openings, million	9.3▼	7.7▼	7.1▼	7.3▲	7.2▼	7.1▼	6.9▲	7.2▲	7.2▼	6.8▼	6.6▼	6.9▲	...

... = data not available, PMI = purchasing managers' index, Q = quarter.

Notes: For PMI, ▲ is greater than 50, ▼ is less than 50, and ↔ equals 50. For other indicators, ▲ is increasing, ▼ is decreasing, and ↔ remains the same.

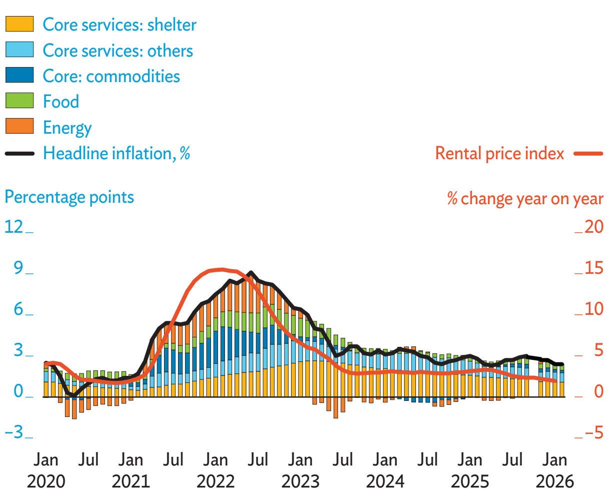
Source: Haver Analytics.

Consumer demand dipped slightly late last year, but early 2026 indicators point to recovery. Growth in final sales to private domestic purchasers declined from 2.9% in Q3 2025 to 1.9% in Q4. Retail sales gained slightly in November, were flat in December, and declined in January. However, consumer sentiment showed tentative improvement early in 2026, as the Conference Board confidence index rose from 89.0 in January to 91.2 in February, and the University of Michigan's sentiment index edged up to 56.6 (Table A.2) amid improved assessment of current conditions and a decline in 1-year inflation expectations to 3.4%. Improvement was driven largely by households with significant stock holdings, underscoring a bifurcated consumer landscape.

Inflation and labor markets shape measured monetary policy as uncertainty persists. Headline inflation eased from 2.7% year on year in December to 2.4% in January and was unchanged in February (Figure A.2). Core consumer price index inflation also held steady at 2.5% in both January and February, suggesting that inflation is stabilizing, albeit above target. Shelter remains the largest contributor to inflation persistence, reflecting sluggish rent adjustment. Recent labor market data suggest a slight weakening. The unemployment rate edged up from 4.3% in January to 4.4%, while payroll employment declined in February and prior gains were revised down, though the average over the past 3 months remained positive. As of December 2025, job openings and hiring appear to have stabilized, and layoffs remain relatively contained. Against this backdrop, the US Federal Reserve kept policy rates unchanged at 3.50%–3.75% acknowledging continued economic expansion and stable unemployment. The Federal Open Market Committee signaled little appetite for rate cuts in the near term despite two governors favoring a reduction by 25 basis points. A mixed picture from the latest employment and inflation trends, following the recent spike in oil prices, underscores the need for further data to assess risks to the Fed's dual mandate for maximum employment and stable prices.

Figure A.2 Inflation and Rental Price Index, United States

Inflation has stabilized but remains above target, mostly from core services and housing.



Note: Rental price index is the Zillow observed rent index.

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

GDP growth is projected at 2.3% in 2026 and 2.0% in 2027 as inflation increases to 2.7%, then eases to 2.4%. Accelerating investment in AI will underpin domestic economic activity this year and next, while a short-lived recovery in consumer confidence will boost growth in the near term. The lagged effects of looser monetary policy will at least partly offset drag from continued policy uncertainty. Business activity is expected to remain robust in services and improve in manufacturing, as expanding investment in AI further boosts demand, and AI adoption buoys labor productivity. Export and import volatility is projected to abate as trade deals are implemented and the trade deficit narrows marginally. Consumer confidence is set to strengthen in the near term, as the labor market stabilizes, but will weaken in the rest of the year as energy prices increase because of the conflict in the Middle East. The energy price shock will accelerate inflation in 2026, but these effects are expected to be transitory, and inflation will subside gradually toward the target rate in 2027. Given renewed price pressures, the Fed is expected to keep interest rates on hold in 2026, and then resume easing in 2027.

Risks to the outlook tilt to the downside. Potential headwinds could stem from heightened geopolitical tensions, uncertain trade policy, and concerns over financial stability. Heightened geopolitical uncertainty raises the risk of disrupted international trade, which could constrain growth and reignite inflation. A prolonged and widening Middle East conflict could dent growth as higher energy prices erode households' real income and could delay further monetary policy easing. The US Supreme Court ruled in February against the US administration's imposition of tariffs on imports under the International Emergency Economic Powers Act, which could worsen trade uncertainty in the short term and may induce businesses to hold back on investment plans. Anticipation of a new Fed chair from May 2026 and the effect on Fed balance sheet normalization have unsettled markets. Quantitative tightening at a pace faster than expected may place pressure on money markets and contribute to tighter credit conditions, potentially weighing on private consumption and investment. In addition, a revaluation by markets of IT companies could dent the outlook by hitting profitability and investment dynamics in the sector amid global competition and the emergence of lower-cost AI alternatives. Finally, as well as higher energy prices, an increase in producer prices and core inflation above expectations following supply chain disruption could prompt the Fed to keep monetary policy tighter for longer, constraining growth.

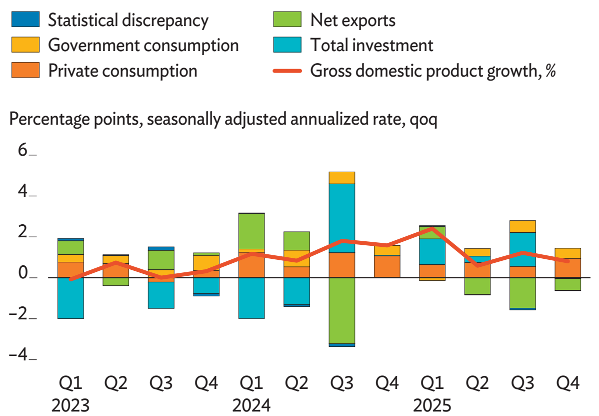
Euro area

The economy expanded at an annualized rate of 0.8% in Q4 2025, slightly less than expected (Figure A.3). Private consumption was the main growth driver, in line with healthy growth in retail trade and loans to the private sector. Government consumption contributed positively to growth, while the contribution of investment was null. External demand weighed heavily on growth for a third straight quarter as the euro appreciated and competitive pressure from foreign producers intensified, boosting imports. Supply-side indicators point to gradual strengthening in industrial production. Industry output rose for a fourth straight month in December 2025 on higher production of intermediate and capital goods. In the whole of 2025, GDP growth was 1.4%.

Headline inflation was recorded at 2.1% in 2025 and dropped slightly below the central bank target of 2.0% in early 2026. Preliminary estimates show inflation at 1.9% in February 2026 as falling energy prices at that time were only partly compensated by rising inflation for services and industrial goods. However, the year-on-year rate masks a significant uptick in inflation month on month, which rose from −0.6% in January to 0.6% in February on rising prices for

Figure A.3 Demand-Side Contributions to Growth, Euro Area

Growth accelerated in Q4.



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

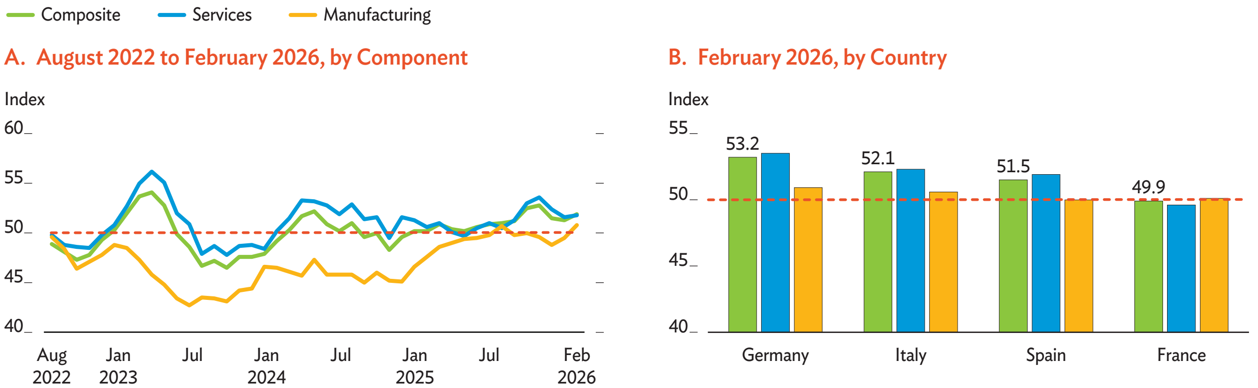
energy and services. The European Central Bank held its policy rate steady at 2.00% at its March meeting, its fifth consecutive hold since July 2025.

Headline inflation is projected to increase to 2.6% in 2026 before falling to 2.3% in 2027. The increase in oil and gas prices triggered by the conflict in the Middle East is expected to push up energy and transportation costs directly and pass through to the broader consumer basket through higher production costs for goods and services, offsetting earlier disinflation. An assumed decline in energy prices in 2027, under this report's early stabilization scenario, will exert downward pressure on inflation but is expected to be offset by wage growth rising gradually throughout the year.

Leading indicators suggest growth was firming in the first 2 months of 2026 before the conflict in the Middle East escalated. The composite purchasing managers' index (PMI) remained comfortably above 50 in February, buoyed by a strong pickup in manufacturing sentiment and resilient activity in services (Figure A.4, panel A). The manufacturing PMI reached its highest in more than 4 years, led by expanded output and orders in Germany and Italy (Figure A.4, panel B). In the same month, a separate indicator of economic sentiment rose to its highest in 3 years along with business confidence. In line with trends in activity indicators, labor markets were relatively tight at the end of 2025. The unemployment rate declined to 6.2% in December and further to 6.1% in January 2026, a historic low, while job

Figure A.4 Purchasing Managers' Indexes, Euro Area

PMIs point to gradual improvement in business conditions, led by services.



Note: An index reading < 50 signals deterioration, > 50 improvement.
Source: CEIC Data Company.

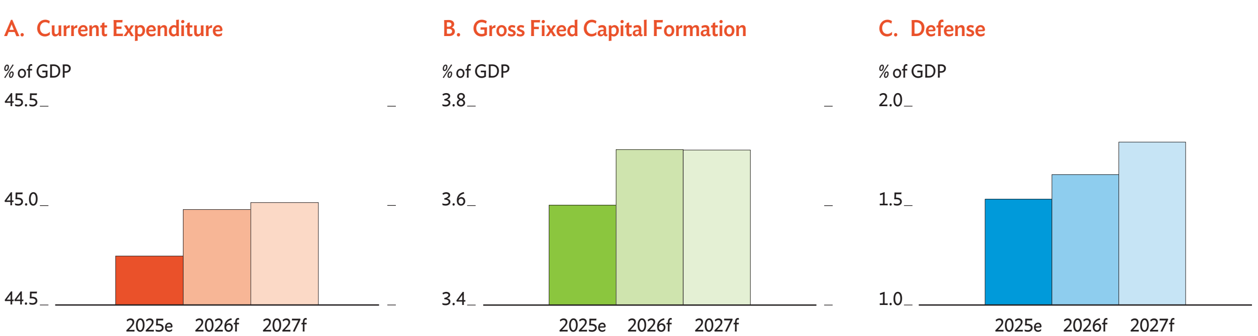
postings stopped falling. Wage growth remained above inflation, sustaining household incomes. However, the Middle East conflict will weigh on the outlook by pushing up energy and import costs and weakening confidence, which is expected to dampen activity in the months ahead.

Governments are expected to adopt energy support measures as the European Central Bank sustains policy in 2026. Such measures will cushion the blow from higher energy prices on vulnerable households. Space to ease monetary policy will be more constrained as the central bank confronts both upward pressure on inflation and downward pressure on activity from by higher energy prices. Moderate easing is nevertheless expected in 2027, in line with declining inflation.

GDP growth is projected to drop to 1.1% in 2026 before edging up to 1.2% in 2027. Domestic demand is expected to underpin activity but remain subdued as weak productivity growth, labor supply constraints, rising energy prices, and heightened external uncertainty limit the pace of expansion. Private consumption will expand only moderately in 2026 and 2027, tempered by weaker confidence and higher inflation in the wake of the conflict in the Middle East. Public investment is expected to rise in 2026, supported by the continued rollout of infrastructure spending under the NextGenerationEU program, higher defense outlays, and additional debt-funded defense and infrastructure spending in Germany (Figure A.5). The contribution of public investment will moderate in 2027 as the NextGenerationEU program is phased out. Private investment will be weighed down by worsening

Figure A.5 General Government Expenditure, Euro Area

Government spending is expected to rise in 2026.



e = estimates, f = forecast, GDP = gross domestic product.
Source: European Commission Annual Macro-Economic (AMECO) database.

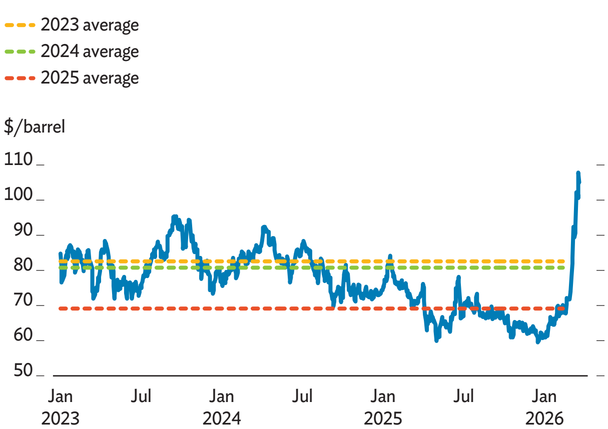
geopolitical uncertainty and weaker business sentiment in 2026, before picking up in 2027 as confidence improves and financial conditions loosen somewhat. The external environment is expected to remain challenging as competition from foreign producers intensifies, global demand softens, and trade and energy concerns grow.

Oil Prices

The Brent crude oil price fell for a third consecutive year, then rebounded sharply in early 2026 as geopolitical risk offset weak market fundamentals. Subdued global manufacturing and firm supply growth from outside of OPEC+, the alliance led by the Organization of the Petroleum Exporting Countries, shaped market conditions. Prices fell from about $79/barrel in January 2025 to $62–$64 by December, averaging $69/barrel for the year (Figure A.6). In early 2026, prices became more sensitive to geopolitical factors. Developments in Venezuela led to some oil price volatility, but effects on the Brent price level were constrained by Venezuela's small output of 1.0 million barrels per day, or 1% of global supply, and persistent infrastructure constraints on exports. Meanwhile, drone attacks on tankers bound for the Caspian Pipeline Consortium Black Sea terminal, and related disruption affecting exports through the Black Sea and Caspian corridor, constrained Kazakh supply, further tightening the market in the near term. Since January, the Middle East conflict has exerted upward pressure on the Brent crude price, as rhetoric, sanctions, and maritime security advisories concerning the Strait of Hormuz periodically lifted geopolitical risk premiums. The sharpest increase came after conflict escalation at the end of February and in early March, which raised concerns over regional production, export logistics, and shipping routes. Brent rose above $80/barrel and settled around $101/barrel on 12 March 2026, its highest since August 2022 and about 45% above its February average. The increase reflected not only fear of immediate supply disruption but also concern that any interruption affecting commodity shipments from the Middle East could have far wider effects on freight and insurance costs, as well as on price volatility.

Figure A.6 Brent Crude Oil Prices

Escalating tensions in the Middle East became the main driver of Brent price movements in early 2026.



Source: Bloomberg.

The Brent crude oil price is forecast to average $72/barrel in 2026 and $63 in 2027. This forecast, finalized on 10 March, assumes an early stabilization scenario in the Middle East, with no significant damage to energy infrastructure and no prolonged disruptions through the Strait of Hormuz. According to the International Energy Agency (IEA), observed global oil inventories rose to more than 8.2 billion barrels in 2025, their highest since 2021, providing a buffer against temporary supply losses. In its March 2026 report, the IEA still projects global oil supply growth in 2026 to outpace demand growth, pointing to a continued market surplus. Additional supply from the planned unwinding of OPEC+ voluntary cuts and the release of emergency reserves by IEA member countries should also cushion disruption. The US Energy Information Administration, meanwhile, expects inventory accumulation to continue in 2027. Together, these stock buffers and softer global activity should limit the duration of price spikes, though prices are likely to normalize only gradually, reflecting lags in adjustment across crude and product flows, refinery activity, inventory drawdown and rebuilding, and producer supply responses.

Risks to the oil price forecasts are tilted upwards. A longer or broader conflict that significantly disrupts regional production, export logistics, shipping routes, or damages energy infrastructure could keep Brent crude oil prices above the early stabilization scenario for longer.

Advanced Asia and the Pacific

Advanced Asia and the Pacific (AAP) comprises the region's most mature economies. Japan generates the largest share of aggregate GDP at 42.6%, followed by the Republic of Korea at 21.2% and Australia at 12.4%. Taipei,China contributes 12.2%; Singapore 5.9%; Hong Kong, China 3.7%; and New Zealand 1.9%. Together, these economies account for a substantial portion of regional output and play a central role in shaping growth dynamics across Asia and the Pacific.

Growth in AAP remains resilient on strong artificial intelligence (AI) demand but will likely moderate. GDP expansion in Taipei,China will normalize in 2027 after surging in 2025 and 2026 on a boom in AI-related exports (Table A.3). Singapore's trade remains resilient but is expected to moderate as the first full year of US tariffs and rising protectionism weigh on sectors other than electronics. Domestic and external demand alike are projected to moderate in Hong Kong, China. Other AAP economies are expected to remain largely stable to the forecast horizon.

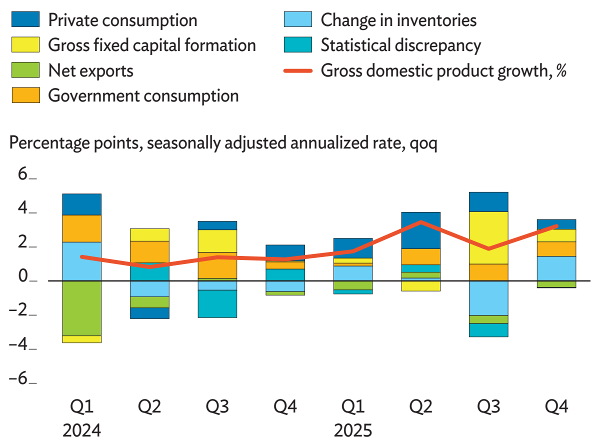
Australia

Growth rebounded from a slowdown in the third quarter (Q3) of 2025 to 3.2% growth in Q4, though momentum was tempered. Domestic spending and inventory accumulation supported expansion but was offset by weaker external demand (Figure A.7).

Household consumption rose by 1.1%, driven by resilient demand for tourism and leisure services, alongside gains in real income. Government spending increased by 3.7% on higher outlays for health care and education, infrastructure investment, and cost-of-living subsidies. Fixed investment moderated from a 13.3% surge in Q3 to 3.0% in Q4, sustained by corporate capital spending to expand data centers and leverage AI and cloud computing. After a broad drawdown in Q3, inventories turned positive in Q4, led by mining and retail as firms rebuilt stocks and managed cost

Figure A.7 Demand-Side Contributions to Growth, Australia

Inventories rose sharply in Q4 while net exports continued to weigh on growth.



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

Table A.3 GDP Growth and Inflation, %

AAP growth to moderate on external headwinds.

	GDP Growth				Inflation			
	2024	2025	2026	2027	2024	2025	2026	2027
	Actual		Forecasts		Actual		Forecasts	
Advanced Asia and the Pacific	**1.5**	**2.5**	**2.2**	**1.8**	**2.6**	**2.5**	**2.6**	**1.9**
Australia	1.1	2.0	2.0	2.9	3.2	2.9	5.1	2.6
Hong Kong, China	2.6	3.5	2.6	3.0	1.7	1.4	1.7	1.5
Japan	−0.2	1.2	0.7	0.6	2.7	3.2	2.4	1.8
Republic of Korea	2.0	1.0	1.9	1.9	2.3	2.1	2.3	2.0
New Zealand	−0.3	0.2	1.9	2.8	2.9	2.8	3.8	1.6
Singapore	5.3	5.0	3.0	2.3	2.4	0.9	1.6	1.7
Taipei,China	5.3	8.7	7.6	4.0	2.2	1.7	1.8	1.5

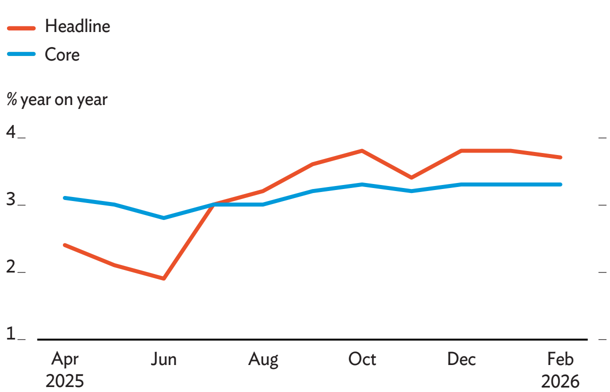
AAP = Advanced Asia and the Pacific, GDP = gross domestic product.
Source: *Asian Development Outlook* database.

pressures under elevated inflation. Net exports dragged on growth as imports rose more than exports despite rebounds in shipments of iron ore and liquefied natural gas. This combination of factors lifted annual growth from 1.1% in 2024 to 2.0% in 2025, underpinned by resilient domestic demand. Leading indicators suggested in January and February, before the conflict in the Middle East and tighter financial conditions, growth picking up into Q1 2026 on household spending and investment led by the private sector. Purchasing managers' indexes (PMIs) for both manufacturing and services stayed in expansionary territory in January and February, pushing the composite PMI to its highest reading in 4 years. Preliminary March estimates, however, point to a contraction, with the composite PMI falling to 47—an 18-month low—driven by weaker services activity. The labor market remains strong, with wage growth stable and the unemployment rate declining from a 4-year high of 4.4% in September to 4.1% in January, before rising slightly to 4.3% in February.

Headline inflation rose to 3.8% in December, prompting the first monetary policy tightening in 2 years. Price increases in late 2025 were widespread—led by housing, food, and recreation and culture—and higher than expected. Excluding volatile items, core inflation edged higher to 3.3%, above the 2.0%–3.0% target band of the Reserve Bank of Australia. In response, the bank's monetary policy board raised the benchmark interest rate from 3.60% to 3.85% in February 2026. In February 2026, headline inflation

Figure A.8 Inflation, Australia

Headline and core inflation alike remain above the 2%–3% target.



Sources: Australian Bureau of Statistics; Haver Analytics.

remained elevated at 3.7%, while core inflation held steady at 3.3%, underscoring persistent price pressures (Figure A.8). February survey data indicate that elevated inflation and the interest rate increase eroded household confidence, driving down the consumer sentiment index for that month a 4-month low. Consumer sentiment rebounded in March but the oil price shock added renewed strain on households and businesses, reinforcing energy-driven inflation. Amid these broader inflationary pressures, the central bank raised the main policy rate by another 25 basis points to 4.10% in mid-March. This combination of higher energy costs and tighter monetary policy could lead to weaker growth in consumption and retail demand in the coming months.

Growth is projected to moderate to 2.0% in 2026 and 2.9% in 2027. Resilient domestic demand underpins the near-term outlook, with robust household consumption supported by firm real income and labor markets. However, the Middle East conflict will hit growth prospects this year. Ongoing review of a bilateral free trade agreement with the People's Republic of China (PRC) is expected to strengthen trade with this important market, but weaker global demand for goods other than energy will continue to constrain exports. Disruption to global gas supply chains are expected to position Australia, a major natural gas exporter, as a key alternative supplier. Monetary policy tightening will weigh increasingly on economic activity, gradually pushing output below potential and modestly worsening unemployment. Growth is expected to strengthen in 2027 as global conditions stabilize, supporting gradual recovery in investment and trade. While tightening financial conditions, weaker global demand, and wavering fiscal support will weigh on activity, robust exports will cushion the impact. Public spending on machinery, industrial goods, and automobiles will fall alongside declining imports, but will be offset by higher energy exports. Inflation is projected to accelerate to 5.1% in 2026 on higher oil prices from the conflict in the Middle East, then drop back to 2.6% in 2027 as global energy prices stabilize and monetary tightening dents domestic demand. Notable risks to the outlook comprise amplified geopolitical volatility and energy price shocks, global trade fragmentation, and weaker demand for commodities.

Hong Kong, China

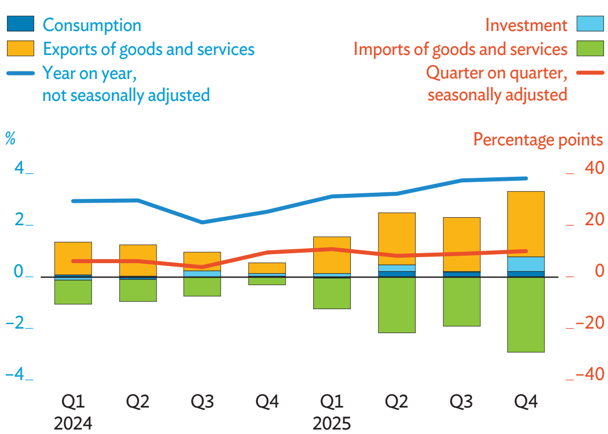
Robust exports raised growth in Hong Kong, China to 3.5% in 2025 from 2.6% in 2024. Exports of goods grew by 12% and those of services by 6.3% (Figure A.9). Exports of electronic-related products, comprising 74% of total exports, grew by 18.4%, benefiting from the boom in artificial intelligence. Exports to the People's Republic of China (PRC)—60% of the economy's total merchandise exports and mainly intermediate inputs—increased by 17%, buoyed by the export boom in the PRC. Exports were also strong to non-PRC markets where trade links have deepened, especially Southeast Asia. Service receipts were driven by the continuing recovery in visitor arrivals (though still just 90% of pre-pandemic levels) and by earnings from cross-boundary financial services.

Domestic demand picked up on lower interest rates and improved sentiment. Following the interest rate cut by the United States Federal Reserve, the Hong Kong Monetary Authority lowered its policy rate by 75 basis points to 4% between September and December 2025. Supported by the interest rate cut and wealth effects from buoyant stock prices and the residential property market's stabilization after a 3-year slump, private consumption grew by 1.7% after contracting by 0.2% in 2024. Domestic private consumption by residents also increased (Figure A.10). Fixed investment and property transactions grew, but construction remained weak due to the still sluggish nonresidential property market (Figure A.11). Government consumption was restrained as the authorities focused on reducing the fiscal deficit.

Despite the pickup in growth and interest rate cut, subdued cost pressures kept inflation low. Headline inflation fell to 1.4% last year from 1.7% in 2024 (Figure A.12). Underlying inflation (netting out the effects of all Government's one-off relief measures) was 1.1%, the same as in 2024. Prices of key imported inputs rose modestly or fell in the case of fuels. Producer prices for most key services also rose moderately or declined, as labor productivity is preliminarily estimated to have grown faster than wages, containing unit costs.

Figure A.9 Demand-side Contributions to Growth, Hong Kong, China

Robust exports drove growth in 2025.

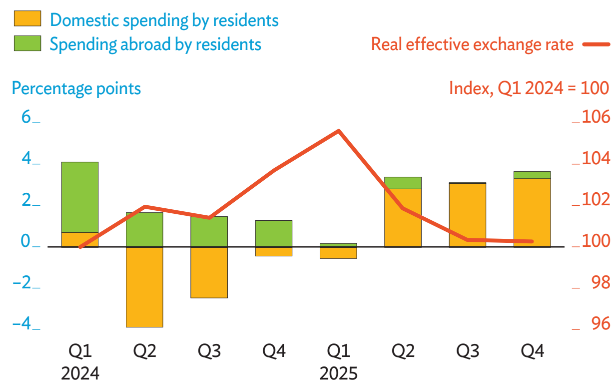


Q= quarter.

Sources: Census and Statistics Department; Haver Analytics.

Figure A.10 Contributions to Growth of Total Private Consumption by Residents, Hong Kong, China

Residents shifted toward domestic spending.

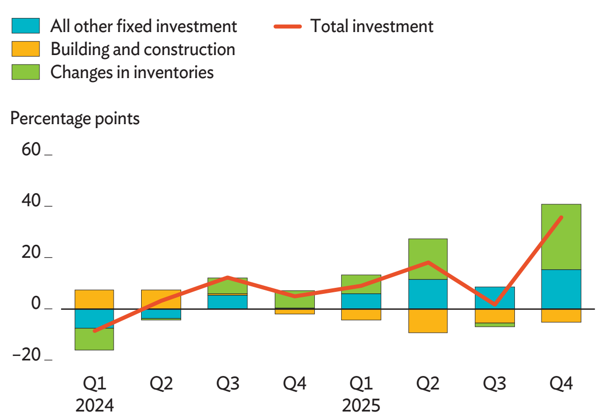


Q= quarter.

Sources: Census and Statistics Department; Haver Analytics; authors' calculations.

Figure A.11 Investment Growth, Hong Kong, China

Investment picked up, but the weak nonresidential property market held back construction activity.

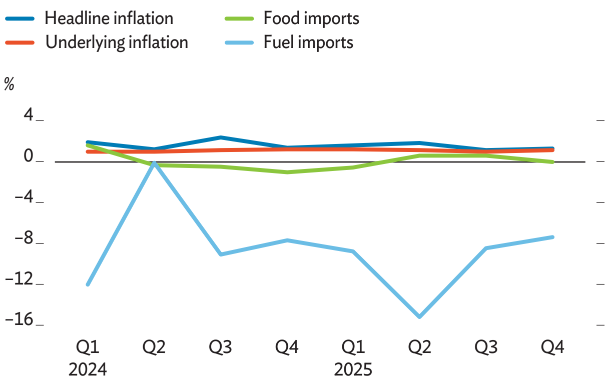


Q= quarter.

Sources: Census and Statistics Department; Haver Analytics.

Figure A.12 Inflation, Hong Kong, China

Low prices for key imports held down inflation.



Q= quarter.

Sources: Census and Statistics Department; Budget Speech as published in The 2026-27 Budget.

The financial sector surged, benefiting from easier financial conditions and keen interest in locally listed PRC companies. Monetary easing, capital inflows to locally listed tech firms, and streamlined listing procedures all helped the Hang Seng Index rise by 28%, with average daily turnover nearly doubling to $33 billion. Initial public offerings (IPOs) totaled 119 listings in 2025 (68% more than in 2024), and raised over $37 billion (more than triple the value in 2024). There are almost 500 listing applications in the IPO pipeline as of end-February 2026.

Buoyant growth enabled more fiscal consolidation. Total revenue in fiscal year 2025 (FY2025, ended 31 March 2026) is estimated to be 4.5% higher than projected. Buoyant collections from stamp duties offset sluggish proceeds from land premium. Total spending continued to wind down from the pandemic peak and is estimated to be 4% lower than projected. The capital account remained in deficit but the consolidated account would be broadly balanced, after taking into account the net proceeds from bond issuance. The authorities intend to step up capital expenditure from 4.9% of GDP in 2024 to about 5.8% of GDP by FY2028, largely to develop the Northern Metropolis growth pole.

Amid high downside risks due to geopolitical uncertainty, growth is expected to remain moderate in 2026, but inflation will likely tick up. Under the scenario of early stabilization in the Middle East conflict, the economy is projected to grow by 2.6% in 2026 with inflation at 1.7%. Exports are expected to remain the key driver, albeit somewhat less strongly, as the effects of frontloading fade and global demand slows. Continued growth in financial activity and a more stable property market will support private consumption. The inflation outlook is relatively sanguine because the economy's energy intensity is relatively low and it can draw on energy resources mainly from the PRC, which has ample energy stocks. A prolonged Middle East conflict, however, could cut growth to as low as 2.4% and raise inflation to almost 2% due to supply chain disruption, energy scarcity, and reduced consumer and investor confidence.

Exports of goods will likely slacken, but exports of services are expected to remain robust in 2026 and 2027. Even as frontloading effects wane and PRC demand likely slows, strong demand for electronics should enable goods exports to grow by about 5%, half the pace in 2025. This outlook, however, assumes that trade and travel disruptions are promptly resolved. In contrast, services exports should grow at about the same rate as in 2025. Tourism services may not grow as fast as earlier projected due to travel constraints, but financial activity should remain robust. The IPO pipeline is substantial—interest remains high in locally listed PRC tech companies—and the economy may benefit from haven-seeking flows of financing and wealth management offices.

Domestic demand is expected to grow moderately this year and next. The vibrant financial sector and recovering property market, coupled with some tax breaks, is likely to raise private consumption growth to about 3%. Fixed investment is projected to grow by about 6%, chiefly due to private construction outlays and public investment in the Northern Metropolis.

Hong Kong, China's vigorous economic integration with the PRC will raise growth to 3.0% in 2027, with inflation remaining moderate at 1.5%. Measures to promote offshore renminbi transactions, green and sustainable bonds, wealth management, gold trading, and IPOs will entrench the economy's role as financial gateway over the forecast horizon. Its role as trade gateway will shift from primarily re-exporting goods to increasingly providing logistics services. These developments will be supported by programs that attract skilled talent to boost the local labor supply and stepped-up investment to develop the Northern Metropolis as a hub for industry, innovation, and technology.

Risks lean to the downside. The most pressing risks stem from the Middle East conflict's impact on global trade and on key input prices. Other downside risks include US trade policy shocks, a slowdown in artificial intelligence-related electronics demand, and asset-market shocks. On the upside, the economy's position as a gateway to the PRC could attract additional finance and people, buoying financial activity, residential property, and private consumption.

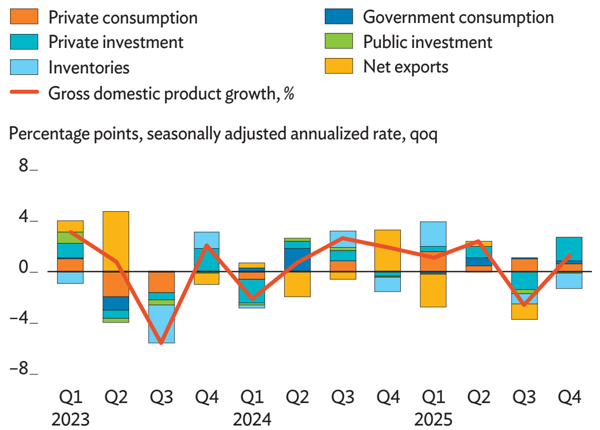
Japan

The economy reversed contraction in 2024 to grow by 1.2% in 2025. Recovery remained subdued, however, with Q4 growth at a weak annualized rate of 1.3%. Performance was dampened by net exports, which weighed on growth in Q1 and Q3 and contributed little in the other quarters (Figure A.13). Consistent with weaker external demand, nominal merchandise exports rose by 3.1% in 2025, only half of 6.1% growth in 2024, as shipments to the PRC and the United States—Japan's two largest trade partners—declined by 0.4% and 4.1%, respectively, while motor vehicle exports declined by 1.7%. Private consumption, which absorbs more than half of output, lost momentum in Q4 to rise by only 1.5% in 2025 as household spending was constrained by real wage contraction throughout the year and persistent cost pressures, especially from food prices. Private residential investment declined for a second consecutive year as the April 2025 Building Standards Act raised compliance and approval requirements, weighing on housing starts, but private nonresidential investment recovered from contraction in 2024. Government consumption provided little support to growth, while public investment was a drag on it for most of the year.

Food and energy imports kept inflation above the 2.0% Bank of Japan target, averaging 3.2% in 2025. Price pressures eased toward year-end with moderating food inflation, particularly lower price increases for rice and several nonessential items (Figure A.14). Meanwhile, utilities continued to add inflationary pressure. Notably, electricity prices rose by 5.6% on average in 2025 despite subsidies reinstated in December, which lowered electricity prices that month by 2.3% year on year. Core inflation, excluding fresh food and energy, hovered around 3.0% last year, indicating continued underlying price pressure. At its

Figure A.13 Demand-Side Contributions to Growth, Japan

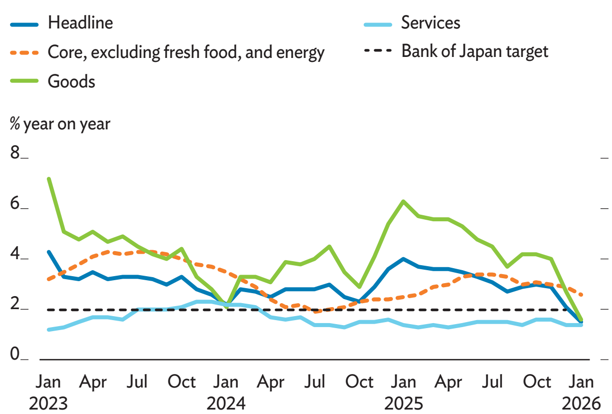
Growth is positive but shows little momentum.



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

Figure A.14 Monthly Inflation, Japan

Inflation continued to decelerate with lower costs for food and energy imports.



Source: CEIC Data Company.

March 2026 meeting, the Bank of Japan kept the policy rate unchanged at 0.75% but signaled that gradual monetary normalization remains on track.

Real GDP growth is forecast to moderate to 0.7% in 2026 and 0.6% in 2027. Expansion will come mainly from domestic demand as net exports remain a drag on growth. Business investment is projected to remain robust in 2026, underpinned by solid corporate profitability and fiscal policy support. Historically high order backlogs in machinery and construction are expected to sustain investment despite only moderate growth. Housing investment is forecast to normalize with the fading of front-loading effects from 2025 building code reform. While a tight labor market will underpin wage growth, and government cost-of-living measures will support disposable income, private consumption will remain constrained as the inflationary effects of the Middle East conflict negatively affect sentiment. Fiscal policy is set to remain supportive following a snap election in February 2026, which secured a lower-house majority for the ruling party. On the external side, export growth will moderate as last year's front-loading effects fade. In addition, exports of tourism-related services are expected to weaken following a PRC travel advisory against Japan. In 2027, growth is forecast to moderate slightly as fiscal support wanes. However, drag on export growth will ease as tariff effects fade and oil prices normalize. Business investment is expected to continue to support growth.

Inflation is forecast to ease to 2.4% in 2026 and 1.8% in 2027. Price pressures are expected to moderate from last year, but the pace of easing will be hampered by the conflict in the Middle East and higher energy prices. Favorable base effects from elevated 2025 inflation should contribute to the projected decline in headline inflation in 2026. Government cost-of-living policies—including continued fuel and utility price relief and income-tax support—are expected to help contain prices.

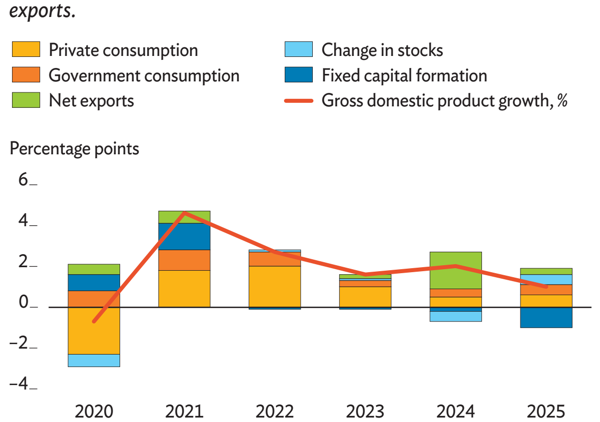
Several external and domestic factors pose risks to the outlook. An escalation of geopolitical tensions in the Middle East could disrupt global supply chains and raise energy and other import costs. This could slow expected disinflation, weighing on real household purchasing power. These effects would be most pronounced if accompanied by renewed yen depreciation. Elevated trade policy uncertainty could also delay investment and reduce exports, hampering economic activity. In addition, worsening relations with the PRC could prolong a downturn in inbound tourism and create further trade friction, weighing on growth, corporate earnings, and investment. On the domestic side, while near-term political uncertainty has dissipated following the February polls, debt sustainability risks may be amplified. With public debt already elevated, expected substantial fiscal stimulus and debt issuance could put upward pressure on government bond yields and renew pressure on the yen to depreciate. On the other hand, proposed measures for relief from consumption tax could, if implemented, offset these effects to some extent. Improving supply conditions and slower inflation for nonessential goods could reduce price pressures.

Republic of Korea

Economic growth slowed to 1.0% in 2025, from 2.0% in 2024, reflecting weaker investment and export growth. Momentum was subdued in the first half of the year, with GDP growth at 0.3% amid domestic political uncertainty and global trade policy headwinds, before strengthening gradually in the second half to 1.7%. Private consumption grew by 1.3% in 2025 and contributed 0.6 percentage points to overall growth, supported by a recovery in consumer confidence following the resolution of political uncertainty and the rollout of fiscal stimulus measures, including consumption vouchers. Government consumption rose by 2.8%, supported by supplementary budgets, and contributed 0.5 points to growth. In contrast, total investment continued to decline, contracting by 1.7% in 2025 and subtracting 0.5 points from growth, largely due to a sharp 9.9% fall in construction. Export growth moderated to 4.1% in 2025 amid higher tariffs and elevated trade uncertainty, while imports grew at a slightly slower pace of 3.8%. As a result, net exports contributed 0.3 points to overall growth (Figure A.15). On the supply side, services grew by a steady 1.7%, contributing 1.0 point to overall growth. Manufacturing growth slowed to 2.0% amid weak investment and exports, while agriculture expanded by 1.4%.

Figure A.15 Demand-Side Contributions to Growth, Republic of Korea

Growth moderated in 2025 mainly due to weak investment and exports.



Source: CEIC Data Company.

Inflation slowed from 2.3% in 2024 to 2.1% in 2025, still slightly above the central bank's target. The easing of inflation was driven mainly by smaller increases in food and energy prices, moderating across most items. Communications recorded deflation by 1.0% after a major mobile carrier granted a one-off reduction in monthly subscription fees following a data breach. Core inflation, which excludes food and energy, also declined, to 1.9% in 2025 from 2.2% in 2024.

Macroeconomic policy turned more supportive in 2025. Amid moderating inflation and subdued growth, the Bank of Korea, the central bank, reduced its key policy rate by 25 basis points in February 2025 and by a further 25 points in May, bringing the policy rate to 2.50%, where it has since remained (Figure A.16). Meanwhile, expansionary fiscal policy widened the fiscal deficit to W89.6 trillion as of November 2025, 10.2% higher than a year earlier.

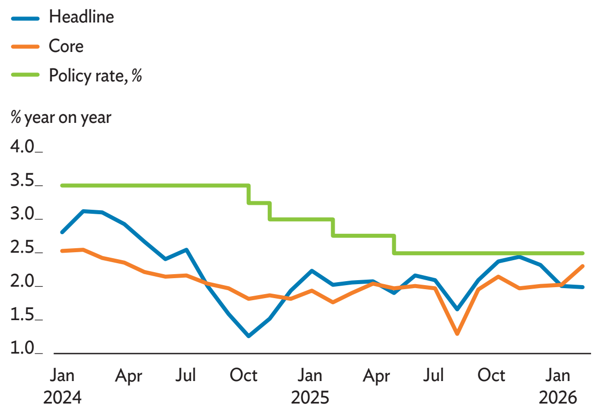
Under this report's early stabilization scenario, growth is projected to pick up to 1.9% in both 2026 and 2027, supported by a gradual recovery in consumption and strong semiconductor exports. Private consumption is expected to grow at a moderate pace, supported by lagged effects of monetary easing and spillovers from a strong semiconductor sector, but partly offset as a boost from voucher support fades and as purchasing power is eroded by higher global energy prices amid conflict in the Middle East. A planned 8.1% increase in government expenditure over the 2025 initial budget will contribute to growth, with spending prioritized toward strategic sectors such as semiconductors, defense, and biotechnology.

Robust demand for semiconductors is forecast to offset slower growth in other exports. Strong global demand for high-end chips, rising memory chip prices amid supply constraints, and increased investment in artificial intelligence (AI) and data centers are expected to support export growth. In the first 2 months of 2026, semiconductor exports surged by 131.1% year on year, driving total merchandise export growth to 31.3% (Figure A.17). However, higher US tariffs and persistent global trade uncertainty continue to weigh on certain export categories, particularly automotive parts and steel products. Shipments of these products, both subject to higher US tariffs, contracted in 2025 and declined further by 10.4% and 3.7% respectively, in the first 2 months of 2026. Nevertheless, robust growth in merchandise exports is expected to more than offset the increase in imports stemming from stronger consumption and a higher oil import bill, leading to widening of the current account surplus in 2026 and 2027.

Investment will likely be dragged down this year and next by the construction slump. Persistently elevated inventories of unsold residential property and a low number of building starts point to a lackluster construction sector (Figure A.18). In February 2026, construction employment declined by 40,000 from the same month a year earlier, marking the 22nd consecutive month of contraction. Partly offsetting

Figure A.16 Inflation and Policy Rate, Republic of Korea

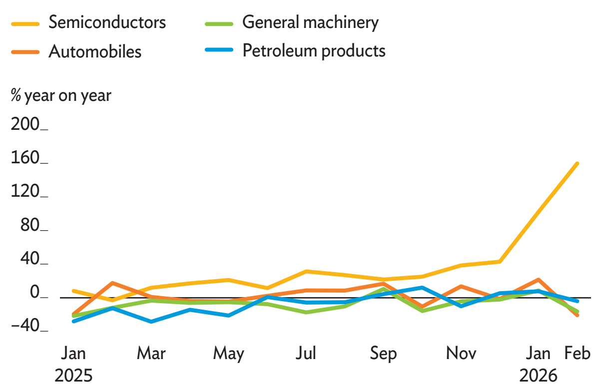
Inflation gradually eased, allowing the central bank to further reduce its key policy rate.



Source: CEIC Data Company.

Figure A.17 Major Commodity Exports Growth, Republic of Korea

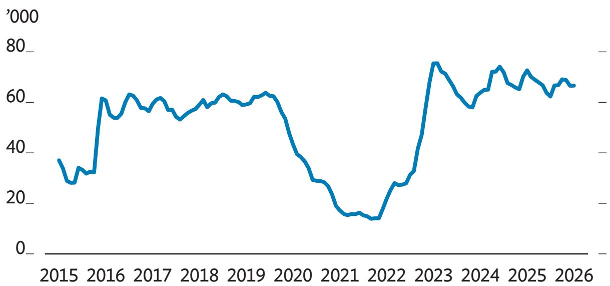
Semiconductor exports are expected to rise significantly on strong demand for artificial intelligence.



Source: CEIC Data Company.

Figure A.18 Unsold Residential Property, Republic of Korea

The number of unsold homes remains high, signaling continued weakness in the property sector.



Note: Data for 2026 is as of January.
Source: CEIC Data Company.

this weakness, investment in facilities is expected to pick up as the outlook improves for export-oriented manufacturing firms, driven largely by robust global demand related to AI. Reflecting this momentum and supported by a rise in new orders, the seasonally adjusted manufacturing purchasing managers' index rose to 51.2 in January 2026, the strongest improvement since August 2024, and remained at 51.1 in February.

Inflation is projected to rise in the near term on higher fuel prices. Prices are expected to rise by 2.3% in 2026 before inflation slows again to 2.0% in 2027, under the early stabilization scenario. Headline inflation eased to 2.0% in the first 2 months of 2026, reflecting softer food and fuel prices, while core inflation, which excludes food and energy, edged up in February 2026, driven by higher recreation and culture prices related to the Lunar New Year holiday. The central bank kept its key policy rate unchanged at 2.50% on 26 February 2026, citing expectations of a stable inflation and improving growth prospects. Since the end of February, however, worsening conflict in the Middle East has driven fuel prices sharply higher, which is expected to push up inflation in the near term. Additional upward pressure may arise from currency depreciation and rising prices for electronics. A fuel tax cut and additional government measures, including a domestic fuel price cap, may partly offset these headwinds and temper inflation.

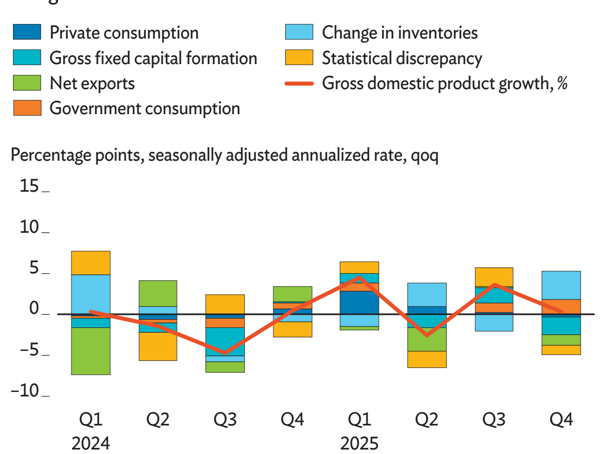
Significant downside risks weigh on the growth outlook. Disruption from global trade and geopolitical tensions, including prolonged conflict in the Middle East and possible changes in US tariff policy, may dampen external demand. Given a large share of semiconductors in exports from the Republic of Korea, shifts in the semiconductor cycle, related to a sharper than anticipated weakness in global demand or abrupt price corrections, could have a significant impact, while stronger than expected performance in the sector could lift growth above projections. The timing and scale of productivity gains from AI remain uncertain; emerging evidence suggests positive effects, but these gains tend to materialize gradually. Risks to the inflation outlook have heightened with pressure from the Middle East conflict on fuel prices, on top of risks from adverse weather, unexpected adjustments to public utility fees, and large exchange rate movements linked to geopolitical developments.

New Zealand

Economic activity rebounded sharply in the third quarter (Q3) of 2025 and remained positive in Q4, though momentum eased toward year-end. Following a 2.6% contraction year on year in Q2, GDP rose by 3.6% in Q3 and by a more modest 0.3% in Q4 (Figure A.19). Household consumption provided support through much of 2025, underpinned by accommodative monetary policy, but softened in Q4 as household final consumption expenditure edged down by 0.6% after a broadly flat outcome in Q3. Spending continued to be supported by demand for services,

Figure A.19 Demand-Side Contributions to Growth, New Zealand

Growth rebounded strongly in Q3 2025 and remained positive in Q4, though momentum eased.



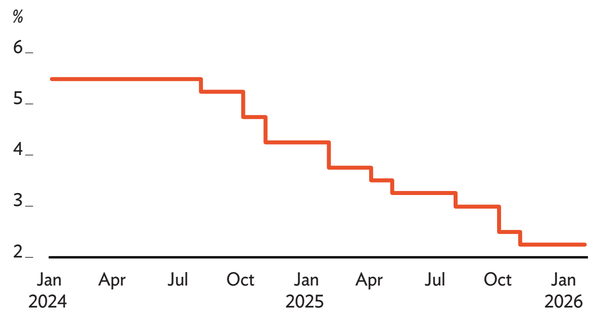
Q = quarter, qoq = quarter on quarter.
Source: CEIC Data Company.

while tourism became more prominent late in the year as overseas visitor spending strengthened. Government consumption also provided support in Q4, driven mainly by an increase in health goods and services purchased on behalf of households. Investment growth strengthened markedly in Q3, but momentum was not sustained in Q4, when gross fixed capital formation fell 8.4%, indicating renewed weakening in private capital spending. Exports of goods and services rebounded strongly by 12.7% in Q3, recovery underpinned by robust travel services and higher international visitor arrivals, and by stronger dairy exports as favorable weather sustained buoyant dairy production. In Q4, overall export growth slowed to 0.2%, but this masked a sharp rise in travel service exports as higher international visitor spending flowed through to tourism-related activity. Imports rose in both Q3 and Q4, led first by motor cars and mechanical machinery, and later by petroleum, machinery and equipment, and travel-related services, suggesting continued demand for foreign goods and services even as domestic momentum softened. On the production side, business services—particularly professional, scientific, and technical activities such as computer system design—provided strong support in Q3, alongside a rebound in manufacturing. In Q4, however, growth became more narrowly led by services with gains in rental, hiring, and real estate services, retail trade and accommodation, and financial and insurance services, while construction fell and business services dipped, tempering the broader upswing.

Inflation edged up from 3.0% year on year in Q3 to 3.1% in Q4, slightly exceeding the target range of 1.0%–3.0%. Upward pressure stemmed mainly from electricity prices, up by 12.2%, local authority rates by 8.8%, and rent by 1.9%. It was partly offset by falling prices for audiovisual equipment and pharmaceuticals. Tradable inflation—which measures the prices of goods and services that are imported or compete with imports—rose to 2.6%, reflecting higher overseas prices for meat and poultry and for accommodation abroad. On 26 November 2025, the Reserve Bank of New Zealand, the central bank, reduced the official cash rate from 2.50% to 2.25%, bringing cumulative cuts to 325 basis points since August 2024 (Figure A.20). On 18 February 2026, the central bank held its policy rate at 2.25% to balance a nascent economic recovery with controlling inflation, which had recently edged above its target range.

Figure A.20 Policy Rate, New Zealand

Central bank policy rate cuts have totaled 325 basis points since August 2024.



Source: CEIC Data Company.

GDP growth is forecast at 1.9% in 2026 and 2.8% in 2027. Delayed pass-through of earlier monetary easing is expected to gradually increase support for domestic demand in 2026–2027, strengthening both private consumption and investment. Private consumption should benefit from stabilizing housing costs, modest employment gains, and gradual improvement in real household incomes. The principal swing factor in 2026 is projected to be recovery in investment, with fixed capital formation returning decisively after 2 consecutive years of contraction. This rebound is expected to be led by business investment as firms respond to improving sentiment, lower financing costs, and the need to rebuild productive capacity following an extended period of underinvestment. Net exports are projected to exert modest drag on growth as imports rise faster than exports. Stronger domestic demand is expected to lift import volume, particularly for capital goods as the investment cycle gains traction. Export growth, meanwhile, is expected to be supported by continued strength in the primary sector, underpinned by firmer meat prices and favorable production conditions for dairy, forestry, and horticulture. The conflict in the Middle East clouds the outlook for this year as New Zealand is a net oil importer with no offsetting energy exports. Inflation is projected to increase to an average of 3.8% in 2026 from higher oil prices and moderate to 1.6% in 2027 as global energy markets stabilize. Risks to the outlook include a sharper slowdown in the PRC affecting primary-sector exports, rising trade friction and US tariffs, ongoing emigration to Australia, pressures on fiscal sustainability, and exposure to global shocks, to which the small and open economy of New Zealand is especially vulnerable.

Singapore

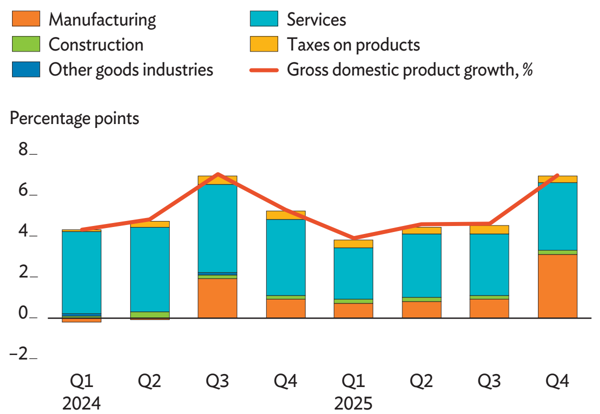
Growth was stronger than expected in 2025 but slightly slower than in 2024. GDP expanded by 5.0% year on year in 2025, a slight moderation from 5.3% in 2024, supported by robust growth in the fourth quarter (Q4), which accelerated to 6.9% from 4.6% in the previous quarter. Manufacturing was the main contributor to Q4 growth, rising 18.8% and posting full-year growth of 8.7% (Figure A.21). This accelerated expansion was driven by strong demand for artificial intelligence (AI)-related electronics and robust output in the biomedical and transport engineering. This was followed by the service sector, which grew by 4.6% in Q4, slightly higher than 4.2% in the previous quarter, supported by trade-related activities, finance and insurance, and the information and communication sectors. For the full year, services grew by 4.3%. Construction activity remained positive but moderated to 4.6% in Q4, easing from 5.6% in Q3, partly reflecting softer private sector demand for industrial and commercial building projects. Nevertheless, ongoing large-scale public infrastructure projects supported full-year growth of 5.2%.

Stronger external demand supported growth in 2025. Exports and imports recorded double-digit growth, with exports expanding by 10.8% and imports rising by 11. 9%. This robust performance was driven by accelerated external trade in Q2 following the postponement of US tariffs from April to August. In Q4, trade strengthened on the back of higher global electronics demand, with net exports rebounding and contributing 2.1% points to overall growth, as export growth accelerated to 12.0%, while imports increased by 12.8% (Figure A.22). On the domestic demand side, private consumption grew by 3.9% in 2025, contributing an average of 1.6% points to overall growth, supported by rising wages and continued employment growth. Government consumption rose by 1.7% in 2025, contributing 0.6% points to growth, underpinned by high fiscal spending on health care, household support measures, and manpower-related programs. Meanwhile, investment grew by 6.1% in 2025, contributing an average of 1.1% points to growth, due to higher public and private investment.

Growth is expected to moderate but remain resilient in the near term. On the supply side, sustained global demand for semiconductor and electronics products, driven by continued investment in AI, will support manufacturing, trade, and export growth. Recent purchasing managers' index readings indicate ongoing expansion and a more optimistic business outlook for the manufacturing and electronics sectors in the first half of 2026 (Figure A.23). This momentum could be moderated by trade uncertainties and heightened geopolitical tensions. In January, domestic electronics exports surged by 65.9%, up from 30.7% in December, while

Figure A.21 Supply-Side Contributions to Growth, Singapore

Strong Q4 manufacturing growth lifted overall growth in 2025.

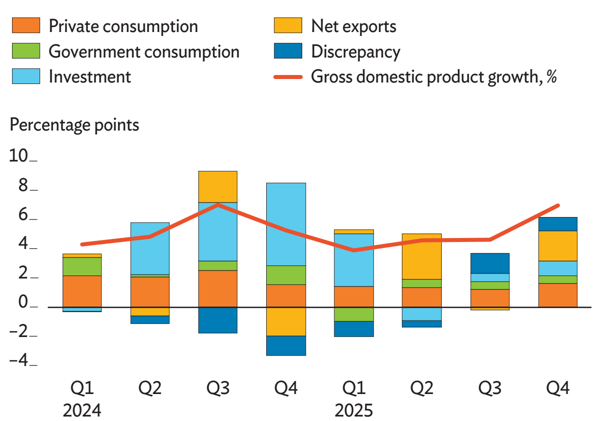


Q = quarter.

Source: Ministry of Trade and Industry. Economic Survey Singapore 2025.

Figure A.22 Demand-Side Contributions to Growth, Singapore

On the demand side, growth was supported by broad-based expansion across most expenditure components in Q4 2025.



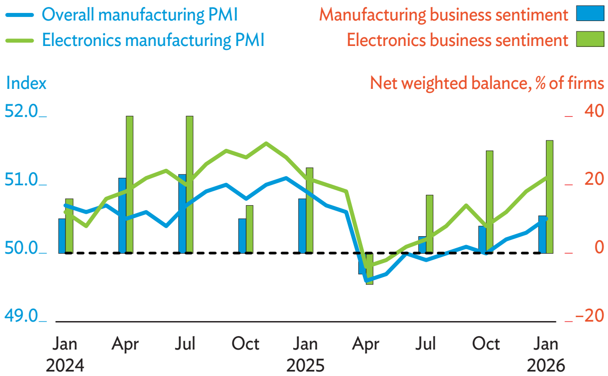
Q = quarter.

Note: The sum of sectoral contributions may not equal total gross domestic product growth due to the chain-linking method.

Sources: Asian Development Bank estimates; Ministry of Trade and Industry. Economic Survey Singapore 2025.

Figure A.23 Leading Economic Indicators, Singapore

The manufacturing and electronics PMI indexes continue to signal expansion, alongside sustained optimism in the business outlook in the next 6 months.



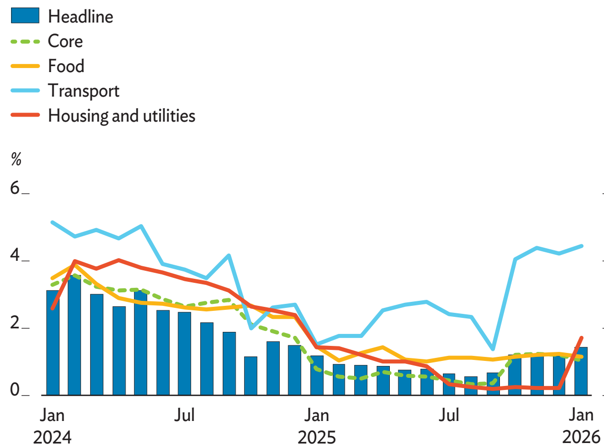
PMI = purchasing managers' index.

Note: A reading < 50 signals deterioration, > 50 improvement.

Source: CEIC Data Company.

Figure A.24 Inflation, Singapore

Inflation eased through most of 2025 but began rising in the latter part of the year and rose further in January 2026.



Source: CEIC Data Company.

non-electronics domestic exports moderated to 3.2% from 5.5% in December. Domestically, construction will expand steadily, supported by the ongoing construction of major infrastructure projects such as Changi Airport Terminal 5 and Mass Rapid Transit extensions. Consumer sectors such as retail trade and food and beverage services are expected to remain subdued as overseas travel, cross-border spending, and shifts to online shopping temper domestic demand. On the demand side, private consumption will be sustained by a resilient labor market and rising incomes. At the same time, government expenditure will remain strong amid an accommodative fiscal stance to support households and overall economic activity. Investment will be supported by increased investment commitments secured in 2025 and a strong pipeline of public infrastructure projects to the forecast horizon. Weighing persistent global headwinds against an ongoing strong semiconductor upcycle, the forecast is for GDP growth to remain resilient at 3.0% in 2026 and 2.3% in 2027, although moderating from 5.0% in 2025.

Inflation eased in 2025 but is expected to edge up this year and next. The Monetary Authority of Singapore measured core inflation as averaging 0.7% in 2025, down from 2.8% in 2024, while headline inflation averaged 0.9%, declining from 2.4% (Figure A.24). Inflation slowed for most goods and services as government subsidies offset rising living costs. Lower housing rents, lower energy prices, and government utility rebates helped ease housing and utility costs. Imported inflation also slowed, supported by a stronger Singapore dollar, which appreciated by 6.1% by the end of December. In 2026, prices may inch up, partly driven by the 5% rise in public transport fares since 27 December 2025. Meanwhile, the introduction of a new sustainable aviation fuel levy will raise airfares. The increase in the carbon tax rate from S$25/ton to S$45/ton since 1 January 2026 will raise household utility bills and business operating costs. Inflation will also be lifted by the dissipation of base effects associated with enhanced subsidies in 2025. Import costs are expected to support higher inflation in 2026 as well, given an increase in global crude oil prices and a modest pickup in regional inflation. Headline inflation is forecast at 1.6% in 2026 and 1.7% in 2027.

Risks to the outlook are broadly balanced. A stronger-than-expected expansion in the global AI investment cycle could further boost electronics demand, supporting trade and manufacturing and gains in equity markets. Gains in global equity markets help strengthen consumption through wealth effects, while stronger economic growth could raise wages and consumer confidence, adding to demand-driven inflationary pressures. Meanwhile, some downside risks remain. Renewed tariff policy uncertainty and longer-than-expected geopolitical tensions in the Middle East could disrupt trade and supply chains, increase inflationary pressure, and dampen business confidence, leading to weaker investment and household spending. Pending concerns over global AI-related capital spending may trigger price correction in global financial markets, which could also slow consumption and financial-related services.

Taipei,China

Strong external demand for tech exports led to near-record GDP growth in 2025. Despite geopolitical shocks this year, growth will likely remain tech-driven and robust, as the global artificial intelligence (AI) boom continues and domestic demand picks up. Inflation is projected to rise while the Middle East conflict continues, but should abate over the forecast period.

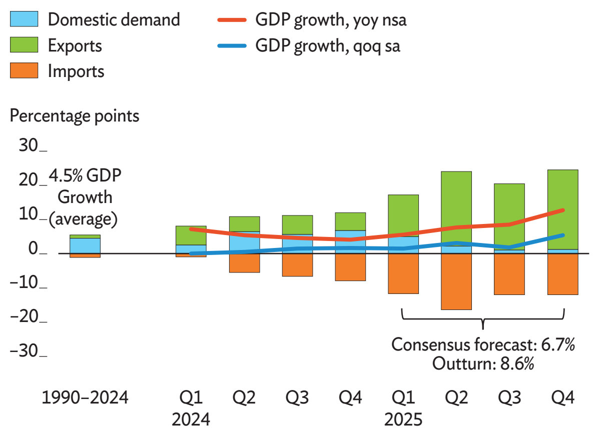
The global AI investment boom boosted growth to 8.7% in 2025. Growth was double the average since Taipei,China became an advanced economy in the 1990s (Figure A.25). Net exports contributed 6.4 percentage points. The AI boom was the main driver of export growth, with some boost in the first half from frontloading. Tech accounted for almost all of the 35% growth of goods exports, while traditional industries (such as automobiles and mature electronics) stagnated (Figure A.26).

Uncertainty and weak activity outside tech limited growth in consumption. Private consumption grew by 1.5% and government consumption by 1.2%, both about half their 2024 rates. Uncertainty over economic prospects along with soft non-tech job and income growth dampened consumer spending, despite the wealth effect of a 25% increase in stock prices. The prospect of lower tariffs on United States (US) imports also made consumers postpone purchases, as evident in sluggish vehicle sales for most of 2025. To stimulate private spending, the government provided cash transfers to households (about 0.8% of GDP), but they only had a modest impact.

Investment grew apace with exports. Overall gross capital formation grew by 4.4% in 2025 from 14.5% in 2024 (Figure A.27). The slowdown, however, resulted from inventories shrinking by almost 2% of GDP, as producers drew down stocks to keep up with export orders. In contrast, investment in plant and equipment grew by 11% from 7% in 2024 as tech producers increased capacity to keep up with the AI boom.

Figure A.25 Gross Domestic Product Growth and Demand-Side Contributions (1990–2025), Taipei,China

Growth in 2025 exceeded expectations, and was twice as fast as the average since the 1990s.



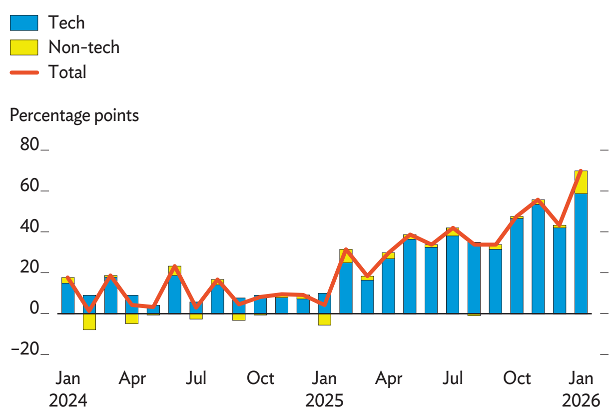
GDP = gross domestic product, Q = quarter, yoy = year on year, qoq = quarter on quarter, nsa = not seasonally adjusted, sa = seasonally adjusted.

Note: The statistical discrepancy resulting from chain-linking is included in domestic demand.

Sources: Haver Analytics; ADB staff calculations.

Figure A.26 Contributions to Exports, Taipei,China

Tech exports boomed while traditional exports stagnated.



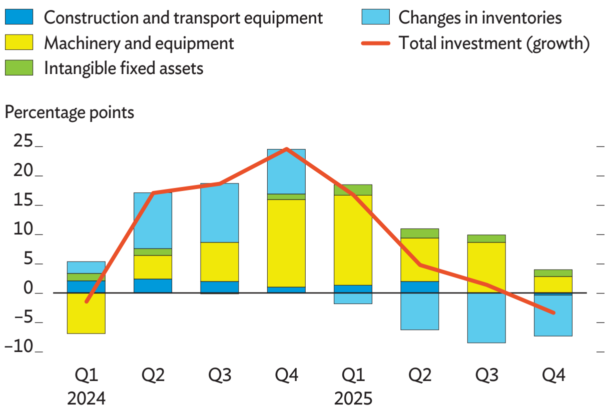
Notes: Tech includes automatic data processing machines and units, parts or accessories for use with machines, and semiconductors. Data are from customs, not gross domestic product accounts.

Sources: Haver Analytics; ADB staff calculations.

Inflation remained low in 2025. Headline inflation was 1.7% and core inflation 1.3%. Food prices eased from their highs after typhoons in 2024, while subdued domestic demand and controls on basic goods and services (such as electricity) held down other consumer prices. Given these trends, the central bank kept the policy rate at 2% throughout 2025.

Figure A.27 Contributions to Investment Growth, Taipei,China

The tech inventory cycle masked healthy investment in productive capacity.



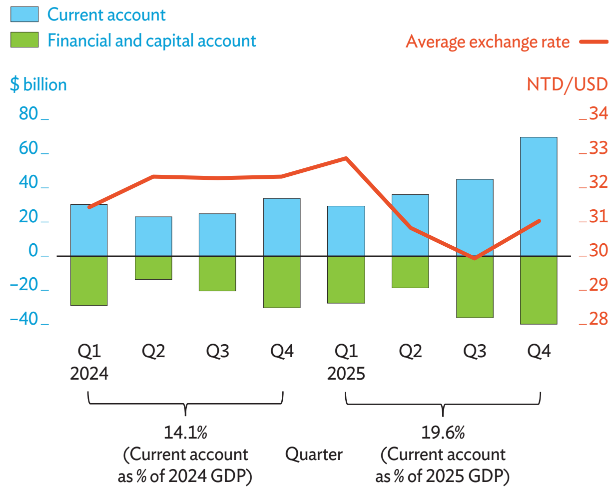
Q = quarter.

Note: The statistical discrepancy resulting from chain-linking is included in inventories.

Sources: Haver Analytics; ADB staff calculations.

Figure A.28 Balance of Payments, Taipei,China

The current account surplus contributed to a stronger currency.



GDP = gross domestic product, Q = quarter.

Sources: Haver Analytics; Bloomberg; ADB staff calculations.

The fiscal balance turned into a deficit of about 0.8% of GDP from a 0.4% surplus in 2024. Government expenditure rose to 15.9% of GDP, slightly below the budgeted 16.2%. Although growth was strong, overall revenue was limited by lower tax receipts from weak property sales, lower vehicle purchases, and tax deferral schemes to help sectors not benefiting from the tech export boom.

The current account surplus widened to a record $181 billion, or 19.6% of GDP, strengthening the local currency. International reserves rose by $25 billion to 15 months of imports, and the local currency appreciated by roughly 12% against the US dollar at its July peak before ending the year about 4% stronger than at the start (Figure A.28).

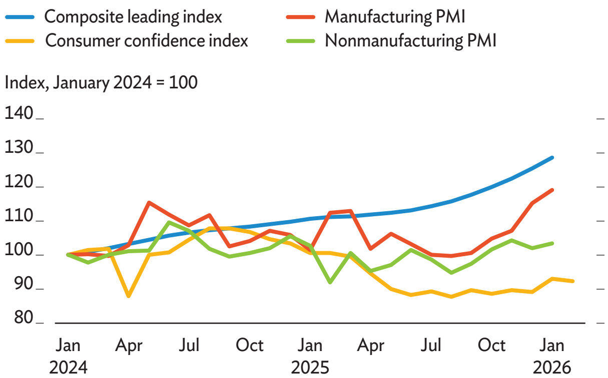
Local currency appreciation in early 2025 led to losses for life insurers. In general, the financial sector remains stable with healthy balance sheets and macroprudential measures, like limits on housing loans, still in effect. However, the currency appreciation led to valuation losses on life insurers' holdings of US dollar-denominated financial assets, which financial regulators are addressing. Revised regulations effective 2026 allow life insurers to defer these losses, reducing the need to purchase forex hedges. These changes would mitigate reduction in insurers' solvency ratios and reduce systemwide volatility.

Despite the conflict in the Middle East, growth prospects remain broadly positive. Under the scenario of early stabilization in the Middle East conflict, the economy is projected to grow by 7.6% in 2026 and inflation to edge up to 1.8%. The AI boom will likely continue, supporting exports and investment. The conflict should not significantly dent global semiconductor sales, which are projected by World Semiconductor Trade Statistics to grow by 26% in 2026. Uniform US tariffs of 10%-15% would place Taipei,China favorably vis-à-vis comparator exporters, benefiting the economy's traditional, non-tech sectors. Exports are thus projected to grow by about 15% and net exports to contribute about 2 percentage points of growth. Improving consumer confidence, continued fiscal transfers to households, and in increase in the minimum wage should raise consumer spending by about 2% (Figure A.29). Although budget passage is delayed, the impasse is not likely to slow growth because estimated fiscal multipliers are low. Healthy exports and consumption in turn should support investment in plant and equipment and restocking of depleted inventories. Inflation, however, will likely rise as the economy is almost wholly dependent on imported fuel.

The economy is projected to grow by 4% in 2027, slightly above its long-run 3%-3.5% potential, with inflation forecast at 1.5%. The projections

Figure A.29 Leading and Confidence Indicators, Taipei,China

Leading indexes point to robust growth in 2026.

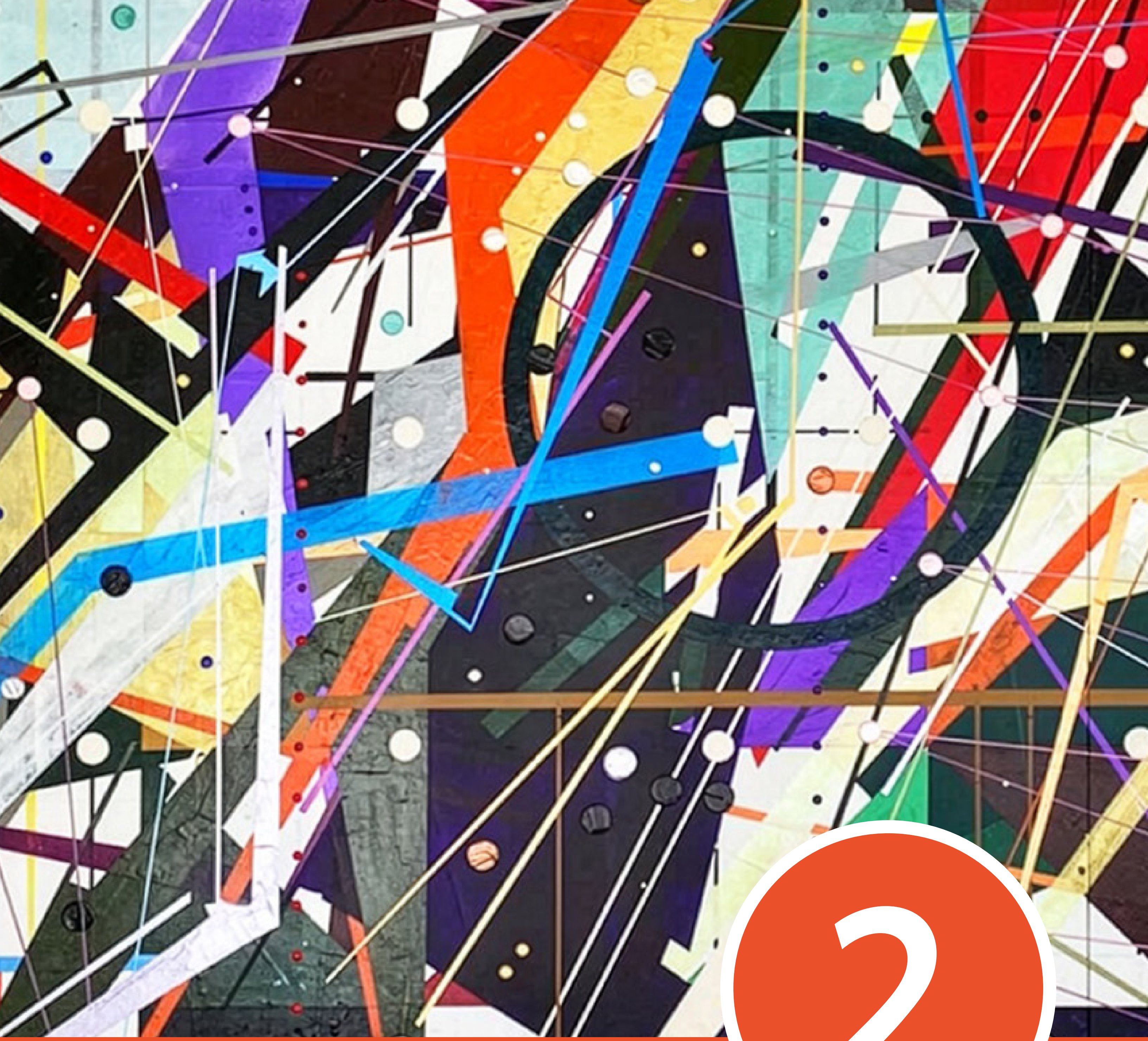


PMI = purchasing managers' index.
Source: Haver Analytics.

assume AI-related demand growth moderates, and that any inflationary spike does not last beyond 2026. For the medium term and beyond, sustaining growth momentum hinges on resolving demographic constraints and strengthening non tech productivity.

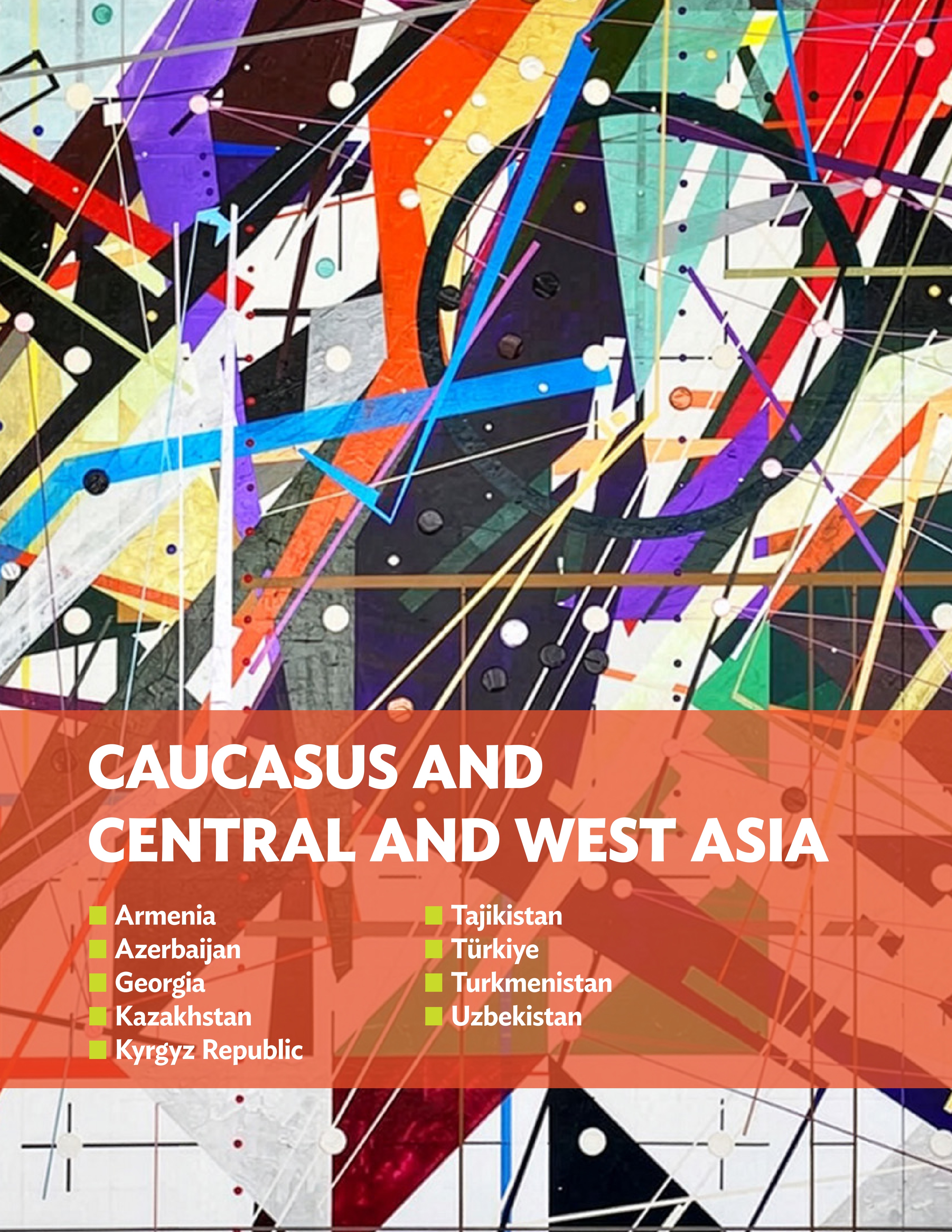
The tech sector depends on ready supply of electricity, land, and skilled professionals. Over the long term, the rapidly aging population and persistent skill shortages are critical constraints. To maintain growth beyond the AI cycle, Taipei,China will need to increase the upskilled domestic labor, integrate foreign skilled labor, and boost productivity in non-tech sectors and services.

Risks lean to the downside. A prolonged conflict in the Middle East would disrupt export production, raise inflation, and reduce consumer and business confidence. Even under the early stabilization scenario, downside risks persist. US trade policy shocks could hurt exports and confidence. Slower growth in the People's Republic of China would reduce demand for Taipei,China exports and increase competition from producers there. AI-related investment remains strong, but if productivity gains disappoint or doubts arise about tech firm financing, demand for semiconductors would shrink and asset prices could fall.



2

ECONOMIC TRENDS AND PROSPECTS



CAUCASUS AND CENTRAL AND WEST ASIA

- Armenia
- Azerbaijan
- Georgia
- Kazakhstan
- Kyrgyz Republic
- Tajikistan
- Türkiye
- Turkmenistan
- Uzbekistan

ARMENIA

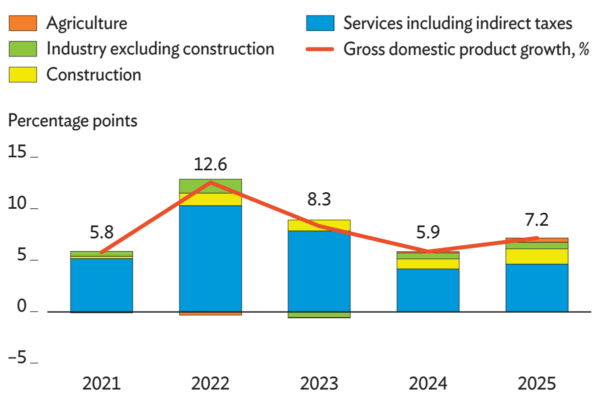
Growth accelerated in 2025 as expansion in industry, construction, and agriculture picked up and consumption and investment supported the economy. Strong domestic demand boosted inflation. However, slightly slower growth is projected for 2026 and 2027, with a small, further deceleration in services offsetting growth in construction and faster growth in industry. Inflation is projected to accelerate despite slower growth. A prolonged conflict in the Middle East, however, would significantly slow growth and sharply exacerbate inflationary pressures. Further reforms in capital markets are needed to promote diversification.

Economic Performance

Growth accelerated to 7.2% in 2025 from 5.9% in 2024. On the supply side, growth reflected gains across all sectors (Figure 2.1.1). Expansion in industry excluding construction rose to 4.1% from 3.6% in 2024, as growth in mining and quarrying rebounded to 6.6% following an 8.3% decline in 2024, amid recovering activity and stronger mineral export demand.

Figure 2.1.1 Supply-Side Contributions to Growth

Growth accelerated in 2025 on gains across all sectors.



Source: Statistical Committee of Armenia.

Utilities and manufacturing also expanded, although manufacturing growth moderated to 2.0% in 2025 from 4.4% a year earlier, as an earlier re-export driven boost in jewelry related production normalized. Construction growth accelerated to 21.0% from 14.1% in 2024, buoyed by robust private investment, strong housing demand, and government-led infrastructure programs on roads, energy networks, and refugee housing. Growth in agriculture surged to 5.3% from 1.5% in 2024, helped by government programs for mechanization and crop diversification. Expansion in services moderated to 6.9% in 2025 from 8.3% a year earlier, with slower growth in most subsectors and a decline in education, despite double-digit growth in information and communication (18.6%) and finance and insurance (14.7%).

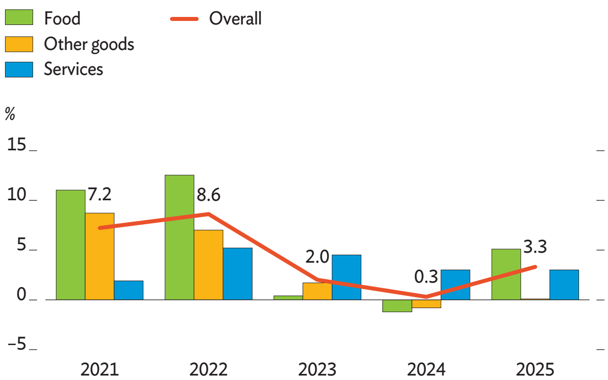
On the demand side, growth came from strong consumption and robust investment. Expansion in private consumption accelerated to 10.7% from 7.9% in 2024, supported by rising wages, increased consumer lending, and higher remittance and money transfer inflows—mainly from the Russian Federation. Public consumption grew by 4.7% in 2025, rebounding from a 9.5% decline in 2024, with higher spending on social programs. Expansion in investment surged to 15.6% from 11.2% a year earlier, propelled by higher infrastructure spending and increased private construction. However, net exports deteriorated further, as exports fell more than imports.

Strong domestic demand and rising food prices boosted inflation. Average annual inflation climbed to 3.3% in 2025 from 0.3% in 2024 (Figure 2.1.2).

This chapter was written by Grigor Gyurjyan of the Armenia Resident Mission, ADB, Yerevan.

Figure 2.1.2 Annual Inflation

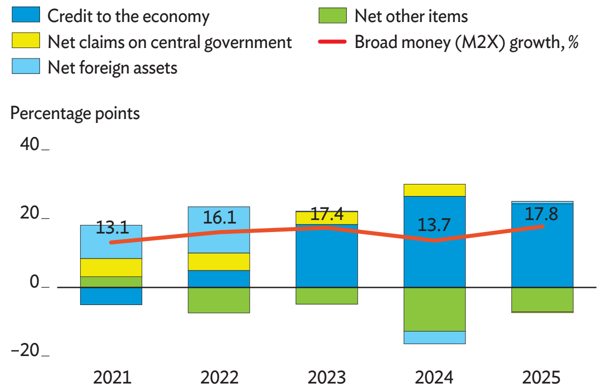
Rising food prices boosted inflation in 2025.



Source: Statistical Committee of Armenia.

Figure 2.1.3 Contributions to Broad Money Growth

Broad money growth accelerated on stronger credit expansion.



Note: M2X refers to the sum of dram broad money (M2) and foreign currency deposits and accounts of residents in the real sector.
Source: Central Bank of Armenia.

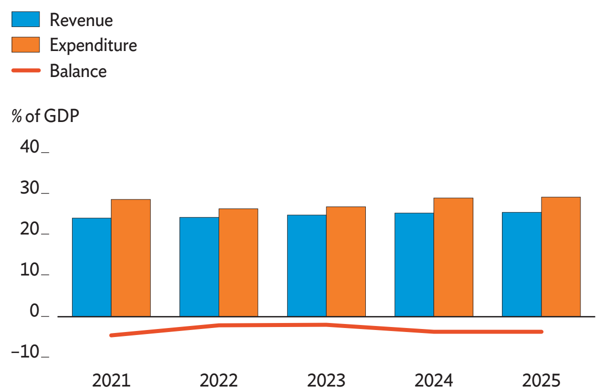
Food prices rose by 5.1%, reversing 1.2% deflation, while prices for other goods increased by 0.1% following 0.8% deflation in 2024. Inflation for services remained at 3.0%. In December 2025 month-on-month inflation was 3.3%, within the Central Bank of Armenia's target of 3.0% ±1.0 percentage points.

Monetary policy became more accommodative to support economic growth, and the financial system remained sound. With inflation expectations well-anchored, the central bank reduced the refinancing rate by 25 basis points in January 2025 and again in December to reach 6.5%. Broad money growth accelerated to 17.8% from 13.7% in 2024, reflecting strong expansion both in net foreign assets (26.7%) and net domestic assets (17.5%) (Figure 2.1.3). Credit to the economy grew by 21.9%, down from 26.4% in 2024, despite higher lending to households (particularly for consumer and mortgage loans) and to firms. The share of nonperforming loans rose marginally to 1.14% by end-2025 from 1.09% a year earlier.

Fiscal policy remained unchanged in 2025. The budget deficit remained at 3.7% of GDP in 2025, below the budgeted 5.5%, as higher-than-expected economic growth helped offset spending pressures (Figure 2.1.4). Total revenue reached 25.5% of GDP, and the tax-to-GDP ratio rose to 24.1%, supported by strong economic growth, improved tax administration, and legislative reforms to overhaul the turnover tax regime.

Figure 2.1.4 Fiscal Indicators

The fiscal deficit remained unchanged at 3.7% of GDP.



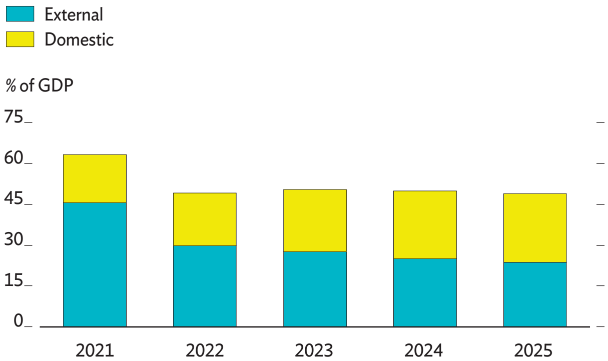
GDP = gross domestic product.
Sources: Ministry of Finance of Armenia; Statistical Committee of Armenia.

Expenditure rose to 29.2% of GDP from 29.0% in 2024, along with a shift in budget priorities toward public investment. Capital outlays reached 6.1% of GDP, up from 5.3% in 2024, on continued investment in roads and social infrastructure.

Public debt declined to 49.0% of GDP by the end of 2025 from 50.0% a year earlier, supported by a stable exchange rate and stronger-than-expected growth. External public debt (including central bank debt) increased by 9.0% to $7.0 billion, while domestic public debt increased by 17.3% to $7.5 billion, outpacing the share of external debt in total for the first time (Figure 2.1.5).

Figure 2.1.5 Public Debt

The public debt ratio remained virtually unchanged during 2022–2025.

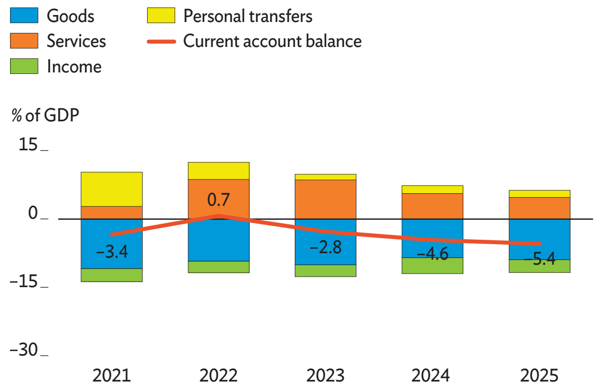


GDP = gross domestic product.

Sources: Ministry of Finance of Armenia; Statistical Committee of Armenia.

Figure 2.1.6 Current Account Balance

The current account deficit widened in 2025 on wider trade deficit and smaller services surplus.



GDP = gross domestic product.

Sources: Central Bank of Armenia; Statistical Committee of Armenia.

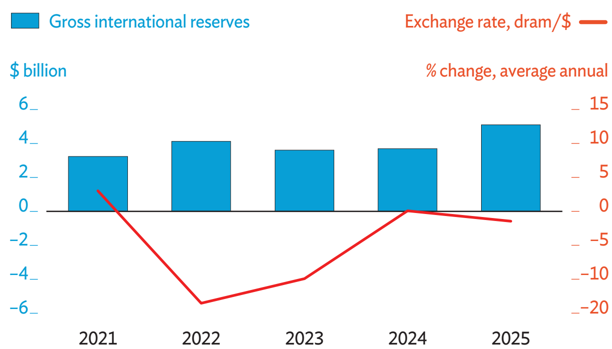
Despite the increase in nominal terms, the external debt-to-GDP ratio declined by 1.4 percentage points to 23.7%, while the domestic debt-to-GDP ratio increased by 0.4 percentage points to 25.3%. In March 2025, Armenia issued its fifth set of Eurobonds, worth $750 million, with a 10-year maturity and a 6.75% annual interest rate.

The current account moved further into deficit, as temporary factors that boosted inflows in previous years continued to fade. The current account deficit is estimated to have widened to 5.4% of GDP from 4.6% in 2024, due to a worsening trade balance and a narrower services surplus (Figure 2.1.6). The merchandise trade deficit increased to 8.9% of GDP from 8.5%, as strong consumption boosted import demand while re-exports of precious metals for processing began normalizing in the second half of the year.

The services surplus, which surged in 2022–2024, slowed to about 5.0% of GDP from 5.6% in 2024, as weaker travel and tourism receipts were partly offset by stronger exports of telecommunications, computer, and information services. The income deficit is believed to have widened slightly, on lower investment income and reduced employee compensation from abroad. Gross international reserves jumped by 38.0% to an all-time high of $5.1 billion, providing cover for an estimated 3.7 months of imports. The Armenian dram appreciated by 1.5% against the US dollar in 2025, following 0.1% depreciation in 2024, as remittance inflows remained steady (Figure 2.1.7).

Figure 2.1.7 Reserves and Average Exchange Rate

International reserves jumped to all-time high along with slight appreciation of the Armenian dram.



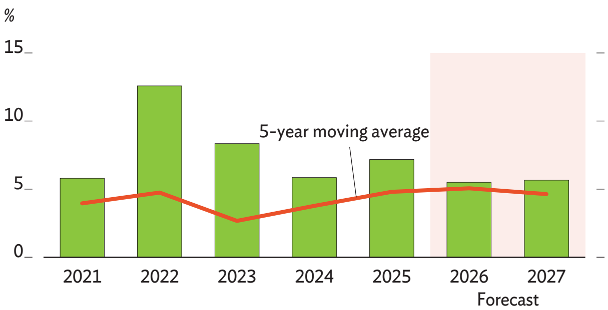
Source: Central Bank of Armenia.

Economic Prospects

Growth is projected to moderate to 5.5% in 2026 before accelerating to 5.7% in 2027, as expansion relies more on domestic demand, particularly higher public investment and targeted social programs (Figure 2.1.8 and Table 2.1.1). The outlook faces downside risks from a prolonged Middle East conflict, however, as disruptions to shipments through the Strait of Hormuz, higher global energy prices, and increased financial market volatility could fuel inflationary pressures, raise logistics costs, and weaken growth momentum. The upside risks stem from progress on the peace framework with Azerbaijan, along with normalization with Türkiye

Figure 2.1.8 Gross Domestic Product Growth

Growth is projected to moderate in 2026 before accelerating in 2027.



Sources: Statistical Committee of Armenia; Asian Development Bank estimates.

Table 2.1.1 Selected Economic Indicators, %

Growth is projected to slow in 2026 before rising in 2027, with inflation rising in 2026 and declining in 2027.

	2024	2025	2026	2027
GDP growth	5.9	7.2	5.5	5.7
Inflation	0.3	3.3	3.8	3.2

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

and a possible land border reopening, which, if sustained, could support growth by boosting trade and connectivity.

On the supply side, all sectors are expected to expand, with services the primary driver. Expansion in services is projected rising to 7.0% in 2026 and in 2027, as strong gains continue in finance, information and communication, real estate, and retail trade. Construction is projected to grow further, by 17.3% in 2026 and 17.9% in 2027, reflecting higher spending for infrastructure, housing programs for refugee integration, and major transport projects. Expansion in industry excluding construction is projected to rise to 4.3% in 2026 and 4.4% in 2027, benefiting from higher output of processed foods, textiles, and nonmetal products, plus government efforts to boost exports and investment. Assuming normal weather, agriculture is expected to grow by 4.1% in 2026 and in 2027. Growth will be supported by targeted government programs promoting smart livestock facilities, intensive horticulture, and expanded crop insurance.

On the demand side, consumption and investment will remain the main growth drivers. Private consumption growth is projected to slow to 7.9% in 2026 and 7.6% in 2027 as moderation of remittance and money transfer inflows should be partially offset by continued credit expansion and planned pension increases effective from April 2026. Expansion in public consumption will accelerate to 5.7% in 2026 and 6.4% in 2027, underpinned by increased allocations for social programs and higher health expenditures from the rollout of universal health insurance. Growth in investment will remain robust, at 15.5% in 2026 and 15.7% in 2027, reflecting increased government spending for infrastructure and social projects and in private investment for housing.

Inflation is expected to accelerate in 2026 despite slower growth. This reflects the impact of higher global energy prices and transport costs associated with the Middle East conflict. Average inflation is projected to increase to 3.8% in 2026 before easing to 3.2% in 2027, as pressures gradually subside. Monetary policy is expected to remain cautious while continuing to support growth. Month-on-month inflation is expected to approach the upper bound of the central bank's target band of 3.0% ±1.0 percentage point at the end of 2026.

Fiscal policy will be more expansionary in 2026. The 2026 budget targets a deficit equal to 4.5% of GDP, narrowing further to 3.5% in 2027. Ongoing improvements in tax administration and legislation will support overall revenue, projected at 25.8% of GDP. Expenditure is forecast to reach the equivalent of 30.3% of GDP in 2026, with continued priority for social sectors and capital outlays, the latter projected at about 5.8% of GDP. Assuming no potential exchange rate pressures on the Armenian dram from elevated external uncertainties, public debt is projected at 51.5% of GDP by end 2026 and stabilizing around 52% of GDP over the medium term.

The current account deficit is projected to widen to about 6.1% of GDP in 2026 before narrowing to 5.6% in 2027. This reflects the impact of the Middle East conflict through higher transport costs, trade disruptions, and elevated import prices. The merchandise trade deficit is projected to widen to about 10.7% GDP in 2026 and 2027, amid export market and supply chain disruptions. Merchandise exports are projected to grow by 11.0% in 2026 and 17.9% in 2027, driven by higher exports of base metals, manufactured goods and processed food items. Merchandise imports are projected to increase by 15.9% in 2026 and 15.7% in 2027 as imports of capital goods are sustained for large public and private investment projects. The surplus in services is expected to narrow in 2026 before recovering in 2027, reflecting weaker tourism, softer financial flows, and pressures on transport services from conflict. The income deficit is expected to narrow gradually as subdued income payments to nonresidents reduce net outflows and earnings moderate.

Policy Challenge—Advancing Capital Market Reforms for Economic Diversification

Armenia's capital market has changed significantly in recent years, marked by a series of reforms aimed at deepening market activity and supporting economic diversification. The reforms have focused on strengthening market infrastructure, expanding the investor base, and integrating sustainable finance standards. Despite these achievements, Armenia's capital market remains shallow and underdeveloped, dominated by government securities. Corporate bonds and equities represent only a small share of activity, with the investor base concentrated among banks and pension funds and limited participation from foreign and retail investors.

To address challenges and build a more diversified and growth oriented financial system, Armenia has launched a broad initiative to strengthen and develop its capital market. The aim is to expand available instruments, attract a wider and more diverse investor base, enhance governance and transparency, and embed sustainability considerations into long-term private sector financing.

The government has strengthened Armenia's capital market infrastructure and expanded the range of available financial instruments. Bond switch auctions have been made fully operational, and market making rules for corporate bonds and inflation indexed securities have been introduced. The legal framework has been modernized to support new financial instruments, clarify share classes, and improve governance standards, while regulations for derivatives and digital assets were strengthened through the adoption of the first comprehensive crypto asset law.

The government has broadened the investor base and reinforced corporate governance practices in the capital market. Investment funds can now transition from non-public to public status, and remote membership has been introduced to facilitate participation by foreign investors. Governance frameworks were strengthened with a new corporate governance code and the introduction of gender diversity and enhanced disclosure requirements for listed companies.

Integrating sustainable finance and environmental, social, and governance standards across the financial system has also advanced. The government has adopted the national Green Taxonomy and Sustainable Finance Roadmap, along with environmental, social, and governance and climate risk considerations incorporating into prudential and reporting frameworks. Financial institutions are now required to embed climate and environmental risks into their governance, strategy, and risk management processes.

Development of the capital market is considered crucial for increasing the availability of long-term financing and supporting investment, economic diversification, and sustainable growth. Further progress will require expanding access to capital market financing for corporates, infrastructure companies, municipalities, and state-owned enterprises; deepening nongovernment securities markets; broadening domestic, foreign, and retail investor participation; and addressing remaining regulatory, institutional, and capacity constraints. Strengthening financial literacy, improving market liquidity, and ensuring consistent implementation of governance, disclosure, and sustainability standards will be essential to support a more diversified and resilient capital market.

AZERBAIJAN

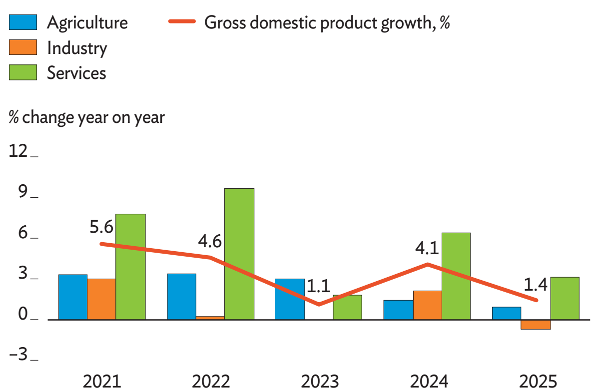
Growth slowed in 2025, reflecting contraction in hydrocarbons and lower-than-expected non-hydrocarbon growth. Inflation increased as prices for food, other goods, and services rose and administered prices were adjusted upward. Growth is forecast to recover modestly in 2026 before decelerating again in 2027 as declining oil production constrains overall economic activity. Inflation is expected to begin easing in 2027, primarily as the impact of cost-push pressures fades. These forecasts are subject to a very high degree of uncertainty. Strengthening small businesses is a key policy challenge.

Economic Performance

Growth fell from 4.1% in 2024 to 1.4% in 2025, driven by a contraction in the hydrocarbon sector (Figure 2.2.1). Growth in services, which account for nearly 45% of GDP, also decelerated, falling from 6.4% in 2024 to 3.1% on weaker transportation, tourism, and communications sectors. Industry contracted by 0.7%, reversing 2.1% growth in 2024, as crude oil production declined by 4.8%, partially offset by a 0.7% increase in gas output, while construction fell by 0.4%, following 9.6% expansion in 2024. Agricultural growth moderated from 1.4% to 0.9%, with livestock growth slowing to 0.3% and crop production growth easing to 1.5%.

Figure 2.2.1 Supply-Side Growth

Growth fell in 2025, with slowdowns in all sectors.



Source: State Statistical Committee of the Republic of Azerbaijan.

Consumption remained the main driver of demand-side growth. Private consumption expanded by 4.8%, unchanged from 2024, while total investment contracted by 5.6% following a 0.7% drop in 2024, reflecting a 10.3% decline in hydrocarbon-related investment and a 3.9% contraction in non-hydrocarbon investment. As in 2024, net exports subtracted from growth, driven by stronger import demand.

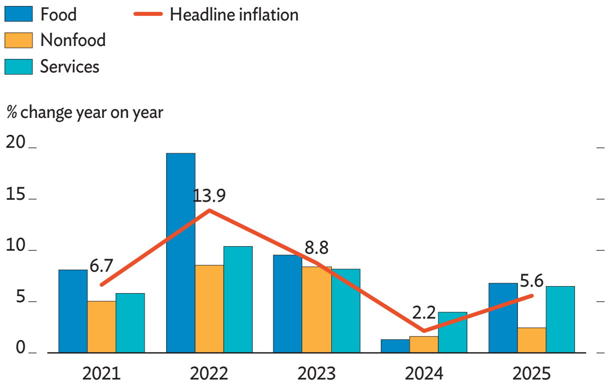
Inflation increased in 2025, driven by higher prices for food, other goods, and services. Average annual inflation rose from 2.2% in 2024 to 5.6% in 2025 (Figure 2.2.2), on higher inflation for food (from 1.3% to 6.8%), other goods (from 1.6% to 2.5%), and services (from 4.0% to 6.5%). Upward adjustments to administered prices in January and October 2025 contributed to overall inflation during the year. Nonetheless, the Central Bank of Azerbaijan lowered its policy rate to 6.75% by December, in two steps, from 7.25% in July, as the central bank anticipated inflation will remain within its target range (4%+/-2%).

The Azerbaijani manat remained stable against the US dollar, while the nominal effective exchange rate (NEER) depreciated. Appreciation of currencies in several trading partners contributed to a 5.2% decline in the NEER. This change was partially passed through to import prices, which, in turn, helped raise domestic

This chapter was written by Khagani Karimov and Elvin Imanov of the Azerbaijan Resident Mission, ADB, Baku.

Figure 2.2.2 Inflation

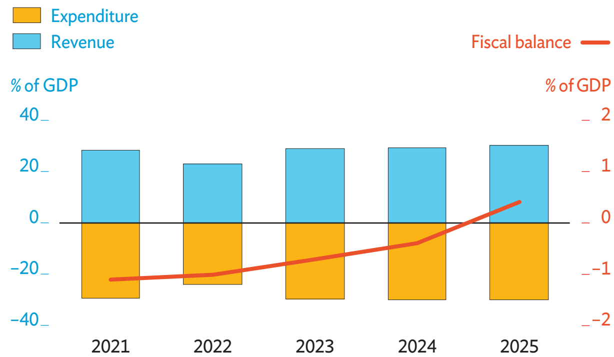
Inflation rose in 2025, with increases in all components.



Source: State Statistical Committee of the Republic of Azerbaijan.

Figure 2.2.3 Fiscal Indicators

The budget moved into surplus in 2025 as revenue grew faster than expenditure.



GDP = gross domestic product.

Source: The Ministry of Finance of the Republic of Azerbaijan.

prices. The real effective exchange rate depreciated by 7.7%, potentially enhancing the economy's external competitiveness.

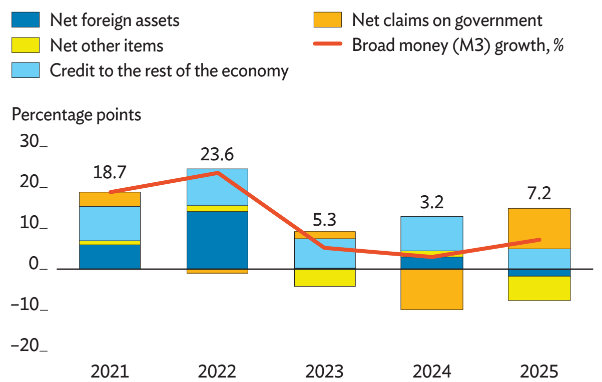
The fiscal position strengthened, with the overall balance moving to a surplus of 0.4% of GDP in 2025 from a deficit of 0.4% in 2024 (Figure 2.2.3). Budget revenue increased by 5.3% from 29.4% of GDP in 2024 to 30.3% in 2025, driven by higher tax revenue and larger transfers from the Sovereign Wealth Fund of Azerbaijan. Despite a 2.4% rise in total expenditure, the expenditure-to-GDP ratio remained unchanged at 29.9%. External public debt declined by 6.2% to $4.8 billion, equivalent to 6.3% of GDP, while domestic public debt fell by 4.6%, trimming domestic debt to 13.8% of GDP from 14.8% at the end of 2024.

Broad money growth accelerated in 2025, driven by a rise in net claims on the government (Figure 2.2.4). Although the expansion in net foreign assets slowed, growth in both net claims on the government and credit to the economy—rising by 9.7% and 5.1% of broad money, respectively—helped double the growth in broad money from 3.2% in 2024 to 7.2% in 2025. Total bank deposits rose by 4.0%, with local currency deposits increasing by 6.0%. Credit to the economy expanded by 9.0%, while nonperforming loans edged up slightly from 1.5% of total credit to 1.6% at the end of 2025. Overall, the share of loans and deposits in foreign currency both decreased.

The current account surplus narrowed from 6.3% of GDP in 2024 to 4.6% in 2025, as oil and gas exports declined and imports increased. The merchandise trade surplus fell from $8.8 billion to $6.4 billion, as exports declined by 7.4% and imports rose by 3.1%, driven by domestic demand associated with non-hydrocarbon sector growth. The services deficit declined by 19.1%, from $2.1 billion to $1.7 billion, supported by higher transport service exports. Combined reserves of the central bank and the sovereign wealth fund rose by 19.8% to $85.0 billion (114.0% of GDP) from $71.0 billion at end-2024 (Figure 2.2.5). Sovereign wealth fund reserves increased by 22.5%, while central bank reserves increased by 5.1% to $11.5 billion, cover for 7.8 months of imports. The increase in sovereign wealth fund reserves largely reflected higher gold purchases, with the share of gold in assets rising from 20.6% to 38.2% over the year.

Figure 2.2.4 Broad Money Growth

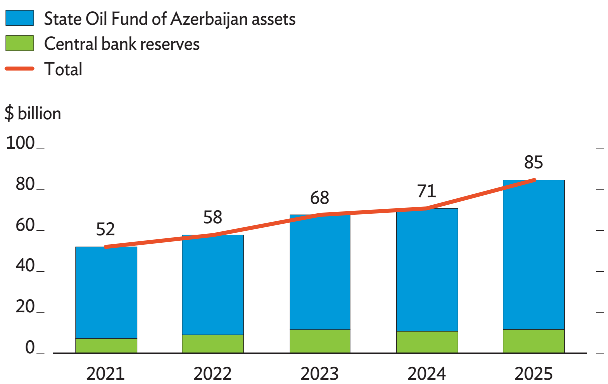
Broad money growth accelerated in 2025, with higher net claims on government.



Source: Central Bank of the Republic of Azerbaijan.

Figure 2.2.5 International Reserves

Total international reserves rose further in 2025.



Sources: Central Bank of the Republic of Azerbaijan; State Oil Fund of the Republic of Azerbaijan.

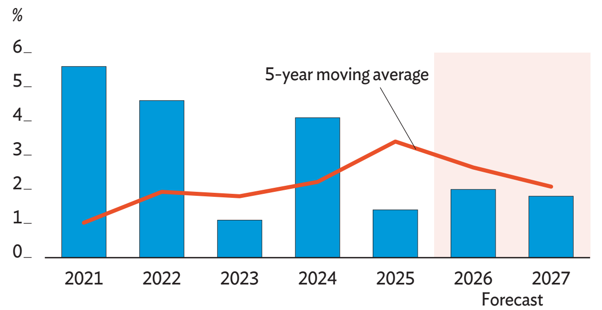
Economic Prospects

Growth is forecast at 2.0% in 2026 due to potentially higher government expenditure. It is expected to moderate to 1.8% in 2027, reflecting an expected decline in hydrocarbon production (Table 2.2.1 and Figure 2.2.6). While overall government expenditure is set to increase, lower investment spending may constrain economic growth. The anticipated contraction in oil production is likely to offset expansion in the non-hydrocarbon sector. In 2026 and 2027, services are projected to expand by 3.5% and 3.4%, and agriculture by 1.4% and 1.0%, while industry is expected to contract modestly by 0.2% and 0.1%, respectively.

Inflation is projected to decline starting in 2027, but is subject to a high degree of uncertainty, due to global geopolitical risks and supply-side disruptions (Figure 2.2.7). Increases in certain utility and transport prices in January 2025, further transport price adjustments in October 2025, and a rise in gasoline prices in January 2026 are expected to

Figure 2.2.6 Growth Forecast

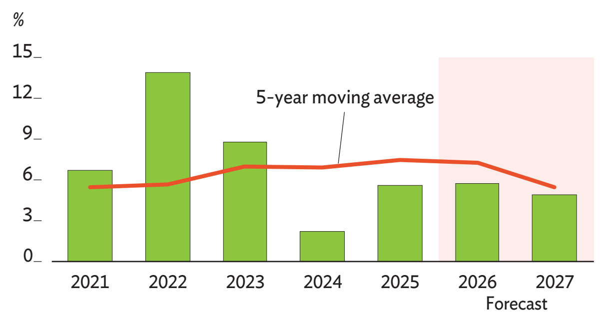
Growth is projected to rise in 2026 before declining in 2027.



Sources: State Statistical Committee of the Republic of Azerbaijan; Asian Development Bank estimates.

Figure 2.2.7 Inflation Forecast

Inflation will rise slightly in 2026 before declining in 2027.



Sources: State Statistical Committee of the Republic of Azerbaijan; Asian Development Bank estimates.

generate inflationary pressures. While the impact of these administrative price adjustments is projected to diminish over the year, inflation is expected to be 5.7% in 2026, due to higher import prices linked to elevated hydrocarbon prices in the global market. In 2027, inflation is projected to moderate to 4.9% if declining hydrocarbon prices lower inflation in trading partners and hence reduce imported inflation.

The government budget deficit is expected to rise to 2.2% of GDP in 2026 and then decline slightly to 2.1% in 2027. These trends reflect slower revenue growth alongside higher government spending. Total revenue is projected at 28.1% of GDP in 2026, including tax revenue of 12.3%, nontax revenue of 6.5%, and transfers from the sovereign wealth fund of 9.3%. Government spending is expected to reach 30.3% of GDP, with 18.3% for current spending and 10.2% for capital investment. Smaller transfers from the sovereign wealth fund are expected to be partly offset by higher tax revenues, mainly from a rise

Table 2.2.1 Selected Economic Indicators, %

Growth and inflation will both rise in 2026 before declining in 2027.

	2024	2025	2026	2027
GDP growth	4.1	1.4	2.0	1.8
Inflation	2.2	5.6	5.7	4.9

GDP = gross domestic product.

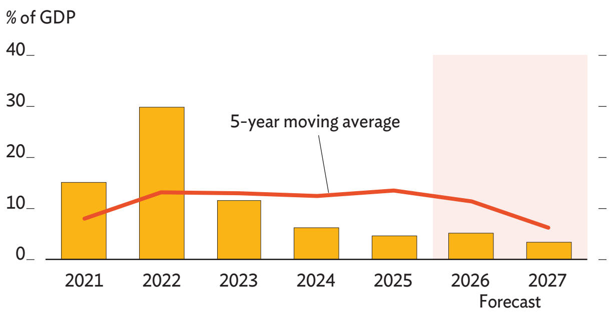
Sources: State Statistical Committee of the Republic of Azerbaijan; Asian Development Bank estimates.

in income taxes starting in January 2026. Higher hydrocarbon prices are expected to increase state budget revenues.

The current account surplus is projected to widen in 2026, then narrow in 2027, largely due to developments in hydrocarbon prices (Figure 2.2.8). Despite declining oil production, higher hydrocarbon prices are expected to increase energy export revenues in 2026, raising the current account surplus to 5.3% of GDP. In 2027, however, lower prices are projected to reduce export revenues, and continued economic growth is expected to support import demand, trimming the current account surplus to 3.5% of GDP.

Figure 2.2.8 Current Account Forecast

The current account surplus will widen in 2026 and narrow in 2027.



GDP = gross domestic product.

Sources: Central Bank of the Republic of Azerbaijan; Asian Development Bank estimates.

Policy Challenge—Strengthening Development and Access to Finance for Micro, Small, and Medium-Sized Enterprises

Small businesses are important in Azerbaijan's efforts to diversify its economy, but structural and financial challenges constrain their growth. Micro, small, and medium-sized enterprises (MSMEs) employ a large share of the workforce and make a meaningful contribution to total output, with services—particularly trade, hospitality, and transport—dominating the sector. Despite recent progress, MSMEs still fall well short of the government's medium-term target for their contribution to the economy, highlighting the need for focused policies to raise productivity, strengthen competitiveness, and improve access to markets.

Ongoing institutional reforms are strengthening state support for MSMEs. Public support mechanisms have been streamlined to improve access to finance and investment, while business development programs provide practical tools, startup incentives, and training to help firms build capacity and adopt green and digital practices. Targeted initiatives have focused on supporting women entrepreneurs and environmentally sustainable projects. At the same time, authorities have introduced new financial measures to encourage green lending and reduce foreign exchange risks, helping to lower borrowing costs and attract additional funding for small businesses.

Recent policy and regulatory reforms support these efforts by improving the overall business environment. New legal frameworks aim to promote fair competition, expand opportunities for small firms in public procurement, and reduce administrative burdens. Digital initiatives and programs targeting young entrepreneurs are helping to encourage innovation and broaden participation in non-oil sectors. In addition, export support measures are helping small businesses access international markets and strengthen non-oil exports.

Limited access to finance remains a major challenge for MSMEs. Bank lending to small businesses and their share of total credit continue to reflect higher interest rates and tighter lending conditions. Microfinance institutions provide some support, but their lending remains small in scale and is largely concentrated on consumer credit rather than business investment. Government credit guarantee schemes have expanded and offer important backing for MSMEs, although their impact is constrained by coverage limits. At the same time, the share of foreign-currency lending has fallen, in line with efforts to promote local-currency financing. These developments point to the need for new financing tools, stronger risk-sharing arrangements, and better credit assessment to improve MSME access to affordable finance.

Despite progress, the sector still faces challenges, especially in financial literacy, access to credit, and availability of collateral, particularly outside major cities. Expanding local credit systems, promoting asset-based lending, and improving access to equity can help unlock MSME potential. Greater participation of women and youth in entrepreneurship, along with incentives for green initiatives, can support economic diversification and productivity. Addressing skills mismatches and shortages, as well as promoting greater adoption of modern technologies, could help mitigate challenges in the sector. Reliable financing, strong institutional support, and better market access are essential for MSMEs to contribute fully to inclusive growth and national development goals.

GEORGIA

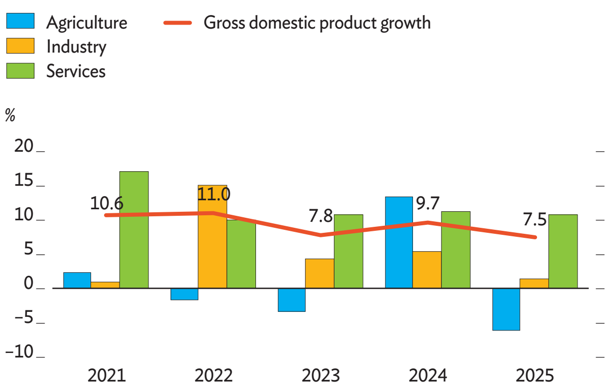
Expansion slowed in 2025 with lower growth in services and industry and contraction in agriculture. Sharply higher food prices boosted inflation, while increased service exports and lower oil prices narrowed the current account deficit. Under the early stabilization scenario, growth is projected to moderate further, reflecting a slowdown in services driven by weaker external demand in 2026 and declining domestic consumption in 2027 as the contribution from Russian migrants diminishes. A sustained conflict in the Middle East would significantly slow growth and contribute to inflationary risks. Strengthening policy coordination to expand participation in global value chains (GVCs) and narrowing infrastructure gaps would help support overall development.

Economic Performance

Growth stayed robust in 2025 but moderated to an estimated 7.5% from 9.7% in 2024, reflecting slower expansion in services and industry and contraction in agriculture (Figure 2.3.1). On the supply side, growth was led by services, where expansion slowed to 10.8% from 11.2% in 2024, with growth decreasing to 2.7% from 9.3% in wholesale and retail trade and to 8.8% from 15.5% in public administration and defense. This was despite gains of 30.1% in information and communication, 8.1% in transport and storage, and 25.6% in education. Growth in industry slowed to 1.4% from 5.4% in 2024, as expansion in construction fell from double digits to 0.2%, although gains in manufacturing rose from 3.9% to 4.2%. Agriculture contracted by 6.1%, as continued migration to urban areas cut farm employment. Continued strong growth cut the unemployment rate to 13.9%.

Figure 2.3.1 Gross Domestic Product Growth by Sector

Growth was driven by expansion in services and industry in 2025.



Source: National Statistics Office of Georgia.

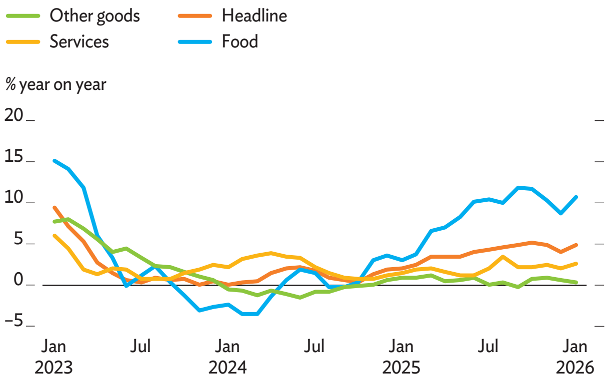
On the demand side, consumption remained the primary growth driver, helped by continued if slower credit expansion and the contribution of Russian migrants. Private consumption grew by 7.4%, down from 9.4% in 2024. This occurred as credit growth slowed to 17.0% from 22.5% with restrictions on unhedged borrowing, despite continued high remittances and rising tourism revenues. Investment showed little growth as lower infrastructure spending offset higher private investment. Net exports contributed to growth as stronger-than-expected global demand boosted service exports, despite higher merchandise imports.

Average inflation accelerated to 3.9% from 1.1% in 2024, reflecting higher food prices. Food prices jumped by 8.5% after showing little change in 2024 (Figure 2.3.2). Prices of other goods rose marginally, by 0.6%, after declining in 2024, while inflation for services

This chapter was written by George Luarsabishvili and Maya Grigolia of the Georgia Resident Mission, ADB, Tbilisi.

Figure 2.3.2 Monthly Inflation

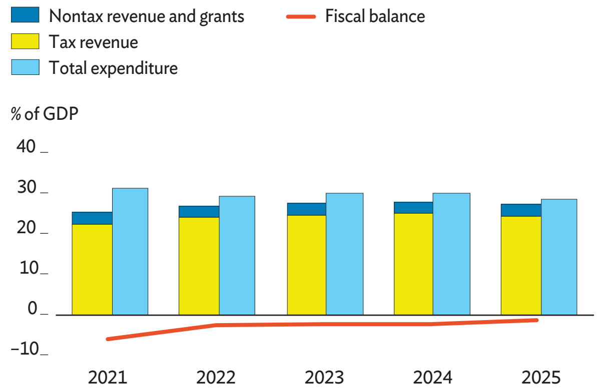
Rapid increases in inflation for food raised headline inflation above 3% in 2025.



Source: National Statistics Office of Georgia.

Figure 2.3.3 Fiscal Indicators

Higher revenue and reduced expenditure trimmed the fiscal deficit in 2025.

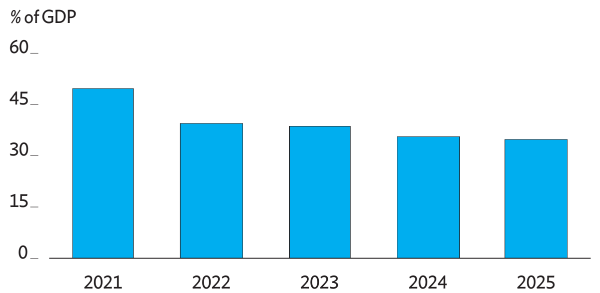


GDP = gross domestic product.

Sources: Ministry of Finance of Georgia; International Monetary Fund.

Figure 2.3.4 Government Gross Debt

Public debt continued to decline as a percentage of GDP.



GDP = gross domestic product.

Sources: Ministry of Finance of Georgia; International Monetary Fund.

remained at about 2.0%, with transport prices falling by 1.9% from lower global oil prices. Core inflation—excluding food and nonalcoholic beverages, tobacco, energy, and regulated tariffs—stood at 2.2%, below the central bank's 3% target. The National Bank of Georgia, the central bank, kept its policy rate at 8.0% throughout 2025. The lari remained broadly stable against the US dollar but appreciated by 16.0% vis-à-vis the Turkish lira while depreciating by 5.1% against the euro. The real exchange rate depreciated by 5.0% in 2025, contributing to higher imported inflation but improving export competitiveness.

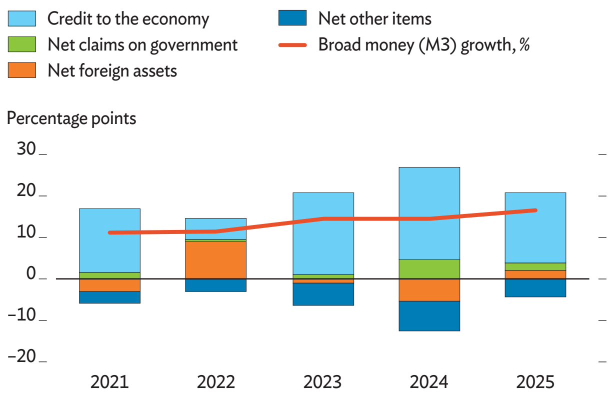
The fiscal deficit narrowed to 1.2% of GDP from 2.2% in 2024, as the growth in public infrastructure spending slowed and tax revenues increased. Budget revenue rose by 10.7%, while expenditure grew by 7.0%, driven partly by higher spending on salaries for public employees, which increased by about 14.3% (Figure 2.3.3). As a share of GDP, revenue amounted to 27.1%, down from 27.7% in 2024. Expenditure declined to 28.3% of GDP from 29.9% in 2024. Public debt fell from 35.7% in 2024 to under 35% (Figure 2.3.4). Georgia successfully rolled over its $500 million Eurobond in January 2026, ahead of schedule, at a coupon rate below the implied country risk premium, with strong foreign investor interest leading to an oversubscribed issuance.

Monetary policy became less restrictive, as lower real interest rates promoted local currency use while an enhanced risk-based supervisory framework limited liquidity mismatches. Broad money growth accelerated to 16.6% from 14.5% in 2024, driven by a rapid increase in net foreign assets and accumulation of foreign exchange reserves, although the growth in credit to the economy slowed to 17.0% from 22.5% (Figure 2.3.5). Market lending rates remained broadly unchanged at 12.9%, and deposit rates remained around 7.5%. Dollarization declined for both deposits and loans (Figure 2.3.6). Nonperforming loans remained low at 2.6%, underpinning strong asset quality, while returns on assets and equity remained high at 3.8% and 22.5%, respectively. Capital adequacy at 20.1% complemented sound bank profitability.

The current account deficit narrowed to a record low of less than 3.0% of GDP, reflecting higher service exports, strong merchandise re-exports, and lower oil import payments from declining global oil prices (Figure 2.3.7). Merchandise export growth rose to

Figure 2.3.5 Contributions to M3 Broad Money Growth

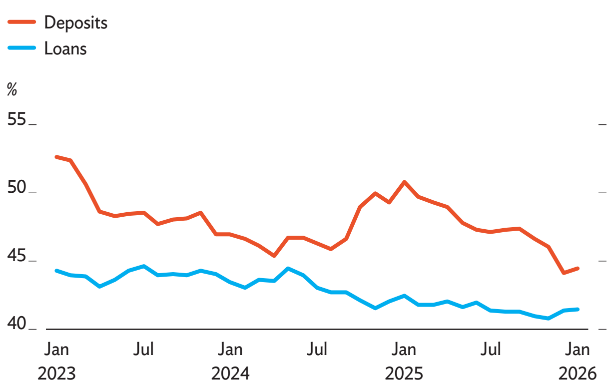
Credit growth decelerated due to reduced unhedged borrowing.



Source: National Bank of Georgia.

Figure 2.3.6 Dollarization in the Banking System

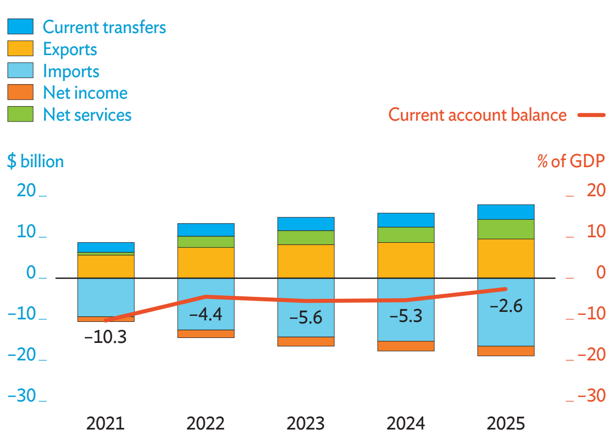
The percentage of loans and deposits in foreign currency declined, both still remaining substantial.



Source: National Bank of Georgia.

Figure 2.3.7 Current Account Components

The current account deficit narrowed in 2025.

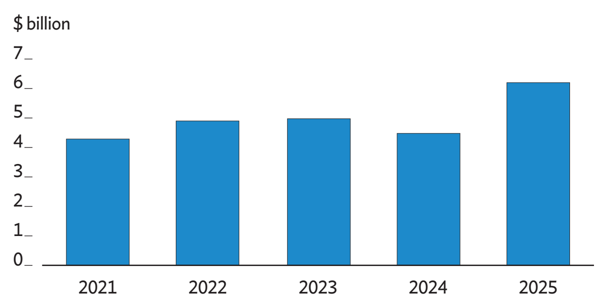


GDP = gross domestic product.
Source: National Bank of Georgia.

10.8% from 6.2% in 2024, as currency depreciation and greater integration of Georgian exporters into European markets boosted exports to the European Union (EU) by 52.8%. Exports to Russia grew by 10.3%, though imports also increased due to cheaper oil. Exports to Türkiye fell by 27.4%, reflecting Georgia's currency strength relative to the lira. Import growth rose to 7.7% from 7.0% in 2024 as imports from the United States grew by 32.9%, largely driven by continued imports of vehicles for re-export, while imports from the EU grew more slowly. Growth in services jumped to 13.5% from 8.8% in 2024, as revenue from tourism rose by 6.0% to a record $4.7 billion, surpassing remittances, as visitor arrivals rose by 6.2%. Money transfers rose by 7.1%, reversing a decline in 2024, as higher remittances from the United States and Europe offset a decline from Russia. Gross international reserves grew by 27.8% to a record $6.2 billion, reaching 100% of the International Monetary Fund's Assessing Reserve Adequacy metric. This reflects strong foreign exchange inflows and a revaluation of gold reserves (Figure 2.3.8). Foreign direct investment increased by 7.6% to $1.7 billion.

Figure 2.3.8 Gross International Reserves

Reserves jumped in 2025.



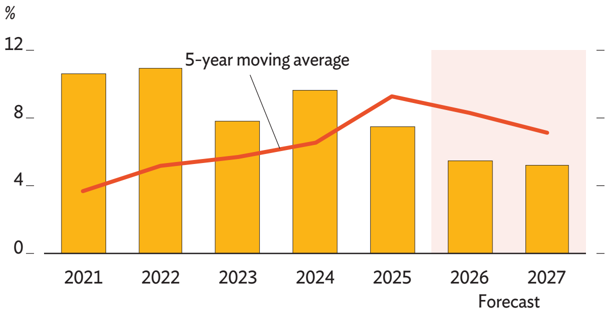
Sources: National Bank of Georgia; International Monetary Fund.

Economic Prospects

Growth is projected to continue in 2026 and 2027 but slow further, because of global headwinds. If the conflict in the Middle East is prolonged, and energy prices remain elevated while supply disruptions persist, growth could slow further. Under the early stabilization scenario, finalized on 10 March, growth is forecast to decline to 5.5% in 2026 with slower expansion in Europe and to 5.2% in 2027 as domestic consumption slows with waning contributions from Russian migrants (Figure 2.3.9 and Table 2.3.1). Eurozone weakness and uncertainty among key trading partners are likely to

Figure 2.3.9 Gross Domestic Product Growth

Growth will slow to more typical levels during 2026–2027.



Sources: National Statistics Office of Georgia; Asian Development Bank estimates.

Table 2.3.1 Selected Economic Indicators, %

Growth and inflation are expected to slow in 2026 and 2027.

	2024	2025	2026	2027
GDP growth	9.7	7.5	5.5	5.2
Inflation	1.1	3.9	3.8	3.3

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

limit external demand. Growth in industry is projected rising to 2.4% in 2026 with a pickup in construction and to 2.0% in 2027 with steady manufacturing expansion. Growth in services will remain strong but slow to 7.5% in 2026 with continued but slower expansion in transport and storage and in wholesale and retail trade and to 6.8% in 2027 from sustained but moderating growth in information and communication. The contraction in agriculture is projected to ease in 2026 even as sector employment continues to fall, with growth resuming in 2027 at 1.7% as improvements in irrigation and crop systems boost productivity and climate resilience.

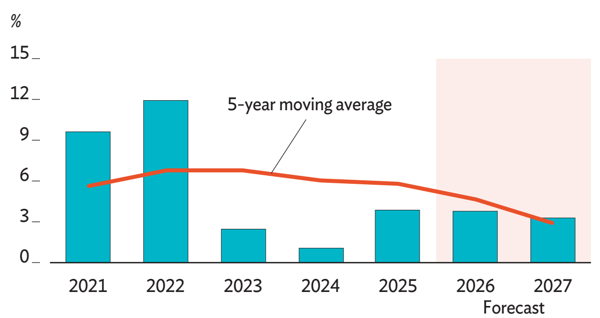
On the demand side, expansion in private consumption will slow further. Growth in private consumption is projected to fall to 5.2% in 2026 as credit growth slows, and to 4.8% in 2027 as Russian migrants start to depart and weaker foreign inflows diminish household spending. Investment is projected to grow by 2.5% in 2026 as inventories are rebuilt and public infrastructure spending expands, and by 1.8% in 2027 as increased investment in plant and equipment offsets a moderation in current spending. Net exports are expected to make a small positive contribution to growth, despite a slowdown in service export growth.

Georgia's suspension of the EU accession process and the EU's calls for course correction may create bottlenecks that weaken export performance and deter investment.

Inflation is projected to ease with lower domestic food prices, but increased global energy prices may add to inflationary pressures. Barring major shocks, inflation is expected to start slowing in the second quarter of 2026 and reach 3.8% for the year (Figure 2.3.10). Inflation is projected to slow further to about 3.3% in 2027, reflecting improved labor productivity, absent supply shocks that could lead to cost-push inflation. Broad money growth is expected to moderate to 15.0% in 2026 as credit growth decelerates, with unhedged borrowers facing still tighter limits, and rise to 15.5% in 2027 as credit expands. However, inflation could be higher in the event of sharp currency depreciation, higher oil or transport prices, or a recurrence of supply-chain disruptions from regional conflicts, including in the Middle East.

Figure 2.3.10 Inflation

Inflation will decline slowly.

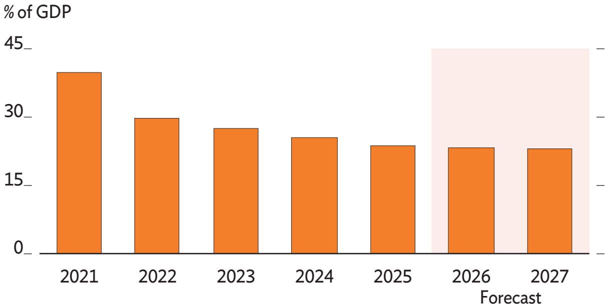


Sources: National Bank of Georgia; Asian Development Bank estimates.

Fiscal policy will become slightly more expansionary. The budget deficit is projected to widen to 2.0% of GDP in 2026, with accelerating investment spending, and rise further to 2.2% in 2027 amid still higher capital expenditure. Revenues are projected to increase to 27.5% of GDP in 2026 because of strong tax performance and 27.7% in 2027 with efforts to improve tax administration and raise excises. Continued fiscal discipline is expected to keep public debt below 35% of GDP together with declining external debt in both years (Figure 2.3.11). Georgia is expected to retain access to international capital markets at favorable terms, though institutional uncertainties may undermine investor confidence and increase the risk of policy slippages.

Figure 2.3.11 Government External Debt

External public debt will continue to decline as a percentage of GDP.



GDP = gross domestic product.

Sources: Ministry of Finance of Georgia; International Monetary Fund; Asian Development Bank estimates.

The current account deficit is expected to widen as export growth slows. Growth in service exports is projected to decline to 6.8% in 2026 with global uncertainties before rising to 7.2% in 2027, benefiting from transportation services and personal travel. Merchandise export growth is projected as slowing to 7.9% in 2026 as vehicle re-exports begin to normalize, before rising to 8.7% in 2027 as trade realigns to new markets. Growth in imports of goods and services is expected to decelerate to 6.6% in 2026 because of trade tensions before rising again in 2027 as geopolitical pressures abate. Money transfers are projected to fall by 7.6% in 2026 from declining inflows from Russian migrants before rebounding in 2027 on stronger transfers from other regions. Tourism revenues are expected to remain steady under the early stabilization scenario, but could weaken if geopolitical tensions in the Middle East intensify or disruptions persist.

Downside risks have intensified significantly, driven primarily by the ongoing and potentially prolonged conflict in the Middle East, which heightens the risk of supply disruptions and further increases in oil prices. Continued regional tensions could lead to economic dislocations, weakening the pace of global recovery and adding to inflationary pressures. If these conditions persist or intensify, outcomes could be weaker than projected. Elevated oil prices may further increase inflation, while disruptions to transit and a weakening of tourism are likely to widen Georgia's current account deficit. Conversely, if the early stabilization scenario materializes, outcomes would align with the projections.

Policy Challenge—Strengthening Policy Coordination for Expanding GVC Participation

Since the 1990s, GVCs have given governments new ways to transition from import substitution and protectionist industrial policies. Today, GVCs account for more than 50% of all global trade and remain crucial for both advanced economies and emerging markets. Like many other economies, Georgia faces various constraints that hinder greater participation in GVCs. These include coordination and infrastructure gaps, limited access to markets due to stringent standards and regulatory requirements, insufficient knowledge spillovers, and limited technology transfers. Recent global developments, reflecting global trade wars and rising US tariffs, have created further uncertainty. At the same time, disruptions arising from the Russian invasion of Ukraine have accelerated the diversification of trade routes and redirected trade flows, creating new opportunities for strategically positioned economies. These developments have made strengthening linkages with regional and global trading partners essential to increase GVC participation and enhance economies of scale.

Georgia aspires to be a regional transport, trade, and logistics hub for global value chains. The government has prioritized measures supporting regional and global economic integration. The country offers a liberal business environment, an open trade regime supported by an expanding network of free trade agreements, strong macroeconomic performance, and demonstrated rapid growth. Reforms in customs procedures, logistics, digitalization, rail and port infrastructure, and multimodal transport have strengthened the country's position as a transit and trade gateway. Strong contract enforcement, secure property rights, investor protections, flexible labor legislation, efficient dispute resolution, free capital movement, and a liberal tax regime further enhance its competitiveness.

Georgia can benefit from adopting more comprehensive approaches to deepening its engagement in GVCs. Logistics offer significant potential for GVC integration by creating new trade opportunities, stimulating cluster development, and supporting integrated economic zones. Tourism-related supply chains and greater investor mobilization can reinforce real estate and location-based development that aligns with GVCs. Expanding collaboration with foreign firms, financiers, and knowledge centers, and ensuring full alignment with EU standards—including their gradual adoption by small and medium enterprises—will help expand access to market intelligence and technological capabilities. Active government facilitation will be critical in this process. External actors, including nongovernmental organizations, can contribute to this process by providing networking support to help Georgia move up the value chain. Deepening multilateral engagement will further stimulate growth, create better jobs, and reduce poverty. With open and predictable policies from industrialized partners, the country can leverage its strategic location and institutional strengths to enhance its supplier networks and advance upstream in GVCs.

KAZAKHSTAN

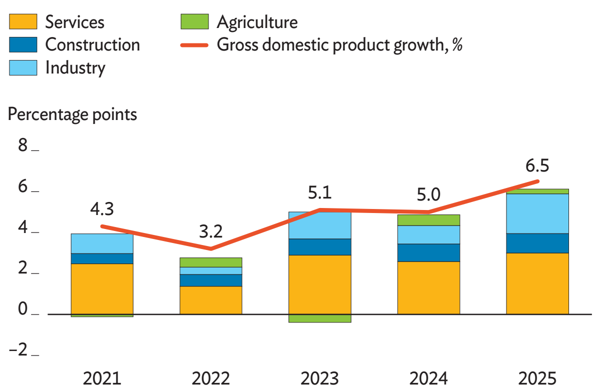
Growth accelerated in 2025 on higher oil production and state-supported investment. Inflation reached double digits despite a tight monetary policy stance. Growth is expected to slow in 2026 and 2027 as oil production plateaus and private demand softens. Inflation is projected to ease gradually to single digits by 2027 as monetary policy remains tight and tax pressures fade. Advancing fiscal decentralization would promote revenue autonomy among subnational governments and their ability to match spending with local development needs.

Economic Performance

Growth accelerated from 5.0% in 2024 to 6.5% in 2025, driven by higher oil production, state-led infrastructure projects, and fiscal stimulus (Figure 2.4.1). On the supply side, mining expanded by 9.4% after marginal growth in 2024, as oil output rose by 13.3% following the ramp-up of the Tengiz Oil Field's Future Growth Project. Total oil output reached 99.4 million tons, with Kazakhstan exceeding its monthly quotas under the Organization of the Petroleum Exporting Countries and its partners (OPEC+). Underpinned by large state-financed infrastructure projects, expansion in construction accelerated from 15.3% to 15.9%. Manufacturing growth moderated from 6.8% to 6.4%, as metallurgical output weakened. Expansion in services accelerated from 4.6% to 5.2%, led by gains of 20.4% in transport and warehousing, on higher cargo volumes and transit flows from oil expansion. Trade again grew by 8.9%, with wholesale trade rising on strong demand for non-industrial goods. Communications slowed from 5.5% to 3.6% as mobile and other services weakened. Growth in agriculture slowed from 13.7% to 5.9%, reflecting smaller gains in both livestock and crop production.

Figure 2.4.1 Supply-Side Contributions to Growth

Growth accelerated in 2025 due to higher oil production and state infrastructure spending.



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

On the demand side, growth reflected gains in private consumption and particularly investment. Demand-side data, available only for the first 9 months of 2025, show that consumption growth accelerated to 8.4% from 5.0% in the comparable period of 2024. Private consumption rose by 9.3%, despite a 0.5% decline in real household income, suggesting that increased borrowing supported spending. Government consumption rose by 5.1%, reversing contraction in the comparable period of 2024. Growth in investment rebounded from 1.7% to 10.6%, with infrastructure spending boosting gross fixed capital formation by 10.8%. Net exports contracted, as exports rose only

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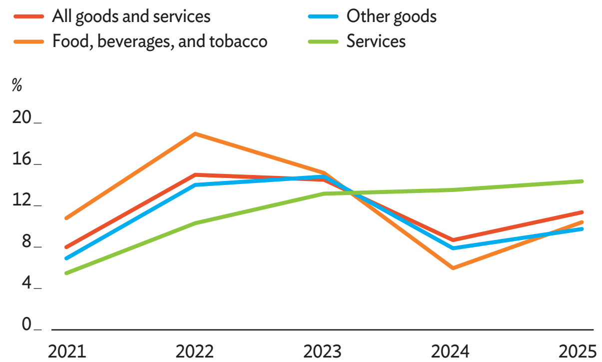
marginally while imports rose by 8.0%. The direct impact on Kazakhstan from new US tariffs was limited, given the high share of tariff-exempt commodities.

Annual average inflation accelerated from 8.7% in 2024 to 11.4% in 2025 (Figure 2.4.2). Food price inflation accelerated from 6.0% in 2024 to 13.5%, as prices on certain food categories jumped and the Kazakhstani tenge depreciated against the Russian ruble. Inflation for other goods rose from 7.9% to 9.8%, reflecting higher import costs amid strong domestic demand and the advance pass-through of the value-added tax (VAT) increase that took effect on 1 January 2026. Inflation for services increased from 13.5% to 14.4%, following regulated tariff adjustments for housing and communal services. Inflationary pressures persisted throughout 2025, driven by fiscal and quasi-fiscal stimulus and heightened inflation expectations from upcoming tax changes, but eased toward year-end due to a temporary freeze on utility and fuel prices and a firmer exchange rate. The Kazakhstani tenge averaged 521 tenge per US dollar in 2025, compared with 469 in 2024 (Figure 2.4.3). This reflected early depreciation pressures followed by a strengthening in the fourth quarter, supported by external borrowing, gold purchase mirroring operations by the National Bank of Kazakhstan—the central bank—and a high key policy rate. The central bank tightened monetary policy twice in 2025, raising the policy rate by 125 basis points in March and by a further 150 basis points in October to 18.00% (Figure 2.4.4). It indicated no scope for easing before mid-2026, while further tightening could not be ruled out without a sustained drop in inflation.

Consumer credit moderated with tighter loan restrictions. Credit growth rose from 19.8% in 2024 to 20.4%, as expansion in consumer lending slowed from 33.5% to 21.0% while corporate lending growth accelerated from 16.5% to 21.2%. Mortgage lending edged up from 14.5% to 14.6% on new government-subsidized mortgage programs (Figure 2.4.5). The rapid expansion of consumer lending in recent years, reaching 38.5% of bank loans in 2025, led to stricter prudential measures by the Agency for Regulation and Development of the Financial Market. These include a revised debt-to-income ratio cap for distressed borrowers, restrictions on uncollateralized loans, stronger income verification procedures, and tighter capital requirements for banks and microfinance institutions. With the entry of new banks, the share of nonperforming loans rose from 3.1%

Figure 2.4.2 Average Inflation

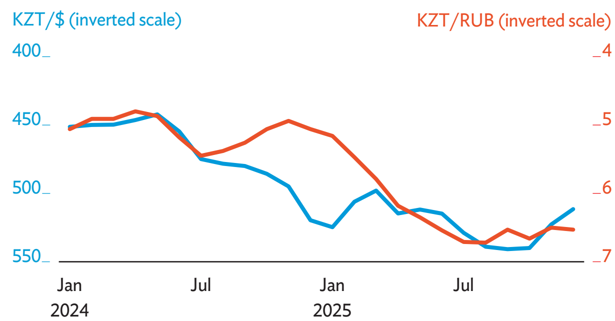
Average inflation accelerated to double digits in 2025.



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

Figure 2.4.3 Average Nominal Tenge Exchange Rate

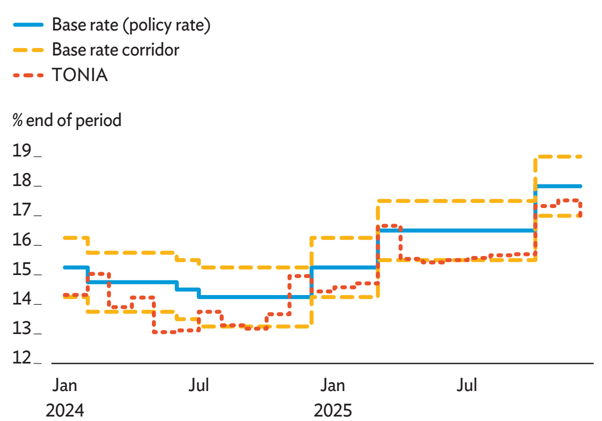
The tenge depreciated for most of 2025 before partially recovering toward year-end.



KZT = Kazakhstani tenge, RUB = Russian ruble.
Source: National Bank of the Republic of Kazakhstan.

Figure 2.4.4 Monetary Policy and Overnight Money Market Rates

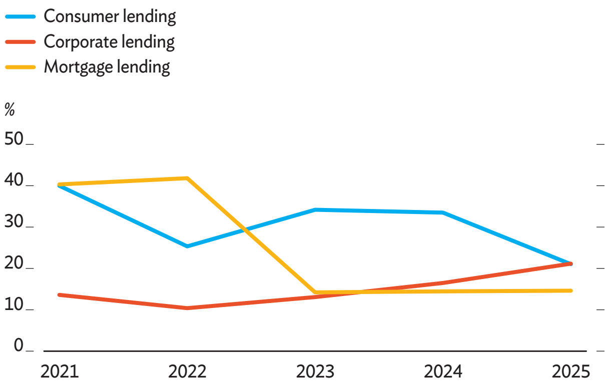
The policy rate was increased twice in 2025, with TONIA fluctuating near the lower bound of the interest rate corridor.



TONIA = Tenge Overnight Index Average.
Source: National Bank of the Republic of Kazakhstan.

Figure 2.4.5 Credit Growth

Consumer lending slowed in response to tightening prudential measures, while corporate lending accelerated.

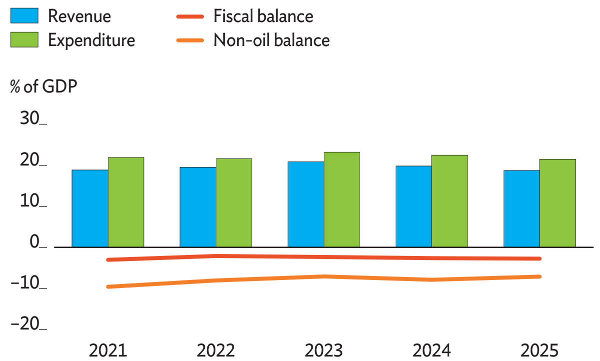


Note: Growth is the percentage change from December to December. Corporate lending includes loans to individual entrepreneurs for business purposes.

Source: National Bank of the Republic of Kazakhstan.

Figure 2.4.6 Fiscal Indicators

The fiscal deficit edged up marginally in 2025, while the non-oil deficit narrowed.



GDP = gross domestic product.

Source: Ministry of Finance of the Republic of Kazakhstan.

in 2024 to 3.6%. Credit-channel transmission remained constrained, as the Tenge Overnight Index Average traded near the lower bound of the interest rate corridor (Figure 2.4.4), while broad money (M3) growth slowed from 19.2% to 15.5%. To absorb excess liquidity, the central bank outlined an expansion of short-term note issuance and a phased increase in minimum bank reserve requirements by September 2026.

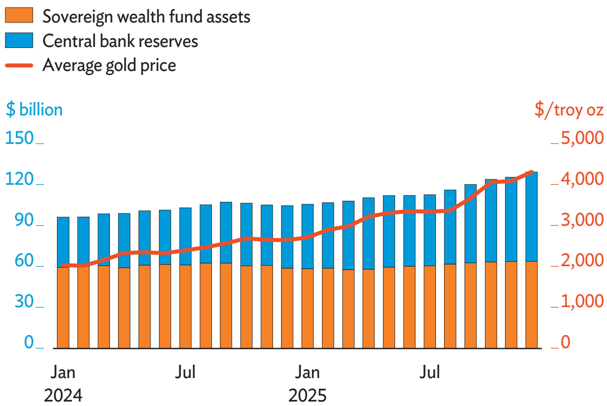
The state budget deficit widened marginally from 2.6% of GDP in 2024 to 2.7% in 2025, with the non-oil deficit narrowing from 7.9% to 7.1% (Figure 2.4.6). General government revenue rose by 10.1%, although its share of GDP declined from 19.8% to 18.7% amid strong nominal GDP growth. Central government revenue increased by 7.5%, with tax receipts rising by 17.5%, driven by gains of 18.0% in VAT and 24.1% in corporate income tax. Transfers from the National Fund of the Republic of Kazakhstan—the sovereign wealth fund—decreased by 6.3%, from 4.1% of GDP to 3.3%, as no additional transfers beyond the budgeted amount were made, unlike in 2024. General government expenditure decreased from 22.5% of GDP to 21.5%. Outlays for social services, representing more than half of total expenditure, rose by 9.2%, with increases of 5.9% for education, 11.1% for social assistance, and 13.9% for health care. Budget-financed investment in fixed capital, representing 21.9% of total investment, increased by 14.5%. Higher domestic interest rates led to an increase in the expenditure on interest payments from 1.6% of GDP to 1.7%. As a share of non-oil revenue, interest payments increased from 11.2% to 11.6%. Government and government-guaranteed debt declined from 24.7% of GDP to 24.3%.

The current account deficit widened from 2.7% of GDP in 2024 to a preliminary 3.9% as the trade surplus diminished. The trade surplus fell to 3.8% of GDP from 5.9%, as lower oil prices reduced export earnings despite higher export volumes, cutting merchandise export earnings by 1.9% to $77.5 billion. Merchandise imports expanded by 6.7% to $65.9 billion, reflecting higher purchases of machinery and equipment for investment and infrastructure projects. The services deficit remained at 0.4% of GDP, as services exports grew by 3.7% to $12.3 billion and services imports rose by 4.9% to $13.6 billion. The primary income deficit narrowed to 7.1% of GDP from 8.1%, as foreign investors continued profit repatriation, while the secondary income deficit declined to 0.1% of GDP from 0.2%.

Total international assets reached an all-time high of $129.3 billion, with central bank reserves exceeding sovereign wealth fund assets (Figure 2.4.7). The sovereign wealth fund assets increased by 8.6% to $63.9 billion, or 20.9% of GDP, as investment income helped offset withdrawals. The central bank's foreign exchange reserves rose by 42.8% to $65.4 billion, or 21.4% of GDP, cover for 9.9 months of imports, due to higher gold holdings and gold prices as central bank purchases doubled the share of reserves in monetary gold to 72.2%. External debt reached a preliminary $183.6 billion in 2025, or 60.0% of GDP, with intercompany debt declining to $91.1 billion.

Figure 2.4.7 International Assets and Gold Prices

Central bank reserves surpassed sovereign wealth fund assets on higher gold prices.

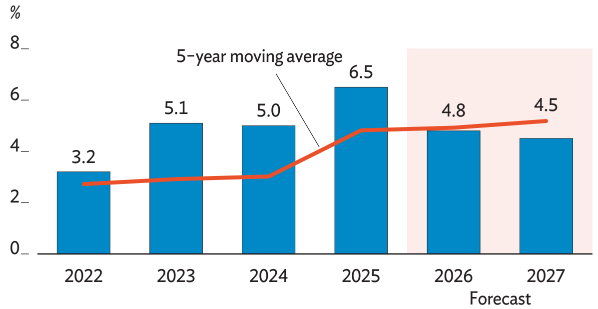


oz = ounce.

Sources: World Bank Commodity Price Data; National Bank of the Republic of Kazakhstan.

Figure 2.4.8 Gross Domestic Product Growth Forecast

GDP growth is projected to moderate in 2026 and slow further in 2027.



Source: *Asian Development Outlook* database.

Table 2.4.1 Selected Economic Indicators, %

Growth will slow in 2026 and again in 2027, with inflation declining in both years.

	2024	2025	2026	2027
GDP growth	5.0	6.5	4.8	4.5
Inflation	8.7	11.4	10.4	9.5

GDP = gross domestic product.

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

General government external debt increased to $16.1 billion, or 5.3% of GDP, reflecting a rise in government debt securities, including two Eurobond issues. S&P Global Ratings raised Kazakhstan's sovereign credit rating outlook to positive, citing a broader revenue base and strong liquidity buffers, while other rating agencies affirmed stable outlooks.

Economic Prospects

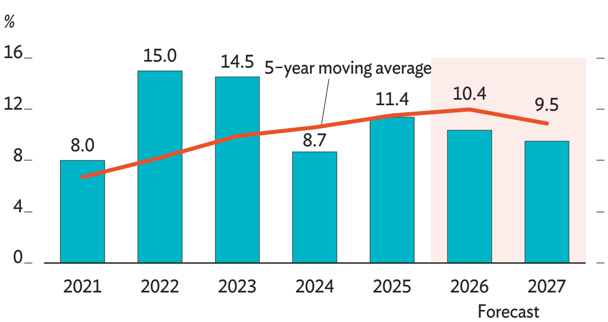
Under the early stabilization scenario of the Middle East conflict, growth is projected to moderate to 4.8% in 2026 and further to 4.5% in 2027 as oil output approaches peak production capacity, with business activity gradually normalizing (Figure 2.4.8 and Table 2.4.1). In 2026, growth in mining is forecast to slow to 1.1% as oil output has already neared capacity and is further constrained by OPEC+ limits, including compensation requirements for earlier overproduction, alongside risks of disruption to exports via the Caspian Pipeline Consortium, which accounts for around 80% of Kazakhstan's oil exports. Manufacturing is projected to expand by 5.7%, underpinned by government efforts to promote domestic production under the National Development Plan. Growth in services is projected to slow to 4.5% amid weaker domestic demand and softer business activity following tax changes. Construction is expected to remain robust, supported by quasi-fiscal stimulus and continued implementation of state infrastructure projects. Growth in agriculture will remain sensitive to weather and harvest conditions, with limited private investment. In 2027, mining growth is projected to slow further amid oil capacity constraints and planned maintenance, with spillover effect on other sectors. Normalizing domestic demand and improved business sentiment are expected to support manufacturing and trade, while growth in extractive industries and oil-related services should slow.

Growth on the demand side will come from quasi-fiscal stimulus, while private consumption is expected to slow. Growth in consumption is expected to slow to 4.7% in 2026 before accelerating in 2027 on higher public consumption. Fiscal consolidation, as sovereign wealth fund transfers to the budget decline from 3.3% of GDP in 2025 to around 1.5% in 2026 and 2027, will reduce direct fiscal stimulus. However, this consolidation is expected to be offset by quasi-fiscal stimulus from additional lending by Baiterek National Investment Holding, expected to be equivalent to 4.4% of GDP, and investment by Samruk-Kazyna. Tighter consumer lending restrictions, weak real income growth, and the higher VAT rate are projected to curb private demand. Investment growth will come from continued state-led infrastructure projects, including through quasi-fiscal activities. Net exports of goods and services will decline further, as imports grow faster than exports amid sustained demand for intermediate and investment goods.

Under the early stabilization scenario, inflation is projected to slow to 10.4% in 2026 and reach 9.5% in 2027, as monetary conditions remain tight, tax pressures fade, and inflation expectations ease (Figure 2.4.9). In 2026, continued tight monetary policy will support disinflation, with the key policy rate maintained at 18.00% at least through mid-year. The VAT rate increase will temporarily increase inflationary pressures, while higher interest rates and additional prudential measures will curtail borrowing and constrain consumer demand alongside weaker real wages. Inflation in services is expected to moderate to 11.9%, as authorities implement a temporary freeze on utility tariffs and fuel prices until April 2026. Food price inflation is expected to rise to 11.0%, reflecting the VAT increase and a possible tenge depreciation against the Russian ruble. Inflation for other goods is forecast at 8.0% as tax changes and strong import demand sustain price pressures. The central bank's gold mirroring operations, mandatory foreign currency sales by quasi-public enterprises, a high key policy rate, and elevated oil prices are expected to limit tenge depreciation against the US dollar, although depreciation pressures will remain amid reduced foreign exchange sales from the sovereign wealth fund and a widening current account deficit. In 2027, inflationary pressures are expected to ease as the impact of the VAT increase wanes and tight monetary conditions persist. Services inflation is expected to rise, reflecting the pace of government-regulated tariff adjustments, including under the Tariff in Exchange for Investment program. Food price inflation is projected to slow as domestic and external price conditions improve, while inflation for other goods is expected to moderate amid lower cost pressures and cooling private demand.

Figure 2.4.9 Inflation Forecast

Inflation is projected to slow gradually in 2026 and 2027.



Source: *Asian Development Outlook* database.

The fiscal deficit is projected to narrow as tax reform takes effect. In 2026, the state budget deficit is expected to fall to 2.5% of GDP, from 2.7%, on higher VAT revenues following the rate increase. The non-oil deficit is projected to decline to 4.9% of GDP, from 7.1%, as transfers from the sovereign wealth fund are reduced. In 2027, tight fiscal conditions are likely to continue, with fewer tax exemptions and improved tax collection strengthening revenue performance, while transfers level off. On the other hand, higher revenues from the oil sector amid ongoing geopolitical tensions could partly offset a potential shortfall in tax receipts and provide an additional fiscal buffer.

The current account deficit is expected to widen over the forecast period. Merchandise exports are forecast to grow moderately during 2026–2027 amid oil price volatility and external risks, while merchandise imports are projected to expand faster, supported by quasi-fiscal spending and government modernization programs. The services deficit is projected to remain broadly unchanged. With foreign investors repatriating windfall profits from oil and gas projects, the primary income deficit is expected to stay elevated, while outward transfers are forecast to decline, narrowing the secondary income deficit.

The outlook, based on early stabilization scenario, is subject to high uncertainty. Easing OPEC+ production limits and faster execution of quasi-fiscal financing could support output and investment. However, prolonged disruptions to oil exports, extended maintenance work, tighter global financial conditions, and a slowdown in key trading partners could reduce growth. Weaker fiscal consolidation, regulated utility tariff increases, and renewed exchange rate pressures could further raise inflation expectations. However, a sharper slowdown in private consumption and weaker import demand could reinforce disinflation. Uncertainty has intensified as the likelihood of a prolonged Middle East conflict rises, pushing up commodity prices and disrupting global supply chains, with potential adverse effects on growth and inflation.

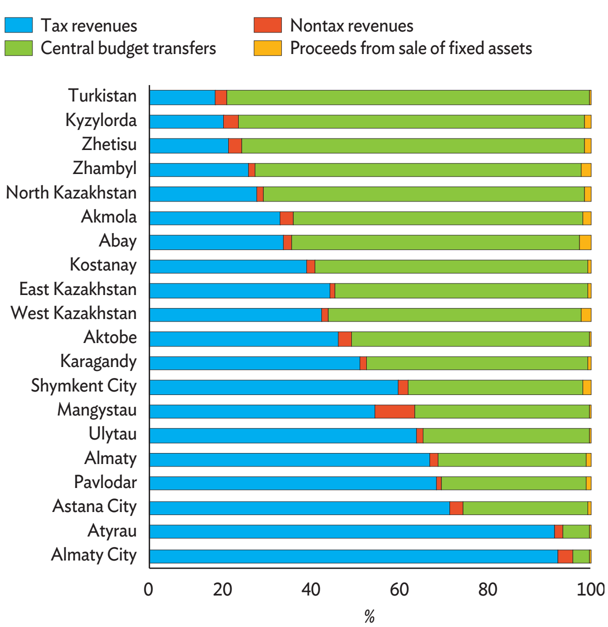
Policy Challenge—Advancing Fiscal Decentralization

Kazakhstan's fiscal system remains highly centralized. Subnational governments deliver key public services and local infrastructure, yet their fiscal autonomy is constrained by a narrow revenue base. In 2025, excluding intergovernmental transfers, subnational governments accounted for 38% of general government revenues and 32% of expenditure, leaving most fiscal decision-making at the center. This vertical fiscal imbalance reduces the scope for region-specific budgeting and limits the responsiveness of public spending to local development needs.

Fiscal outcomes vary markedly across regions. Subnational fiscal capacity remains uneven, with tax revenues ranging from 6.7% of gross regional product in Almaty City to 3.8% in West Kazakhstan on average during 2023–2025. Heavy reliance on central transfers—amounting to about half of total local budget revenues in 2025 and reaching over 80% in some regions—can weaken local revenue effort and incentives to strengthen tax administration (Figure 2.4.10).

Figure 2.4.10 Local Budgets Revenue Structure

In some regions, central budget transfers accounted for more than 80% of revenues in 2025.



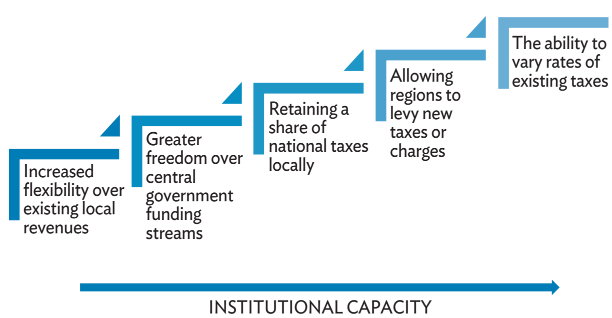
Source: Ministry of Finance of the Republic of Kazakhstan.

Since 2020, the government has taken steps to strengthen subnational finances. Under the Concept for the Development of Local Self-Government until 2030, 25 types of taxes and payments were transferred to the fourth level of the budget to enhance the financial autonomy of districts, including personal income and property taxes, land and vehicle taxes, and selected fees and levies. In 2020, the corporate income tax paid by small and medium enterprises was also allocated to local budgets. The new Budget Code, effective from 2026, further expands revenue decentralization by transferring certain mineral extraction taxes to local budgets. Corporate income and VAT rates are set centrally, although differentiated corporate rates support priority sectors.

Further fiscal decentralization would benefit from a sequenced, rules-based approach. Progress along the "fiscal devolution ladder" should move from limited flexibility over existing local revenues toward greater autonomy (Figure 2.4.11). Retaining a larger share of national taxes locally—starting with corporate income tax and, over time, VAT—could give regions a direct stake in fostering economic growth. Allowing local governments to introduce new taxes and adjust existing tax rates within specified ranges would enable fiscal policies tailored to regional needs. Robust equalization mechanisms and careful transfer design remain essential, as excessive earmarking or performance requirements could constrain subnational autonomy.

Figure 2.4.11 Fiscal Devolution Ladder

A gradual shift toward greater subnational fiscal autonomy.



Source: Asian Development Bank.

Building local government capacity is critical for effective decentralization. Expanded responsibilities for revenue administration at local and regional levels should be matched with adequate administrative capability. Targeted training, upgraded revenue management systems, clear accountability arrangements, and stronger digital platforms can help improve service delivery while managing fiscal and governance risks. Overall, advancing fiscal decentralization and strengthening local government capacity would help align spending more closely with local development needs.

KYRGYZ REPUBLIC

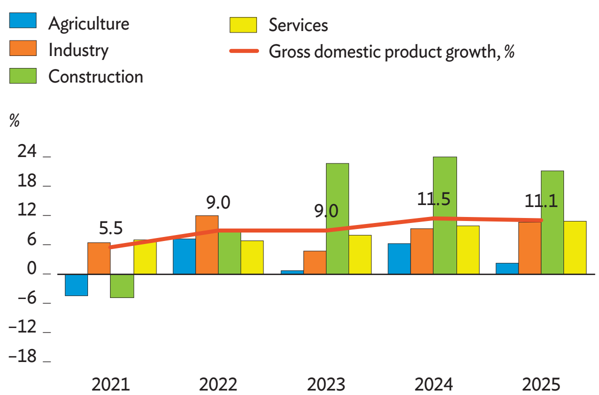
Growth remained robust in 2025, driven by continued public investment, strong private consumption, and broad-based gains across major sectors, while inflation accelerated. Expansion is projected to moderate but remain robust in 2026 and 2027, reflecting gradual easing in construction and trade, despite resilient domestic demand. Inflation will accelerate in 2026 before slowing in 2027, amid strong domestic demand, higher utility tariffs, and exchange rate pass-through. Strengthening the foundations for private investment is key to sustaining high growth and improving productivity.

Economic Performance

Growth was strong at an estimated 11.1%, moderating from 11.5% in 2024, supported by continued public investment and economic diversification efforts (Figure 2.5.1). Industry expansion accelerated from 9.3% in 2024 to 10.7%, as new industrial facilities were commissioned under the government's "100 Industrial Enterprises–2025" initiative. Food processing, construction materials, and chemical manufacturing posted solid gains, while pharmaceutical production nearly doubled. These advances partially offset continued contraction in base metal production, mainly gold. Construction rose by 21.1%, down from 28.7% in 2024 but remaining elevated on sustained investment, mainly from domestic sources. Growth in agriculture slowed from 6.2% in 2024 to 2.2% as drought reduced crop production, offsetting increased livestock. Services, representing half of GDP, grew by 10.9%, up from 9.8%, with a 20.9% rise in wholesale and retail trade.

Figure 2.5.1 Gross Domestic Product Growth by Sector

Growth remained robust in 2025 with continued gains in services, construction, and industry.



Source: National Statistical Committee of the Kyrgyz Republic.

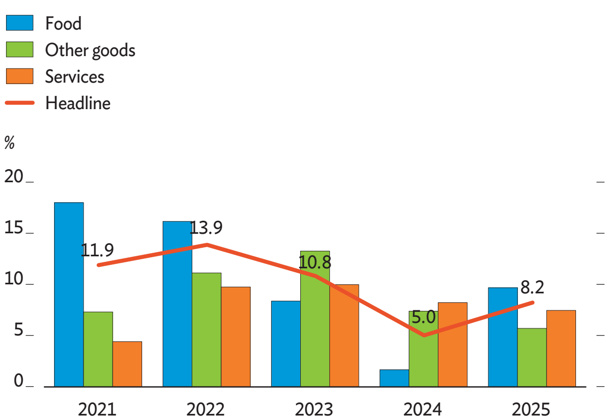
Rising household incomes and strong investment growth underpinned domestic expansion. Private consumption increased by 17.5% in the first 9 months of 2025, up from 11.8% in the same period of 2024, as households increased spending amid rising disposable incomes from multiple sources. Net money transfers, including remittances from abroad, rose by 22.6%, remaining a critical income stabilizer. Real wages increased by 9.9%, and consumer credit surged by 67.2%. Gross capital formation grew by 19.0%, reversing an 8.0% contraction a year earlier, supported by expansion in both fixed asset investment and inventory accumulation. Growing public investment concentrated on extractive industries, transport infrastructure, energy, and housing development. The deficit in net exports widened by 14.0% as exports fell more than imports.

This chapter was written by Gulnur Kerimkulova of the Kyrgyz Republic Resident Mission, ADB, Bishkek.

Inflation accelerated in 2025, with average annual inflation rising to 8.2% from 5.0% in 2024, driven by strong domestic demand, rising import costs, and administered price adjustments (Figure 2.5.2). Global commodity price volatility, geopolitical tensions affecting supply chains, and elevated inflation in key trading partners increased import costs, while planned increases in electricity and heating tariffs and supply disruptions from drought-affected agricultural production added to domestic price pressures. Food price inflation, representing 45% of the consumer basket, drove much of the increase, rising to 9.7% from 1.7% in 2024. Structural weaknesses, including high dependence on imported goods and limited domestic production capacity, amplified vulnerability to external price shocks. Core inflation rose to 6.6% from 5.7% in 2024, signaling price pressures beyond food and energy.

Figure 2.5.2 Annual Inflation

Headline inflation accelerated in 2025, driven by strong demand and high food prices.



Source: National Statistical Committee of the Kyrgyz Republic.

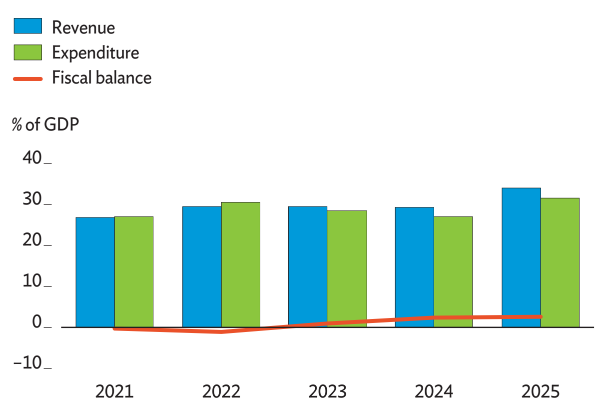
Monetary policy remained tight as inflation accelerated. The National Bank of the Kyrgyz Republic, the central bank, raised the policy rate in three steps from 9.0% in mid-2025 to 11.0% by late 2025 as inflation intensified. It also made net foreign exchange sales of $853.0 million, equivalent to about 17% of international reserves at the start of 2025; that and rising net money transfers limited depreciation of the Kyrgyz som against the US dollar to just 0.2%. According to the World Bank's World Development Indicators, the interest rate spread between lending and deposit rates remained high at 18.1 percentage points in 2024, far above the 2–6 percentage points in some peer countries. Banks maintained high capitalization rates and robust profitability. However, nonperforming loans remained elevated at 10.5% of total loans, down only slightly from 10.8% in 2024, warranting continued supervisory vigilance.

Buoyant revenue performance yielded a fiscal surplus at 2.5% of GDP, little changed from 2.4% in 2024 (Figure 2.5.3). Improved tax administration and cyclical gains helped boost total revenue by 44.1%, with tax revenue increasing by 32.3% to 23.4% of GDP on rising profit and income taxes and customs duties; and nontax revenue rising by 86.8% on higher central bank profit distribution. Total expenditure rose by 45.1% on higher spending for public investment and social priorities. Total public debt rose to 39.5% of GDP from 36.2% at end-2024 (Figure 2.5.4), partly reflecting the country's debut $700 million Eurobond issued in 2025 and increased domestic debt.

The external position strengthened markedly while remaining vulnerable to commodity price fluctuations and the economy's reliance on remittance inflows. The current account deficit narrowed to 18.8% of GDP in the first 9 months of 2025 from 35.7% a year earlier on import compression, improved services performance, sustained remittance inflows, and lower but still significant errors and omissions (Figure 2.5.5). The merchandise trade deficit widened by 9.9% as exports contracted by 24.9%, including a 27.9% decline in earnings from gold shipments, while imports decreased by 1.4% as external demand for re-exports declined. Those

Figure 2.5.3 Fiscal Indicators

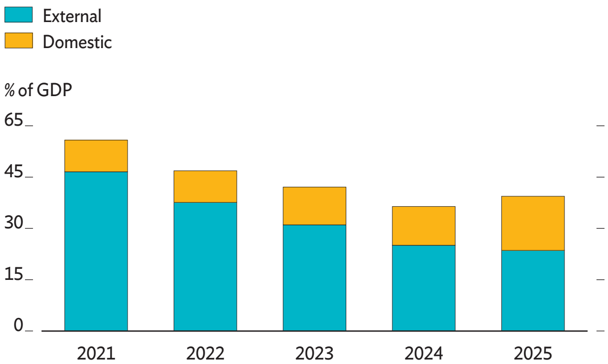
The fiscal surplus rose slightly to 2.5% of GDP as revenue growth offset higher expenditure.



GDP = gross domestic product.
Source: National Statistical Committee of the Kyrgyz Republic.

Figure 2.5.4 Public Debt

Total debt rose as a share of GDP after a first Eurobond issue and higher domestic borrowing.

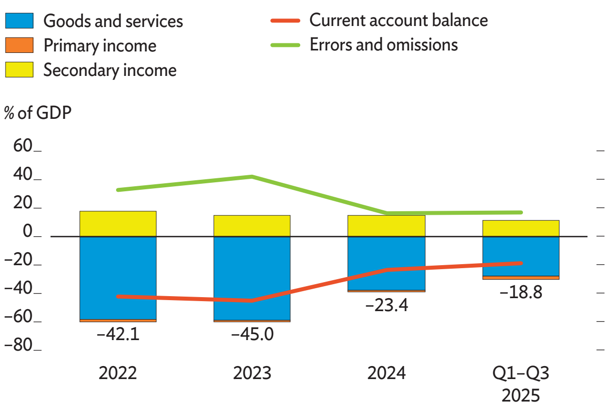


GDP = gross domestic product.

Source: Ministry of Finance.

Figure 2.5.5 Current Account Components

The current account deficit narrowed markedly in 2024 and continued that trend in the first 9 months of 2025.



GDP = gross domestic product, Q = quarter.

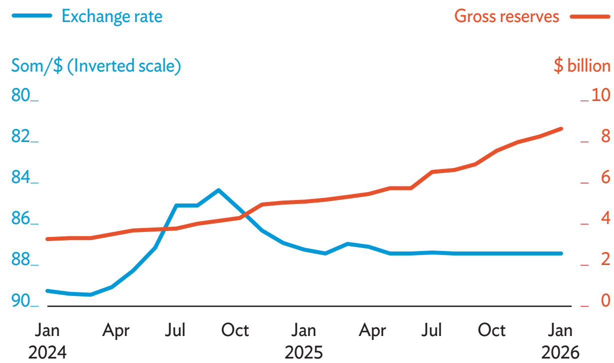
Note: Preliminary data for 2025 cover the first 9 months and are presented as a percentage of annualized GDP.

Source: National Bank of the Kyrgyz Republic.

earnings were down as a contraction in export volumes driven by reduced production more than offset gains from higher global gold prices. The services account shifted into surplus, supported by stronger tourism receipts and reduced transport service payments. Despite net foreign exchange sales, ongoing purchases of domestically mined gold and the conversion of nonmonetary gold on the central bank's balance sheet to reserves increased gross reserves by 69.1% to $8.6 billion at the end of 2025, covering an estimated 7 months of projected imports, up from 4 months in 2024 (Figure 2.5.6).

Figure 2.5.6 Exchange Rate and Gross Reserves

The Kyrgyz som remained broadly stable in 2025, while gross reserves increased sharply.



Source: National Bank of the Kyrgyz Republic.

Economic Prospects

Growth is projected to slow but remain robust at 8.9% in 2026 and 8.4% in 2027 as construction normalizes and re-exports grow more slowly (Table 2.5.1 and Figure 2.5.7). Construction growth is expected to ease to about 15.0% a year and services to an average of 8.6% as re-export activity subsides, with gains in both sectors diminishing in 2027. Industry expansion will moderate as weakness in gold output persists, partly offset by new and recently commissioned production facilities. Agriculture is forecast to rebound to about 4%–5% on increased allocations for farm support programs and assuming favorable weather conditions.

Domestic demand is expected to continue underpinning growth, though at a more moderate pace. Private consumption is projected to grow by about 12% on average, supported by continued remittance inflows, real wage gains, and consumer

Table 2.5.1 Selected Economic Indicators, %

Growth will slow in 2026 and 2027, with inflation rising in 2026 and declining in 2027.

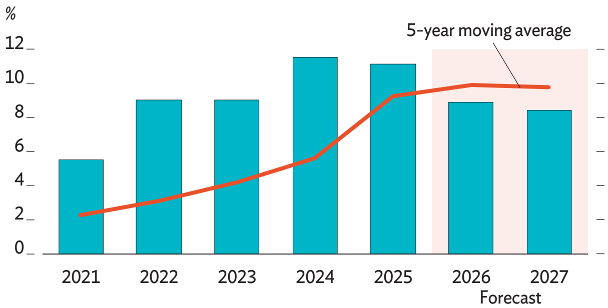
	2024	2025	2026	2027
GDP growth	11.5	11.1	8.9	8.4
Inflation	5.0	8.2	10.3	8.5

GDP = gross domestic product.

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

Figure 2.5.7 Growth Forecast

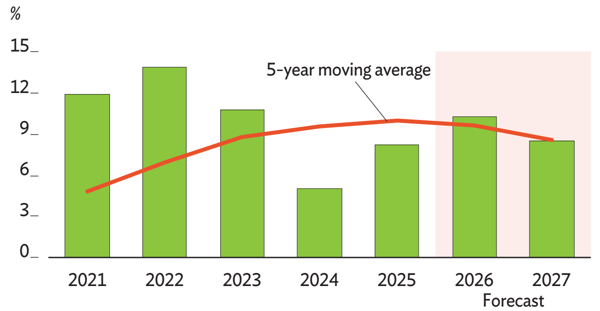
Growth is forecast to moderate in 2026 and 2027 but remain strong, supported by continued investment.



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

Figure 2.5.8 Inflation Forecast

Inflation is projected to rise in 2026 before declining in 2027.



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

credit expansion. However, the pace of credit-fueled spending is expected to slow as tighter monetary conditions raise borrowing costs and stronger supervisory oversight moderates credit growth. Investment will remain elevated but expand more slowly as the initial surge in construction subsides. The new National Development Program 2030 and its 5-year action plan, approved at the end of 2025, will shape the medium-term trajectory. This plan includes public spending on transport, energy, water supply, and housing, partly financed by international development organizations, supporting capital formation. A moratorium on business inspections in 2026 may ease compliance burdens and support entrepreneurial activity and private investment. Presidential elections during the forecast period could provide additional fiscal stimulus.

Inflation is projected to accelerate to 10.3% in 2026 before moderating to 8.5% in 2027, as domestic demand remains strong and with exchange rate pass-through and utility tariff increases (Figure 2.5.8). Robust consumer spending will sustain underlying price momentum, reinforced by persistently elevated inflationary expectations. The Kyrgyz som is forecast to depreciate moderately, with considerable upside risks from heightened geopolitical uncertainty, and the economy's high import dependence will amplify the pass-through from exchange rate movements to a broad range of consumer prices. Scheduled increases in electricity and heating tariffs over the projected period will strengthen price pressures. The moderation in 2027 reflects slower domestic demand growth, an easing in import prices, and improved food supply as agriculture recovers. Inflation will remain well above the central bank's 5.0%–7.0% target range, however, as underlying factors and elevated inflation expectations continue to exert upward pressure. The central bank is expected to maintain its tight policy with the policy rate remaining above inflation and will likely continue intervening in the foreign exchange market, though accumulated excess liquidity in the banking system will continue to limit the effectiveness of monetary policy transmission.

Fiscal policy is expected to become mildly expansionary, with a deficit averaging 1.0% of GDP in both forecast years. After 3 consecutive years of surpluses, the budget is projected to record a deficit of about 0.8% of GDP in 2026 and 1.3% of GDP in 2027 as capital expenditure accelerates and revenue growth moderates with declining trade volumes, despite continued improvements in tax and customs administration. Expenditure will rise faster owing to higher domestically financed investment in infrastructure, increased social spending, and growing interest payments. Public debt is projected to edge up but remain below the 60% sustainability threshold. Moody's revised the Kyrgyz Republic's sovereign credit outlook to positive in July 2025, citing active economic diversification and improved fiscal performance.

The external position is expected to continue improving. The current account deficit is forecast to narrow further as merchandise import growth moderates with declining re-exports. Remittances will remain a critical and resilient source of external inflows. Despite continued exchange rate management pressures, the reserve buffer built up in previous years will provide important insurance against external shocks. Gross reserves should remain adequate on higher gold prices.

The outlook faces considerable uncertainty, and risks are predominantly on the downside. A sharper-than-expected regional slowdown could weigh on trade, investment, and remittances. The external environment remains subject to significant geopolitical and trade policy uncertainty, and shifts in supply chains could alter the trade flows, with sustained energy price increases posing particular downside risks to growth and inflation. Domestically, the election cycle may introduce policy uncertainty, potentially delaying reforms or shifting spending priorities. Risks from delays in implementing the National Development Program 2030's large investment program represent a drag on the growth trajectory. Rapid consumer loan expansion, if not carefully managed, poses risks both to inflation and financial stability. The economy also remains vulnerable to power shortages from inadequate and aging energy infrastructure.

Policy Challenge—Stronger Foundations for Private Investment

Strong economic growth has not yet yielded productivity gains and high-paying employment. Despite economic growth averaging 10.2% in 2022–2025, labor productivity gains have been limited and employment in the informal sector is widespread, reflecting insufficient private investment in productive, job-creating sectors. Mobilizing private capital—domestic and foreign—is essential to higher-productivity growth, underpinned by a stronger regulatory environment. Recent macroeconomic improvements—fiscal surpluses, growing reserves, and manageable public debt—provide a unique opportunity to introduce structural reforms that boost private investment before external tailwinds fade.

Domestic financial resources remain underutilized. Banks maintain substantial excess liquidity—on average $1.3 billion in 2025, about 6% of GDP—and the banking sector's liquidity ratio rose to 86.2% at end-2025, nearly double the regulatory minimum. This indicates that idle resources continue to grow rather than flow to productive enterprises. While the credit portfolio has expanded, lending remains skewed toward consumption. Consumer loans account for approximately 40% of bank lending and over 45% in microfinance, whereas credit to industry has been continuously declining. High lending rates, driven in part by currency risk premiums, restrict the access of micro, small, and medium enterprises to affordable credit. Overall, according to the World Development Indicators, domestic credit to the private sector in the Kyrgyz Republic remained at 23.2% of GDP in 2024. This was well below the average of 133.7% for middle- and low-income countries and 39.8% for non-high-income countries in Europe and Central Asia. Pension resources are another underused pool of funding. Reforms to simplify the system and broaden the contribution base could channel funds toward productive investment and reduce budget transfers, freeing fiscal space for enabling infrastructure and services.

Foreign direct investment (FDI) has been volatile and trending lower. After averaging about 9.2% of GDP in 2010–2015, net FDI inflows fell sharply in the second half of that decade and have remained subdued, averaging 1.8% of GDP in 2022–2024. With gross fixed capital formation at 22.5% of GDP over the same period, foreign investment accounts for less than 10% of total investment, leaving the economy overwhelmingly reliant on domestically financed, often public, capital formation. This limits the inflow of modern technologies, management practices, and access to global markets that FDI typically brings.

The government has initiated important reforms. The Government Accelerators program targets business process simplification. In addition, a de-bureaucratization drive eliminates redundant procedures, and the Zero Plus initiative seeks to minimize licensing requirements. Digitalization is advancing through the centralized service platforms.

Deeper structural reforms are needed to unlock private investment. Domestically, priorities include further developing the local money market and encouraging local-currency lending to reduce currency risk premiums in lending rates, alongside longer-term instruments to channel savings toward productive sectors. To attract FDI that brings modern technologies and business practices, the investment legal framework should be further modernized and the investor grievance mechanism made fully operational. Success requires a well-sequenced approach: removing barriers to investment, adopting modern technologies, and building innovation capacity. As a cross-cutting priority, closing the implementation gap in business regulation—through transparent enforcement, competitive neutrality between state-owned and private enterprises, and continued digitalization—is essential to an environment where private investment can generate sustainable growth and higher-quality formal employment.

TAJIKISTAN

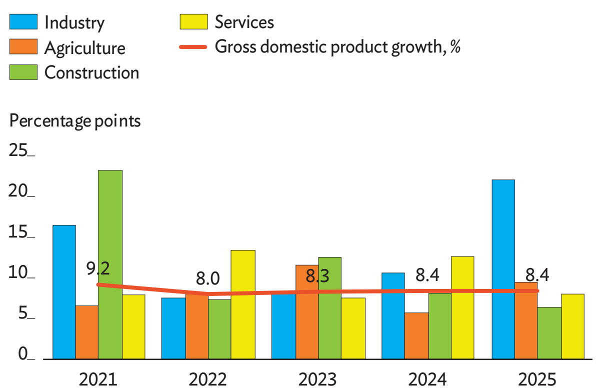
Growth stayed high in 2025 as record remittance inflows and acceleration in industry and agriculture offset slower expansion in services and construction. Inflation eased marginally, as lower inflation in other goods offset higher inflation in food and services. Growth is expected to remain strong but moderate in 2026 and 2027, with less expansion in agriculture and construction. Inflation is expected to rise on growing demand. Greater competitiveness and value addition in industry would support long-term growth.

Economic Performance

Growth remained robust at 8.4% in 2025, supported by remittances, strong public spending, elevated investment, and ongoing expansion in industry and services (Figure 2.6.1). Industry expanded 22.1%, up from 10.6% in 2024, as 400 new industrial enterprises were established. Mining grew by 36.2%, reflecting high prices for gold, silver, aluminum, and antimony. Despite a slowdown in construction, from 8.4% to 6.1%, investment in the Rogun hydropower project and other large-scale infrastructure boosted manufacturing output by 10.5%, with sharp increases in cement (18.1%), bricks (44.4%), and concrete (26.7%). Services growth slowed to 11.4% from 15.7% in 2024, despite robust gains in hospitality (21.6%) and trade (13.9%). Expansion in agriculture rose to 9.5% from 5.7%, reflecting production gains in fruits (23.9%), potatoes (10.4%), vegetables (8.7%), and wheat (2.4%).

Figure 2.6.1 Gross Domestic Product Growth by Sector

Growth in 2025 remained strong at 8.4%, driven primarily by industry and services.



Source: Agency on Statistics under the President of the Republic of Tajikistan.

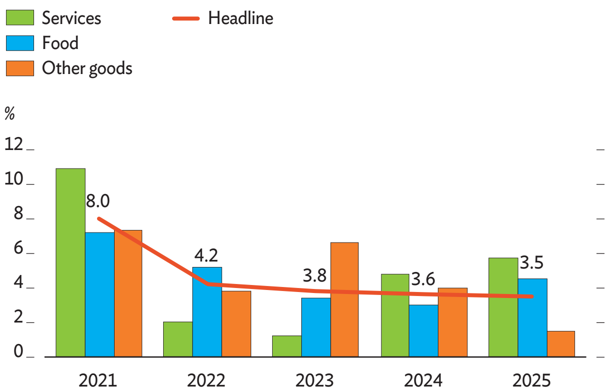
Private consumption and credit growth remained buoyant in 2025, supported by rising wages and record remittance inflows. Average salaries increased by 20%, while the minimum wage rose by 25%. Remittances reached an estimated $9.2 billion or 52% of gross domestic product (GDP), a national record and the highest share of GDP worldwide, underscoring Tajikistan's dependence on migrant labor earnings. Around 16% of rural and 13.5% of urban households received remittances, mostly from Russia, according to the World Bank report of June 2025 Listening to Tajikistan. Public investment expanded by 42.6%, reaching 8.1% of GDP, with emphasis on infrastructure projects in energy, transport, and social services. The stock of foreign investment totaled $6.9 billion, up 35.1% from 2024, and focused on construction, industry, and energy. Foreign direct investment rose an estimated 25.3% to $575.3 million, equivalent to 3.3% of GDP, with 81% of inflows to industry.

Inflation edged down from 3.6% in 2024 to 3.5% in 2025, within the 3%–7% target range of the National Bank of Tajikistan, the central bank (Figure 2.6.2). Stable import prices helped contain overall inflation,

This chapter was written by Shuhrat Mirzoev, Tajikistan Resident Mission, ADB, Dushanbe.

Figure 2.6.2 Annual Inflation

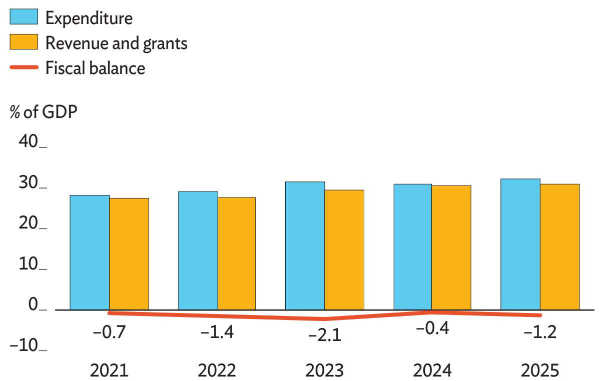
Despite high growth, inflation decreased slightly to 3.5%, with lower inflation for other goods offsetting higher inflation for food and services.



Source: Agency on Statistics under the President of the Republic of Tajikistan.

Figure 2.6.3 Fiscal Indicators

The fiscal deficit remained low at 1.2% of GDP as revenues remained healthy amid increasing spending pressures.



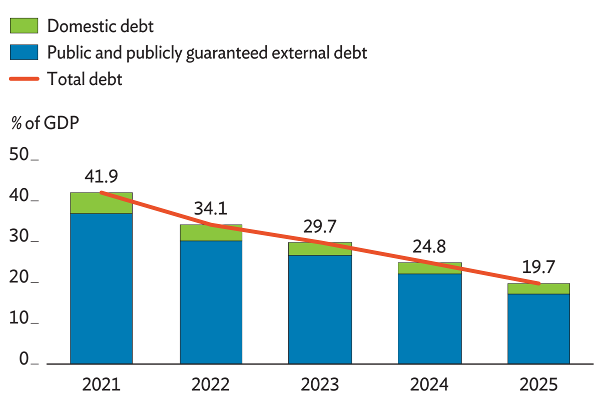
GDP = gross domestic product.
Source: Ministry of Finance of Tajikistan.

but food prices rose 4.5%, accelerating from 3.0% in 2024, as higher global fertilizer prices caused local supply to lag growing demand and temporary export restrictions in neighboring countries tightened markets for staple items. Inflation for other goods slowed from 5.0% to 1.5%, reflecting lower prices for petroleum products and pharmaceuticals. Inflation in services rose to 5.7%, from 4.8%, reflecting higher utility tariffs and costs for personal services, supported by rising incomes. Lower imported energy costs—driven by higher domestic hydropower output and favorable regional arrangements, including fixed-price fuel quotas from Russia and reintegration into the Central Asia Power System—helped reduce costs for industry and kept producer price inflation at 4.5%. In 2025, the Tajik somoni appreciated 7.1% against the US dollar and 4.2% against the Russian ruble, lowering the domestic cost of external debt servicing and imports.

The fiscal deficit expanded to 1.2% of GDP in 2025 from 0.4% in 2024 but remained below the government's 2.5% ceiling (Figure 2.6.3). Stronger revenue collection offset the impact of increased public sector wages and pensions and a higher minimum wage—all introduced from September 2025—and greater investment. Revenues expanded by 29.4% to reach 31.1% of GDP in 2025, driven by higher metal export receipts, improved tax collection, a growing taxpayer base likely boosted by a 2-year moratorium on business inspections, and lower tax expenditures. Tax revenues rose by 28.6% to reach 21.2% of GDP, boosted by customs duties, natural resource taxes and royalties, and increases in corporate income tax (44.3%), excise taxes (27.1%), and value-added tax (22.3%). Higher non-tax fees and payments also boosted revenues, growing by 75.1% to 3.6% of GDP in 2025. With increases of 28.1% for public-sector pay and 42.6% for infrastructure, total spending increased from 31.0% to 32.3% of GDP. External public debt, representing 89% of total public debt, declined from 22.1% to 17.1% of GDP in 2025, totaling $3.0 billion as the government began repaying a $500 million Eurobond and other obligations amid a weaker US dollar. External debt service rose from 2.1% to 2.9% of GDP, reaching a record $504.6 million. Total public debt decreased by 3% in absolute terms, equaling $3.5 billion or 19.7% of GDP at year-end, compared to 24.8% in 2024 (Figure 2.6.4).

Figure 2.6.4 Public Debt

External debt continued to decline in 2025 as repayments accelerated.

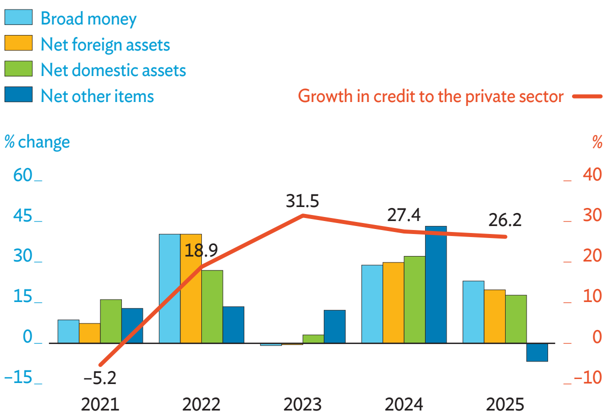


GDP = gross domestic product.
Source: Ministry of Finance of Tajikistan.

The central bank eased policy in 2025. Subdued inflation led the central bank to cut its policy rate three times, from 10.0% in January to 7.5% in October. Private sector credit rose by 26.2%, down slightly from 27.4% in 2024 (Figure 2.6.5), facilitated by strong remittances, higher incomes, and greater banking-system liquidity. Strong demand contributed to a 23.0% jump in broad money, down from 28.8% in 2024. Reserve requirements remained at 3% on local currency and 9% on foreign currency deposits, reflecting a policy to de-dollarize the banking system.

Figure 2.6.5 Monetary Indicators

Broad money continued expanding in 2025, fueled by strong remittance inflows and credit to the private sector.



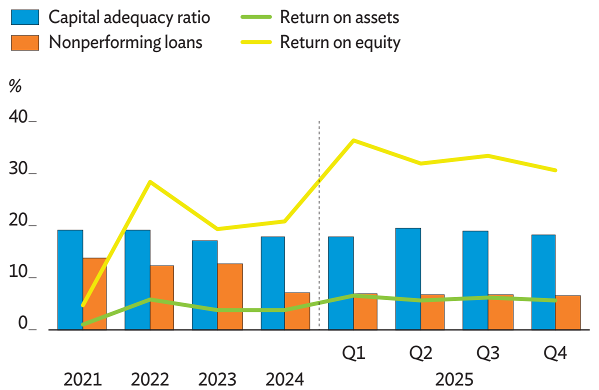
Source: National Bank of Tajikistan.

Banking soundness indicators improved in 2025. The capital adequacy ratio strengthened from 17.8% of risk-weighted assets to 18.2%, while the current liquidity ratio increased from 78.3% to 81.6%, signaling the banking system's solvency and liquidity (Figure 2.6.6). Strong regulation, risk-based supervision, and macroprudential tools helped lower the share of nonperforming loans from 7.1% to 6.6% and raise the ratio of regulatory capital to risk-weighted assets from 21.8% to 23.1%. The ratio of deposits to loans increased from 122.1% to 131.1% in 2025, and the share of loans in local currency increased from 72.8% to 77.6%.

The current account surplus widened to 15.5% of GDP from a surge in remittances and export receipts. Remittance receipts rose by an estimated 47.4%, while higher mining and metal export earnings

Figure 2.6.6 Banking System Soundness Indicators

In 2025, financial soundness indicators continued improving, with capital adequacy rising and the share of nonperforming loans falling.

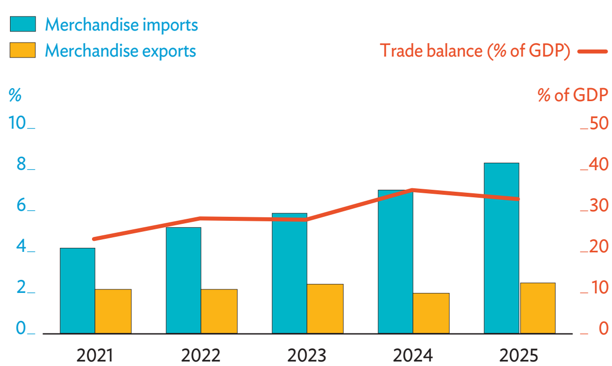


Q = quarter.
Source: National Bank of Tajikistan.

boosted exports, offsetting declines in ores and concentrates, fruits and vegetables, and garments. Total trade expanded by 20.5%, with merchandise exports expanding by 27.8% to $2.5 billion, while imports rose by 18.5%, trimming the merchandise trade deficit to 33.0% of GDP from 35.1% in 2024 (Figure 2.6.7). Exports of non-precious metals and mineral products grew by 60.0% and 30.0% respectively, jointly accounting for 65.4% of merchandise exports. Gross reserves rose to 7.2 months of import cover in 2025 from 7.1 months a year earlier, as gains from the stronger current account surplus exceeded decreases in gold production.

Figure 2.6.7 Merchandise Trade

In 2025, merchandise imports continued rising while exports recovered to the 2023 level.



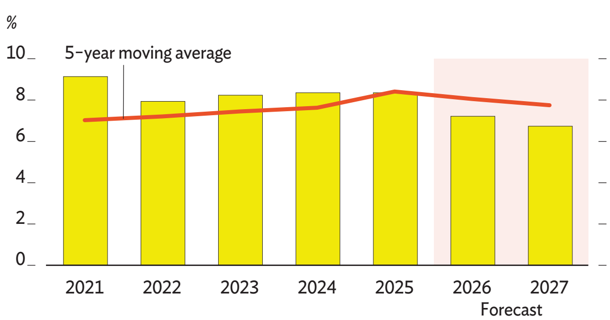
GDP = gross domestic product.
Source: National Bank of Tajikistan.

Economic Prospects

Growth is forecast to remain strong but slow to 7.3% in 2026 and 6.8% in 2027 (Figure 2.6.8 and Table 2.6.1). Industry (excluding construction) and services will remain the main growth drivers, expanding in 2026 by 18.0% and 15.2%, with agriculture and construction expanding more modestly at 6.5% and 7.0%. Greater power generation capacity, administrative measures, and tax-related incentives for the private sector should lead to substantial growth in the medium term. However, growth is expected to moderate through 2027 as lower prices for some metals (notably gold and silver) and agriculture (except cotton) trim the growth of merchandise exports, while slower demand from the People's Republic of China and Russia and regional uncertainties in Ukraine and Iran may curb trade and remittances. Rising public spending can initially support growth but risks triggering higher inflation, faster credit growth, and financial vulnerabilities unless accompanied by prudent revenue measures and tighter macroprudential policies.

Figure 2.6.8 Growth Forecast

GDP growth is projected to slow gradually in 2026 and 2027 but remain strong.



GDP = gross domestic product.

Sources: Agency on Statistics under the President of the Republic of Tajikistan; Ministry of Economic Development and Trade of the Republic of Tajikistan; Asian Development Bank estimates.

Table 2.6.1 Selected Economic Indicators, %

Growth is likely to moderate in 2026 and 2027, with inflation rising steadily.

	2024	2025	2026	2027
GDP growth	8.4	8.4	7.3	6.8
Inflation	3.6	3.5	4.0	4.5

GDP = gross domestic product.

Sources: Agency on Statistics under the President of the Republic of Tajikistan; National Bank of Tajikistan; Asian Development Bank estimates.

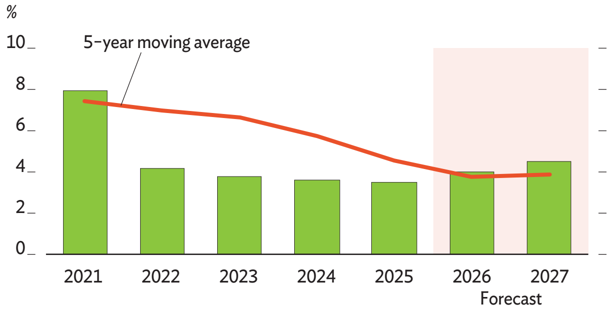
Private consumption will remain the largest contributor to growth, financed primarily by remittances and higher wages. Expected increases of at least 20% in public sector wages and 30% in the minimum wage in September 2026, the fifth increase since 2020, will stimulate demand. Remittance volatility and external shocks are the main downside risks to growth. Net inflows should remain substantial despite minor swings caused by Russia's stringent immigration regulations. Rising incomes and foreign currency inflows will continue to stimulate credit and liquidity growth. Anticipation of more cuts to the central bank's key policy rate, after a 50-basis-point reduction to 7.0% in February 2026, reinforces the trend.

Investment is expected to rise markedly in the medium term. Approaching the 35th anniversary of independence in 2026 and the approaching presidential election in 2027, public spending will increase, widening fiscal deficits. Private investment is likely to remain strong in 2026–2027, concentrated in energy (including non-hydro renewables), transport, industry, and information and computer technology. Major construction in 2026–2027 includes solar power plants with a combined capacity of 1,500 megawatts, continued work on the Rogun hydropower project, national road corridors, food processing factories, logistics centers, and the modernization of industrial enterprises. These projects will boost supply capacity, support import substitution for key commodities and staple foods, create jobs, and strengthen private sector dynamism. Incentives for merchandise producers and electric vehicles are expected to generate broad economic benefits.

Headline inflation is projected to rise to 4.0% in 2026 and 4.5% in 2027 (Figure 2.6.9). The increases will reflect expected utility and service tariff adjustments (including a 17.0% hike in heating and electricity tariffs from February 2026 toward attaining cost recovery by end-2027), higher consumer lending, announced public-sector and minimum-wage increases, and strong remittance inflows. Rising world prices of cotton and fertilizers will have offsetting effects on inflation. Anticipated modest depreciation of the somoni against the US dollar is likely to stimulate

Figure 2.6.9 Inflation Forecast

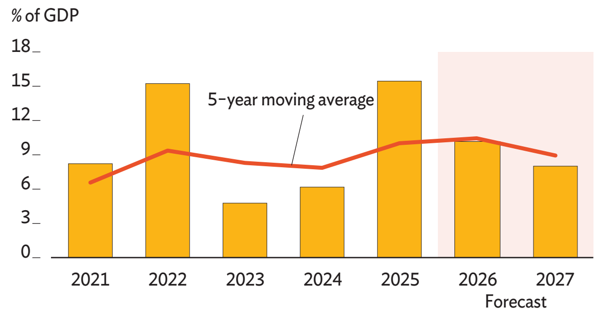
Inflation is projected to increase in both 2026 and 2027 but remain within the target range of 3%–7%.



Sources: Agency on Statistics under the President of the Republic of Tajikistan; Asian Development Bank estimates.

Figure 2.6.10 Current Account Forecast

The current account surplus is expected to narrow in 2026 and 2027.



GDP = gross domestic product.

Sources: National Bank of Tajikistan; Asian Development Bank estimates.

exports, while possible appreciation against the ruble will lower the local value of remittances. The central bank has signaled a measured stance that balances support for growth with price-stability objectives, using policy rates, reserve requirements, and foreign-currency operations to anchor expectations and limit pass-through from shocks. This is expected to keep inflation expectations well anchored and within the central bank's target range.

The government will maintain a prudent fiscal stance in 2026–2027, with the deficit not exceeding 2.5% of GDP. Measures will include tax adjustments—reducing the value-added tax to 13% and raising export rent (export tax on raw materials and commodities) to 6% from 2027—and new environmental taxes and administrative incentives to spur firms and investment. No new non-concessional borrowing is planned except for Rogun-related financing. Eurobond repayments will raise debt servicing costs in 2026–2027 but reduce external debt and increase the capacity for additional borrowing. Tajikistan is expected to graduate from grant-only support from the World Bank (by mid-2026) and the Asian Development Bank (by 2027). With multiple tax cuts, revenues are expected to decline, stabilizing at 29.6% of GDP, although both non-tax receipts and the tax base will gradually expand. Public investment will rise to 8.5% of GDP in 2026–2027. Total spending is projected at 30.5% and 28.9% of GDP in 2026 and 2027.

The current account surplus is expected to narrow modestly in 2026–2027 (Figure 2.6.10). Remittances are expected to moderate to about 44% of GDP in 2026–2027, while external financing for large infrastructure projects boosts capital-goods imports and widens the trade deficit. Slower projected growth in neighboring economies and regional uncertainty will further restrain exports. The smaller current account surplus could put pressure on foreign exchange reserves because of heavy scheduled external debt payments and additional borrowings sought to fund infrastructure projects.

Policy Challenge—Strengthening Competitiveness and Value Added in Industry

Tajikistan's macroeconomic performance provides a favorable platform for advancing the government's policy agenda for industry in 2026–2030. Output growth in industry has been impressive. However, the economy remains constrained by a narrow production base and job creation. Between 2013 and 2025, the share of industry in GDP increased while its share of employment rose by less than 1%. Export revenues are concentrated in commodities and low- to mid-tech products, such as precious metals, ores and concentrates, unprocessed cotton, and unwrought aluminum. Manufactured and higher value-added products represent less than 10% of merchandise exports. These patterns indicate limited diversification and weak integration into regional and global value chains.

Tajikistan's dynamism in industry is now strongest in resource-based and capital-intensive activities. While this pattern supports output expansion and export earnings, it generates little employment and limited domestic linkages unless complemented by downstream processing and supplier development. The country is blessed with a broad and geologically diverse mineral endowment, with around 600 deposits comprising 50 different minerals. Within this resource base, the potential for critical minerals has become increasingly visible, particularly antimony, gold, silver, lithium, and rare earth elements. Over 80% of total investment, including foreign direct investment, already goes to industry. Against this backdrop, accelerated industrialization represents the most effective way to implement the government's National Development Strategy 2030 and sustain high-growth momentum.

The government should consider adopting an integrated, ecosystem-based industrial policy framework. This would address the interdependence of competitiveness constraints and stimulate job creation at scale, particularly in labor-absorbing sectors, such as agro-processing, textiles, and services linked to industry value chains, including logistics, maintenance, and digital services. It should prioritize the shift to higher value-added production and diversification of export earnings. Continued reforms and investment in the enabling sectors—most notably energy, transport, and digital infrastructure—will reduce external imbalances and support long-term growth.

TÜRKIYE

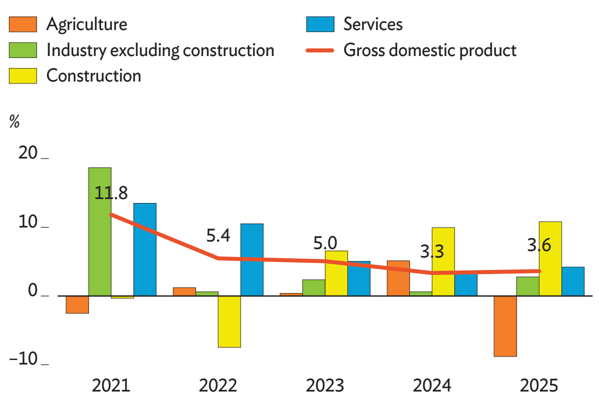
Growth recovered in 2025 following a dip in 2024 as private consumption and exports increased and investment picked up amid higher infrastructure spending. Inflation eased in 2025 but remained elevated, with higher service inflation and continued currency depreciation. Growth is projected to hold steady in 2026 before accelerating in 2027 from continued growth in private consumption and further gains in investment. Inflation is forecast to decline further, reflecting continued tight monetary policy and moderating price pressures such as in food, with heightened downside risks due to the conflict in the Middle East. The prolonged conflict and supply chain disruptions would seriously undermine energy production and trade, raise inflation risks, and significantly increase the likelihood of a severe economic slowdown. Implementing structural reforms to avoid a middle-income trap is a key policy challenge.

Economic Performance

Growth recovered to an estimated 3.6% in 2025 from 3.3% in 2024, led by strong expansion in construction, private consumption, and investment (Figure 2.7.1). On the supply side, growth in industry excluding construction rose to 2.8% from 0.6% in 2024, with manufacturing accelerating. Construction expanded sizably, by 10.8%, up from 9.9% in 2024, following a surge in reconstruction spending after the 2023 earthquake. Expansion in services accelerated to 4.2% from 3.3%, with gains of 4.6% in trade, transportation, accommodation and food services, 8.0% in information and communication, 3.8% in finance and insurance, and 2.7% in real estate. This was alongside smaller gains in public administration, education, and health. Agriculture contracted by 8.8% from volatility in crop production due to adverse weather, reversing growth of 5.1% in 2024. Unemployment declined to 7.8% in 2025 from 8.8% in 2024, with the poverty rate (the population below 50% of median income) falling to 13.0% from 13.6% in 2024.

Figure 2.7.1 Gross Domestic Product Growth by Sector

Growth rose in 2025 with faster expansion in industry, construction, and services.



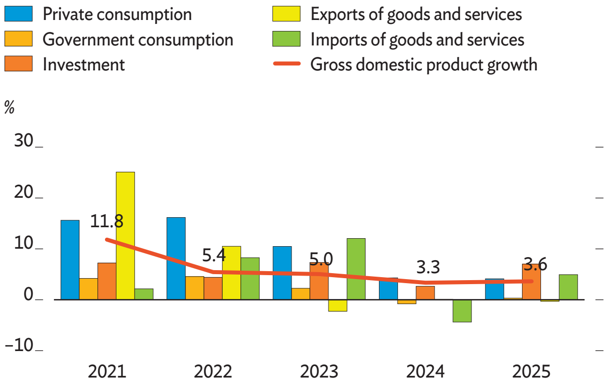
Source: Turkish Statistical Institute.

On the demand side, private consumption and investment were the main growth drivers. However, disinflationary measures trimmed expansion in private consumption to 4.1% from 4.3% in 2024, while fiscal consolidation pushed public consumption growth to near zero (Figure 2.7.2). Expansion in investment more than doubled to 7.0% from 2.7% in 2024, thanks to higher spending on public infrastructure. Net exports turned more negative, as merchandise imports expanded faster than exports, though exports reached a record high.

This chapter was written by Kiyoshi Taniguchi and George Luarsabishvili of the Central and West Asia Department, ADB, Manila.

Figure 2.7.2 Gross Domestic Product Growth by Expenditure

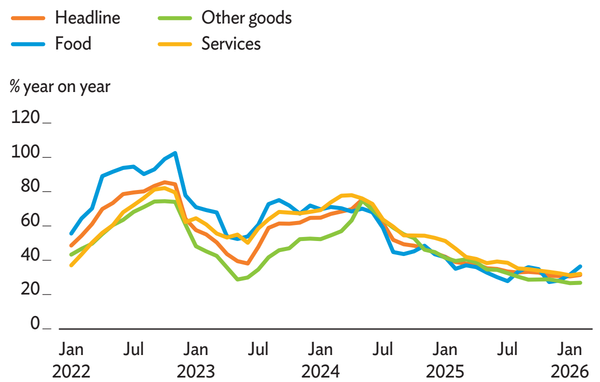
Growth in 2025 was driven by expansion in investment and private consumption.



Source: Turkish Statistical Institute.

Figure 2.7.3 Monthly Inflation

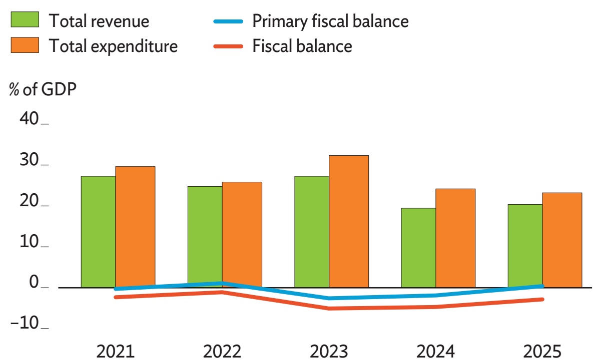
Inflation continued to decline in 2025.



Source: Central Bank of the Republic of Türkiye.

Figure 2.7.4 Fiscal Indicators

Higher revenue and lower expenditure trimmed the fiscal deficit in 2025.



GDP = gross domestic product.

Sources: Republic of Türkiye Ministry of Treasury and Finance; Turkish Statistical Institute.

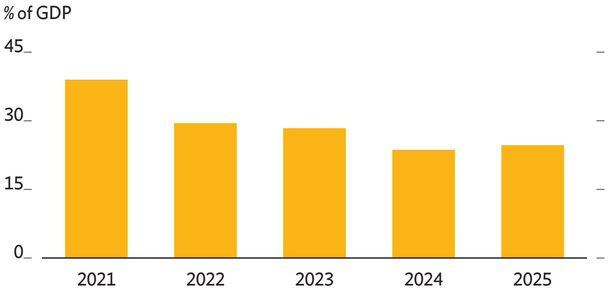
Inflation slowed considerably during 2025 but remained elevated. After it peaked at 72.0% in 2022 before easing to 44.4% in December 2024, inflation declined further to 30.9% in December 2025 and 30.7% in January 2026 (Figure 2.7.3). Pressure came mainly from food, where prices rose by 33.4%, and, to a lesser extent, energy prices, with inflation in services (39.0%) overtaking goods inflation (33.9%), a trend that began in 2023. Exchange rate depreciation closely tracked inflation, with the Turkish lira (TL) depreciating a further 21.7% against the US dollar in 2025 following a 19.8% depreciation in 2024 and 57.2% in 2023. However, the real effective exchange rate appreciated by 1.4% in January 2026 after a limited depreciation in 2025, contributing to a 3.9% decrease in exports. Market expectations signal gradual disinflation and slower but persistent currency depreciation into 2026. The Central Bank of the Republic of Türkiye overnight borrowing rate stood at 36.5% in 2025, down from 46.0% in 2024, but higher in real terms, continuing policy tightening that began in mid-2023. Market interest rates followed suit, with the one-year TL borrowing rate declining to 46.8% in 2025 from 50.1% in 2024. Wage growth, which had slowed to 22.2% in 2024 from 42.9% in 2023, diminished further, to 4.3% in 2025.

Fiscal performance strengthened, with the overall budget deficit narrowing substantially to 2.9% from 4.7% in 2024 as tax revenue grew faster than expenditure, underscoring greater fiscal discipline. Total revenue of the central government reached 20.4% of GDP, up from 19.5% in 2024, as tax revenue grew by 51.3% (Figure 2.7.4). Total expenditure fell to 23.3% of GDP, down from 24.2% in 2024, with outlays growing by 35.8%. Higher income and consumption tax collections drove revenue gains, while spending rose from increased outlays on personnel and capital expenditure, particularly to finance infrastructure. General government debt rose to 24.5% of GDP in 2025 from 23.6% in 2024 (Figure 2.7.5). Interest payments on domestic debt remained high, rising to 2.9% from 2.3% of GDP in 2024, while those on foreign debt fell to 0.4% from 0.5%. The primary surplus reached 0.4%, reversing a deficit of 1.9% in 2024.

The banking sector remained sound and resilient, with capital adequacy at 19.7% in 2025, similar to 2024. Nonperforming loans, at 2.5% of total loans,

Figure 2.7.5 Government Gross Debt

Public debt rose slightly in percent of GDP during 2025.



GDP = gross domestic product.

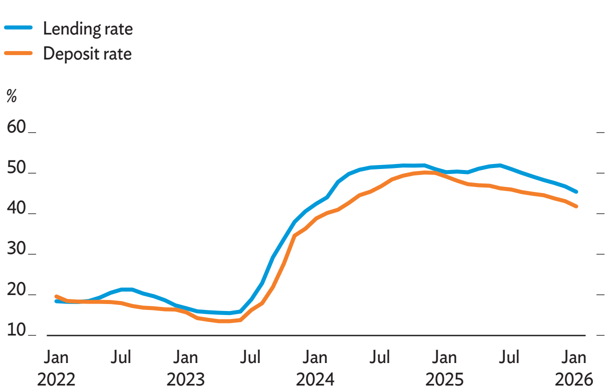
Source: Republic of Türkiye Ministry of Treasury and Finance.

were slightly higher than the 1.8% observed at the end of 2024. Broad money (M3) growth remained stable at 40.5% in 2025. Credit growth, at 43.9% in 2025, was below the 54.1% average during 2022–2023 although up from 36.7% in 2024, as the central bank's shift to tighter monetary policy took effect. The policy rate, separate from the overnight borrowing rate, stood at 37.0% in January 2026, up significantly from 9.0% in 2022. TL deposit rates declined from 50.1% in 2024 to 43.1% in 2025, reflecting moderation in market interest rates (Figure 2.7.6).

The current account deficit widened because of higher merchandise imports and moderating service exports, despite record-high merchandise exports. The deficit, which had narrowed from 5.0% of GDP in 2022 to 0.8% in 2024, widened to 1.6% in 2025 (Figure 2.7.7). Merchandise exports grew by 4.4%, up from 2.4% in 2024, while imports increased by 6.2% alongside

Figure 2.7.6 Market Lending and Deposit Interest Rates in Turkish Lira

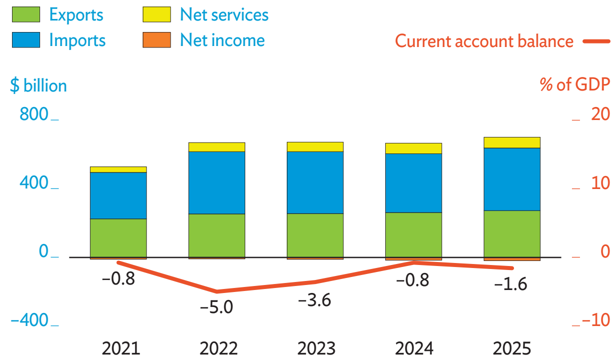
Lending and deposit rates decreased, reflecting policy rate cuts in 2025.



Source: Central Bank of the Republic of Türkiye.

Figure 2.7.7 Current Account Components

The current account deficit widened in 2025.



GDP = gross domestic product.

Source: Central Bank of the Republic of Türkiye.

higher growth, reversing a 5.0% contraction in 2024. Exports of manufactured goods rose by 4.5%, reflecting higher value added, while growth in agricultural exports remained muted at 0.9%. The growth in service exports slowed to 4.6% from 11.0% in 2024, despite a 6.5% rise in tourism revenue to $64.4 billion. International reserves (including gold) rose to $227.9 billion, amounting to 80% of the Assessment of Reserve Adequacy metric, up from 73% at the end of 2024. Foreign direct investment amounted to a high $13.1 billion in 2025, an increase of 12.2%.

Economic Prospects

Growth is projected to remain steady at 3.6% in 2026, supported by sustained private consumption and increased investment, before edging up to 4.0% in 2027 with stronger spending on durable goods and growing construction (Table 2.7.1 and Figure 2.7.8). Market expectations at the start of 2026 remained positive amid confidence in the outlook. Capacity utilization in manufacturing held

Table 2.7.1 Selected Economic Indicators, %

Growth is projected as stable in 2026 and accelerating in 2027, with inflation slowing in both years.

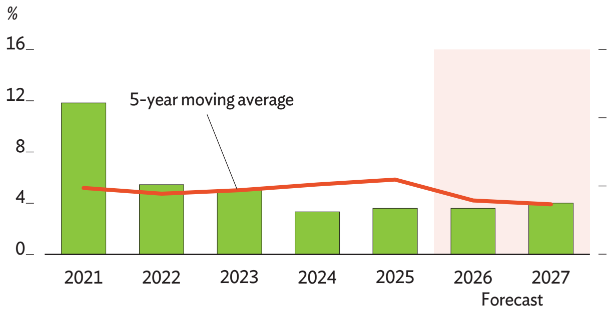
	2024	2025	2026	2027
GDP growth	3.3	3.6	3.6	4.0
Inflation	60.0	35.2	27.7	21.5

GDP = gross domestic product.

Source: Asian Development Bank estimates.

Figure 2.7.8 Gross Domestic Product Growth

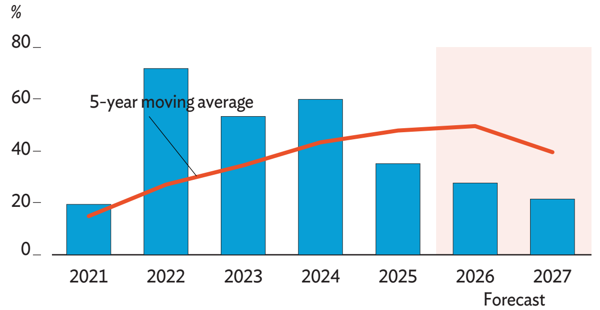
Growth will be stable in 2026 and strengthen in 2027.



Sources: Turkish Statistical Institute; Asian Development Bank estimates.

Figure 2.7.9 Inflation

Inflation will decline further in 2026 and 2027.



Sources: Central Bank of the Republic of Türkiye; Asian Development Bank estimates.

broadly stable at 74.1% in January 2026, while the Manufacturing Purchasing Managers' Index, a leading indicator of aggregate economic activity, remained at 48.1, indicating cautious optimism. Nonetheless, the ongoing conflict in the Middle East creates significant uncertainty in the outlook.

Industry is projected to support growth on the supply side. The sector, including construction, is projected to grow by 4.8% in 2026 and 5.1% in 2027, supported by continued investments in plant and equipment and driven by strength in manufacturing and construction, with the latter acting as an important growth multiplier through spillovers across economic sectors. Services are projected to grow by 3.2% in 2026, reflecting weaker external demand from the European Union, before accelerating to 3.7% in 2027, as exports of services strengthen. Output in agriculture is forecast to grow modestly by 2.4% in 2026 and 1.5% in 2027, driven by improvements in production capacity and supply chain efficiency.

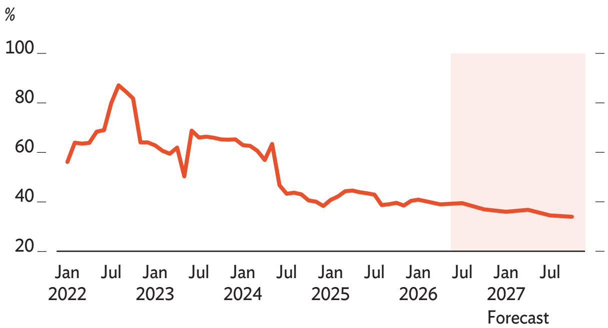
On the demand side, tighter monetary and fiscal policies are expected to limit the rise in government consumption. Private consumption is projected to grow by 3.0% in 2026, with continued credit growth, and 3.2% in 2027, with higher real wages and increased consumer confidence. Government consumption is projected to expand but at a slower pace. Continued investments in machinery and equipment should help raise productivity, boosting investment growth to 5.9% in 2026 and 6.8% in 2027. Net exports are projected to contribute to expansion, increasing by 2.4% in 2026 with a relative slowdown in import growth, and 3.1% in 2027 owing to a more favorable outlook for service exports.

Inflation is forecast to decline further. Average inflation is projected to decelerate to 27.7% in 2026 and 21.5% in 2027, as subsidy reforms and a tighter public spending framework take effect (Figure 2.7.9). The introduction of a sliding-scale mechanism for fuel taxation—enabled by greater fiscal space—will help cushion the impact of temporary oil price fluctuations on consumers and support disinflation, assuming only short-lived pressures from global energy markets. Long-term progress in inflation will depend on reinforcing the inflation-targeting framework, enhancing exchange-rate flexibility, restraining ad hoc wage increases, and improving liability management in state-owned enterprises. The introduction of caps on loans during 2024 and 2025, which require banks to hold additional reserves, should continue to reduce inflation, strengthen the exchange rate, and attract foreign capital to local debt and equity markets. Positive real interest rates should also help limit loan growth and anchor inflationary expectations, while strengthening the transmission mechanism of monetary policy. Broad money growth is projected to fall below 35% during the next 2 years, with credit growth following a similar path (Figure 2.7.10). However, the exchange rate remains vulnerable to abrupt shifts in offshore investors' currency swap positions with domestic banks.

Fiscal policy is expected to continue performing a balancing act, combining ongoing consolidation with higher capital spending and further revenue reforms. This is expected to keep the fiscal deficit to 3.3% of GDP in 2026 and 3.6% in 2027. Revenues are projected to increase to 20.5% of GDP in 2026 with improved direct tax collection and gains from

Figure 2.7.10 Broad Money Growth

Broad money growth will decelerate, reflecting continued monetary tightening.

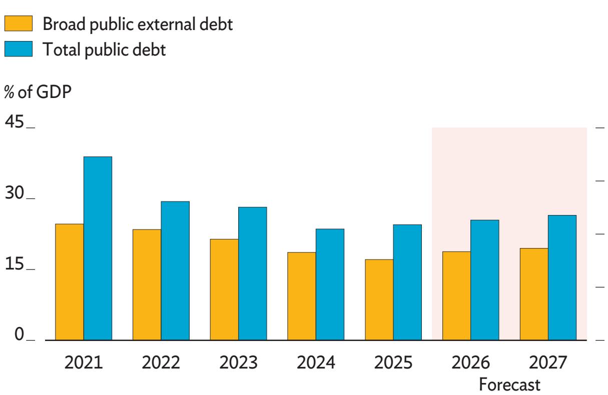


Sources: Central Bank of the Republic of Türkiye; Asian Development Bank estimates.

previously enacted increases in indirect taxes, and to 20.7% in 2027, from higher import tax revenue. Expenditures are projected at 23.8% of GDP in 2026 and 24.3% in 2027, with higher spending on capital projects and social safety nets. Well-coordinated monetary and fiscal policies will be key to promoting disinflation and ensuring macroeconomic stability, with rules-based taxation that broadens the tax base, reduces loopholes and arbitrary exemptions, and decreases the size of the informal economy. Public debt is projected to rise but remain moderate at 25.5% of GDP in 2026 and 26.5% in 2027, but a high share of foreign exchange-denominated debt and quasi-fiscal activities by state enterprises heighten risks in the public sector (Figure 2.7.11).

Figure 2.7.11 Public External and Total Public Debt

Total and external public debt will rise as a percent of GDP.



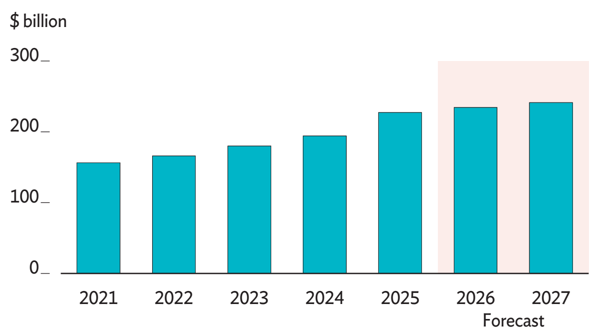
GDP = gross domestic product.

Sources: Central Bank of the Republic of Türkiye; Asian Development Bank estimates.

The current account deficit is projected to expand further. Growth in merchandise exports is forecast to slow to 4.1% in 2026 from uncertainty and volatility in global demand, before increasing to 5.3% in 2027, helped by higher global growth. As a net energy importer, Türkiye will remain sensitive to fluctuations in global energy prices, with elevated import costs likely weighing on the current account. Service exports are projected to moderate, with growth slowing to 3.2% in 2026 due to softer tourism receipts—especially from Gulf economies—but recovering to 6.5% in 2027 as tourism activity rebounds and non-tourism service exports continue to expand. With the prolonged conflict, however, the country could face significant losses both in merchandise trade and service receipts from the region. Growth in reserves is projected to slow (Figure 2.7.12). However, reduced gold purchases, and recent sovereign ratings upgrades, supported by lower credit default swap risk premiums, should further strengthen Türkiye's external position despite its extensive external financing needs.

Figure 2.7.12 Gross International Reserves

Reserves are projected to increase, but at a slower rate.



Sources: Central Bank of the Republic of Türkiye; Asian Development Bank estimates.

The outlook is subject to a very high degree of uncertainty. The current conflict in the Middle East may substantially slow growth and lift headline inflation, while rapid credit growth may add to macro-financial vulnerabilities. Structural challenges, including high underemployment, a large informal economy, and low labor force participation rates, continue to constrain potential growth and productivity. Additional risks stem from global trade tensions that could fuel inflation, rising bond yields that may increase borrowing costs or trigger volatile capital inflows, and delays in fiscal consolidation that could undermine policy credibility and investor confidence.

Policy Challenge—Avoiding the Middle-Income Trap

Türkiye, as an upper middle-income country, aims to be firmly established as a high-income economy and avoid the middle-income trap. However, avoiding the trap, also referred to as the non-convergence trap, will be challenging, based on other countries' experience. Since the 1990s, only 34 middle-income economies have achieved high income status. The rest—108 at the end of 2023—have been stuck in middle-income status. Successful transitions have typically involved moving from final-goods assembly with intermediate imports and labor-intensive production (e.g., textiles) toward electronics, advanced manufacturing, and higher-value activities in which high-income economies have a comparative advantage. While Türkiye has a dynamic, well-diversified economy with a vibrant private sector and a solid production base, it lacks a technology orientation and strong value added in manufacturing to support higher-complexity exports. The share of manufacturing employment in total employment has not exceeded 20% since at least 2010, while the economy has increasingly shifted toward low-productivity services. Until recently, growth came more from domestic consumption and credit expansion than investment, exports, or productivity gains.

The Government of the Republic of Türkiye aims to overcome these challenges by developing technology-intensive and value-added production and export capacity. This includes improving research, development, and innovation, supporting product and market diversification, and promoting a greener economy. It also aims to strengthen human capital and social welfare, improve business and investment environments, increase the supply of advanced infrastructure to catalyze private sector investment, and promote good governance and the rule of law.

Productivity growth will ultimately turn on structural reforms in labor markets and human capital development, including mass education, skills transfer, and continued skills upgrading. Income inequality across regions can also constrain growth and prevent graduation to high-income status. By comparison, sound contract enforcement, protection of intellectual property rights, streamlined taxation, efficient energy regulations, and expanded access to risk-tolerant finance, such as venture capital, to support new market entrants would help the transition. Given Türkiye's deep integration into European value chains, efforts to decarbonize production and advance a credible green transition—supported by regulatory reform and investment de-risking mechanisms—could attract foreign capital, reduce emissions, and drive productivity-enhancing structural change.

The economy needs to evolve from a more conventional production structure to a highly sophisticated, knowledge-based and productivity-driven model. Prudent macroeconomic management and comprehensive structural reforms will be needed to achieve significant progress. Adopting emerging technologies, such as artificial intelligence to complement labor productivity, may help the transition to high-income status, in part by potentially narrowing persistent income gaps.

TURKMENISTAN

The government reported stable, robust growth amid strong public investment and steady hydrocarbon exports. Inflation is estimated to have remained unchanged at moderate levels. Growth is projected to rise slightly in 2026 as exports expand, and decelerate in 2027, as consumption slows. Strengthening public investment management is crucial to improve its efficiency and effectiveness.

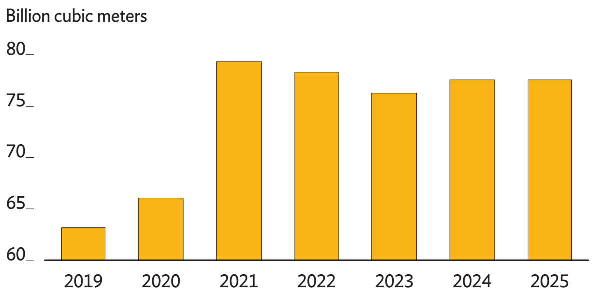
Economic Performance

According to the annual government reports, growth in 2025 remained at 6.3%, underpinned by public investments and hydrocarbon exports. On the supply side, the government noted expansion in industry and services. Industry excluding construction was reported to grow by 1.8%, reflecting moderate expansion in traditional hydrocarbons—gas, crude oil, oil products—as well as chemicals, electricity, food processing, textiles, and construction materials. Construction was reported to grow by 7.9% on a notable increase in construction activity, including in the smart city, Arkadag, officially opened in 2023, as well as new housing and social infrastructure across the country. Agriculture grew by 7.0% as it hit production targets in horticulture and in the strategic crops of cotton and wheat. Services are estimated to have grown by 8.3%, with transport and communications growing by 9.8%, while other services grew by 7.5%.

On the demand side, the main drivers were public investments and net exports. The volume of gross investment in various production facilities and social infrastructure under the President's program for socioeconomic development in 2022–2028 was reported to have risen by 6%, reaching 16.6% of GDP. Of the total capital investments, 49.1% were allocated for industrial production and 50.9% for social sector facilities. Stable production and exports of natural gas, Turkmenistan's main export, boosted net exports (Figure 2.8.1). Private consumption growth, however, remained constrained by low incomes and limited employment opportunities.

Figure 2.8.1 Natural Gas Production

Natural gas output remained stable in 2025.



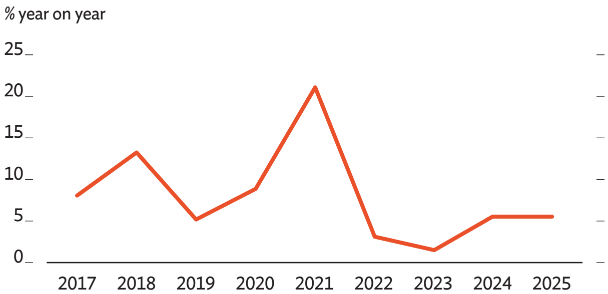
Sources: BP Statistical Review of World Energy 2024; government reports; Asian Development Bank estimates.

Preliminary ADB estimates show that average annual inflation remained at 5.5% in 2025 (Figure 2.8.2). This rise in prices reflected expansionary credit policy and government spending, despite administrative price and exchange rate controls. The government maintained a fixed exchange rate regime, which regulates foreign currency sales and international money transfers. Bank lending to state-owned enterprises in the priority sectors is considerable, with some credit allocated to private firms engaged in import substitution and oriented for exports.

This chapter was written by Jennet Hojanazarova of the Turkmenistan Resident Mission, ADB, Ashgabat.

Figure 2.8.2 Inflation

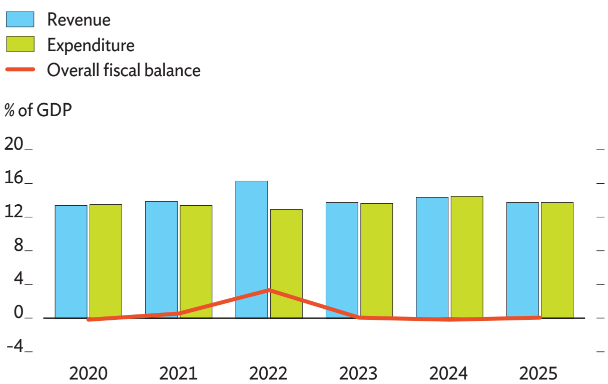
Average annual inflation was unchanged in 2025.



Sources: International Monetary Fund. 2025. *World Economic Outlook, Middle East and Central Asia*. October; Asian Development Bank estimates.

Figure 2.8.3 Government Fiscal Indicators

The fiscal surplus remained near balance in 2025.



GDP = gross domestic product.

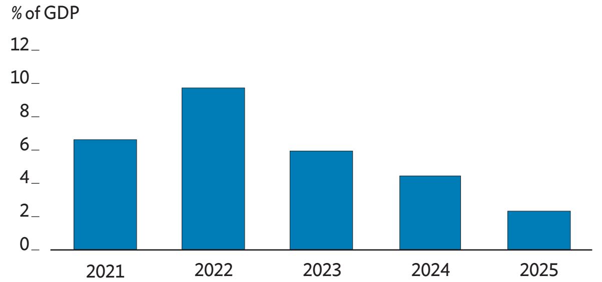
Source: International Monetary Fund. 2024. *World Economic Outlook*. October.

The state budget surplus was estimated at 0.1% of GDP, near balance, versus a 0.1% deficit in 2024. Revenue declined marginally to 13.8% of GDP, from 14.4%, while expenditure decreased to 13.8% of GDP from 14.5% (Figure 2.8.3). While the state budget does not capture off-budget spending, the latest report by Fitch Ratings (2025) estimated public debt at 3.9% of GDP, suggesting limited new borrowing. Turkmenistan's current long-term sovereign rating, BB–, reflects the country's extremely strong sovereign balance sheet, with the highest net foreign assets-to-GDP and the lowest public debt among peers in the "BB" category.

The current account surplus is estimated to have narrowed to 2.3% in 2025 from 4.4% in 2024, reflecting some relaxation of import controls

Figure 2.8.4 Current Account Balance

The current account surplus narrowed in 2025.

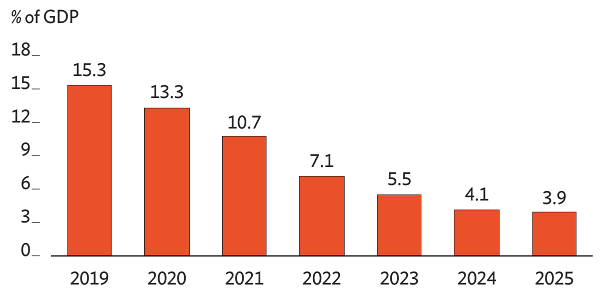


GDP = gross domestic product.

Source: International Monetary Fund. 2025. *Regional Economic Outlook database*. October.

Figure 2.8.5 External Debt

External debt declined further in 2025.



GDP = gross domestic product.

Source: International Monetary Fund. 2025. *Regional Economic Outlook, Middle East and Central Asia*. October.

(Figure 2.8.4). Export earnings came primarily from gas exports, mainly to the People's Republic of China (PRC), and additional exports to neighboring countries under gas swap agreements. With extensive repayment of external loans and the government's aversion to foreign borrowing, external debt at the end of 2025 declined further to 3.9% of GDP (Figure 2.8.5).

Economic Prospects

Growth is projected to rise slightly to 6.5% in 2026, before slowing to 6.2% in 2027 (Table 2.8.1 and Figure 2.8.6). Turkmenistan's policy objectives for 2026 emphasize expanding regional cooperation, diversifying the economy, and broadening export routes for natural gas. These are embodied in the government's Program for Socioeconomic Development and Investment of Turkmenistan

Table 2.8.1 Selected Economic Indicators, %

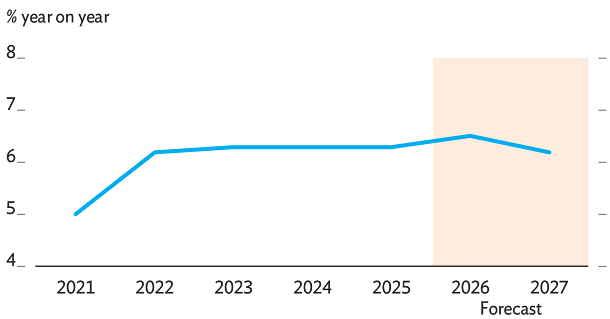
Growth is forecast to accelerate in 2026 and then slow in 2027, with inflation rising.

	2024	2025	2026	2027
GDP growth	6.3	6.3	6.5	6.2
Inflation	5.5	5.5	6.0	6.0

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

Figure 2.8.6 Gross Domestic Product Growth

GDP growth is projected to rise in 2026 and moderate in 2027.



GDP = gross domestic product.
Sources: Turkmenistan government statistics; Asian Development Bank estimates.

in 2026, which seeks to maintain economic growth through continued public investment in infrastructure, including in oil and gas, and through economic diversification in transport, agriculture, and non-industrial sectors. Continued strong gas exports and rising consumer spending are projected to increase growth in 2026. Infrastructure development through continued capital investment will remain a priority. Domestically, the government aims to strengthen food security while limiting inflation. Policy efforts will also focus on developing transport, green energy, and digital sectors. Broader goals include advancing economic and social development and improving living standards. However, the recently announced discontinuation of public-sector salary and pension increases from 2026 may weigh on household incomes, given the dominance of public-sector employment, trimming growth in 2027.

Inflation is projected to rise to 6.0% in 2026 and 2027. This forecast is based on expectations of higher public spending, rising import prices, and the continued application of foreign exchange restrictions. Expansionary bank lending to state-owned enterprises is also expected to contribute to inflationary pressures over the projection period.

The fiscal outlook is projected to be near balance in both years. Hydrocarbon export revenues will continue to support public finances, as they account for the bulk of government revenue. Strong and steady demand from the PRC will support revenue, and cooperation between Turkmenistan and the PRC on gas is expected to deepen as the PRC gradually shifts toward greater natural gas consumption and away from coal. On the expenditure side, the government remains focused on social programs, including price controls and basic food subsidies, which are expected to continue. However, data on detailed fiscal plans are not yet available.

Infrastructure upgrades will remain a priority. Key projects include ongoing work on the Ashgabat–Turkmenabat motorway—now in its final phase—and continued investment in the $5 billion project, Arkadag City, scheduled for completion in 2027. While financing for public investment projects will remain large, with the bulk of it coming off budget, public debt is projected to decrease further to 3.3% of GDP by the end of 2027. While debt is projected to remain moderate over the medium term, large-scale construction projects could exert pressure on public finances and affect long-term fiscal sustainability.

The Presidential Program of Socio-Economic Development for 2022–2028 provides the medium-term framework for economic policy. The program prioritizes macroeconomic stability and calls for diversifying the economy through expanded domestic production, greater export variety, private sector development, innovation, digitalization, and deeper regional trade integration. The program also emphasizes a gradual transition toward a greener economy through enhanced international cooperation. Additional measures aim to address infrastructure and social needs and attract more foreign direct investment.

Several key activities are expected to drive Turkmenistan's economic growth in the coming years. In the hydrocarbon sector, these include further development of major gas fields such as the Galkynysh Gas Field, progress in building the Turkmenistan–Afghanistan–Pakistan–India gas pipeline, the expansion of gas-chemical production, including gas-to-gasoline, and additional facilities for gas swap exports to neighboring countries. In construction, continued investment in social and cultural infrastructure will play a crucial role, as will the modernization of transport networks, including railways. Initiatives in agriculture will focus on cotton and grain production, livestock rearing, and the integration of modern technology. In trade, efforts will be made to ensure market stability, food security, and a sufficient supply of commodities. Further, the government will continue to support state-owned enterprises and private firms engaged in import substitution and export promotion programs.

Relaxed import constraints may narrow the current account surplus to 1.0% of GDP in 2026 and 0.5% in 2027. The bulk of export revenue in the coming years will likely continue to come from hydrocarbon exports, which should remain stable. Any increase in total exports will be matched by increases in imports for large construction projects and consumer goods. External debt is projected to remain below 4.0% of GDP in the coming years.

Policy Challenge—Strengthening Public Investment Management to Improve the Efficiency and Impact of Public Spending

Public investment has been a key driver of Turkmenistan's economic development. Sustained spending on infrastructure, industrial capacity, and social services are important contributions to GDP growth. High public investment has supported activity in construction, industry, and social infrastructure, including flagship initiatives such as Arkadag City, noted earlier. Medium- and long-term state investment programs—most notably the Presidential Program of Socio Economic Development (2022–2052) and medium-term development strategies (e.g., 2022–2028)—prioritize large scale infrastructure and industrial projects, strengthen links between capital spending and national development objectives, and improve coordination across government entities.

Recent efforts have helped further develop the public investment framework. At the same time, there remains scope to enhance the overall efficiency and effectiveness of public investment spending. The state still dominates the investment landscape, with private sector participation and sectoral diversification evolving gradually. International experience suggests that maximizing the long-term growth and development impact of high public investment benefits from a strong public investment management (PIM) framework, underpinned by clear prioritization, transparency, and efficient allocation of resources. Progress toward alignment with international good practices, supported by cooperation with development partners, could help strengthen economic resilience, diversification, and sustainable growth prospects.

Turkmenistan's PIM framework is not yet fully aligned with the international good practices reflected in World Bank, International Monetary Fund, or Public Expenditure and Financial Accountability standards. Initial international assessments, including from ADB, suggest scope to strengthen the efficiency and coherence of existing arrangements through gradual and well sequenced reforms.

Moving toward a more unified PIM system. Public investment is organized through two main channels. Investments in social infrastructure are financed and managed through the central government budget ("Tier I"), while a significant share of economic and energy-related projects is implemented by state-owned enterprises (SOEs) and line ministries outside the central budget framework ("Tier II"). While this structure allows flexible implementation, it can result in process differences, oversight levels, and information coverage. Greater integration of these arrangements could provide a more comprehensive view of public investment and support stronger coordination and strategic alignment. A more unified PIM system—anchored in common institutions and procedures and incorporating extrabudgetary investments within a general government framework consistent with Government Finance Statistics-based international norms—could enhance transparency and effectiveness.

Strengthening state-owned enterprise governance and oversight. SOEs play a leading role in public investment and undertake a range of activities with fiscal implications, including quasi-fiscal operations. At present, much of this activity occurs outside the central budget and is subject to limited public reporting. Available estimates suggest that SOEs account for a substantial share of the broader public sector, although their operations are not fully reflected in fiscal accounts. In addition, SOEs often rely on directed lending from the central bank, rather than on-budget financing mechanisms. Gradual enhancements to SOE governance, financial disclosure, and oversight—such as clarifying commercial and noncommercial mandates, expanding the use of external audits, and publishing financial statements—could support better risk management and facilitate incorporation of SOE activities into broader fiscal risk assessments.

Enhancing project appraisal and selection. Strengthening such processes could help prioritize public investments and align them with national development objectives and sectoral strategies. Introducing standardized methodologies for economic appraisal, including cost benefit analysis where appropriate, would support more consistent and transparent decision making across projects and sectors.

Improving data and statistical capacity. Enhancements in the quality, coverage, and timeliness of economic and fiscal statistics would support more informed policymaking and strengthen the analytical basis for public investment decisions. Improved data availability would also facilitate better project prioritization, implementation monitoring, and ex-post evaluation—key components of an effective PIM cycle—and contribute to enhanced policy credibility.

Modernizing PIM processes through a phased digital transformation could strengthen coordination and transparency across government entities and SOEs. Development of integrated information systems—supporting real-time data sharing, automated workflows, and unified monitoring—could improve efficiency, timeliness, and institutional coordination, and narrow information gaps.

Operationalizing reform through diagnostic assessment. To support reform efforts, conducting a diagnostic review—such as the International Monetary Fund's Public Investment Management Assessment—could help benchmark current practices against international standards, identify priority areas for improvement, and inform development of a sequenced reform roadmap. Preparatory steps, including establishment of an internal working group within the Ministry of Finance and Economy, could help consolidate institutional knowledge, coordinate stakeholders, and facilitate engagement with external partners.

UZBEKISTAN

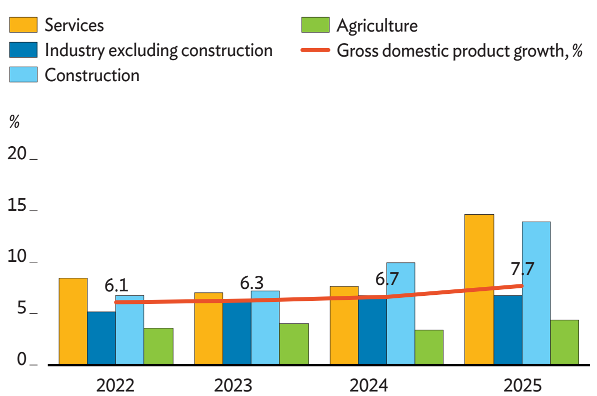
Growth accelerated in 2025, exceeding expectations, reflecting gains in all major sectors. Inflation moderated faster than expected, aided by tight monetary policy and exchange rate appreciation, and is projected to decline further in 2026 and 2027. Growth is expected to moderate somewhat in 2026 before edging up in 2027 as reforms advance and investment strengthens. Pivoting from demand-led expansion to productivity-driven growth makes World Trade Organization accession and accelerated state enterprise reform key policy challenges.

Economic Performance

Growth accelerated to 7.7% in 2025 from 6.7% in 2024, reflecting strong performance in all sectors (Figure 2.9.1). Growth in services jumped to 14.7% in 2025 from 13.3% in 2024, reflecting strong gains in trade, accommodation and food services (12.0%), and transportation, storage, and information and computer technology (14.5%). Expansion in industry (excluding construction) remained strong at 6.8%, driven mainly by increases in manufacturing (7.7%), utilities (3.5%), and mining (3.5%). Growth in construction jumped to 14.2% from 8.8%, reflecting strong investment in residential and infrastructure projects. Expansion in agriculture rose to 4.4% from 3.6%, from continued gains in crop and livestock production.

Figure 2.9.1 Supply-Side Growth

Growth accelerated in 2025, with faster expansion in most sectors.



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

Domestic demand underpinned growth and strengthened as rising incomes, expanding deposits, and strong business activity provided support. Underlying information suggests a sharp rise in consumption. Real household incomes grew by 9.2%. In addition, on-line cash register turnover rose by 17.0%, while receipts from trade and monetary services rose by 24.7%. Investment also supported growth, rising by 10.5%, driven primarily by enterprise resources, household savings, and foreign direct investment. Investment focused particularly on manufacturing, logistics, construction, and urban development. Moreover, commissioned housing rose by 35.7% and housing transactions by 16.7%. Net exports arguably also contributed to growth, as exports rose faster than imports.

Inflation eased faster than anticipated as tight monetary conditions took effect and cost pressures eased. Headline inflation declined to 7.3% in 2025 from 9.8% in 2024 as tight monetary policy continued amid currency appreciation despite strong wage growth exceeding 18%. Food inflation moderated to 5.4% from 8.0% and inflation for other goods declined to 5.1%

This chapter was written by Sherzod Akbarov of the Uzbekistan Resident Mission, ADB, Tashkent.

from 6.9% as supply conditions improved and global commodity pressures eased. Inflation for services remained elevated at 13.9% but significantly below the 21.8% rise in 2024 following administered energy price adjustments. The Uzbek som appreciated against the US dollar in 2025 amid strong remittances and robust export earnings.

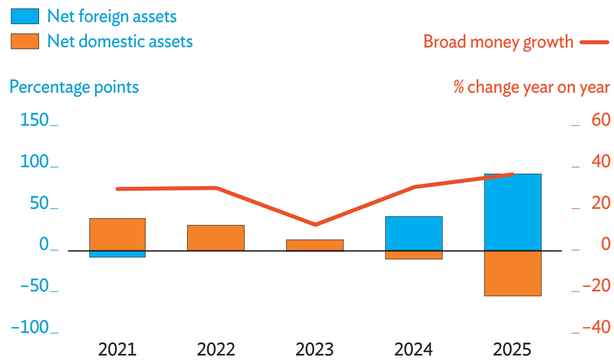
The fiscal deficit narrowed from 4.0% of GDP in 2024 to 2.1% in 2025 on consolidation while protecting social spending. Ongoing improvements in tax administration and public financial management helped raise revenue to 27.2% in 2025 from 26.5% of GDP in 2024. Total expenditure diminished to 29.3% in 2025 from 29.7% of GDP in 2024. Tight management of spending, including better targeting of subsidies and stricter control over non-priority outlays, helped limit expenditure, with 52.0% going toward education, healthcare, and social protection. Local budgets gained additional flexibility through greater retention of personal income tax revenues and the reallocation of turnover and land tax receipts. Maintaining consolidation will be important to contain fiscal risks, including those linked to state enterprises and directed lending.

Monetary conditions remained tight, supporting disinflation and the stabilization of inflation expectations. Credit growth moderated to about 13.0% from 14.2% in 2024 on stricter credit policies and lower demand for consumer and corporate borrowing, although a rise in net foreign assets raised broad money growth (Figure 2.9.2). The slowdown was most evident in consumer lending and in transport and communication. Nonperforming loans declined from 4.0% in 2024 to 3.2%, indicating somewhat improved asset quality. The Central Bank of Uzbekistan kept its policy rate at 14.0% to reinforce its credibility in achieving its medium term inflation target of 5.0%. Continued coordination between monetary and fiscal policy will remain important for further disinflation.

External balances strengthened as exports and remittances increased, while reserves remained robust. The current account deficit narrowed sharply to about 2.5% in 2025, from 5.0% of GDP in 2024, supported by buoyant gold exports, rising tourism receipts, and a strong rebound in remittances (Figure 2.9.3). The latter increased by 27.2% to $18.9 billion. Exports rose by 24.0%, supported by strong global gold prices and rising non-gold shipments,

Figure 2.9.2 Contributions to Money Supply Growth

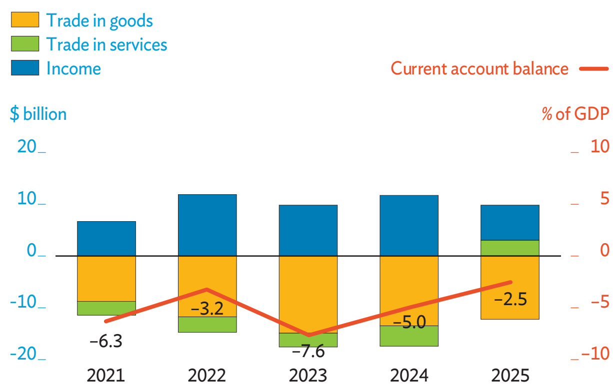
Broad money growth accelerated in 2025 with a larger increase in net foreign assets.



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

Figure 2.9.3 Current Account Components

The current account deficit narrowed in 2025.



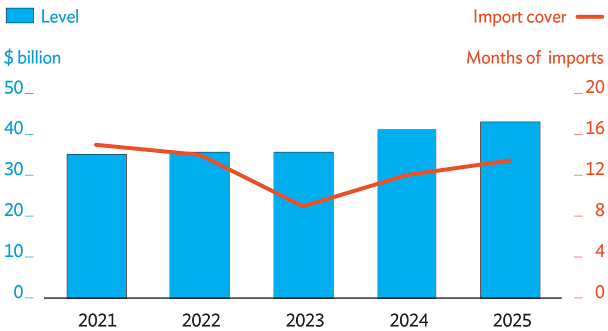
GDP = gross domestic product.

Sources: The Central Bank of Uzbekistan; 2025 Balance of Payments, International Investment Position, and External Debt of Uzbekistan; Asian Development Bank estimates.

growing faster than imports and thus narrowing the trade deficit. Gold accounted for 29.3% of total exports, posting a robust 32.3% increase, while industrial goods rose by 11.8%, food products by 8.7%, chemical products by 6.3%, and mineral fuels by 4.4%. While gold remained dominant, this also underscores Uzbekistan's exposure to a potential normalization of global gold prices—a downside risk the International Monetary Fund has repeatedly highlighted—and the importance of diversifying into higher value-added manufacturing and service exports. Imports rose by 18.5%, reflecting strong demand for capital and intermediate goods. Imports of food and live animals grew by 23.5%, driven by household consumption and inventory replenishment. The strong expansion of tourism and other cross-border services boosted service exports, supporting a broader improvement in the current account balance. International reserves remained ample at $66.3 billion, or 12–15 months of prospective imports, at end-2025 (Figure 2.9.4).

Figure 2.9.4 Gross International Reserves

Gross international reserves increased in 2025.



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

Economic Prospects

Under this report's early stabilization scenario finalized in early March, growth is projected to moderate to 6.7% in 2026 before rising to 6.8% in 2027, as the economy transitions from the exceptional expansion in 2025 (Table 2.9.1 and Figure 2.9.5). The International Monetary Fund projects that Uzbekistan will be one of the fastest growing economies in Central Asia. Strong domestic demand, continued investment in productive capacity, and ongoing structural transformation toward services and higher value-added industry will be important for growth. These projections are subject to a very high degree of uncertainty, reflecting rapidly evolving regional and global conditions.

On the supply side, services are expected to remain the main driver of growth. They are projected to expand by about 14.5% in 2026, supported by continued expansion in trade, logistics, digital services, and tourism, and 14.3% in 2027. Growth in construction is expected to moderate to about 10.2% in 2026 and 8.3% in 2027 as infrastructure development, housing demand, and industrial investment projects continue, albeit at a more sustainable pace following rapid expansion in recent years. Expansion in industry (excluding construction) is projected to moderate slightly to about 6.4% in 2026 before rising to 6.7% in 2027. Continued investment in modernization of manufacturing and mining and expansion in energy-related sectors will support the sector. Growth in agriculture is forecast to slow marginally to around 4.2% in 2026 and 4.3% in 2027, reflecting gradual productivity improvements alongside structural constraints, including water resource pressure and climate variability. These projections are aligned with the macroeconomic framework underpinning the 2026 State Budget Law and remain broadly consistent with the medium-term growth trajectory outlined in *ADO April 2025*.

Table 2.9.1 Selected Economic Indicators, %

More moderate growth and lower inflation are projected for 2026 and 2027.

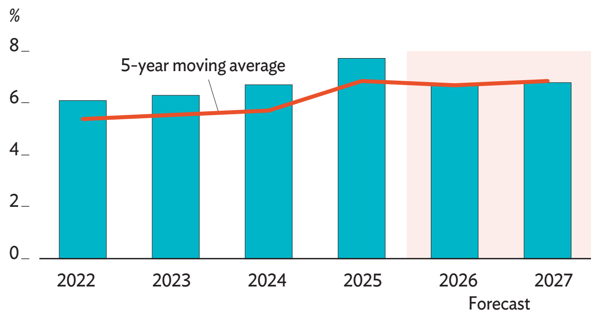
	2024	2025	2026	2027
GDP growth	6.7	7.7	6.7	6.8
Inflation	9.8	7.3	6.5	5.0

GDP = gross domestic product.

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

Figure 2.9.5 Gross Domestic Product Growth Forecast

Growth is forecast to decline in 2026 and rise marginally in 2027.



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

On the demand side, high investment, continued fiscal support, and elevated remittance inflows are expected to sustain income growth and consumer demand in 2026 and 2027. Investment in infrastructure, housing, and industrial capacity is expected to support employment and wage growth, while government spending will continue to support domestic demand through social transfers and priority development outlays, even with continued fiscal consolidation. Remittances are expected to remain high, supporting household consumption and small businesses, although growth is expected to normalize following the exceptionally strong expansion in

2025. These trends are consistent with central bank assessments that resilient aggregate demand remains a key driver of economic activity.

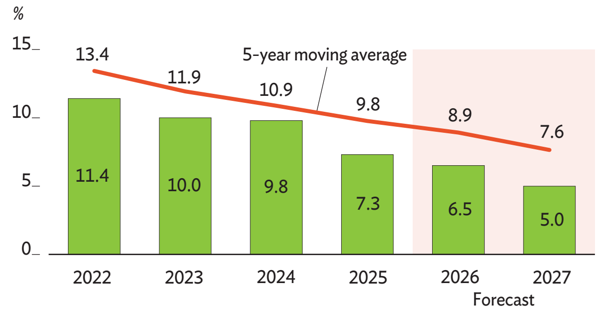
Inflation is expected to continue easing, although administered energy price adjustments and supply risks in certain food products may temporarily slow the pace. The central bank projects inflation declining to 6.5% by the end of 2026 and converging toward its medium term target of 5.0% by 2027 (Figure 2.9.6). Continued tight monetary conditions, a relatively stable exchange rate, and moderating core inflation will support disinflation. However, inflation in services may remain relatively elevated due to demand-side pressures, while seasonal supply disruptions could create temporary food price volatility. Inflation expectations have recently shown signs of stabilization, suggesting that tight monetary conditions may need to be maintained for longer to ensure a return to targeted inflation levels.

Government will continue to consolidate fiscal policy, with the deficit projected to remain below 3.0% of GDP (Figure 2.9.7). Continued reforms to reduce energy subsidies, limit policy-directed lending, and improve targeting of social transfers are expected to support fiscal sustainability and macroeconomic stability. Maintaining consolidation will be important to contain fiscal risks, including potential contingent liabilities from state-owned enterprises (SOEs) and state-linked financial institutions.

The current account deficit is projected to remain between 4% and 5% in 2026 and 2027 (Figure 2.9.8). High imports of machinery and capital goods for infrastructure projects will drive this expansion. Exports are expected to remain strong, reflecting high precious metal prices and improving non-gold exports and services, although export concentration in gold remains a structural vulnerability. Remittances are expected to stabilize at high levels, supporting domestic demand and external balances, while international reserves are expected to remain adequate. External debt is projected to decline slightly in percent of GDP (Figure 2.9.9). Downside risks stem primarily from potential administered price adjustments, global financial volatility, uncertainty in global trade conditions, slower-than-expected progress in SOE reform, and potential contingent fiscal liabilities from state-linked financial institutions.

Figure 2.9.6 Inflation Forecast

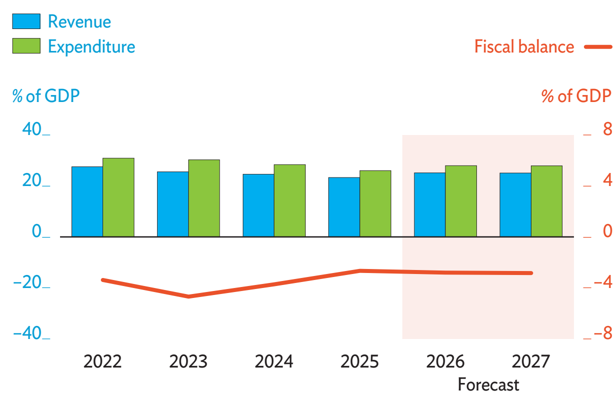
Inflation is projected to decline in both 2026 and 2027.



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

Figure 2.9.7 Fiscal Forecast

The budget deficit is projected to widen slightly in 2026 and 2027.

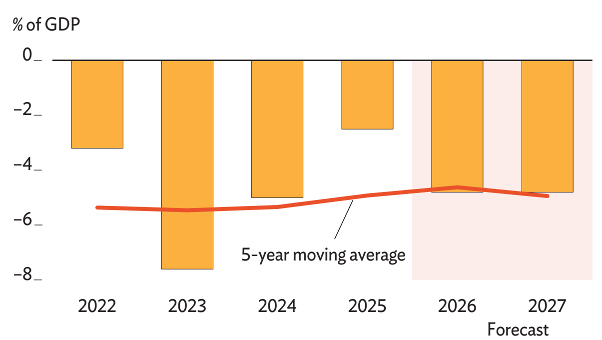


GDP = gross domestic product.

Sources: International Monetary Fund; Asian Development Bank estimates.

Figure 2.9.8 Current Account Forecast

The current account deficit is projected to widen in 2026 and 2027.

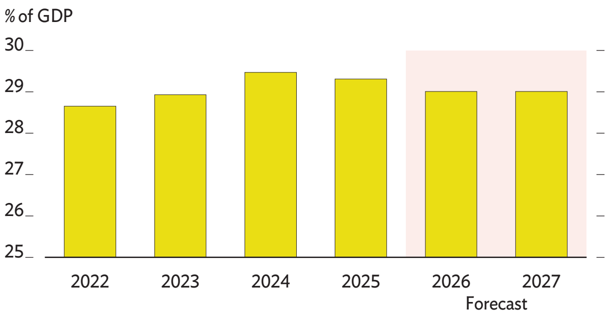


GDP = gross domestic product.

Sources: The Central Bank of Uzbekistan. 2025. Balance of Payments, International Investment Position, and External Debt of Uzbekistan; Asian Development Bank estimates.

Figure 2.9.9 External Debt Forecast

External debt is projected to narrow slightly in percent of GDP in 2026–2027.



GDP = gross domestic product.

Sources: The Central Bank of Uzbekistan. 2025. Balance of Payments, International Investment Position, and External Debt of Uzbekistan; Asian Development Bank estimates.

Policy Challenge—Accelerating Economic Transformation Through State Enterprise Reform and WTO Accession

Uzbekistan aims to use imminent World Trade Organization (WTO) accession to reinforce economic transformation by strengthening competition, improving market institutions, and advancing SOE reform. Bilateral market access negotiations have been completed with 33 of the 34 engaged WTO members and the country has entered the final stage of Working Party discussions, underscoring strong reform momentum. WTO accession externally anchors deepening structural reforms, enhanced policy predictability, and the shift toward a more open, rules-based economy. Importantly, WTO accession will serve as a medium-term growth mechanism by improving export diversification, raising services productivity, and attracting higher quality foreign investment—key channels repeatedly highlighted by international assessments. Recent regional disruptions have underscored the need for policy agility, with the Government of Uzbekistan actively monitoring external risks and preparing responses to mitigate potential spillovers, particularly through inflationary pressures, logistics disruptions, and external demand, while advancing WTO accession and structural reforms to strengthen economic resilience amid an increasingly uncertain external environment.

SOE reform remains pivotal to this transformation, as SOEs and state-linked finance continue to influence competition, investment decisions, and resource allocation. Recent actions, such as removing exclusive rights previously granted to certain SOEs and replacing export permits with transparent export duty mechanisms, reflect progress in moving from administrative controls toward WTO-consistent, rules-based approaches. However, many large SOEs and state-owned banks still experience soft budget constraints, policy-directed lending, and weak corporate governance, which risk distorting markets and creating contingent fiscal pressures. Weak SOE balance sheets and policy-directed lending may also create contingent fiscal risks and weaken monetary transmission. Without deeper SOE reform, the shift toward productivity-led growth will be difficult to sustain, even if headline growth remains strong.

Privatization and capital market development can accelerate transformation if sequenced with governance and restructuring measures. Planned initial and secondary private offerings and broader privatization beginning in 2026, supported by international advisers, can increase transparency, strengthen commercial discipline, and attract investment. Complementary reforms, including establishing the National Investment Fund and pro-competition regulatory measures in sectors such as telecommunications, can reduce the state's footprint and improve the market environment.

Regulatory modernization is also essential, as export competitiveness increasingly depends on meeting international standards rather than tariff preferences alone. To unlock potential in sectors such as textiles, processed food, and agriculture, Uzbekistan is reforming its technical regulation, sanitary and phytosanitary, and food safety systems, including work on a new "field to table" framework. Strengthening these systems will help domestic producers meet stringent market requirements and deepen integration into global value chains.

Sequencing and social support measures will be vital to ensure that transformation is inclusive and sustainable. WTO accession will introduce stronger competitive pressures, while SOE restructuring and privatization may require labor reallocation. Uzbekistan is negotiating transition periods for sensitive sectors, and continued investment in targeted social protection, skills upgrading, and labor market programs will help sustain public support as reforms advance.

By aligning SOE reform, regulatory modernization, and WTO accession, Uzbekistan can consolidate its shift toward a more competitive, private sector-driven economy. This will strengthen productivity, attract higher quality investment, and support deeper integration into regional and global markets.

DEVELOPING EAST ASIA

- People's Republic of China
- Mongolia

PEOPLE'S REPUBLIC OF CHINA

Economic growth is expected to moderate in 2026 and 2027 and inflation to rise. Exports and investment in high-tech sectors will support near-term growth, helping offset subdued household consumption and property investment. Boosting productivity growth through improving firm exit mechanisms is key for resilient growth amidst heightened uncertainty.

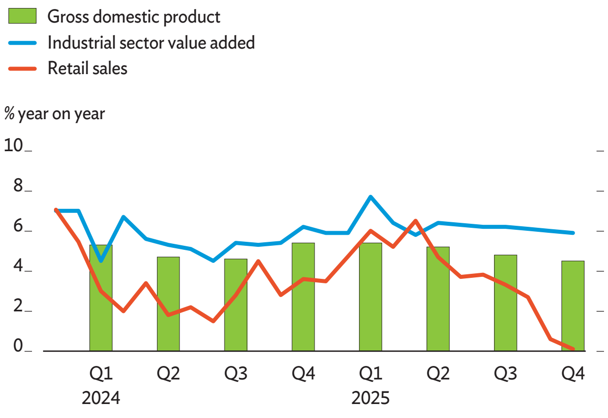
Economic Performance

The economy grew by 5.0% in 2025 on strong export and industrial activity. After rising by 5.4% in the first quarter (Q1), GDP growth gradually slowed in the following quarters amid subdued investment growth and household consumption, as shown by plummeting retail sales (Figure 2.10.1).

On the demand side, stronger contributions from consumption and net exports offset the slowdown in investment's contribution to GDP growth (Figure 2.10.2). Investment contributed only 0.8 percentage points to GDP growth in 2025, down from 1.3 percentage points a year earlier. Fixed asset investment weakened across the board, driven by a deeper contraction in property investment and slower infrastructure spending (Figure 2.10.3). While manufacturing investment grew modestly by 0.6%, infrastructure investment declined by 2.2%, reflecting both a pullback in fiscal spending and the government's continued focus on debt resolution. The property market downturn persisted amid falling home prices and large housing inventories, with real estate investment contracting by 17.2%, a sharper decline than the 10.6% drop recorded in 2024.

Figure 2.10.1 Real Economic Growth

Despite robust industrial production, GDP growth slowed through 2025 as retail sales plummeted.

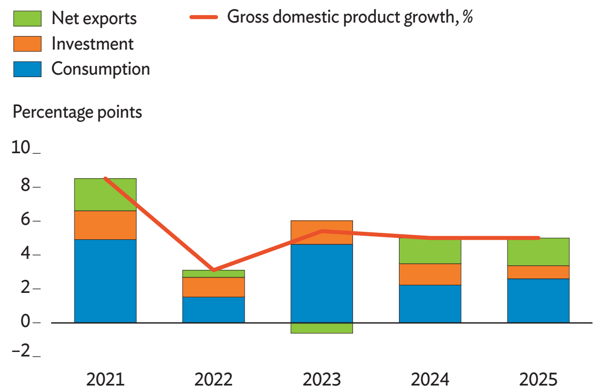


GDP = gross domestic product, Q = quarter.

Sources: CEIC Data Company; Asian Development Bank estimates.

Figure 2.10.2 Demand-Side Contributions to Growth

The decline in investment's contribution to growth was compensated by continued support from consumption and net exports.

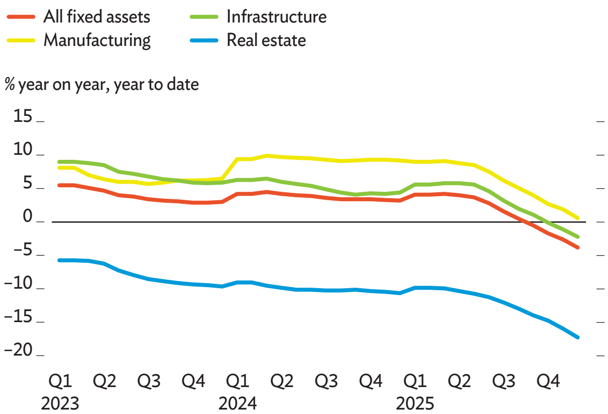


Source: CEIC Data Company.

This chapter was written by Yothin Jinjarak, Yajing Wang, and Wen Qi of the People's Republic of China Resident Mission, ADB, Beijing.

Figure 2.10.3 Growth in Fixed Asset Investment

Investment growth declined across the board, with property investment contracting more sharply and infrastructure investment also falling.

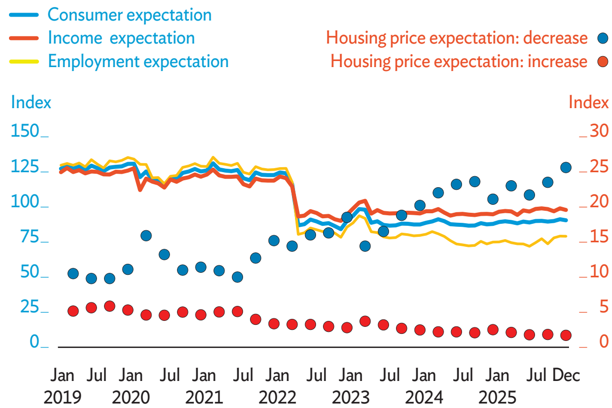


Q = quarter.

Source: CEIC Data Company.

Figure 2.10.4 Consumer Confidence Index

Consumer confidence stayed low amid declining property prices.

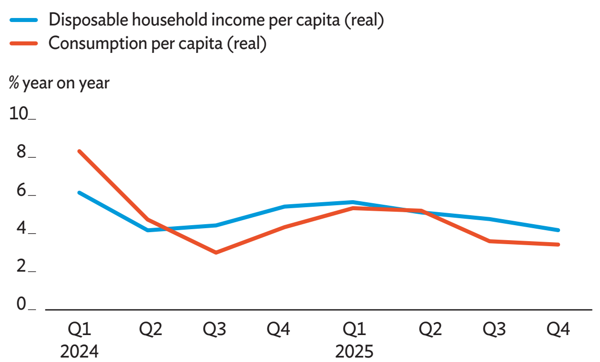


Source: CEIC Data Company.

Household consumption remained subdued, but government spending provided a counter-cyclical buffer. As a result, the contribution of consumption to GDP growth rose to 2.6 percentage points in 2025, from 2.2 points in 2024. Private consumption was constrained by subdued income growth and low consumer confidence (Figure 2.10.4). Growth in household expenditure slowed by 0.7 percentage points from last year—faster than the slowdown in income growth—indicating a more cautious consumption attitude among households (Figure 2.10.5). The fading impact of consumer goods trade-in subsidies weighed on retail sales, while services consumption remained relatively robust, reflecting an ongoing shift in spending toward services. Against this backdrop, higher government spending aimed at supporting livelihoods and boosting consumption likely strengthened domestic demand.

Figure 2.10.5 Growth in Income and Consumption per Capita

Household consumption growth slowed more than income growth, indicating a cautious consumption attitude among households.



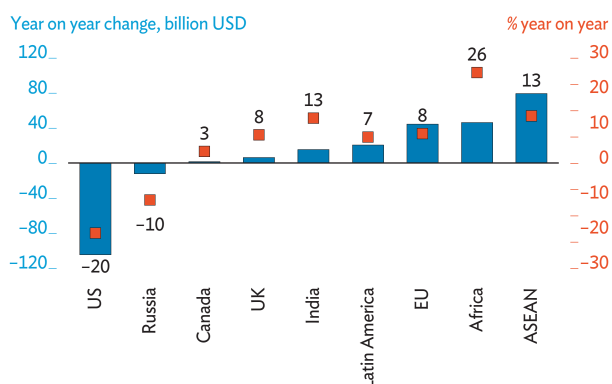
Q = quarter.

Sources: CEIC Data Company; Asian Development Bank estimates.

Net exports contributed 1.6 percentage points to growth in 2025, slightly higher than in 2024. The trade surplus reached a record high of $1.2 trillion with the sharp 19.8% decline in exports to the United States (US) more than offset by the resilient exports to non-US markets, including the Association of Southeast Asian Nations, the European Union, and Africa (Figure 2.10.6). Exports shifted from traditional goods, such as furniture and garments, toward higher-value and mechanical and electrical products (Figure 2.10.7). Notably, exports of electric vehicles rose by 50.9%, followed

Figure 2.10.6 Change in Goods Exports by Destination, 2025

Rising exports to emerging markets largely offset declining exports to the United States.

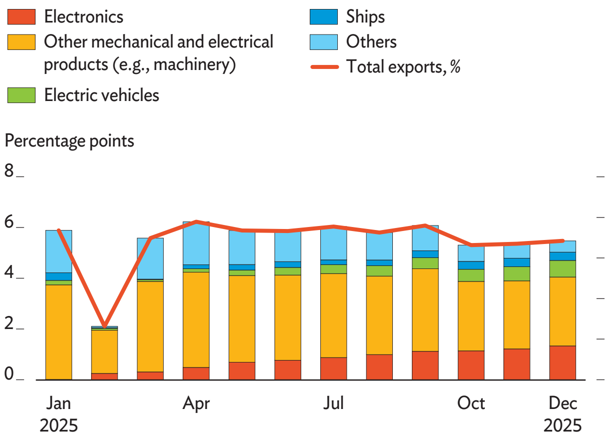


ASEAN = Association of Southeast Asian Nations, EU = European Union.

Sources: CEIC Data Company, Asian Development Bank calculations.

Figure 2.10.7 Goods Exports by Products, 2025

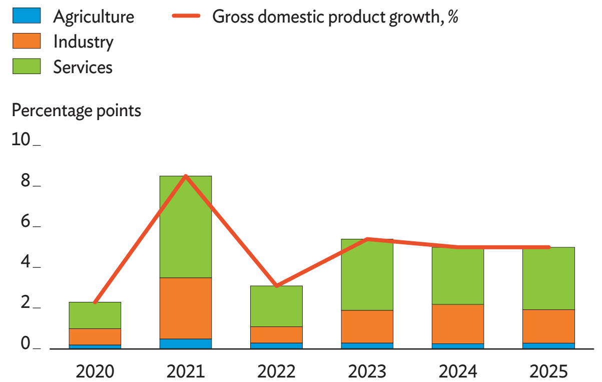
Export composition is shifting toward higher-value goods such as electric vehicles.



Sources: CEIC Data Company, Asian Development Bank calculations.

Figure 2.10.8 Supply-Side Contributions to Growth

Robust services and export-driven manufacturing sustained growth.



Source: CEIC Data Company.

by electronic integrated circuits (26.8%), lithium batteries (25.6%), additive manufacturing machines (38.4%), and high-tech products (7.5%). Imports remained flat, lower commodity imports offset higher semiconductor imports. Meanwhile, the services trade deficit narrowed to 1% of GDP, in part as inbound tourism improved amid expanded visa free policies.

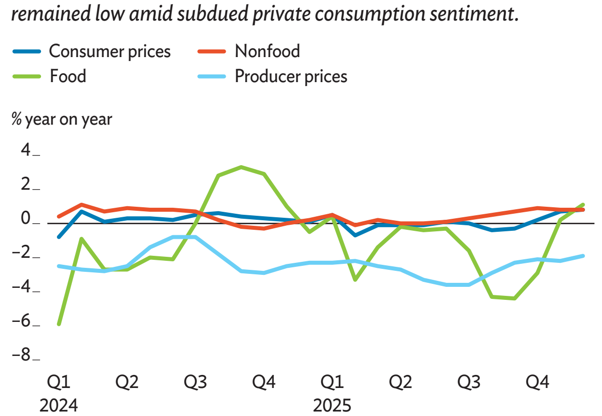
The services sector remained the main driver of growth, while resilient exports supported industrial activity (Figure 2.10.8). Services grew by 5.4%, up from 5.1% in 2024, contributing 3.1 percentage points to GDP growth, 0.3 percentage points higher than a year earlier. Information technology services (up 11.1%) and leasing and business services (10.3%) led growth, while financial intermediation services benefited from a rally in the equity market. The industrial sector grew by 4.5%, down from 5.0% in 2024, contributing 1.6 points to GDP growth. While construction activity contracted by 1.1%, the overall industrial sector remained resilient, supported by strong manufacturing performance, which grew 6.1% thanks to robust exports. Meanwhile, agriculture contributed a steady 0.3 percentage points to growth.

The labor market remained soft in 2025. Job creation increased by 0.9% in 2025, while other indicators pointed to continued weakness. The urban unemployment rate edged up from 5.1% in 2024 to 5.2% in 2025, and youth unemployment (excluding students aged 16–24) averaged 16.7%, up from 15.8% a year earlier. The Employment Expectation Index in 2025 was lower than in 2024, signaling soft labor market conditions. Despite improvement toward the year-end of 2025, the PMI Employment Index—reflecting firms' hiring expectations over the next 6 months—softened by 0.1 point in January 2026 compared with December 2025, indicating persistent softness in labor demand.

Consumer price inflation remained subdued (Figure 2.10.9). The headline consumer price index (CPI) remained unchanged in 2025. Food prices fell 1.5%, mainly due to lower prices of fresh vegetables, pork, and eggs amid ample supply, and energy prices

Figure 2.10.9 Monthly Inflation

Consumer price inflation picked up toward the end of the year but remained low amid subdued private consumption sentiment.



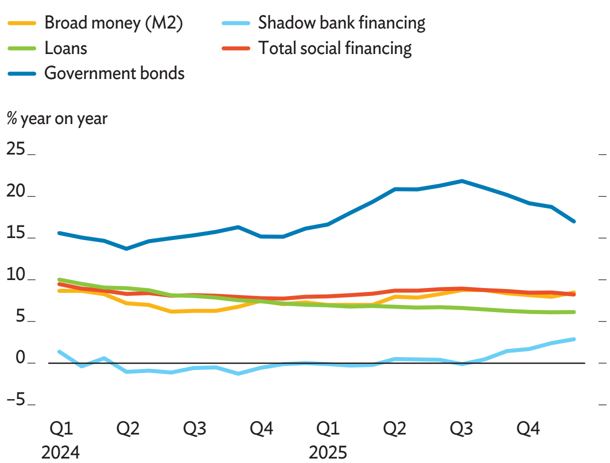
Q = quarter.
Source: CEIC Data Company.

declined by 3.3% in line with the drop in global oil prices, while core inflation edged up to 0.7%, supported by services inflation and rising gold prices, which surged by 43.2% during the year. Meanwhile, producer price deflation deepened, with the producer price index declining 2.6% year on year, compared with 2.2% a year earlier reflecting persistent overcapacity and weak demand.

The People's Bank of China (PBOC) eased monetary policy modestly in 2025 amid weak private credit demand and squeezed bank net interest margins. In May, the PBOC announced a 0.5-percentage-point reduction in the reserve requirement ratio for eligible financial institutions and cut its market-based benchmark lending rates by 10 basis points. The 1-year loan prime rate (LPR) was lowered to 3.0% from 3.1%, while the over-5-year loan prime rate, on which many lenders base their mortgage rates, was reduced to 3.5% from 3.6%. Amid monetary easing, total social financing—an aggregate that includes bank loans, shadow bank financing, government and corporate bonds, and equity financing—rebounded by 8.3% compared to 8.0% in 2024. However, this rebound was mainly driven by increased government bond issuance (Figure 2.10.10). In contrast, loan growth fell to a record low of 6.2%, from 7.0% in 2024, reflecting subdued private credit demand.

Figure 2.10.10 Growth in Credit and Government Bonds Outstanding

Despite growth in government bonds, loans grew slower.



Note: Shadow banking includes entrust loans, trust loans, and bank acceptance bills.

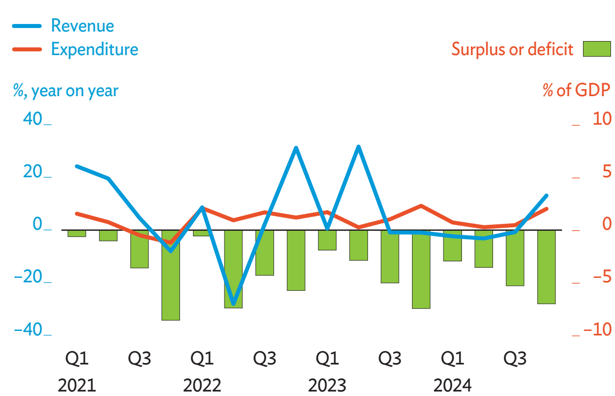
Sources: CEIC Data Company; Asian Development Bank calculations.

The general government fiscal deficit widened to 5.1% of GDP in 2025 from 4.8% in 2024, driven by higher social welfare spending and declining revenue (Figure 2.10.11). Fiscal revenue declined by 1.7%, despite a 0.8% increase in tax receipts supported by higher value-added, capital gains, and personal income tax collections. General government expenditure (including central and local governments) increased by 1.0%, with spending on social security and employment, health, and education rising by a combined 9.5% from a year earlier, as authorities expanded social welfare. Fiscal pressures on local governments continued as their income from land-use rights transfers fell by 14.7% and their debt level rose by 15%, due to the property market downturn and the record scale of local government bond issuance in 2025. Notably, about Chinese yuan (CNY) 4.93 trillion of the total CNY10.31 trillion in local government bond issuance was used for debt replacement and repayment of existing obligations rather than to finance new economic activity, a trend that is likely to continue in 2026.

The current account surplus increased significantly in 2025, on a strong merchandise trade surplus, rising to 3.7% of GDP from 2.2% in 2024 (Figure 2.10.12). Supported by robust exports and subdued imports, the goods trade surplus expanded by about 33%, reaching 5.2% of GDP in 2025, up from 4.1% of GDP in 2024. Meanwhile, the services trade deficit narrowed slightly, from 1.2% of GDP in 2024 to 1.0% in 2025, reflecting higher tourism services receipts.

Figure 2.10.11 General Government Fiscal Revenue and Expenditure

The fiscal deficit increased amid declining revenue.



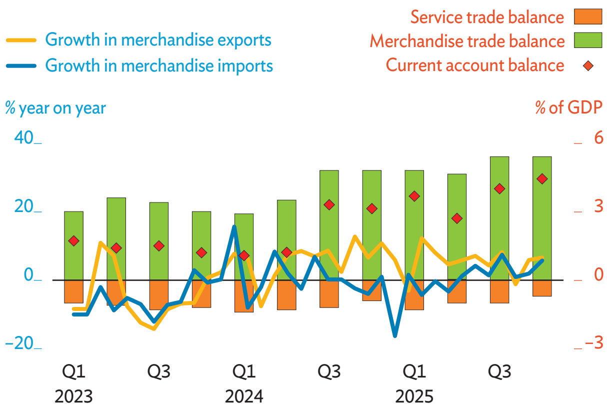
GDP = gross domestic product, Q = quarter.

Note: Public finance budget only.

Sources: CEIC Data Company; Asian Development Bank calculations.

Figure 2.10.12 Current Account Balance and Merchandise Trade

The current account surplus widened as the merchandise trade surplus grew.



GDP = gross domestic product, Q = quarter.

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

Sources: CEIC Data Company; Asian Development Bank calculations.

Net foreign direct investment (FDI) outflow moderated in 2025 and net non-FDI capital outflow increased. The direct foreign investment deficit shrunk to $82 billion in 2025, reflecting a rebound in inbound investment—with FDI inflow rising to $76.5 billion from $18.6 billion in 2024—alongside relatively stable outward investment. Meanwhile, portfolio investment outflow increased to $308.2 billion in the first 3 quarters of 2025, up from $38.1 billion during the same period in 2024. This partly reflected increased purchases of offshore equities and bonds by People's Republic of China (PRC) investors, following the expansion of the Southbound Bond Connect scheme to nonfinancial institutions, which allows eligible PRC institutional investors to invest directly in offshore bonds traded in Hong Kong, China. Nevertheless, reserve assets increased by $288.7 billion to $3.7 trillion at the end of 2025. The yuan appreciated by 2.2% against the US dollar over the year while it depreciated against a trade-weighted basket of currencies.

Economic Prospects

Economic growth is forecast to moderate to 4.6% in 2026 and 4.5% in 2027 driven by exports and government investment in high-tech sectors (Table 2.10.1). The government has emphasized a proactive fiscal stance and moderately accommodative monetary policy going forward, with a focus on boosting consumption, especially services consumption and investment in key industries. Funding from ultra-long special treasury bonds for the consumer goods trade-in program has been reduced this year (CNY250 billion, down from CNY300 billion in 2025). While the program will continue to support consumption, it is unlikely to fully offset broader structural headwinds for private consumption, including weak income expectations and subdued consumer confidence from the continued declines in property prices (see Figure 2.10.3). Reflecting a continued shift toward services spending and subdued goods consumption as the effects of the consumer goods trade-in program fade, household consumption growth this year is expected to remain broadly in line with last year's pace. Demand-supporting measures such as increased social welfare spending, consumption support programs, and labor market stabilization policies are expected to help restore consumer confidence, which would support stronger consumption growth in 2027 as the effects of policy measures start to materialize. Meanwhile, government consumption is expected to remain resilient this year and next, as boosting domestic demand remains a policy priority.

Table 2.10.1 Selected Economic Indicators, %

Growth is expected to moderate in 2026 and 2027 and inflation to rise.

	2024	2025	2026	2027
GDP growth	5.0	5.0	4.6	4.5
Inflation	0.2	0.0	0.6	1.0

GDP = gross domestic product.

Sources: CEIC Data Company; Asian Development Bank estimates.

Prioritized support for high-tech sectors and innovation is expected to boost investment, while infrastructure and property investment may remain weak. Investment in high-tech and AI-related sectors should remain resilient given the prospects for rolling-out incentives, subsidies, and favorable policy guidance as the 15th Five-Year Plan is implemented. However, infrastructure investment is likely to stay subdued as local governments continue prioritizing debt repayment over new project investment. Weak land-sale revenue amid the property slump and stricter discipline on local government financing vehicles should limit their scope to increase capital expenditure, while declining returns on investment projects following years of high investment further constrain spending. Similarly, property investment is expected to continue contracting as falling house prices, high inventories, and weak market sentiment continue to weigh on the sector. This is expected even amid supporting policy measures, such as loosening financial regulatory guidelines to curb borrowing in the property sector, easing mortgage rate floors, and re-lending facilities to absorb unsold housing.

Exports are expected to continue supporting growth in 2026 and 2027, albeit less than in previous years, while import growth will remain constrained by private consumption and investment. Increased trade with non-US markets and persistent cost competitiveness will support export resilience. The PRC's major bilateral relationships are showing signs of stabilization and reengagement. PRC–US trade ties have improved following high-level agreements in October 2025 to reduce tariffs and roll back export controls (and assuming current tariff levels stay unchanged), while recent visits by senior leaders from Canada, the United Kingdom, and key European Union member states signaled positive prospects for external trade through preliminary trade agreements and sectoral cooperation. Domestically, the 15th Five-Year Plan emphasizes high-tech manufacturing and industrial upgrading as key drivers of long-term growth, with coordinated support for strategic and advanced manufacturing sectors. These initiatives are expected to help sustain competitiveness in high-value, high-tech exports in the coming years. Meanwhile, higher import demand stemming from high technology investment, such as semiconductors, is expected to support a modest pickup in import growth compared with 2025. However, subdued private demand is still likely to hold back import growth. Even though higher oil prices associated with the Middle East conflict under this report's early stabilization scenario will raise the nominal import bill, energy import volumes are likely to remain relatively sticky in the short-term due to long-term supply contracts, refinery operating requirements, and inventory smoothing.

The labor market is expected to benefit from continued strength in advanced manufacturing and modern services. Employment conditions are likely to remain broadly stable in 2026 and 2027, supported by ongoing investment and production in high-end advanced manufacturing sectors, including clean energy electric vehicles, semiconductors, and robotics. Recent labor market reports from recruitment platforms suggest strong hiring in advanced industries such as robotics, defense, and artificial intelligence, as well as modern service sectors like gaming, pet care, and online-to-offline lifestyle services, a trend that is likely to continue in the next 2 years. At the same time, the labor market may face pressure from a record-high 12.7 million new college and university graduates entering the market in 2025—up 4.1% from 2024—adding to challenges related to youth unemployment (16.7% in 2025).

Inflation is forecast to rise slightly to 0.6% this year and 1.0% in 2027. Headline CPI rose from 0.2% in January 2026 to 1.3% in February, largely due to Lunar New Year effects. Higher food and services prices were associated with holiday travel and consumption, amplified by the extended holiday period. Likewise, core inflation increased sharply, climbing from 0.8% to 1.8% during the same period led by tourism-related price increases. Looking ahead, several factors may push inflation higher from a low base. These include anti-involution efforts—such as industry consolidation, capacity controls, and more selective subsidies—higher energy prices due to the Middle East conflict, and rising pork prices.

Monetary policy is expected to remain accommodative. At the annual work conference, the PBOC reaffirmed its commitment to a moderately loose monetary policy stance in 2026, signaling continued use of tools such as the reserve requirement ratio and policy rate cuts to maintain ample liquidity. The PBOC plans greater use of targeted refinancing facilities for services consumption and elderly care, aiming to channel more credit toward the services sector. Following the conference, the PBOC announced a package of credit-easing measures in January, including targeted rate cuts, expanded credit quotas, and guidance on further reserve requirement ratio reductions to support economic growth.

Fiscal policy will support growth and will shift to emphasizing social spending. The government maintained the fiscal deficit target at 4% of GDP in 2026, unchanged from 2025, signaling continued support for the economy amid slowing growth. The government's budget report says expenditure growth in 2026 is being reoriented toward education, healthcare, social security, employment, childcare, and elderly care, with these categories projected to grow faster than overall fiscal spending. Meanwhile, fiscal policy will continue to rely on ultra-long special treasury bonds and local government special bonds to finance strategic investment and upgrading. Issuance of special central government bonds is planned at CNY1.6 trillion, down from CNY1.8 trillion in 2025, to support strategic sectors, the consumer goods trade-in program, large scale equipment upgrades and bank recapitalization. Meanwhile, planned issuance of special local government bonds remains at CNY4.4 trillion, to support major projects, replace hidden debts and settle overdue payments owned by governments. The absence of any increase in special bonds earmarked for new spending, together with local government debt risk concerns, may constrain the scope for a larger fiscal impulse from local governments.

The PRC is expected to maintain a sizable current account surplus. This reflects continued goods trade surpluses and relatively moderate import growth. The services trade deficit is likely to narrow, supported by a recovery in inbound tourism following visa-free entry policies for more countries, even as outbound travel continues to move toward pre-pandemic levels. Net FDI inflows are expected to remain weak, despite resilient inward investment in high-technology sectors, while outward direct investment is projected to increase as firms continue to relocate production facilities abroad. Capital outflows—particularly portfolio outflows—may rise on increased purchases of offshore equities and bonds by PRC investors. At the same time, foreign portfolio inflows could strengthen, supported by the recent equity market rally and expectations of yuan appreciation given the large current account surpluses.

Risks are tilted to the downside. With a prolonged conflict now more likely, risks to the outlook have increased substantially. If energy prices stay elevated and supply chain disruptions are persistent, this could dent growth through higher energy prices, supply chain and trade disruptions, tighter financial conditions, and weaker investment and consumption sentiment. Larger price upward pressures stemming from a prolonged Middle East conflict, capacity issues, and intensified price competition, could further weigh on corporate profitability and inflation. The government is likely to tighten controls on selected exports (such as refined fuel and certain fertilizers) and release strategic reserves to stabilize domestic supply and prices. Domestic retail prices for gasoline and diesel are expected to be kept unchanged or raised only minimally when international oil prices exceed USD 130 per barrel, helping to cushion the impact of higher input costs on firms. While stable and gradually declining PRC–US trade flows and current tariff levels serve as baseline assumptions, bilateral relations remain volatile, and a persistently large PRC trade surplus could intensify trade frictions. Domestic demand may weaken further amid subdued consumer confidence, fragile business sentiment, and ongoing stress in the property sector.

Policy Challenge—Declining Productivity and the Firm Exit Mechanism

The 15th Five-Year Plan emphasizes the importance of total factor productivity (TFP) for efficiency and innovation-led growth through 2030. The plan strongly emphasizes enhancing total productivity and increasing the share of household consumption in GDP. Boosting productivity will be particularly important amid demographic shifts and a rapidly aging population, requiring more targeted investments in human capital development and elderly support programs to improve employability and labor productivity. Productivity gains from more efficient resource allocation, including improving exit mechanisms for firms will also be important.

TFP growth, which drove industrial dynamism for 3 decades after the PRC's reform and opening-up policy began, has moderated over the past 2 decades. Between 1998 and 2007, sharp TFP growth was associated with the country's strength in manufacturing, which led the PRC from under 5% of global manufacturing output to about 30%. Breakthroughs in technological innovation and productivity growth have come in high-tech sectors including electric vehicles, renewable energy, humanoid robots, artificial intelligence, commercial aerospace, and biomedicine, culminating years of policy effort, investment, and work in a dedicated and talented labor force.

Overall, however, the PRC's TFP growth has been in a large and persistent slowdown. It has dropped from 3.5% per year in pre–2007, to below 1% during 2007–2013, and has averaged slightly above 1% for 2013–2019. Firm entry and exit have also slowed since 2007, affecting industry dynamism. It is especially noteworthy that the slowdown occurred earlier than in economies such as the Republic of Korea and Japan, when they were at comparable levels of GDP per capita relative to the US.

The slowdown in PRC TFP growth is, in turn, detrimental to industry dynamism, affecting state-owned enterprises most, as well as private and foreign enterprises.[1] TFP growth in the PRC was still around 3% in sectors such as food, furniture, pharma, and automobiles, whereas it was lower or negative in other sectors, including metals, paper, and transport equipment. The share of assets held by firms in the PRC that do not earn enough from operations to cover interest expenses rose from 5% in 2018 to 16% in 2024.

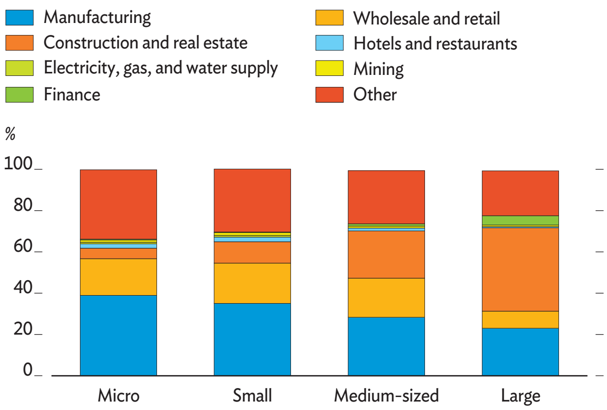
Amid declining aggregate productivity in the PRC, authorities worry about potential misallocation of resources to unviable, financially distressed firms. Lending that keeps these "zombie firms" alive inevitably suppresses entry of new firms. International evidence points to the adverse economic consequences of too many zombie firms in an economy. Credit booms, such as the one observed during the global financial crisis of 2007–2008, are often associated with more zombies in the years that follow, especially if firm-exit procedures are inadequate. In Japan, low minimum regulatory capital requirements and lax loan rollovers conditions led to the ever-greening of loans to unviable zombie firms, a slowdown in firm entry, and increasing investment in zombie-dominated industries during the 1990s, dragging down overall productivity growth. Although zombie lending in the PRC and its macroeconomic context are somewhat different from Japan, the lessons from Japan's experience could still be relevant for the PRC. The larger the zombie firms, as measured by their asset levels, the more negative their impact on industrial upgrading. Some studies have shown that the resolution of the PRC's zombie firms could raise TFP growth around 1–2 percentage points (footnote 1).

Recognizing the problems zombie firms pose, the PRC government has focused on facilitating the exit of unprofitable firms from industry. To this end, it has considered including regulations on information disclosure and credit oversight (State Council 2024) and strengthening the bankruptcy system, which is currently burdened with a growing number of cases spreading across sectors (Figure 2.10.13). Recent studies support these policies, indicating that bankruptcy reforms are associated with an average 1.4 percentage-point decline in the share of zombie firms across countries. They also indicate that the introduction of specialized bankruptcy tribunals in the PRC have been associated with a decrease in employment in industries dominated by zombies and with a shorter bankruptcy duration, increased firm entry and exit, and higher firm-level TFP (Table 2.10.2). There is also evidence, based on data at the firm-, city-, and provincial levels, that the effects of zombie firms on investment, employment, and deflationary pressures in the PRC are mitigated by specialized bankruptcy tribunals.

1 The rest of this section draws on the conclusions of the following studies on the evolution and the impact of Zombie firms on the economy.
Brandt, Loren, Johannes Van Biesebroeck, Yifan Zhang, and Luhang Wang. 2025. Where Has All the Dynamism Gone? Productivity Growth in China's Manufacturing Sector, 1998–2013. *Journal of Development Economics*.
Caballero, Ricardo J., Takeo Hoshi, and Anil K. Kashyap. 2008. Zombie Lending and Depressed Restructuring in Japan. *American Economic Review*. 98 (5): pp. 1943–77.
Davis, J. Scott, and Brendan Kelly. 2025. China Debt Overhang Leads to Rising Share of 'Zombie' Firms. Federal Reserve Bank of Dallas, 23 December.
Dreier, Silas, and Yothin Jinjarak. 2026. Bankruptcy System, Industry Dynamism, and Their Effects on Investment, Employment, and Deflationary Pressures. Unpublished manuscript. Asian Development Bank.

Figure 2.10.13 Sectoral Composition of Bankrupt Firms in the PRC, 2011–2022

The proportion of zombie firms has risen in construction and real estate and dropped in hotel and restaurant industry.



Notes: The composition of firms with court-accepted bankruptcy proceedings (reorganization or liquidation) for each sector is presented as the share of bankrupt firms across size groups (stacked bars sum to 1 within each sector).

Source: Based on a background analysis in Li (forthcoming); bankruptcy cases are drawn from the National Enterprise Bankruptcy Information Disclosure Platform; sectoral classification is from business registration data on the Tianyancha database (accessed 16 December 2025).

Table 2.10.2 Bankruptcy Resolution and Total Factor Productivity Growth in the PRC

Specialized courts reduce bankruptcy duration and shorter duration raises TFP growth.

	Bankruptcy Duration	TFP Growth
Specialized court established	–2.50 (0.05)	
Bankruptcy case duration		–0.17 (0.06)
Goodness of fit: R-squared	0.35	0.86

PRC = People's Republic of China, TFP = total factor productivity.

Notes: Based on a background analysis in Li (forthcoming), using 2007–2020 firm-level data from the National Tax Survey. TFP is estimated using the Olley-Pakes method. The sample size is 127,937 observations. Case duration is computed as the number of days between the recorded acceptance date and the closing date. The documents are filed separately in the National Enterprise Bankruptcy Information Disclosure Platform, resulting in half of the cases not being matched. The estimation includes fixed effects for year, city-sector, and sector-year. Standard errors are in parentheses.

A more efficient bankruptcy system can address zombie firm presence in the PRC and improve industry dynamism, but the implications require further study. Evidence suggests that reducing zombie firms was associated with labor outflows from affected cities during 2000–2015. However, the impact of this reduction on socioeconomic conditions—such as labor outflows—should be analyzed to ensure full benefits are realized and policies should then be introduced to alleviate adverse effects. Crucially, the next stages of improvement in the firm-exit mechanism should aim for several outcomes. These include (i) stronger nationwide specialized bankruptcy courts and pre-reorganization and out-of-court workout, (ii) reducing non-market forbearance that sustains zombie lending and impedes market competition, and (iii) expanding personal bankruptcy beyond selected pilots and ensuring cross-province consistency to enhance creditor confidence and private investment.

MONGOLIA

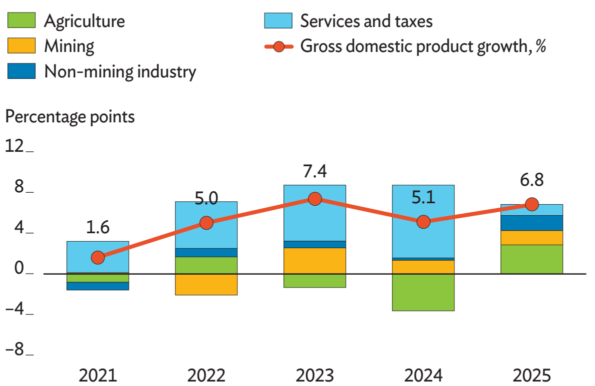
Economic growth strengthened in 2025 despite a weak start, while inflation averaged above the central bank's 8% upper bound before easing by year-end. The current account deficit narrowed slightly and the government budget returned to surplus. Risks to the outlook have increased substantially as a prolonged conflict in the Middle East becomes more likely, particularly if elevated energy prices and supply chain disruptions weigh on exports, inflation, and fiscal balances. Under the early stabilization scenario finalized on 10 March 2026, growth is projected to moderate in 2026 before recovering in 2027, while inflation is expected to ease over the coming years, although these projections are subject to a very high degree of uncertainty. Mongolia's high exposure to climate shocks underscores the need to mobilize innovative financing for ecosystem-based adaptation.

Economic Performance

Economic growth accelerated to 6.8% in 2025, primarily driven by strong agricultural recovery (Figure 2.11.1). Notwithstanding a sizable decline in harvest, broadly favorable weather conditions facilitated increased livestock production, leading to a marked recovery of the agricultural sector after two consecutive harsh winters and raising its contribution to growth to 2.9 percentage points in 2025. The contribution of the mining sector to growth remained notable at 1.4 percentage points. The Oyu Tolgoi underground mine made a substantial progress in its ramp up, expanding production of copper concentrates by 36.2%. While the coal market deteriorated in the first half of the year, a significant rebound in the second half raised production to a record 95.5 million tons in 2025. Non-mining industrial sectors contributed 1.5 percentage points to GDP growth in 2025, benefiting from residential and public infrastructure construction and as the energy sector expanded capacity with new power plants. Contributions from service activities were lower at 1.0 percentage points in 2025, down from 5.4 percentage points in the previous year, reflecting contractions in trade sales and a slowdown in public service and transport activities.

Figure 2.11.1 Supply-Side Contributions to Growth

Recovery in agricultural production was the key driver of economic growth in 2025.



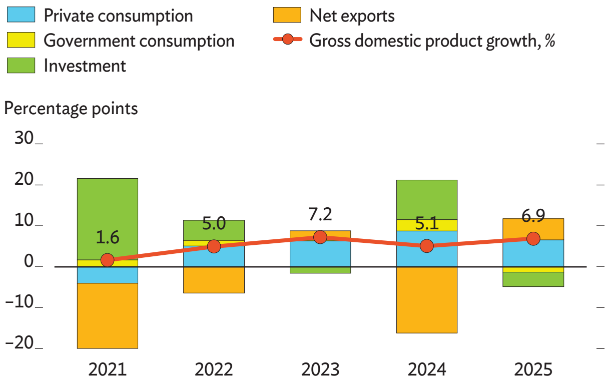
Sources: National Statistics Office of Mongolia. Statistical Information Services; Asian Development Bank estimates.

On the demand side, household consumption expanded 9.2% and contributed 6.6 percentage points to GDP growth during 2025 (Figure 2.11.2). Facilitating this increase was an average 5.7% rise in real household earnings, driven by wages. Labor market conditions remained robust with a stable labor

This chapter was written by Martino Pelli and Munkh-Orgil Zorig of the Mongolia Resident Mission, ADB, Ulaanbaatar.

Figure 2.11.2 Demand-Side Contributions to Growth

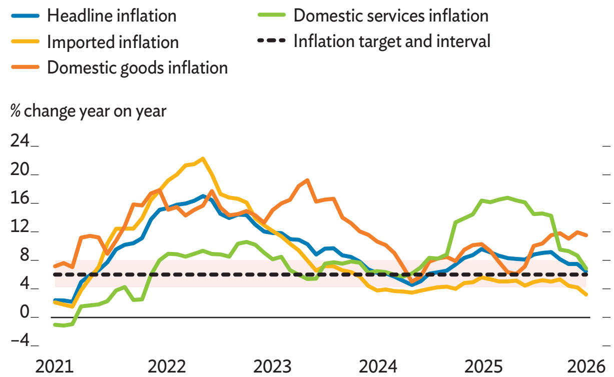
Robust household consumption boosted the economy in 2025.



Sources: National Statistics Office of Mongolia. Statistical Information Services; Asian Development Bank estimates.

Figure 2.11.3 Inflation

Inflation remained mostly above the target range in 2025.



Sources: National Statistics Office of Mongolia. Statistical Information Services; Parliament Resolutions on Monetary Policy Guidelines, 2021–2025; Asian Development Bank estimates.

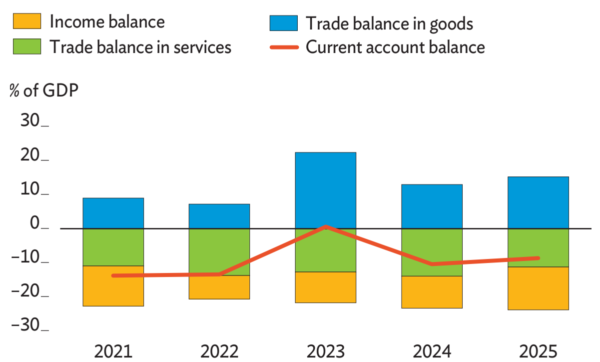
participation rate (62.5%) and a low unemployment rate (5.5%). By contrast, government consumption subtracted 1.3 percentage points from growth, as austerity measures kicked in mid-2025. Despite the buildup of livestock resources and a moderate expansion in business lending, gross capital formation contracted by 7.2% and subtracted 3.6 percentage points from growth. With higher export revenue and lower import bills, net exports boosted growth by 5.1 percentage points.

The consumer price index increased by 8.6% on average in 2025, while year-on-year inflation eased to 7.5% in December (Figure 2.11.3). Services were the largest contributor to inflation, after a hike in the regulated prices of electricity, education, and public transportation. This raised average service inflation to 14.5%. Domestic goods inflation also remained elevated, at 9.3% on average, as persistent supply pressures increased prices of meat, flour, bread, and vegetables. Exchange rate depreciation in early 2025 pushed average imported goods inflation to 5.0%. Despite recurring supply shortages, imported fuel prices contracted by 1.0% on average in 2025, reflecting developments in the oil market. Meanwhile, the central bank kept the policy rate unchanged at 12%, after raising it by 200 basis points in March 2025.

External balances improved slightly in 2025, with the current account deficit narrowing to $2.2 billion, or 8.6% of GDP, supported by a stronger trade performance (Figure 2.11.4). Imports fell

Figure 2.11.4 Current Account Balance

External imbalances narrowed with improvements in the trade balance of goods and services.



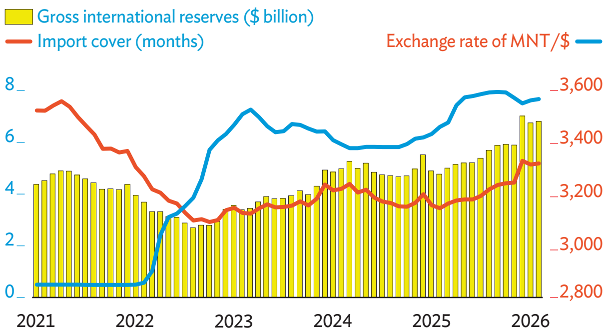
GDP = gross domestic product.

Sources: Bank of Mongolia. Balance of payments statistics; Asian Development Bank estimates.

by $0.7 million, while exports of goods and services increased by $0.6 billion, leading to a trade surplus. Coal export volumes reached a record 90 million tons (up 7.5% from 2024), though declining market prices offset the impact. Expansion in gold, copper concentrates, transportation, tourism, and business services exports provided additional support. However, a widening income account deficit due to higher profit repatriation by foreign investors partly offset these gains. The current account deficit was financed by net financial inflows of $3.3 billion, broadly unchanged from 2024. International reserves increased by $1.5 billion to reach $7.0 billion by end-2025, sufficient to cover 5.3 months of imports, fueled by an improved

Figure 2.11.5 Gross International Reserves and Exchange Rate

An improved trade balance and higher gold prices led to higher reserves.



Sources: Bank of Mongolia. External sector statistics; Asian Development Bank estimates.

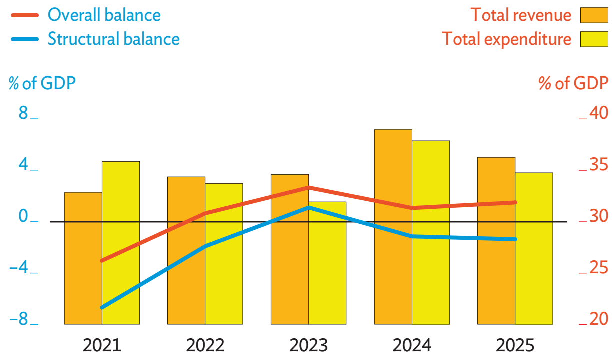
trade balance and higher gold prices (Figure 2.11.5). The exchange rate depreciated by 4.0% against the US dollar in 2025 but appreciated by 10.5% in real effective terms.

Fiscal performance remained resilient for the fourth consecutive year in 2025, as government restrained expenditure and revenues recovered, supporting a budget surplus of 1.5% of GDP (Figure 2.11.6). Shortfalls of coal-linked fiscal revenues in the first half of the year necessitated an amendment to the 2025 budget, cutting expenditures by around 2.4% of GDP. Fiscal revenues gradually picked up toward year-end to reach 36.3% of GDP, indicating nominal growth of 3.8% in 2025. Wage-related receipts from social security contributions and personal income taxes rose, though mining-related royalties and corporate income taxes declined on lower coal prices. Fiscal expenditures grew by 2.3% and amounted to 34.8% of GDP. Current spending on public wages and pensions rose on inflation-indexed increases, while capital spending was lower than planned. Government debt management efforts, coupled with strong nominal GDP growth, reduced public debt from 41.8% of GDP in 2024 to 39.4% by end-2025. Accordingly, most credit agencies upgraded Mongolia's sovereign ratings for the second consecutive year.

Tightening of monetary policy in 2025 led to slower money and credit growth while financial sector risks remained contained. Broad money supply (M2) growth slowed to 10.6% in 2025, from

Figure 2.11.6 Government Budget

Total revenue exceeded spending for the fourth consecutive year.



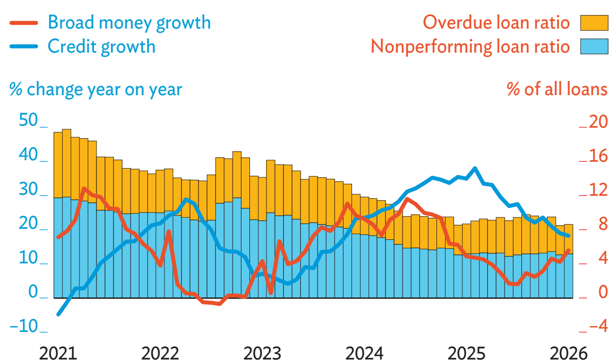
GDP = gross domestic product.

Note: The structural balance is the gap between expenditure and the revenue trend over the longer term, the ceiling for which is set by the Fiscal Stability Law but subject to parliamentary amendment.

Sources: National Statistics Office of Mongolia. Statistical Information Services; Parliament resolutions on government budget, 2021–2025; Asian Development Bank estimates.

Figure 2.11.7 Money and Credit

Growth of money and credit indicators gradually decelerated amid broadly stable loan quality.



Sources: Bank of Mongolia. Monthly Statistical Bulletin and Banking Sector Consolidated Balance Sheet; Asian Development Bank estimates.

15.5% in 2024, as demand for consumer credit moderated (Figure 2.11.7). Outstanding bank credit rose by 19.0% in 2025, down from 35.5% in 2024. Consumer loans, which had expanded considerably in recent years, slowed faster than business loans. Reflecting concerns about household debt accumulation, the central bank further tightened debt-service-to-income ratios on consumer loans in early 2026. Loan quality in the banking sector remained broadly stable in 2025, with the nonperforming loan ratio hovering around 5.2%.

Economic Prospects

With a prolonged conflict in the Middle East now more likely than earlier anticipated, the growth outlook has become markedly more uncertain and downside risks have increased substantially. Under the early stabilization scenario finalized on 10 March 2026, growth is projected to moderate to 5.7% in 2026 before accelerating to 6.0% in 2027 (Table 2.11.1), although these projections are now subject to heightened uncertainty. The mining sector is expected to be a key near-term driver, contributing an average of 0.8 percentage points to growth. In particular, coal production is expected to be supported by continued demand from the People's Republic of China (PRC), and a dedicated export railway, scheduled to begin operations in 2027. The ramp-up of the Oyu-Tolgoi mine will continue to boost production of copper concentrates though at a lesser extent than 2025. Following a strong performance, agriculture growth is projected to normalize and contribute around 0.5 percentage points of GDP growth, assuming weather conditions remain stable. The non-mining industry is expected to contribute an average of 0.8 percentage points to growth, benefiting from urban infrastructure development and energy sector projects. Mining spillovers to transport, rising tourism, and a gradual recovery in trade are anticipated to support service sector growth, while contributions from public services and net taxes are projected to moderate over the forecast horizon.

Table 2.11.1 Selected Economic Indicators, %

Under forecasting assumptions, growth is expected to remain robust in 2026 and 2027, while inflation should remain within the central bank target range.

	2024	2025	2026	2027
GDP growth	5.1	6.8	5.7	6.0
Inflation	6.2	8.6	7.8	6.8

GDP = gross domestic product.

Sources: National Statistics Office of Mongolia. Statistical Information Services; Asian Development Bank estimates.

Under the early stabilization scenario, households and external demand are expected to drive growth in the forecast period, while fiscal restraint tempers the public sector contribution. Household consumption is expected to contribute 6.7 percentage points to GDP growth during 2026-2027. Household income is projected to be supported by increases in public wages, pensions, and mining dividend distributions, despite tighter regulations on consumer lending. Gradual recovery of gross capital formation is anticipated over the forecast horizon, due to the replenishment of coal inventories, depleted following the increase in demand in the second half of 2025, contributing 2.1 percentage points to growth. External demand is expected to support strong mineral exports and tourism services, while demand for investment-related imports is projected to bounce back steadily, in tandem with export demand. On balance, net exports are likely to subtract 3.0 percentage points from growth.

Inflation is projected at 7.8% in 2026 and 6.8% in 2027, although these projections are subject to a high degree of uncertainty. Robust domestic demand and continued increases in household income are expected to keep demand-driven inflation elevated, while supply-related pressures on domestic food items are likely to persist. The postponement of planned utility tariff increases in 2026 will temporarily tamp down price pressures. Nonetheless, inflationary pressures will stem from imported goods, particularly fuel supply disruptions, amid the conflict in the Middle East and impact from exchange rate depreciation. The central bank will aim to anchor inflation around a reduced target of 5% plus or minus 2% from 2027, from the current 6% plus or minus 2%, aiming to lower inflation expectations.

Export-led momentum is projected to keep external balances improving, although recovering imports will limit the pace of adjustment. Current account balances in 2026 and 2027 are expected to be supported by mineral export revenues, as well as associated transport services. Household consumption and gradual recovery of investments are likely to facilitate a steady rebound in import demand, while income account balances are projected to remain in deficit, due to repayments to foreign investors and bondholders.

A more prolonged conflict in the Middle East than previously anticipated has materially increased downside risks to the outlook. Mongolia's high pass-through from global oil markets, together with broader imported inflation, may rapidly add to domestic inflation, erode purchasing power, and weigh on consumption. Increases in global fertilizer prices, including through supply disruptions from the Russian Federation, could also raise agricultural input costs and put upward pressure on domestic food prices, particularly later in the year. Persistent global supply chain disruptions and weaker external demand could also affect mineral exports, slowing growth and weakening external and fiscal balances. Moreover, demand for Mongolian export commodities, especially coal, is vulnerable to long-term global decarbonization trends. Implementation delays in the export railway may limit the gains in export capacity. Climate-related risks remain at the forefront, with recurring harsh winters and summer droughts threatening herders' livelihoods and agricultural output and triggering supply shortages of staple food items, with potential inflationary and growth effects.

Policy Challenge—Nature as a Macroeconomic Stabilizer: Financing Adaptation at Scale

Nature functions as a macroeconomic stabilizer in Mongolia by buffering climate shocks, but ecosystem degradation is increasing exposure to climate and economic risks. Livestock, rangelands, and agriculture are highly exposed to rising temperatures, droughts, and dzud (harsh winters), and these sectors shape rural incomes, food supply, and inflation dynamics. When ecosystems deteriorate, climate shocks translate more directly into output losses, food price volatility, and fiscal pressures through disaster response and social protection. Strengthening ecosystem resilience is thus a macroeconomic risk-management strategy in addition to an environmental objective. In line with Mongolia's Nationally Determined Contributions 3.0 (NDC 3.0) and National Adaptation Plan 2024–2030, land degradation, pasture management, and livestock systems are priority adaptation areas. Indeed, Mongolia's NDC 3.0 includes a commitment to restore 10% of heavily degraded rangelands.

Yet financing ecosystem-based adaptation at the required scale exceeds available fiscal revenue and concessional finance. Total adaptation financing needs to implement Mongolia's National Adaptation Plan are estimated at $7.8 billion by 2030 (30.7% of 2025 GDP). Fiscal space is limited, constraining the scope for budget-financed adaptation. Land restoration and sustainable livestock management rely largely on public expenditure, concessional finance from multilateral and bilateral partners, and grant-based climate funding, given their public-good characteristics and limited immediate private revenue potential. However, these financing sources remain fragmented and project-based, leaving ecosystems underfunded and heightening macroeconomic vulnerability as climate-driven volatility persists in rural incomes, food supply, and inflation.

Closing this gap will require mobilizing new and innovative financing sources to support ecosystem restoration and capture the economic value of nature. Beyond traditional public and concessional finance, nature-based revenue streams, such as payments for ecosystem services and carbon credit mechanisms, can monetize emission reductions and carbon sequestration generated through rangeland restoration, improved grazing, and sustainable livestock practices. Mongolia has initiated steps toward developing a domestic carbon market framework through pilot projects. It is also facilitating private sector participation in international voluntary markets and cooperative arrangements under Article 6 of the Paris Agreement that enable international carbon credit transfers. These carbon credit mechanisms are results-based, generating revenue only upon verified emission reductions, and can support land-based adaptation programs implemented by herder groups and local entities. However, several constraints limit the ability to scale financing from these sources, including fragmented land management and limited mechanisms to bundle multiple pasture areas and herder groups into single carbon credit projects. Also limiting are incomplete monitoring, reporting, and verification systems, and unclear benefit-sharing arrangements for herders and local communities.

Scaling nature-based adaptation requires shifting from fragmented, small-scale pilot projects to integrated, landscape-level programs embedded within national adaptation and land-use policy. Aggregation mechanisms—such as cooperative structures or programmatic carbon projects—are needed to bundle pasture areas managed by herder groups into market-ready programs meeting international standards. Clear participation and revenue-sharing frameworks should link ecosystem restoration to rural income generation through carbon revenues and ecosystem service payments. Public investment in robust monitoring, reporting, and verification systems is also critical to ensure credibility. Integrating the diversified nature-finance pipelines into National Adaptation Plan implementation would transform ecosystem restoration from a project-based activity into a macro stabilization tool.

As host in August 2026 of the United Nations Convention to Combat Desertification (COP17), Mongolia can position land restoration and rangeland resilience not only as climate action, but as a strategy for macroeconomic stability and resilient growth.

SOUTH ASIA

- Afghanistan
- Bangladesh
- Bhutan
- India
- Maldives
- Nepal
- Pakistan
- Sri Lanka

AFGHANISTAN

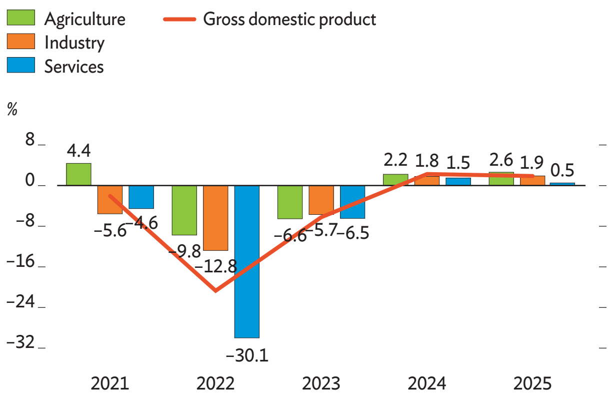
Growth slowed but remained positive in FY2025 as agriculture improved and millions of refugees returned to the country. However, GDP per capita declined and essential services suffered, despite higher private consumption and public expenditure. Deflation continued but diminished. Growth is projected to accelerate in FY2026 and FY2027, despite persisting structural issues. Positive inflation is projected for FY2026, with some moderation in FY2027. Reintegrating returnees remains a challenge.

Economic Performance

Afghanistan's economy grew by 1.9% in fiscal year (FY) 2025, down slightly from 2.3% in FY2024, marking a second year of modest growth since the 2021 Taliban takeover (Figure 2.12.1). Private consumption led growth on the demand-side, surging by 15.0%, up from 6.8% in FY2024, to reach 110% of GDP. The pickup reflected the return of 1.4 million refugees from Iran and Pakistan in 2024, which caused the population to rise by almost 4.0% in 1 year (another 2.6 million returned in 2025). However, GDP per capita declined as the rise in population exceeded economic growth. Households relied heavily on savings and international aid, pushing gross domestic savings to –35.3% of GDP. Public consumption rose by 8.0%, mainly from higher spending on security and administration. Investment grew by 2.8%, reversing contraction in FY2024. However, it remained low at 17.0% of GDP and came mainly from private spending on construction and housing to accommodate returning families.

Figure 2.12.1 Growth

Recovery continued with modest, slightly slower growth in FY2025.



FY = fiscal year.

Note: Years are fiscal years ending 20 March of that year.

Source: National Statistics and Information Authority.

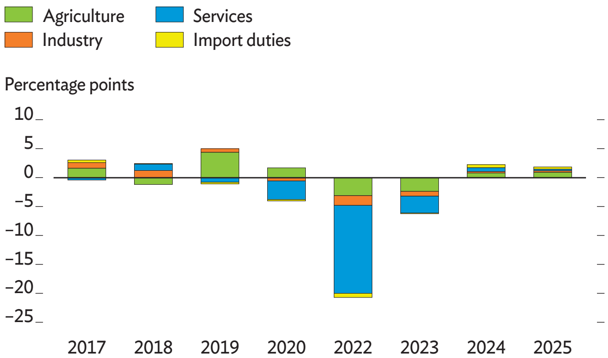
Agriculture led growth on the supply side. It accounted for 0.9 percentage points of total growth, reflecting expanded irrigation networks, improved seed distribution, and favorable weather conditions (Figure 2.12.2). Industry and services added approximately 0.3 and 0.2 percentage points to growth, respectively, while net taxes (mainly import duties) contributed the remaining 0.5 percentage points of growth at market prices. However, ongoing reductions in international humanitarian assistance, a constrained fiscal environment, and restrictive policies affecting women's education and employment have intensified pressures on essential services. Healthcare services declined by 15.2% and education by 9.0%.

Deflation eased from -7.7% in FY2024 to -4.2% in FY2025, reflecting a milder drop in food prices and higher rents (Figure 2.12.3). Intermittent supply chain disruptions with Pakistan and a surge in domestic demand from the influx of returnees explain most of the decline. The population influx strained local markets, especially in urban areas, contributing to a 5.5% year-on-year rise in rents

ADB placed on hold its regular assistance to Afghanistan effective 15 August 2021.

Figure 2.12.2 Supply-Side Contributions to Growth

Agriculture led growth in FY2025.



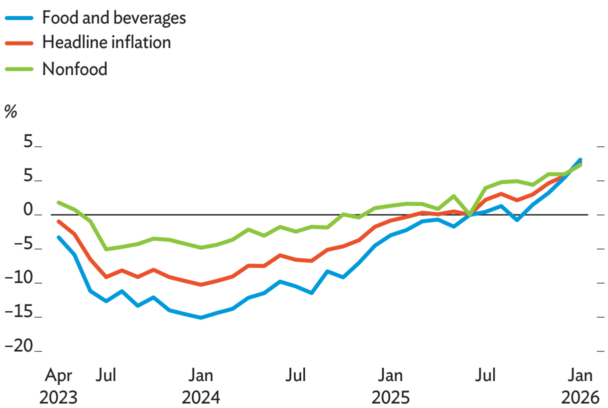
FY = fiscal year.

Note: Years are fiscal years ending on 20 March of that year.

Sources: National Statistics and Information Authority; Asian Development Bank calculations.

Figure 2.12.3 Inflation

Deflation diminished in FY2025 as inflation for nonfood items accelerated.



FY = fiscal year.

Source: Official statistics from national and international institutions.

and increased consumption of essentials. Currency appreciation and higher agricultural output provided a counterbalance, with a stronger currency helping offset inflationary pressures.

Afghanistan's external position deteriorated sharply, with the merchandise trade deficit soaring from 43.5% of GDP in FY2024 to 62.6% in FY2025. The widening trade deficit came primarily from a 36.6% increase in imports, reflecting structural imbalances and Afghanistan's growing dependence on imports. Imports of most categories of goods surged, the largest being capital goods (75.0%) and fuel (65.3%). Imports of intermediate goods rose by 33.4%. Consumer goods, representing nearly half of imports, jumped by 28.0% because of demand from returning refugees for furnishing their households. Exports of goods rose only by 2.1%, reversing contraction in FY2024. Exports of food remained robust, as dry fruit exports to India and Pakistan were steady, and a good harvest boosted vegetable exports to Iran. These gains offset losses in mineral and textile exports. Export earnings covered around 15.0% of the import bill, down from 21.0% in FY2024.

The fiscal deficit narrowed to 0.4% of GDP from 1.4% in FY2024 as revenue grew faster than expenditure. Domestic revenue increased significantly to 19.2% of GDP from in 15.6% in FY2024, mainly reflecting robust tax collection and one-time revenues from asset sales. Expenditure rose to 19.6% of GDP from 16.8%. Current outlays accounted for 90.6% of total spending, while development expenditure rose slightly to 1.8% of GDP, still far below the approximately 12.0% of GDP recorded in 2020. The marked decline in development spending since 2020 has undermined public infrastructure and the delivery of essential services.

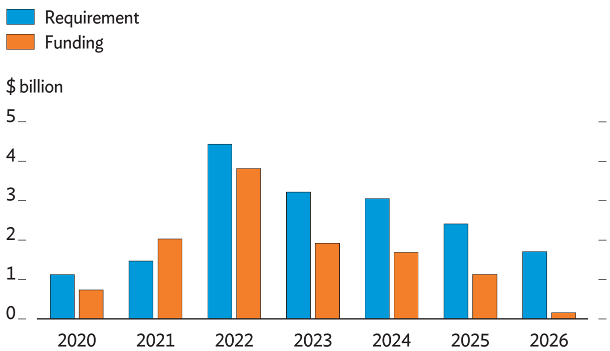
Economic Prospects

Significant internal and external challenges threaten Afghanistan's economic stability. Regional political tensions and the persistent closure of its key trade corridor hinder trade and limit access to key markets. The estimated return of 2.6 million refugees in 2025 will further strain resources, infrastructure, and essential services. Internally, growth remains constrained by weak institutions, ongoing residual security concerns, and low investment. Meanwhile, rapid population growth is outpacing job creation, causing sustained high unemployment. Reductions in international aid and remittances have cut household income, weakened social protection systems, and diminished development opportunities (Figure 2.12.4). Moreover, restrictive policies on women's education and employment, as noted, continue to inhibit human capital development and inclusive economic activity.

Under the early stabilization scenario finalized on March 10, economic growth is projected to rise to 2.3 % in FY2026, driven mainly by robust domestic consumption fueled by the large influx of returnees

Figure 2.12.4 Humanitarian Assistance

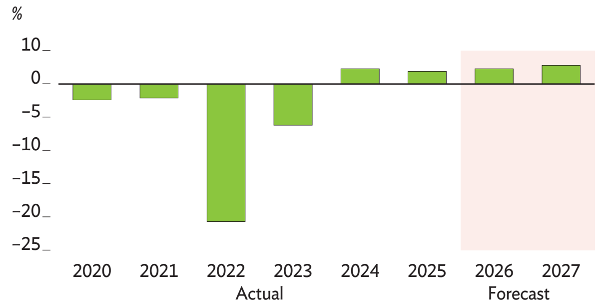
Funding for humanitarian assistance has declined steadily since 2023.



Source: UN Office for Coordination of Humanitarian Affairs.

Figure 2.12.5 Growth Forecast

Growth will rise in FY2026 and increase further in FY2027.



FY = fiscal year.

Note: Years are fiscal years ending on 20 March of that year.

Sources: National Statistics and Information Authority; Asian Development Bank estimates.

(Table 2.12.1 and Figure 2.12.5). As most returnees resettle in urban areas, their demand for food, housing, transportation, and other essential goods and services is anticipated to have jumped, providing a timely boost to services and industry. However, these gains are being partially offset by escalating regional tensions and ongoing conflict with Pakistan. The closure of Afghanistan's main border crossings with Pakistan since mid-October 2025, combined with conflict in the Middle East, has severely disrupted trade and increased costs. Crucial inputs for industry are expected to be delayed and more expensive, raising production costs and slowing manufacturing and activity in industry. The loss of main transit routes has increased delivery times and freight costs, eroding the competitiveness of Afghan exports. Thus, despite vibrant consumer demand, industry is expected to expand by only 2.2% and services by 2.0% in FY2026. Services related to private consumption, such as retail, wholesale trade, and transportation, are expected to perform well. However, public and social services may lag due to limited funding and restrictive policies. Agriculture, the largest sector of the workforce, is projected to grow by only 1.7%. Drought, pests, floods, and limited rainfall will continue to challenge the sector, although better seed quality and increased rural labor may partially offset these problems.

Table 2.12.1 Selected Economic Indicators, %

Growth will rise in FY2026 and FY2027, with inflation rising in FY2026 and moderating in FY2027.

	2024	2025	2026	2027
GDP growth	2.3	1.9	2.3	2.8
Inflation	−7.7	−4.2	4.6	3.2

GDP = gross domestic product.

Note: Years are fiscal years ending 20 March of that year

Source: Asian Development Bank estimates.

Growth is expected to accelerate to 2.8% in FY2027 as resolution of the regional conflict is anticipated to reinvigorate the economy. Assuming tensions between Afghanistan and Pakistan ease and the Middle East conflict is resolved, critical trade routes are expected to reopen, restoring normal transit through both Pakistan and Iran. This normalization of trade routes will sharply reduce freight times and costs, ensuring reliable access to fuel and raw materials while lowering import prices. In particular, re-opening the Pakistan border and stability along Iran's transport corridors will relieve the supply bottlenecks. The resulting lower energy prices and shorter transit routes will revitalize industrial production and trade activity. Firms in manufacturing and construction should benefit from improved input availability and cheaper logistics, allowing industry growth to accelerate to around 3.0% in FY2027. Services are likewise poised for expansion, with growth expected to reach about 2.5%, including noticeable expansion in wholesale and retail trade, transport, and finance and insurance. Meanwhile, the positive impact of returnees on consumer spending will start to wane, with many households having depleted the savings that underpinned their initial spending. Agriculture will remain subdued without major interventions but could see marginal gains of 1.8% if better access to irrigation equipment and input materializes.

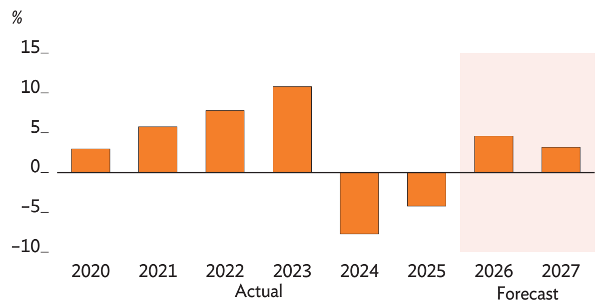
Inflation is projected to rise to 4.6% in FY2026 and ease to 3.2% in FY2027, driven by ongoing supply chain disruptions and revived demand (Figure 2.12.6). Food prices are expected to rise to 5.0%, reflecting a supply shock from the ongoing closure of the border with Pakistan and a lean winter season. While the use of alternative supply routes may contribute to food inflation, this increase is expected to subside by mid-FY2027 with the next harvest and a possible reopening of the border. Nonfood inflation is also likely to accelerate to 4.2% in FY2026, primarily from rising housing and transportation costs. In contrast, nonfood inflation should moderate in FY2027 as inflows from returnees stabilize. Overall, a strong afghani, the national currency, and stable global food and fuel prices will likely moderate overall inflationary pressures (Figure 2.12.7).

Afghanistan's trade deficit is projected to widen in FY2026 and FY2027 as imports continue to rise. Increased household spending and a stronger afghani led to an average monthly trade deficit of $0.95 billion for the first 9 months of FY2026—35% above the same period in FY2025. Imports rose from a monthly average of $0.85 billion to $1.1 billion, while exports remained flat (Figure 2.12.8). The indefinite closure of the Afghanistan-Pakistan border in October 2025 disrupted a key trade route, prompting efforts to accelerate trade diversification efforts. Although total imports rose, the share from Pakistan fell, with traders turning instead to Iran, the People's Republic of China, and Central Asian countries for essential goods. This shift is likely to raise the trade deficit in FY2026 and FY2027, as imports continue despite disruptions, but at higher cost.

While liquidity and confidence in the formal banking sector are improving, these achievements remain too tenuous to provide substantial economic support. Banks have started issuing new loans, with national currency lending rising by 7.0% and deposits increasing by 7.6% from November 2024 to November 2025. However, credit growth is likely to stay limited. High provisioning requirements are expected to significantly reduce sector profitability—reportedly down by 90% between March and June 2025, which curtails banks' ability to boost lending. In addition, capital buffers are likely to deteriorate further, as longstanding nonperforming loans are officially acknowledged. Persistent payment restrictions, along with an ineffective credit recovery system and unresolved issues surrounding the treatment of interest-

Figure 2.12.6 Inflation Forecast

Inflation will turn positive in FY2026 and slow somewhat in FY2027.



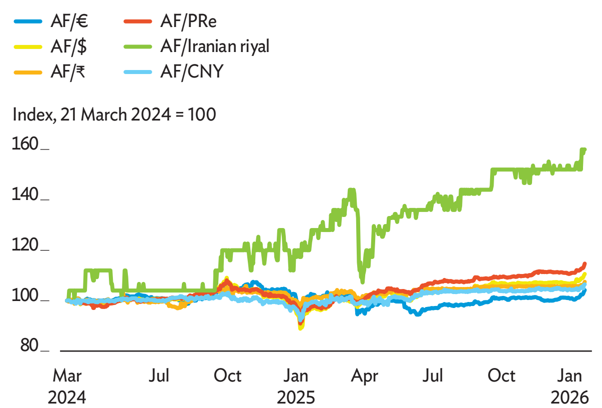
FY = fiscal year.

Note: Years are fiscal years ending 20 March of that year.

Sources: National Statistics and Information Authority; Asian Development Bank estimates.

Figure 2.12.7 Afghani Bilateral Exchange Rate Indices

The afghani appreciated against most neighboring currencies in 2025.

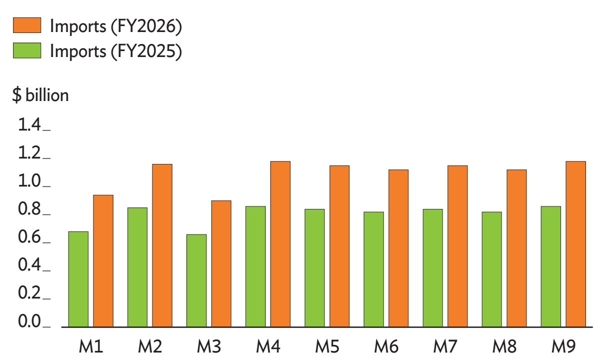


AF = afghani, CNY = Chinese yuan, PRe = Pakistan rupee.

Source: Data collection from official sources.

Figure 2.12.8 Imports

Imports were higher in the first 9 months of FY2026 than in the same period of FY2025.



Source: Official statistics from national and international institutions.

bearing loans under the Islamic finance system, are anticipated to keep the sector highly risk averse. This will limit its role to preserving balance sheet stability rather than supporting economic growth.

The economic outlook faces substantial downside risk, mainly due to potential shifts in the regional political landscape. Increasing political turmoil in neighboring countries could adversely impact Afghanistan's economy, affecting trade, manufacturing and domestic revenue collection, and leading to a new wave of returnees. This would further strain basic service provision and increase unemployment. Moreover, climate-related risks could undermine the agricultural sector and threaten food security.

The outlook is subject to exceptionally high uncertainty. With a prolonged conflict increasingly likely, the risks to the outlook are substantially greater. Persisting high energy prices and supply chain disruptions would intensify inflation pressures, while production and trade would weaken, significantly reducing growth.

Policy Challenge—Reintegrating Returnees

In 2024 and 2025, 4.0 million refugees returned to Afghanistan from neighboring Iran and Pakistan, one of the largest returns in recent history. This mass return included both voluntary repatriation and forced deportation, with many returnees being undocumented migrants. The returnees entered Afghanistan in highly vulnerable conditions. Most had spent decades abroad and returned with few possessions and limited knowledge of the country's socio-political situation.

The demographic profile of returnees is diverse and includes a high proportion of children, women, elderly individuals, and many female-led households and persons with disabilities. The influx has put significant pressure on the country's already weak and fragile infrastructure and services. Housing shortages are acute, with over 80.0% of returnee families lacking permanent shelter and facing extreme difficulty feeding their children and family members. Given the economic challenges, employment opportunities are scarce, with only 11.0% of returnees having secured full-time employment. A lack of funding, documentation, and the de facto government's restrictive policies hinder access to basic services, such as education and healthcare, increasing the risk of secondary displacements.

Supporting livelihood and economic reintegration is essential to keep returnees from becoming chronically unemployed and impoverished. Implementing livelihood and job-creation programs and skills-training initiatives for returnees and vulnerable host communities can foster self-reliance, reduce the risk of returnees falling into extreme poverty, or remigrating. Given the current socio-political context, households headed by women merit special attention. This could include promoting home-based income-generating opportunities for women, such as handicrafts, poultry farming, and tailoring, as well as policies and interventions that ease local restrictions and enable women-run businesses to operate in a secure environment.

Developing tailored microfinance products—such as group lending schemes and start-up grants—can greatly enhance entrepreneurial opportunities for returnees who lack collateral and adequate documentation to access standard financial services. These initiatives can help returnees launch small businesses, particularly in sectors such as retail, transport, agriculture, and services. To ensure long-term success, these efforts should be paired with financial literacy programs and training. Start-up grants and credit guarantee schemes can reduce lending risks for returnees and encourage entrepreneurship. Expanding the presence of microfinance institutions and mobile banking services in high-return areas is essential. When well-coordinated and adequately funded, these measures can empower returnees as active contributors to local economies and reduce prolonged dependence on humanitarian aid.

A community-based approach is vital for maintaining social cohesion and promoting the successful integration of returnees. Engaging community elders and leaders in planning and decision-making helps foster trust and shared ownership of reintegration efforts. Given that most returnees share ethnic and linguistic ties with host communities, integration can be achieved if resources are distributed fairly among returnees and host community members and local voices are included in shaping the response. This inclusive approach ensures that returnees are seen as part of the community's recovery and not as a burden.

BANGLADESH

GDP growth slowed in fiscal year 2025 (FY2025, ended 30 June 2025) on political instability that weakened demand, as well as labor disputes, recurring floods, and restrictive macroeconomic policies. Elevated inflation persisted due to supply constraints. Despite these challenges, the current account was broadly in balance. Growth is expected to gradually recover in FY2026 and FY2027 as consumption and investment pick up, and especially as political uncertainty recedes with the general election out of the way. Inflation should ease and the current account may slide into a small deficit. This assumes that the conflict in the Middle East is not prolonged and global supplies gradually normalize. Rising interest payments and increasing public debt levels warrant prudent debt management going forward.

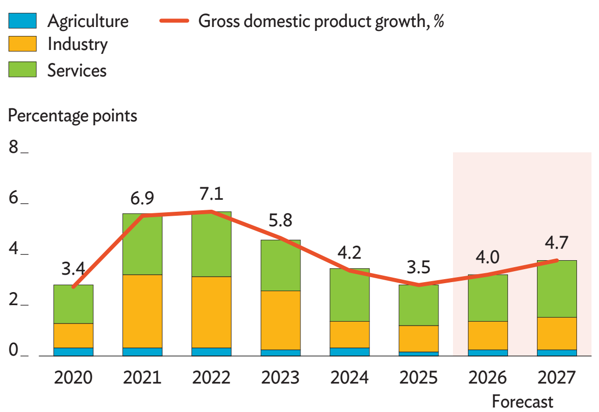
Economic Performance

GDP growth slowed to 3.5% in FY2025, from 4.2% in the previous fiscal year (Figure 2.13.1). The slowdown, which marked the third consecutive deceleration since FY2023, occurred as service sector growth slowed to 4.4%, from 5.1% in FY2024, because of political instability, weaknesses in the financial sector, and reduced household real purchasing power. Agriculture also slowed markedly, expanding by 2.4% from 3.3% in FY2024, amid recurring floods and adverse weather conditions damaging crops. In contrast, the industrial sector was resilient, with growth edging up to 3.7% from 3.5%, largely on the back of increased merchandise exports.

Both domestic and external demand weakened in FY2025, lowering GDP growth. Restrictive monetary and fiscal policies and a cautious stance among investors led to a slump in investment and lower consumption growth (Figure 2.13.2). Private consumption continued to drive growth, supported by strong remittance inflows. But overall consumption growth slumped as fiscal consolidation measures lowered government expenditure. The expansion of imports and exports slowed, with net exports weighing on overall growth.

Figure 2.13.1 Supply-Side Contributions to Growth

Growth slowed in 2025 on political unrest and floods, but is expected to accelerate in 2026 and 2027 as services rebound.



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

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

Headline inflation averaged 10.0% in FY2025, up from 9.7% in FY2024 (Figure 2.13.3). Nonfood inflation increased to 9.5% from 8.9%, while food inflation persisted at 10.7%. Pass-through effects of the 3.9% depreciation of the Bangladeshi taka against the US dollar, and supply-side constraints, particularly

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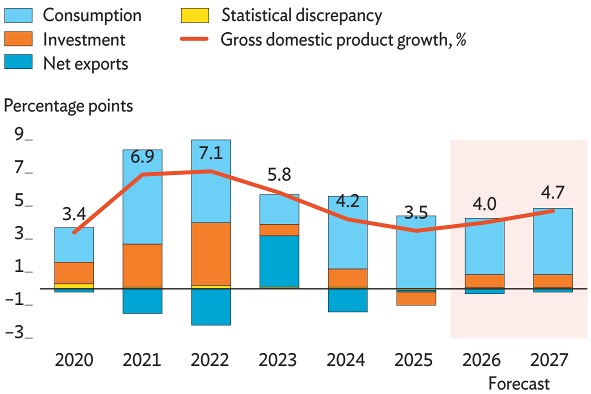
Figure 2.13.2 Demand-Side Contributions to Growth

The economy slowed in 2025 on weaker consumption and investment, but higher consumption is expected to boost growth in 2026–2027.

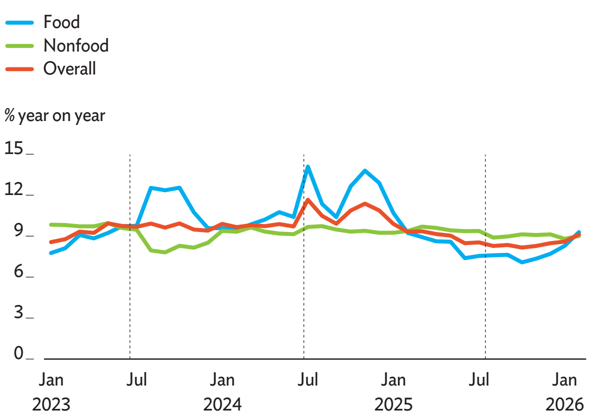


Note: Years are fiscal years ending on 30 June of that year.

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

Figure 2.13.3 Monthly Inflation

Price pressures accelerated in the first half of FY2025, eased in the second half and rose again into FY2026.



FY = fiscal year.

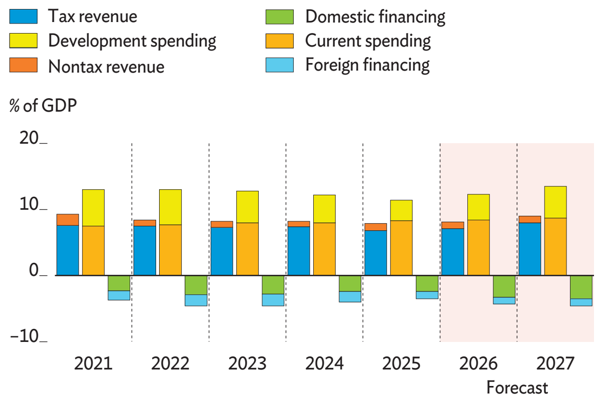
Source: Bangladesh Bank. 2026. *Monthly Economic Trends*. January.

in food and energy, drove persistently high inflation, especially in the first half of the fiscal year. These dynamics placed considerable strain on household purchasing power and business operating costs.

The fiscal deficit narrowed to 3.5% of GDP in FY2025 from 4.0% in FY2024, despite a shortfall in tax revenue, mostly reflecting suppressed capital spending (Figure 2.13.4). Revenue grew by 5.8%, bringing it to 7.9% of GDP but down from 8.2% in FY2024, resulting from weaker compliance, slow economic activities, political disruptions, and

Figure 2.13.4 Fiscal Indicators

The fiscal deficit fell in FY2025, but is expected to widen going forward.



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

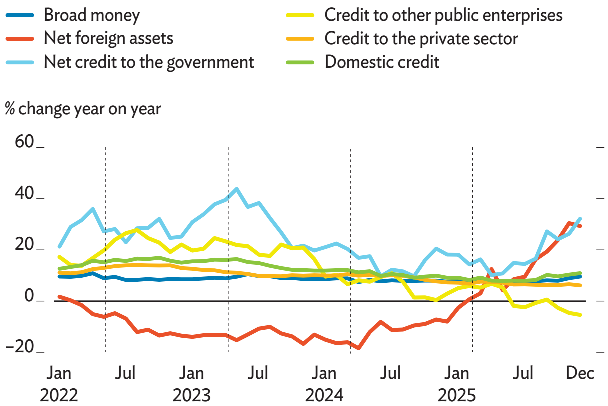
Sources: *Asian Development Outlook* database.

strikes among revenue authority employees. Public spending rose by a modest 2.8%, reaching 11.4% of GDP, primarily driven by increased subsidies to cover the expanding gap in electricity cost recovery and efforts to clear arrears. Nonetheless, the shortfall in revenue and the rise in current spending were more than compensated by lower-than-planned capital expenditure.

Money supply grew by 7.0% in FY2025, down from 7.7% in FY2024 (Figure 2.13.5). Credit to the public sector surged, growing by 13.1% in FY2025 versus 9.7% previously. However, private sector credit growth decelerated significantly, rising by 6.5%, down from 9.8% in FY2024, as elevated borrowing costs driven by the central bank's tight monetary stance and ongoing political instability dampened demand. The central bank has kept the policy rate steady since October 2024, but abundant unsecured liquidity provided to struggling banks from November 2024 impaired monetary transmission as short-term interest rates and government bond yields dropped. In fact, government bond yields decreased by around 250 basis points between June and October 2025. Prolonged regulatory forbearance and weak institutional governance have left the banking sector under significant stress, resulting in historically low private credit growth. Nonperforming loans surged to 34% by June 2025 from 12.6% at the end of June 2024, driven by tighter asset classification and provisioning standards. The authorities responded by implementing stricter regulatory oversight and required banks to tighten risk management procedures.

Figure 2.13.5 Monetary Indicators

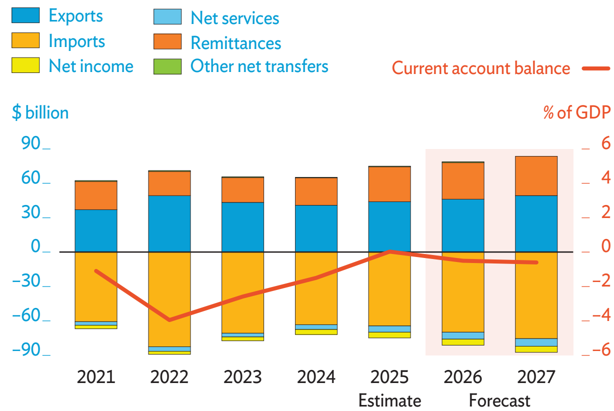
Credit growth moderated in FY2025 on weaker demand.



Source: Bangladesh Bank. 2026. *Major Economic Indicators: Monthly Update*. January.

Figure 2.13.6 Current Account Components

The current account was broadly in balance in 2025 on stronger remittances but is expected to move toward a deficit in FY2026 and FY2027 on rising import growth.



GDP = gross domestic product.

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

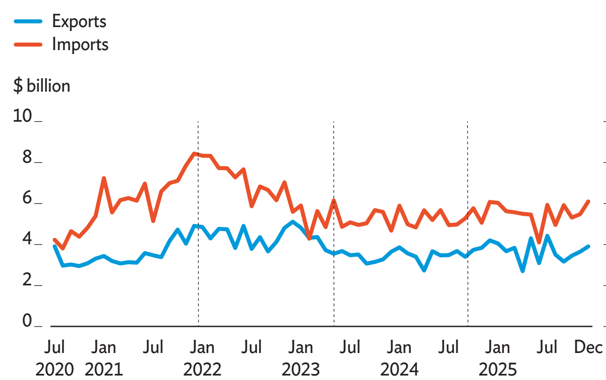
Source: Bangladesh Bank.

The current account registered a surplus of 0.03% of GDP in FY2025 compared to a deficit of 1.5% in FY2024 (Figure 2.13.6). This improvement was due to a reduced trade deficit and a surge in remittances. Exports grew by 7.7% in FY2025, reversing a decline of 5.9% in FY2024, supported by competitive pricing and direct cash subsidies to exporters provided by the government (Figure 2.13.7). Imports also rebounded, growing by 1.8% after a sharp 10.6% contraction in FY2024, reflecting demand for intermediate goods and raw materials. The depreciation of the taka, government cash incentives, and stringent oversight on informal money transfer channels led to an increase in remittances of 26.8%, significantly up from 10.7% growth in the previous year (Figure 2.13.8).

Gross foreign exchange reserves rose in FY2025 and a more flexible exchange rate management system was introduced. The financial account surplus fell to $4.0 billion, from $4.5 billion in FY2024, on repayment of external arrears by nonfinancial public enterprises. However, with unrecorded capital outflows reflected in errors and omissions falling by more than half, and supported by the stronger current account and disbursements of donor funds, gross foreign exchange reserves increased by $5.1 billion, settling at $26.7 billion. This is sufficient to cover about 4 months of imports of goods and services (Figure 2.13.9). In mid-May 2025, the central bank implemented a crawling peg with a band regime, complemented by the adoption of freely quoted exchange rates by banks and a shift toward auction-based foreign exchange

Figure 2.13.7 Monthly Exports and Imports

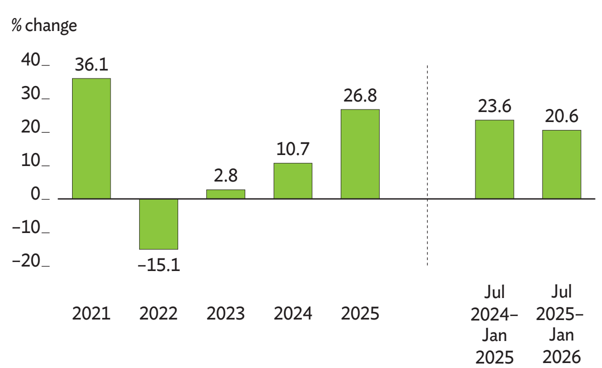
The trade deficit widened after June 2025 on faster growth in imports.



Source: Bangladesh Bank. 2026. *Monthly Economic Trends*. January.

Figure 2.13.8 Growth in Remittances

Remittances grew markedly in 2025.



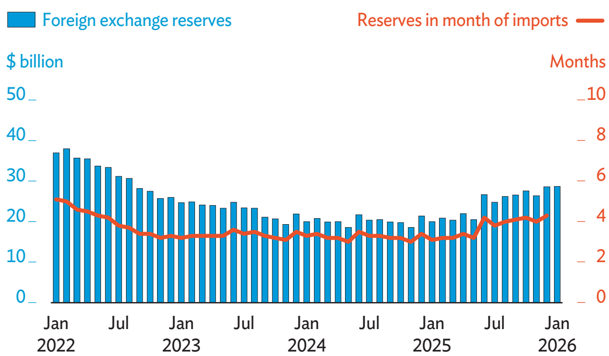
Note: Years are fiscal years ending on 30 June of that year.

Source: Bangladesh Bank.

interventions. The taka depreciated by 3.9% against the US dollar (Figure 2.13.10). However, effective exchange rate flexibility has been limited due to continued administrative guidance and periodic interventions by the central bank to hold the rate around the lower bound of the band. A full two-way movement consistent with the flexible exchange rate regime's design will contribute to external sector stability. Gross foreign exchange reserves increased by $2.0 billion to $28.7 billion (around 4 months of imports) at the end of January 2026 from June 2025, driven by strong remittance inflows and central bank's purchase of over $4 billion US dollars to manage the exchange rate and market liquidity. The taka remained broadly stable in the first seven months of FY2026, depreciating by only 0.3% against the US dollar.

Figure 2.13.9 Gross Foreign Exchange Reserves

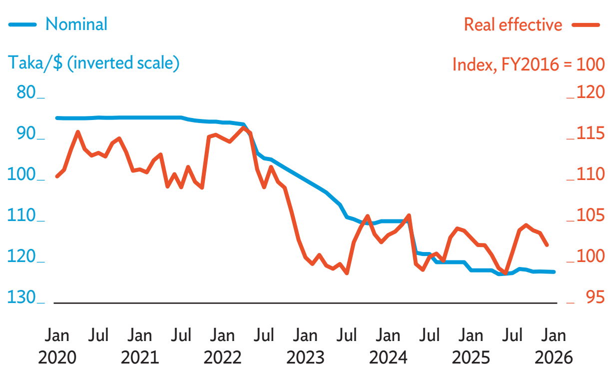
Gross foreign exchange reserves rose in FY2025.



FY = fiscal year.
Source: Bangladesh Bank.

Figure 2.13.10 Exchange Rates

The taka continued depreciating.



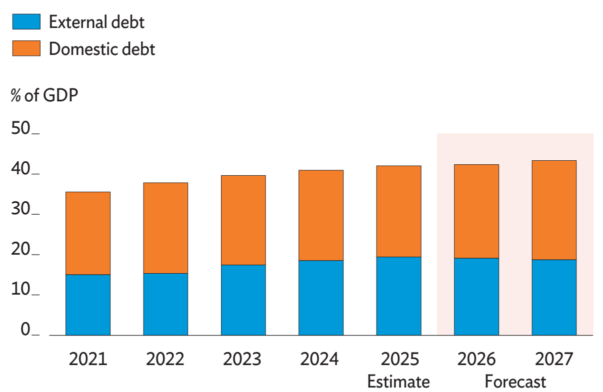
FY = fiscal year.
Source: Bangladesh Bank.

Economic Prospects

Bangladesh's economic growth is forecast to rise in FY2026 and FY2027, assuming the conflict in the Middle East is not significantly prolonged and global supplies gradually normalize (Figures 2.13.1 and 2.13.2 and Table 2.13.1). In FY2026, GDP growth is projected to increase to 4.0%, as services rebound, agricultural output normalizes, and investor sentiment strengthens following the general elections in February 2026. Ongoing financial sector reforms aimed at enhancing stability, transparency, and efficiency should support the expansion. Growth

Figure 2.13.11 Government Debt

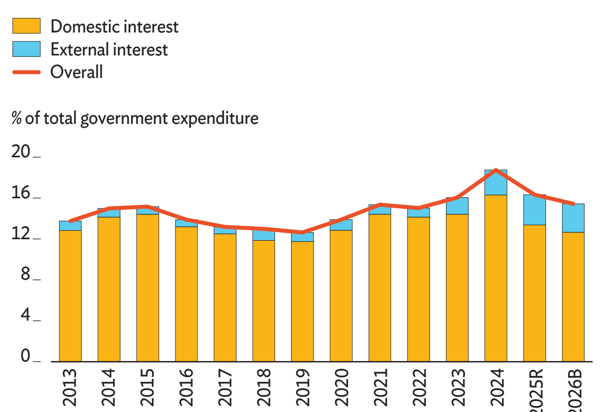
Government debt continues to rise.



GDP = gross domestic product.
Note: Years are fiscal years ending on 30 June of that year.
Source: International Monetary Fund.

Figure 2.13.12 Interest Payments

Interest payments are estimated to account for nearly one-sixth of total government expenditure in FY2026.



FY = fiscal year, R = Revised, B = Budget estimate.
Source: Budget documents, Finance Division, Bangladesh.

Table 2.13.1 Selected Economic Indicators, %

Growth in FY2025 was lower than in FY2024, but inflation was higher. Growth is forecast to gradually rise in FY2026 and FY2027, with inflation easing.

	2024	2025	2026	2027
GDP growth	4.2	3.5	4.0	4.7
Inflation	9.7	10.0	9.0	8.5

FY = fiscal year, GDP = gross domestic product.

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

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

accelerated in the first quarter of FY2026 to 4.5% from 2.6% in the same quarter of the previous year, underpinned by rising domestic demand and business activity. This trend is expected to continue in FY2026, although the conflict in the Middle East will affect economic activities in the last quarter through supply chain disruptions, especially imported fuel and export shipments. As a result, the services sector is projected to grow by 4.6%, industry by 3.8%, and agriculture by 2.8% assuming favorable weather and continued government policy support.

On the demand side, private consumption will remain the main engine of growth. It will be bolstered by strong remittance inflows and election related public expenditure. Both private and public investments are also expected to gradually increase, as imports of capital and intermediate goods are rising and the government implements its election pledges, which focus on investment promotion and ease of doing business. Net exports are expected to drag on growth as improvement in domestic demand will push import growth higher than export growth.

GDP growth is projected at 4.7% in FY2027. It is expected to be supported by a gradual recovery in investor sentiment as regulatory burdens are eased in line with the governing party's election manifesto and external uncertainties moderate. A rebound in private consumption and investment, aided by lower inflation, higher remittances, and improvement in the ease of doing business, and enhanced public investment will underpin this improved outlook. On the supply side, the services sector will continue to drive growth, supported by rising household incomes, increased government spending on social protection, and ongoing reforms. The agriculture sector is projected to maintain its normal growth trajectory, provided weather conditions remain favorable. Industrial output, while subdued in FY2026 due to external headwinds, is anticipated to pick up in FY2027 as export demand strengthens. It will also benefit from easing supply constraints, which have included disruptions in energy supply and difficulties in sourcing raw materials, and from government continued policy support as it prioritizes infrastructure development and energy security.

Inflation is expected to remain high at 9.0% in FY2026 and 8.5% in FY2027. Average headline inflation, measured by the consumer price index, which hovered around 8.5% in the first 8 months of FY2026, will likely to rise amid high global energy prices and ongoing supply disruptions. Inflation is projected to ease to 8.5% in FY2027, as the effects of external shocks diminish and domestic supply conditions improve.

The central bank is expected to adopt an accommodative monetary policy. The policy rate may be revised downward from the current 10.0% and the Standing Lending Facility rate from the current 11.5%, as the central bank focuses on boosting private investment. It is expected to simultaneously ease loan provisioning for priority sectors, including agriculture and cottage, micro, small and medium-sized enterprises. The authorities view this calibrated approach as balancing the need to contain inflationary pressures with supporting credit flows to productive sectors. The central bank also remains committed to maintaining exchange rate stability and rebuilding foreign exchange reserves.

The current account is projected to move to a small deficit of 0.5% of GDP in FY2026, widening to 0.6% in FY2027. This shift reflects a growing trade deficit, driven by rising import demand, particularly for capital and intermediate goods, as domestic investment and consumption rebound. Imports increased by 5.0% in the first half of FY2026 compared with 3.5% in the same period in the previous year. Exports were weak and volatile in the first 7 months of FY2026. After a July 2025 surge from shipment backlogs and on tariff concerns, total exports dropped 1.9% during July 2025–January 2026, due to weak global demand, cautious ordering before the election, and rising costs, including for energy. This compares to 11.7% growth in the same period of the previous year. Exports are projected to rebound in FY2027 as the external situation improves. Remittances rose by 20.6% during July 2025–January 2026, down slightly from 23.6% during July 2024–January 2025, but are expected to remain resilient, despite the tensions in the Middle East, aided by the weak exchange rate and government policy support for fund transfers through official channels. Maintaining external stability will require prudent management of the exchange rate, diversifying export markets, and continuing to facilitate remittance transfers.

The fiscal deficit is projected to expand to 4.3% of GDP in FY2026 and further to 4.6% in FY2027, as energy-related subsidies and interest costs rise while revenue mobilization remains constrained. In the first half of FY2026, the National Board of Revenue collected only 28.8% of its annual target. This indicates that revenue collection will likely fall short of the target and is expected to increase only marginally to 8.1% of GDP in FY2026 from the FY2025 low of 7.9%. The interim government reduced annual development program spending by 12.5% because of slow project execution, subdued revenue growth, and a strategic shift away from high-cost mega projects. Although total government spending remains below target levels, it is forecast to rise to 12.4% of GDP in FY2026, reflecting a higher recurrent expenditure from FY2025's restrained levels. Ongoing tax reforms, if implemented in earnest, are expected to enhance revenue over the medium term, permitting an increase in priority spending, including for social protection and infrastructure development.

Public debt is projected to rise marginally from an estimated 42.1% of GDP in FY2025 to 42.4% in FY2026. Domestic debt is expected to increase, while external debt will likely decline slightly during this period on repayment of maturing debt. Although public debt remains sustainable with moderate risk, rising domestic debt service limits fiscal space. Sustaining debt sustainability will hinge on prudent borrowing, effective public investment management, and stronger domestic revenue mobilization to support repayment capacity over the medium term.

The downside risks to the outlook are substantial, as the consequences of a prolonged conflict could be significant. The evolving situation in the Middle East presents a material downside risk to the macroeconomic outlook, with its eventual impact highly uncertain and dependent on the duration of conflict and extent of disruptions to global energy markets, shipping routes, and supply chains. Sustained increases in global oil and gas prices will amplify domestic inflationary pressures and complicate the ongoing disinflation effort, constraining macroeconomic policy flexibility. Higher energy prices could widen the fiscal deficit if energy-related subsidies rise or if full pass-through to consumers is delayed. Exports and remittances may also soften if economic activity slows in countries near the Strait of Hormuz. Elevated import costs and freight rates would strain the current account amid already tight external liquidity. Overall, the balance of risks is firmly tilted to the downside, underscoring Bangladesh's vulnerability to external shocks amid fragile macroeconomic conditions. Weather-related shocks are also a perennial risk.

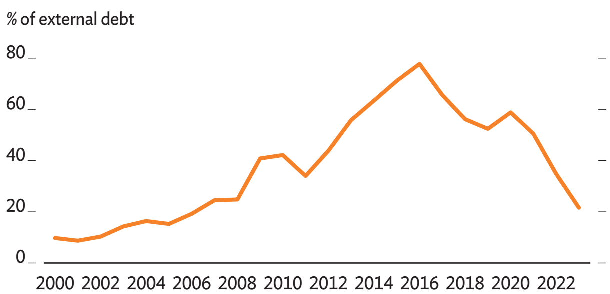
Policy Challenge—Strengthening Public Debt Management

Bangladesh has so far managed to avoid a public debt default, but clear warning signs call for immediate and strategic action to safeguard its fiscal sustainability. The country's public debt has expanded in both scale and complexity, reflecting a sustained strategy of infrastructure-led growth financed through significant borrowing (Figure 2.13.11). This expansion has been underpinned by persistent fiscal deficits, with expenditures consistently exceeding revenues and necessitating continued reliance on debt financing. The composition of the debt portfolio has also shifted, notably toward short-term internal borrowing, which accounts for over 55% of total debt, heightening liquidity and rollover risks. At the same time, the gradual transition toward less concessional financing has increased exposure to higher interest costs and external shocks. Interest payments are absorbing a rising share of resources, accounting for 16.3% of total expenditure in FY2025 and projected at 15.4% in FY2026 (Figure 2.13.12), constraining fiscal space for priority spending in human capital and infrastructure. The International Monetary Fund assesses Bangladesh as facing moderate risk of both external and overall debt distress. It notes its limited space to absorb shocks in the near term, reflecting structural vulnerabilities such as inadequate international reserves, low revenue-to-GDP ratio, and shallow domestic debt markets rather than a sharp deterioration in headline debt ratios.[1]

As Bangladesh's short-term external debt exposure increases, maintaining adequate foreign exchange reserves becomes critical to mitigating potential "debt reversal" risks. However, reserve buffers have eroded significantly relative to external liabilities, declining from over 75% of total external debt in 2016 to just 21.5% in 2023 (Figure 2.13.13). While the overall external debt stock has remained broadly stable at around 22% of gross national income, this sharp deterioration in reserve adequacy weakens the country's external resilience, reducing its capacity to absorb global shocks and heightening vulnerability to liquidity pressures and sudden stops in external financing.

Figure 2.13.13 Foreign Exchange Reserves

Foreign exchange reserves declined by over 56% between 2016 and 2023.



Source: World Development Indicators, World Bank Group.

The rapid growth of public debt and debt service cost together with low foreign exchange reserve buffers point to the need for improving debt management. To this end, through proper fiscal management, the authorities should ensure the annual budget's borrowing requirements are in line with repayment capacity and macroeconomic objectives. Furthermore, proper debt management also includes reform of the governance frameworks, transparency, and risk management practices that govern how borrowing is contracted, structured, monitored, and serviced.

The government has undertaken several policies and institutional measures to contain debt growth and improve the cost-risk profile of the debt portfolio. The legal framework has been strengthened through instruments such as the Public Debt Management Act 2022, the Public Money and Budget Management Act 2009, the Sovereign Guarantee Guidelines 2014, and the Bangladesh Government Treasury Bonds Rules (2007, 2013, 2022). Collectively, these define borrowing authority, govern guarantee issuance, and regulate the range of debt instruments. On the strategic front, the Debt Management Branch of the Finance Division prepares a Medium-Term Debt Management Strategy to guide borrowing decisions and manage refinancing, interest rate, and exchange rate risks. For transparency and oversight, the Finance Division publishes regular quarterly debt reports, while the Economic Relations Division applies structured appraisal for external borrowing—including use of a cost-risk matrix—to ensure alignment with national planning priorities and prudent debt management practices.

Despite these reforms, important institutional gaps persist. The Public Debt Management Act does not clearly articulate borrowing purposes, establish explicit debt ceilings, or mandate parliamentary approval, limiting its effectiveness as a binding fiscal anchor. It also falls short of creating an autonomous debt management office and does not sufficiently institutionalize interagency coordination. Transparency and accountability frameworks remain underdeveloped, with no legal requirement for publishing an Medium-Term Debt Management Strategy or comprehensive annual debt reports. In addition, core risk management practices—such as systematic stress testing, formal legal risk assessments, and codes of conduct—are not embedded in the framework. Finally, integration with the broader public financial management system is weak, with inadequate oversight of contingent liabilities.

Strengthening public debt management requires a comprehensive institutional and policy reforms. First and foremost, the Public Debt Management Act should be revised to introduce explicit debt ceilings and establish an autonomous debt management office with a clear mandate for risk analysis, strategy

[1] IMF. 2026. Bangladesh: 2025 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director of Bangladesh, IMF Country Report No. 26/24.

formulation, and transparent reporting. Adoption of a unified Debt Management Information System can enhance risk management and transparency, alongside stronger audit and oversight mechanisms. This is particularly relevant for large-scale infrastructure projects, where containing cost overruns and limiting the buildup of state-owned enterprise liabilities is critical. Institutionalizing the regular publication of annual and quarterly debt reports covering domestic, external, and guaranteed debt, as well as fiscal arrears and state-owned enterprise exposures, would strengthen accountability. At the same time, closer coordination between fiscal and debt management authorities is essential to align borrowing decisions with debt sustainability objectives and medium-term fiscal frameworks. Improvements in public investment management—especially in project appraisal, selection, and execution—are also critical to ensure that debt-financed spending delivers high economic returns. Finally, developing robust monitoring and disclosure frameworks for state-owned enterprise debt and other contingent liabilities would help better capture and manage underlying fiscal risks.

BHUTAN

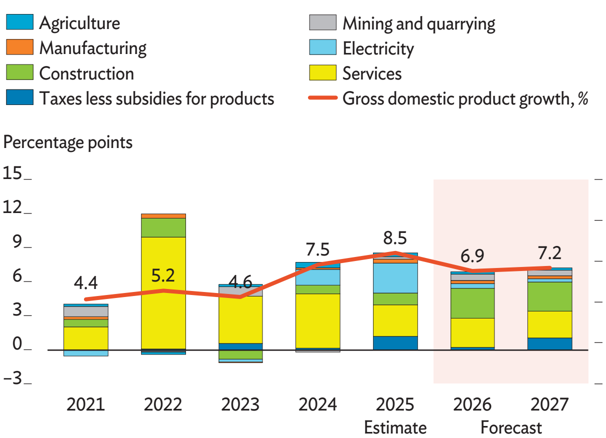
Growth accelerated in 2025 as industry expanded and private investment rose. Inflation increased and fiscal and current account deficits grew. Based on this report's early stabilization scenario, growth will likely remain robust in 2026 and 2027 on construction of new hydropower plants. Inflation will edge up this year, before softening in 2027. Reduced crypto mining-related imports this year will help narrow the current account deficit. Targeted reforms are essential to retain talent in Bhutan amid structural challenges and global opportunities.

Economic Performance

Bhutan's economic expansion was robust and broad-based in 2025 (Figure 2.14.1). GDP grew 8.5% in the year, up from 7.5% in 2024, reflecting a sustained uptick in domestic demand and pronounced recovery in productive sectors. On the supply side, industrial output grew 14.0%, mainly on strong construction and hydroelectricity-related activities. Electricity expanded most, increasing by 20.5%, supported by the commissioning of projects including the 1,020 megawatt (MW) Punatsangchhu II, the 18 MW Suchhu Hydropower Plants, and the 22 MW utility-scale Sephu Solar project, and even though heavy rainfall and severe flooding in early October temporarily shut down several power plants nationwide. Construction grew in the double digits, primarily as construction of the 600 MW Khorlochhu Hydroelectric Power Plant resumed and amid sustained progress across six ongoing hydroelectric power plants and construction at the Gelephu Airport. A substantial 30% year-on-year rise in tourist arrivals supported services output and led to pronounced gains in the hotel, restaurant, and transport subsectors. The agricultural sector, likewise, maintained a positive trajectory, although its contribution to aggregate growth remained modest, consistent with historical trends of moderate expansion.

Figure 2.14.1 Supply-Side Contributions to Growth

GDP growth in 2025 was driven by industry.



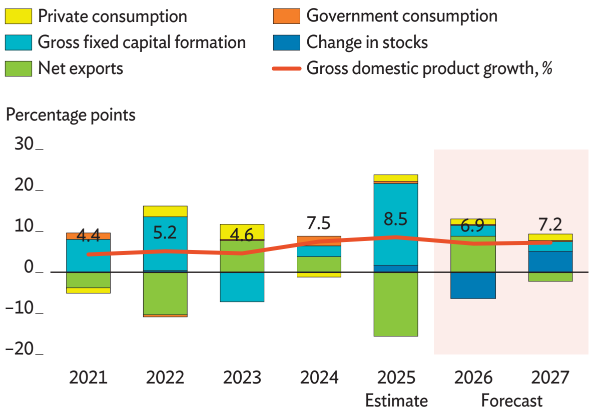
GDP = gross domestic product.
Sources: National Statistics Bureau; Asian Development Bank estimates.

Strong investment and higher consumption, supported by more credit and remittances, drove Bhutan's economic growth in 2025, though net exports remained a drag (Figure 2.14.2). Gross fixed capital formation grew 43.4% amid heightened private sector investment in crypto-mining assets. The growth also reflects notable recovery in construction, reversing a previously sluggish performance. Private sector credit growth of 46.2%, meanwhile, also contributed to non-crypto-related private sector investment. Private consumption expenditure expanded 3.5%, underpinned by credit availability and rising remittance

This chapter was written by Sonam Lhendup of the Bhutan Resident Mission, ADB, Thimphu.

Figure 2.14.2 Demand-Side Contributions to Growth

GDP growth in 2025 was led by gross fixed capital formation.



GDP = gross domestic product.

Sources: National Statistics Bureau; Asian Development Bank estimates.

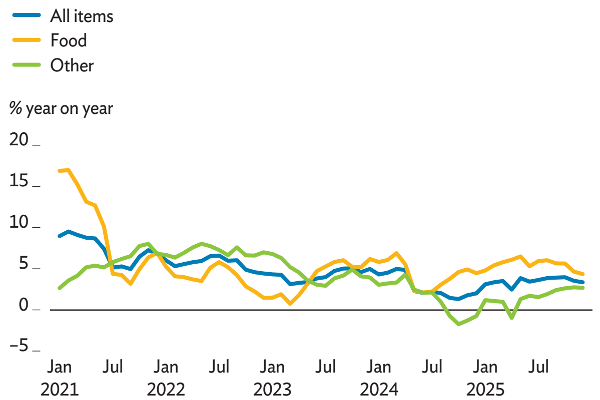
inflows. Public consumption growth stabilized at 3.1%, mirroring a nominal rise in current government expenditure, particularly after the substantial public sector salary revision implemented in fiscal year 2024 (FY2024, ended 30 June 2024). Net exports dragged significantly on growth as the trade deficit surged, mainly as imports of crypto-related equipment rose sharply.

Inflation increased to 3.5% in 2025, up from 2.8% in the previous year (Figure 2.14.3). Food prices rose 5.5% in 2025, from 4.3% in 2024, pushed by supply-side constraints but tempered by declining food prices in India, Bhutan's major import partner. Nonfood prices remained stable, reflecting ongoing deflationary trends evident in the transport sector, driven by lower fuel prices.

The fiscal deficit widened from 1.6% of GDP in FY2024 to 2.7% of GDP in FY2025, financed through increased external concessional borrowing (Figure 2.14.4). Government spending increased from 28.2% of GDP in FY2024 to 30.0% in FY2025, driven by a 2.8-percentage-point increase in capital allocation. The increase in capital expenditure was partly offset by a decline in current spending, which fell from 16.4% of GDP in FY2024 to 15.4% in FY2025, mainly due to wage and salary stabilization after a marked pay increase for public servants in FY2024. Revenue and grants also increased almost 1 percentage point of GDP in FY2025, primarily in tandem with increased grants and transfers from the Government of India and Bhutan's

Figure 2.14.3 Inflation

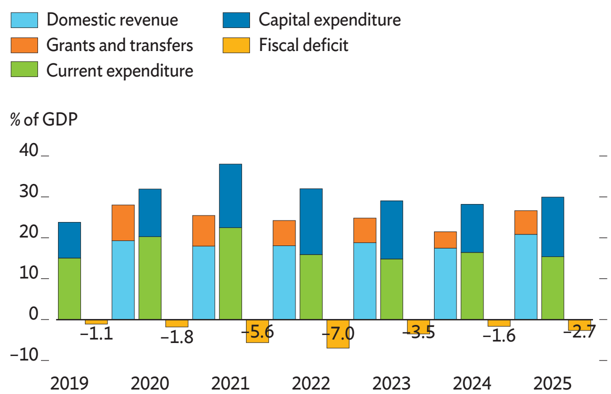
Inflation edged up in 2025 amid faster food price increases.



Source: National Statistics Bureau.

Figure 2.14.4 Fiscal Indicators

The fiscal balance worsened in FY2025.



FY = fiscal year, GDP = gross domestic product.

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

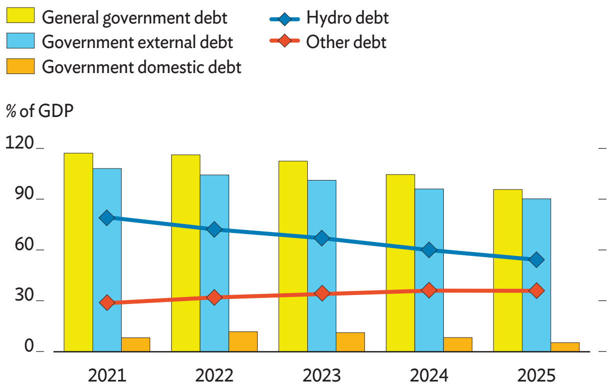
Source: Ministry of Finance.

development partners. With GDP growth outpacing debt growth, total public debt declined to 95.7% of GDP in 2025 from 104.6% the previous year, as the external debt-to-GDP ratio dropped by 5.8 percentage points year on year and the domestic debt-to-GDP ratio fell by 3 percentage points (Figure 2.14.5).

Monetary policy remained accommodative throughout 2025 (Figure 2.14.6). The Royal Monetary Authority maintained the cash reserve ratio at 8% and lowered the minimum lending rate from 6.8% in 2024 to 6.1% in 2025, reducing borrowing costs. Domestic credit expanded an estimated 41.1% in 2025, including a 46.2% increase to the private sector, while credit to the government contracted

Figure 2.14.5 Government Debt

The public debt-to-GDP ratio declined in 2025.

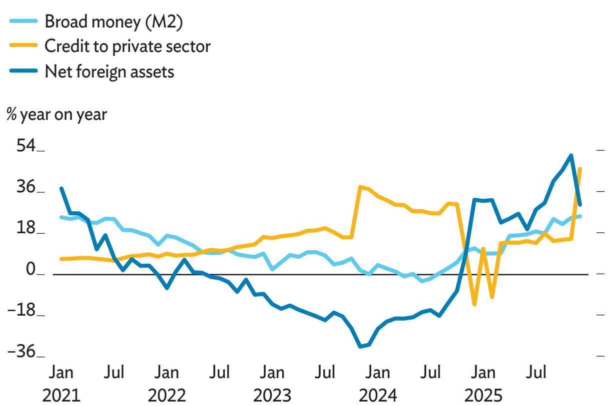


GDP = gross domestic product.

Source: Ministry of Finance.

Figure 2.14.6 Monetary Indicators

Monetary policy was accommodative in 2025.



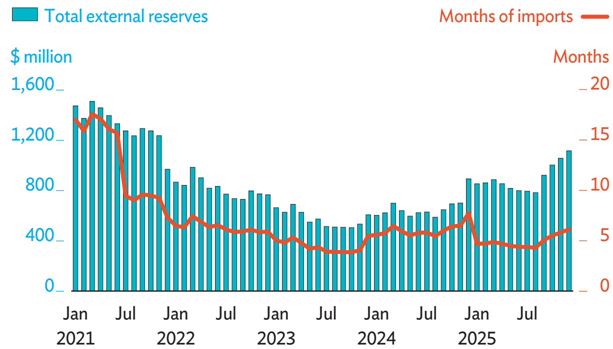
Source: Royal Monetary Authority.

6.8%. Net foreign assets of the banking system rose by 30.5%, supported by growth in remittances, official grants, and revenue from hydroelectricity exports to India. Reflecting these developments, money supply increased by 25.4%.

The current account deficit increased to an estimated 28.0% of GDP in 2025 from 14.3% in 2024. The trade deficit widened sharply to 38.1% in 2025 from 19.4% of GDP in 2024, as import growth substantially outpaced export growth. The deterioration was driven mainly by nearly $500 million in capital goods imports of crypto mining equipment by Bitdeer Technologies Group, a wholly foreign-owned direct investment enterprise operating two crypto mining facilities in Bhutan with a combined

Figure 2.14.7 External Reserves

External reserves grew but import cover worsened in 2025 amid a surge in imports.



Source: Royal Monetary Authority.

installed capacity of about 600 MWs. Importantly, these purchases were financed directly by the investor from abroad, and therefore did not draw on Bhutan's foreign exchange reserves, even though they materially enlarged the recorded trade deficit. While primary income registered a deficit of 3.3% of GDP, secondary income remained robust, growing at 8.9%, resulting in a net inflow of 5.6% of GDP. Gross international reserves increased to $1,116.3 million in 2025 from $892.7 million in 2024, covering 6.1 months (Figure 2.14.7). The improvement in reserves was driven by stronger tourism and hydropower earnings, higher remittances, and the partial redemption of a special dollar bond issued by Druk Holding Investment to the Royal Monetary Authority in 2022.

Economic Prospects

GDP is forecast to expand 6.9% in 2026 and 7.2% in 2027 (Table 2.14.1). This outlook is based on an early stabilization scenario and subject to significant uncertainty owing to the ongoing conflict in the Middle East. It is anchored on continued capital investment, particularly in the industrial sector, financed in part by private equity participation. Industrial output is projected to increase by 12.1% in 2026 and 10.6% in 2027, reflecting sustained double-digit growth in construction, which is expected to remain the primary driver of economic activity over the forecast years. The development and ongoing construction of large-scale hydropower projects—including Wangchhu, Dorjilung, and Khorlochhu,

Table 2.14.1 Selected Economic Indicators, %

After easing in 2026, growth is expected to rise marginally in 2027, while inflation is forecast to edge up in 2026 then soften in 2027.

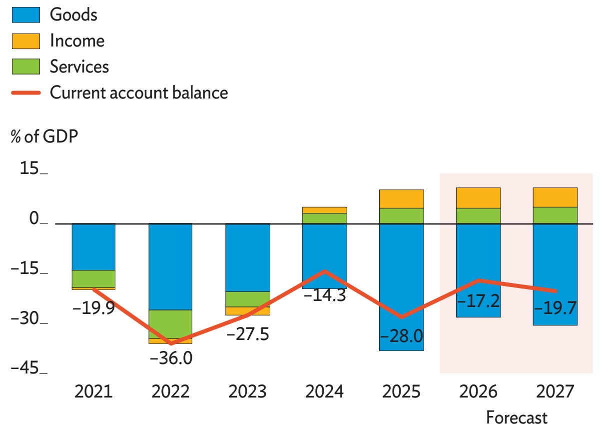
	2024	2025	2026	2027
GDP growth	7.5	8.5	6.9	7.2
Inflation	2.8	3.5	3.9	3.2

GDP = gross domestic product.

Sources: Ministry of Finance; National Statistics Bureau; Asian Development Bank estimates.

Figure 2.14.8 Components of the Current Account

The current account deficit will narrow in the forecast years.



GDP = gross domestic product.

Sources: National Statistics Bureau; Asian Development Bank estimates.

with a combined generation capacity of 2,295 MW—will be central to supporting construction growth. Mining and quarrying output is forecast to rise in tandem with the expansion of the construction sector. Electricity growth will remain muted, as no major hydropower plants are scheduled for commissioning during this period. Services growth will moderate to 4.8% in 2026 and 4.5% in 2027, as tourist arrivals taper toward the historical average and flight and hotel capacity temper growth of transport and hospitality activities. Agricultural growth will remain moderate, benefiting from improved input availability, although productivity gains will continue to be shaped by weather-related factors and limited sectoral diversification.

Domestic demand will be buoyant in 2026, driven by strong private and public investment. Sustained increases in government capital spending and the continued ramp-up of hydropower construction are expected to underpin the growth momentum. Budget documents project fixed investment to increase by 4.2% in 2026 and 3.8% in 2027. Private consumption is expected to grow moderately by 3.2%, as expansion in private sector credit and remittance inflows ease over the forecast period. Public consumption is projected to remain broadly stable at about 2.0% in both years, reflecting steady current expenditure. The external position is expected to improve, with net exports projected to strengthen by 34.2%, supported by a marked decline in imports, as no further crypto-related capital goods are expected to be imported, although export growth will be muted because no major changes in non-hydropower exports are expected and no new hydropower projects are commissioned. As a result, the current account deficit is projected to narrow to 17.2% of GDP in 2026, before edging up to 19.6% in 2027 (Figure 2.14.8).

The fiscal deficit is forecast to widen to 3.5% of GDP in FY2026 and 4.0% in FY2027. The higher deficits will result from both an escalation in capital outlays, as the implementation of the government's 13th Five-Year Plan covering FY2024–2029 advances, and a decline in revenue on the rollout of comprehensive tax reforms starting in January 2026. The reforms include the merger of business income tax and personal income tax, a reduction in the corporate income tax rate to a flat 22% from prior differentiated rates of 30% for state-owned enterprises and 25% for other corporations, and the exemption of intercorporate dividends. Additionally, the government expects the 5% goods and services tax (GST) introduced in January 2026 to be broadly revenue-neutral in the short run, as initial transitional frictions and offsetting effects from the wider tax changes temper immediate revenue gains.

Headline inflation is forecast to edge up to 3.9% in 2026, before easing to 3.2% in 2027 assuming early stabilization scenario. The marginal price increase in 2026 is mainly driven by one-off transition effects from GST implementation, notably double taxation as pre-GST inventories face GST again upon sale. Given Bhutan's significant reliance on imports, domestic inflation will remain closely aligned with global price trends for petroleum, food, and other key commodities. Notably, since Indian imports make up around half of Bhutan's consumer price index, inflation in India will play a crucial role in price pressures in Bhutan.

As global supply chains stabilize and inflation in India moderates, inflation in Bhutan is expected to ease in 2027.

Bhutan's economic outlook faces several significant downside risks. A prolonged conflict in the Middle East would increase fuel and import costs and weaken tourism receipts, adding to imported inflation, with spillovers to transport, construction, and other domestic prices. Increased import costs and lower-than-expected tourist arrivals amid deferred travel would expand the fiscal deficit and reduce foreign exchange earnings, widening the current account deficit. Other external risks include global trade conflicts, and depreciation of the Indian rupee against the US dollar. Bhutan pegs its currency, the ngultrum, to the Indian currency at par. Delays in construction or in investor funding could undermine growth. Rising domestic energy demand, especially from cryptocurrency operations, could cut into hydropower exports to India, further pressuring fiscal and external balances. Tight fiscal conditions and large-scale skilled worker emigration also pose threats to both economic expansion and the quality of public service delivery. Extreme weather events, such as unpredictable monsoons or floods, threaten the agriculture and hydropower sectors. On the upside, including income from the sale of crypto assets in national accounts—which are believed to account for about a third of Bhutan's GDP—could inflate reported growth in the forecast years.

Policy Challenge—Retaining Skilled Talent Amid Growing Migration

Bhutan faces a serious migration problem as educated youth and skilled professionals leave for better opportunities and advanced education abroad, often settling there. Nearly 9% of Bhutanese now live overseas, up from just 1% in 1990. Australia hosts about 57% of the migrants. Civil servants represent the predominant migrant group, of which a quarter are teachers and educators. The World Bank reports that 53% of migrants hold university degrees and youth with at least higher secondary education are considerably more likely to migrate. Strong pull factors, such as significant wage differences, better education quality, and improved living conditions, far outweigh the government's efforts to retain talent. Limited quality jobs, modest domestic earning prospects, limited opportunities for career progression, heavy workload, bureaucratic processes, and red tape remain the main push factors.

Bhutan's out-migration impacts economic resilience, innovation, and sustainable development. Even though 77% of the population is of working age, the steady loss of skilled individuals weakens fiscal stability, private-sector growth, and social cohesion. The departure of professionals from the education and health sectors threatens the government's mandate for free services and increases reliance on external hires, restricting innovation and entrepreneurial activity. Additionally, this outflow disrupts families and erodes the country's tradition of social connectedness.

The Bhutanese government has implemented several measures to address migration challenges. A notable 2024 review of public servants' salaries increased pay by 54% to 75%, with the largest increases for teachers and health professionals. Entry procedures for clinical professionals have been streamlined to reduce shortages. Technical and vocational education and training modernization and better skill pathways target employability, while the national reintegration program offers entrepreneurship training and re-entry support for skilled returnees. The Gyalsung National Service program develops skills and promotes national cohesion and the Gelephu Mindfulness City is being developed as an economic hub to generate high-quality jobs for skilled Bhutanese.

Despite ongoing initiatives, out-migration rates remain elevated, underscoring the need for more targeted interventions for job support to the youth, including entrepreneurship. Continued government action is essential to resolve longstanding structural challenges. These include diversifying the economy, improving access to credit through financial sector reforms, enhancing interagency coordination, and improving working conditions by effectively enforcing labor laws, providing safer workplaces, improving job quality, and ensuring skill alignment. Targeted interventions are needed to counter the emigration of educated youth. Bhutan must prioritize private-sector reforms by ensuring predictable regulations, streamlined entry procedures, equitable competition, and better access to finance. Key actions include improving regulatory quality, establishing a single-window clearance system, addressing the crowding-out effect of state-owned enterprises, and improving lending to small- and medium-sized enterprises. The youth entrepreneurship development program must shift from “start-up promotion” to a youth-oriented, comprehensive “business development and decent jobs” strategy. This approach includes (i) strengthening school-to-work pathways through enhanced entrepreneurship education, mentoring, and targeted support for youth and women; (ii) addressing the “missing middle” by expanding acceleration services and growth-stage finance to enable viable youth businesses to scale and hire; and (iii) improving enabling conditions and coordination to ensure coherent and practical support to businesses.

INDIA

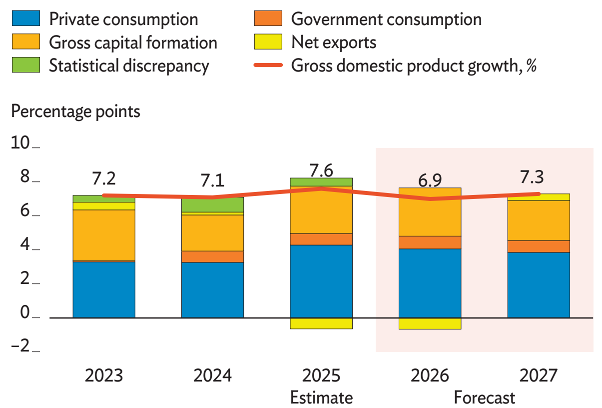
Economic growth accelerated in fiscal year 2025 (FY2025, ended 31 March 2026) amid resilient household consumption, steady public investment, and lower-than-expected drag from net exports. GDP growth is projected to decline to 6.9% in FY2026 primarily due to external challenges, and expand to 7.3% in FY2027 as consumption and investment benefit from favorable policies and the external environment improves. Inflation is forecast to rise to 4.5% in FY2026 amid conflict in the Middle East, before easing to 4.0% in FY2027 as food prices moderate. A key policy challenge is to rationalize subsidies and transfers to protect vulnerable groups while preserving fiscal space for growth-enhancing public investment.

Economic Performance

Economic growth in India accelerated in fiscal year 2025 on strong domestic demand (Figure 2.15.1). Real GDP grew by 7.6% in FY2025, higher than the 7.1% recorded in FY2024, supported by resilient household consumption and steady public investment. Private final consumption expenditure growth increased to 7.7% in FY2025 from 5.8% in FY2024, stimulated by lower income tax and goods and services tax (GST) and falling food prices. Government consumption grew 6.6%, helped by slower fiscal consolidation. Investment expanded a robust 7.1% as private investment responded to easing financial conditions, including falling interest rates, complementing an increase in public capital expenditure. Exports grew by 6.5% despite the impact of higher US reciprocal tariffs on several Indian goods, while imports grew at 6.4%.

Figure 2.15.1 Demand-Side Contributions to Growth

GDP growth accelerated in FY2025 on rising domestic demand.



FY = fiscal year, GDP = gross domestic product.

Notes: Years are fiscal years ending on 31 March of the next year.

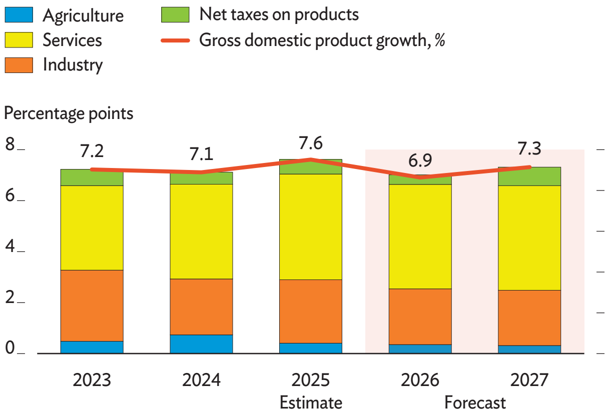
Sources: Ministry of Statistics and Programme Implementation; CEIC Data Company.

On the supply side, a buoyant services sector and recovery in the manufacturing sector led growth in FY2025. Services sector growth accelerated to 9.0% in FY2025 compared to 7.9% in FY2024 (Figure 2.15.2). This was helped by 9.9% growth in financial, real estate, and professional services, as the sector shifted towards high-value-added services and on continued robust real estate demand. Trade, hotel, transport, and communication services grew by 10.1%. The industrial sector grew by 8.8%, underpinned by a 11.5% expansion in manufacturing, helped by higher domestic demand and falling input prices. The construction sector also grew by 7.1%, but mining and quarrying grew by only 4.1% from a high base in the previous year. Agriculture continued robust growth of 2.4%, helped by supportive weather conditions, although this was lower than the 4.2% of FY2024.

This chapter was written by Abhijit Sen Gupta, Chinmaya Goyal, and Deeksha Bhardwaj of the India Resident Mission, ADB, New Delhi.

Figure 2.15.2 Supply-Side Contributions to Growth

Higher growth of services sector pushed up GDP growth in FY2025.



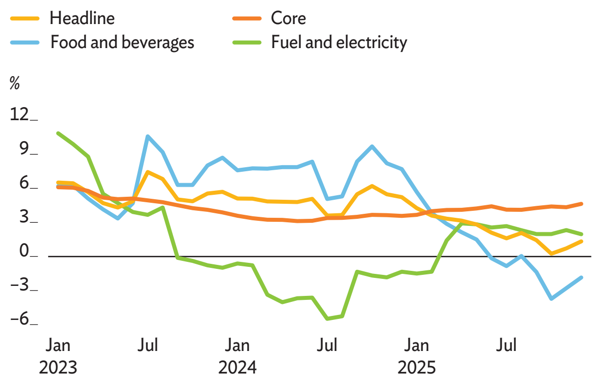
FY = fiscal year, GDP = gross domestic product.

Note: Years are fiscal years ending on 31 March of the next year. Net taxes on products are tax receipts minus subsidies.

Sources: Ministry of Statistics and Programme Implementation; CEIC Data Company.

Figure 2.15.3 Consumer Price Inflation

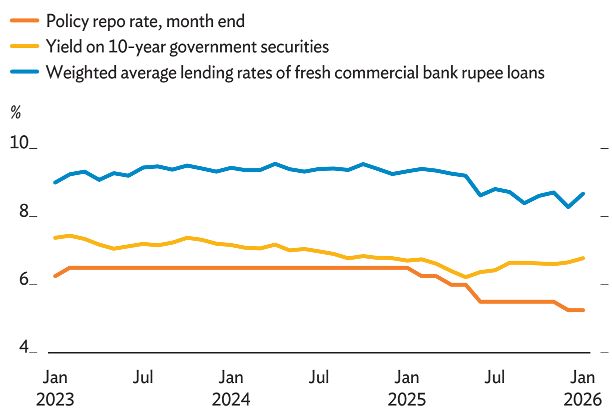
Consumer inflation plunged as food prices dropped.



Source: CEIC Data Company.

Figure 2.15.4 Interest Rates

Bank lending rates declined in 2025 as the Reserve Bank of India lowered its policy rate.



Source: CEIC Data Company.

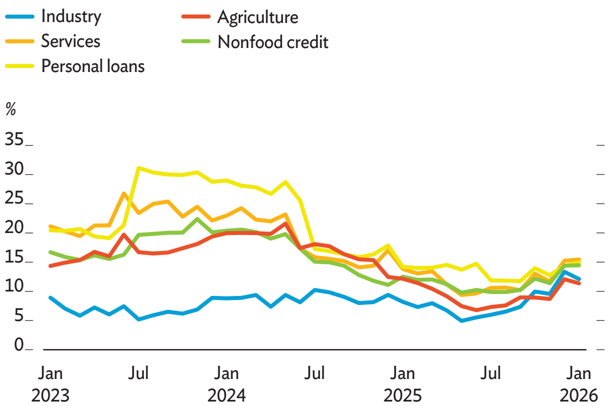
Inflation eased sharply through FY2025, driven by food price deflation. Consumer price inflation averaged 1.7% in the first 9 months of FY2025, much lower than 4.6% in FY2025 (Figure 2.15.3). Inflation fell to near zero in October 2025 and then rose gradually to 1.3% by December 2025. Food prices began to fall from mid-2025 and were 1.8% lower year on year in December 2025. This was driven largely by the fall in volatile vegetable prices from a high base in FY2024 as weather conditions led to higher supply. Fuel inflation also remained muted, as global commodity price pressures declined. This mitigated the impact of the 4.5% depreciation in the Indian rupee against the US dollar on energy imports. Core inflation remained stable, averaging 4.3% in the first 9 months of FY2025. This was partly due to higher prices for precious metals such as gold, implying that underlying pressure on other goods and services was relatively subdued. Moreover, imports from the People's Republic of China, where inflation is muted, helped keep domestic prices in check.

In light of disinflation in FY2025, monetary policy focused on easing rates and enhancing liquidity. As inflation fell below the monetary policy target band of 2–6%, the Monetary Policy Committee reduced the policy repo rate by 125 basis points cumulatively to 5.25% in calendar year 2025 (Figure 2.15.4). To enhance liquidity to the economy, the Reserve Bank of India (RBI), the central bank, implemented a phased reduction of the cash reserve ratio to 3.00% by late 2025. As a result of these initiatives, average interest rates on fresh loans declined by 97 basis points during calendar year 2025. The yield on 10-year government securities remained below 7.0% for much of FY2025, helped by macroeconomic stability and fiscal consolidation, but since have risen from market reaction to the conflict in the Middle East. The government continued to fine tune policy measures, particularly for food items, in response to inflation trends. This included a cut in the import duty on crude edible oil in May 2025 and relaxation of the export duty on onions in April 2025.

Bank credit growth regained some momentum during FY2025 after a marked deceleration through FY2024. After dipping to 8.8% in May 2025, year-on-

Figure 2.15.5 Growth in Bank Credit

Bank credit growth dipped in the first half of 2025 on tighter monetary policy but rose in the second half as policy was relaxed.

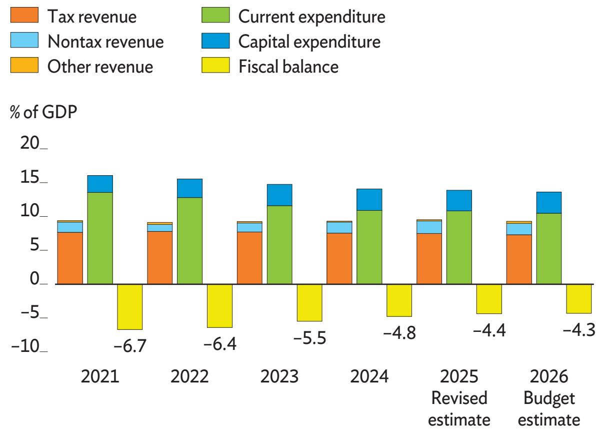


Note: Excludes public loans to buy crops from farmers and the impact of a merger combining HDFC, a large bank, with a nonbank financial corporation, which drove up outstanding bank credit.

Sources: CEIC Data Company; Reserve Bank of India.

Figure 2.15.6 Central Government Fiscal Indicators

The budget deficit fell as expenditure growth was contained in the face of a revenue shortfall.



GDP = gross domestic product.

Note: Years are fiscal years ending on 31 March of the next year.

Source: Ministry of Finance Union Budget.

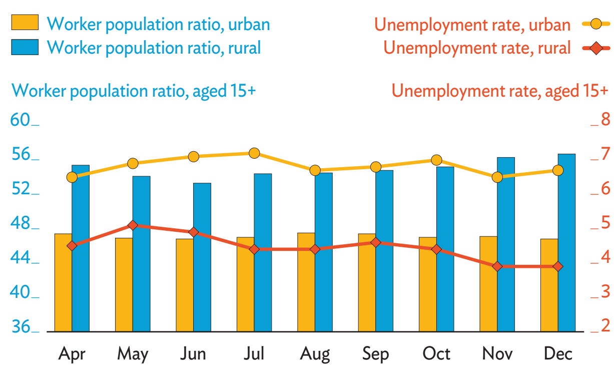
year, growth in nonfood credit rose to 14.5% in January 2026 from 12.5% in January 2025 (Figure 2.15.5). The increase in bank credit was broad-based, led by a strengthening in industry credit to 12.1% year on year in January 2026 from 8.2% a year earlier, as services credit grew a robust 15.5% year on year from 13.8% in January 2025. Personal loan growth remained resilient at 14.9% in January 2026, but well below the rapid rate of expansion in FY2023 and FY2024. The banking sector remained broadly in a healthy state, with the gross nonperforming assets ratio for scheduled commercial banks declining to 2.3% in March 2025 and easing further to around 2.1% by end-September 2025. Better credit management and robust prudential norms supported the trend.

Fiscal consolidation continued as expected despite a shortfall in revenues. The central government's fiscal deficit is estimated to have fallen to 4.4% of GDP in FY2025, from 4.8% of GDP in FY2024, in line with the budget target, with lower expenditure than budgeted compensating for shortfall in revenue growth (Figure 2.15.6). Total revenue rose by 10.1% in FY2025, 2.3% below the budgeted amount, despite larger dividend received from the RBI, as receipts from income tax and GST grew less than original budget estimates owing to unplanned tax cuts during the fiscal year. With the subsidies on food and fertilizers growing due to higher than expected commodity prices, current expenditure rose by 7.4% in FY2025, but remained below Indian rupees (₹) 39.4 trillion estimated in the budget. Capital expenditure, too, is estimated to have grown by 4.2% to ₹10.9 trillion in FY2025, less than the budget estimate of ₹11.2 trillion.

The labor market improved, with unemployment declining and work participation continuing to rise. The overall unemployment rate fell to 4.8% in December 2025 from 5.1% in April 2025, with rural unemployment declining to 3.9% by late 2025, but the urban unemployment rate rising marginally (Figure 2.15.7). The worker population ratio improved

Figure 2.15.7 Worker Population Ratio and Unemployment Rates

Overall unemployment rate remained relatively stable in 2025.



Notes: Estimates use current weekly status.

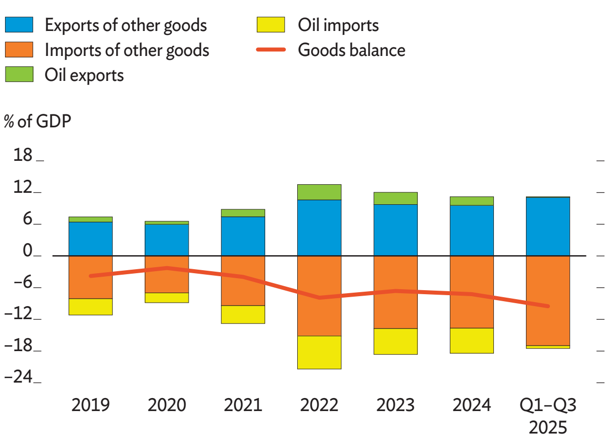
Sources: Ministry of Statistics and Program Implementation, Periodic Labor Force Survey; CEIC Data Company.

through FY2025, from 53.3% in June 2025 to 56.7% in December 2025, driven by improvements in rural areas while work participation in urban areas remained stable. One noteworthy trend was the improvement in the female labor force participation rate, for aged 15 or above, to 35.3% in December 2025 from 34.2% in April 2025.

The overall trade deficit widened, with an elevated merchandise trade deficit tempered by strong services exports. Merchandise exports rose by 2.1% year on year in the first 10 months of FY2025 as oil exports declined by 14.0% due to lower global prices, while non-oil exports grew moderately at 4.9%, led by electronic and engineering goods and marine products (Figure 2.15.8). Over the same period, merchandise imports grew by 7.3% year on year due to higher purchase of silver, gold, electronics, and capital goods; counterbalancing the 3.9% year on year decline in crude petroleum imports. Consequently, the goods trade deficit widened to 8.6% of GDP during this period, up from 8.1% of GDP in the corresponding period of FY2024. This impact was partially mitigated by a higher services trade surplus, that rose to 5.4% of GDP from 4.9% of GDP a year earlier, as services export receipts increased by 8.8% year on year while import payments rose by 2.3% (Figure 2.15.9). Worker remittances surged by 25.6% in the first 9 months of FY2025 compared to 24.1% in FY2024. As a result, the current account deficit narrowed to 1.0% of GDP in the first 9 months of FY2025.

Figure 2.15.8 Trade in Goods

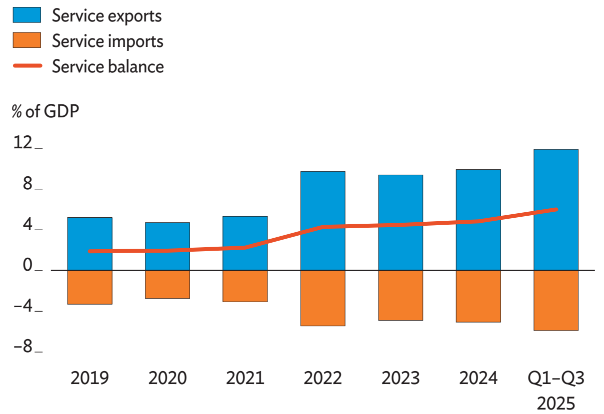
The goods trade deficit widened in FY2025.



GDP = gross domestic product, Q = quarter.
Notes: Years are fiscal years ending on 31 March of the next year.
Sources: CEIC Data Company; Ministry of Commerce.

Figure 2.15.9 Trade in Services

The surplus in services expanded on strong exports.

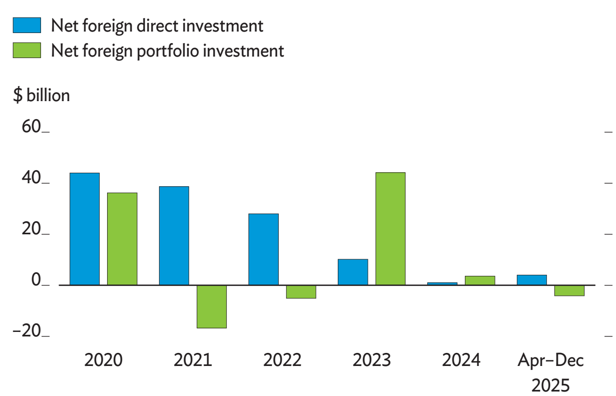


GDP = gross domestic product, Q = quarter.
Notes: Years are fiscal years ending on 31 March of the next year.
Sources: CEIC Data Company; Reserve Bank of India.

Elevated US interest rates amid rising economic uncertainties led to capital outflow in FY2025. Net foreign portfolio investment recorded a net outflow of $4.3 billion during the first 9 months of FY2025 compared to a net inflow of $9.4 billion in FY2024, as foreign investors shifted toward US assets, AI-driven semiconductor markets, and other equity markets (Figure 2.15.10). Net foreign direct investment inflows, however, improved to $3.0 billion as repatriation by multinationals moderated, along with strong gross inflows. Outward investment by Indian companies remained elevated, though at a slower pace compared to

Figure 2.15.10 Foreign Direct and Portfolio Investment

Net foreign direct investment and net portfolio outflows grew in FY2025.



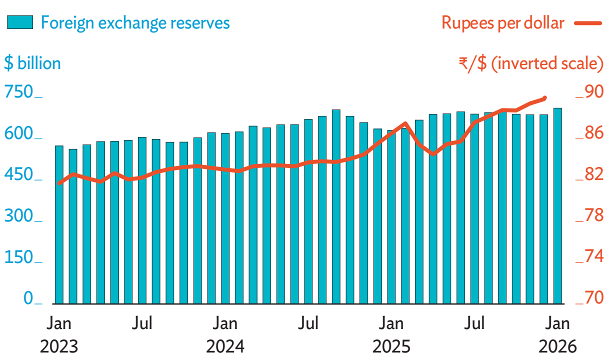
FY = fiscal year.
Note: Years are fiscal years ending on 31 March of the next year.
Sources: CEIC Data Company.

the sharp surge in FY2024. The Bombay Stock Exchange index declined over 7.0% in FY2026, as a sharp foreign investor led selloff driven by global uncertainty more than offset record domestic and retail participation supported by strong festive and rural demand, lower input costs, and accomodative monetary policy.

Due to a narrower current account deficit, the balance of payments was in surplus in the first 9 months of FY2025, despite muted net capital inflows. Foreign exchange reserves trended upwards from April 2025, peaking in February at $728.5 billion, sufficient for 11.3 months of imports (Figure 2.15.11). The rupee depreciated by 4.5% in FY2025, as a stronger dollar, higher dollar demand from importers, and periodic portfolio outflows weighed on the currency. In real effective terms, the rupee depreciated by 7.4% over 11 months to February 2026, modestly improving the export price competitiveness in global markets at the cost of higher import prices.

Figure 2.15.11 Foreign Exchange Rate and Reserves

Foreign exchange reserves rose but the rupee depreciated against the US dollar in 2025.



Sources: CEIC Data Company; Reserve Bank of India.

Economic Prospects

Under this report's early stabilization scenario, economic growth is expected to remain strong at 6.9% in FY2026, before strengthening further to 7.3% in FY2027 (Table 2.15.1). Rising consumption and investment will drive growth in FY2026, supported by favorable policies and structural reforms, while a more benign external environment compared to FY2025 will bolster exports. On the supply side, manufacturing and services growth are expected to remain strong, aided by domestic reforms and favorable access to foreign markets under newly signed trade deals. Growth in FY2027 improves markedly as domestic demand strengthens due to hikes in salaries/pensions of government employees and an uptick in investment benefitting from key regulatory reforms. External demand is expected to strengthen as the benefits from the trade deal with the European Union (EU) boosts exports.

Table 2.15.1 Selected Economic Indicators, %

Growth will moderate this fiscal year but rise in FY2027, while inflation will rise this fiscal year and moderate in FY2027.

	2024	2025	2026	2027
GDP growth	7.1	7.6	6.9	7.3
Inflation	4.6	2.1	4.5	4.0

GDP = gross domestic product.

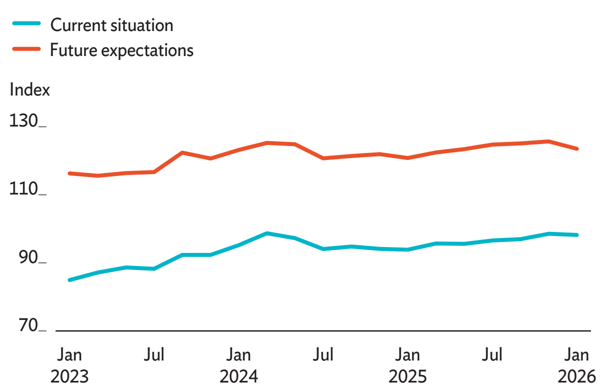
Note: Years are fiscal years ending on 31 March of the next year.

Sources: Ministry of Statistics and Programme Implementation, Government of India; Reserve Bank of India; Asian Development Bank estimates.

Consumption is likely to remain the key driver, bolstered by real income growth in rural and urban areas. Consumption growth is expected to normalize in FY2026 as the boost from tax cuts introduced in FY2025 dissipates during the course of the year (Figure 2.15.12). Rising inflation, especially food and petroleum products, may also temper private consumption. On the other hand, the reduction in key RBI policy rate by a cumulative 125 basis points would help demand for consumer durables. Rural consumption will continue to be supported

Figure 2.15.12 Consumer Confidence Survey

Consumer confidence is on the rise.



Note: Years are fiscal years ending on 31 March of the next year.

Source: Reserve Bank of India.

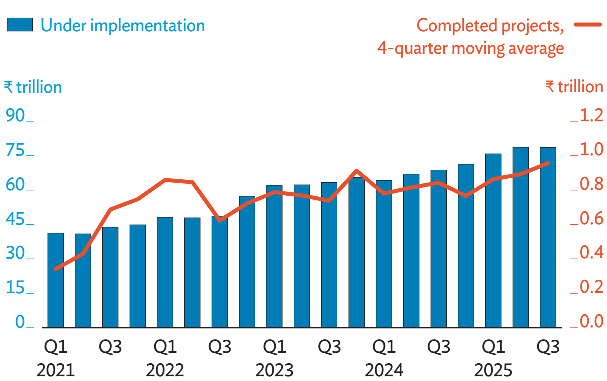
by public spending on rural welfare programs, price support for key agriculture commodities, and resilient rural incomes. The RBI's rural and urban consumer confidence surveys show that consumers remain firmly optimistic for the year ahead due to healthy expectations about general economic conditions, income, and spending. A once-in-a-decade revision of salaries and pensions of central government employees is expected to fuel consumption in FY2027.

Investment will continue to support growth in FY2026. Central government capital expenditure is budgeted to grow by 11.5% in FY2026, up from 4.2% in FY2025 (Figure 2.15.13). Prospects for private investment remain robust amid supportive monetary policy, regulatory reforms comprising labor flexibility, measures to improve integration with global value chains, and stronger logistics. Healthier corporate balance sheets and better bank asset quality, following a decade of deleveraging and lower nonperforming assets, have enhanced capacity to invest.

Net exports are expected to subtract from growth this fiscal year and next. Despite uncertainty over the final level of US tariffs on India, the effective tariff rate in FY2026 is expected to be lower than in FY2025, supporting moderate export growth. A weaker rupee relative to many peer economies should help maintain export competitiveness. However, higher oil prices are likely to increase merchandise imports, while remittance growth—particularly from the Middle East—may moderate over the forecast period.

Figure 2.15.13 Investment Projects Under Implementation and Completed

Projects implemented have increased steadily over the past 4 quarters.



Q = quarter.

Note: Years are fiscal years ending on 31 March of the next year.

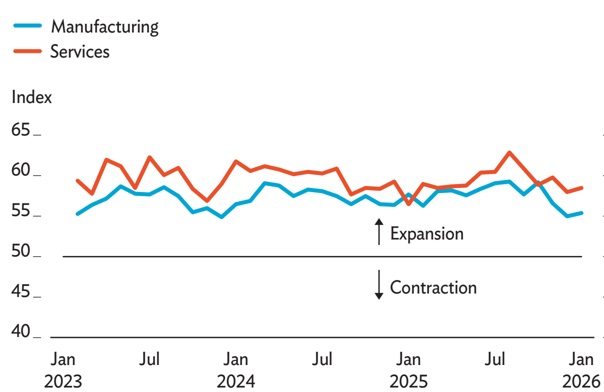
Source: Centre for Monitoring Indian Economy.

On the supply side, the manufacturing sector is expected to benefit significantly from the recent trade agreements with the EU, the United States, and New Zealand. Lower tariffs and preferential access for textiles and apparel, leather and footwear, plastic and rubber, generic pharmaceuticals, gems and diamonds, and aircraft parts will stimulate their production in FY2026 and FY2027. Support measures outlined in the budget for semiconductors, electronic components, and rare earth are also expected to bolster output. Growth in services is anticipated to remain healthy. GST reforms are also expected to support manufacturing and services. Recent Purchasing Managers' Index readings indicate continued strong private-sector activity (Figure 2.15.14). Manufacturing momentum has strengthened on robust domestic demand, while services growth remains elevated but has moderated slightly, suggesting economic activity should remain resilient in the near term. Agriculture growth is also expected to remain strong, with an increase in winter crop sowing, although initial estimates indicate that the monsoon in 2026 may be weaker than the long-term average.

Inflation will rise to 4.5% in FY2026 before moderating to 4.0% in FY2027. Food inflation is expected to inch up during FY2026, driven both by a base effect and resilient rural incomes. In particular, prices of cereals, meat and fish, fruits and nuts, and vegetables are expected inch up. However, the increase is expected to be rangebound due to robust agricultural output. Moreover, the lower weight of food products in the new consumer price index basket will contain the impact on overall inflation. The waning impact of

Figure 2.15.14 Purchasing Managers' Indexes

Private sector confidence in future growth remains steady.



Source: CEIC Data Company.

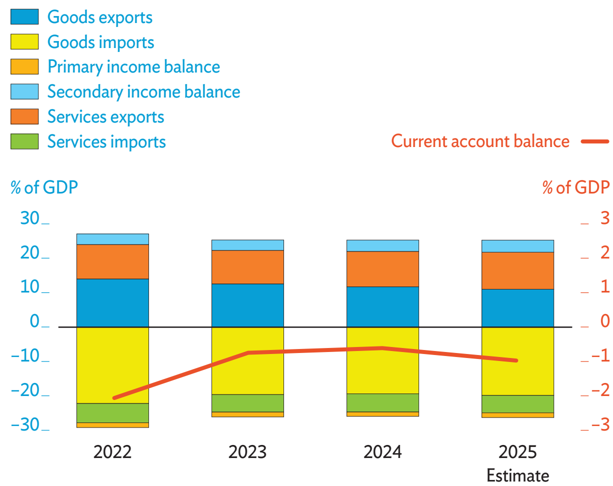
GST rate cuts and a rise in prices of precious metals will push inflation up in the second half of FY2026, although precious metals like gold have a lower weight under the new price index. The weakening of the rupee due to widening external imbalances would also put upward pressure on inflation. The inflationary impact of higher oil prices may be rangebound in the near term, as the pass through of prices from the oil shock may be tempered by fiscal measures. On balance, overall inflation is expected to average around 4.5% in FY2026. The impetus to consumption from the hike in salaries and pensions of central government workers would add to inflationary pressure in FY2027, but this effect will be tempered by lower expected crude oil prices. Inflation is thus forecast to decline to 4.0% in FY2027.

The monetary policy stance is expected to remain unchanged in the near term, while fiscal consolidation should continue. With growth remaining strong and inflation likely to average around the mid-point of the inflation target band, the central bank is expected to keep key policy rates at their current level through most of FY2026. Fiscal consolidation in FY2026 will be driven less by revenue buoyancy and more by expenditure discipline. The central government has adopted a gradual and growth-supportive fiscal consolidation path, with the fiscal deficit forecast to decline only marginally to 4.3% of GDP in FY2026. Capital expenditure will continue to be prioritized, with double-digit growth, underscoring the government's investment-led growth strategy. In contrast, current expenditure is being compressed to enable deficit reduction despite rising interest payments and potential pressures from subsidies. Revenue growth is assumed to be soft, reflecting modest tax and non-tax growth amid weak GST collections. Debt consolidation is backloaded with public debt, estimated to decline to 55.6% of GDP in FY2026, implying more aggressive consolidation in the remaining years to reach the target of 50% ±1% of GDP by FY2030.

The current account deficit will widen in FY2026 before shrinking in FY2027 (Figure 2.15.15). The merchandise trade deficit, as a share of GDP, is expected to widen in FY2026 on the back of a higher import bill, driven by higher crude and gas prices and a weaker currency. Goods exports are expected to grow as recent trade agreements with the United Kingdom, the US, and other partners

Figure 2.15.15 External Current Account

The current account deficit widened in FY2025 on increased goods imports.



GDP = gross domestic product.

Note: Years are fiscal, ending on March of the next year

Sources: CEIC Data Company; Asian Development Bank estimates.

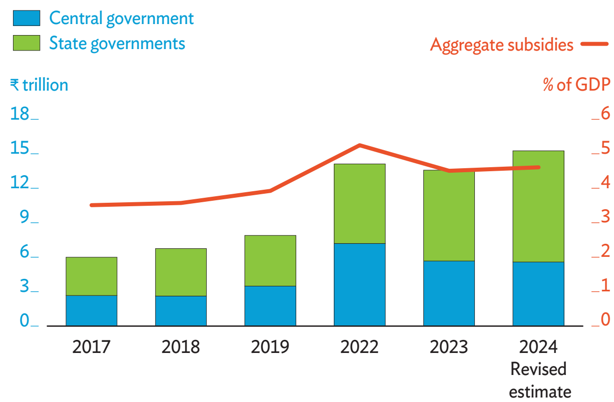
translate into improved market access for textiles, pharmaceuticals, engineering goods and electronics. Services exports are expected to grow moderately, buoyed by expansion of Global Capability Centers, where multinational corporations carry out key business or technology work in India for their worldwide operations, based on trade pacts with key partners. Remittances could come under some pressure as economic activity in the Middle East, home to a large number of Indian blue-collar workers, is adversely impacted by the conflict there. Overall, the current account deficit is expected to widen in FY2026, compared to FY2025. A more benign external environment, including lower oil prices, and favorable access to EU markets will help reduce the current account deficit in FY2027.

Capital flows are expected to remain volatile in FY2026 amid global uncertainties, but strong external buffers and improving investment inflows should help maintain external stability. Continued global uncertainties and elevated interest rates in advanced economies could trigger intermittent portfolio outflows and place pressure on the balance of payments. However, an expected easing of global monetary conditions later in FY2026 may help stabilize portfolio flows. Net foreign direct investment inflows are projected to strengthen, supported by recent trade agreements and continued expansion of Global Capability Centers in India, which are attracting multinational investment in business services and technology. If capital inflows fall short of financing the current account deficit, adjustment is expected to occur through exchange rate flexibility and use of foreign exchange reserves, currently at $728.5 billion, and provide a significant buffer. In FY2027, external stability should improve as global financial conditions ease, energy prices normalize, and the benefits of recently concluded trade agreements increasingly support exports and investment inflows.

With a prolonged conflict now more likely, downside risks to the outlook have increased substantially. A prolonged conflict in the Middle East could undermine India's macroeconomic performance through multiple channels. These include higher energy prices, disruptions to trade flows, and weaker remittance inflows given the region's continued importance for India's external sector. Higher global oil prices would put upward pressure on inflation, significantly widen the current account deficit, and weigh on growth by increasing input costs. The extent of the impact would depend on the degree of pass-through to domestic fuel prices. While limited pass-through could cushion the effect on inflation and growth in the near term, it would increase fiscal pressure through higher subsidy requirements.

Figure 2.15.16 Combined Subsidies and Transfers

Combined subsidies and transfers have risen sharply, with the state-level share growing as a proportion of the total.



Note: Years are fiscal years ending on 31 March of the next year. Included states have state GDP of over INR1 trillion each in FY2023.

Sources: Asian Development Bank, A Study of Subsidies and Transfers in India (2025), based on demand-for-grants data and RBI Study of State Budgets.

Policy Challenge—Rationalizing Subsidies and Transfers

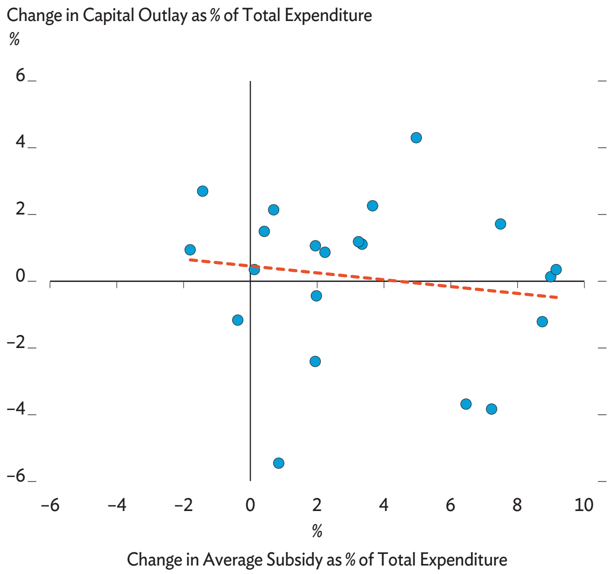
Combined central and state government subsidies and transfers have risen from about 3.5% of GDP in FY2017 to an estimated 4.6% in FY2024 (Figure 2.15.16). The figure is based on a comprehensive assessment, including some cash transfers and electricity subsidies, often not included in official figures, for the central government and major states, each with GDP over INR1 trillion and representing most of India's economy. Central government subsidies expanded during the pandemic, driven by food and fertilizer costs, and have since moderated. At the state level, the subsidies have increased across almost all major states, raising the states' share in aggregate subsidies from 56% to 63% during FY2017 to FY2024. The increase is driven by the expansion of cash transfer schemes for various beneficiary groups, a rise in electricity subsidies, and growing pension and subsistence outlays. Additionally, certain subsidies are often not accounted for in the budget, as they are provided through state public sector units, often in the electricity sector.

The growth in subsidies has led to a squeeze on public investment and other development spending (Figure 2.15.17). For the major states, while capital expenditure was higher than subsidies in FY2017, it is now lower than subsidies. This could affect long-term growth as public investment in infrastructure often generates higher economic returns than subsidies and transfers, through higher productivity, enhanced private investment, and additional employment. Subsidies can often become committed expenditure, that is, once introduced, tend to be difficult to scale back, reducing the fiscal space for development-oriented outlays. This includes spending on economic services such as agriculture, energy, transport, and urban development.

Subsidy spending can be better targeted. Owing to differences in economic growth trajectories in the past, states vary widely in per-capita income. A well targeted program would result in higher subsidies disbursed in the lower-income states, but this has not been the case. Due to greater fiscal resources available to higher-income states, the per-capita subsidy is higher

Figure 2.15.17 Change in Subsidies and Change in Capital Expenditure as Shares of Total State Government Expenditure Between 2017–19 and 2022–24

States where subsidies rose most as a share of expenditure saw the largest declines in the capital spending share.



Sources: ADB. 2026. A Study of Subsidies and Transfers in India; RBI Study of State Budgets.

in such states. This points to a structural misalignment between need and provision. Within states, too, large subsidy programs such as free electricity schemes in several states can be regressive, as the higher-income households benefit more from the subsidies because of their higher energy consumption. Energy subsidies also tend to distort prices and affect the fiscal health of the electricity distribution companies.

Scope exists to improve the fiscal efficiency of subsidies without compromising social protection. Expanding direct benefit transfers linked to verified beneficiary identities can reduce leakage and duplication. Moving toward vulnerability-based targeting, especially in the case of general subsidies, would concentrate resources on those who need them most. Attaching sunset clauses to new programs—with mandatory impact assessments before renewal—would ensure subsidies continue only where they achieve their intended objectives. A shift from consumption-oriented subsidies toward investment-oriented support, such as rooftop solar installations in place of free electricity, can simultaneously reduce the recurrent fiscal burden and strengthen household resilience.

An integrated social protection framework would address the fragmentation that currently characterizes social protection schemes across all levels of government. Multiple central and state schemes serve overlapping beneficiary groups, with limited coordination on eligibility, benefit levels, or delivery. A unified framework—combining pensions, health insurance, and disability coverage, complemented by contributory schemes—would reduce duplication of benefits and better address the varied vulnerabilities of individuals. This can allow a differentiated approach at the state level, where social protection needs can vary based on demographic profile, employment structure, and fiscal capacity. Such an approach would allow governments to maintain or strengthen the protective function of transfers while containing their aggregate fiscal cost, freeing resources for the infrastructure and human capital investments that underpin long-term growth.

MALDIVES

Economic growth accelerated in 2025, led by tourism and a recovery in fishing. Following the critical repayment of a $500 million *sukuk* on 2 April, growth is nonetheless projected to slow sharply this year as the recovery in fisheries wanes, the conflict in the Middle East dampens tourism revenue and raises oil prices, and dwindling fiscal space and foreign-reserve buffers constrain countercyclical policies. Inflation is projected to rise on higher oil prices and a widening parallel exchange rate premium. Urgent reforms are essential to restore fiscal sustainability, notably balancing universal health coverage with the long-term financial viability of the healthcare insurance scheme.

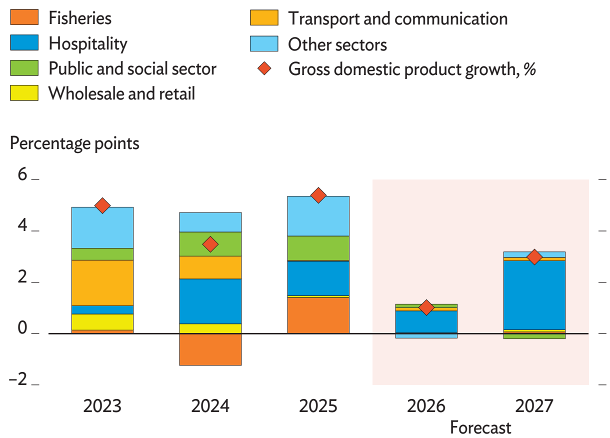
Economic Performance

The Maldives Monetary Authority estimates that gross domestic product (GDP) accelerated to 5.4% in 2025. Hospitality and a steep rebound in fisheries drove growth, each contributing about 1.4 percentage points (Figure 2.16.1). The public and social sectors added about 1 point, driven by public administration (0.5 points) and health and social services (0.3 points). Transport and communication, as well as wholesale and retail, broadly stagnated.

Fishing rebounded in 2025, reversing a sharp drop in 2024. The removal of price controls in July 2024 boosted private-sector fish processing and exports last year, while the Maldives Industrial Fisheries Company—the state-owned firm that buys most of the catch—expedited payments to fishers, incentivizing higher fishing activity. This boosted the fisheries' value added by 83% in the first 9 months of 2025, reversing a steep contraction in 2024. As a result, fish exports rose 95% in volume and 65% in value over the same period in 2024 (Figure 2.16.2). Overall, the fisheries' value added last year was 16% above that in 2023, suggesting a full recovery.

Figure 2.16.1 Supply-Side Contributions to Growth

The growth uptick in 2025 mostly reflected a rebound in fishing after a sharp drop in the previous year.



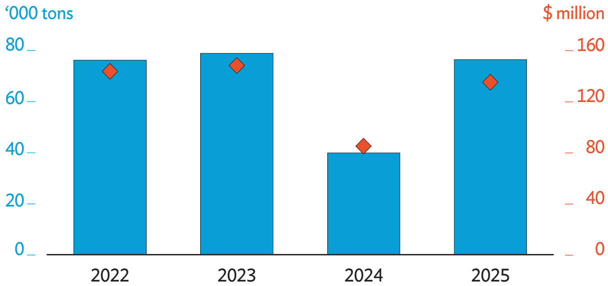
Notes: As sectoral value added data for 2025 are not yet available, sector contributions are estimated to be proportional to those in the first 9 months and scaled to match the full-year growth rate. Hospitality comprises accommodation, food, and beverage services. "Public and social sector" comprises public administration and defense; compulsory social security; education; human health and social work activities; and arts, entertainment, and recreation and other service activities.

Sources: Maldives Monetary Authority. 2026. Monthly Statistics, February 2026. 27 (2); and Asian Development Bank estimates.

This chapter was written by Jules Hugot of the South Asia Department (SARD), ADB, Manila, and Macrina Mallari, SARD consultant.

Figure 2.16.2 Fish Exports

Fish exports bounced back close to their 2023 levels last year.

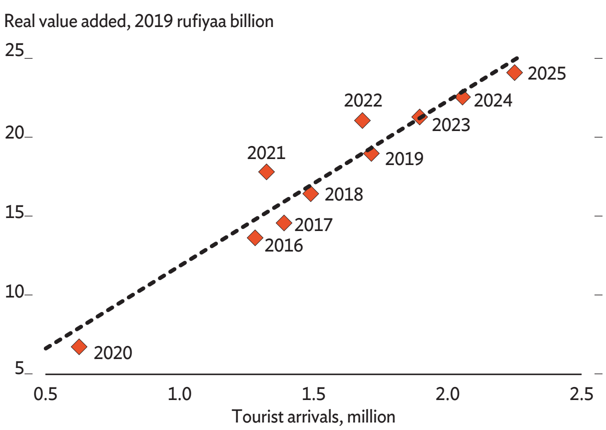


Source: Maldives Monetary Authority. 2026. Monthly Statistics, February 2026. 27 (2).

The Malé airport expansion supported a surge in tourist arrivals, but shorter stays tempered value added. Visitor numbers rose 9.8% in 2025, but value added in the hospitality sector increased only about 6.0%, down from 8.2% in 2024, as the average stay shortened from 7.4 to 7.0 days (Figure 2.16.3). A 25% surge in visitors from the People's Republic of China; Hong Kong, China; and Taipei,China, who stay on average 4.6 nights, drove this trend. These markets accounted for 15% of visitors, followed by Russia (12%) and the United Kingdom (9%) (Figure 2.16.4). The new Malé airport terminal, which opened in July, expanded annual passenger capacity to 7.5 million, from 1.5 million, supporting gains in the sector. Additionally, a domestic airport opened on Muli Island in May, facilitating tourism development in the Meemu Atoll.

Figure 2.16.3 Hospitality Sector Value Added and Visitor Arrivals

Hospitality sector value added rose in 2025, but at a slower rate compared to visitor arrivals.

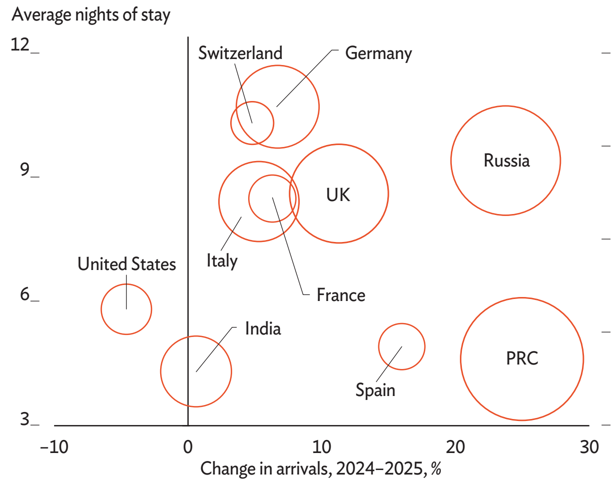


Note: Hospitality comprises accommodation, food, and beverage services.

Source: Maldives Monetary Authority. 2026. Monthly Statistics, February 2026. 27 (2).

Figure 2.16.4 Tourist Arrival Growth versus Average Stay, Top-10 Markets

Arrivals from the PRC and Russia increased most, while visitors from Germany and Switzerland stayed longest.



PRC = People's Republic of China, UK = United Kingdom.

Note: Bubble areas are proportional to arrivals in 2025.

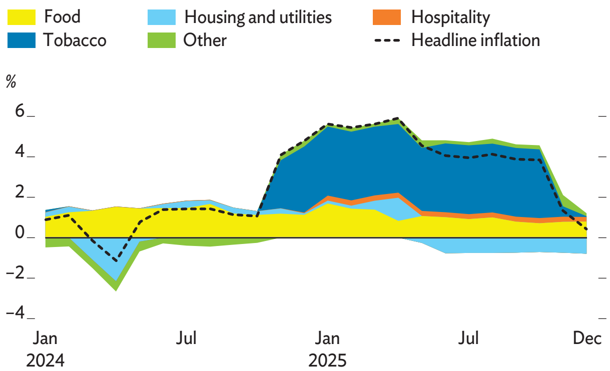
Sources: Ministry of Tourism and Environment. Maldives Visitor Surveys; and Maldives Monetary Authority. 2026. Monthly Statistics, February 2026. 27 (2).

Construction expanded by about 4.8% despite sharp cuts in public investment. After contracting in 2024, activity rebounded last year mainly on private investment in housing and resorts. The 49% drop in government cash outlays for capital expenditure did not translate into a commensurate fall in real construction value added, as payments for some projects were delayed while construction work continued. In addition, responsibility for completing some projects was transferred to state-owned enterprises, shifting spending off budget while raising contingent liability risks.

Average inflation rose to 4.0% in 2025 from 1.4% in 2024, mainly due to an import tariff hike that nearly doubled tobacco prices. Excluding tobacco, inflation was just 1.2% (Figure 2.16.5). The Green Tax on resort, hotel, and guesthouse stays was doubled in January 2025, and the tourism goods and services tax rate rose from 16% to 17% in July, both marginally adding to inflation. A reduction in household electricity tariffs slightly tempered these upward pressures in the second half of the year. With the Maldivian rufiyaa pegged to the United States (US) dollar, monetary policy focused on alleviating foreign currency shortages rather than steering the

Figure 2.16.5 Inflation

Inflation spiked in 2025 on higher tobacco import tariffs.



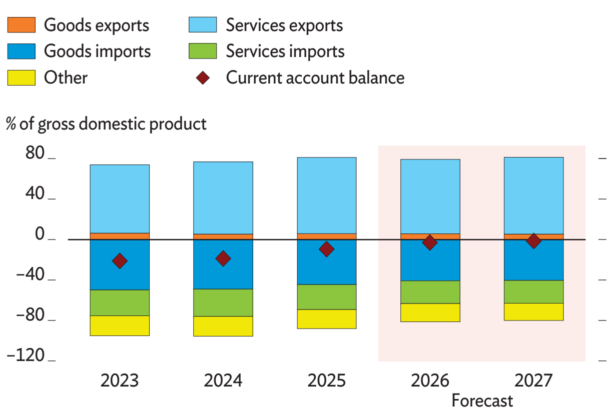
Source: Maldives Monetary Authority. 2026. Monthly Statistics, February 2026. 27 (2).

business cycle. Accordingly, the minimum reserve requirement on foreign currency deposits was lowered from 7.5% to 5.0% in July, while the policy rate remained unchanged.

The current account deficit narrowed to 7.0% of GDP in 2025 from 18.7% in 2024. This reflects a 12.8% rise in services exports on account of tourism growth, while goods exports also rose, driven by the rebound in fishing (Figure 2.16.6). Meanwhile, goods imports dropped 2.7% on lower public investment and fuel prices.

Figure 2.16.6 Current Account

The current account deficit narrowed in 2025 as tourism service exports rose while goods imports declined.

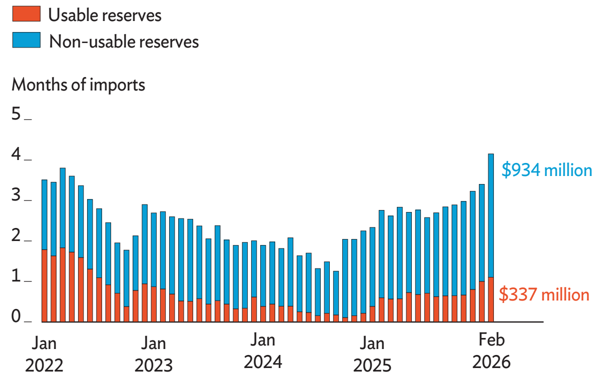


Note: "Other" notably includes remittances from resort workers and profit repatriation of foreign owned resorts.

Sources: Maldives Monetary Authority. 2026. Monthly Statistics, February 2026. 27 (2); and Asian Development Bank estimates.

Figure 2.16.7 International Reserves

Although reserves rose last year, usable reserves covered just over 1 month of imports at the end of February 2026.



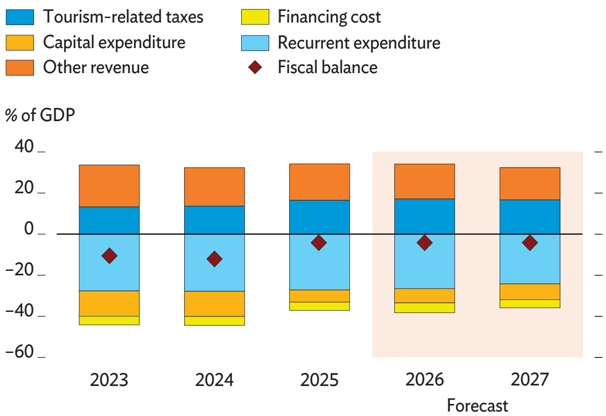
Source: Maldives Monetary Authority. 2026. Monthly Statistics, February 2026. 27 (2).

Foreign reserves have increased but remain thin. Gross reserves jumped 53% to $1.3 billion in February 2026 from a year earlier, supported by growth in travel receipts, tighter foreign currency deposit and conversion rules, and the $400 million currency swap between the Reserve Bank of India and Maldives' central bank, in place since October 2024 (Figure 2.16.7). However, usable reserves were only $337 million in February—just over 1 month of imports. This included about $88 million of the swap proceeds placed in local banks to support US dollar liquidity, making these funds less liquid than official reserves. Further supporting reserve accumulation, since January 2025, tourism and large non-tourism businesses must deposit 20% of their foreign currency earnings in local banks; and since June 2025, banks must sell 90% of their foreign exchange deposits to the central bank, up from 60%.

The fiscal deficit narrowed to 3.0% of GDP in 2025 from 12.1% in 2024, mostly on capital spending cuts. The primary balance even recorded a slight surplus, for the first time since at least 1990. Total cash expenditure fell 10.6%, entirely driven by a 48.8% drop in capital expenditure, while recurrent expenditure rose 4.1% (Figure 2.16.8). The government accumulated arrears as construction work often continued without timely payments to contractors. Meanwhile, plans to shift from universal energy and food subsidies to targeted support under the 2025 budget have not yet been implemented. Government revenue grew 13.0%, entirely on higher tourism-related taxes, which further narrowed the fiscal deficit.

Figure 2.16.8 Fiscal Balance

The fiscal deficit narrowed to 3.0% of GDP in 2025 on drastic investment cuts and tourism-related revenue growth, and despite rising recurrent spending.

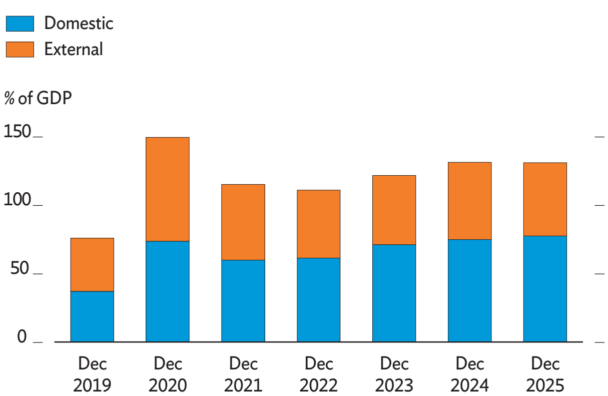


GDP = gross domestic product.

Sources: Maldives Monetary Authority. 2026. Monthly Statistics, February 2026. 27 (2); Ministry of Finance and Planning. 2026. Weekly Fiscal Developments - as of 31 December 2025; and Asian Development Bank estimates.

Figure 2.16.9 Public Debt

Public debt remained at 133% of GDP in December 2025.



GDP = gross domestic product.

Note: Public debt includes publicly guaranteed debt.

Source: Maldives Monetary Authority. 2026. Monthly Statistics, February 2026. 27 (2).

In December 2025, public and publicly guaranteed debt remained at 133% of GDP—the same as a year earlier. This reflects a 6.8% rise in total debt, driven by rising domestic debt as access to external financing has been limited (Figure 2.16.9). In its June 2025 review, Fitch Ratings maintained Maldives' sovereign credit rating at CC, indicating very high credit risk; in November, Moody's reaffirmed its Caa2 rating.

Maldives met its critical sovereign debt obligation on 2 April. Overall, the country faced $1.1 billion in maturing debt during the year. Most obligations were rolled over in the first quarter, leaving a $500 million *sukuk* and its final $25 million coupon due on 8 April as the main challenge. The government paid on time, combining funds from the Sovereign Development Fund and US dollars purchased from the central bank.

Economic Prospects

Growth is projected to slow to 1.0% this year due to the conflict in the Middle East and limited buffers to offset it, before rebounding to 3.0% next year. This outlook is shaped by slowing tourism receipts resulting from travel disruptions and a surge in energy prices—both caused by the conflict (Table 2.16.1). Besides slowing growth, these factors further narrow fiscal space, heighten sovereign credit risk, and drain foreign reserves. These projections were made under this report's scenario of early stabilization in the Middle East, finalized on 10 March, and are subject to high uncertainty. The stronger growth forecast for 2027 reflects a rebound in tourism, normalization of oil prices, and improved fiscal space—supported by increased tax revenue and lower recurrent spending—allowing public spending to pick up slightly.

Table 2.16.1 Selected Economic Indicators, %

Growth is expected to slow sharply in 2026 and rebound in 2027, and inflation is projected to accelerate.

	2024	2025	2026	2027
GDP growth	3.5	5.4	1.0	3.0
Inflation	1.4	4.0	5.0	4.0

GDP = gross domestic product.

Note: These forecasts reflect this report's scenario of early stabilization in the Middle East, finalized on 10 March.

Sources: Maldives Monetary Authority. 2026. Monthly Statistics, February 2026. 27 (2); and Asian Development Bank estimates.

The conflict in the Middle East will slow tourism growth this year. Visitor arrivals fell 21% year on year in March as major Gulf airport hubs remained largely closed. Arrivals will also be lower in April compared to 2025 as air traffic remains disrupted. The impact has fallen particularly on higher-spending visitors from

Europe, Russia, and the US, who stay 8.8 days on average, compared to 4.5 for Asian tourists. However, solid growth is expected later in the year as the Malé airport expansion and new direct flights should attract more high-end travelers. The upgraded Hanimaadhoo International Airport may also support tourism in the northern atolls. Additionally, the launch of seven new resorts—raising the total to 182—and further investment in accommodation on inhabited islands will also drive tourism growth. Overall, the tourism shortfall resulting from the conflict is expected to shave about 2 percentage points off GDP growth this year, as tourism receipt growth is projected to fall to 6% from a pre-conflict forecast of 11%.

The surge in energy prices will slow growth across sectors. This is because Maldives depends almost entirely on imported oil for power generation, water desalination, and transport. Assuming the conflict in the Middle East raises oil prices to $72 per barrel on average this year, as per this report's early stabilization scenario, that would raise the oil import bill by about $135 million. These higher costs are expected to slow growth by about 1.5 percentage points as they squeeze purchasing power and divert fiscal resources toward subsidies rather than growth-enhancing spending.

Construction and fisheries are projected to contribute only slightly to growth this year and next. Construction is projected to rise marginally as public investment stabilizes—but does not rebound—after last year's drop, while private resort development continues, driven by better air connectivity. The fishing sector may see gradual gains from price liberalization providing more space to private processors, but growth will be curtailed by capacity constraints as the industry has already recovered from the collapse in 2024.

The current account balance is projected to narrow to a deficit of 2.0% of GDP in 2026 and turn slightly positive in 2027. This mainly reflects a contraction in goods imports this year despite rising fuel costs, as non-essential goods and services imports fall sharply due to lower purchasing power, foreign currency shortages, and continued weakness in public investment. Meanwhile, growth in tourism services exports is expected to slow due to the conflict in the Middle East. In 2027, a sharp rebound in tourism services exports is expected to outweigh goods and services import growth, as foreign reserves remain scarce and government spending subdued.

Inflation is forecast to rise to 5.0% in 2026 on the fallout of the conflict in the Middle East and easing to 4.0% in 2027. The forecast for this year reflects higher energy prices, as net oil and gas imports are equivalent to 11% of GDP in Maldives—a share far larger than the 3% average in South Asia. Higher fuel and shipping costs will impact consumers directly and indirectly, while potential reductions in energy subsidies to contain the fiscal deficit would raise electricity prices. These factors will outweigh the fading effect of last year's tobacco tariff hike. Prices are likely to continue rising in 2027 as subsidies are cut amid broader fiscal consolidation, while moderating oil prices after this year's surge will mitigate these effects.

The fiscal outlook remains precarious as the conflict in the Middle East has worsened already weak fiscal sustainability. The government budget for 2026 projected a fiscal deficit of 7.1% of GDP this year and 5.5% in 2027. This reflected a 50% rebound in capital spending and an 18% rise in the wage bill, without any new measures to reduce spending in subsidies, healthcare, or pensions. The oil price surge could raise the cost of energy subsidies by $110 million, adding to a $65 million drop in tourism-related tax revenue. Together, these shocks amount to 6.7% of budgeted government revenue. However, expanding the fiscal deficit to absorb these shocks may be difficult, given high sovereign credit risk and the already high exposure of domestic banks to the sovereign. In this context, the government may pursue fiscal consolidation to contain the fiscal deficit. Failure to contain the deficit and rebuild foreign reserves poses major risks to the outlook, especially as the conflict in the Middle East persists.

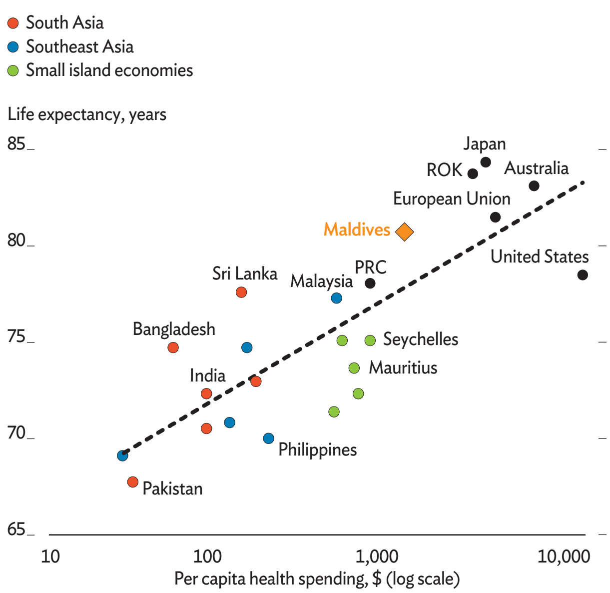
Policy Challenge—Balancing Universal Health Coverage with Fiscal Sustainability

***Aasandha*—Maldives' universal health insurance plan—poses fiscal challenges.** It replaced the targeted *Madhana* scheme in 2012 and offers free universal health insurance without premiums. The initial reimbursement cap at about $6,500 annually per person was lifted in 2014, while coverage was expanded to overseas treatments, emergency transport, and pregnancy care. In 2015, the government acquired the insurance company it had partnered with through a joint venture, making *Aasandha* a fully state-owned entity. A new scheme introduced in 2019 supports Maldivians abroad, and in 2024, biannual medical checkups were added, as well as in-vitro fertilization.

***Aasandha* has improved health outcomes but raised fiscal pressure.** Life expectancy in Maldives is 81 years—higher than the US and similar to the European Union, despite per capita health spending of about $1,200 against $5,800 in the European Union and $13,500 in the United States (Figure 2.16.10). In 2001, Maldives, Mauritius, and Seychelles all had life expectancy of about 72 years; now, Maldives leads by close to 10 years. This progress, however, comes with higher costs. Maldives spent 9.2% of its GDP on healthcare in 2023, compared to 4%–6% in the PRC and Malaysia, despite similar income levels (Figure 2.16.11). This puts Maldives closer to advanced economies like Australia and Japan, though without matching fiscal capacity.

Figure 2.16.10 Health Spending and Life Expectancy, 2023

Maldives' life expectancy is close to high-income country levels.



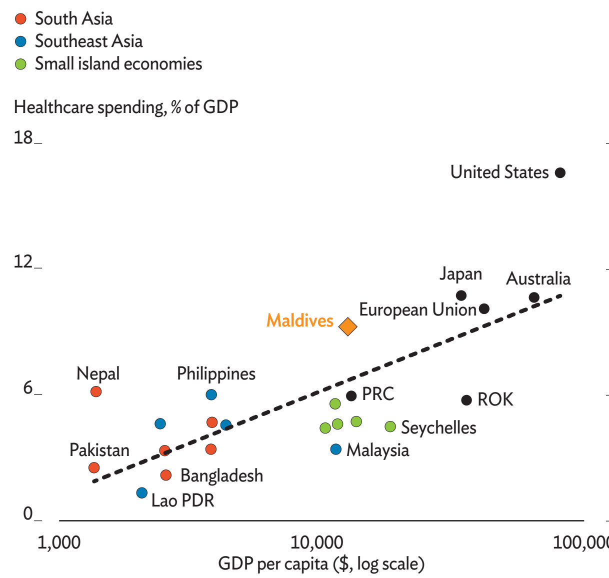
PRC = People's Republic of China, ROK = Republic of Korea.

Source: World Bank. World Development Indicators Database (accessed 11 March 2026).

Balancing broad coverage with limited fiscal space is a key challenge. *Aasandha* expenditures have been around 2% of GDP since 2020, significantly surpassing approved budgets (Figure 2.16.12). Pharmaceuticals account for more than half of *Aasandha*'s expenditures—far above the average share among members of the Organisation for Economic Co-operation and Development, where retail drugs

Figure 2.16.11 GDP per Capita and Health Spending, 2023

Maldives' healthcare spending is high for its income level.

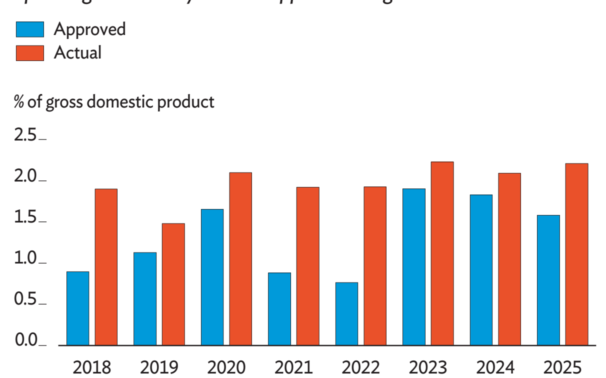


PRC = People's Republic of China, GDP = gross domestic product, ROK = Republic of Korea, Lao PDR = Lao People's Democratic Republic.

Source: World Bank. World Development Indicators Database (accessed 11 March 2026).

Figure 2.16.12 Government *Aasandha* Spending

Spending consistently exceeds approved budgets.



Sources: Ministry of Finance and Planning. 2025. Government Budget 2026; and Ministry of Finance and Planning. 2026. Weekly Fiscal Developments - as of 31 December 2025.

account for just one-sixth of healthcare spending. Drug prices far exceed international benchmarks due to limited bargaining power, fragmented procurement, and weak retail price controls. For example, as of October 2025, a 250-milligram amoxicillin capsule in Maldives cost seven times more than in India. Heavy reliance on overseas referrals, which both results from and exacerbates insufficient primary care domestically, also raises costs and undermines financial sustainability. Finally, governance gaps further erode efficiency, including weak claims oversight, opaque pricing, and fragmented provider regulation.

The government has recognized the fiscal challenges facing *Aasandha*. The 2025 budget envisioned reforms such as contributions and co-payments for higher-income earners and overseas referrals; standardized reimbursement rates for private hospitals; enforcing treatment guidelines and strengthening referral systems to reduce unnecessary recourse to specialist doctors and overseas care; and requiring private health insurance holders to use their coverage first. These measures were not implemented, underscoring the political and social sensitivities surrounding them.

***Aasandha* reform options are clear; political buy-in is needed.** In addition to the reforms outlined in the 2025 budget, bulk procurement should be broadened, building on a current pilot for a narrow range of drugs. Centralized procurement would also help ensure an uninterrupted supply of generic drugs, preventing reliance on costly alternatives. Reimbursement price ceilings should also be set for drugs and medical supplies, alongside enhancements in digitalization, claim validation systems, and independent audits to reduce fraud and abuse. However, the main challenge is not identifying solutions but securing political support to sustain long-term reform. To balance fiscal sustainability with equity, reforms may be implemented in stages, accompanied by open communication and stakeholder involvement, allowing flexibility for adjustments.

NEPAL

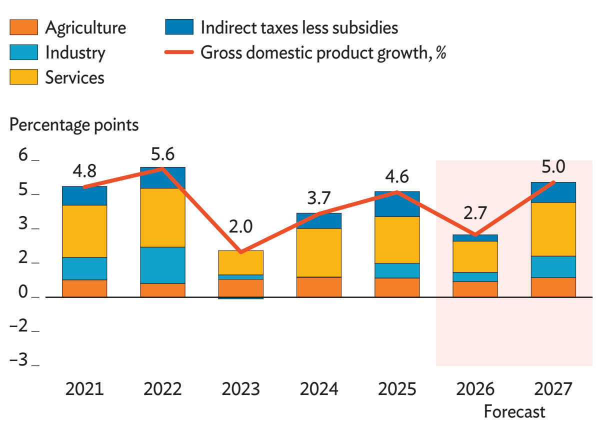
Nepal's economy grew strongly in fiscal year 2025 (FY2025, ended 16 July 2025), buoyed by a favorable paddy harvest and expanded hydropower capacity. Inflation eased and the current account surplus widened, despite a growing trade deficit. FY2026 will slow as weather-related shocks, September's political upheaval, and conflict in the Middle East weigh on growth. A rebound is expected in FY2027, driven by renewed political stability following the March elections, recovering demand, rising hydroelectricity exports, and a tourism revival—contingent on early resolution of the Middle East conflict. Inflation is set to ease slightly before ticking up in FY2027, with the current account remaining in surplus on the back of steady remittances. Strategic reforms and targeted investment could unlock Nepal's tourism growth potential. However, the outlook is subject to a very high degree of uncertainty.

Economic Performance

Gross domestic product (GDP) grew by 4.6% in FY2025, up from 3.7% in FY2024, as the paddy harvest strengthened markedly and hydropower capacity expanded (Figure 2.17.1). Agriculture grew by 3.3%, with paddy yield increasing 4.0%, amid a normal monsoon and greater use of farm technology. Industry growth rose to 4.5%, from 0.1% in FY2024, as key economic sectors such as manufacturing and construction expanded on stable oil and raw input prices, higher liquidity, and falling interest rates. The industrial sector meanwhile continued to benefit from a strong electricity subsector, which expanded by 13.8% from 11.0% a year earlier. Services' growth moderated to 4.2%, after rising by 4.4% a year earlier, as upgrading of the Tribhuvan International Airport reduced arrivals. Wholesale and retail trade expanded by 3.3%, and transportation and storage growth continued at a robust, 9.5% pace on the back of higher vehicle imports.

Figure 2.17.1 Supply-Side Contributions to Growth

Economic growth accelerated in FY2025 but will significantly underperform in FY2026, following civil unrest in September of 2025 and the conflict in the Middle East.



FY = fiscal year.

Note: Years are fiscal years ending in mid-July of that year.

Sources: National Statistics Office. 2025. National Accounts of Nepal 2023/24. *National Accounts of Nepal 2024/25*; Asian Development Bank estimates.

Domestic demand strengthened modestly in FY2025 on higher private consumption (Figure 2.17.2). Private consumption grew by 1.7% from 1.0% in FY2024 as remittance inflows strengthened, digital payments expanded, and prices moderated. Public investment growth slowed from 8.4% to 3.5% in FY2025, as no more than 63.2% of the federal capital budget was implemented. Private investment increased marginally by 0.2%, after declining by 1.7%, on a gradual revival of business confidence, lower interest rates, and

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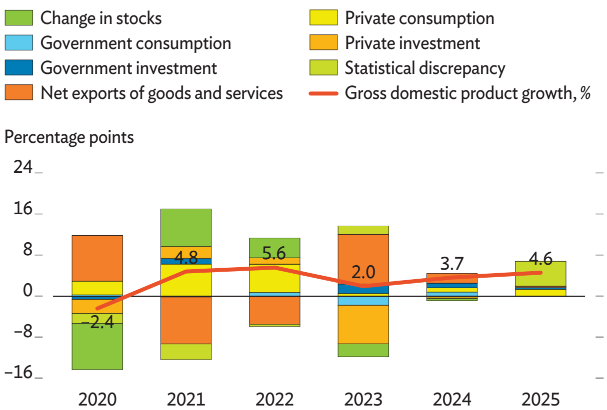
Figure 2.17.2 Demand-Side Contributions to Growth

Domestic demand improved in FY2025, supported by higher remittances and the expansion of digital payments.



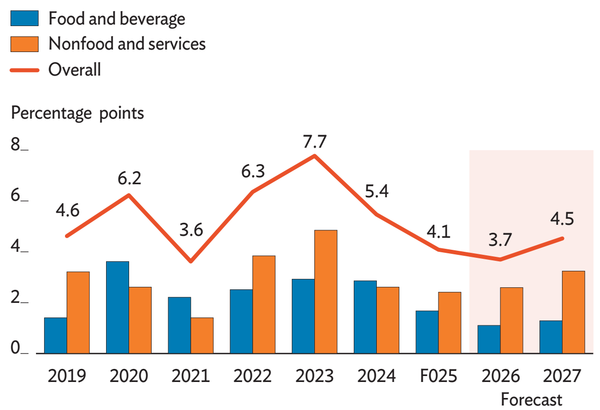
FY = fiscal year.

Note: Years are fiscal years ending in mid-July of that year.

Sources: National Statistics Office. 2025. *National Accounts of Nepal 2024/25*; Asian Development Bank estimates.

Figure 2.17.3 Inflation

Average inflation moderated in FY2025 on lower food and nonfood prices.

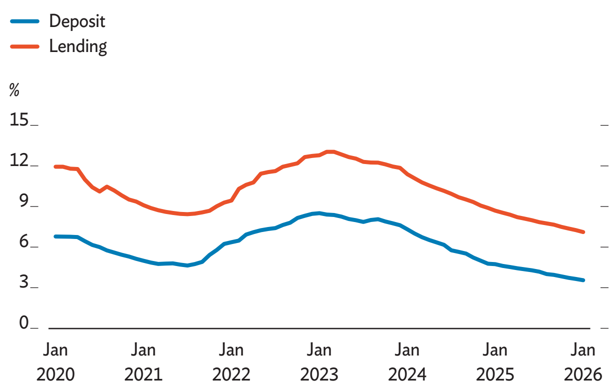


FY = fiscal year.

Source: Nepal Rastra Bank. 2025. *Recent Macroeconomic Situation*.

Figure 2.17.4 Weighted Average Commercial Bank Interest Rates

Interest rates trended downward in FY2025 following reductions in the policy and ceiling rates.



Source: Nepal Rastra Bank. 2025. *Recent Macroeconomic Situation*.

a recovery in domestic demand. Exports of goods and services rose by 17.7% in FY2025 and imports 3.2%, easing the net export deficit, which narrowed from 29.5% of GDP in FY2024 to 28.0% in FY2025.

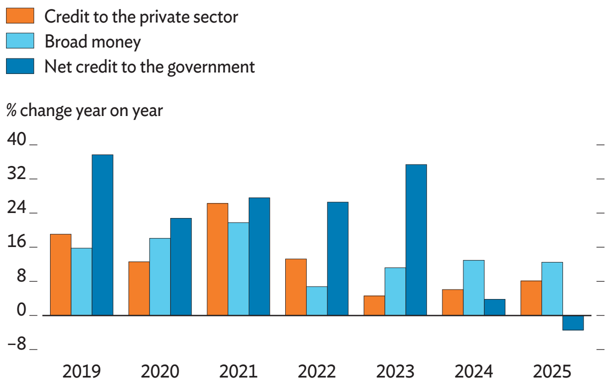
Price pressures subsided in FY2025, with broad based declines in food and nonfood inflation. Annual average inflation decreased to 4.1% in FY2025 from 5.4% in FY2024 on lower international oil prices, stable wholesale and consumer prices in India, and a good harvest (Figure 2.17.3). Prices of cereal grains, pulses and legumes, milk products, eggs, and fruit rose more moderately on sustained improvement in domestic agricultural production. Prices of nonfood items also rose less than in the last fiscal year, mainly due to weaker growth in restaurant and accommodation services, which reflected the slower rise in international tourist arrivals.

Monetary conditions eased in FY2025 following the central bank's reduction of policy rates. The central bank cut its interest rates on 26 July 2024, as inflation moderated and foreign exchange reserves remained adequate. It lowered both the policy rate (overnight repo) and the ceiling rate (standing liquidity facility) by 50 basis points, to 5.0% and 6.5%, respectively, and deposit and lending rates dropped in response (Figure 2.17.4). Private sector credit in FY2025 grew 2.0 percentage points more than in FY2024, expanding 8.1%, as lower interest rates raised credit demand (Figure 2.17.5). However, net credit to the government decreased by 3.4% on foreign borrowing and disinvestment. Broad money (M2) increased by 12.5% on larger credit growth and strong remittance inflows. The nonperforming loan ratio, meanwhile, has been rising and by mid-July 2025 stood at 5.1%, signaling growing stress in the banking sector.

The fiscal deficit moderated to 2.0% of GDP in FY2025 from 3.1% in FY2024 as revenue mobilization improved (Figure 2.17.6). Collections of customs duties, VAT, income tax, and excise duties increased in FY2025 on higher imports and greater economic activity. Central government revenue

Figure 2.17.5 Credit and Broad Money Growth

Credit to the private sector increased in FY2025 on falling interest rates.



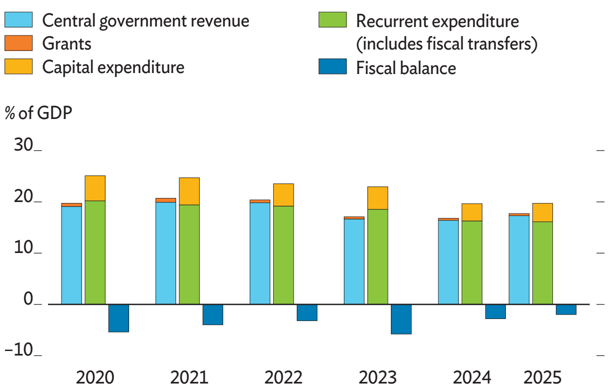
FY = fiscal year.

Note: Years are fiscal years ending in mid-July of that year.

Source: Nepal Rastra Bank. 2025. *Recent Macroeconomic Situation*.

Figure 2.17.6 Fiscal Indicators

The fiscal deficit moderated in 2025 as revenue collection improved.



GDP = gross domestic product.

Note: Years are fiscal years ending in mid-July of that year.

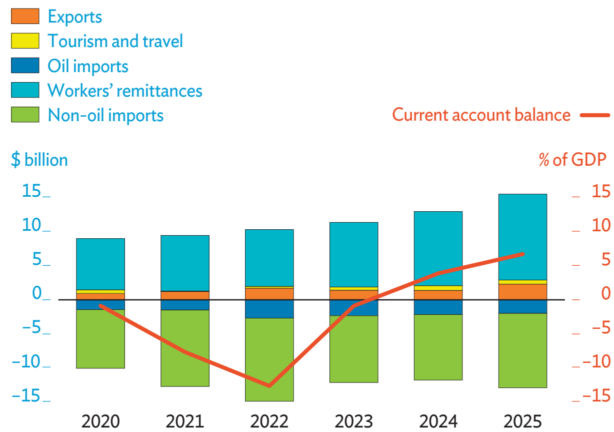
Source: Ministry of Finance, Financial Comptroller General Office.

(excluding foreign grants) increased by 12.9% to 17.3% of GDP, with better direct and indirect tax collection. Total expenditure increased by 7.3% to 19.7% of GDP on higher recurrent and capital expenditure.

External balances strengthened in FY2025, with strong remittance inflows widening the current account surplus and lifting reserves. The current account surplus rose to 6.7% of GDP from 3.9% the previous year, as robust remittance inflows offset a growing trade deficit, which amounted to 21.8% of GDP (Figure 2.17.7). Merchandise imports increased by 9.4% after decreasing by 2.5% in FY2024 owing to revival in

Figure 2.17.7 Current Account Indicators

The current account of the balance of payments recorded a surplus as higher remittances offset a widening trade deficit.



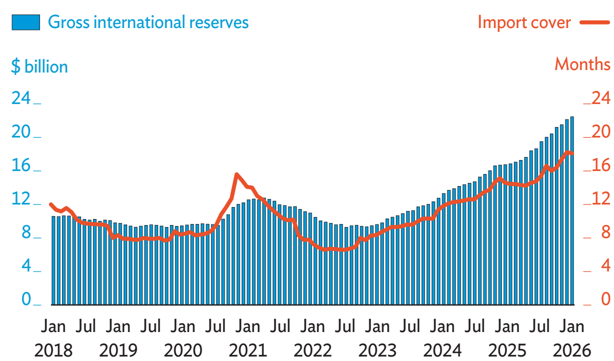
GDP = gross domestic product.

Note: Years are fiscal years ending in mid-July of that year.

Source: Nepal Rastra Bank. 2025. *Recent Macroeconomic Situation*.

Figure 2.17.8 Gross International Reserves and Foreign Exchange Adequacy

Foreign exchange reserves rose markedly in FY2025 as the current account balance surplus widened.



FY = fiscal year.

Note: Years are fiscal years ending in mid-July of that year.

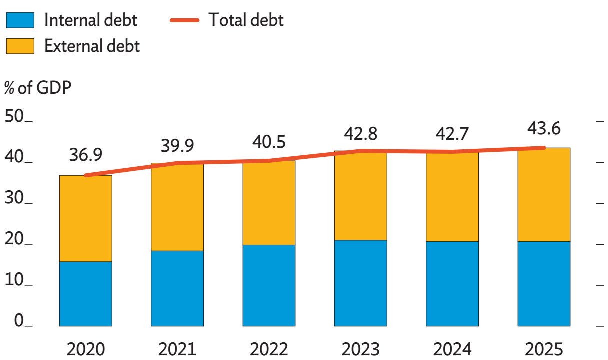
Source: Nepal Rastra Bank. 2025. *Recent Macroeconomic Situation*.

domestic demand and manufacturing and construction subsectors. Merchandise exports increased by 64.7%, reversing a contraction of 2.5% in FY2024. Workers' remittances increased by 16.3%, on increased out-migration for foreign employment and the increasing use of formal channels for transfers. Foreign exchange reserves rose to $19.5 billion, covering 15.4 months of imports (Figure 2.17.8). Owing to the Indian rupee's depreciation against the US dollar, the Nepalese rupee depreciated 2.4% nominally against the US dollar in FY2025.

Public debt levels increased slightly in FY2025, although overall debt distress risks remained low. Total public debt increased to 43.6% of GDP in FY2025 from 42.7% in FY2024, with domestic debt increasing by 7.0% and external debt by 11.8% (Figure 2.17.9). Nepal's risk of external and public debt distress is considered low given the low external debt-to-GDP ratio and the external debt service-to-revenue ratio, at 5.3% in FY2024, reflecting high levels of concessional borrowing with long maturities.

Figure 2.17.9 Public Debt

Public debt trended upward in fiscal 2025 on higher domestic and foreign borrowing.



GDP = gross domestic product.

Note: Years are fiscal years ending in mid-July of that year.

Sources: National Statistics Office; Financial Comptroller General Office; Public Debt Management Office.

Economic Prospects

Under the early stabilization scenario, growth is expected to significantly slow to 2.7% in FY2026 amid prolonged political uncertainty following the civil unrest in early September last year and the ongoing conflict in the Middle East (Table 2.17.1). Youth-led protests over a social media ban, weak accountability, and limited jobs forced the government to resign. The outcome of the federal election on 5 March is expected to lead to increased political stability. The conflict in the Middle East, however, poses downside risks through higher oil prices, lower tourist arrivals, and in particular reduced Gulf Cooperation Council countries-linked remittances which make up about 40% of overall remittances. Agricultural growth is projected to slow from 3.3% in FY2025 to 2.7% in FY2026 as paddy output declines by an estimated 4.2% due to delayed monsoon rains and the October 2025 floods. Industry growth

Table 2.17.1 Selected Economic Indicators, %

Growth and inflation will decelerate in FY2026 before picking up in FY2027.

	2024	2025	2026	2027
GDP growth	3.7	4.6	2.7	5.0
Inflation	5.4	4.1	3.7	4.5

GDP = gross domestic product, FY = fiscal year.

Note: Years are fiscal years ending in mid-July of that year.

Sources: Government and Asian Development Bank estimates.

is estimated to fall to 2.8% from 4.5% in FY2025 as weaker investor sentiment and delayed capital spending weigh on manufacturing and construction. Electricity subsector growth will likely moderate as the floods temporarily affected a few hydropower plants. Federal capital spending has lagged this year as the interim government shifted its focus from project implementation to holding parliamentary elections (on 5 March 2026), diverting funds from smaller capital projects toward election-related expenses.

Services expansion will also slow to 2.8% in FY2026 from 4.2% in FY2025, weighed down by weaker wholesale and retail trade, soft real estate activity amid ongoing uncertainty and regulatory constraints, and subdued tourism. Tourist arrivals dipped 18.3% in September amid the protests but were 1% higher in 2025 over 2024. Notably, disruptions at key Middle East transit hubs during Nepal's peak spring climbing season (March to May) risk dampening tourist inflows and mountaineering activity this fiscal year.

Domestic demand is expected to remain weak for FY2026 as political instability for much of the year weighed on consumer confidence and business sentiment. Political instability dampened private consumption while investment was affected by the September civil unrest's disruption to production, prompting domestic and foreign investors to delay capital commitments and weakening private sector confidence. However, these effects will be tempered by the improved political stability and an increase in public consumption expenditure on election expenses of about 0.4% of GDP.

Growth is expected to strengthen in FY2027 to 5.0% as the effects of recent shocks fade, leading to stronger domestic demand, hydropower exports, and tourism. A key assumption underlying the FY2027 growth forecast is that the ongoing Middle East conflict will not be significantly prolonged, allowing a timely restoration of regional air travel and supporting a recovery in tourist arrivals and migrant outflows. Growth will be supported by the implementation of priority reforms under a 100-point reform agenda, approved on 27 March 2026 by the Nepal government, including strengthened single-window approvals, faster land acquisition and Environmental Impact Assessment processes, and targeted relief for firms affected by last year's civil unrest. These measures will be integrated into national plans, programs, and the FY2026/27 budget.

Inflation is projected to increase from the pre conflict FY2026 estimate as higher energy prices feed into domestic costs. In the first 6 months of FY2026, inflation averaged 1.7%, down from 5.0% in the first half of FY2025, on lower food and international oil prices and moderating inflation in India. However, the Middle East conflict has since lifted oil prices, raising fuel, transport, food, and service costs and given Nepal's heavy reliance on imported petroleum despite significant expansion of hydropower capacity and growing electric vehicle registrations. As a result, inflation is now expected to hover around 3.7% in FY2026 and rise to about 4.5% in FY2027 on stronger domestic activities, reconstruction of damaged buildings during the civil unrest, and lags in price normalization through energy supply chains.

The escalation of the Middle East conflict will tamp down the expansion of Nepal's current account surplus. It is forecast to widen to 7.2% of GDP in FY2026 on moderate growth of remittance inflows and exports, tempered by a temporary halt in out migration, a rising import bill driven by higher petroleum and LPG prices, and potential losses in tourism receipts during the peak spring season. Remittance inflows grew a strong 32.3% year on year in the first half of FY2026, a sharp acceleration from 2.7% a year earlier. The current account surplus is expected to significantly moderate to 5.3% in FY2027. Demand for crude edible oils and for construction equipment of hydropower projects will mainly drive imports. Soybean oil exports, which are not subject to Indian tariffs, and hydropower, the country's other key export, will drive exports. US tariffs are expected to have minimal impact given Nepal's limited merchandise exports to the US (0.3% of GDP) and the modest shift to a flat 10% duty, while key exports remain niche or face relatively lower tariffs.

With subdued revenue growth in FY2026 and higher spending for the election and reconstruction, the fiscal deficit is forecast to increase to 2.9% of GDP, up from 2.0% in FY2025. Total revenue increased a modest 3.2% year on year in the first 6 months of FY2026 and is unlikely to grow more rapidly in the second half given the uncertain economic environment. Expenditure will grow moderately as election-related spending is partially offset by lower infrastructure and development spending.

The outlook remains subject to very high uncertainty and substantial downside risks. The growth and inflation projections for both fiscal 2026 and 2027 are subject to a very high degree of uncertainty. These include a prolonged Middle East conflict, weak capital budget execution, financial sector vulnerabilities, and climate-related hazards. There is elevated risks from global oil price volatility and potential sustained weakness in GCC countries-linked remittances in case of a prolonged conflict. These will weigh more heavily on consumption and investment, resulting in a pronounced growth slowdown and elevated inflationary pressures, reflecting structural dependence on imported fuel and remittance-financed domestic activity. With a prolonged conflict now more likely, including energy prices staying elevated and remittances falling substantially, risks to the outlook have increased substantially and growth could materialize much lower. A prolonged conflict would also complicate policy, requiring coordinated fiscal–monetary measures and structural reforms to support jobs, diversify migration, and raise productive investment.

Policy Challenge—Accelerating Nepal's Tourism Growth Through Strategic Investment and Reform

Nepal's unique natural and cultural assets create immense, yet unexploited opportunities for tourism-driven growth. The country is endowed with extraordinary natural and cultural assets—from the world's highest peaks to rich biodiversity, vibrant traditions, and diverse landscapes. Yet despite this inherent advantage, it has not fully capitalized on tourism as a transformative engine of economic growth. Structural challenges such as limited connectivity, inadequate infrastructure, and low global visibility continue to constrain the sector's performance.

Tourism's strong potential for even greater impact on Nepal's economy can be realized through strategic reforms. The sector serves as a major source of employment, foreign exchange earnings, and regional development. Its contributions extend across multiple sectors, supporting livelihoods in both urban centers and remote communities. With strategic reforms and targeted investment, the country can reposition itself within an increasingly competitive global tourism market. Strengthening its tourism framework will enable the country to capture greater value, diversify its visitor base, and enhance its standing as a premier international destination.

Building on the country's tourism potential, the government is launching transformative reforms to modernize and elevate the sector. The Tourism Bill 2025 aims at modernizing mountaineering regulations, simplifying cross-border travel, rationalizing high-cost permits, and promoting sustainable, high-value tourism. Greater digital connectivity and decentralizing tourism decision making and governance to local governments will complement these reforms. Likewise, streamlined service delivery through simpler administrative procedures and less bureaucratic delay will help the sector.

Nepal's long term tourism growth requires further bold, strategic investment that expands access and visitors' experiences. The country's diverse destination themes offer strong opportunities for growth, led by its high potential outdoor and adventure segment. However, massive investments are required to unlock the strategic barriers that impede the sector. Foremost among these are the relatively low service standards in the primary tourism hot spots and the poor access to them. Upgrading critical road networks, improving travel amenities, and strengthening multimodal transport systems will reduce access barriers and open new regions to visitors. Integrated tourism initiatives, such as ecotourism development in national parks and the upgrading and implementation of the 1,700 kilometer Greater Himalayan Trail will diversify offerings while safeguarding natural and cultural heritage.

Robust governance and cross sector collaboration are also crucial to unlocking Nepal's tourism potential. Tourism governance must be strengthened by shifting decision making and resource management to provincial and local authorities. This will allow better tailoring of projects to local priorities, encourage private sector participation, and enhance workforce skills, leading to greater long-term success. Given that tourism development encompasses multiple sectors, including infrastructure, hospitality, and utilities, collaboration among various government agencies and stakeholders will be essential for effective execution. Enforcing stricter regulation of haphazard development will be essential to preserving Nepal's natural and cultural appeal as a tourist destination.

PAKISTAN

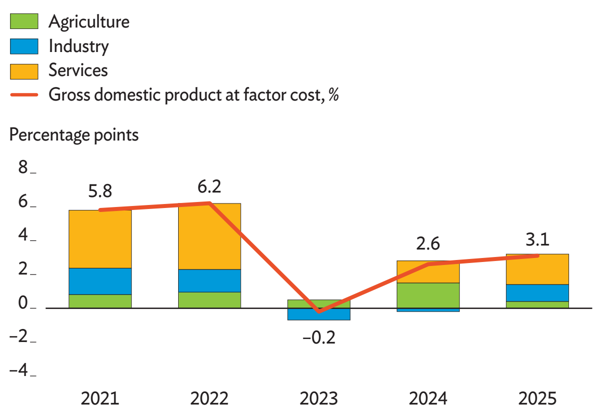
Growth accelerated in fiscal year 2025 (FY2025, ended 30 June 2025), reflecting faster expansion in services, industry, and investment. Inflation fell dramatically, thanks to much smaller increases in food prices and stable commodity prices. Growth is projected to rise further in FY2026 and FY2027 as manufacturing recovers and investment increases. Inflation is expected to rise, reflecting higher demand and a temporary disruption to fuel and wheat supplies. A prolonged Middle East conflict, by raising energy and fertilizer costs, would cut growth by dampening output in agriculture and industry, while also curbing remittances from the Gulf, boosting inflation, and widening the current account deficit.

Economic Performance

Prudent macroeconomic policy maintained stability in FY2025. Growth picked up as economic reform and stabilization measures boosted confidence. Inflation fell sharply, the current account moved into surplus, and international reserves reached a 3-year high of $14.5 billion. Fiscal consolidation continued as overall and primary budget balances exceeded targets. Progress under the International Monetary Fund's Extended Fund Facility remained on course, with the first and second reviews approved in May and December 2025.

Figure 2.18.1 Supply-Side Contributions to Growth

Growth accelerated in 2025, driven by industry and services.



Notes: All years are fiscal, ending on 30 June of that year. Gross domestic product at factor cost excludes indirect taxes less subsidies.

Source: Pakistan Bureau of Statistics. Updated National Accounts Tables Base FY2016: Table 6 and 7a.

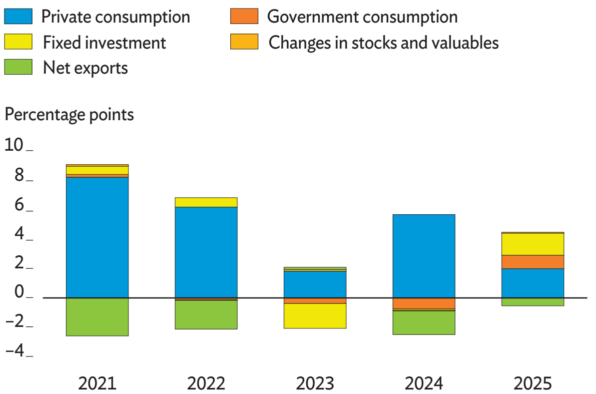
Growth accelerated to 3.1% in FY2025 from 2.6% in FY2024, driven mainly by services and industry. Expansion in services accelerated to 3.1% from 2.3% in FY2024, as most subsectors gained, adding 1.8 percentage points to GDP growth (Figure 2.18.1). Industry expanded by 5.3%, reversing a 0.9% decline in FY2024, as higher contributions from utilities and construction offset a 0.7% decline in large-scale manufacturing attributable to higher input costs and lower crop production, especially sugarcane. Agriculture grew just 1.5%, well down from 6.4% in FY2024, as higher input costs, excessive rain, and flooding during the monsoon season cut wheat, sugarcane, and cotton production. Livestock, representing about two-thirds of the sector's total value added, grew by 3.0%. However, agriculture's contribution to GDP growth fell from 1.5 percentage points in FY2024 to 0.4 points in FY2025.

On the demand side, investment lifted growth. While higher worker remittances supported household spending, lower farm incomes slowed growth in private consumption to 2.2% from 6.1% in FY2024

This chapter was written by Khadija Ali and Maleeha Rizwan of the Pakistan Resident Mission, ADB, Islamabad.

Figure 2.18.2 Demand-Side Contributions to Growth

Investment boosted growth in 2025, supported by lower interest rates and improved business sentiment.

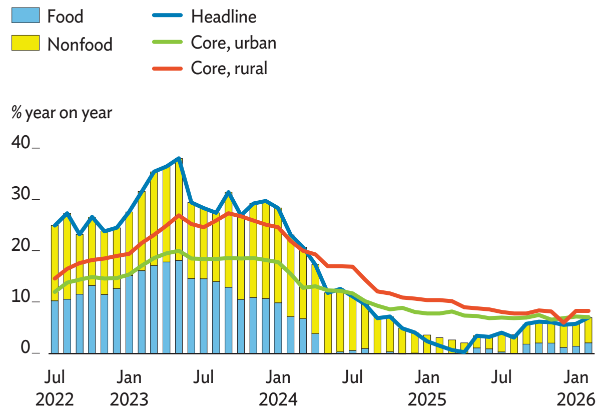


Note: All years are fiscal, ending on 30 June of that year.

Source: Pakistan Bureau of Statistics. Updated National Accounts Tables Base FY2016: Table 9.

Figure 2.18.3 Contributions to Inflation

Despite a rebound in 2026, inflation remained anchored within the central bank's medium-term target following a sharp decline in 2025.



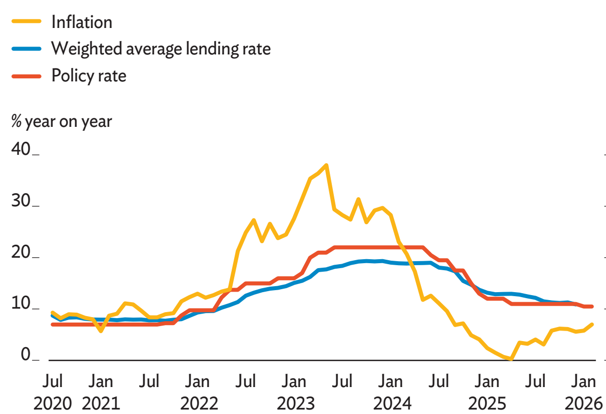
Source: Pakistan Bureau of Statistics. Price Statistics: Monthly Review on Price Indices—February 2026.

(Figure 2.18.2). However, greater macroeconomic stability and lower interest rates stimulated investment, which grew by 12.0% after a 0.7% decline in FY2024. Amid increased economic activity, imports remained steady at about 23.4% of GDP, while global uncertainty, lower export prices for rice, and higher input costs cut exports to 9.8% of GDP from 10.1% in FY2024.

Headline inflation hit record lows in FY2025, dropping to 0.3% in April 2025 before rising to 3.2% in June. Average annual inflation fell to 4.5% from 23.4% in FY2024, reflecting much lower food inflation and stable global commodity prices (Figure 2.18.3). Food inflation plunged to 1.6% from 22.0% in urban areas and to −0.9% from 23.0% in rural areas, while nonfood inflation decreased to 7.9% from 25.5% in urban areas, and to 7.7% from 23.3% in rural areas. Core inflation dropped to 8.5% from 16.1% a year earlier in urban areas and to 11.1% from 22.7% in rural areas. The sharp decline in inflation and the improved external position prompted the State Bank of Pakistan, the central bank, to cut its policy rate a cumulative 1,100 basis points, from a peak of 22.0% in June 2024 to 11.0% in May 2025 (Figure 2.18.4). It then cut the rate a further 50 basis points to 10.5% in December 2025 as inflation remained within its medium-term target range.

Figure 2.18.4 Interest Rates and Inflation

Easing inflation created room for monetary easing, totaling 1,100 basis points in policy rate cuts during 2025.



Source: State Bank of Pakistan. Economic Data.

Private-sector credit increased as monetary relaxation and rising confidence boosted demand. After subdued growth in the 2 previous years, expansion in private sector lending more than doubled to 12.8% in FY2025. The decline in weighted average lending rates from 20.2% in June 2024 to 11.7% in June 2025 improved loan affordability, leading to increased borrowing in manufacturing, consumer finance, wholesale and retail trade, telecommunication, and construction. Greater macroeconomic stability and growing business confidence boosted fixed investment loans by 13.2%, up from 3.3% a year earlier. Meanwhile, loans for working capital grew by 13.8%, primarily supported by increased export financing.

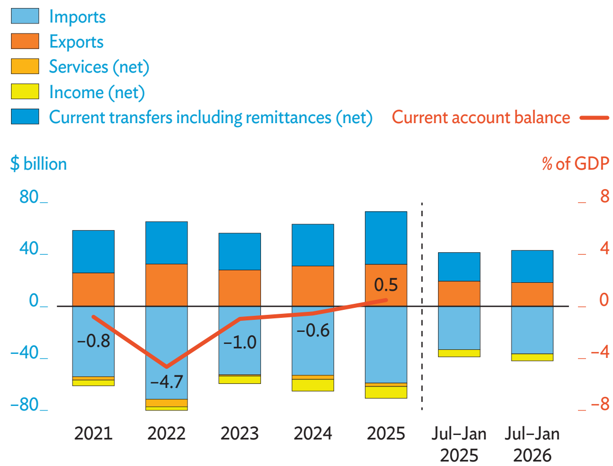
The overall fiscal deficit narrowed to 5.4% of GDP, below the budget estimate of 6.0% and down from 6.8% in FY2024. The primary balance achieved a surplus of 2.4% of GDP, exceeding the 2.0% target. A sharp increase in revenue to 15.8% of GDP from 12.6% the previous year underlay fiscal improvement, with higher contributions from both tax and nontax sources. Federal Board of Revenue collections reached 10.3% of GDP, the highest in 25 years, although still 0.5 percentage points below the revised target. The increase reflected significant growth in income tax collection, fueled by higher tax rates and a broader tax base, and in sales tax collection, with the removal of many concessions and exemptions. Overall, the tax-to-GDP ratio increased to 11.2% from 9.6% in FY2024. Nontax revenue increased to 4.6% of GDP from 3.0%, supported by higher profit transfers from the central bank. Total expenditure grew to 21.2% of GDP from 19.4%, reflecting higher spending on development and current noninterest outlays, particularly for defense affairs and services as well as for general subsidies and grants. Interest payments remained at about 8.3% of GDP.

Despite a significant primary surplus, public debt increased in FY2025. Gross public debt rose to 70.7% of GDP (Pakistan rupees [PRs] 80.5 trillion) in June 2025 from 67.6% a year earlier, mainly because of large interest payments. Public external debt increased to $103.8 billion from $98.3 billion in FY2024, reflecting higher disbursements from multilateral and commercial creditors, although its share in GDP remained unchanged.

Strong remittances led to the first current account surplus in 14 years. A surplus in the current account of $1.9 billion (0.5% of GDP) in FY2025 reversed a deficit of $2.1 billion in FY2024 (0.6% of GDP) (Figure 2.18.5). Robust remittance inflows produced this notable turnaround, rising 26.6% to $38.3 billion in FY2025. However, the trade deficit rose by 16.2% to $29.4 billion because imports grew faster than exports, as noted earlier. Merchandise imports rose 11.2%, reflecting a modest recovery in demand and a smaller domestic cotton harvest that caused raw cotton imports to rise notably. Export growth slowed to 4.4% from 11.1% in FY2024 because of low rice prices and rising global trade uncertainties.

Figure 2.18.5 Current Account Components

Despite a wider trade deficit, robust remittances supported a current account surplus in 2025.

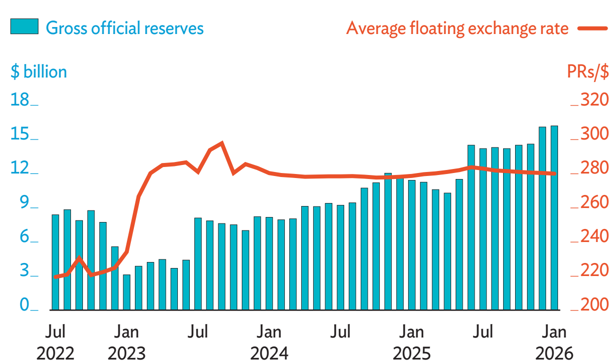


GDP = gross domestic product.
Note: All years are fiscal, ending on 30 June of that year.
Source: State Bank of Pakistan. Economic Data: External Sector. Summary Balance of Payments as per BPM6—January 2026.

The current account surplus and higher official inflows bolstered reserves. In FY2025, Pakistan received $12.1 billion in official foreign loans, almost $2.3 billion more than in FY2024. The rise in official inflows and remittances enabled the central bank to purchase $7.7 billion in foreign exchange during FY2025, raising gross reserves from $9.4 billion at end-FY2024 to $14.5 billion at end-FY2025 and boosting import cover from 1.6 months to 2.3 months (Figure 2.18.6). Lower external risks prompted the

Figure 2.18.6 Gross Official Reserves and Exchange Rate

International reserves strengthened in 2025 and continued to rise in 2026, while the exchange rate remained stable.



PRs = Pakistan rupees.
Source: State Bank of Pakistan. Economic Data.

three main global credit rating agencies to upgrade Pakistan's sovereign credit ratings to a stable outlook in 2025.

Economic Prospects

Growth is projected to accelerate to 3.5% in FY2026 and 4.5% in FY2027 (Table 2.18.1 and Figure 2.18.7). The FY2026 increase reflects a quicker-than-anticipated recovery in manufacturing and less crop damage from floods than initially expected. Large-scale manufacturing output rebounded strongly in the first half of FY2026 (July–December), growing by 4.8% as automobiles, cement, and textiles picked up, supported by accommodative monetary policy, low inflation, and renewed confidence. Provisional first quarter (Q1) FY2026 GDP data indicates that damage from flooding is much less than initially feared. Services are expected to benefit from increases in manufacturing and greater macroeconomic stability. Growth was provisionally recorded at 3.7% in Q1 FY2026, driven by livestock, large-scale manufacturing, construction, utilities, wholesale and retail trade, and transport and storage. Fiscal incentives for construction announced in the FY2026 budget and reconstruction efforts after the floods have boosted construction, which grew by 21.0% in Q1 FY2026.

Table 2.18.1 Selected Economic Indicators, %

Growth and inflation are both projected to increase in fiscal years 2026 and 2027.

	2024	2025	2026	2027
GDP growth	2.6	3.1	3.5	4.5
Inflation	23.4	4.5	6.4	6.5

GDP = gross domestic product.

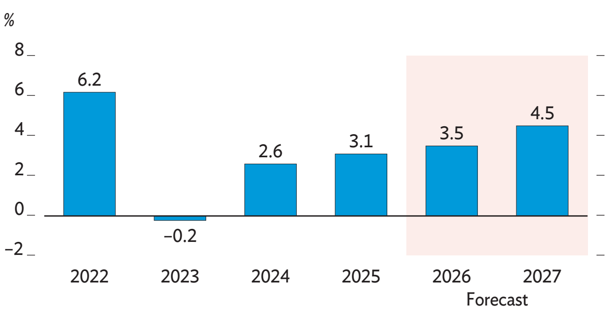
Sources: Pakistan Bureau of Statistics. Updated National Accounts Tables Base FY2016: Table 5; Pakistan Bureau of Statistics. Price Statistics: Monthly Consumer Price Index; Asian Development Bank estimates.

On the demand side, private investment will continue to support growth. Investment is projected to increase due to accommodative monetary conditions, greater macroeconomic stability, and lower government financing requirements, which will free up funds for private sector lending, particularly for small and medium enterprises and agriculture. The revival of privatization, including the successful privatization of Pakistan International Airways, will further boost private investment. Private consumption is expected to recover as lower inflation and moderate growth increase household incomes. Remittance inflows are also projected to remain resilient, partly to aid reconstruction after last year's floods.

Inflation is projected to increase to 6.4% in FY2026 and 6.5% in FY2027, reflecting a pickup in economic activity and a temporary disruption to wheat supplies and crude oil and liquefied natural gas from countries near the Strait of Hormuz (Figure 2.18.8). Headline inflation has risen during FY2026, increasing from 3.2% in June 2025 to 7.0% in February 2026, because of rising food prices—particularly for wheat and related products—and higher energy costs following the

Figure 2.18.7 Growth Forecast

Economic growth is projected to rise to 3.5% in FY2026 and 4.5% in FY2027 amid recovery in manufacturing and construction.

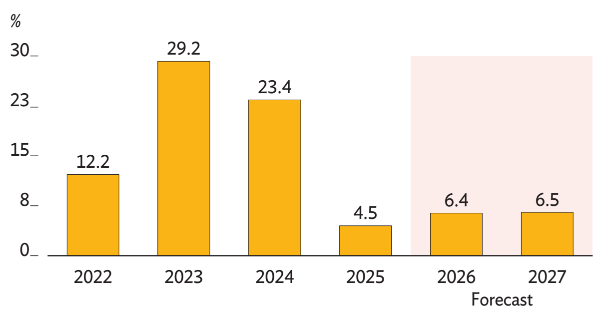


Note: All years are fiscal, ending on 30 June of that year.

Sources: Pakistan Bureau of Statistics. Updated National Accounts Tables Base FY2016: Table 5; Asian Development Bank estimates.

Figure 2.18.8 Inflation Forecast

Inflation is forecast to increase modestly through 2026–2027, driven by stronger activity and temporary supply-side pressures.



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

Sources: Pakistan Bureau of Statistics, Price Statistics: Monthly Review on Price Indices—January 2026; Asian Development Bank estimates.

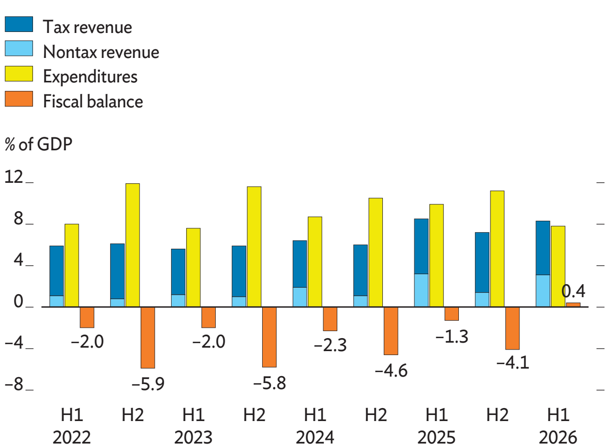
1 July increase in gas prices. Inflation during the first 8 months (July–February) of FY2026 averaged 5.5%. Surging oil prices and disrupted trade routes amid the Middle East conflict will drive inflation and import costs up further, with oil and gas constituting a large share of Pakistan's imports. Inflation is anticipated to increase in the coming months, most likely breaching the upper bound of the central bank's medium-term target range of 5%–7%. The central bank is committed to keeping the real policy rate sufficiently positive to anchor inflation expectations within the medium-term target range.

Maintaining fiscal discipline is essential for stability, growth, and expanding public spending. The FY2026 budget aims for a primary surplus of 2.6% of GDP and an overall deficit of 4.0%, to decline further over the medium term. The government plans to achieve these targets by raising tax revenue to 13.3% of GDP and containing spending. Despite a tax shortfall, fiscal performance in the first half (H1) of FY2026 remained on target, showing an overall surplus of 0.4% of GDP and a primary surplus of 3.2% (Figure 2.18.9). Total revenue stood at 8.2% of GDP, primarily reflecting a PRs2.4 trillion (1.9% of GDP) profit transfer from the central bank. Tax collection increased by 10.9% compared to H1 FY2025 but fell short of the target by PRs331 billion (0.3% of GDP). Expenditure decreased to 7.8% in H1 FY2026 from 9.9% a year earlier as interest payments declined to 2.8% from 4.5% of GDP. With lower interest rates and continued fiscal discipline, this declining trend is expected to continue, creating the fiscal space needed for essential social and development spending.

The current account is projected to return to a deficit in FY2026 as global energy prices rise amid the Middle East conflict. The deficit reached \$1.2 billion in the first 7 months of FY2026 (July–January)—reversing a \$564 million surplus a year earlier and reflecting a 28.9% increase in the deficit of goods and services to \$20.5 billion—because of a sharp rise in imports and continuing weak exports (Figure 2.18.10). Higher growth helped merchandise imports grow by 9.8%, reflecting higher imports of automobiles, machinery, metals, and chemicals. Merchandise exports fell by 5.5%, mainly because flood-related crop losses cut rice exports by about \$1 billion. In addition, no sugar was exported in H1 FY2026, compared to exports of \$343 million in H1 FY2025, to rebuild domestic inventory. Workers' remittances remained resilient, rising by 11.3% to \$23.2 billion in July–January FY2026 (Figure 2.18.11). As noted, oil and gas take up a prominent share of Pakistan's imports, and the surge in global energy prices resulting from the Middle East conflict will swell

Figure 2.18.9 Fiscal Indicators

Fiscal performance stayed on target in the first half of 2026, despite weaker-than-expected tax revenues.



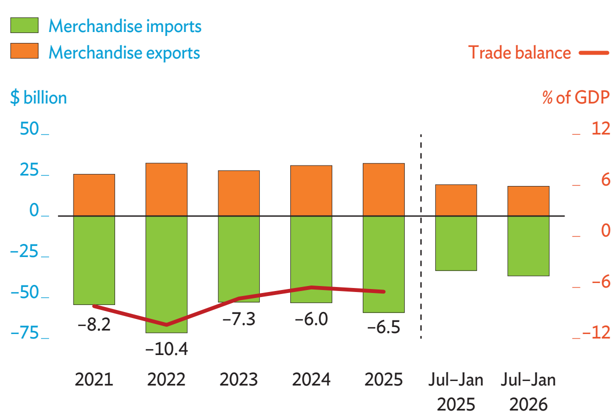
GDP = gross domestic product, H = half.

Note: All years are fiscal, ending on 30 June of that year. Data refers to consolidated federal and provincial governments.

Source: Ministry of Finance. Pakistan Summary of Consolidated Federal and Provincial Fiscal Operations 2022–23, 2023–24, 2024–25, and 2025–26.

Figure 2.18.10 Trade Balance

Strong import growth amid weak exports widened the trade deficit in the first half of 2026.



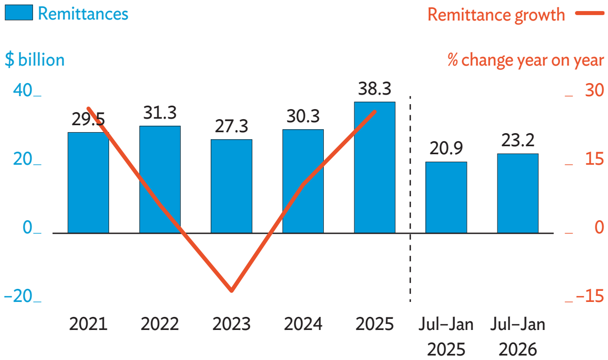
GDP = gross domestic product.

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

Source: State Bank of Pakistan. Economic Data: External Sector. Summary Balance of Payments as per BPM6—January 2026.

Figure 2.18.11 Remittances

Remittances grew strongly in 2025 and the first half of 2026, supported by external stability and a market-determined exchange rate.



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

Source: State Bank of Pakistan. Economic Data: External Sector. Workers' Remittances.

the import bill. Higher import costs, coupled with any export disruptions, will further widen the trade deficit. If instability deepens and Gulf economies struggle, Pakistan's remittance inflows may decline, widening the current account gap.

Downside risks to the economic outlook remain. Pakistan is at a crucial moment with its economy stabilized and efforts underway to address key structural issues in energy, trade, investment, and state-owned enterprises. However, expectations of rapid growth without fully tackling these issues could lead to reform fatigue and risk policy slippage. Deploying overly loose macroeconomic policies to support higher growth could revive balance-of-payments pressures and threaten hard-earned macroeconomic stability. Externally, rising geopolitical tensions and uncertainties, especially from a prolonged conflict in the Middle East, could worsen the volatility in global commodity prices, particularly energy, and disrupt international trade. This has potential implications for domestic inflation and the external position, weighing on the growth outlook.

Over the medium term, Pakistan must continue pursuing growth through structural transformation to prevent repeating the boom-bust cycle. Raising long-term growth and living standards depends crucially on making deeper changes to the country's development strategy. This includes opening further to foreign investment and trade, privatizing state-owned enterprises, and addressing taxation and energy costs.

Policy Challenge—Promoting Sustainable Value Chains in Agriculture

Agriculture plays a key role in livelihoods, food security, and rural development, accounting for about 20% of Pakistan's GDP and 38% of employment. With its geographical and climatic diversity and suitability, the country can grow a large variety of cash crops, fruits, and vegetables. However, agriculture continues to underperform, largely because of inefficient use of water and land resources, limited private investment, and significant gaps in cold chain logistics, certification systems, and mechanization. Gender disparities and inadequate support for small and medium-sized enterprises further hinders growth for key segments along the value chain. Although women account for an estimated 65% of the labor force in agriculture, they remain largely excluded from the formal ecosystem in formal agribusiness ownership, access to finance, and market linkages.

Climate-induced shocks, including floods, droughts, heatwaves and erratic rainfall, have significantly harmed food and agricultural value chains. The 2022 floods destroyed 4.4 million acres of crops. Such shocks routinely disrupt farming systems, degrade soil and water resources, and increase input costs. The impacts were particularly severe for smallholder farmers who lack access to adaptive technologies or risk mitigation tools.

Structural inefficiencies also hinder value chains in agriculture. These include inadequate post-harvest infrastructure, limited market integration, and restricted access to value-added processing. Pakistan's post-harvest losses remain among the highest in South Asia, particularly in perishables such as fruits and vegetables. Agro-processing and cold chains remain underdeveloped, leading to lost export potential and foregone income for farmers. Agri-based small and medium-sized enterprises face financing constraints, low investment readiness, and regulatory barriers that limit formalization and scalability.

Pakistan's tremendous export potential in agriculture remains largely untapped. Exports are concentrated in a few commodities, with rice accounting for around 47% of total export earnings from food in FY2025. Among fruit and vegetables, citrus fruit, mangoes, dates, onions, and potatoes constitute more than 80% of export revenues. Besides a lack of diversification, sector performance is limited by the mismatch between global market demand and the characteristics and varieties of crops the country cultivates.

Pakistan needs to invest an additional estimated $220 million in agriculture (across federal and provincial budgets), to meet its nationally determined contribution (NDC) commitments by 2030. While climate finance in the country remains heavily skewed toward energy-related mitigation (64%), less than 1% is directed to agriculture. Despite its potential, the agribusiness sector accounts for only 5% of private sector investment. Innovative instruments, such as blended finance and nature-based performance bonds, offer viable pathways to crowd in private investment for agriculture.

Government strategies to promote and modernize value chains in agriculture have progressed in recent years. These include establishing and strengthening public-private partnerships to develop agro-processing zones, storage facilities, and digital platforms for agriculture-based small and medium-sized enterprises. Greater digital integration and a more conducive policy framework can strengthen industry's climate-resilience, improve food security, and promote sustainable economic growth. This will require coordinated action by federal and provincial governments, development partners, and the private sector. Stronger value chains require greater private investment in climate-resilient agriculture and improved access to finance among smallholder farmers.

SRI LANKA

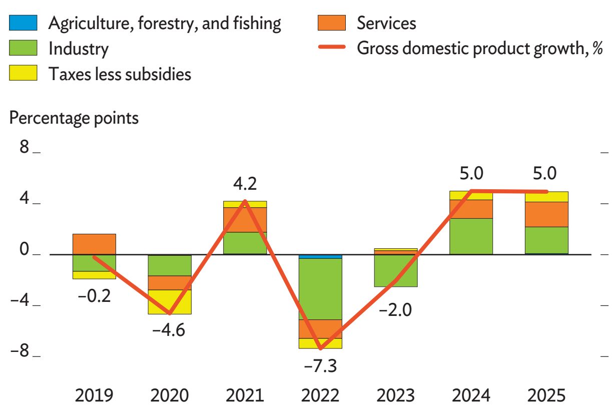
Sri Lanka's economic recovery remained resilient in 2025, supported by broad-based growth, subdued inflation, and improving financial conditions, despite late-year disruptions from Cyclone Ditwah. Growth is projected to moderate in 2026 before rebounding slightly in 2027. This trajectory reflects a fading surge following the economic crisis in 2022–2023, partially offset by post-cyclone reconstruction spending, and a notable drag from the Middle East conflict. A prolonged conflict would add significant downside risk. Inflation is projected to notably accelerate, partly driven by emerging energy price pressures. Chronic under-execution of public capital spending is a key policy challenge.

Economic Performance

Economic recovery remained resilient across all sectors in 2025, notwithstanding the late-year impact of Cyclone Ditwah. Real GDP expanded by 5.0% in 2025, underpinned by broad-based growth (Figure 2.19.1). Agriculture grew 1.4% and industry expanded strongly by 7.8%, albeit slower than the year before, reflecting normalization from the crisis-era lows. Construction expanded 9.2%, mirroring a 19.8% increase in domestic cement production. Services grew by 3.3%, with financial services growth accelerating to 10.6% and accommodation and food services surging by 12.4%, reflecting strong tourism momentum. The cyclone struck on 28 November 2025, triggering floods and landslides across 22 districts and causing significant supply chain disruptions, dampening activity in the fourth quarter—with GDP growth moderating to 4.8%, from 5.5% in the same quarter of 2024—and causing $1.4 billion of losses, as estimated by the Post-Disaster Needs Assessment.

Figure 2.19.1 Gross Domestic Product Growth by Sector

Growth remained strong and broad-based in 2025, with all three sectors contributing positively.



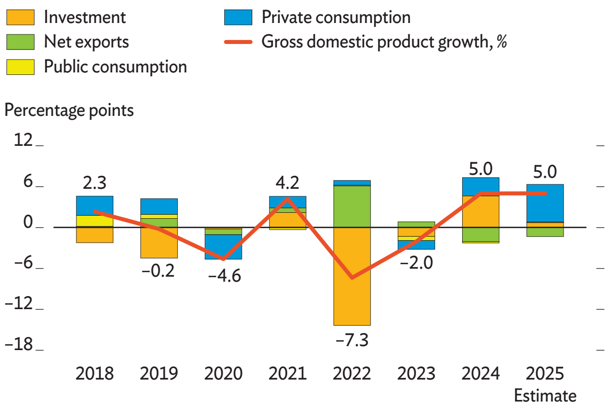
Sources: Department of Census and Statistics of Sri Lanka.

Higher consumption drove domestic demand in 2025. Consumption expanded robustly, growing by 7.7% in the first 9 months compared with just 0.7% in the same period a year earlier. Private consumption, which rose 8.6% from 1.3% the year before, drove gains, buoyed by low inflation, easing interest rates, and the normalization of retail and trade activity. Investment growth moderated sharply, with gross capital formation expanding by just 2.2% compared with 29.3% in 2024, as the post-crisis rebound in private investments tapered off and public investment remained weak. Net exports were broadly neutral for growth, with import growth slightly offsetting export growth (Figure 2.19.2).

This chapter was written by Lilia Aleksanyan, Lakshini Fernando, and Nirukthi P. Kariyawasam of the Sri Lanka Resident Mission, ADB, Colombo.

Figure 2.19.2 Demand-Side Contributions to Growth

Private consumption remained the main engine of growth, while investment recovery lagged behind.



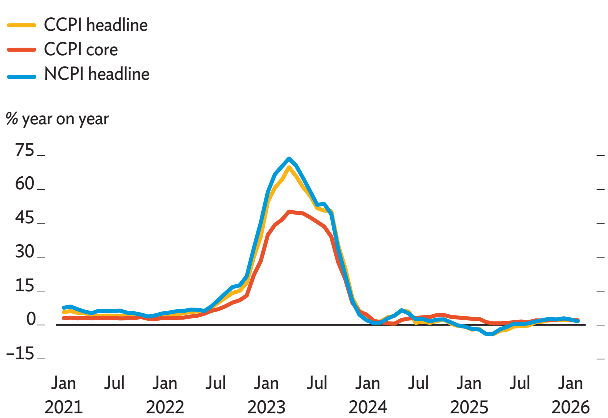
Note: The 2023 breakdown does not sum to GDP because full-year revised data for the individual components are not yet available.

Sources: Department of Census and Statistics of Sri Lanka; Asian Development Bank estimates.

Annual average headline inflation, as measured by the Colombo consumer price index, turned negative in 2025 (Figure 2.19.3). The index contracted by 0.5% after rising 1.2% in 2024, far below the central bank's inflation target of 5.0%. Deflation reflected limited cost-push pressures from administered prices—including energy prices that were raised only slowly—and strong base effects from earlier price surges. Food inflation accelerated to 2.0%, while nonfood inflation moved into negative territory (−1.7%),

Figure 2.19.3 Inflation

Inflation turned positive in mid-2025 after an extended deflationary period, but remained well below the 5% target through year-end.



CCPI = Colombo consumer price index, NCPI = national consumer price index.

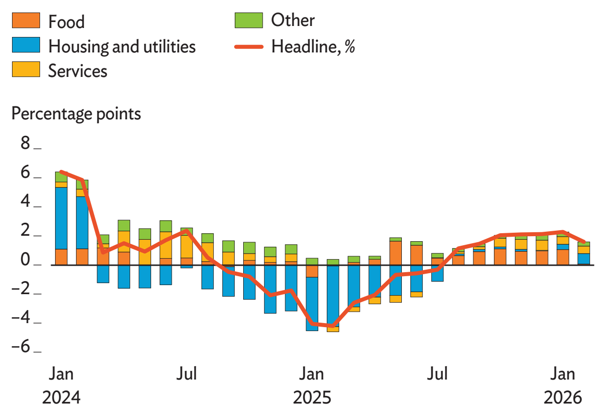
Note: In 2023, the Department of Census and Statistics revised the inflation base measured by the CCPI and NCPI from 2013 to 2021.

Source: Department of Census and Statistics of Sri Lanka.

and core inflation decelerated to 1.6%, indicating underlying disinflationary pressures (Figure 2.19.4). Temporary supply-side pressures toward year-end did not generate sustained price increases, pointing to well-anchored inflation expectations. In May 2025, the Central Bank of Sri Lanka reduced its Overnight Policy Rate by 25 basis points to 7.75%, maintaining this rate through year-end (Figure 2.19.5).

Figure 2.19.4 Contributions to Inflation

Food and services price increases drove a gradual uptick in inflation in H2-2025, while energy prices rose marginally.



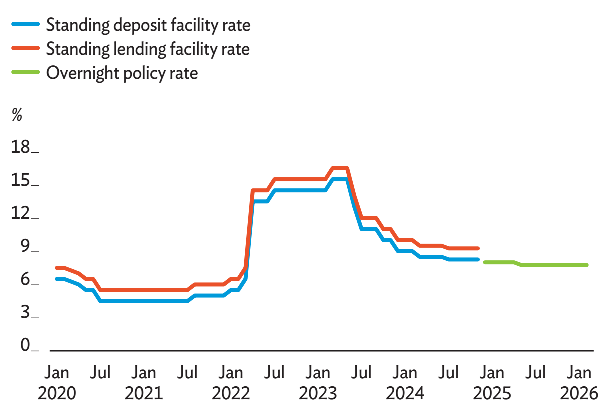
H = half.

Notes: In 2023, the Department of Census and Statistics revised the inflation base measured by the Colombo consumer price index from 2013 to 2021. Services include transport, health, education, communications, and restaurants and hotels. Housing and utilities include housing, water, electricity, gas and fuel.

Source: Department of Census and Statistics of Sri Lanka.

Figure 2.19.5 Policy Rates and Key Interest Rates

The central bank maintained its accommodative monetary policy stance throughout 2025.



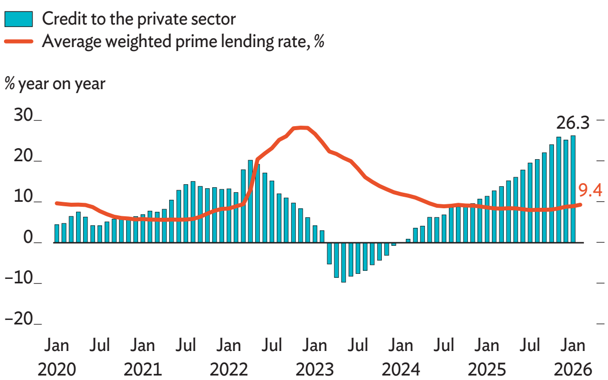
Note: The Central Bank of Sri Lanka replaced the standing deposit and lending facility rates, heretofore its twin policy rates, with the overnight policy rate on 27 November 2024, linking them to the overnight policy rate with a predetermined margin of ± 50 basis points.

Source: Central Bank of Sri Lanka.

Private sector credit growth accelerated sharply in 2025 (Figure 2.19.6). Easing lending rates and the broader recovery supported credit growth of 25.2% by end-2025, compared with 10.7% by end-2024, expanding total outstanding credit to 31.2% of GDP. The annual Average Weighted Prime Lending Rate fell to 8.4% from 9.9%. Demand was broad-based, led by wholesale and retail trade, financial and business services—including leasing for vehicle imports following the relaxation of import restrictions in early 2025—personal housing, and pawning. Services sector lending surged 41.8%—its highest rate in over a decade—followed by industry at 16.9% and agriculture at 26.2%.

Figure 2.19.6 Private Sector Credit Growth

Private sector credit expanded sharply, reflecting improved economic confidence and the low interest rate environment.



Note: Average Weighted Prime Lending Rate is a weekly rate compiled by the Central Bank of Sri Lanka based on data provided by commercial banks on the weekly lending rate offered to their prime customers.

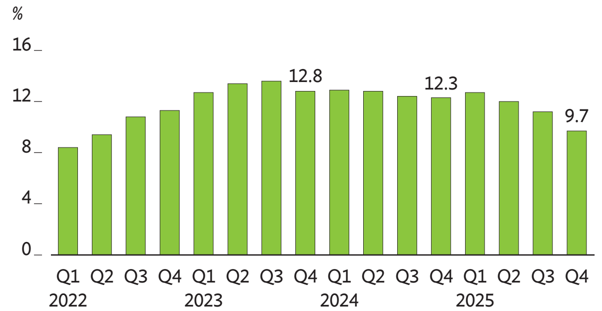
Source: Central Bank of Sri Lanka.

The banking sector remained well-capitalized and profitable, with asset quality continuing to improve. Profitability improved markedly, with profit after tax growing by 13.7% year-on-year in 2025, driven by higher net interest income as deposit rates adjusted faster than lending rates. Capital buffers strengthened on the back of improved profitability, with the Tier 1 ratio rising to 19.3% in 2025 and the capital adequacy ratio edging up to 17.9%, as retained earnings grew faster than risk-weighted assets despite rapid credit expansion. The ratio of stage-3 loans—loans with payments past due over 90 days—to total loans declined to 9.7% in 2025 from 12.3% in 2024 (Figure 2.19.7).

Strong fiscal revenue growth and contained spending supported a third consecutive primary surplus in 2025 (Figure 2.19.8). The budget deficit narrowed to 2.3% of GDP from 6.8% in 2024, while the primary surplus rose to 5.4% of GDP—well above both the 2.2% recorded in 2024 and the International Monetary Fund (IMF) indicative target of 2.3% of GDP. Total revenue grew 35.2% and reached 16.6% of GDP (from 13.4% in 2024) (Figure 2.19.9). This was led by increased receipts from import duties and value-added tax, both boosted by a one-off surge in vehicle imports following the removal of the import ban. Total expenditure declined slightly to 19.0% of GDP (from

Figure 2.19.7 Impaired Loan Ratio

The nonperforming loans ratio declined steadily, reflecting improving borrower conditions alongside the broader economic recovery.



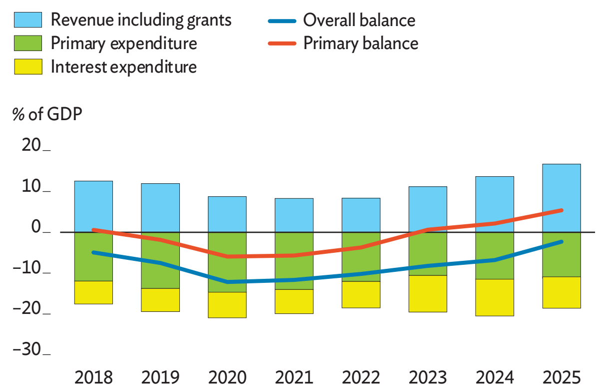
Q = quarter.

Note: The central bank in 2022 discontinued its method of calculation of nonperforming loans and introduced a three-stage loans classification, which gives banks more discretion to provision against high-risk assets even before default.

Source: Central Bank of Sri Lanka.

Figure 2.19.8 Central Government Finances

The primary surplus widened further in 2025, underpinned by strong revenue growth and contained spending.



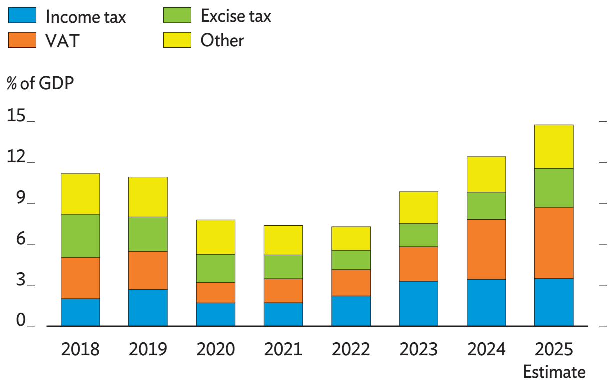
GDP = gross domestic product.

Notes: Preliminary figures from the Sri Lanka budget speech used for 2025. Data on government expenditure for 2019 and 2020 are from the October 2025 edition of IMF's *World Economic Outlook* and adjusted for the new GDP base (2015=100).

Sources: Ministry of Finance, Planning and Economic Development; International Monetary Fund. 2025. *World Economic Outlook*. October.

Figure 2.19.9 Components of Revenue

Revenue collection strengthened, buoyed by a surge in vehicle imports and improved tax compliance.



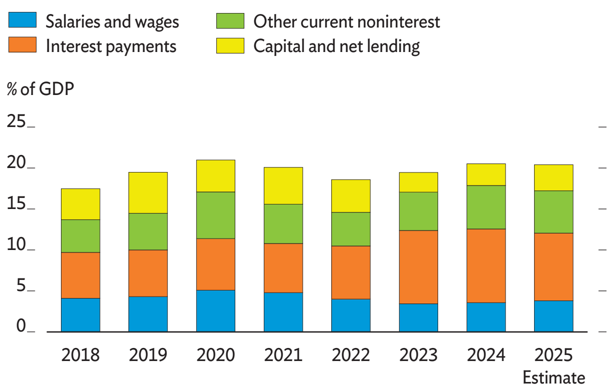
GDP = gross domestic product, VAT = value-added tax.

Note: 2025 is estimated using the 2026 government budget speech and associated budget estimates.

Source: Ministry of Finance, Planning and Economic Development.

Figure 2.19.10 Components of Government Expenditure

Total expenditure slightly edged down in 2025 as higher capital spending partly offset the continued decline in interest payments.



GDP = gross domestic product.

Notes: The 2025 figures are estimated using the 2026 government budget speech. Data on government expenditure for 2019 and 2020 are from the October 2025 edition of the International Monetary Fund's World Economic Outlook and adjusted for the new GDP base and subsequent categories (2015 = 100).

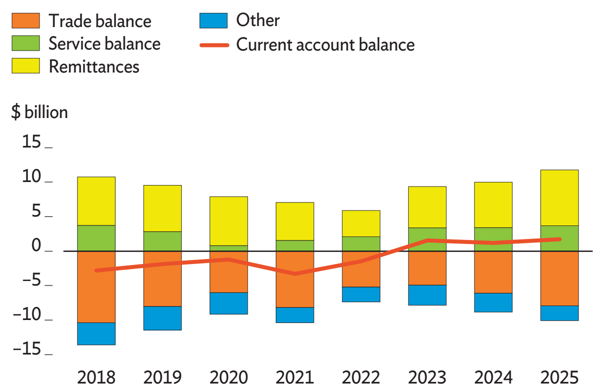
Sources: Ministry of Finance; International Monetary Fund. 2025. *World Economic Outlook*. October.

20.4% in 2024), with capital expenditure at 3.0% of GDP—below the 4.0% target (Figure 2.19.10). Capital under-execution remained severe with cumulative capital expenditure equivalent to $3.3 billion in 2025, against a full-year fiscal envelope of $4.4 billion. Public debt declined marginally to an estimated 98.3% of GDP (from 103.2% in 2024) under the IMF-supported Extended Fund Facility program.

Remittances and tourism earnings underpinned a third consecutive current account surplus, reaching $1.7 billion or 1.6% of GDP, despite surging vehicle imports (Figure 2.19.11). The trade deficit widened 30.1% to $7.9 billion (7.3% of GDP), partly driven by vehicle imports (7.5% of total imports) following the lifting of a 5-year ban. Worker remittances rose by 22.8% to $8.1 billion, with December recording the highest-ever monthly inflow of $879.1 million (43.2% increase compared to December 2024) (Figure 2.19.12). Diaspora support following Cyclone Ditwah likely boosted the inflow. The remittance base remained structurally robust, as the number of Sri Lankan workers abroad stayed near record levels. Tourist arrivals grew 15.1%, though revenue edged up just 1.6% and remained below pre-pandemic levels.

Figure 2.19.11 Key Balance of Payments Indicators

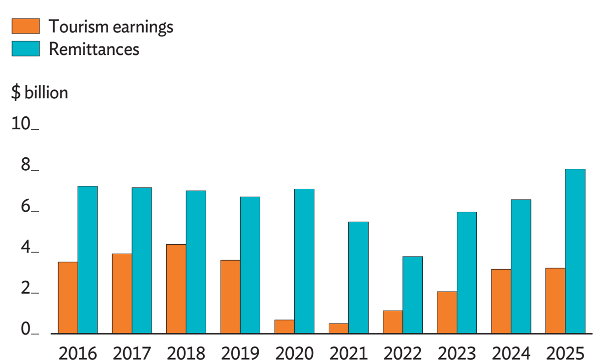
The current account remained in surplus for a third consecutive year, sustained by strong remittances despite a widening trade deficit.



Source: Central Bank of Sri Lanka.

Figure 2.19.12 Tourism Earnings and Remittance Inflows

Remittances reached a record high in 2025, compensating for muted tourism earnings as per-visitor spending declined despite higher arrivals.

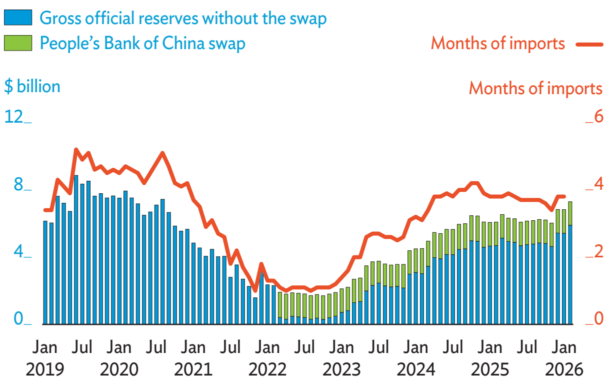


Source: Central Bank of Sri Lanka.

Official reserves reached $6.8 billion by end-2025, covering 3.8 months of imports, supported by record remittances, recovering tourism earnings, and multilateral disbursements (Figure 2.19.13). The rupee depreciated 5.6% against the US dollar as external debt service payments reached $2.5 billion.

Figure 2.19.13 Gross Official Reserves and Months of Imports

Gross official reserves rose steadily, driven by substantial net foreign exchange purchases by the central bank.



Note: The People's Bank of China swap of $1.4 billion becomes usable once gross international reserves rise above 3 months of import cover for the previous year.

Source: Central Bank of Sri Lanka.

Table 2.19.1 Selected Economic Indicators, %

Growth moderates as the post-crisis rebound fades and Middle East spillovers lift inflation.

	2024	2025	2026	2027
GDP growth	5.0	5.0	4.0	4.2
Inflation	1.2	−0.5	5.2	4.0

GDP = gross domestic product.

Sources: Department of Census of Statistics of Sri Lanka; Asian Development Bank estimates.

Economic Prospects

GDP growth is projected to moderate to 4.0% in 2026, edging up to 4.2% in 2027, assuming the Middle East conflict does not escalate further or become protracted (Table 2.19.1). This projection—which is subject to a very high degree of uncertainty—incorporates an estimated 0.4 percentage point drag from the conflict on growth, operating through four channels. These are (i) higher global oil prices raising energy and logistics costs and compressing household real incomes, (ii) a partial softening of remittance inflows from Gulf economies, (iii) reduced tourist arrivals due to disrupted air connectivity through Gulf hub carriers, and (iv) possible exchange rate depreciation amplifying imported inflation pressures. Post-Ditwah relief and rehabilitation will partly support growth, but persistent structural weaknesses including low productivity, possible capital spending under-execution, and weak institutional capacity will still constrain the economy. The early-2026 Purchasing Managers' Index (PMI) for manufacturing shows continuing economic momentum. The Index of Industrial Production rose 4.4% year-on-year in January 2026, pointing to sustained industrial momentum in early 2026. The PMI for Construction signaled strong activity at the start of the year, reflecting the resumption of previously stalled projects. However, rising energy and input costs stemming from the Middle East conflict are expected to weigh on industry growth. The PMI for services continued to indicate expansion through February 2026, although at a slower pace compared with late 2025. Agricultural output is projected to remain subdued, as cyclone damage during the early stages of the Maha cultivating season—Sri Lanka's main cultivating period that accounts for 60%–65% of annual production—is estimated to have cost around 10% of the output. As global oil prices climbed past $100 per barrel in March 2026, Sri Lanka reinstated fuel rationing and declared Wednesdays a public holiday to slash national energy consumption. Over the medium term, sustaining higher growth will hinge on structural reforms to enhance resilience against exogenous shocks, raise productivity, and catalyze private investment.

Consumption is expected to remain the main growth driver, while private investment is projected to recover gradually. Supported by the public sector wage hike and cyclone-related relief measures, private consumption will continue to support growth in 2026–2027, tempered by higher inflation. Reconstruction-related public spending and improved investor confidence are expected to support investment activity. However, private investment is likely to recover only gradually, constrained by heightened uncertainty, regulatory rigidities, and a narrow export base. Net exports will weigh on growth as import demand strengthens on the back of rebounding construction and rising consumption.

While the United States Supreme Court struck down the 20% tariff in February 2026, the replacement 10% temporary tariff and ongoing uncertainty about the future trade regime will continue to suppress external demand for Sri Lankan exports, particularly in the apparel and rubber sectors.

Inflation is expected to accelerate in 2026, driven in part by Middle East-related energy price pressures. The Colombo consumer price index edged up to 1.6% year-on-year in February 2026, driven increasingly by utility prices. Headline inflation is projected to reach 5.2% in 2026 and 4.0% in 2027, reflecting both domestic price pressures and the pass-through effects of the Middle East conflict. Upward pressure is expected from exchange rate depreciation, an expected double-digit electricity tariff adjustment in the first half of 2026, elevated global oil prices, and wage- and relief-led consumption. Fuel price increases are already feeding into transport and logistics costs. Under the assumption of a contained and relatively short-lived conflict, the shock is estimated to account for 1.5-2.0 percentage points of the projected 5.2% headline inflation in 2026. Credit growth is expected to moderate as pent-up demand normalizes; early-2026 data suggest initial moderation, with private sector borrowing at an 11-month low in January 2026. The Average Weighted Prime Lending Rate has been rising since July 2025, reaching 9.35% by the end of February 2026, which if sustained could limit demand-driven price pressures. Domestic financial conditions are expected to remain sensitive to external shocks, with government bond yields showing episodic volatility in early 2026 in response to Middle East–related risk sentiment and energy price movements, despite improved macroeconomic fundamentals.

Fiscal policy over 2026–2027 is expected to remain anchored in consolidation, notwithstanding the additional expenditure demands from post-Ditwah recovery. Parliament's approval of a supplementary allocation equivalent to 1.5% of GDP for post-cyclone relief and reconstruction lifted planned expenditure in 2026 and would breach the fiscal rule that limits primary expenditure to 13% of GDP. Capital expenditure is projected to rise, driven largely by reconstruction-related investment, but longstanding execution bottlenecks may continue to result in under-utilization. On the revenue side, strong recent performance is expected to moderate as pent-up import demand fades and vehicle-related receipts decline with the normalization of imports. The government expects tax revenue to reach 14.2% of GDP in 2026. The primary surplus is expected to narrow to 1% of GDP in 2026 according to budget estimates.

The current account will be supported by resilient remittance inflows, but the external position faces growing headwinds. The current account recorded a surplus of $370 million in January 2026, the latest month for which data are available, as remittance inflows rose 31% year-on-year in January and 33% in February. Reconstruction-related demand for capital goods and building materials imports is projected to be largely offset by the normalization of vehicle imports, keeping the trade deficit contained. The liberalization of rules of origin for garments under the United Kingdom (UK) Developing Countries Trading Scheme, effective January 2026, is projected to support garment exports to the UK. However, external risks remain elevated. With around 40% of remittances originating from Gulf economies, a sustained Middle East conflict will weigh on external buffers. Further, disruption to Gulf airspace—the last point of departure for over 30% of tourist arrivals to Sri Lanka in February 2026—will reduce tourism earnings. Revenues already declined year on year in February 2026 despite solid arrivals, reflecting weaker per-tourist spending. Under a contained Middle East conflict scenario, the current account surplus is expected to narrow and potentially shift to a small deficit, with higher fuel import costs and some moderation in Gulf-sourced remittances and exports.

External buffers have strengthened but remain vulnerable to conflict-related shocks. Official reserves reached $7.2 billion by end-February 2026, estimated at 4 months of imports, of which $1.4 billion represents a People's Bank of China currency swap. The IMF projects reserves to be rebuilt toward the Extended Fund Facility target of $8.9 billion by end-2026, supported by three expected IMF disbursements, although higher fuel import costs and moderation in Gulf-sourced remittances pose risks to this path. Improved policy credibility is expected to limit disorderly exchange-rate pressures.

Risks to the 2026–2027 outlook are tilted to the downside and dominated by external factors. In the event of a more severe or prolonged Middle East disruption—involving Strait of Hormuz transit restrictions, a sustained fall in Gulf Cooperation Council remittances, and constrained air connectivity—inflationary pressures could rise sharply and growth would slow markedly. Higher energy and logistics costs would compress household real incomes and weigh on economic activity, while weaker remittances and disrupted tourism earnings would widen external imbalances and put downward pressure on the exchange rate, amplifying imported inflation. This stronger supply-side shock may prompt a tighter monetary policy stance than assumed under the early stabilization scenario, further denting growth. Global trade uncertainty could weigh on exports and investment. Weather-related risks remain significant, including drought during the Yala season. On the domestic front, fiscal discipline will be tested by reconstruction pressures, the normalization of one-off revenue gains, and social demands to balance consolidation with welfare needs. Delays in structural reform implementation could weaken confidence and constrain private-sector-led growth.

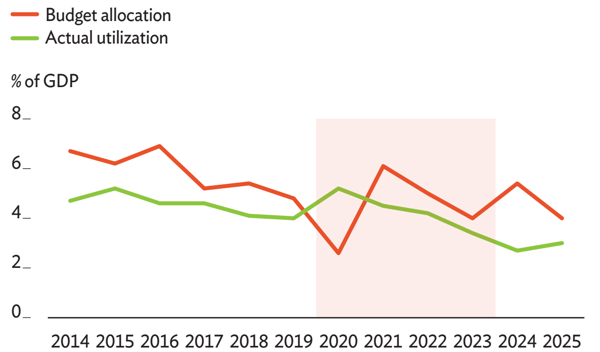
Policy Challenge—Unlocking Public Investment Potential

Sri Lanka's capital spending has consistently fallen short of budgeted levels, averaging only 3.0% of GDP between 2022 and 2025—substantially below the 5.0%–6.0% typically allocated (Figure 2.19.14). In 2024, actual capital spending stood at just 2.6% of GDP, less than half the 5.4% projected in the original budget. For 2026, capital expenditure is projected at SLRs1.37 trillion (approximately $4.4 billion), a 37.2% increase over the 2025 actual spending, but achieving this will require overcoming persistent structural and fiscal constraints.

The chronic under-execution of capital budgets reflects weaknesses on both the financing and implementation fronts (Figure 2.19.15). On the financing side, recurrent expenditure has repeatedly exceeded budgeted levels, particularly due to higher-than-expected interest payments averaging 17.8% of annual budgeted expenditure during 2020–2024, up from 10.5% during 2015–2019. The problem is compounded by rigidity in other recurrent spending items, while revenue persistently underperformed by an average of 14.7% during 2015–2024. In the absence of sufficient fiscal buffers, the deficit has been contained by compressing capital spending by an average of 28.6% over 2015–2024—except in 2019, 2020, and 2022. This pattern has become entrenched, limiting the government's ability to sustain multi-year investment programs and undermining the credibility of medium-term fiscal planning.

Figure 2.19.14 Capital Under-Utilization

Public capital budget utilization remained chronically low, as fiscal consolidation continued to compress investment spending.

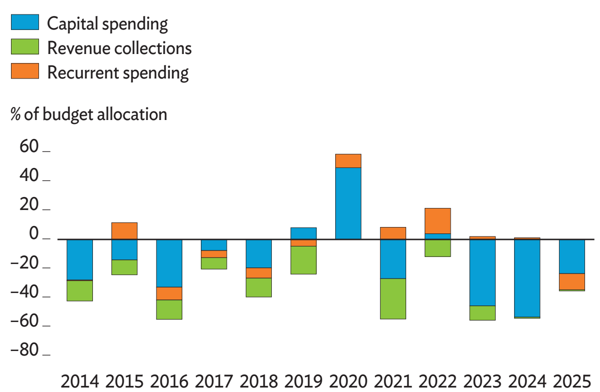


Notes: The shaded orange area represents the COVID-19 pandemic and the subsequent economic crisis. Ratios reflect different gross domestic product (GDP) bases, as allocations and actuals come from separate sources from the Ministry of Finance, one forward-looking and the other actual. In 2022, actual capital spending was higher than the budget allocation in real terms, but lower compared with the estimated share of GDP.

Source: Ministry of Finance.

Figure 2.19.15 Utilization as a Share of Budget Allocation

Capital expenditure has consistently borne the burden of recurrent spending pressures, constraining effective public investment.



Notes: For 2020, the fiscal budget was presented mid-year due to the Presidential and Parliamentary elections in late 2019 and early 2020. Positive values indicate actual revenue or spending exceeds the budget allocation; negative values indicate it falls below. In 2022, actual capital spending was higher than the budget allocation in real terms, but lower compared with the estimated share of gross domestic product.

Source: Ministry of Finance.

Implementation capacity constraints compound these financing pressures. Project execution is heavily back-loaded, with an average of 50.3% of disbursements occurring in the fourth quarter of 2019–2024, reflecting delays in procurement, land acquisition, feasibility assessments, and inter-agency coordination. Line ministries often lack the technical capacity to prepare bankable projects, while weak monitoring systems limit timely identification of bottlenecks. The IMF's 2019 Public Investment Management Assessment found that only a third of major projects had feasibility studies and over half entered the budget without proper appraisal. As a result, even when funds are available, execution remains slow and uneven.

These challenges have broader macroeconomic consequences. IMF research finds that a 1-percentage-point increase in public investment raises output by 1.5% over 4 years, with larger effects in capital-scarce economies. Persistent under-investment constrains potential growth, slows the modernization of transport, energy, and water infrastructure, and limits the economy's capacity to adapt to climate risks. Initial assessments of Cyclone Ditwah estimate damage at around $2 billion, underscoring the urgency of resilient infrastructure investment. Under-execution also weakens the transmission of countercyclical fiscal policy.

A comprehensive reform strategy must therefore prioritize four core areas. First, capital expenditure targets should be set realistically, grounded in rigorous project preparation and matched to available budgetary resources and implementation capacity. The ongoing IMF-supported update of the Public Investment Management Assessment is expected to facilitate these reforms. Second, implementation capacity must be strengthened through improved contractor oversight and streamlined procurement, including standardizing documentation, reducing approval layers, expanding e-procurement, and enforcing clear timelines. Third, project planning should embed rigorous feasibility assessments, realistic timelines, and early coordination among agencies responsible for utilities, land, and environmental approvals. Fourth, monitoring frameworks should be reinforced through quarterly performance reviews and clear accountability for persistent under-delivery.

While these institutional reforms are central, mobilizing private participation can complement them by easing fiscal pressures and accelerating delivery. Well-structured public–private partnerships can help convert slow-moving public projects into implementable investments by bringing in private capital, technical expertise, and stronger project management discipline. By improving early-stage preparation—where most delays occur—and allocating risks more efficiently, such partnerships can help ensure priority infrastructure is delivered on time while reducing the burden on the public budget.

DEVELOPING SOUTHEAST ASIA

- Brunei Darussalam
- Cambodia
- Indonesia
- Lao People's Democratic Republic
- Malaysia
- Myanmar
- Philippines
- Thailand
- Timor-Leste
- Viet Nam

BRUNEI DARUSSALAM

Economic activity weakened, and prices remained subdued in 2025 amid disruptions to oil and gas (referred to as hydrocarbon hereafter) production, weaker non-hydrocarbon production, and soft domestic demand. A gradual recovery is expected over 2026–27, supported by upstream and downstream oil and gas sector expansions, growing services, and modest inflation under the currency peg and subsidies. Risks could emerge from disruptions to hydrocarbon production, global energy market volatility, and lagging economic diversification. Policy reforms targeting Information and Communication Technology (ICT) skills and digital infrastructure could revitalize long-term economic growth.

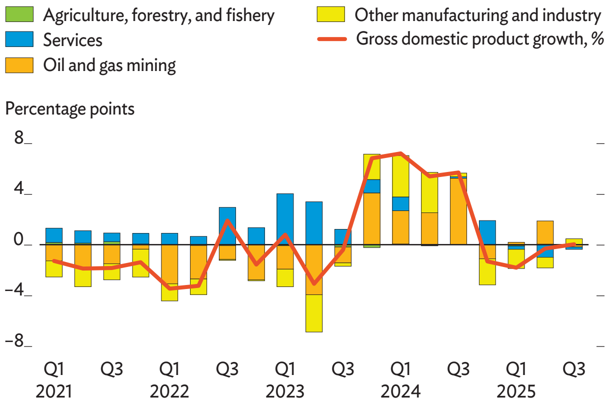
Economic Performance

Brunei Darussalam's economy contracted sharply from Q4 2024 through Q3 2025. Growth fell from 5.7% in Q3 2024 to –1.3% in Q4 2024, before reaching –1.8% in Q1 2025, due in part to maintenance-related disruptions to natural gas and Liquefied Natural Gas (LNG) production (Figure 2.20.1), falling global crude oil prices, and weaker non-hydrocarbon sector performance. The contraction moderated to –0.3% in Q2 2025, before stabilizing at 0.03% by Q3 2025. The persistent contraction stemmed from the services sector, which offset a Q2 rebound in hydrocarbon production.

Volatility in hydrocarbon output and weakness in non-hydrocarbon industries drove the economic slowdown through 2025. Hydrocarbon production declined from 10 to 9.4 million barrels between Q3 and Q4 2024, triggering the initial contraction (Figure 2.20.2). Year on year hydrocarbon production rose through the first half of 2025, peaking at 19.5% in Q2 despite monthly fluctuations. The rebound partially offset contractions in services and manufacturing. However, a 2.5% year on year decline in hydrocarbon production in Q3 2025, the first decline since Q2 2023, due to additional offshore maintenance, restoration, and upgrading activities for major upstream operators, has kept the latest growth figures close to 0%. These production swings translated directly into trade volatility.

Figure 2.20.1 Supply-Side Contributions to Growth

Oil and gas production remains the most significant contributor to growth, followed by manufacturing and services.



Q = quarter.

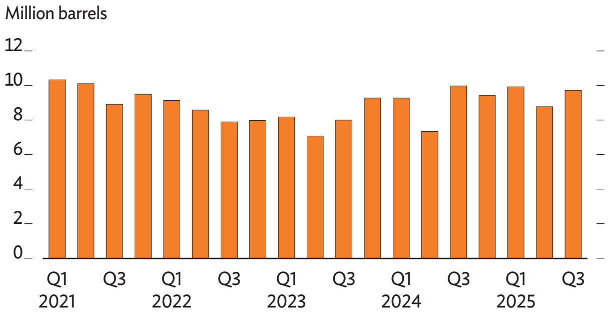
Source: CEIC Data Company.

External trade dominated quarterly growth, with net exports driving most volatility. Investment and net exports contracted, driving the Q4 2024 downturn (Figure 2.20.3). Expenditure weaknesses broadened in

This chapter was written by Roshen Fernando and Patrick Jaime Simba of the Economic Research and Development Impact Department, ADB, Manila.

Figure 2.20.2 Oil and Gas Production

Oil and gas output continued to stabilize in 2025.



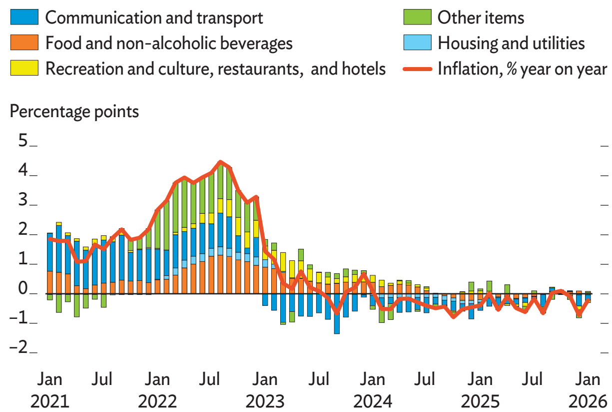
Q = quarter.

Note: Oil and gas production is total crude production that includes crude oil and liquid natural gas.

Source: CEIC Data Company.

Figure 2.20.4 Sources of Inflation

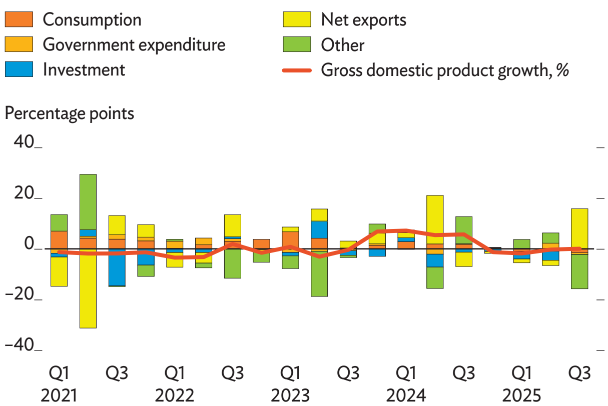
Price pressures remained largely subdued in 2025.



Source: CEIC Data Company.

Figure 2.20.3 Demand-Side Contributions to Growth

Net exports remain the dominant source of volatility in quarterly growth.



Q = quarter.

Notes: Investment is the share of gross capital formation in GDP—contributions to GDP year on year growth. Positive import contributions reflect import compression.

Source: CEIC Data Company.

Q1 2025 as consumption, investment, and net exports all declined. The contraction moderated in Q2 2025 due to increased government expenditure, despite continued net export drag. By Q3 2025, while net exports turned positive, weak domestic demand kept GDP growth near zero.

Price pressures remained subdued in 2025, with persistent deflation in most months. Prices reflected persistent downward pressure from food, communication, and transport, which outweighed modest increases from health, clothing and footwear, and restaurants and hotels (Figure 2.20.4). Headline inflation remained negative throughout most of 2024, ranging from −0.8% to −0.5% in Q4 2024. In 2025, inflation remained weak, reaching −0.7% in August, then rising to 0.1% in October before returning to deflation in November (−0.1%) and December (−0.7%). Falling communication and transport prices drove deflation, with food and non-alcoholic beverages also contributing to deflation from Q1 to Q3 2025, as global supply pressures eased. Subsidies and general price controls are expected to continue to contain inflation despite a slight uptick in food and non-alcoholic beverage prices in Q4 2025.

Economic Prospects

Growth is projected to reach 1.6% in 2026, up from 0.7% in 2025 (Table 2.20.1). The recovery is expected to be supported by a gradual normalization of hydrocarbon-related activities as maintenance-related disruptions ease and new wells and related facilities are brought onstream, supporting production and downstream output, including methanol and urea. Over the medium term, downstream developments in the hydrocarbon value chain will boost economic activity. These include the expected end-of-2028 completion of the Refinery and Petrochemical Plant Phase II project, and the commencement of the Marine Maintenance Yard and Decommissioning Yard in 2026. Services will also expand, driven by increased activities in various sectors in the economy.

Table 2.20.1 Selected Economic Indicators, %

Growth is expected to modestly pick up in 2026 and continue into 2027.

	2024	2025	2026	2027
GDP growth	4.1	0.7	1.6	1.9
Inflation	−0.4	−0.3	0.9	0.4

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

Economic diversification efforts are expected to drive more robust growth over 2026–27. Wawasan 2035, the long-term development agenda, prioritizes downstream oil and gas, food, tourism, ICT, and services. Fisheries are expected to expand in 2026, with operations commencing at the Pure Salmon Aquaculture Facility. Attracting diverse foreign direct investments (FDI), developing agri-food and aquaculture activities, and advancing digitalization could strengthen growth in the non-hydrocarbon sectors. However, outcomes depend on meeting project timelines and the investment climate.

Inflation is projected to rise modestly but remain low, averaging 0.9% in 2026 before further easing to 0.4% in 2027. Higher global food prices and imported inflation will drive price pressures, given high import dependence, particularly for food and non-alcoholic beverages. However, inflation could remain below 1% as the exchange-rate anchor to the Singapore dollar, continued subsidies and administered prices, and subdued domestic demand moderate the impact of higher global prices on domestic inflation. The recent disinflation in transport, communications, clothing, and footwear prices will also be accommodative.

Downside risks remain linked to hydrocarbon production, global energy market volatility, and slow economic diversification progress. Operational disruptions or delays in maintenance and investment projects could weaken hydrocarbon production, affecting exports and fiscal revenues. Rising maintenance costs from ageing infrastructure remain concerning. Externally, stronger-than-expected global supply or weaker demand could reduce energy prices, while geopolitical tensions could disrupt shipping and raise import costs, posing upside risks to inflation. Over the medium term, delays in implementing the intended FDI projects, weaker FDI inflows, and labor market challenges, particularly skill mismatches, high youth unemployment and underemployment, and high labor turnover, could stall economic diversification.

Policy Challenge—Building the ICT Workforce and Digital Infrastructure

Policy reforms targeting skill development and ICT infrastructure are vital for Brunei Darussalam to benefit from technological transformation driven by artificial intelligence (AI). AI and humanoid robots will transform economic sectors, increasing demand for high-skilled occupations and ICT infrastructure. ICT services are among the five priority sectors promoted under Goal 3 of Wawasan 2035. Achieving specific targets for the ICT sector, as well as long-term economic growth targets, requires alleviating constraints on expanding human capital through labor reforms and physical capital or infrastructure through investments.

Despite modest contributions to GDP and employment, sustained vacancies and strong job-seeker preferences indicate a growing pipeline of opportunities and talent for the ICT sector. The ICT sector contributes approximately 2% to both GDP and employment. However, the sector accounted for 6.2% of active job vacancies in 2024, rising to 13.7% in 2025, according to Indeed and LinkedIn. As of 2025, 47% of job seekers hold at least a Higher National Diploma, and 35% hold at least a first degree. ICT also ranks third in interest among job seekers registered with the Job Centre Brunei Portal. These trends suggest growing opportunities and strong interest among job seekers in the expanding sector.

Brunei Darussalam already meets several favorable conditions for attracting FDI in the ICT sector. Global evidence indicates that ICT infrastructure, high-quality human capital, a strong and stable economic and regulatory environment, and innovation ecosystems are critical preconditions for attracting ICT-related FDI. Attractive preconditions include strong political leadership, a business-friendly regulatory environment, dedicated investment promotion agencies, stable economic conditions, and growing investment and trade linkages within Asia and the Pacific. Proximity to Singapore and Malaysia, which are leading contributors to global ICT services and value chains, is also a unique advantage. The abundant renewable and non-renewable energy resources, along with the intended expansion of the energy sector, can competitively support energy-intensive ICT infrastructure critical to powering AI-related technologies.

Addressing the ICT skills gap through targeted labor interventions is essential. The government's Digital Economy Masterplan 2025 aims to develop digital skills. However, existing difficulties in matching job seekers with ICT vacancies demand additional training and development. Targeted policy interventions, such as enhancing ICT skills among school leavers and increasing the availability of tertiary ICT programs, could address the skill gaps. In the short- to medium-term, labor law reforms to attract skilled ICT professionals to the country will enable the sector to thrive and expand while facilitating knowledge spillovers.

Beyond workforce development, expanding digital infrastructure through targeted investments is critical. The country has improved the accessibility, affordability, and quality of its telecommunications infrastructure. However, expanding the ICT sector will require additional investments to foster ICT ecosystems and to establish and power the digital infrastructure. Ongoing FDI attraction efforts should also be extended to the ICT sector. Accelerating the establishment of the stock exchange will also provide additional means to attract portfolio investments.

CAMBODIA

Growth moderated in 2025 as the economy weathered shocks from border closure with Thailand and uncertainty over US trade policy. Growth will continue to slow in 2026 before rebounding in 2027. Inflation rose modestly in 2025 from a low base, driven by higher food prices. It is expected to rise further in 2026 before moderating in 2027. Looking ahead, initiatives that promote private-sector engagement in human capital development will be critical to achieving Cambodia's medium-term growth aspirations.

Economic Performance

The economy continued to grow in 2025, albeit at a slower pace than in 2024 (Figure 2.21.1). Real gross domestic product growth moderated to an estimated 5.2% in 2025, down from 6.0% in 2024. Growth was driven primarily by expanded manufacturing and continued post-pandemic recovery in tourism.

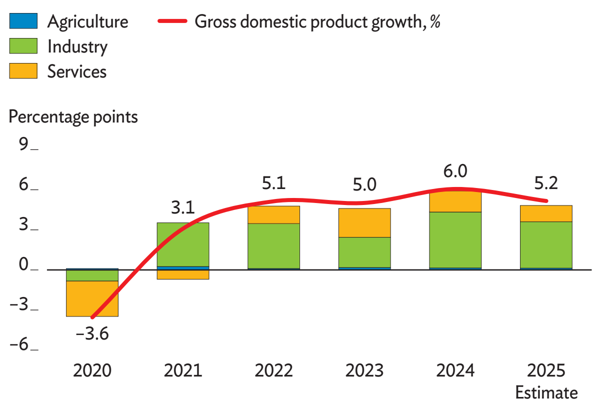
Industrial output was the main driver of growth in 2025, expanding by an estimated 7.9%. This acceleration was supported by a 16.3% increase in garment exports. Exports of other manufactures—such as wooden articles, electrical parts, car tires, and bicycles—expanded by 15.2%. Construction recovery continued to lag due to weak domestic demand, with output still lower than it was before the pandemic.

Growth in services slowed to an estimated 3.4% in 2025 as border closure with Thailand weighed on tourism. Tourist arrivals from the People's Republic of China (PRC) grew by 41.5% in 2025. However, the border closure dampened Cambodia–Thailand tourism, remittances, and supporting trade and services. Arrivals from places other than the PRC and Thailand declined after the conflict, dragging international arrivals in 2025 down by 16.9% (Figure 2.21.2).

Agriculture grew by an estimated 0.9% in 2025 on export demand and favorable weather. Agricultural exports increased by 8.4% in 2025, led by cashew nuts and rice, offsetting declines in cassava and rubber.

Figure 2.21.1 Supply-Side Contributions to Growth

The economy continued to expand in 2025, maintaining solid growth despite moderating from its 2024 pace.



Sources: Ministry of Economy and Finance; National Institute of Statistics; Asian Development Bank estimates.

Inflation picked up moderately in 2025, from a low base, on food price pressures. Inflation dropped sharply in the first half of 2025 with lower price increases for food. Lower fuel prices also offset price pressures in other areas. Inflation briefly picked up in September as disrupted trade with Thailand brought higher import costs, before easing in December. Overall, inflation averaged 2.5% in 2025, up from 0.8% in 2024.

The fiscal deficit widened in 2025 as expenditure growth outpaced revenue. The budget deficit increased from 2.7% of GDP in 2024 to an estimated

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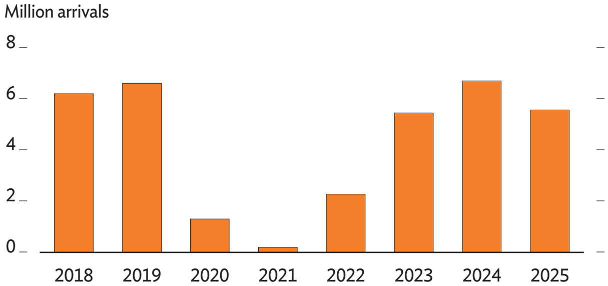
Figure 2.21.2 Tourist Arrivals

International visitor arrivals fell by 16.9% in 2025 with Thai border closure.



Source: Ministry of Tourism.

3.7% in 2025. Revenue rose marginally from 14.6% of GDP in 2024 to an estimated 14.7% in 2025, supported by improved goods and services tax collection. Expenditure expanded more, from 17.3% of GDP in 2024 to an estimated 18.4% in 2025, reflecting higher wage spending and increased social benefit outlays.

Public debt inched up in 2025. Public debt rose to $13.1 billion, equal to 26.5% of GDP, from $12.0 billion, or 26.3% of GDP, in 2024. To finance public investment projects, the government issued bonds worth $172.2 million in 2025. The issuance raised public domestic debt stock to $246.8 million in 2025.

The current account balance deteriorated to an estimated 3.5% of GDP deficit in 2025, from a surplus of 0.5% in 2024. A rising goods trade deficit and declining remittances drove the deterioration. Remittance inflows declined from 6.0% of GDP in 2024 to an estimated 4.0% in 2025 with the return of migrant workers from Thailand.

Strong foreign direct investment (FDI) supported reserves growth. FDI surged by 24% in the first 9 months of 2025 to $3.9 billion, with garments benefiting less than other manufacturing. This buoyant investment inflow lifted international reserves from $22.5 billion in 2024 to $27.5 billion in 2025, maintaining adequate import coverage of 8.2 months.

Economic Prospects

Growth is forecast to slow in 2026 from geopolitical shocks, then reaccelerate in 2027 (Table 2.21.1 and Figure 2.21.3). This forecast is based on supply-side projections of sectoral growth, as well as analysis of the border closure based on a trade model (Figure 2.21.4). Under this chapter's early Middle East stabilization scenario, which was finalized on 10 March, growth will be driven by rising external demand for Cambodian manufactures, with additional support from continued recovery in tourism and modest growth in agriculture, construction, and real estate.

Industry will continue to drive growth in 2026 and 2027. Export-led industrial output is projected to expand by 7.3% in 2026 and accelerate to 7.9% in 2027, boosted by rising contributions from light manufactures such as tires, electrical parts, and furniture. Solid garment orders have extended into early 2026. Manufacturing FDI increased by 54% year on year in the first 9 months of 2025, down from 75% growth in 2024. The composition of inflows points to increased

Table 2.21.1 Selected Economic Indicators, %

Growth will decelerate in 2026 before rebounding in 2027, while inflation will rise in 2026 before easing in 2027.

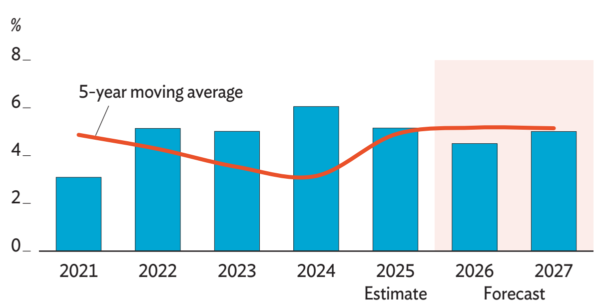
	2024	2025	2026	2027
GDP growth	6.0	5.2	4.5	5.0
Inflation	0.8	2.5	2.8	2.5

GDP = gross domestic product.

Sources: Ministry of Economy and Finance; National Institute of Statistics; Asian Development Bank estimates.

Figure 2.21.3 Gross Domestic Product Growth

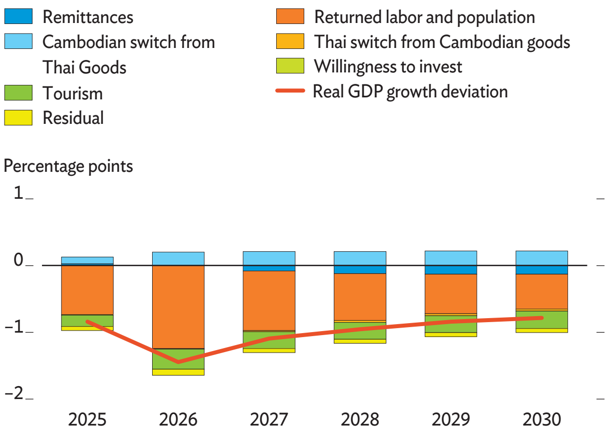
Growth will slow in 2026 before recovering in 2027, yet it will stay below the 5 year moving average in both years.



Sources: National Institute of Statistics; Asian Development Bank estimates.

Figure 2.21.4 Expected Impact of Border Closure

The border closure and associated impacts are expected to slow GDP growth by 1 percentage point per year to 2030.



GDP = gross domestic product.

Source: Victoria University Centre of Policy Studies.

diversification, as non-garment manufacturing accounted for 93% of total inflow, indicating rising investor interest beyond traditional sectors. Meanwhile, approved fixed-asset investment surged by 45% in 2025, signaling strong investor confidence. Gradual recovery in construction is expected in both years, supported by industrial activity and residential real estate.

Growth in services is expected to slow to 2.3% in 2026 before accelerating to 2.9% in 2027. The projected slowdown in 2026 reflects continued losses in remittances and tourism stemming from border closure with Thailand, as well as weaker tourist arrivals from other markets due to higher travel costs. However, the recent opening of the new Phnom Penh International Airport and government efforts to promote tourism may partially offset these challenges. Recovery in real estate is expected to remain gradual as FDI inflow continues to be subdued.

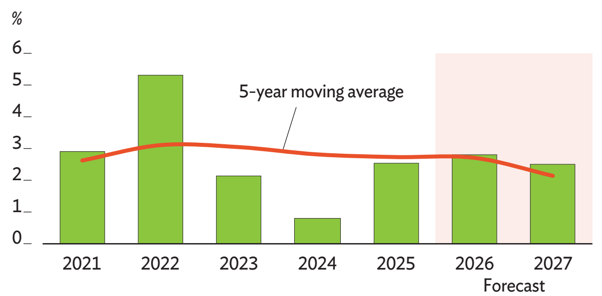
Sustaining modest growth at 0.9% in 2026 and 2027, agriculture is expected to diversify exports. Growth prospects are reinforced by rising external demand for key agricultural exports, notably rice and cashew nuts. Government initiatives support these trends by promoting sustainable, higher-quality agricultural production and the economic reintegration of returning migrant workers. Continued inflow of FDI into agriculture is expected to bolster productivity and support growth in 2026–2027.

Inflation is projected to edge up in 2026 before moderating in 2027, but like for GDP growth, the projection is subject to a very high degree of uncertainty (Figure 2.21.5). Anticipated increases in international fuel prices following conflict escalation in the Middle East are expected to push inflation to 2.8% in 2026, before it eases to 2.5% in 2027. The National Bank of Cambodia's continued focus on maintaining exchange rate stability will help contain inflation expectations and bolster confidence in the riel.

The budget deficit is expected to widen modestly in 2026 (Figure 2.21.6). The fiscal deficit is projected to rise marginally to equal 3.8% of GDP as spending outpaces weakened revenue amid slowing economic growth. Higher expenditure includes rising defense spending and expanded social assistance for households affected by the border disruptions.

Figure 2.21.5 Inflation

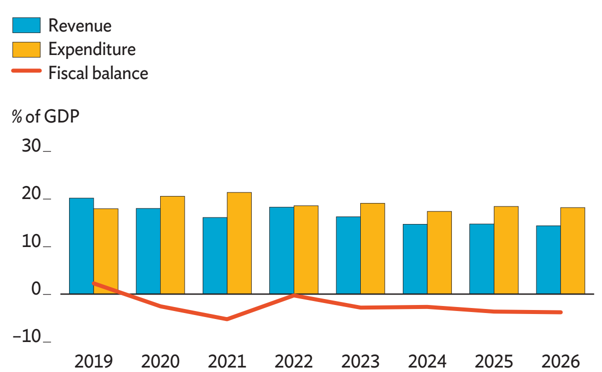
Inflation is projected to rise in 2026 following conflict in the Middle East before moderating in 2027.



Sources: National Institute of Statistics; Asian Development Bank estimates.

Figure 2.21.6 Fiscal Indicators

The fiscal deficit is expected to widen modestly in 2026 as growth slows and revenue weakens.



GDP = gross domestic product.

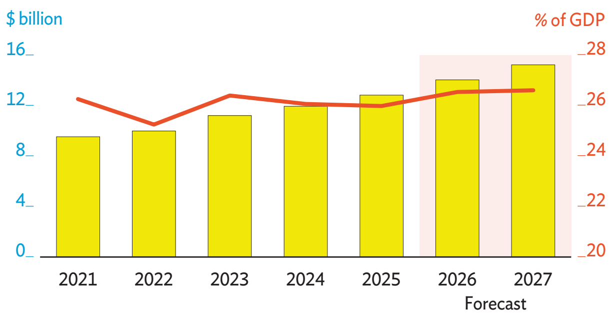
Sources: Ministry of Economy and Finance; Asian Development Bank estimates.

To finance the gap, the government plans to borrow approximately $2.2 billion externally and $0.5 billion domestically, with additional financing likely to come from drawdown of government deposits. The authorities intend to balance near-term support for vulnerable groups with medium-term fiscal sustainability to enable response to future shocks.

Cambodia remains at low risk of debt distress. Public external debt is projected to edge up slightly to $14.0 billion in 2026 and $15.2 billion in 2027, or from 26.5% of GDP to 26.6% (Figure 2.21.7). The government plans to issue up to $528 million in bonds in 2026, over four times the amount in 2025, to finance public investment projects.

Figure 2.21.7 Public External Debt

Public external debt remains sustainable and at low risk of debt distress.



GDP = gross domestic product.

Sources: Ministry of Economy and Finance; Asian Development Bank estimates.

The current account deficit is expected to widen to 6.9% of GDP in 2026 before narrowing in 2027. The wider deficit in 2026 reflects further decline in remittance inflow and a persistent merchandise trade deficit, as imports of raw materials and capital goods for FDI financed production continue to outpace exports. Buoyant FDI inflow should cover the current account deficit and boost international reserves to about $29.6 billion by the end of 2027, sufficient to cover 7.1 months of imports.

Risks to the outlook tilt strongly to the downside. Renewed border disruptions would exacerbate adverse impacts on tourism, agricultural production, and domestic demand. Any unexpected delay in reintegrating returned migrants could further dampen household incomes and consumption. High private debt and rising nonperforming loans may heighten financial vulnerability for firms and households, weakening growth. Higher-than-expected commodity price increases from a prolonged Middle East conflict would add inflationary pressure and constrain economic activity. To mitigate this downside risk, the government has introduced relief measures, including fuel subsidies and tax cuts, tighter fuel market oversight, public-sector energy-saving measures, and contingency pricing. Extreme weather could disrupt agriculture and damage infrastructure. On the upside, effective reintegration of returned workers into the domestic labor market could support consumption, while government initiatives to expand direct flights may stimulate tourism.

Policy Challenge—Public–Private Partnership for Skills Development

Cambodia aspires to achieve high-income status by 2050. Reaching that goal will require annual GDP growth of over 7% for the next 2 decades. Commensurately strong growth was achieved in the 2 decades before the pandemic, but growth since then has averaged closer to 5% per year.

A key constraint on accelerating growth is weak human capital. Labor productivity remains far below that of regional peers, and enterprise surveys indicate a persistent skills gap. A 2024 assessment by the European Chamber of Commerce in Cambodia found that 74% of companies are challenged to find qualified employees. This is a symptom of weak alignment of education, training systems, and labor market needs.

Technical and vocational education and training institutes are essential for supporting livelihoods. These institutes are at the forefront of government efforts to reskill hundreds of thousands of migrant laborers returning from Thailand in the second half of 2025. A long-standing issue, though, is that employers report that institute graduates lack job-ready skills, especially in construction, manufacturing, and agro-processing.

Unlocking the full potential of Cambodia's young workforce requires innovation. The country needs an ecosystem approach to skills development that links public education and the private sector. In 2023, the government operationalized the Skills Development Fund to incentivize private sector investment in workforce skills. Building on this progress, it introduced in 2025 a system led by the private sector to assess and recognize prior learning, enabling some 10,000 experienced workers to obtain certification. An improved regulatory framework that allows public training institutions to codesign and deliver industry-responsive training programs with the private sector would strengthen skills development. Increased private sector participation in skills development would allow public resources to focus on foundational and transferable skills.

In the longer term, a labor force with better skills would attract more diverse FDI. The availability of skilled workers is a key consideration behind FDI decisions, according to the World Investment Report 2025 from the United Nations Conference on Trade and Development. A virtuous cycle of workforce upskilling and investment attraction would ultimately support Cambodia's shift from labor-intensive FDI to higher-value investment, boosting sustainable and equitable economic growth.

INDONESIA

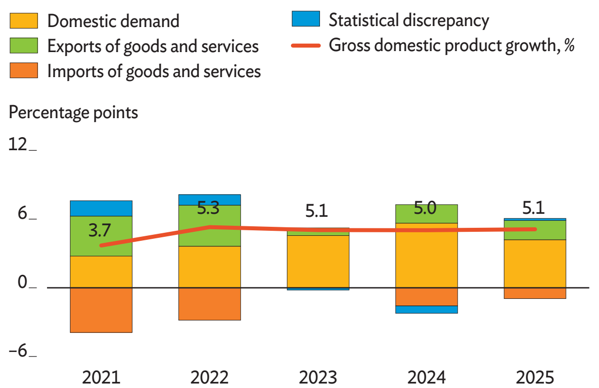
Despite a difficult global environment, GDP grew by 5.1% in 2025 on resilient domestic demand and contained inflation. Under this report's early stabilization scenario, GDP is projected to grow by 5.2% in 2026 and 2027 on improving investment and steady consumption. Inflation expectations should remain well anchored within the target range. Risks to the outlook increase with a prolonged conflict in the Middle East. Sustaining long-term inclusive growth requires stronger formal job creation.

Economic Performance

GDP growth edged up in 2025 on the back of resilient domestic demand. The economy expanded by 5.1% in 2025, up from 5.0% in 2024, with domestic demand remaining the main driver (Figure 2.22.1). After averaging around 5.0% in the first three quarters of 2025, growth accelerated to 5.4% year on year in the fourth quarter—its strongest expansion since the post-pandemic rebound in the third quarter of 2022. The pickup reflected firmer household spending and strengthening investment activity.

Figure 2.22.1 Demand-Side Contributions to Growth

Resilient domestic demand underpinned growth in 2025.



Source: Haver Analytics.

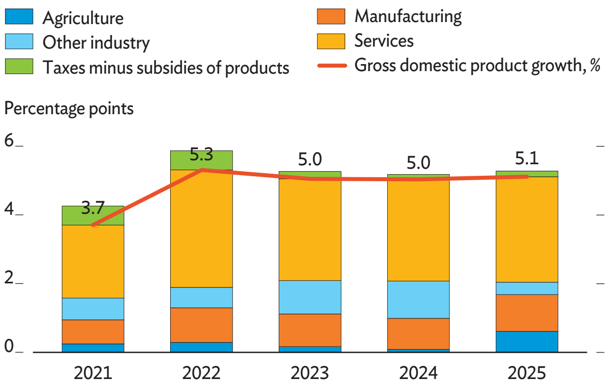
Private consumption remained the backbone of the economy and was central to the year-end acceleration. Private consumption grew by 5.1% in 2025 from 5.0% in 2024, strengthening toward the end of the year amid holiday-season spending. Government support focused on household-targeted measures, fiscal stimulus, and incentives. The gradual expansion of the Free Nutritious Meals (Makan Bergizi Gratis (MBG)) program and internship support for young workers helped sustain household resilience and wage income, reinforcing consumption momentum. In contrast, government consumption slowed to 2.5% in 2025 from 6.6% in 2024 on the unwinding of election-related spending and efficiency measures.

Investment strengthened. Gross fixed capital formation strengthened to 5.1% in 2025 from 4.6% in 2024, driven primarily by a sharp acceleration in machinery and equipment investment, which rose by 18.0%. Vehicle investment also recovered, expanding by 5.2% after contracting in 2024. By contrast, construction investment moderated to 3.3%, while inventory accumulation eased following a strong buildup in 2024, as stock and inventory levels normalized. On the supply side, growth remained underpinned by resilient domestic demand (Figure 2.22.2). Services expanded by 6.3% and remained the main contributor to overall growth, supported by trade, transport, hospitality, and information and communications. Agricultural output rebounded, growing by 5.3% after a weak 2024, while manufacturing grew by 5.3%.

This chapter was written by Reza Anglingkusumo and Priasto Aji of the Indonesia Resident Mission, ADB, Jakarta.

Figure 2.22.2 Supply-Side Contributions to Growth

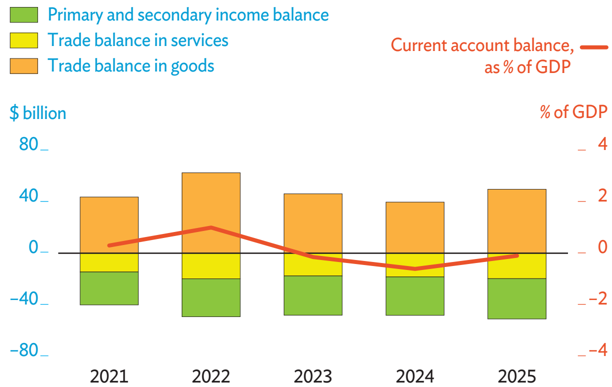
The supply side expanded in tandem with domestic demand.



Source: Haver Analytics.

Figure 2.22.3 Current Account Balance

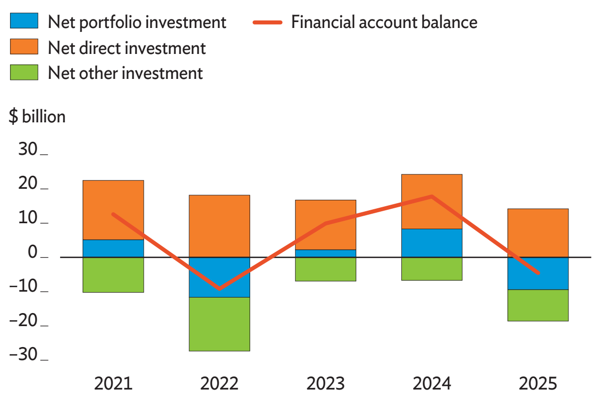
The current account deficit narrowed.



Source: Haver Analytics.

Figure 2.22.4 Financial Account Balance

The challenging external environment weighed on capital flows.



Source: Haver Analytics.

Net exports were positive. Real exports increased by 7.0% in 2025 from 6.5% in 2024, supported by shipments to the United States, Europe and ASEAN markets. Meanwhile, real imports grew by a more moderate 4.8%, down from 8.0% in 2024, reflecting base effects from strong election-related demand the previous year. As a result, net exports made a positive contribution to overall growth.

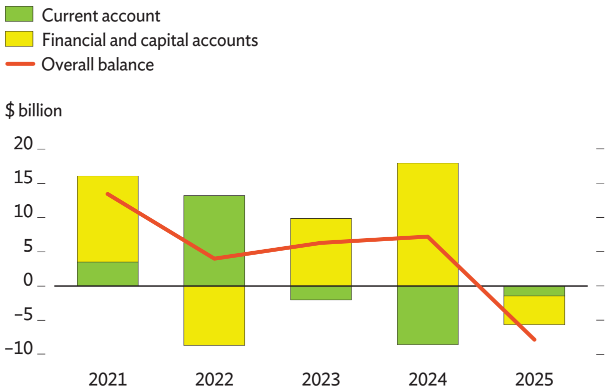
The improvement in net exports was reflected in a stronger current account. The current account deficit narrowed to 0.1% of GDP in 2025 from 0.6% in 2024, as a larger goods surplus partially offset higher services and income outflows (Figure 2.22.3). The merchandise trade surplus increased to $49.8 billion from $39.8 billion in 2024, with export growth accelerating to 6.6% as import growth moderated to 3.3%. Commodity prices remained below their 2022 peak and broadly stable, indicating that the stronger goods balance was also driven by real export growth. Larger imports reflected continued demand for capital and intermediate goods, consistent with firmer investment. The services deficit widened slightly despite a stronger travel surplus, while the primary income deficit increased due to higher payments on direct and portfolio investment income.

The financial account shifted to a net outflow in 2025, reversing the 2024 surplus. It registered a net outflow of $4.5 billion compared with a $17.7 billion surplus in 2024, reflecting a reversal in portfolio flows despite continued solid direct investment (Figure 2.22.4). Net portfolio investment showed a $9.4 billion outflow compared with an inflow of $8.2 billion in 2024 amid changing global financial conditions and portfolio rebalancing. By contrast, net direct investment remained positive at $14.1 billion. Other investments recorded a larger net outflow of $9.1 billion, reflecting movements in loans, deposits, and trade credits. Overall, financial flows in 2025 were more volatile than in 2024, with stable direct investment helping to cushion portfolio-related outflows.

The overall balance of payments recorded a $7.8 billion deficit in 2025, reversing the $7.2 billion surplus in 2024 (Figure 2.22.5). The improved current account was more than offset by net financial outflows, reflecting portfolio reversals and larger outflows from other investments. Gross international reserves reached $156.5 billion at year-end, equivalent to 6.2 months of imports and official external debt

Figure 2.22.5 Balance of Payments

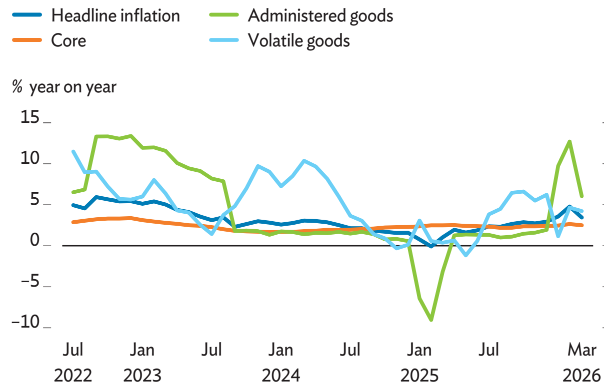
The overall balance of payments deficit remained manageable.



Source: Haver Analytics.

Figure 2.22.6 Inflation

Inflation remained well anchored within the official target range.



Source: Haver Analytics.

repayments, indicating continued adequate external buffers. The rupiah depreciated moderately and orderly during the year.

Inflation remained within the official target range. Headline inflation averaged 1.9% year on year in 2025, down from 2.3% in 2024. The moderation reflected lower administered prices and softer volatile food inflation, which helped contain overall price pressures despite strong domestic demand. Core inflation edged up from 2024, signaling resilient consumption, but remained consistent with well-anchored inflation expectations within the 2.5% ± 1% official target range. Inflation picked up in early 2026. The rebound in administered inflation in early 2026 pushed headline inflation above the target range. However, it reflected base effects from the 50% electricity tariff discount introduced in early 2025. Inflation moderated in March 2026, as these base effects began to unwind, bringing headline inflation back toward the target range. Core pressures, however, remained stable (Figure 2.22.6).

With inflation contained and expectations well anchored, monetary policy eased in 2025. Bank Indonesia, the central bank, reduced its policy rate by a cumulative 150 basis points since September 2024, bringing it to 4.75% amid benign inflation risks. Easing was accompanied by improved liquidity conditions, with M2 growth rebounding and deposit growth recovering from earlier weakness. This indicated a gradual transmission of lower policy rates to domestic financing conditions. Accommodative macroprudential measures complemented the easing cycle, while the central bank remained attuned to external volatility. Private sector credit growth rose from an average of 7.0% in Q3 2025 to 7.3% in Q4, and further to 8.1% in January–February 2026, driven mainly by strong investment lending. Bank Indonesia expects overall credit growth to stay in the 8%–12% range in 2026. Heightened uncertainty stemming from a prolonged conflict in the Middle East may prompt a recalibration of the central bank's policy mix in 2026 to contain spillovers from tighter global financial conditions.

Fiscal policy remained supportive in 2025. The budget deficit widened to 2.9% of GDP in 2025 from 2.3% in 2024, exceeding the initial target but remaining within the statutory 3.0% ceiling. The larger deficit partly reflected weaker revenue, as the tax ratio declined to 9.3% of GDP (from 10.1%) amid moderating domestic collections. Expenditure went toward targeted social assistance, food subsidies, and priority programs—reinforcing household purchasing power. Continued implementation of National Strategic Projects helped sustain investment momentum. Overall, fiscal policy maintained its countercyclical yet rules-based stance, supporting domestic demand while preserving fiscal discipline.

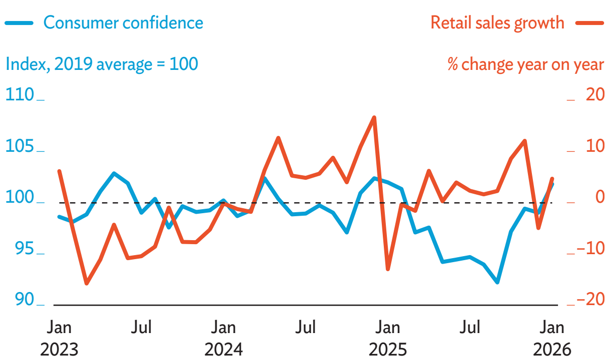
Economic Prospects

The economy gained momentum in early 2026. A combination of cyclical and policy-driven factors lifted expected growth. Improved agricultural productivity contributed to resilient rural income and food supply, providing early support to growth at the start of the year. This was reinforced by seasonal demand associated with Ramadan and Eid al-Fitr festivities in March, which lifted household consumption in food, retail, transportation, and hospitality. High-frequency indicators show continued strong consumption (Figure 2.22.7). The Purchasing Managers' Index (PMI) had been in expansion territory since the second half of 2025 and strengthened further at the start of 2026 to its fastest pace since March 2025 (Figure 2.22.8). However, the March 2026 reading showed a marked easing while remaining near the expansion threshold, pointing to possible early effects of heightened external uncertainty, particularly related to developments in the Middle East.

GDP growth is projected to rise to 5.2% in 2026 and 2027 (Table 2.22.1). Unless the conflict in the Middle East becomes prolonged and worsens,

Figure 2.22.7 Consumer Demand Indicators

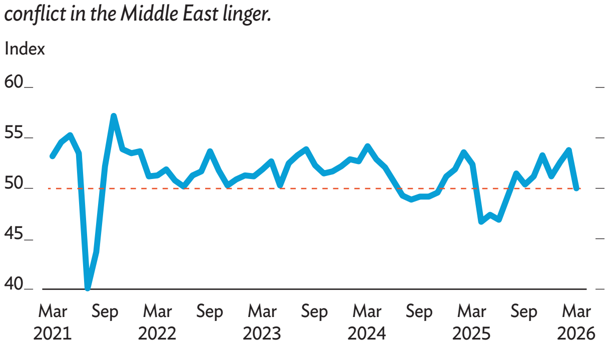
Consumer spending is gaining traction with sustained confidence.



Note: Levels above 100 indicate optimism, below 100 signal pessimism.
Source: Haver Analytics.

Figure 2.22.8 Purchasing Managers' Index

Factory activity strengthened in early 2026, although risks related to the conflict in the Middle East linger.



Note: Above 50 indicate improvement, below 50 indicate deterioration.
Source: CEIC Data Company.

Table 2.22.1 Selected Economic Indicators, %

GDP growth is projected to strengthen to 5.2% in 2026 and 2027 while inflation remains within the central bank's target range.

	2024	2025	2026	2027
GDP growth	5.0	5.1	5.2	5.2
Inflation	2.3	1.9	2.5	2.5

GDP = gross domestic product.
Sources: Central Bureau of Statistics; Asian Development Bank estimates.

early growth momentum may be sustained. Private consumption should remain resilient, underpinned by stable income growth and sustained policy support. Investment will likely improve gradually as downstream development and private participation gain more traction. Progress in mineral processing, manufacturing, and related supply chains should continue to crowd in domestic and foreign investment, supporting formal job creation. Structural reforms to strengthen the business climate together with supportive financing conditions will likely drive capital formation. Public infrastructure and strategic projects will remain important complements to private investment.

Average inflation will likely rise to 2.5% in 2026 and 2027, remaining within target. The stable price environment gives Bank Indonesia the flexibility to balance growth and stability, while continued priority spending under the 2026 budget sustains household purchasing power and investment momentum. A well-calibrated monetary policy stance together with accommodative macroprudential measures should help credit expand along with private investment.

The external sector should remain broadly balanced, with manageable current account deficits over the forecast period. Export growth may moderate given slower expansion among major trading partners, including the United States, the People's Republic of China, and euro area, along with softer commodity prices. Diversification of export markets should partially help. Import growth will likely strengthen alongside firmer domestic investment and consumption, particularly for capital and intermediate goods. Continued solid direct investment inflows are expected to help finance external gaps and support exchange rate stability.

The domestic equity market entered 2026 with sharp corrections, highlighting the need for further reforms. In late January, investment firm Morgan Stanley Capital International (MSCI) imposed an interim freeze on index rebalancing for Indonesian stocks, citing investability concerns. This triggered a sharp sell-off, halted trading, and significant repricing of stocks previously supported by index-related inflows. Market sentiment weakened further during the first quarter of 2026, as Fitch Ratings highlighted potential fiscal strains and revised their outlooks to negative while affirming the country's investment-grade ratings. Together, they amplified equity market volatility through valuation compression.

The authorities responded to the equity market volatility by expediting reforms and reaffirming their commitment to a rules-based fiscal framework. Capital-market regulators announced measures to strengthen ownership disclosure, raise minimum free-float requirements, and improve transparency of equity market data. The government also reaffirmed its commitment to fiscal discipline and accelerated reforms to systematically strengthen revenue, ensuring it would continue to adhere to the 3% of GDP deficit cap.

Fiscal policy will continue to support growth while adhering to fiscal rules amid the challenging geopolitical environment. Under this report's early stabilization scenario, the government's 2026 budget should withstand pressures and maintain its 3% of GDP legal deficit cap. The government is expected to navigate the turbulence through budget-efficiency measures, calibrated adjustments to priority programs, and proactive management of energy demand. Improvements in tax administration and compliance are projected to strengthen fiscal capacity, providing space to support priority spending while keeping the deficit within the 3 percent cap.

Spending is expected to support household purchasing power and human capital development. Priority program allocations will likely continue, reflecting the focus on human capital development initiatives. The implementation of the Free Nutritious Meals program remains central, alongside allocations for education, social assistance and protection, as well as food security. These programs will also reinforce purchasing power—particularly among lower- and middle-income households.

Risks to the outlook increase with a prolonged conflict in the Middle East. Elevated external uncertainty and slower-than-anticipated reform implementation could weigh on economic performance. Developments in the Middle East warrant close monitoring, as ensuring energy and food security remains important alongside the implementation of a sound macroeconomic policy framework. A prolonged escalation could tighten global financing conditions, disrupt global supply chains, and raise energy and other input prices, potentially moderating growth and pushing up consumer prices—thereby complicating macroeconomic policy calibration. In addition, delays in structural reform execution and weaker-than-expected revenue mobilization could dampen investor sentiment. On the upside, easing geopolitical tensions, accelerated reform momentum, strong fiscal revenue performance, continued progress in enhancing energy and food security, and further improvements in the investment climate could lift growth above the current projections. As an early response to the conflict in the Middle East, the government has implemented a coordinated set of measures to manage energy demand, preserve fiscal space through efficiency gains and calibrated adjustments to priority spending, and accelerate reforms to reduce reliance on imported fossil fuels.

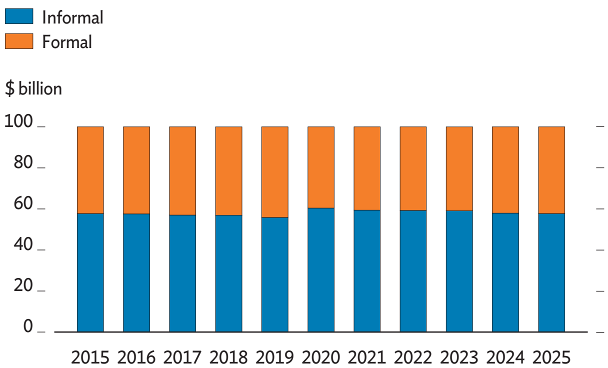
Policy Challenge—Strengthening Formal Job CreationThrough Structural Transformation

The labor market is structurally constrained in expanding formal job creation. This poses a key challenge for sustaining productivity growth and achieving Indonesia's long-term development goals. Informal employment has remained high over the past decade (Figure 2.22.9), suggesting that growth has not translated into sufficient formal job opportunities. Sectors absorbing the largest share of workers remain dominated by informal employment, while highly formalized sectors account for a relatively small share of total employment (Figure 2.22.10). This limits productivity gains and weakens structural change toward better job quality.

Demand for formal employment is concentrated in a narrow set of high-productivity sectors that require higher levels of skill and education.

Figure 2.22.9 Formal and Informal Employment Shares

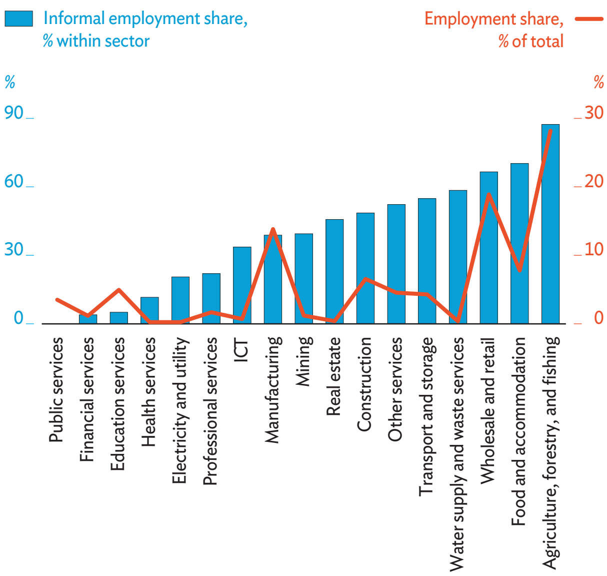
Significant informality remains a key feature of the labor market



Source: National Labour Force Survey (Sakernas) 2024, Statistics Indonesia.

Figure 2.22.10 Employment Share and Informal Employment Shares by Sector, 2024

Sectors with the large employment shares are also those with higher informality.



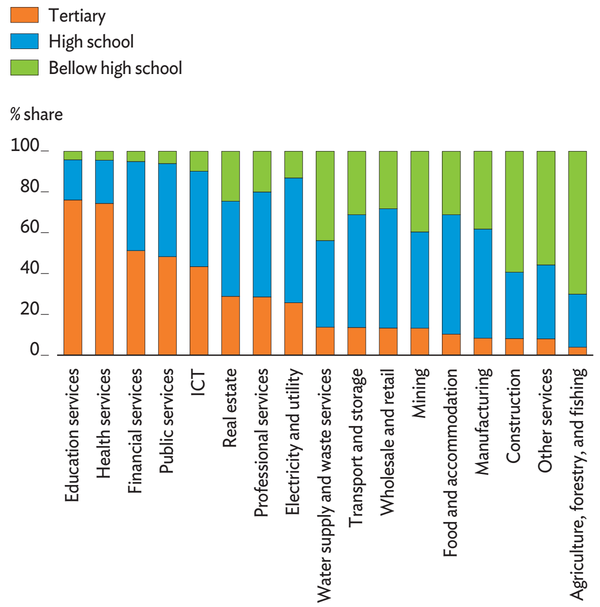
ICT = information and communication technology.

Source: National Labour Force Survey (Sakernas) 2024, Statistics Indonesia.

This contributes to the concentration of workers in lower-productivity roles. Sectors with high informal employment tend to absorb workers with less education, exacerbating the challenge to formal employment (Figures 2.22.11 and 2.22.12). Moreover, demand for routine tasks has declined for all workers alongside a gradual shift toward nonroutine cognitive and interpersonal tasks (Figure 2.22.13). The shift is more pronounced among formally paid employees,

Figure 2.22.11 Educational Composition Within Formal Employment by Sector, 2024

Formal employment is concentrated among higher-educated workers.

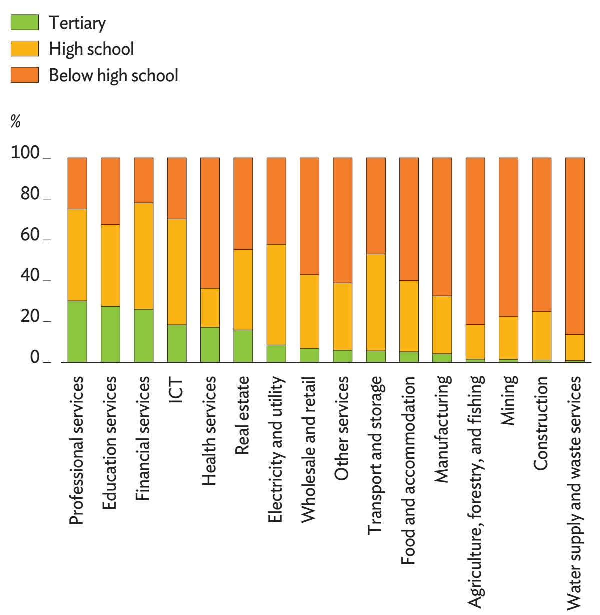


ICT = information and communication technology.

Source: National Labour Force Survey (Sakernas) 2024, Statistics Indonesia.

Figure 2.22.12 Educational Composition of Informal Employment by Sector, 2024

Informal employment is dominated by workers with less education.



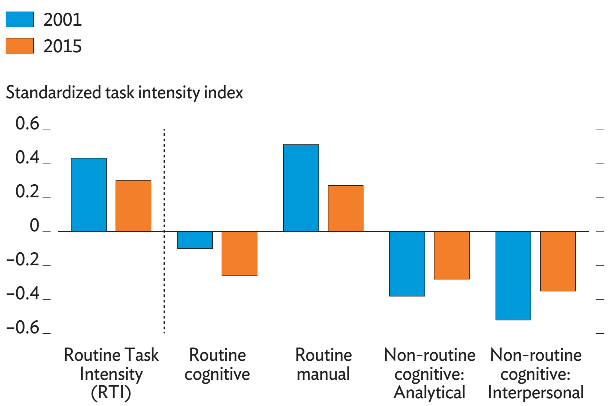
ICT = information and communication technology.

Source: National Labour Force Survey (Sakernas) 2024, Statistics Indonesia.

suggesting stronger demand for nonroutine skills in formal employment. However, the expansion of higher-value cognitive roles remains modest, pointing to persistent constraints in science, technology, engineering, and mathematics (STEM) education and interpersonal skills, as well as limited diffusion of more productive jobs across sectors.

Figure 2.22.13 Routine Task Intensity in Formal Labor Market by Type of Occupation (Paid Employees)

Formal employment is marked by a shift away from routine tasks reflecting stronger demand for higher-educated workers with nonroutine skills.



Notes: Routine task intensity is calculated as routine content minus nonroutine content. Routine tasks include routine cognitive and manual tasks, while nonroutine tasks include nonroutine cognitive analytical and nonroutine cognitive interpersonal tasks. Positive values indicate above-average task intensity, while negative values indicate below-average intensity.

Source: Adapted from A. A. Yusuf and Putri R. Halim. 2023. Indonesia: Employment and Inequality Trends. In C. Gradin et al., eds. *Tasks, Skills, and Institutions: The Changing Nature of Work and Inequality*. Oxford University Press.

Stronger formal employment growth in manufacturing is critical to support an inclusive structural transformation. While agriculture continues to absorb a large employment share, it remains characterized by low productivity and high informality (Figure 2.22.10). Similar patterns are in wholesale and retail trade, transportation, and other services, where informal employment continues to dominate. In contrast, sectors with higher skill demand and productivity account for a smaller share of total employment. This suggests that labor reallocation has lagged, with workers shifting more into low-productivity services than into higher-productivity sectors. As a result, productivity growth and gains are limited.

The government should continue to support inclusive and sustainable growth through coordinated labor market policies. Policies should continue to prioritize improving the labor market by strengthening job matching and certification systems, enabling workers to transition from declining routine occupations into emerging nonroutine roles, particularly in formal employment. Expanding access to quality secondary and vocational education, as well as STEM education, is welcomed as this would develop an adaptable workforce, alongside targeted reskilling and retraining programs that support worker mobility. Also, industrial and investment policies should continue to promote the expansion of labor-intensive manufacturing and other higher-productivity sectors that can absorb workers transitioning out of informal activities. This requires strengthening the investment climate, regulatory certainty, and logistics performance to lower costs, enhance competitiveness, and incentivize firms to expand and formalize employment.

LAO PEOPLE'S DEMOCRATIC REPUBLIC

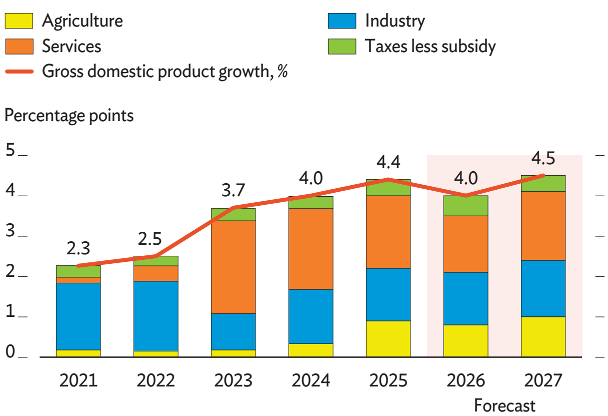
Growth strengthened in 2025, supported by services, electricity generation, and construction. Fiscal and monetary tightening brought inflation down into single digits and created a fiscal surplus. The external position improved amid stronger export and tourism receipts. However, external buffers remain limited and public debt vulnerabilities persist. Growth is constrained by heightened external risks and structural weaknesses, underscoring the importance of continued state-owned enterprise (SOE) reform, particularly in the power sector, to safeguard fiscal sustainability and medium term growth.

Economic Performance

The economy strengthened in 2025 despite persistent structural challenges. Growth expanded after gradual stabilizing during the last quarter of 2024. Real GDP grew by an estimated 4.4% in 2025, supported by expanding services (especially tourism, transport, and logistics) steady electricity generation from favorable hydrology, and growth from construction and agriculture (Figure 2.23.1). The good performance reflects the broader pattern of recovery since 2023, when easing border restrictions, normalized travel, and enhanced connectivity—especially through the Lao PDR–PRC railway—began to attract increased transport flows, merchandise exports, and visitor arrivals.

Figure 2.23.1 Supply-Side Contributions to Growth

Tourism, transport, and logistics services drove growth.



Source: Asian Development Bank estimates.

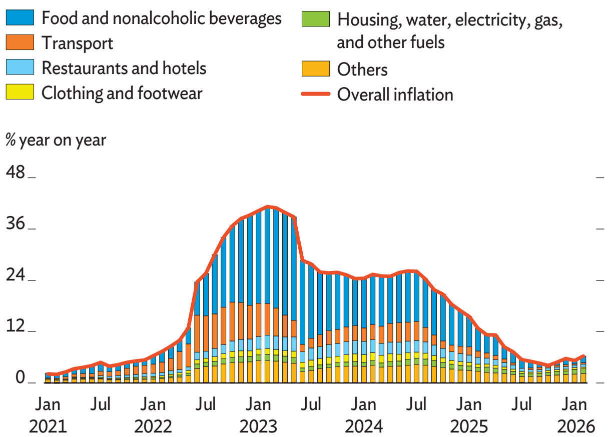
With fiscal and monetary tightening, inflation fell into single digits. The annual inflation rate declined sharply to 7.7% in 2025 from 23.1% in 2024 and 31.2% in 2023 (Figure 2.23.2). Average inflation during January–October 2025 was 8.5%, easing further to 4.0% in October but rising to 5.6% in December, driven by electricity tariff adjustments and strengthening domestic demand. Core inflation remained elevated due to structural cost pressures and high import dependence. However, moderating global fuel and food prices helped reduce imported inflation. Following prolonged currency depreciation—during which the kip lost about half its value against the US dollar in 2022 and a further 16.3% in 2023—depreciation eased to 4.8% in 2024. In 2025, the exchange rate stabilized with the kip appreciating by a modest 0.6% (Figure 2.23.3). However, it depreciated 7.2% against the Thai baht. The overall improvement, however, is also attributable to better cash management following the introduction of the Treasury Single Account and regulatory measures that improved foreign exchange availability.

Services expanded by 5.2%, remaining the dominant driver of growth. Foreign tourist arrivals increased by over 11.2% to 4.6 million in 2025, aided by better regional mobility, the effectiveness of Visit Laos

This chapter was written by Kavita Iyengar and Soulinthone Leuangkhamsing of the Lao PDR Resident Mission, ADB, Vientiane.

Figure 2.23.2 Monthly Inflation

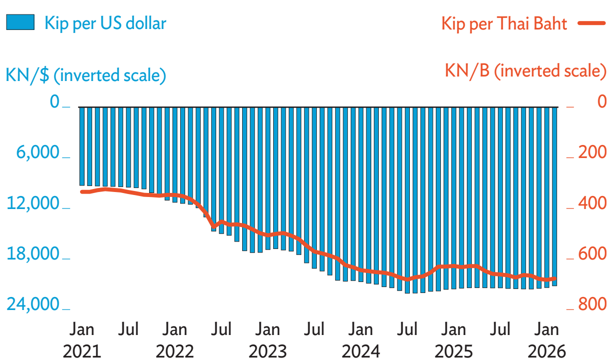
Inflation slowed as the kip stabilized.



Source: Lao Statistics Bureau.

Figure 2.23.3 Lao Kip Exchange Rate

The kip stabilized in the fourth quarter of 2024 amid tightened monetary policy.



US = United States.

Note: Based on the average rate of the kip per US dollar and Thai baht at the commercial bank official rate.

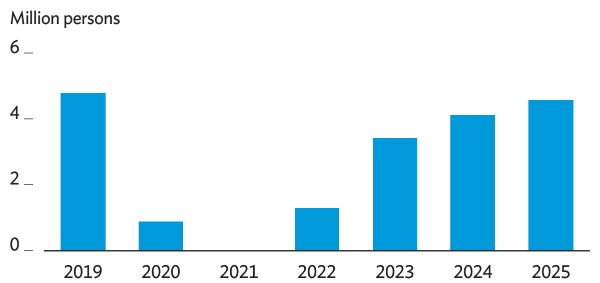
Source: Bank of the Lao PDR.

promotional campaigns, and the continuing recovery of tourism from neighbors Thailand, Viet Nam, and the People's Republic of China (Figure 2.23.4). Logistics and transport services expanded by 10.3% from high use of the cross-border railway and stronger demand for intraregional goods trade.

Manufacturing remained robust, driven largely by export-oriented production of electrical components and agro-processing. Persistent labor shortages, linked partly to outward migration, constrained recovery among certain subsectors. Electricity production benefited from strong rainfall

Figure 2.23.4 Tourist Arrivals

Tourist arrivals were close to pre-pandemic levels.



Source: Ministry of Information, Culture, and Tourism.

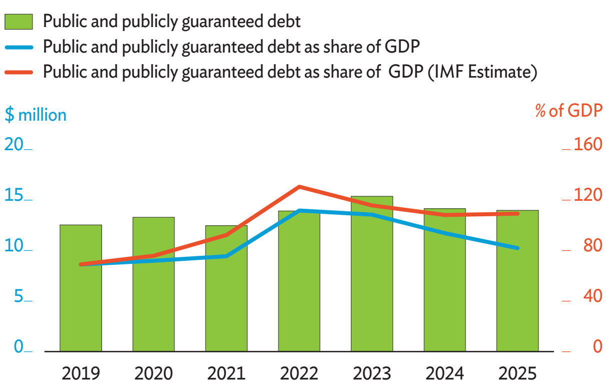
and the completion of new hydropower capacity, while power exports to Thailand and Viet Nam remained robust. Electricity output increased by 6.5% over 2024 to 536,370 million kilowatt hours (kWh). Despite high global commodity prices, mining output, particularly gold and copper, declined due to lower ore grade and tighter environmental controls on new exploration. Domestic consumption remained soft due to high prices for essential goods, currency depreciation effects, and reduced purchasing power.

Agricultural output expanded by 2.9% in 2025, supported by rising demand for non-rice crops as well as continued growth in fisheries and livestock production. However, performance remained constrained by persistent structural challenges—including weather variability, limited irrigation coverage, and rising labor costs—which weighed on productivity gains. More broadly, economic growth in 2025 was largely externally driven, underscoring both the opportunities created by deeper regional integration and the heightened vulnerabilities associated with reliance on commodity exports, tourism inflows, and external financing. These dynamics highlight the importance of strengthening domestic productive capacity and resilience to external shocks.

Fiscal performance improved in 2025, though public debt continues to be unsustainable. Stronger revenue mobilization, improved tax administration, the reinstated value-added tax, and cautious expenditure control—supported by revenue from higher electricity exports, tourism, and mining—created a fiscal surplus. Social and capital spending remained subject to limited fiscal space. Public and publicly guaranteed debt remained unsustainably high at 94% of GDP in 2024, and an estimated 82% for 2025, weighed down by large foreign-currency exposure, legacy arrears, and continued reliance on deferrals and restructuring (Figure 2.23.5). Risks are amplified by sizable contingent liabilities from SOEs—particularly Electricité du Laos (EDL), which faces below-cost tariffs, weak operations, and long-term power purchase agreement obligations—alongside off-budget public–private partnership commitments. While progress was made on debt transparency and the preparation of the 2026–2030 Medium-Term Debt Management Strategy, high external debt service obligations through 2027 will continue to constrain fiscal space and limit room for countercyclical policy.

Figure 2.23.5 Public and Publicly Guaranteed Debt

Public debt remained unchanged, while declining in percent of GDP.

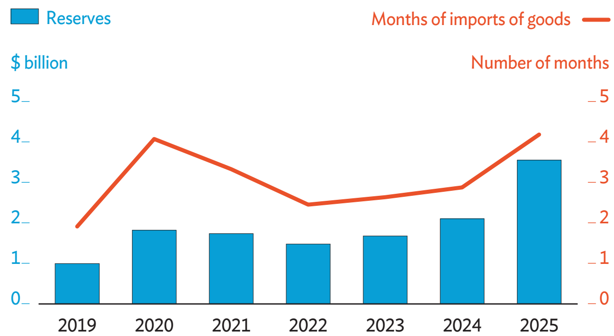


GDP = gross domestic product, IMF = International Monetary Fund.
Sources: Ministry of Finance; Asian Development Bank estimates.

The external position strengthened as the current account surplus increased. The increase was driven by strong electricity and mineral exports, recovering tourism receipts, and expanding transport services. These inflows more than offset external debt service payments, allowing foreign exchange reserves to rebuild. Gross international reserves reached $3.5 billion, equivalent to 4.2 months of imports in December 2025, up from $2.1 billion and about 2 months of imports cover in 2024 (Figure 2.23.6). Improved terms of trade, stronger regional demand, ad hoc debt-service deferrals from major creditors, and enhanced foreign-exchange management contributed to the recovery. Dollarization gradually declined, supported by exchange-rate stabilization, tighter monetary conditions, and improved foreign-exchange availability (Figure 2.23.7). Nonetheless,

Figure 2.23.6 Foreign Exchange Reserves

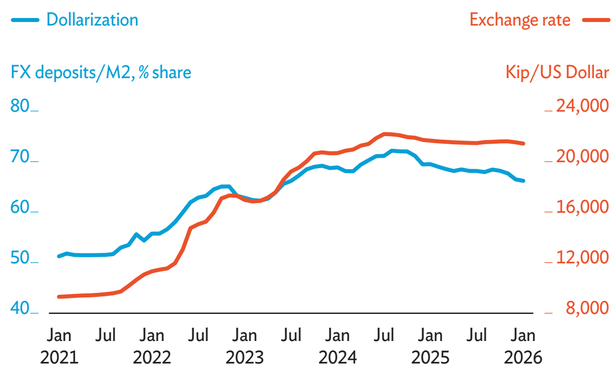
Reserves benefited from a large current account surplus.



Source: Bank of the Lao PDR.

Figure 2.23.7 Dollarization

Dollarization slowly declined.



FX = foreign exchange, M2 = broad money, US = United States.
Source: Bank of the Lao PDR.

the exchange rate remains vulnerable to sentiment-driven shifts amid high import dependence and limited export diversification.

Economic Prospects

The outlook has weakened amid elevated external risks even as domestic stabilization efforts continue. Growth is forecast to slow down to 4.0% in 2026 and 4.5% in 2027 (Table 2.23.1). Global uncertainty following the conflict in the Middle East has already begun to affect trade, financing conditions and investor confidence. Connectivity and energy still provide buffers. Regional tourism and freight movement, supported by the Lao PDR–PRC railway, along with foreign direct investment in clean energy, will underpin growth, partially offsetting weaker global

Table 2.23.1 Selected Economic Indicators, %

Moderate growth should continue and inflation increases.

	2024	2025	2026	2027
GDP growth	4.0	4.4	4.0	4.5
Inflation	23.1	7.7	9.8	6.7

GDP = gross domestic product.
Sources: Lao Statistics Bureau; Asian Development Bank estimates.

demand. Increased exports of electricity, minerals, and agricultural products should offset import demand. Fiscal consolidation and tight monetary policy are expected to continue.

Near-term inflation risks have increased. After easing sharply in 2025, inflationary pressures have reemerged, driven by spillovers from higher global oil prices, transport costs, and the related pass-through to food and other imported goods. Inflation is projected to reach 9.8% in 2026 and 6.7% in 2027. Upward pressures in 2026 also derive from electricity tariff adjustments and increases in public wages. A cautious monetary policy stance is projected to continue, including measures to limit broad money (M2) growth, increasing reserves to cover 5 months of imports, and further tightening the use of foreign currency in domestic transactions.

Fiscal policy will remain tight with a high public debt burden and increased vulnerability. The 2026 budget targets a surplus of 0.5% of GDP, with revenue projected to rise by 20.0% to 83.6 trillion kip and expenditure by 19.5% to 81.4 trillion kip. Revenue gains are expected from tax policy reforms and better administration, including the removal of tax and customs exemptions that conflict with existing laws along with higher excise taxes on selected goods—such as fuel-powered vehicles. However, the conflict in the Middle East will raise fuel-related costs and slow activity, weighing on revenue performance. Elevated debt servicing costs and rising civil servant wages will continue to test fiscal sustainability and limit public investment, particularly in social sectors.

Services may benefit from regional connectivity and tourism, but growth momentum is normalizing. Driven by tourism and logistics, services should grow by 4.2% in 2026 and 5.2% in 2027. Broader improvement in transport connectivity is expected to strengthen connectivity to regional travel markets. International tourist arrivals were projected to rise by 7.1% in 2026 but will be impacted by the global slowdown. The hospitality industry will likely benefit from sustained investment in tourism-related infrastructure, particularly the development of new hotels and accommodation.

Electricity generation, renewables, and mining continue to drive growth. Industry is expected to expand by 4.6% in 2026 and 5.2% in 2027, driven largely by continuing investments in power generation and resource extraction. There are currently more than 11 energy projects under development, with a combined installed capacity of 9,129 megawatts, including major hydropower projects such as Pak Lay, Pak Beng, and Luang Prabang, as well as the Xekong thermal power project. These large-scale investments will also have positive spillovers on construction, boosting activity and employment in the medium term.

Agriculture faces mounting climate-related challenges that impact productivity and food security. Expected El Niño conditions in 2026 will likely bring drought and heatwaves alongside heightened flood risk. Agricultural growth is projected to slow to 2.3% in 2026 and 2.2% in 2027, though livestock and fisheries will expand. The structural slowdown is due to climate pressures, labor shortages, and rising costs, further dampening farmer incentives to increase investment.

The trade surplus will narrow as higher energy and transport costs raise import values. Strong exports and lower external debt service supported a sizable trade and current account surplus, while international reserves improved, providing a short term buffer against external volatility. Export values for electricity, minerals, and agricultural products are forecast to rise by 6.0%. In addition, foreign direct investment in large energy projects will drive capital goods imports. As a result, the trade surplus should reach 6.5% of GDP in 2026 and 6.6% in 2027 with the current account surplus expected to narrow to 3.6% of GDP in 2026 and 4.3% in 2027.

Risks are tilted on the downside, shaped by a volatile global environment and persistent domestic constraints. Weaker growth in neighboring markets will dampen tourism, logistics, and commodity demand, although better-than-expected rainfall could support agriculture and hydropower output. Price pressures will intensify if exchange-rate strains reappear or budget discipline slips, highlighting the importance of maintaining a careful policy mix. Domestically, high debt, limited reserve buffers, and incomplete reforms continue to restrain confidence and investment. Constraints on external refinancing and ongoing liquidity pressures in the banking system will slow private-sector activity, while SOEs also face refinancing pressure. Maintaining stability will require renewed reform momentum, including comprehensive SOE reforms, especially at EDL, alongside fiscal consolidation that protects social spending.

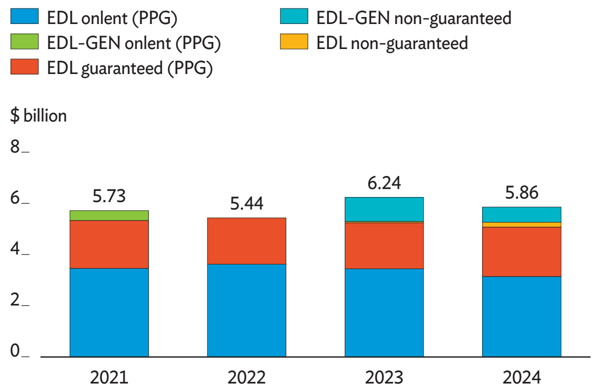
Policy Challenge—SOE Reform in the Power Sector

SOE reform remains critical to macroeconomic recovery and in managing fiscal vulnerabilities. Large SOEs continue to generate sizable contingent liabilities, amplifying public debt risk and constraining fiscal space. Among SOEs, EDL is the most significant source of systemic risk, given its scale, foreign currency exposure, and long-standing quasi-fiscal role. It underscores the need to move beyond short-term liquidity management toward more sustainable corporate reforms that strengthen governance, transparency, and financial discipline, all while safeguarding the provision of essential services. In parallel, advancing the transition to cleaner transport fuels can help reduce exposure to imported fuel price shocks and support broader decarbonization objectives.

EDL entered the current reform phase as a major source of macro-fiscal stress following years of underpricing, weak financial transparency and controls, and substantial borrowings. EDL's debt burden is a key contributor to public and publicly guaranteed debt, exacerbated by large foreign-currency-denominated borrowings and opaque power purchase agreements (Figure 2.23.8). The absence of cost-reflective tariffs—combined with extensive take-or-pay contractual obligations and arrears from public-sector customers—has undermined EDL's financial position and transferred risks to the sovereign balance sheet (Figure 2.23.9). These challenges highlight the urgency of separating EDL's social obligations from its commercial operations and clarifying the fiscal cost of public service delivery.

Figure 2.23.8 Électricité du Laos (EDL)-linked Debt Breakdown

EDL's debt burden is a key contributor to public and publicly guaranteed debt.



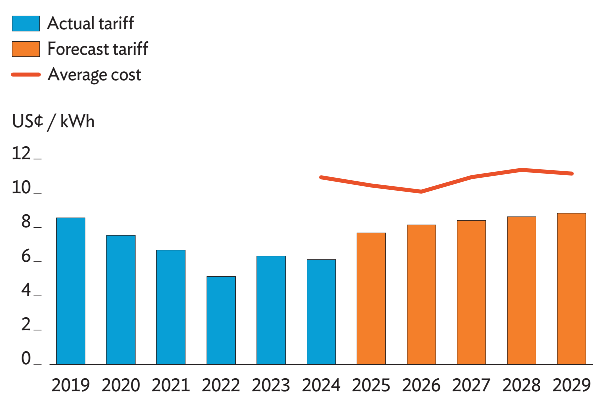
PPG = public and publicly guaranteed.

Note: EDL accounts for ~36–39% of total PPG over 2021–2024.

Source: Ministry of Finance, Public and Publicly Guaranteed Debt Statistics Bulletins (various issues).

Figure 2.23.9 Électricité du Laos (EDL) Tariffs Versus Cost Recovery Benchmark

Electricity tariffs remain below cost-recovery, constraining EDL's financial sustainability.



kWh = killowatt-hour, US = United States.

Note: A numeric cost recovery (breakeven) tariff benchmark is only available for recent reform years (2024–2025). For earlier years, no benchmark is shown—contemporaneous EDL, Asian Development Bank, and World Bank sources say tariffs were below cost recovery, but they do not publish a quantified breakeven tariff. EDL's average domestic tariff fluctuated across 2010–2025 between 6.77 and 8.69 US¢/kWh. In 2025, the approved average tariff (7.76 US¢/kWh) remained below the projected breakeven supply cost (10.43 US¢/kWh), leaving a 2.67 US¢/kWh gap.

Source: Asian Development Bank estimates from EDL data.

Recent reforms are initial steps toward stabilization. Since 2025, EDL has announced organizational and financial restructuring plans, including liability reprofiling that reduced near-term debt servicing pressures, selective cost-containment measures, and ways to strengthen revenue collection. The establishment of EDL Transmission as a separate entity was intended to ring-fence high-voltage assets and related liabilities. However, it also added complexity to sector governance and to transparency of funds flows. While these measures move beyond incremental changes, they remain at an early stage and have yet to demonstrate any sustained balance sheet recovery and improvements in the power sector.

Structural risks remain substantial. EDL's currency mismatch (kip revenues versus foreign-currency debt) leaves it highly exposed to depreciation. Opaque legacy power purchase agreements constrain operations and can generate off-peak losses, while uncleared public-sector arrears perpetuate circular debt. Addressing these risks will require sustained political commitment, contract renegotiation, and stronger cross-policy coordination.

Looking ahead, the medium-term strategy aims to place EDL on a path toward financial recovery by 2030. Key policy pillars include gradual tariff adjustments toward cost-reflective pricing while protecting vulnerable households, tighter limits on new government guarantees for SOE borrowing, and improved corporate governance frameworks to shield commercial decisions from administrative interference. Planned legal reforms—including a new state enterprise reform law—intend to strengthen accountability, transparency, and harden budget constraints across SOEs. Successful implementation of these reforms would significantly reduce contingent liabilities, enhance fiscal sustainability, and support more resilient, inclusive growth.

MALAYSIA

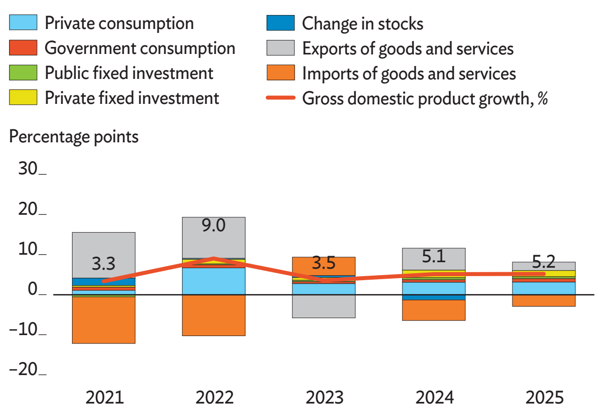
The economy outperformed 2025 projections despite global trade uncertainties, driven in part by resilient consumer and investment spending. Inflation slowed on lower energy and import prices. GDP is forecast to grow moderately in 2026 and 2027 amid a softer external environment. Inflation will likely edge up as the impact of domestic policy reforms takes effect. To support long-term competitiveness, labor will need to upskill and restructure to transition to higher-value-added production.

Economic Performance

GDP growth inched up to 5.2% in 2025 from 5.1% in 2024 despite a tumultuous external environment (Figure 2.24.1). Robust domestic demand sustained growth, helped by a broad-based expansion across sectors. Private consumption rose by 5.2% from 5.1% in 2024, while government consumption jumped by 6.6% from 4.7%. Household spending remained resilient, supported by a favorable labor market, government assistance, and moderate inflation. The unemployment rate declined further, from 3.0% to 2.9% in November 2025. Additional policy measures, such as increasing the minimum wage from RM1,500 to RM1,700, raising civil servant salaries, and providing direct cash aid, also strengthened household spending.

Figure 2.24.1 Demand-Side Contributions to Growth

Robust consumption, investment, and exports sustained growth.



Source: Haver Analytics.

Investment remained robust, though down from 2024. Private investment rose by 9.4% in 2025, down from 12.3% in 2024, while public investment eased to 10.3% from 11.1%. Net foreign direct investment reached RM53.5 billion in 2025, supported largely by services inflows, specifically the information and communications technology (ICT) and financial and insurance subsectors. Approved investments also continued to grow, rising to RM285.2 billion between January and September 2025, up 13.2% over the same period in 2024.

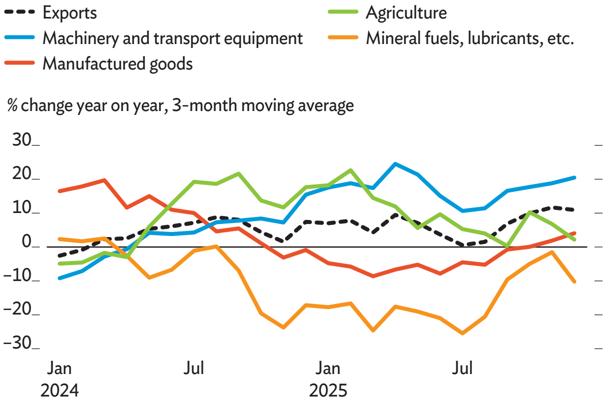
Exports remained resilient despite global tariff volatility (Figure 2.24.2). Exports increased by 3.1% with strong demand from Taipei,China (31.2%); the United States (US) (17.2%); European Union (EU) (11.5%); Hong Kong, China (8.4%); and Singapore (8.1%). Exports of manufactured goods increased by 7.7% with agricultural goods up by 5.7%, driven by high export growth in machinery and equipment, electrical and electronics, and palm-oil products. Imports rose by 4.6% on a surge in capital goods imports, which increased by 29.1%. With import growth outpacing exports, the trade balance declined by 19.3%, after growing by 9.2% in 2024.

Construction continued double-digit growth in 2025, supported by strong data center demand and public infrastructure (Figure 2.24.3). It grew by 12.2%, following a strong 17.5% expansion in 2024.

This chapter was written by James Villafuerte of the Southeast Asia Department (SERD), ADB, Manila, and Mae Hyacinth Kiocho, SERD consultant.

Figure 2.24.2 Merchandise Exports

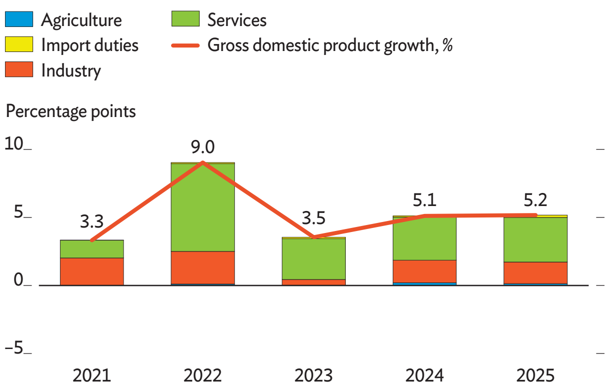
Exports grew despite volatile global trade policies.



Source: Haver Analytics.

Figure 2.24.3 Supply-Side Contributions to Growth

Construction, services, and manufacturing fueled growth.



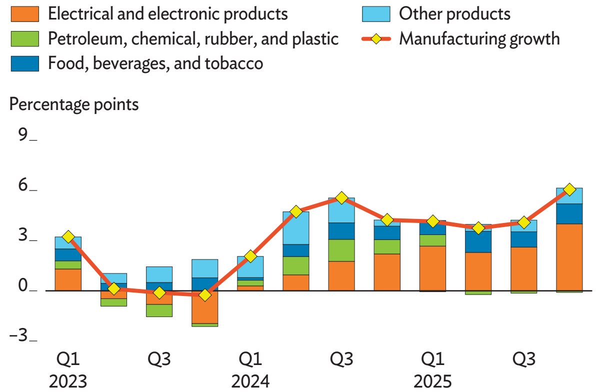
Source: Haver Analytics.

Construction in 2025 was valued at RM178.6 billion, up 12.5% from 2024. Private sector construction grew by 15.7% with public works up by 7.2%. Momentum was further supported by regional developments in Johor and Sabah, particularly major infrastructure projects tied to the Johor–Singapore Special Economic Zone and the Pan Borneo Sabah Highway.

Services grew by a steady 5.5% and manufacturing by 4.5%. Services expanded mainly from stronger consumer- and tourism-related activities, with accommodation growing by 14.1% and transport and storage by 8.6%. Tourist arrivals rose by 6.4% compared to 2024, driven by increased visitors from the People's Republic of China and India following visa-free entry. Additional gains came from other services, including ICT-related segments, supported by new data center

Figure 2.24.4 Contributions to Manufacturing Growth

Manufacturing grew from a recovery in electrical and electronics and large gains in vegetable and animal oils and food processing.



Q = quarter.
Source: Haver Analytics.

operations, such as real estate (9.3%), business services (7.8%), and information and communications (6.2%). Manufacturing was lifted by the recovery in electrical and electronics, which accelerated to 9.6% from 3.4% in 2024. Other manufacturing subsectors also did well, including vegetable and animal oils, beverages, and food processing (Figure 2.24.4).

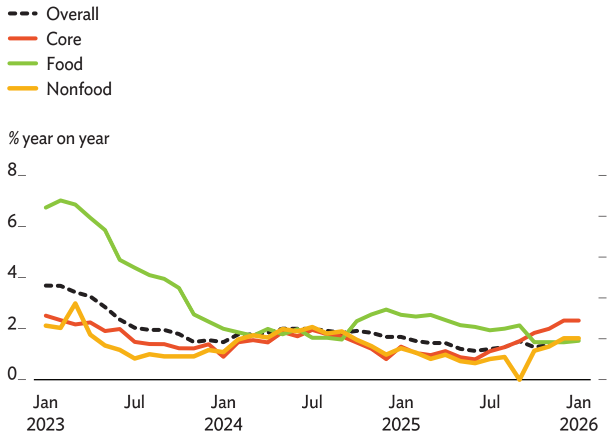
Agriculture grew by a modest 2.2% with mining up by 0.7%. Expansion in rubber, oil palm, and livestock supported agricultural growth. Despite a drop in natural gas production, mining and quarrying was bolstered by increased crude oil and other mining and quarrying output.

Inflation eased to 1.4% in 2025, down from 1.8% in 2024, largely due to slower price increases in non-food commodities and services (Figure 2.24.5). Communication and electricity, gas, and other fuel costs fell notably. Inflation also moderated across health, recreation, sports and culture; transport; and household furnishings and routine items. Food and beverage inflation remained at 2.0%. Core inflation, however, edged up slightly to 2.0% from 1.8%. Inflation began 2026 at a higher level, posting 1.6% in January, driven by rising non-food commodity prices. Core inflation also increased to 2.3%.

The central bank lowered the monetary policy rate to support growth amid high external uncertainty. In July 2025, the monetary policy rate was decreased

Figure 2.24.5 Monthly Inflation

Inflation slowed, driven by lower electricity and fuel prices.



Source: Haver Analytics.

to 2.75% after holding at 3.00% since 2023 to support the domestic economy given uncertain tariffs and geopolitical tensions (Figure 2.24.6).

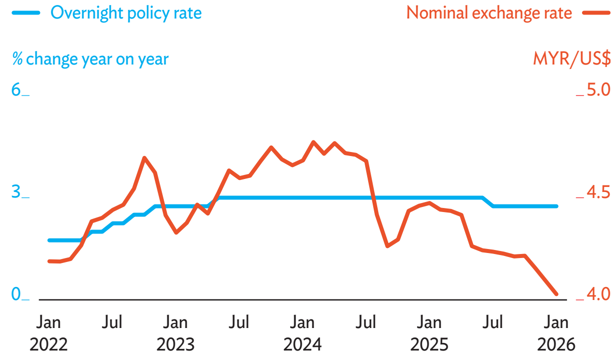
The ringgit gained strongly against the US dollar in 2025. The currency appreciated from RM4.47 per US dollar at the end of 2024 to RM4.06 per US dollar at end-2025. It strengthened further to RM3.88 per US dollar in February 2026. The rise was driven by a weaker US dollar and reinforced by a resilient, stable domestic economy.

The government remained on course for fiscal consolidation, with the deficit for the first 9 months of 2025 below target. The fiscal deficit fell to RM49.8 billion in the third quarter of 2025 from RM58.2 billion a year earlier. A 6.7% increase in revenue outpaced the 2.1% rise in operating expenditure and a 3.9% increase in net development spending. The resulting fiscal deficit through September 2025 was 3.3% of GDP, below the 3.8% full-year target (Figure 2.24.7).

External debt reached 68.9% of GDP at the end of 2025 (or RM1.4 trillion), down from 69.9% at the end of 2024. In dollar terms, outstanding external debt at end-December 2025 was 3.3% higher than at end-December 2024. The rise came from larger loans and nonresident holdings of domestic debt securities. International reserves rose to $126.9 billion at end-January 2025, an import cover ratio of 4.8 months, below the 5.2 months 2024 average.

Figure 2.24.6 Monetary Policy

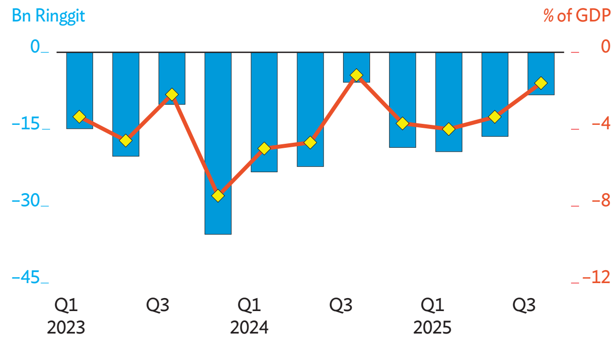
The central bank reduced the monetary policy rate slightly to support growth given the uncertain external environment.



MYR = Malaysian ringgit, US = United States.
Source: Haver Analytics.

Figure 2.24.7 Federal Government Fiscal Deficit

The fiscal balance improved through higher tax revenue and subsidy rationalization.



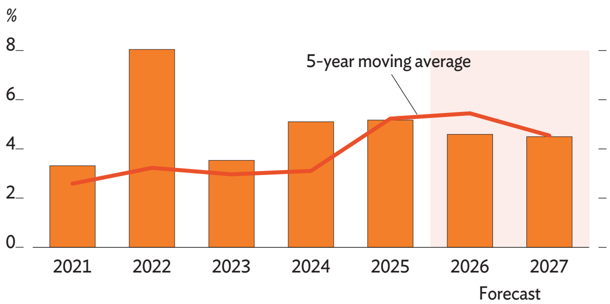
Bn = billion, GDP = gross domestic product, Q = quarter.
Source: Haver Analytics.

Economic Prospects

Growth is projected to soften in 2026 before picking up modestly in 2027. The delayed effects of tax reforms and restrictive trade measures introduced in 2025 will likely weigh on the economy in the near term. By 2027, although external challenges may persist, planned initiatives under the 13th Malaysia Plan should support growth. The 13th Malaysia Plan sets out the country's medium-term vision, prioritizing higher-value economic sectors. The shift is supported by substantial RM611.0 billion in investment. GDP is forecast to grow by 4.6% in 2026 and 4.5% in 2027 with significant downside risks in the event of a prolonged Middle East conflict (Table 2.24.1 and Figure 2.24.8).

Figure 2.24.8 Gross Domestic Product Growth

Growth will likely moderate due to a slowdown in global trade.



Source: *Asian Development Outlook* database.

Table 2.24.1 Selected Economic Indicators, %

GDP is forecast to grow slower, while inflation is expected to rise.

	2024	2025	2026	2027
GDP growth	5.1	5.2	4.6	4.5
Inflation	1.8	1.4	1.8	1.9

GDP = gross domestic product.
Sources: Department of Statistics Malaysia; Asian Development Bank estimates.

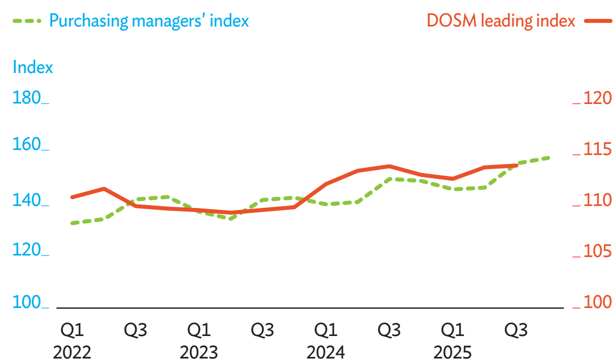
Domestic consumption should remain resilient, though some downside risks persist. Continued growth in employment and income levels will support household spending. The government has also introduced measures to stimulate consumption, including Phase Two of civil service salary adjustments under the Public Service Remuneration System, along with the SARA Bulanan and SARA Untuk Semua programs, which provide eligible beneficiaries RM50 to RM200. However, concerns remain that higher prices, partly from the delayed effects of the 2025 expanded Sales and Services Tax, may constrain discretionary spending. Also, higher oil prices stemming from the Middle East conflict have increased the government's fuel subsidy burden, prompting the government to reduce the monthly subsidized quota from 300 liters to 200 liters per citizen.

Growth in services will be supported by a continued expansion in tourism, reinforced by government initiatives. Building on a strong 2025, the government aims to attract 47 million visitors through its Visit Malaysia 2026 campaign. Domestic tourism is also encouraged by a special income tax deduction of up to RM1,000 for Malaysians traveling within the country.

The business outlook remains cautiously optimistic. Following the mid-2025 volatility, conditions have stabilized and sentiment has improved, with firms reporting renewed production activities and more manageable costs (Figure 2.24.9). The first quarter 2026 Business Tendency Survey showed optimism would continue into 2026. While external developments may pose new uncertainties, government measures are in place to help mitigate risks. These include an additional RM2.5 billion allocated to the central bank's Small and Medium Enterprise fund, as well as the planned transition toward RM10 billion in guaranteed financing.

Figure 2.24.9 Business Activity Indicators

Improving conditions bolster business sentiment.



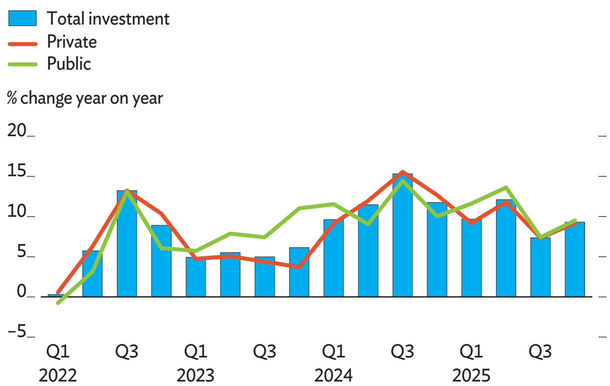
DOSM = Department of Statistics Malaysia, Q = quarter.
Notes: For the PMI, a reading above 100 indicates expansion, below 100 contraction. For the leading index, a value above 100 indicates that economic conditions are above the long-term trend, below 100 indicates conditions below trend.
Sources: Department of Statistics Malaysia; Haver Analytics.

The rise in construction and investment will likely continue this year. Demand for data centers remains strong, with the industry projecting the country's data center capacity to double by the end of 2026. Also, a rise in demand for water-related projects is expected. Ongoing public infrastructure projects and planned regional development will continue, such as the Penang Export Expansion, the Pan Borneo Highway, the Johor-Singapore Economic Zone, and development projects in Sarawak and Sabah, with each region receiving at least RM6.0 billion under the 2026 budget (Figure 2.24.10).

Exports may face headwinds from global developments. The country's technology sector should benefit from broad-based recoveries in artificial intelligence (AI), automotive, industrial, and consumer electronics, with the Semiconductor

Figure 2.24.10 Investment Growth

Both public and private investment will continue with projects across sectors.



Q = quarter.
Source: Haver Analytics.

Industry Association forecasting a 26% increase in global semiconductor sales in 2026. On the downside, growth in electrical and electronics exports may be constrained by the 25% US tariff on AI chips introduced in January.

Inflation will remain manageable. Thus far, pass-through effects from fiscal policy reforms have been contained. Some upward pressures may be driven by tariff adjustments and the delayed impact of the higher sales and services tax. Additionally, rising oil prices may raise production costs and eventually lead to higher prices for goods. Inflation is projected at 1.8% in 2026 and 1.9% in 2027 (Table 2.24.1).

The ringgit is expected to strengthen, averaging slightly above RM4.00 per US dollar. An appreciating ringgit reflects stronger confidence in the domestic economy and investment climate. For domestic-driven sectors, a stronger ringgit can reduce import costs. However, it may pose challenges for export industries where revenues are largely denominated in US dollars.

External factors continue to pose the greatest downside risks to the outlook. Geopolitical tensions and shifts in trade policies could disrupt global trade flows and weaken demand. Growth prospects may be affected if major trading partners experience slower-than-expected growth. The Middle East conflict may have a mixed impact on Malaysia's economic outlook. Higher oil prices arising from the Middle East conflict may support Malaysia's oil commodity exports. However, persistently elevated oil price can raise the cost of goods, potentially dampening consumption and production activities.

Policy Challenge—Strengthening the Workforce for Sustainable High-Income Growth

To escape the middle-income trap, the country is realigning its growth model toward the digital transformation, green technology, and advanced manufacturing. Harnessing the full potential of emerging technologies and sustainable practices require a highly skilled workforce to maximize productivity gains, foster continuous innovation, and sustain competitiveness in an increasingly dynamic global economy.

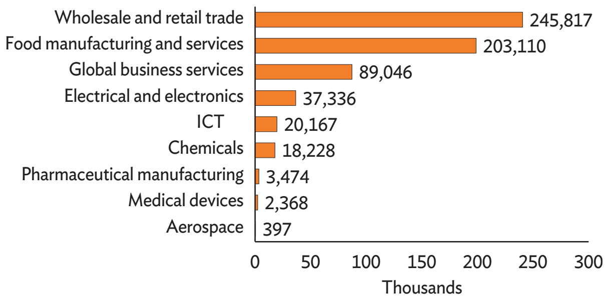
In response to the rising demand for skilled workers, the labor market is targeting to increase its share of highly skilled workers to between 35% and 45% by 2030. The target is supported by five main strategies: (i) releasing the National Human Resources Policy Framework (2024–2030), a strategic blueprint to build a high-skilled workforce; (ii) expanding technical and vocational education and training; (iii) encouraging regional governments to set their own highly-skilled workforce targets; (iv) strengthening private sector partnerships and encouraging investments in training local workers; and (v) reducing dependence on low-skilled foreign labor through automation. The government has also committed RM740 billion under the "Ekonomi Madani" Budget 2026 to support a future-ready workforce, including a targeted RM7.9 billion for technical and vocational education and skills development in high-growth sectors.

Transforming the workforce must overcome constraints such as skills gaps, job mismatches, demographic pressures, the persistence of informal work, the brain drain, low female participation, and slow technology adoption. The rise of AI heightens certain vulnerabilities, with routine and manual jobs most at risk. AI adoption favors firms with greater resources, leaving micro, small, and medium enterprises at a competitive disadvantage.

Automation and digitalization are phasing out many low-skill jobs while simultaneously creating new, higher-value employment opportunities in advanced industries. According to a study by Talent Corporation Malaysia Berhad, an estimated 620,000

Figure 2.24.11 Estimated Number of Employees Impacted by Automation and Digitalization

Employment in services will likely be affected by automation and digitalization.



ICT = information and communications technology.

Source: Ministry of Human Resources and TalentCorp Group of Companies. 2025. *Impact Study of Artificial Intelligence, Digital, and Green Economy on the Malaysian Workforce*.

jobs, or 18% of the formal workforce, are at risk of displacement over the next 3 to 5 years due to rapid technological advances (Figure 2.24.11).

Skills are the foundation of the digital-green transition. However, persistent skills gaps remain a significant problem. In the third quarter of 2025, around 35.5% of tertiary graduates were underemployed, creating a risk of underutilized human capital in low-productivity roles. Despite widespread internet access, there remains a deficit in advanced digital competencies, with training costs a major deterrent to upskilling. Some micro, small and medium-sized enterprises have also resisted advanced technologies due to financial constraints, talent scarcity, and limited digital infrastructure.

The large number of informal workers weakens the capacity to sustain productivity growth and foster innovation. Informal workers lack social protection, regular income, and are often exposed to hazardous working conditions. Limited access to training and upskilling opportunities restricts informal workers from moving into higher-value-added roles.

The ageing population is reshaping workforce dynamics, with far-reaching implications for building a high-skilled labor force. The declining share of young workers limits the supply of talent for high-skill roles, while retirement among older workers may slow economic growth unless offset by productivity gains.

Low female labor force participation remains a critical barrier to building a strong, high-skilled workforce. Despite women comprising the majority of university graduates—particularly in science, technology, engineering, mathematics, and other professional fields—many leave the workforce due to caregiving responsibilities and workplace constraints. This underutilization of educated women reduces the supply of high-skilled professionals in the economy.

The country has a long brain drain history. Over the past half century, around 1.9 million Malaysians (5.6% of the population) have moved abroad to seek employment, affecting local industries such as semiconductors, engineering, and information technology.

To develop a resilient, highly skilled workforce, the country needs a comprehensive strategy to overcome structural constraints. Strengthening industry-education partnerships is critical to address the skills gap. Integrating internships and apprenticeships can bridge the gap between theory and practice. Courses on soft skills such as critical thinking, communication, teamwork, and leadership can ensure graduates are technically proficient and workplace-ready. Incorporating micro, small and medium-sized enterprises into workforce development ensures they benefit from the same talent upskilling as larger firms. Expanding public-private partnerships to help fund training programs will ensure affordability and better alignment with market demand. Introducing tax incentives and government subsidies can encourage employers to invest in their employees. Complementing these measures with targeted scholarships and flexible learning pathways, particularly for women and informal workers, will ensure vulnerable sectors have equitable access to training opportunities. Targeted communication campaigns through social media, community centers, and local government offices can help promote training opportunities, particularly among rural populations. Developing competitive career pathways and expanding opportunities for advancement can help curb the brain drain. Providing incentives and relocation support can encourage those already abroad to return. Integrating digital literacy training into mid-career and pre-retirement programs will ensure older workers sustain their productivity.

MYANMAR

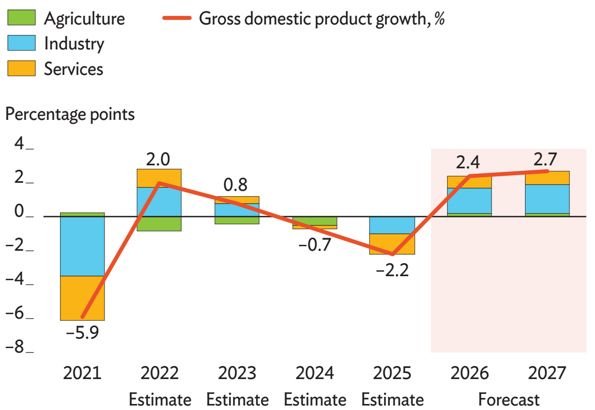
The economy contracted further in 2025 from persistent security issues, macroeconomic instability, and the destructive March earthquake. Despite the highly uncertain outlook and significant downside risks, a modest recovery is likely over the forecast period. Inflation remains high. The rising cost of living and overlapping shocks require coordinated measures to protect livelihoods and strengthen resilience.

Economic Performance

Continued instability and the devastating March 2025 earthquake deepened the economic contraction. GDP declined by a further 2.2% in fiscal year 2025 (FY2025, ending 31 March 2026), following a 0.7% contraction in FY2024 (Figure 2.25.1). The earthquake disrupted major business sectors, worsening conditions amid ongoing conflicts. Agriculture contracted 0.2% from the instability, high input costs, labor shortages, and poor logistics as extreme weather continued to reduce output. Industry fell 2.7% from capital constraints, weak investment, and supply disruptions. Services declined 2.8%, affected by lower household consumption and high inflation.

Figure 2.25.1 Supply-Side Contributions to Growth

A modest broad-based recovery is expected over the forecast period.



Note: Years are fiscal years ending 31 March of the following year.
Sources: Central Bank of Myanmar; Asian Development Bank estimates.

Inflation remained high despite a moderate decline. Headline inflation fell to 25.2% in FY2025 from 29.6% in FY2024 on stricter price controls and a more stable exchange rate. In the first quarter of FY2025, food inflation fell to 25.3% from 30.1% a year earlier, driven by tighter food price controls and gradually easing domestic trade disruptions. This was partially offset by increased non-food inflation, up 26.1% from 22.8%, mainly due to persistent price pressures on health, housing, utilities, and household equipment and maintenance.

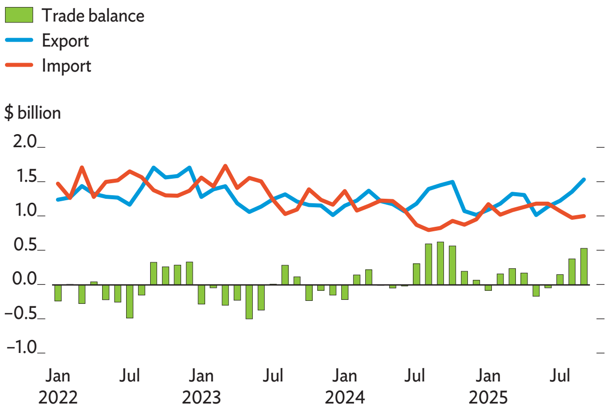
Merchandise trade improved. Trade surged by 11.2% in the second quarter of FY2025 compared to the same period in FY2024, partly on global frontloaded trade orders (Figure 2.25.2). Textiles, garments, and mining products helped drive growth, while imports rose on earthquake-related reconstruction. Under an export-first policy and stricter import controls, a $304.9 million trade surplus was recorded in October 2025. Consequently, the current account likely reached a modest surplus of 1.2% of GDP in FY2025, down from 4.8% in FY2024. There were few foreign direct investment commitments. As of December 2025, it was 90.6% below the precrisis level.

The fiscal deficit likely widened on additional spending for earthquake-recovery efforts. Following the March 2025 earthquake, a MK2.8 trillion recovery

This chapter was written by Eve Cherry Lynn of the Myanmar Resident Mission, ADB, Nay Pyi Taw. Effective 1 February 2021, ADB placed a temporary hold on sovereign project disbursements and new contracts in Myanmar.

Figure 2.25.2 Trade Performance

The trade balance was in surplus.



Source: CEIC Data Company.

program was announced, including MK700 billion in concessional loans to affected businesses and MK2.1 trillion in direct household support. Revenue collections were strong, rising by 3.2% of GDP in FY2025 compared to the previous year, partially offsetting the higher spending. Nevertheless, the fiscal deficit is expected to increase to 4.0% of GDP in FY2025 from 2.8% of GDP in FY2024.

Economic Prospects

The economy should recover yet remain weak amid continued uncertainty. Based on the early-stabilization scenario, growth is forecast to rebound to 2.4% in FY2026, driven by a moderate increase across sectors and post-earthquake reconstruction (Table 2.25.1). Industrial output should expand by 4.2% on steady demand in processing and manufacturing, particularly textiles and garments, and increased construction. Mining will likely pick up on strong global demand. Despite inflation risks, services is projected to grow by 1.6% on higher demand fueled by remittances and international assistance. Inward remittances surged nearly tenfold in June 2025 compared with June 2024, providing critical support to household incomes (Figure 2.25.3). Agriculture should grow by a modest 1.0% on reduced rural conflict, the timely arrival and distribution of monsoon rains, less extreme weather, improved supplies and logistics, and the full resumption of cross-border trade. Still, elevated energy costs and supply chain disruptions stemming from the current Middle East conflict could weigh heavily on the near-term growth outlook across all real sectors.

Table 2.25.1 Selected Economic Indicators, %

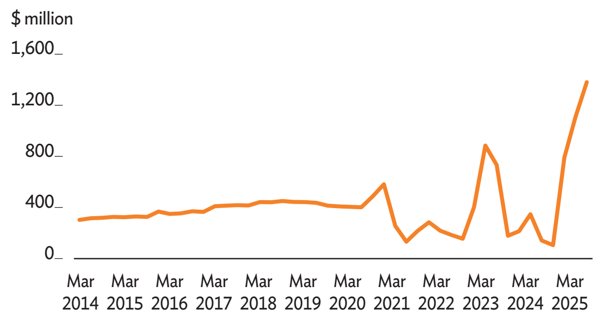
Growth will recover slowly while inflation remains high.

	2024	2025	2026	2027
GDP growth	−0.7	−2.2	2.4	2.7
Inflation	29.6	25.2	24.0	16.0

GDP = gross domestic product.
Note: Years are fiscal years ending 31 March of the following year.
Sources: Central Bank of Myanmar; Asian Development Bank estimates.

Figure 2.25.3 Remittances

Remittance inflows increased sharply, supporting domestic consumption.



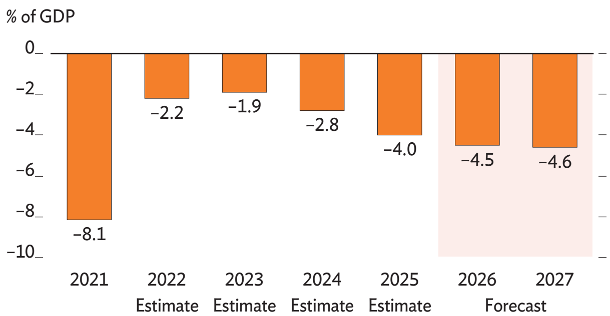
Source: CEIC Data Company.

Inflation is expected to remain elevated amid intensified risks to the outlook. Supply constraints driven by trade disruptions and tighter import controls continue to limit market availability, while post-earthquake reconstruction demand is expected to exert additional near-term pressure on prices. Risks to the outlook stem from unfavorable changes in trade policy, the size of administered energy tariff adjustments, uncertainty from persistent political unrest, and additional measures to reduce the fiscal deficit. In addition, the current conflict in the Middle East is raising energy prices and could further increase imported inflationary pressures in the near term.

The external current account will likely be in deficit. The Purchasing Managers' Index has been expansionary, underpinned by higher new orders, suggesting healthy exports. But imports will also likely rise as demand for imported post-earthquake reconstruction materials grows. Consequently, the current account deficit is projected to reach 2.2% of GDP in FY2026 and 3.0% in FY2027.

Figure 2.25.4 Fiscal Balance

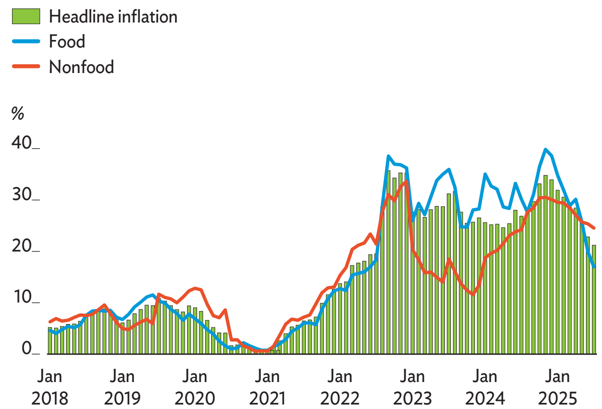
The fiscal deficit will likely remain sizable as spending pressures continue.



GDP = gross domestic product.
Note: Years are fiscal years ending 31 March of the following year.
Sources: Central Bank of Myanmar; Asian Development Bank estimates.

Figure 2.25.5 Food and Non-Food Inflation

Persistently high inflation underscores the need to cushion adverse impacts.



Source: CEIC Data Company.

Fiscal policy will continue to lead toward gradual economic growth. Tax and non-tax revenues should increase as economic and trade activity improves. However, the fiscal deficit is projected to widen to 4.5% of GDP in FY2026 and 4.6% in FY2027 as planned spending, particularly for reconstruction, will likely outpace revenue growth (Figure 2.25.4).

Risks to the outlook remain firmly on the downside. Political uncertainty persists, particularly around the electoral process, and continues to undermine business confidence, macroeconomic resilience, and stability. Increased geopolitical tensions, including the conflict in the Middle East, could further disrupt trade and undermine external accounts and economic growth. Also, high exposure to natural hazards poses significant risks, as severe disasters could substantially disrupt economic activity and strain already limited fiscal and institutional capacity.

Policy Challenge—Easing the Rising Cost of Living Amid Polycrisis

Inflation has become a growing concern. Inflation has been on an upward trend since 2022, reaching 25.2% in 2025, driven by a sharp rise in both food and non-food prices (Figure 2.25.5). Between 2022 and 2025, food inflation averaged 26.7%, with staples such as rice, meat, eggs, and edible oil prices rising significantly. Non-food inflation has steadily increased, driven by higher costs for healthcare, housing, and transport. It averaged 27.6% in the first half of 2025, up from 27.4% in 2024, significantly up from 4.4% in 2021. Prices for health services surged most, rising to 30.5% in the first half of 2025 from 11.4% in the first half of 2024. Supply constraints, including trade disruptions, import restrictions, and earthquake impacts contributed to these increases. Housing was also heavily affected, with material and maintenance costs jumping by an average 44.7% from 20.8% over the same period.

Expensive essential goods aggravate a worsening socioeconomic situation. While inflation affects the entire economy, it disproportionately impacts marginalized and displaced populations, deepening vulnerability and widening inequality. Persistently high inflation severely erodes household purchasing power, as prices continue to outpace wage growth. Many households resort to negative coping strategies, impacting nutrition, wellbeing, and future human capital. Rising health and education costs have sharply reduced access to essential services. With an estimated 4.8 million people in 2025 requiring education support, a large share of youth is missing out on learning or training opportunities. Humanitarian needs remain high, with millions requiring health and nutritional assistance.

Addressing inflation requires a multidimensional approach. Approaches can range from protecting livelihoods through targeted social protection and livelihood support to broader macroeconomic reforms that sustain purchasing power and economic resilience. A supply-side focus is critical: restoring and improving domestic food production and distribution, stabilizing the exchange rate, and ensuring smooth trade flows can relieve price pressures. Targeted support for vulnerable households delivered through humanitarian and community channels can cushion social impacts, while enhanced coordination across policy agencies and improved price monitoring will strengthen responses to ongoing inflationary pressures.

PHILIPPINES

Growth will remain subdued amid heightened risks from the ongoing Middle East conflict. Inflation is projected to rise this year from a 2025 low of 1.7% amid the surge in global commodity prices. Price pressures are expected to subside in 2027, supporting a rise in domestic demand and growth. Policy measures that promote lifelong learning are critical to strengthen human capital and inclusive growth.

Economic Performance

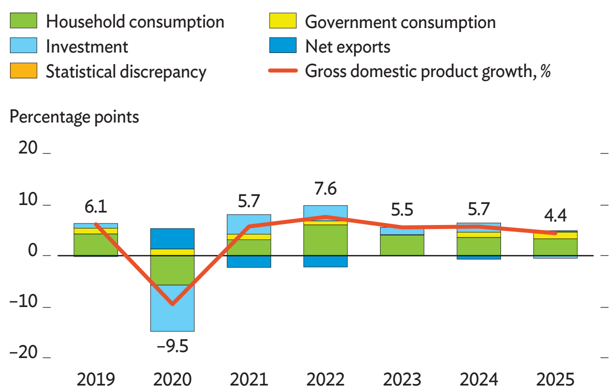
GDP growth decelerated to 4.4% in 2025 from 5.7% in 2024, largely due to a contraction in investment. Stricter oversight of public infrastructure projects and tighter budget controls led to a marked decline in public investment in the second half of the year. Weather disturbances, including typhoons and earthquakes, also restrained economic activity, as did external headwinds stemming from volatility in global economic policies. Investor and consumer sentiment weakened.

Private consumption remained the main driver of growth. Household spending grew by 4.6% in 2025, down from 4.9% in 2024, but still the largest share of GDP growth (Figure 2.26.1). Spending on food strengthened, while outlays on transport, recreation, restaurants, and hotels grew more moderately than in 2024. Labor market conditions softened, with the unemployment rate rising to 4.2% in 2025 from 3.8% in 2024. Employment rose in services, while jobs in agriculture and industry declined. Real wages increased by about 5.0% relative to 2024. Household consumption also continued to benefit from cash remittances from overseas Filipinos, which rose by 3.3% to $35.6 billion, equivalent to 7.3% of GDP.

Investment contracted by 2.1% in 2025 as public infrastructure spending fell, reversing the 7.7% expansion in 2024. Public infrastructure spending declined sharply in the second half of 2025 amid heightened oversight and investigations into alleged anomalies in publicly funded projects, which delayed implementation (Figure 2.26.2). This was only partly offset by continued brisk private construction. Equipment investment was particularly volatile, rising by 9.9% in the first half before declining by 0.6% in the second half. Net exports provided a modest lift to GDP, as exports outpaced import growth in real terms.

Figure 2.26.1 Demand-Side Contributions to Growth

Household consumption remained the main driver of growth.



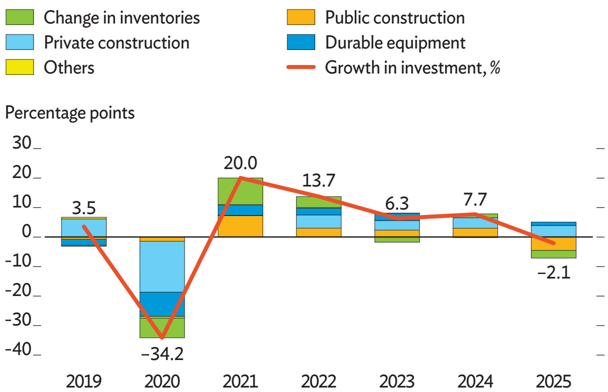
Sources: Philippine Statistics Authority; CEIC Data Company.

On the supply side, services remained the main driver of growth, expanding across subsectors (Figure 2.26.3). Services grew by 5.9% in 2025, moderating from 6.7% in 2024, and accounted for

This chapter was written by Teresa Mendoza of the Philippines Country Office, ADB, Manila.

Figure 2.26.2 Contributions to Investment Growth

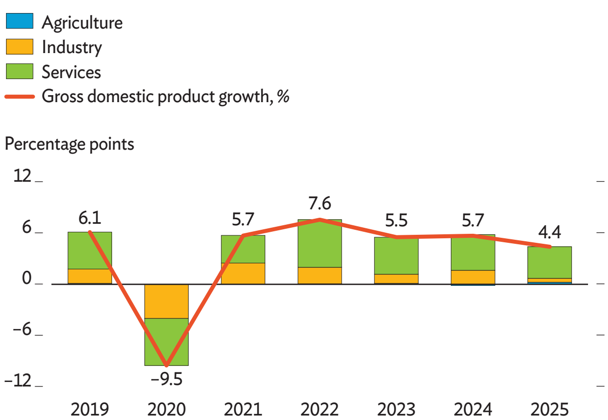
Lower public construction dampened investment.



Sources: Philippine Statistics Authority; CEIC Data Company.

Figure 2.26.3 Supply-Side Contributions to Growth

Broad-based expansion in services fueled growth.



Sources: Philippine Statistics Authority; CEIC Data Company.

about 60% of both GDP and employment. Wholesale and retail trade expanded by 5.2% and remained the largest contributor alongside business services, information and communications, finance, and real estate. Transport, accommodation, and food services also continued to grow, though slower than in 2024. International tourist arrivals remained below pre-pandemic levels.

Industry growth slowed as manufacturing moderated and construction declined. Accounting for nearly one-third of GDP, industry expanded by a modest 1.5% in 2025, down from 5.6% in 2024. Manufacturing grew by 2.5% from 3.7%. Stronger food processing (one-half of manufacturing) was partly offset by lower machinery and electrical equipment production following the high 2024 base. Construction slipped by 0.2%, mainly on reduced public infrastructure spending, only partly offset by brisk private construction (up by 10.1% from 9.2% in 2024). Agriculture grew by 3.1% after contracting in 2024, supported by better crop harvests.

Inflation eased to 1.7% in 2025 from 3.2% in 2024 on lower food and transport costs. Food inflation slowed to 1.0% from 4.6% as rice prices declined by an average 12.3% during the year. Given the larger share of food in low-income household consumption, inflation for the bottom 30% income group slowed to 0.3% in 2025 from 4.2% in 2024. Transport inflation turned negative, averaging −0.4% on softer global oil prices. Core inflation moderated to 2.4% from 3.0%, indicating relatively subdued underlying price pressures. To help stabilize rice prices, the government introduced a tiered, price-triggered rice import tariff system effective January 2026. Instead of a flat tariff, rice import duties will be adjusted depending on global rice prices, within a 15%–35% range.

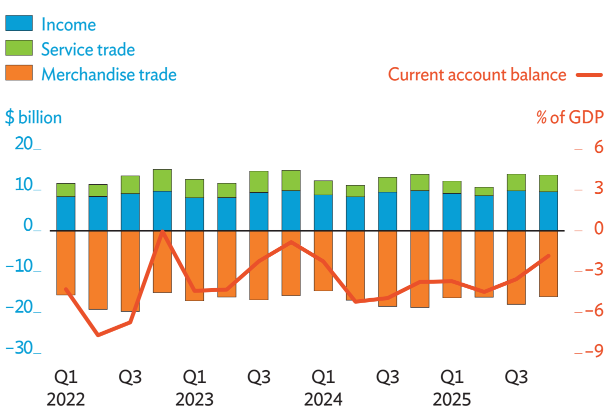
The monetary policy interest rate was reduced by a further 25 basis points in February 2026 to 4.25%. This brought the cumulative rate cut to 225 basis points since the easing cycle began in August 2024. The reserve requirement ratio was lowered again in March 2025, following an earlier reduction in October 2024. Broad liquidity expanded by 8.6% year on year in January 2026 (from 6.8% a year ago), driven by credit growth. Loans to businesses increased by 8.2% while consumer lending grew by 21.3% in January. The nonperforming loan ratio was at 3.3%, about the same from a year earlier, with the 15.8% (December 2025) capital adequacy ratio above the 10% regulatory minimum.

The fiscal deficit narrowed to 5.6% of GDP in 2025 from 5.7% in 2024, though slightly above target. Expenditure grew by 1.8%, while revenue growth was more subdued at 0.8%. Tax revenue, about 90% of total revenue, rose by 7.3% year on year, but fell short of target. Non-tax revenue declined by 39.2% due mainly to base effects from one-off remittances in 2024. Primary expenditure, excluding interest payments and around 85% of total disbursements, were broadly flat relative to 2024. Spending continued to support health, education, and social assistance programs. Infrastructure spending contracted.

The current account deficit narrowed to 3.3% of GDP in 2025 from 4.0% in 2024 as the merchandise trade deficit declined (Figure 2.26.4). Exports grew briskly ahead of anticipated tariff hikes, outpacing imports and narrowing the trade deficit to 13.7% of GDP from 14.9%. Export growth was led by electronic products, which account for half of total exports, alongside shipments of machinery, transport equipment, and consumer electronics. Exports to key markets—including the United States, the European Union, and Regional Comprehensive Economic Partnership members—were robust. Imports increased on higher demand for capital and consumer goods. Sustained growth in remittance inflows and services exports, particularly business process outsourcing, partly offset the trade deficit. In the financial account, net inflows declined amid global uncertainty, driven by weaker portfolio and foreign direct investment. Overall, the balance of payments moved into a 1.2% of GDP deficit from a 0.1% surplus in 2024. Official reserves remained an adequate $113.2 billion at end-February 2026, or 7.5 months of import cover. However, the peso depreciated by 2.9% against the US dollar from January to March, slipping slightly past ₱60 per US dollar, a record low, in late March. The external debt to GDP ratio edged up to 30.3% at end 2025 from 29.8% a year earlier but remained manageable.

Figure 2.26.4 Current Account Components

The current account deficit narrowed as the merchandise trade deficit fell.



GDP = gross domestic product, Q = quarter.
Source: CEIC Data Company.

Economic Prospects

Growth will remain subdued amid heightened risks from the ongoing Middle East conflict. The Philippines is highly exposed given its heavy reliance on imported crude oil and refined oil products. Other transmission channels include possible disruption in remittances from overseas Filipinos, tighter financial conditions, and weaker investor and consumer sentiment. Heightened downside risks are weighing on the growth outlook of 4.4% in 2026 and 5.5% in 2027 (Table 2.26.1). In response, the government declared a state of national energy emergency on 24 March 2026 to help secure the supply of energy, food, and other essentials, while providing targeted social assistance.

Table 2.26.1 Selected Economic Indicators, %

Growth is projected to remain subdued amid heightened global uncertainty.

	2024	2025	2026	2027
GDP growth	5.7	4.4	4.4	5.5
Inflation	3.2	1.7	4.0	3.5

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

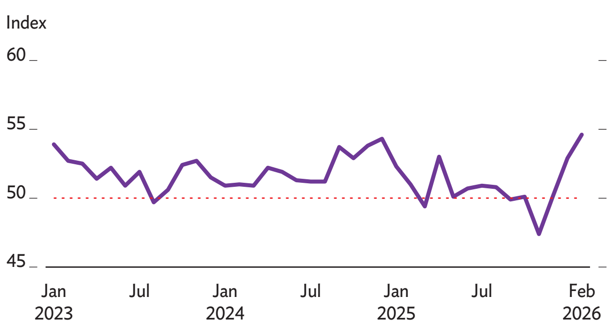
Domestic demand will continue to drive growth, although it will remain subdued. Private consumption and investment should continue to benefit from the lagged effects of monetary easing since 2024, but gains will be partly offset by recent inflationary pressures and heightened uncertainties over the Middle East conflict, which weigh on investment and erode household purchasing power. Remittances from overseas Filipinos, an important buffer to household income, grew by a steady 3.5% year on year in January 2026. However, a prolonged conflict in the Middle East pose downside risks given the region's 17.1% remittance share, largely from Saudi Arabia and the United Arab Emirates.

There are labor market challenges with unemployment rising to 5.8% in January 2026 from 4.3% a year earlier. Heavy job losses in agriculture (nearly one-fifth of employment), were only partly offset by gains in manufacturing and services. Job creation in services was concentrated in administrative and support services and transport, alongside modest increases in professional and business services, education, and health. Employment gains were driven mainly by wage and salaried jobs in private establishments, while own-account and unpaid family work declined. Government initiatives, including the National Employment Master Plan, are supporting upskilling, employment facilitation, and labor market programs. These help address persistent challenges, including high youth unemployment of 17.3% in January 2026, up from 12.0% a year earlier.

The business outlook will remain cautious. Business indicators show expansion heading into 2026, but uncertainty over the Middle East conflict is weighing on investor confidence. The manufacturing purchasing managers' index increased to 54.6 in February from 52.9 in January on higher output and new orders (Figure 2.26.5). Strong growth in January's volume of production index occurred in computer and electronic products, electrical equipment, and non-metallic mineral products. Imports of capital goods continued to rise, 55.5% higher year on year in February, including telecommunications equipment, and electrical machinery. The services purchasing managers' index, however, fell below the expansion threshold to 49.1 in February. While domestic tourism has been supported by household spending, the 5.9 million international tourist arrivals in 2025 remain below the pre-pandemic 8 million visitors in 2019. Tourism faces renewed pressure from the Middle East conflict, driven by higher transport costs, route disruptions, and weaker travel demand.

Figure 2.26.5 Manufacturing Purchasing Managers' Index

Manufacturing continues to expand, supported by domestic demand.



Note: A reading <50 signals deterioration, >50 improvement.
Sources: CEIC Data Company; S&P Global.

Structural reforms are increasing opportunities for foreign investment. Full foreign ownership is now allowed in telecommunications, shipping, railways, and renewable energy. Amendments to the Foreign Investors' Long-Term Lease Act allow 99-year property leases for investors (excluding agricultural land), further supporting the investment climate. The Open Access in Data Transmission Act reduced entry barriers to broadband and data infrastructure, while the CREATE MORE Act enhances the competitiveness of tax incentives and strengthens governance in administrating fiscal incentives. The government's "green lanes" initiative expedites issuance of permits and licenses, with 232 projects endorsed as of December 2025, mainly in renewable energy, digital infrastructure, and food security. Effective implementation of these reforms alongside sustained efforts to improve regulatory processes should support investment. The Philippines ranked 51st of 69 economies in the 2025 IMD World Competitiveness Ranking, below other ASEAN economies in the survey.

Public–private partnerships support investment under the strengthened regulatory environment. There are 248 projects in the pipeline as of March 2026, with railway accounting for the biggest share. Other projects cover airports, roads, water supply, waste-to-energy and sanitation facilities, and school infrastructure, among others. This reflects broader efforts to mobilize private capital alongside public investment to narrow infrastructure gaps.

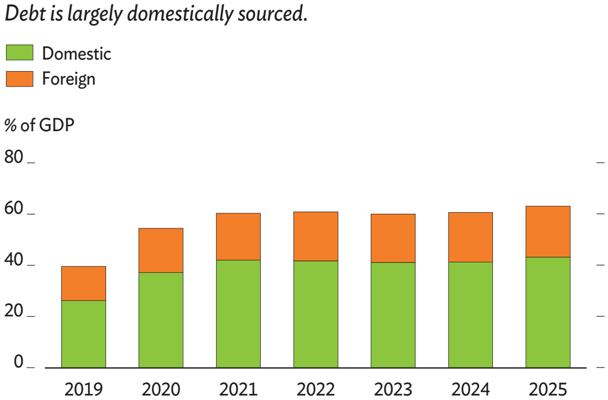
The 2026 national budget is 7.4% higher than 2025 and continues to emphasize social services and infrastructure. Social spending remains substantial, allocating funds for national health insurance, better health and education facilities, workforce upskilling and training, and social protection—such as conditional cash transfers and food vouchers for poor households. These support the government target of reducing poverty incidence to 9% by 2028 from 15.5% in 2023.

Public infrastructure investment is expected to rebound, supported by improved budget execution. Under the flagship infrastructure program, 82 projects are ongoing (together estimated at about $72 billion), while 27 more have been approved as of March 2026. Projects aligned with an agency's absorptive capacity are being prioritized, and linkages among planning, budgeting, and monitoring are being strengthened. Key priorities include education and health facilities, agricultural infrastructure such as farm-to-market roads, digitalization, along with climate and disaster resilience. To strengthen accountability and governance, the government is pursuing tech-based monitoring measures such as geographic information system mapping, unified project identifiers, a national infrastructure asset registry, and public dashboards that provide project information, including fund sources and utilization, along with implementation status.

The fiscal program remains anchored on consolidation under its medium-term framework. The government targets a gradual reduction in the fiscal deficit to 3.7% of GDP by 2029 and a decline in public debt to below 60% of GDP by the same year, from 63.2% at end-2025. Debt remains largely domestic, about two-thirds of the total and predominantly long-term (Figure 2.26.6). Fiscal consolidation will require stronger revenue mobilization and tighter expenditure efficiency. Proposed measures include an excise tax on single-use plastics, higher road user charges, and expanded digitalization to strengthen tax administration. These support tax reforms, including imposing a value-added tax on nonresident digital service providers, reforms to real property valuation and assessment, and an enhanced tax regime for mining. Continuing public financial management reforms—such as tightening the link between planning and budgeting, promoting program convergence, and enhancing beneficiary targeting through community-based monitoring systems—improve budget execution and public spending impact.

Figure 2.26.6 National Government Debt

Debt is largely domestically sourced.



Sources: CEIC Data Company; Bureau of the Treasury.

Inflation is projected to rise to 4.0% in 2026, largely due to high global commodity prices, before easing to 3.5% in 2027. Inflation remained a relatively low 2.2% in the first 2 months of 2026, but price pressures rose sharply in March following the Middle East conflict. Given the heavy dependence on imported oil, higher global prices have quickly passed through to domestic fuel costs. Gasoline and diesel prices rose sharply in March, though the government coordinated with oil companies to stagger adjustments and soften the immediate impact on consumers. To help ease the spike in fuel pump prices, a law was approved on 25 March 2026 granting the executive emergency powers to temporarily suspend or reduce excise taxes on specific petroleum products when the average Dubai crude price exceeds $80 per barrel for one month. Higher fuel and transport costs, together with rising global prices of food, fertilizer, and other commodities, will generate broader inflationary pressure. Currency depreciation adds to this by raising import costs.

Monetary policy remains accommodative. The policy rate was maintained during the Monetary Board meeting in March 2026, noting that upside risks to inflation are largely supply-driven. Future policy decisions will hinge on persistence of external shocks and their pass-through to domestic inflation, including possible second-round effects, while keeping inflation expectations anchored.

The government declared a state of national energy emergency on 24 March 2026, effective for one year, adopting the Unified Package for Livelihoods, Industry, Food, and Transport or UPLIFT program. Different government agencies are tasked to coordinate efforts to ensure steady supply of energy, food and other essentials, continued delivery of services including public transportation, utilities and healthcare, and provide social assistance to the vulnerable sector. Energy supply management measures will be rolled out including energy conservation efforts, safeguards against hoarding, profiteering and supply manipulation. The government also seeks to accelerate the transition to renewable energy, promote the use of electric vehicles, and integrate clean energy solutions across key sectors such as agriculture and manufacturing.

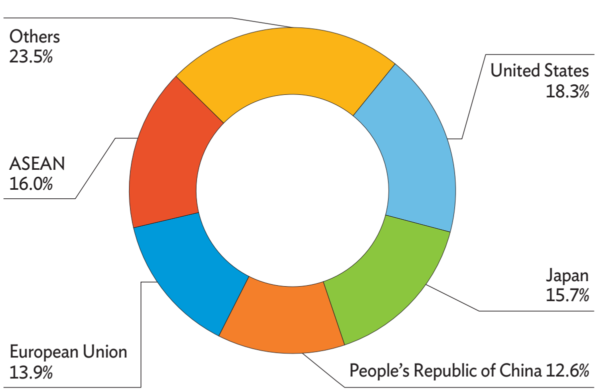
The government has begun rolling out targeted assistance programs to cushion the impact of the Middle East conflict. One-off cash assistance and fuel subsidies were given to farmers, fisherfolk, and public transport drivers, helping them continue operations without passing higher costs to consumers. Other measures include livelihood assistance programs, fare discounts on Metro Manila railways and toll fee relief for public utility vehicles and cargo trucks along major expressways.

The current account will remain in deficit over the forecast period. Export growth will moderate, reflecting softer trade with key markets and dissipation of earlier frontloading. Major advanced economies account for nearly half of merchandise exports. In 2025, the United States was the largest export destination, followed by Japan, European Union, and the People's Republic of China (Figure 2.26.7). Higher global commodity prices will raise the import bill, widening the merchandise trade deficit. As domestic demand strengthens in 2027, imports will rise further, particularly for capital goods as investment recovers. Offsetting these are remittances, assuming no major disruptions, along with higher business process outsourcing revenues following a 4.8% increase to $33.5 billion in 2025, supported by demand for digital, computer, and related business services.

Downside risks have increased significantly. A prolonged conflict in the Middle East will intensify price pressures and dampen growth prospects further.

Figure 2.26.7 Share of Exports to Major Markets, 2025

Major advanced economies absorb the majority of exports.



ASEAN = Association of Southeast Asian Nations.
Source: CEIC Data Company.

Domestically, severe weather events and a prolonged slowdown in public investment—particularly if tighter project oversight leads to delays—could further constrain growth.

Policy Challenge—Fostering Inclusive, Quality Education and Lifelong Learning

Systemic challenges, including weak foundational literacy, malnutrition, and high youth unemployment, are undermining the country's ability to harness its demographic advantage and advance inclusive growth. The country faces serious learning challenges, particularly in foundational literacy and numeracy. According to a World Bank report, learning poverty remains high, with 91% of children at a late primary age not proficient in reading. A report by the Second Congressional Commission on Education cited that learning deficits start early and worsen over time. Based on the national assessment of early language, literacy, and numeracy (2023–2025), only 30.5% of Grade 3 learners are proficient at their grade level, falling to 19.6% in Grade 6 and to 0.4% by Grade 12. In the 2022 Programme for International Student Assessment, the Philippines ranked 77th out of 81 participating economies, near the bottom in reading, mathematics, and science.

Access to education has expanded, but major challenges remain. School attendance and cohort survival rates have improved over the past decade. But learning quality, particularly basic education, remains an issue. Gaps persist in educational attainment across regions and socioeconomic groups, underscoring the need for more targeted interventions and stronger support mechanisms. Poor nutrition weakens learning with about a fifth of school-age children stunted, limiting cognitive development and increasing the risk of early learning deficits. Supplemental feeding programs have limited coverage, leaving several unenrolled nutritionally at-risk children unsupported. The Early Childhood Care and Development Act of 2025 is an important step in broadening access and integrating foundational support, including childcare and nutrition, with greater engagement of local government units.

Deficits in quality learning resources, school infrastructure, teacher development, and digital access have also undermined learning outcomes. Significant infrastructure constraints persist—including classroom congestion, uneven power and connectivity, and inadequate water, sanitation, and hygiene facilities—with pronounced regional disparities. Climate shocks, natural hazards, and school disruptions intensify learning losses. Greater investment in resilient, adaptive, inclusive digital infrastructure is critical. Early-grade literacy, numeracy, and socio-emotional skills must be strengthened by targeting investment in teacher quality, instructional materials, and evidence-based pedagogy. Professional development systems for teachers should focus on mastering subject matter, communities of knowledge-sharing and practice, and using technology effectively.

Some progress is being made in infrastructure investments and in strengthening foundational learning. Basic curriculum reforms, for example, streamline content and emphasize early-grade literacy and numeracy. Work has continued to improve the availability and quality of textbooks and other instructional materials, while accelerating learning recovery. Efforts such as the Literacy Remediation Program show that well-targeted support can help lagging learners. These gains can be sustained and expanded under the Academic Recovery and Accessible Learning Program Act through stronger learner profiling and targeting. Education infrastructure investment remains equally important, particularly for last-mile schools. The 2026 budget increases allocations for school facilities, including classrooms and technical/vocational laboratories. The government is also tapping public–private partnerships to help address infrastructure gaps.

Reforms are establishing a stronger foundation for tackling long-standing structural weaknesses. The National Education Plan (2026–2035) sets out a more integrated, data-driven, and results-oriented framework, prioritizing reforms across the learning cycle, from early childhood nutrition and early learning, foundational literacy and numeracy, smooth school-to-work transitions, more inclusive education, and stronger system governance and resource allocation. Operationalizing the Lifelong Learning Development Framework will need stronger inter-agency coordination as well as with local governments, and deeper private sector partnerships. The private sector has an important role to play in mobilizing investment, including improving digital access and learning infrastructure, and modernizing curricula to align with market needs. Efforts to expand enterprise-based education and training and to strengthen Technical and Vocational Education and Training (TVET), including embedding it in senior high school curricula, are helping to better align skills with evolving industry needs. These reforms and initiatives offer wider scope for stronger collaboration across government, private sector, and other stakeholders, while ensuring complementarity and synergies in actions, and enhanced monitoring and measurement systems for evidence-based, adaptive policies and program delivery.

THAILAND

Growth moderated in 2025 due to weak domestic demand and tourism, despite robust merchandise exports, particularly to the United States (US). Looking ahead, economic growth is forecast to slow further in 2026 before improving in 2027, reflecting softer global demand and the impact of rising energy prices and heightened geopolitical uncertainty following the conflict in the Middle East. Downside risks include prolonged geopolitical tensions, global trade policy uncertainty, fiscal constraints, and persistent structural bottlenecks. Strengthening productivity through skills upgrading, deeper domestic value chains, along with the green and digital transformations remain policy priorities.

Economic Performance

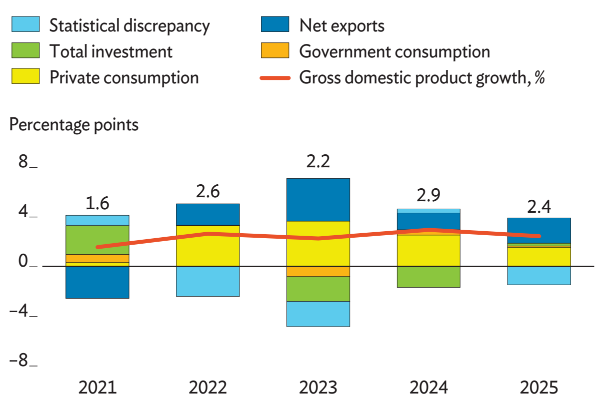
Economic growth moderated in 2025. The drop was largely due to weaker domestic demand, while external factors were mixed (Figure 2.27.1). While merchandise exports drove growth, slower tourism dampened activity. For the full year, real gross domestic product (GDP) expanded by 2.4% year on year, down from 2.9% in 2024 amid a challenging external environment and persistent structural constraints.

Merchandise exports grew by 11.9%, driven by electronics, electrical appliances, and other technology-related products. Export growth reflected resilient demand from key markets, a partial recovery in the global electronics cycle, and front-loaded shipments to the US ahead of potential tariff increases, as exporters and importers accelerated deliveries to mitigate trade policy risk. The impact of US tariffs on merchandise exports did not materially affect exports in 2025. Merchandise imports increased by 9.8%, led by higher demand for intermediate goods and electronic components consistent with export-oriented production.

Services exports weakened in 2025 as international tourist arrivals declined. The number of foreign visitors fell to 32.9 million in 2025, down from 35.5 million in 2024 and still below the 2019 pre-pandemic 40 million level (Figure 2.27.2). The decline was driven mainly by fewer arrivals from the People's Republic of China (PRC) and increased competition from other destinations. While some long-haul arrivals rose, they did not offset the overall decline.

Figure 2.27.1 Demand-Side Contributions to Growth

Exports led growth in 2025 while domestic demand softened.



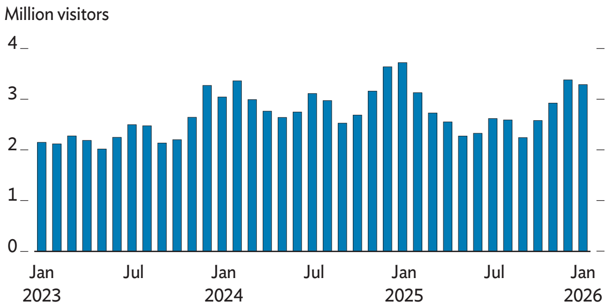
Source: Office of the National Economic and Social Development Council.

Private consumption growth slowed to 2.7% in 2025 compared to 4.4% in 2024 due to persistently high household debt, weak real income growth, and

This chapter was written by Chitchanok Annonjarn of the Thailand Resident Mission, ADB, Bangkok.

Figure 2.27.2 International Tourist Arrivals

Tourism softened in 2025 after the 2024 rebound.



Source: CEIC Data Company.

subdued earnings from agriculture. Labor market conditions remained broadly stable in 2025 with the unemployment rate at 0.8%. Household debt remained high at 86.8% of GDP in the second quarter of 2025, though down from 87.1% at the beginning of the year. This was due to slower credit growth, the impact of ongoing debt restructuring efforts, and cautious lending by financial institutions.

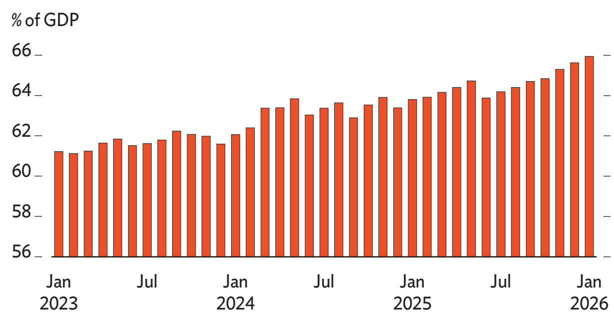
Fiscal stimulus helped private consumption in the fourth quarter of 2025. The domestic tourism stimulus program and "Half-Half Plus" co-payment scheme—which subsidized some household purchases at participating small retailers—supported short-term demand, particularly spending on travel, accommodation, food, and retail services. While helping lift consumption toward year-end, their overall impact on annual consumption growth was limited as they were time-bound and did not reduce the underlying structural constraints on household purchasing power.

Private investment expanded marginally in 2025. Construction continued to contract on weak demand for commercial and residential property and tightened lending standards, particularly for vehicles and real estate-related activities. Investment in machinery and equipment improved in certain industries toward the latter part of the year in line with stronger merchandise exports and related capital goods imports. Foreign direct investment (FDI) inflows increased in electronics, electrical equipment, and financial and real-estate activities. Investment promotion applications to the Board of Investment (BOI) also increased by 66% in value from 2024, particularly in electronics, electric vehicles, digital industries, and renewable energy.

Public spending helped the economy in 2025 as budget execution improved with accelerated disbursements. Public consumption expanded by a marginal 0.6% as spending increased on employee compensation and goods and services following the fiscal year (FY) 2024 (ending September 2024) budget delay. Public investment increased by a strong 8.9%, particularly for transport infrastructure, utilities, and energy-related projects. The FY2025 deficit increased to 4.8% of GDP, up from 4.0% in FY2024. Fiscal policy space remains limited as public debt rose from 63.2% at end-FY2024 to 65.1% at end-FY2025, remaining below the 70% of GDP ceiling (Figure 2.27.3).

Figure 2.27.3 Public Debt

Gradually rising public debt has narrowed fiscal space.



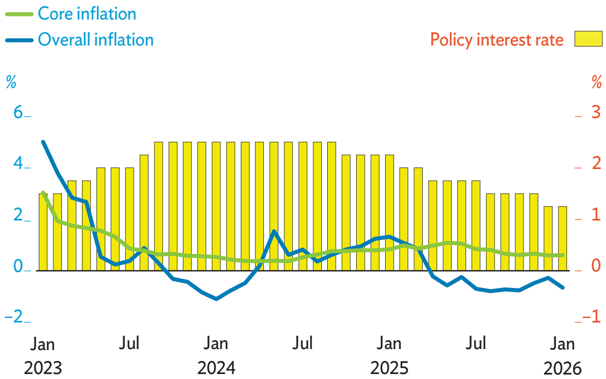
GDP = gross dometic product.
Source: CEIC Data Company.

Deflation in 2025 stemmed from the continued decline in energy prices, government measures to ease the cost of living, and weak domestic demand. Headline inflation averaged –0.1% for the year as global oil prices softened. Domestic energy prices also fell as the government capped electricity and fuel prices, amplifying the global impact. The fall in energy prices significantly reduced headline inflation despite modest price increases in food and services. Weak domestic demand reinforced these downward price pressures.

With a slowing economy and elevated household debt, the central bank eased monetary policy in 2025. The policy interest rate fell by 100 basis points during the year to support economic activity and alleviate debt-servicing (Figure 2.27.4). The baht strengthened by 7% against the US dollar, driven mainly by dollar weakness and increased capital inflows, while gold-related foreign exchange transactions—amid elevated gold prices—also contributed to 2025 currency movements.

Figure 2.27.4 Inflation and Policy Interest Rate

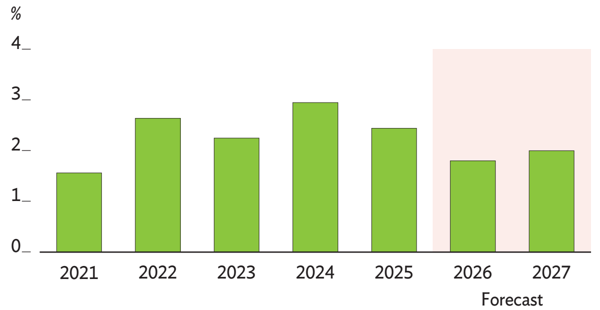
Lower prices continued monetary policy support amid weak demand.



Source: CEIC Data Company.

Figure 2.27.5 Gross Domestic Product Growth

Growth will continue to soften in 2026 before gradually recovering in 2027.



Source: *Asian Development Outlook* database.

Economic Prospects

Economic growth will likely slow further in 2026 before picking up in 2027. Real GDP is forecast to grow by 1.8% in 2026 and 2.0% in 2027 (Table 2.27.1 and Figure 2.27.5). The 2026 slowdown reflects softer global trade conditions, dissipation of front-loaded export shipments in 2025, and the impact of higher energy prices and elevated logistics costs following the escalation of conflict in the Middle East, alongside subdued private consumption amid high household debt. This forecast is under an early stabilization scenario and subject to a very high level of uncertainty. Growth should improve in 2027 on increased tourism and private investment.

Exports of goods and services will weaken in 2026 before recovering modestly in 2027 amid the challenging global trade environment. Merchandise exports will absorb the full impact of US reciprocal tariffs, currently subject to a a temporary 10% global tariff along with additional product-specific duties and heighted tariff uncertainty. The temporary boost from 2025 front-loaded shipments will fade. External conditions will likely worsen with the projected slowing growth in world trade volume, compounded by higher freight and insurance costs and disruptions to shipping routes following the conflict in the Middle East. With a prolonged conflict now more likely, the risks to the outlook have increased and have a very high degree of uncertainty. While global demand for electronics and related goods will likely remain positive this year and next, the benefit to exports will be muted as electronics is more concentrated in assembly and intermediate components rather than high-value items.

Tourism is expected to remain highly uncertain in 2026 amid geopolitical tensions. Arrivals may continue to recover but the pace is likely to be uneven as the conflict in the Middle East affects travel costs, aviation routes, and sentiment. The recovery of arrivals from the PRC is expected to remain gradual in the context of intensified regional competition. Additional risks, including border restrictions and related travel advisories, may further weigh on tourism demand. Tourism is expected to play a more supportive role in growth in 2027 as external conditions stabilize and travel demand strengthens.

Private consumption will remain subdued this year and next. Private consumption will be constrained by high household debt, modest income growth, and the fading effects of temporary fiscal stimulus in late 2025. While labor market conditions are expected to remain broadly stable, consumption growth will likely remain weak as households continue to prioritize debt servicing. Rising energy and transportation costs

Table 2.27.1 Selected Economic Indicators, %

Growth will continue to slow in 2026 as external demand and domestic sources weaken.

	2024	2025	2026	2027
GDP growth	2.9	2.4	1.8	2.0
Inflation	0.4	−0.1	1.3	1.0

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

following the conflict in the Middle East are also expected to weigh on real incomes. Farm income growth will remain uneven on volatile prices and rising input costs. Moreover, production of export-oriented crops such as rice and cassava may remain constrained by weaker external demand. Consumption growth should strengthen gradually in 2027 in line with improving tourism and rising services income.

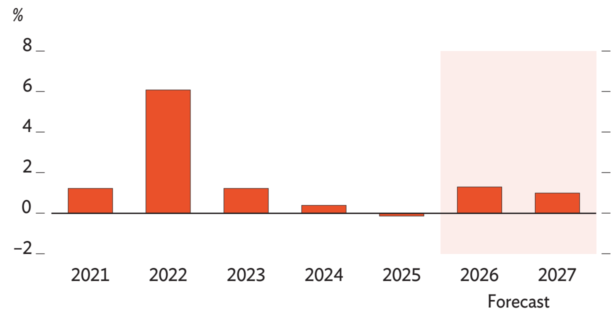
Private investment should maintain momentum over the forecast period supported by continued FDI inflows and ongoing supply-chain relocation. The BOI promoted projects in electronics, electric vehicles, digital industries, and renewable energy will likely underpin investment. Tourism-related, transportation, and trade investments should increase alongside rising international tourist arrivals. However, investment in export-oriented industries will likely slow in 2026, as lower export growth impacts output. In addition, higher energy and input costs following the conflict in the Middle East, together with cautious domestic sentiment, may weigh on investment decisions. Investment's overall contribution to GDP growth will remain constrained by high product import content, which limits domestic value-added.

Public spending will provide limited support to growth this year due to delays related to the February 2026 general election. After parliament was dissolved on 12 December 2025, a caretaker administration awaited the formation of a new government, expected by June 2026. During these months, legal and administrative constraints limited any major new spending and the launch of large infrastructure projects. As a result, the preparation, approval, and execution of the FY2027 budget (starting October 2026) will likely be delayed, slowing the rollout of new public investment and policy initiatives. Combined with limited fiscal space, public spending will likely play a limited countercyclical role in supporting economic growth in the near term.

Inflation is forecast to return to a positive 1.3% in 2026 and 1.0% in 2027 (Figure 2.27.6). Despite weak domestic demand, inflation is expected to increase in 2026, driven mainly by higher energy prices following the conflict in the Middle East. Inflation is expected to ease slightly in 2027 as energy price pressures moderate, while gradual improvements in tourism and services provide some upward pressure on prices.

Figure 2.27.6 Inflation

Inflation gradually returns positive but remains subdued.



Source: *Asian Development Outlook* database.

Risks to the outlook are tilted to the downside. Global trade policy uncertainty, fiscal constraints, and structural bottlenecks—including high household debt, weak productivity growth, skill mismatches, and limited domestic value added—will continue to weigh on exports, investment, and domestic demand. A prolonged conflict in the Middle East increases the downside risks and levels of uncertainty to this outlook substantially. As a net energy importer, Thailand is vulnerable to sustained energy price increases, which could raise inflation, compress real incomes, and slow growth. While energy reserves mitigate immediate supply risks in the short-term, prolonged disruptions could affect trade and investor confidence.

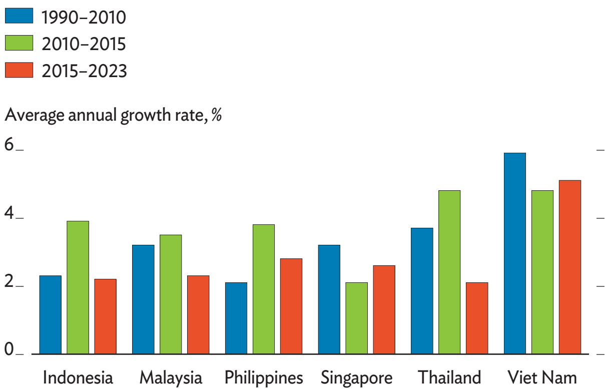
Policy Challenge—Greater Domestic Value-Added

The key policy challenge is to build new growth engines as traditional drivers face rising constraints. While merchandise exports supported growth in 2025, relying on external demand raises volatility. At the same time, productivity growth has slowed, domestic value added from exports has declined, and demographic pressures have intensified. Without structural reforms, investment and export recovery will likely not lift the country's medium-term growth potential.

Productivity growth is slowing and lags regional peers (Figure 2.27.7). Reports by the Organisation for Economic Co-operation and Development show that Thailand's labor productivity growth has lagged behind

Figure 2.27.7 Labor Productivity Growth

Productivity growth lags regional peers.



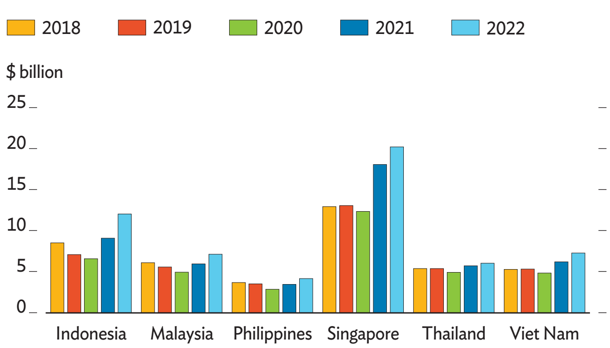
Notes: Per-hour labor productivity is calculated by dividing output by hours worked. Total factor productivity growth is the residual growth accounting for hours worked and changes in capital stock. Abstracting from the business cycle using long-run averages, total factor productivity shows output gains from technological change and innovation. In 2015–2023, Thailand's total factor productivity grew by an average 0%.

Source: APO Productivity Database 2025.

its regional peers over the past decade. Total factor productivity growth was 0% in 2015–2023, showing minimal effects from technological change, innovation, and improved efficiency. The domestic value-added in exports is also relatively low given the high reliance on imported intermediate inputs and limited spillovers from foreign investment (Figure 2.27.8). Many export goods are produced with significant inputs sourced abroad, reducing the share of domestic value added and limiting productivity spillovers to local firms. This pattern emanates from deep integration into global production networks, where foreign-owned firms and imported inputs play a central role. But it also implies that gains from export growth benefit import suppliers, reducing growth in domestic income, employment, and productivity.

Figure 2.27.8 Value-Added in Exports

The value added to exports is low relative to regional peers.



Source: Trade in Valued Added (TiVa) 2025 edition.

Raising productivity and innovation is central to restoring growth momentum. Skill mismatches, limited technology adoption among micro, small and medium-sized enterprises (MSMEs), and relatively low research and development spending continue to slow productivity and innovation.

To address structural weaknesses, authorities introduced measures to upgrade production and strengthen productivity. Investment facilitation has been strengthened through the BOI's FastPass approval mechanism, targeted upgrading support, and regulatory streamlining, including a review of the Foreign Business Act. These measures could lift medium-term productivity. But their impact hinges on effective implementation and stronger spillovers to domestic firms, especially MSMEs. Deepening domestic value chains is equally important. FDI inflows continue, particularly in electronics, electric vehicles, and renewable energy. However, the high import intensity limits domestic value-added. Strengthening local supplier development and technology transfer, improving MSME access to finance, and supporting technology upgrading and quality certification would help raise local content and amplify investment spillovers.

Tourism and services offer additional growth opportunities should a recovery occur in 2026–2027. Policies such as visa facilitation and destination diversification can support the rebound. But increasing tourism's contribution will require improving service quality, promoting higher-value segments, and strengthening linkages with local suppliers to broaden income gains.

There are clear directions set for achieving a green and digital transformation. These include expanding renewable energy, promoting electric vehicles, and developing better digital infrastructure. Aligning regulatory frameworks, financing instruments, and industrial policy with these priorities are key to unlock new sources of growth.

Going forward, policies should focus on productivity and innovation-driven transformation. Upgrading skills, adopting new technologies, expanding research and development, deepening domestic value chains, and improving public investment efficiency are critical to ensuring investment leads to increased productivity, greater domestic value-added, and more resilient medium-term growth.

TIMOR-LESTE

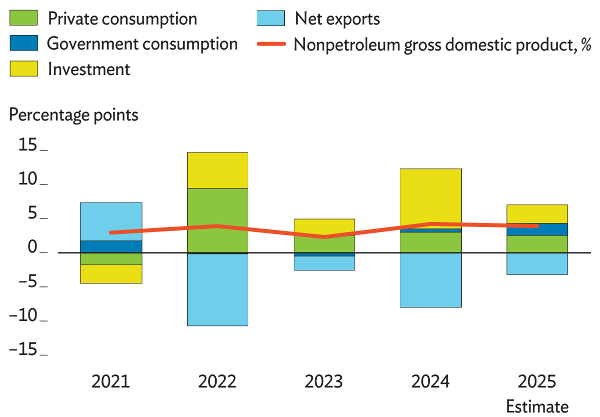
Economic growth remained solid in 2025, driven by strong domestic demand. Inflation fell to a 9-year low, while the current account deficit widened. Growth is forecast to remain stable in 2026 before accelerating in 2027. Inflation is projected to rise, although the overall low-inflation environment will persist. The external account gap will likely widen, largely due to higher import growth. Deepening ASEAN integration offers Timor-Leste an important opportunity to advance private sector development and diversify the economy.

Economic Performance

The economy remained solid in 2025, driven by strong domestic demand. Over the past 2 years, growth averaged 4.1%, higher than the long-term historical 3.2% average, supported by consumption and investment (Figure 2.28.1). The estimated nonpetroleum GDP expanded by 3.9% in 2025. Private consumption contributed 2.6 percentage points to growth due to public transfers, higher wages, remittances, and rising retail credit. Government consumption added 1.8 points, driven by an 11.4% increase in goods and services spending. Investment contributed 2.7 points, reflecting significant budgetary capital spending and private outlays. Net exports, however, subtracted 3.2 points from growth as the nonpetroleum current account deficit widened by 10.2%, largely due to a rise in goods and services imports.

Figure 2.28.1 Demand-Side Contributions to Growth

Consumption and investment continue to power growth.



Sources: National Institute of Statistics of Timor-Leste; Asian Development Bank estimates.

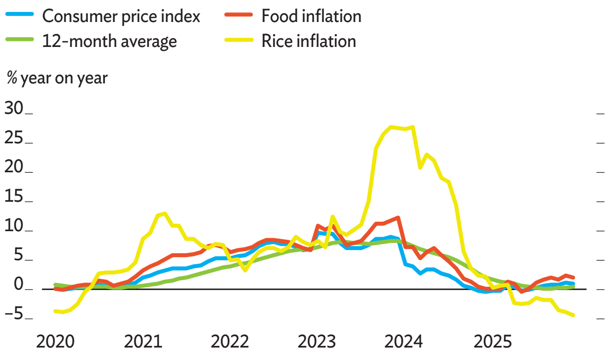
Inflation fell to its lowest level since 2016. With both tradable and non-tradable inflation subdued and food inflation easing by 3.2 percentage points to 1.1%, average consumer price inflation declined from 2.1% in 2024 to 0.5% in 2025. By December 2025, prices were a mere 1.0% higher than a year earlier (Figure 2.28.2).

The fiscal deficit remains persistently high. Although gross revenues, including domestic revenues and estimated sustainable income, rose by 5.4%, total budget spending increased by 2.9% in 2025. This resulted in an estimated budget deficit 0.9% higher than in 2024, reaching 52.1% of GDP (Figure 2.28.3). The estimated debt-to-GDP ratio edged up slightly to 14.6% in 2025 from 14.2% in 2024. Persistent pressure on the Petroleum Fund and low public debt underscore the need for low-cost, long-term, productivity-enhancing investments in human capital, core infrastructure and basic services, and private development.

This chapter was written by Bold Sandagdorj of the Timor-Leste Resident Mission, ADB, Dili.

Figure 2.28.2 Inflation

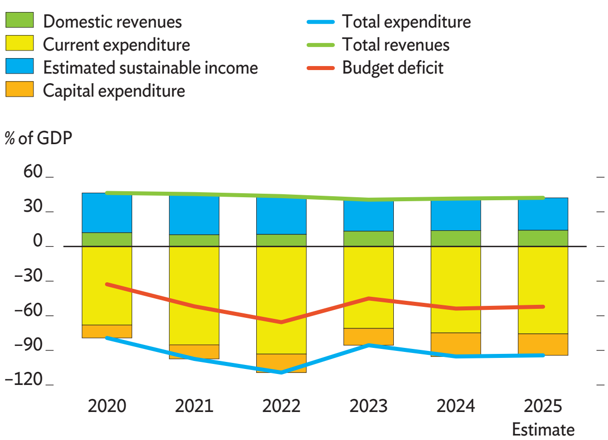
Consumer price inflation remained muted and broadly stable.



Sources: National Institute of Statistics of Timor-Leste; Asian Development Bank estimates.

Figure 2.28.3 Government Budget

The fiscal deficit remained large, financed by withdrawals from the Petroleum Fund.

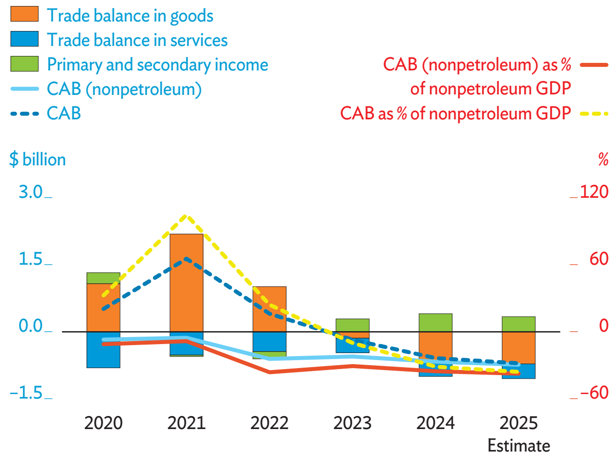


GDP = gross domestic product.

Sources: National Institute of Statistics of Timor-Leste; Ministry of Finance of Timor-Leste. 2025. Budget Transparency Portal; Asian Development Bank estimates.

Figure 2.28.4 Current Account Balance

The external position weakened due to an expanding trade deficit.

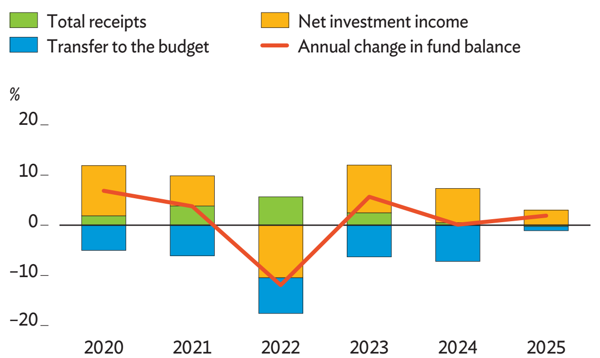


CAB = current account balance, GDP = gross domestic product.

Sources: National Institute of Statistics of Timor-Leste; The Central Bank of Timor-Leste; Asian Development Bank estimates.

Figure 2.28.5 The Petroleum Fund

Investment income fully offset withdrawals from the Petroleum Fund.



Sources: The Central Bank of Timor-Leste. 2020–2025. The Annual and Quarterly Reports of the Petroleum Fund; Asian Development Bank estimates.

A widening merchandise trade deficit further deteriorated the external account. The estimated nonpetroleum current account deficit increased to 37.4% of GDP as the merchandise trade deficit rose by 11.2% and the income balance weakened by 15.8%, despite a 6.4% reduction in the services trade deficit (Figure 2.28.4).

Petroleum Fund savings rose by 1.9% to $18.6 billion in 2025. Despite an 11.7% increase in withdrawals and a 57.6% drop in petroleum receipts—which together dragged the fund's savings down by 1.1 percentage points—the balance remained stable, supported by a 45.9% surge in investment income that contributed 3.0 percentage points to growth (Figure 2.28.5).

The banking sector has been stable, with adequate liquidity and a low nonperforming loan ratio of 2.4%. Bank credit growth slowed by 17.1 percentage points to 14.7% in 2025, largely due to tighter risk appetite in agriculture, manufacturing, transport, and communications. In contrast, consumer lending and business loans in construction, trade, and finance continued to expand.

Economic Prospects

The near-term economic outlook remains stable, supported by broadly positive expectations. Deepening ASEAN integration, driven by domestic policy reforms and effective implementation of the National ASEAN Economic Community Implementation Roadmap for 2026–2030, should attract increased foreign direct investment, mobilize private financing, expand trade, and create new opportunities for economic development.

Growth will primarily be driven by private consumption and overall investment. Supported by strong domestic demand, the economy will grow by a solid 3.8% in 2026, then accelerate to 4.1% in 2027 (Table 2.28.1). Public spending on goods and services, consumer lending, remittances, tourist arrivals—which surpassed pre-pandemic levels—and public transfers will support consumption. Timor-Leste's renewed use of highly concessional, long-term development financing for priority infrastructure in 2025, together with continued efforts to mobilize funding for prospective public investment programs, will help narrow the infrastructure gap, strengthen the business climate, and sustain higher investment contributions to growth.

Table 2.28.1 Selected Economic Indicators, %

Growth will remain solid with inflation gradually firming.

	2024	2025	2026	2027
GDP growth	4.3	3.9	3.8	4.1
Inflation	2.1	0.5	1.7	2.0

GDP = gross domestic product.

Note: 2025 GDP growth is an estimate.

Sources: National Institute of Statistics of Timor-Leste; Asian Development Bank estimates.

Private investment and financing should expand, driven by domestic policy reforms and the launch of key projects. ASEAN integration will support efforts to strengthen the legal and regulatory framework, simplify business processes, and build both digital infrastructure and financial-sector capabilities. These measures will improve the investment climate, attract private financing, and encourage digital business activity. Bank lending is expected to continue growing, especially in trade, services, telecommunications, and construction. Flagship projects, such as the Manatuto solar and battery energy storage system, will attract new investors and generate multiplier effects across the economy.

Inflation is projected to increase gradually from its low base, averaging 1.9% over the forecast period, while the current account deficit will widen further. Driven by higher import prices, average inflation is projected to rise to 1.7% in 2026 and 2.0% in 2027 under the early stabilization scenario, though it will remain low and within a comfortable range to support the real sector. The current account deficit is projected to widen, mainly due to higher imports.

There are downside risks to the outlook. Wider conflict in the Middle East could intensify terms-of-trade risk by raising international oil prices, increasing prices of imported fuel and other goods, and amplifying inflationary pressures. The government is prioritizing fuel-supply security and temporary price caps supported by state-budget subsidies, while mitigating shocks through close monitoring and targeted measures to adjust domestic fuel prices as needed. Additional vulnerabilities could arise from disasters caused by natural hazards and domestic challenges, notably the slow implementation of public capital investment projects.

Policy Challenge—Leveraging ASEAN Integration for Private Sector Development

Timor-Leste's private sector remains underdeveloped, dependent on public procurement, with weak linkages between micro, small, and medium-sized enterprises (MSMEs) and larger firms. ASEAN integration offers Timor-Leste a strategic pathway to accelerate private development by expanding market access, attracting investment, and anchoring domestic reforms to regional standards. The National ASEAN Economic Community Implementation Roadmap identifies sector-specific development actions, marking an important step toward advancing private sector growth through domestic reforms. Private sector development can be strengthened in three ways.

First, Timor-Leste should prioritize the implementation of key ASEAN economic agreements. This will reduce trade barriers, liberalize services, and mobilize more private financing. Collaboration under ASEAN MSME strategic action plans will build MSME capabilities, improve competitiveness, and support integration into regional supply and value chains.

Second, domestic regulatory and institutional reforms must be deepened. Priority actions include: (i) completing the land registry and titling process to secure property rights and expand credit access; (ii) simplifying business licensing and modernizing company, investment, and consumer-protection laws; (iii) improving tax and customs administration to align with ASEAN trade-facilitation standards; (iv) establishing credit and collateral registries; and (v) adopting a digital unique identification system while ensuring the national digital payments ecosystem is interoperable with ASEAN frameworks.

Third, Timor-Leste should design targeted programs for investment promotion and MSME development. They should prioritize women-led enterprises, youth entrepreneurs, and sectors with strong export potential, such as agribusiness and tourism. Close collaboration with ASEAN Investment Promotion Agencies and the ASEAN Coordinating Committee on MSMEs will be essential to attract investors, strengthen promotional capabilities, and integrate local firms into regional markets.

VIET NAM

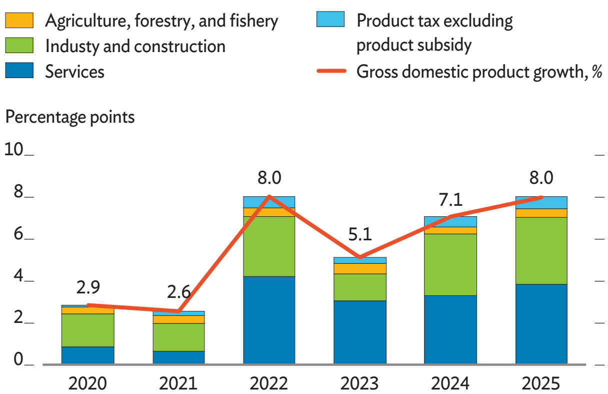
In 2025, expansionary policies and strong export performance ahead of the United States (US) reciprocal tariff adjustments along with record foreign direct investment (FDI) disbursements drove solid economic growth. The economy should remain resilient in 2026 and 2027, primarily due to large public investment and sustained domestic demand. A key policy challenge is to further develop the domestic bond market to diversify financing beyond banking and better support the economy's long-term investment needs.

Economic Performance

Despite mounting global challenges, the economy remained strong in 2025. GDP grew by 8.0%, up from 7.1% in 2024, matching the record post-pandemic growth of 8.0% attained in 2022 (Figure 2.29.1).

Figure 2.29.1 Supply-Side Contributions to Growth

Growth accelerated in 2025.



Sources: National Statistics Office; Ministry of Finance.

Export-led manufacturing remained a major contributor to growth in 2025. Industry and construction expanded by 8.9%, up from 8.2% in 2024. Manufacturing grew by 10.0%, well above its long-term average, supported by rising orders and increased production. Higher public investment disbursements contributed to construction growing by 9.6%, up from 7.9% in 2024. Despite unfavorable weather, agriculture grew by 3.8%, supported by stable commodity prices.

Growth in services was supported by a strong recovery in tourism. Visa facilitation measures and tourism promotion boosted visitor arrivals. Total arrivals rose by over 20%, with visitors from Europe up by 38.8% and from Asia by 18.8%. As a result, services expanded by 8.6% in 2025, up from 7.4% a year earlier.

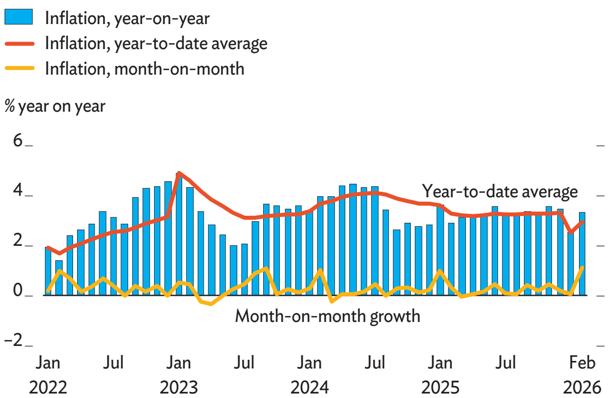
On the demand side, growth was driven by strong investment, steady consumption, and resilient trade. Gross capital formation increased by 8.7% in 2025, supported in part by total realized investment, which rose by 12.1%, up from 7.8% in 2024. Realized FDI reached an estimated $27.6 billion, up by 9.0% year on year and the highest level in 5 years. Accommodative fiscal and monetary policies supported domestic demand with final consumption expanding by 8.0%, compared with 6.6% in 2024. Trade growth was reinforced by front-loaded export orders ahead of US tariffs, alongside resilient global demand.

In 2025, inflation averaged 3.3%, down from 3.6% in 2024 and within the government's target range. Food prices remained relatively stable, while transport prices declined by 2.1% year on year, largely reflecting

This chapter was written by Nguyen Ba Hung, Nguyen Luu Thuc Phuong, and Chu Hong Minh of the Viet Nam Resident Mission, ADB, Ha Noi.

Figure 2.29.2 Monthly Inflation

Inflation was subdued in 2025.



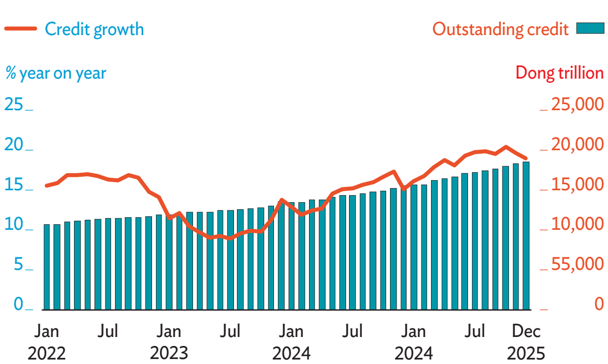
Sources: National Statistics Office; Ministry of Finance.

lower gasoline prices. Core inflation increased by 3.2% year on year, slightly below headline inflation, suggesting that price pressures were driven mainly by noncore components rather than broad-based demand (Figure 2.29.2).

Relatively stable inflation has allowed the State Bank of Viet Nam, the central bank, to maintain its policy rate at 4.5% since 2023 while adopting a more accommodative stance using open market operations. In 2025, the central bank maintained its credit growth target of about 16%, but raised credit quotas for several banks to support increased lending. Banks were also encouraged to keep lending rates low to support economic activity. As a result, bank credit to the economy expanded by about 19% compared with end-2024 (Figure 2.29.3).

Figure 2.29.3 Credit Growth

Credit grew fast to support domestic production.



Sources: State Bank of Viet Nam; Asian Development Bank estimates.

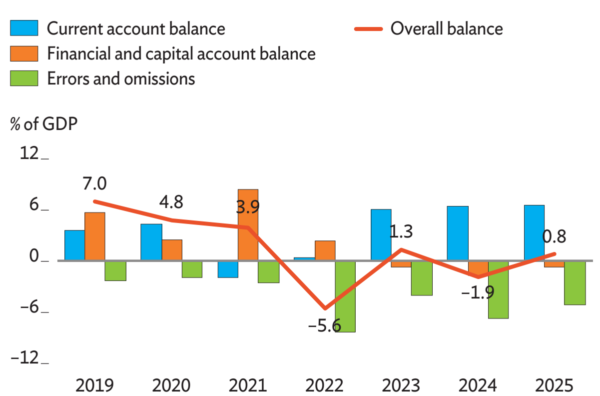
Rapid credit expansion pushed outstanding bank credit to about 145% of GDP by year-end. The increase heightened financial stability risks, including maturity mismatches and rising nonperforming loans. The credit surge coincided with a 3.2% dong depreciation against the US dollar since end-2024, despite the dollar's global weakening. Depreciation increased foreign debt-servicing costs and raised the cost of corporate borrowing in foreign currency.

Strong trade performance continued to support the current account balance in 2025. Faster growth in merchandise imports relative to exports, however, narrowed the trade surplus to about 8.2% of GDP, down from 9.1% in 2024. This includes a difference between customs and balance-of-payment import data of about 3.9% GDP, indicating higher international supply chain cross-border operations. The current account surplus improved to an estimated 6.5% of GDP in 2025, marginally higher than the level in 2024. Higher short-term inflows helped narrow the financial account deficit to an estimated 0.7% of GDP, compared with 1.7% a year earlier.

A substantial current account surplus in 2025 offset the financial account deficit. This resulted in an overall balance of payments surplus of about 0.8% of GDP, up from a deficit in 2024 (Figure 2.29.4). With the rapid growth of imports, by end-2025, foreign exchange reserves were estimated to cover 2.4 months of imports, down from 2.8 months at end-2024.

Figure 2.29.4 Balance of Payments

Both the current account balance and overall balance recorded surpluses in 2025.



GDP = gross domestic product.

Sources: State Bank of Viet Nam; Asian Development Bank estimates.

Fiscal performance improved in 2025. This was supported by tax reforms and a strong increase in land-related revenue, reflecting robust activity in real estate. Budget revenue reached an estimated VND2,650 trillion, up by 29.7% year on year, while expenditure rose by 31.2% to VND2,401.5 trillion, driven by a 38.3% increase in capital spending. The on-budget balance recorded an estimated surplus of 1.9% of GDP, compared with a 3.6% deficit a year earlier.

The government increased borrowing to finance infrastructure, mainly through bond issuance. In 2025, Viet Nam issued a record VND360 trillion in government bonds to support public investment. The average maturity of local currency bonds was about 11–12 years, with domestic borrowing accounting for around 76% of total public debt. Despite the increased issuance, public debt likely remained below 34% of GDP by end-2025, well under the 60% statutory limit and continuing its decline from 50.9% in 2016. Sovereign credit ratings remained at BB+ (stable) by S&P Global Ratings and Fitch Ratings as of early 2026.

Economic Prospects

The economy is projected to grow by 7.2% in 2026 and 7.0% in 2027 (Table 2.29.1). Growth will be supported by a substantial increase in public investment and accommodative monetary policy. Although FDI and exports remain key drivers of growth, global headwinds—including the conflict in the Middle East and US tariffs—may weigh on investment inflows and export performance. Inflation is forecast to edge up to 4.0% in 2026 before easing to 3.8% in 2027. These projections are based on an early stabilization scenario and subject to a very high degree of uncertainty.

Table 2.29.1 Selected Economic Indicators, %

Growth will moderate and inflation will rise.

	2024	2025	2026	2027
GDP growth	7.1	8.0	7.2	7.0
Inflation	3.6	3.3	4.0	3.8

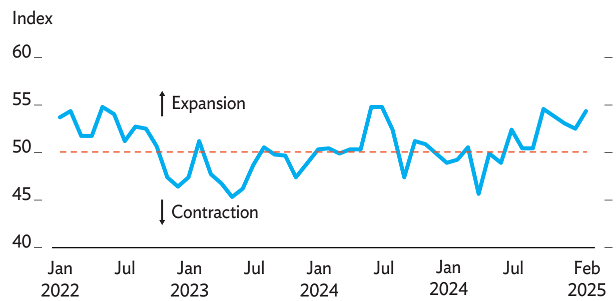
GDP = gross domestic product.

Sources: National Statistics Office; Ministry of Finance; Asian Development Bank estimates.

Heightened global tensions and geopolitical uncertainty given the Middle East conflict pose risks to export-oriented manufacturing. Manufacturing remained resilient at the start of 2026 with the purchasing managers' index rising to 54.3 in February—the highest in 4 months and eighth consecutive month of expansion—supported by stronger output and new orders (Figure 2.29.5). The replacement of the US reciprocal tariffs of 20% with new global tariffs of about 15% may provide a short-term benefit to exports. However, renewed uncertainty over future US trade policy given the increased bilateral surplus and ongoing geopolitical tensions could weigh on export performance. Additional pressures include slower growth among major trading partners, the broader conflict in the Middle East, which could disrupt global supply chains, and higher input prices due to currency depreciation. As a result, industrial growth will likely moderate to 7.7% in 2026, down from 9.2% in 2025.

Figure 2.29.5 Purchasing Managers' Index

The index continued to expand in early 2026.



Note: A purchasing managers' index <50 signals deterioration, and >50 an improvement.

Source: IHS Markit.

Services should maintain momentum in 2026, supported by tourism recovery and expanding technology driven activity. Visa facilitation, stronger promotion, and improved service quality continued to boost visitor arrivals, which reached nearly 4.7 million in February 2026, up 18.1% year on year. The digital transformation also supports financial and retail services. However, global economic uncertainty may weigh on travel demand. Overall, services will likely grow by 7.5% in 2026.

Agricultural growth should remain steady at 3.6% in 2026, slightly lower than the 3.8% expansion in 2025. Continued external demand and effective use of free trade agreements will support the sector. However, agriculture may face stronger climate pressures as El Niño intensifies drought and salinity intrusion, particularly in the Mekong Delta, threatening rice and aquaculture output. Rising input costs—linked to high global energy and fertilizer prices—may add further pressure. In addition, further revised US tariffs, as well as stricter sustainability and traceability requirements, could weigh on agricultural exports.

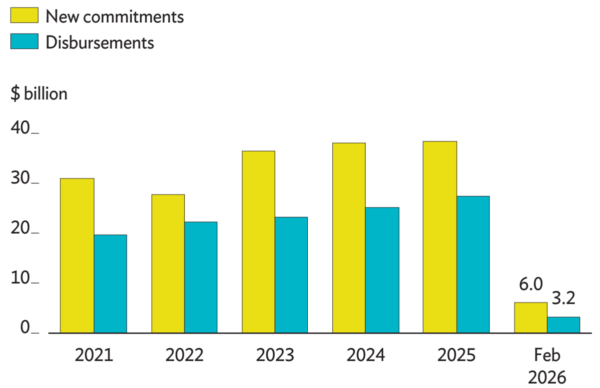
On the demand side, domestic consumption may suffer from weaker household spending and tighter bank credit. Retail sales continued to grow with consumption increasingly shifting toward services. Retail sales at current prices rose by 7.9% year on year in the first 2 months of 2026, lower than the 9.3% increase a year earlier. However, subdued Lunar New Year spending and a rise in business exits—77,000 firms in the first 2 months of 2026—underscore persistent demand side pressures and rising cost constraints.

Investment is expected to underpin economic growth in 2026. The government plans to accelerate public investment disbursements—estimated at about $38 billion—particularly for infrastructure, supporting construction activity. However, FDI inflows may weaken amid slowing global investment and heightened uncertainty. Many investors are expanding existing operations rather than launching new projects. In addition, the application of a global minimum corporate tax, together with infrastructure bottlenecks and administrative constraints, could add to slowing down new FDI registrations. As of 28 February 2026, newly registered FDI totaled $6.0 billion, 12.6% lower than a year earlier, while realized FDI rose by 8.8% to $3.2 billion (Figure 2.29.6).

Trade prospects in 2026 should soften amid moderating global demand. In February, total merchandise trade reached $67.2 billion, down month on month but up 5.1% year on year. Meanwhile, strong import growth outpaced exports in the first 2 months of the year, resulting in a trade deficit of $3.0 billion (Figure 2.29.7). Looking ahead, slower growth among major trading partners, new US tariffs uncertainty, exchange rate volatility, and potential supply chain disruptions will likely slow trade growth.

Figure 2.29.6 Foreign Direct Investment

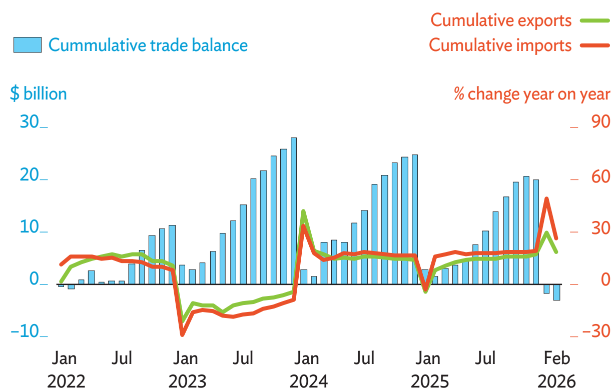
Inflows could moderate amid slower global investment and rising uncertainty.



Sources: National Statistics Office; Ministry of Finance.

Figure 2.29.7 Trade Growth

Trade growth might face difficulties in 2026 given rising trade tensions.



Sources: National Statistics Office; Ministry of Finance.

Inflation is projected to edge up to 4.0% in 2026. Fiscal expansion and accommodative monetary policy may generate inflationary pressures through stronger domestic demand. Rising global oil prices could add further pressure. Oil prices remain highly volatile given the evolving conflict in the Middle East, global supply conditions, the country's diversification of import sources, and demand management measures. Accelerated public investment, credit growth, and dong depreciation may also contribute to domestic cost pressures. Inflation will likely ease to 3.8% in 2027, as global commodity prices stabilize and domestic demand pressures moderate.

External risks to the outlook have deepened on the downside, with a prolonged Middle East conflict now appearing more likely. Revised US tariffs could weigh on global demand and trade and create additional investment uncertainties. The Middle East conflict disrupts oil flows through the Strait of Hormuz, raising international shipping costs and timing, and together with the prolonged war in Ukraine, increases commodity price volatility and disrupts global supply chains. Combined with slower growth in the People's Republic of China and the European Union, these risks could narrow the trade surplus and dampen GDP growth.

To mitigate these risks, Viet Nam's government responded swiftly to the energy disruption caused by the Middle East conflict. The government implemented time-bound fiscal measures to cushion rising fuel costs, combining tax relief, a stabilization fund with a budget contribution, more flexible price adjustments, while making efforts to strengthen supply coordination and fuel-saving efforts. These actions are expected to contain near-term inflation hike to support growth momentum. The government also pursued a longer-term strategy to diversify energy sources, improve efficiency, and accelerate the transition to clean energy, for reduced vulnerability to future shocks.

Institutional reforms offer upside potential for the growth outlook. Efforts to streamline administrative procedures and improve regulatory efficiency should support near-term growth stimulus and long-term development priorities. If effectively implemented, these reforms could boost public sector efficiency, improve the business climate, and enhance economic resilience.

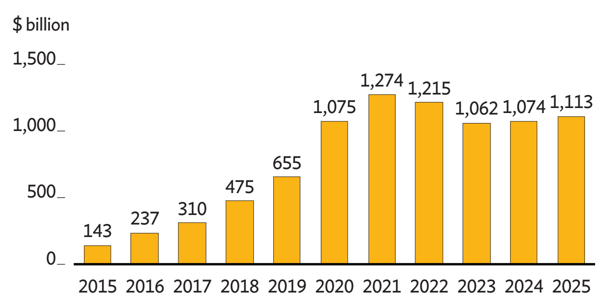
Financial risks, however, continue to constrain growth prospects. Liquidity pressures in the banking system require proactive management. Rising nonperforming loans and dong depreciation could reduce monetary policy effectiveness. This may constrain bank credit growth, already set at a lower target of 15% for 2026. Meanwhile, limitations in the corporate bond market continue to hamper capital market development. Higher government bond yields may help mobilize funding for public investment but also raise financing costs.

Policy Challenge—Deepening the Corporate Bond Market

The corporate bond market has become an increasingly important source of medium- and long-term finance, providing firms with an alternative to bank lending. The market expanded rapidly during 2019–2021, with issuance growing by more than 50% annually and bonds outstanding reaching nearly 15% of GDP (Figure 2.29.8). However, this rapid expansion exposed regulatory gaps, weak disclosure practices, and rising credit risk. The government responded with tighter regulations on private placements, investor eligibility, and credit rating requirements. While these reforms helped strengthen market discipline, they coincided with a sharp contraction following the coronavirus disease pandemic and problems in real estate, exposing deeper structural weaknesses.

Figure 2.29.8 Corporate Bonds Outstanding

The market expanded rapidly during 2019–2021.



Source: *AsianBondsOnline* Data Portal.

Issuers remain highly concentrated while the investor base remains unbalanced. Credit institutions and real estate firms accounted for more than half of total bond issuance in 2018 and over 90% in 2024–2025 (Figure 2.29.9). Commercial banks dominate bond holdings, accounting for about 55% of bonds outstanding, while insurance companies and pension funds account for only about 9%. This structure exposes systemic imbalances—banks access capital markets to manage liquidity and provide credit to the real economy, whereas firms have limited direct access to bond markets.

The market is also heavily reliant on private placements, which account for more than 90% of issuance since 2018. Although private placements offer issuers flexibility, they reduce transparency and limit investor access to information. Weak disclosure practices have reduced market confidence and increased systemic risk. Limited secondary markets also increase the liquidity premium for bondholders.

Credit rating and disclosure frameworks are still at an early stage of development and investor confidence is fragile. Viet Nam's credit rating requirements have recently been introduced, with a relatively limited number of issuances subject to mandatory ratings. This narrow coverage increases investor risk, weakens market transparency, and constrains the development of a credible pricing mechanism.

Legal and institutional gaps continue to affect market development. Recent reforms have strengthened investor protection and market oversight, including stricter conditions for individual investors and stronger requirements related to credit ratings and collateral. While these measures enhance investor protection, they can also constrain market depth if institutional participation does not expand.

Viet Nam's corporate bond market, therefore, stands at a critical juncture. Policymakers need to strengthen market discipline while facilitating compliance and transparency to boost investor confidence, thereby supporting long-term market development. Broadening the issuer and investor base, strengthening transparency and credit rating frameworks, and ensuring consistent regulatory enforcement is essential. Expanding institutional investor participation is vital to reducing reliance on banks and strengthening market resilience. If these are effectively addressed, the corporate bond market can become a key pillar of the financial system, providing stable, long-term financing to support sustainable and inclusive economic growth.

THE PACIFIC

- Fiji
- Papua New Guinea
- Solomon Islands
- Vanuatu
- Central Pacific economies
- North Pacific economies
- South Pacific economies

FIJI

The economy grew moderately in 2025, supported by steady tourism, agriculture and construction which stimulated private consumption. Economy-wide consumer prices declined in 2025, reflecting reductions in value-added tax (VAT) and subdued import prices. However, economic activity is likely to soften in the medium term as visitor arrivals grow more slowly, pre-election uncertainties rise, and a potentially prolonged Middle East conflict adds to external risks. Non-communicable diseases (NCDs) continue to strain the health system and threaten productivity. The health system needs increased investment and reform, especially in primary care, to strengthen long-term health outcomes and resilience.

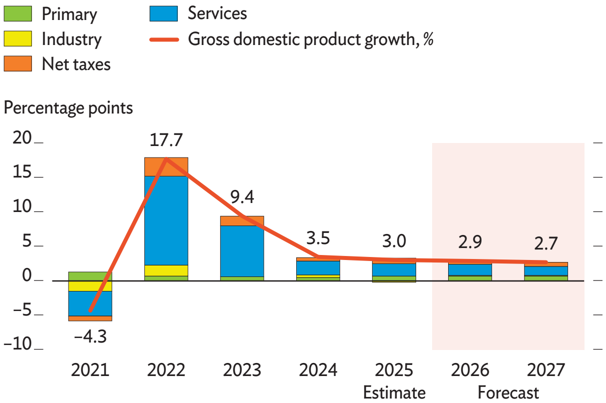
Economic Performance

GDP growth moderated. The economy grew by an estimated 3.0% in 2025 (Figure 2.30.1), supported by private consumption and modest growth in tourist arrivals. Annual visitor arrivals edged up by 0.3% to 986,367 in 2025 from 982,938 in 2024, driven by marginal growth from source markets in the United States (US), Canada, the United Kingdom and Europe, which offset slight declines in the main Australia and New Zealand markets (Figure 2.30.2).

A pickup in domestic tourism nevertheless supported activity, with room occupancy increasing, particularly in Nadi and the Coral Coast. The country remains a key transport hub in the Pacific, with transit passengers up by 14.1% in 2025, supported by the introduction of new routes to the US. There are about 12,000 hotel rooms available. Tourism continues to attract both foreign and domestic direct investment, particularly from the Fiji National Provident Fund.

Figure 2.30.1 Supply-Side Contributions to Growth

GDP growth moderated.

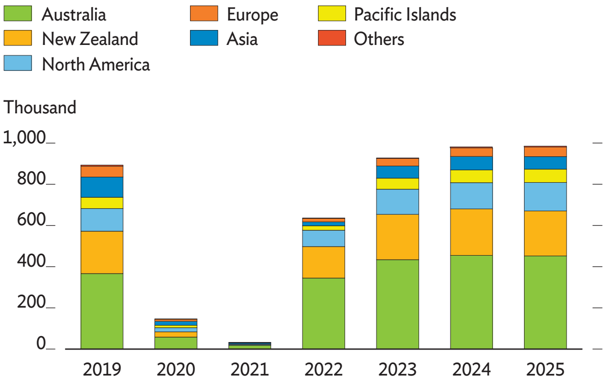


GDP = gross domestic product.

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

Figure 2.30.2 Tourist Arrivals from Source Markets

Australia and New Zealand remain the main source markets.



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

This chapter was written by Emma Allen and Tu'i Sikivou of the South Pacific Subregional Office, ADB, Suva.

The trade deficit widened. Favorable weather supported exports of kava, taro, ginger, mahogany and woodchips, while high gold prices boosted gold export value despite lower production. The trade deficit widened by 6.0% in 2025 to F$4.8 billion, driven in part by a 3.7% rise in imports, while total exports fell by 0.6%. The decline in exports was largely due to a 6.8% drop in re-exports, which outweighed a 4.6% growth in domestic exports.

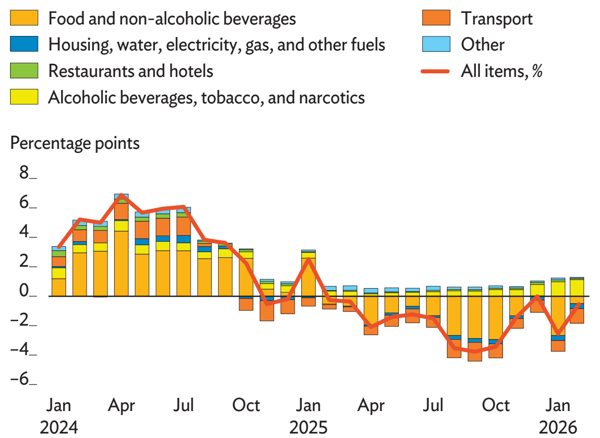
Construction continues to expand steadily. Construction activity grew by an estimated 5% in 2025, supported by a 0.8% growth in the value of work completed with prospects strengthened by leading indicators such as a 10.4% rise in building permits issued during the period and a 6.3% increase in imports of construction related materials. Construction continued to support capital formation, underpinned by ongoing investment in mining and quarrying along with tourism-related industries.

Consumption remained strong in 2025. Net VAT tax collections fell by 2.5% in the year to November, broadly mirroring the rate reduction from 15.0% to 12.5% and higher VAT refunds over the period. However, consumption indicators remain strong, including a 23.6% increase in new consumption lending, a 9.2% rise in private credit growth, and a 2.6% increase in inward remittances. There was also a 27.7% increase in new vehicle registrations with second-hand vehicle registrations up by 20% to November. These—along with a higher national minimum wage—suggest robust domestic demand. An accommodative monetary policy of 0.25% for the overnight policy rate since 2020 and ample banking liquidity have helped keep interest rates low.

VAT adjustments and strong supply have kept prices low. Ten consecutive months of deflation, supported by the lower VAT rate, culminated in no headline inflation in December and an overall 1.4% deflation in 2025 (Figure 2.30.3). Over the year, lower prices for food, transport, cooking gas and fuel, and household equipment offset higher prices for alcohol and tobacco, restaurants and hotels along with miscellaneous goods and services.

Figure 2.30.3 Contributors to Inflation

Policy adjustments kept inflation low.

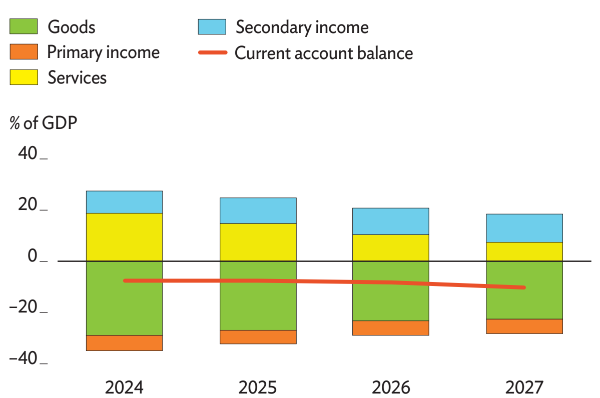


Sources: Fiji Bureau of Statistics; Asian Development Bank estimates.

Higher imports drove a wider goods trade deficit over the first three quarters of 2025, weighing on the external position despite stronger tourism-related services receipts. Improvements in the net primary income balance provided some offset, but this was partly countered by a weakening in net secondary income. As a result, the current account deficit remained elevated relative to the same period in 2024 and is estimated at 7.8% of GDP in 2025 (Figure 2.30.4).

Figure 2.30.4 Current Account Balance

The current account deficit widened.



GDP = gross domestic product.

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

Long-term debt remains elevated. At the end of fiscal year 2025 (FY2025, ended 31 July 2025), government debt was estimated at 77.5% of GDP, with 65% domestic and 35% external. External debt is mainly denominated in US dollars (82.8%), with Japanese yen (10.2%) and the People's Republic of China's yuan (6.9%) making up the rest. The maturity profile is long-term, with an average maturity of 12 years (external debt at 13 years and domestic debt at 11 years). Annual debt servicing is projected at F$540.0 million in FY2025, or 13.7% of total revenue, indicating moderate fiscal pressure.

Economic Prospects

Growth is projected to slow to 2.9% in 2026 and 2.7% in 2027 (Table 2.30.1). The slowdown in visitor arrivals in 2025 will likely carry over into 2026 due to price competition from other destinations along with domestic airline and hotel capacity constraints, and deteriorating external conditions. Also, the government's fiscal consolidation plan from FY2027 onward, and investor caution ahead of the upcoming elections, suggest that medium-term growth will be subdued. These projections are subject to a high degree of uncertainty, given ongoing geopolitical tensions, particularly the conflict in the Middle East.

Table 2.30.1 Selected Economic Indicators, %

Growth is forecast to continue moderating.

	2024	2025	2026	2027
GDP growth	3.5	3.0	2.9	2.7
Inflation	3.9	–1.4	3.3	1.9

GDP = gross domestic product.
Source: Fiji Bureau of Statistics; Asian Development Bank estimates.

Tourism remains vital to the economy but is showing signs of slowing. Major new and ongoing 4- and 5-star hotel projects should increase room supply; however, these will likely take time to materialize. Tourism faces several headwinds—including recent travel advisories, stringent US visitor visa bond requirements, expected policy rate hikes by the Reserve Bank of Australia, and the introduction of the Commercial Use of Marine Areas Act in Fiji—all of which may dampen the attraction for an increase in tourism. Despite this, new promotional efforts by Tourism Fiji, strong potential from the Canadian market, and recent Airbnb growth offer some buffers against limited room and aviation capacity.

Consumption should remain robust. With credit growth and remittance inflows still strong, consumption growth will likely continue, with election-related spending providing an additional boost. This consumption strength should support continued growth in agriculture, local food manufacturing, and financial services. Strong mahogany, sugarcane, and kava production are expected to offset cyclically weak fisheries output barring any adverse weather events.

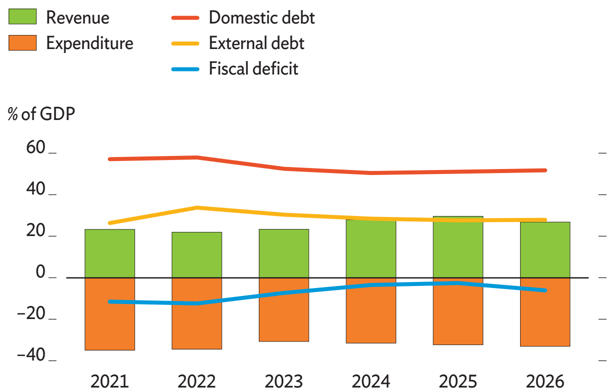
Construction will likely remain subdued. The start of new projects may face headwinds amid near-term increases in building material costs—which have risen by a cumulative 26.8% since 2022 and by 0.9% in 2025—and a wait-and-see approach by investors ahead of the upcoming elections. This uncertainty is reflected in lower domestic cement sales in October 2025 (down by 2.1%)—a key forward-looking indicator—and a 0.2% rise in new investment lending in 2025, despite ample liquidity and higher private sector credit.

Inflation is projected to increase over the medium-term. The recent deflationary trend in imported food prices and lower VAT rate will likely be offset by higher prices for food and fuel (due to heightened uncertainty surrounding the conflict in the Middle East), and alcoholic beverages—particularly due to challenges in domestic kava supply. Consequently, inflation is projected to rebound to 3.3% in 2026 and 1.9% in 2027.

The fiscal deficit is projected to widen to 6% of GDP in FY2026 (Figure 2.30.5). The increase stems from the government's countercyclical stimulus (a F$281 million spending increase, equivalent to 2% of GDP) to support household income and respond to intensifying socioeconomic pressures. These include multiple emerging public health crises arising from illicit drug use, human immunodeficiency virus, and NCDs. In the second quarter of FY2026, the government recorded a net deficit of 1.1% of GDP, with total revenue 2.4% above forecast, driven by strong tax revenue, and total expenditure 32.4% below forecast. Although first half data points to a smaller than targeted deficit, the anticipated reduction in VAT collections will likely widen the deficit. Fiji has introduced new measures

Figure 2.30.5 Fiscal Position

The deficit will likely widen.



Note: Years are fiscal years ending on 31 July of that year.

Sources: Fiji Ministry of Finance.

to respond to global oil price volatility and ongoing geopolitical risks, including drafting regulations to support contingency measures, appointing a national Fuel Controller alongside a multi-agency Fuel Advisory Committee, and creating a Cabinet Subcommittee for Energy to guide a coordinated national response. These steps underscore government's commitment to closely monitor and respond to changes in supply conditions and domestic stock levels.

Risks tilt to the downside. Risks to the outlook include uncertainties surrounding a potentially prolonged conflict in the Middle East, weak implementation of private construction constrained by labor shortages and crowding out by publicly funded projects. There are also possible electricity tariff increases, and a further slowdown in visitor arrivals from the key Australia and New Zealand source markets due to lower disposable incomes and price competition from other destinations. Upside risks to the outlook include continued high gold prices supporting mining potential, and increased digitalization to overcome capacity gaps.

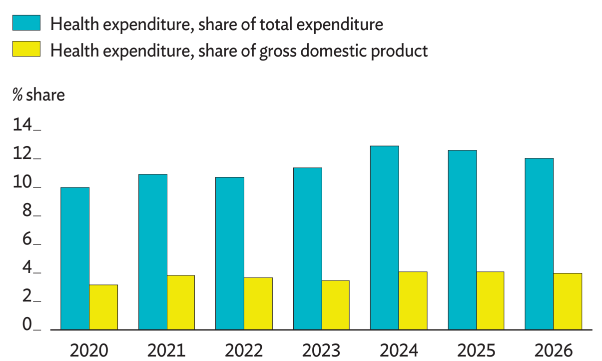
Policy Challenge— Addressing the NCD Crisis

Fiji faces a severe health crisis, with NCDs accounting for over 80% of deaths and costing approximately $263 million annually. Diabetes, cardiovascular disease, and obesity are widespread, driven by poor diets, sedentary lifestyles, and limited preventive care. This burden strains the health system and reduces workforce productivity, creating long-term economic risks. Addressing NCDs is critical not just to improve health. It will help reduce poverty and sustain long-term economic growth. Without urgent intervention, healthcare costs will rise further and shrink fiscal space, limiting resources for other development priorities.

NCDs have significant long-term economic implications. High NCD prevalence has contributed to Fiji's stagnant labor force participation rates (below 58.9% since 2014) and age dependency ratios (hovering between 53.6% and 50.6% from 2014–2024), undermining productivity, competitiveness, and resilience. While people enjoy relatively low out-of-pocket heath expenditures, with around 70% of health spending publicly funded, public health spending is only about 4% of GDP, lower than some of Fiji's peers with similar income levels, and below the World Health Organization's recommended 5% of GDP (Figure 2.30.6).

Figure 2.30.6 Health Expenditure

Health expenditure remains below the World Health Organization's recommended 5% of gross domestic product.



Note: Years are fiscal years ending on 31 July of that year.

Source: Fiji Ministry of Finance.

The Ministry of Health and Medical Services recently completed a national survey providing critical data on key NCD risk factors to target interventions that will ease the health crisis. Promotion campaigns encourage healthy eating and physical activity, while legislation restricts tobacco and sugary drink consumption. The health ministry is investing more resources toward strengthening infrastructure upgrades and awareness, along with screening and treatment programs for primary healthcare. Digital health systems are being established and used to improve patient data and service delivery. Also, healthy school policies aim to reduce childhood obesity. These measures represent progress, but implementation gaps and resource constraints remain, requiring sustained commitment and innovative financing.

Health sector reforms must be accelerated further by aligning support with national priorities. Looking ahead, policy reforms are needed to raise public health expenditure towards reducing NCD prevalence and enhancing primary healthcare service delivery. This will help improve long-term socioeconomic outcomes and build resilience against health and climate-related shocks. The necessary funding could be raised by expanding excise tax coverage to include additional high-sugar products and applying tiered excise rates based on sugar content. This will incentivize product reformulation and provide healthier consumer choices.

PAPUA NEW GUINEA

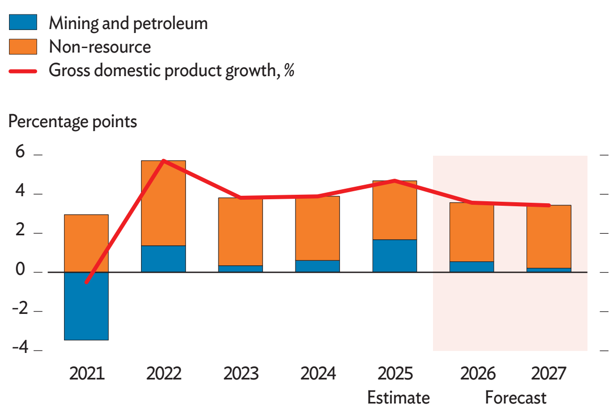
The economy improved in 2025 with stronger fiscal and external balances, favorable commodity prices, increased foreign exchange availability and business confidence, and growth across both resource and non-resource sectors. Production from the new Angore field boosted liquefied natural gas (LNG) output, while the Porgera, K92, and Ok Tedi mines strengthened mining output. Headline inflation rose during the year, driven primarily by domestic factors. Structural challenges—particularly power shortages, security, inefficiency of public capital spending, and limited skilled human resources—continue to weigh on the outlook, further amplified by inflationary pressures from the conflict in the Middle East. Strengthening government revenue collection is critical to fiscal consolidation, with forestry revenue reform as one option that also supports forest management.

Economic Performance

Economic growth accelerated to 4.7% in 2025, driven both by resource and non-resource sectors (Figure 2.31.1). Despite mixed performance, mining output overall was robust, supported by high metal prices, mine upgrades, and minimal plant shutdowns. Porgera recorded its highest gold output since reopening in 2023, reaching 66% of full production capacity. K92 and Ok Tedi also had strong gains in gold and copper production (Figure 2.31.2). Among hydrocarbons, LNG production remained key with the Angore field coming online. LNG output rose by 7.2% year on year—its strongest since 2020—partially offsetting softer LNG and crude oil prices.

Figure 2.31.1 Supply-Side Contributions to Growth

Growth in 2025 was driven by both resource and non-resource sectors.



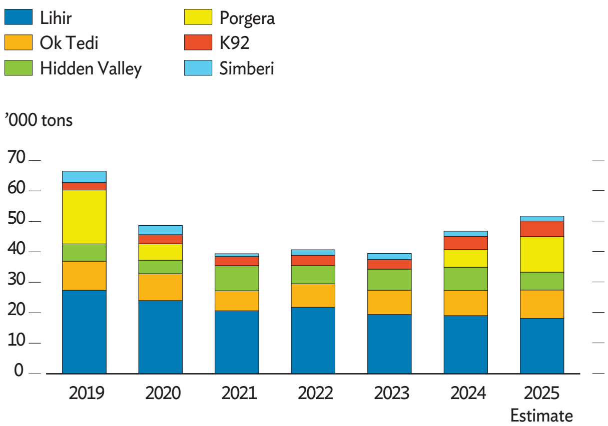
Sources: National Statistical Office of Papua New Guinea; Asian Development Bank estimates.

The non-resource sector was supported by higher agricultural commodity prices and better foreign exchange availability that increased business confidence. Cocoa performed strongly, with export volumes rising by 71.6% year on year and receipts up by 92.0% in the first 9 months of 2025. This reflects both the maturation of more than three million trees planted over 5 years ago and record-high international prices. In contrast, coffee export volumes fell by 18.4% over the same period, while export earnings increased by 27.9%, solely due to high international prices. It underscored the persistent challenges

This chapter was written by Sudyumna Dahal and Natasha Onesimo of the Papua New Guinea Resident Mission, ADB, Port Moresby, and Jennifer Umlas, consultant, Pacific Department, ADB, Manila. The policy challenge section was co-authored with Saurabh Shome, consultant, Papua New Guinea Resident Mission, ADB, Port Moresby and Le N. Lan, Agriculture, Food, Nature, and Rural Development Sector Office, Sectors Department, ADB, Manila.

Figure 2.31.2 Gold Production, by Mine

Mining continued to rebound.



Source: Quarterly mining reports.

facing agriculture—transport, finance, and aging coffee plants. Foreign exchange availability—long cited by businesses as a major constraint—improved significantly in 2025. Central bank reform toward greater exchange rate flexibility, together with higher export earnings from cash crops, LNG, and mining boosted foreign exchange supply. Foreign exchange orders by the end of 2025 were cleared in less than a week, compared to delays of up to 4 weeks in 2024. Recent business survey results showed increased private sector confidence in 2025.

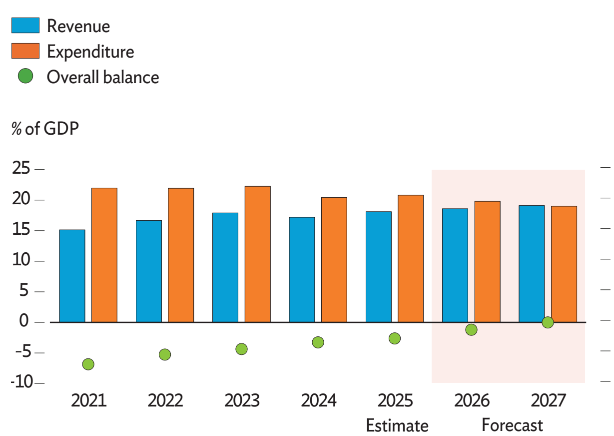
Large trade and current account surpluses continued in 2025. As a result of increased export values for key commodities from higher commodity prices, merchandise exports in 2025 are estimated at about 44% of GDP, more than triple the value of imports, generating a trade surplus of about 31% of GDP. Imports have contracted for three consecutive years—initially due to persistent foreign exchange shortages and more recently the result of exchange rate depreciation. The current account surplus in 2025 is estimated to have widened to around 20% of GDP.

Government revenues from mining offset declines in other revenue streams in 2025. Excluding mining-related receipts, other revenue growth slowed due to shortfalls in tax revenue from the PNG LNG project, nontax revenue relative to government projections, and goods and services tax (GST) collections following tax relief on 13 essential household items effective from June 2025. Strong mining revenue mitigated these gaps, with total revenue estimated at around 18% of GDP in 2025 compared with 17.2% in 2024.

Fiscal consolidation continued in 2025 (Figure 2.31.3). Expenditure remained in line with the government's Budget Repair Plan, but capital spending is estimated to have increased only marginally after contracting in 2023 and 2024 (Capital spending is defined as Government Finance Statistics 2014 manual which differs from the government's public investment). As a result, revenue growth in 2025 outpaced expenditure growth, narrowing the fiscal deficit to 2.6% of GDP. New external borrowing was well below the $1.66 billion ceiling (in present value) set under the International Monetary Fund program. Public debt likely declined from 52.1% of GDP in 2024 to 51.8% in 2025. While the country remains at "high risk" of debt distress—as debt sustainability analysis shows a breach of liquidity indicators from a $500 million Eurobond repayment due in 2028—its debt continues to be considered sustainable.

Figure 2.31.3 Fiscal Balance

The fiscal deficit narrowed further.



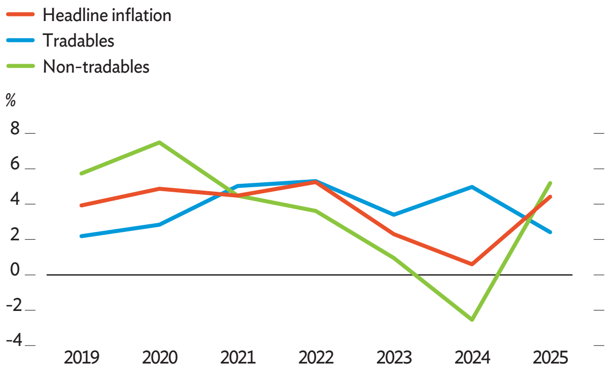
GDP = gross domestic product.

Sources: Papua New Guinea Department of Treasury; International Monetary Fund; Asian Development Bank estimates.

Inflation accelerated to 4.4% in 2025, up from a record 0.6% low in 2024 (Figure 2.31.4). While currency depreciation contributed to higher imported inflation, domestic factors dominated. Imported inflation averaged 2.4% in 2025, compared to a sharp rise in domestic inflation to 5.2% (Figure 2.31.4). The

Figure 2.31.4 Inflation

Headline inflation rebounded after a historic low in 2024.



Source: National Statistical Office of Papua New Guinea.

Table 2.31.1 Selected Economic Indicators, %

Growth should ease in 2026 and 2027 while inflation remains elevated.

	2024	2025	2026	2027
GDP growth	3.9	4.7	3.6	3.4
Inflation	0.6	4.4	4.6	4.0

GDP = gross domestic product.

Sources: National Statistical Office of Papua New Guinea; Asian Development Bank estimates.

alcoholic beverages, tobacco and betel nut component of the consumer price index surged by 17.1% in 2025. This highlighted persistent volatility caused by limited supply and unfavorable road and weather conditions. Communications prices grew by 1.9% after contracting by 9.6% in 2024. Inflation in food, clothing, and household equipment remained modest, likely dampened in part by the zero-rated GST on 13 essential items introduced in June 2025.

The central bank adopted a mixed monetary policy stance in 2025. The central bank tightened policy to contain inflation while easing liquidity pressures to support banks and maintain a smooth functioning market. The Kina Facility Rate was raised from 4.0% to 5.0% in September 2025, while the cash reserve requirement was gradually reduced from 12.0% at the start of the year to 9.0% by December.

Economic Prospects

Growth is forecast to ease to 3.6% in 2026 and 3.4% in 2027 with a mixed performance across resource and non-resource sectors (Table 2.31.1). However, these projections face significant uncertainty amid the evolving Middle East conflict. Hydrocarbons—which make up around 70% of resource output—should benefit from the effects of the Middle East conflict, depending on the intensity and duration of the disruption. Oil output is projected to rise in 2026 on the recent price surge, but its share is only around 3% in total hydrocarbon production. LNG production dominates with over 90% share, but minimal increase is expected in 2026 as it already operates at near-maximum capacity in 2025. As conditions stabilize, prices should gradually normalize, resulting in overall flat hydrocarbon output in 2027.

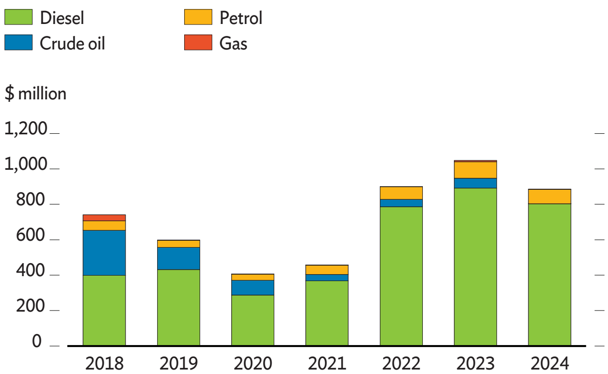
Mining will likely remain a key growth driver in both 2026 and 2027, with higher production anticipated at Porgera and Lihir. Porgera's output is forecast to reach more than 90% of full capacity by end-2026 and achieve full capacity in 2027, while planned maintenance at Lihir is expected to be partly completed in 2026, supporting increased output.

While the non-resource sector should continue to support growth, structural constraints and the Middle East conflict will affect overall momentum. Ongoing reforms to enhance exchange rate flexibility should continue to improve foreign exchange availability, bolstering business confidence and supporting import-dependent activities. However, export earnings from coffee, cocoa, and other cash crops will likely soften as global prices moderate due to a rebound in global production, such as higher expected cocoa output in Côte d'Ivoire and Ghana. Persistent challenges—power shortages, security concerns, limited skilled labor, and high business costs—will also continue to constrain non-resource sector growth.

The non-resource sector will also be adversely affected by the Middle East conflict. Although the country is a net hydrocarbon exporter it remains heavily reliant on imported refined petroleum products—particularly diesel (Figure 2.31.5). The Napa Napa refinery has been non-operational since 2023. The lack of power system planning and policies to attract renewable energy investment have led to electricity generation investments dominated by fossil-fuel-based

Figure 2.31.5 Fuel Imports

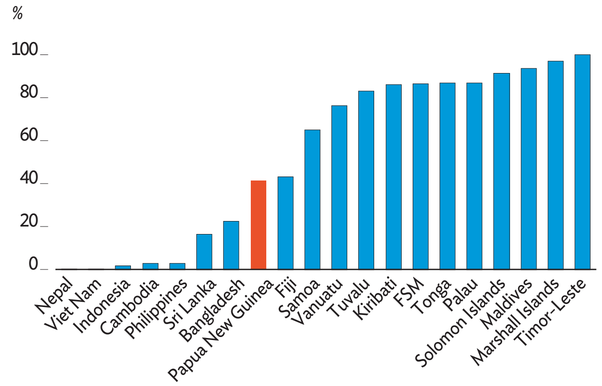
The country is heavily reliant on imported diesel.



Note: Fuel categories are defined using UN Comtrade mirror data at the HS-6 level: diesel (HS 271019), petrol (HS 271012), crude oil (HS 270900), and gas (HS 271111, 271112, 271113, and 271119).
Source: United Nations Comtrade Database.

Figure 2.31.6 Share of Electricity Generation from Oil

The country ranks among the highest in oil-based electricity use in Asia and the Pacific



FSM = Federated States of Micronesia.
Note: The database covers more of Asia and the Pacific countries, but the figure shows only the highest and lowest shares for visual clarity.
Source: International Renewable Energy Agency.

sources. Comtrade mirror data indicate that annual diesel imports averaged about $800 million in 2022–2024. Diesel-powered generators account for more than 40% of total electricity generation, implying that any increase in diesel price would adversely impact the general populace along with business, road transport, and aviation (Figure 2.31.6).

While the improvement in fiscal balance should continue as revenue increases, spending pressures may rise. Resource revenue should remain relatively strong, supported by hydrocarbon and mining receipts. Higher dividends to the central government are expected from 2026 onward, reflecting improved profitability of Kumul Petroleum following the full repayment of borrowings used to finance the government equity in the PNG LNG project at the end of 2025. The dividend policy effective in 2025 will likely further support revenue. However, the Middle East conflict may require the government to introduce relief measures for households and businesses. The election scheduled for mid-2027 will also likely increase recurrent spending, further pressuring government expenditure. Although public contracts may accelerate in 2026 ahead of the election, public capital spending will likely slow in 2027 as the government shifts its focus to the election process. In balance, revenue growth should outpace expenditure growth over the forecast period, narrowing the fiscal deficit to 1.2% of GDP in 2026 and returning the budget to balance in 2027.

Figure 2.31.7 Sovereign Risk Premium

The sovereign risk premium continues to fall steadily as macroeconomic reforms continue.

Note: The risk premium is measured by the Mid G-spread which represents the difference between United States government bond yields and Papua New Guinea sovereign bond yields with the same maturity.
Source: Bloomberg.

While the fiscal balance improves and government borrowing eases, the low share of capital spending remains a concern. Total gross borrowing is expected to decline from 2027 onward—especially external borrowing—bringing public debt down to an estimated 49.6% of GDP in 2026 and 46.8% in 2027. With these positive macroeconomic trends, the sovereign bond risk premium (G spread) narrowed further in the first quarter of 2026, reaching one of its lowest levels ever (Figure 2.31.7). It should remain stable in 2026. However, the persistently low share of capital spending will likely continue through 2026 and 2027, weighing on both short- and long-term growth given the country's significant development needs.

Inflation is projected to remain high during the forecast period. The GST exemption on essential goods will help dampen inflation, after which it will add to price pressures. The upward shift will stem from lagged effects of exchange rate depreciation and volatility in betel nut prices, which can spike sharply. The conflict in the Middle East will intensify inflationary pressures through higher petroleum prices and cascading increases in the cost of electricity, food, fertilizer, and other imported goods. Election-related spending may also contribute to higher inflation in 2027. Overall, inflation will likely increase to 4.6% in 2026 and remain elevated at 4.0% in 2027.

The outlook carries both downside and upside risks. The Middle East conflict poses a significant downward risk to the outlook, if the conflict deepens or is prolonged, especially given PNG's high reliance on imported petroleum products for electricity generation and transport. Severe development challenges and law-and-order conditions also continue to weigh on economic prospects. The Financial Action Task Force grey-listing of Papua New Guinea in February 2026 could complicate banks' ability to maintain correspondent banking relationships. A decline in precious metal prices can also pressure the economy. The complexities around the Autonomous Region of Bougainville could pose additional challenges. On the upside, a final investment decision and start of the multibillion-dollar Papua LNG project—along with progress on other resource developments—could substantially boost economic activity.

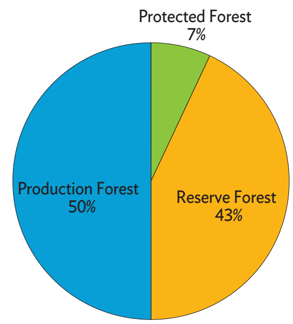
Policy Challenge—Forestry Revenue Reform

The country's forest management remains an important policy area. Forest coverage is extensive—equivalent to 73% of total landmass —but only 7% of forests are protected. (Figure 2.31.8). While the rate of deforestation remains lower than other major rainforest countries, it has accelerated since 2014. Deforestation largely affects natural forests, as plantations account for only about 0.3% of total forested land.

The country exports most of its roundwood harvest without any value addition. Globally, PNG is the largest exporter of tropical roundwood. The share of tropical roundwood exports to harvests is consistently second highest in the world (Figure 2.31.9). Although Malaysia and Cameroon harvest more, they export much lower quantities of tropical roundwood.

Figure 2.31.8 Classification of Forest Land

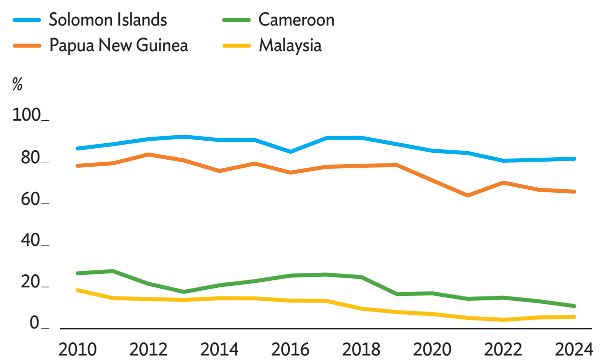
The share of protected forest remains small.



Source: Papua New Guinea Forest Authority. 2021. PNGFA Corporate Plan 2021–2030.

Figure 2.31.9 Percentage of Roundwood Exports to Roundwood Production (2010–2024)

Most PNG's roundwood exports have no value added.



PNG = Papua New Guinea.

Source: International Timber Trade Organization.

Despite half of forests being earmarked for logging exports, its benefits are small. Official data show that the share of forestry activity in GDP is less than 1%. The estimated share of logging revenue in central government revenue averaged around 3.6% in 2022–2024. Forest revenue reform can improve the government's overall domestic revenue mobilization while supporting forest conservation.

One of the key challenges is the lack of standardization, making it difficult to estimate, administer, and collect forest-related revenue. Forestry revenue accrues from six sources—log export duty (LED), royalty, levies, in-kind landowner premiums, permission and compliance charges, and corporate income taxes (CIT). Only LED and CIT are collected by the central government. The remaining revenue streams, administered by the Forest Authority, remain outside central government accounts. The Non-Tax Revenue Administration Act 2022, which took effect in 2026, aims to bring all revenue from the 22 nontax-revenues agencies under central government accounts—but full implementation will proceed in phases.

The revenue regime is not standardized because contracts are customized, resulting from trilateral negotiations among companies, the Forestry Authority, and landowner groups. For instance, the number of levies ranges between 16 and 21, with the same levy often given different rates in different documents. The LED formula is a progressive tax schedule based on the price of wood species, discounted by an adjustment factor that reduces the progressivity of the tax formula, otherwise met by simply adjusting the tax schedule.

CIT revenue collections are very low, indicating low profitability or transfer pricing malpractices. Government budget data show that annual CIT revenues from forestry averaged $0.47 million in 2015–2024, just 0.6% of LED revenues during the period. Sustained low collection implies either low profitability or weak tax policy and administration. Reports suggest transfer pricing malpractices, with companies deliberately underpricing exports and inflating costs to evade CIT. An analysis from United Nations Office on Drugs and Crime based on timber trade estimated that Papua New Guinea lost potential revenue of $1.5 billion between 2018 and 2022.

Tax policy reforms can standardize the revenue regime and improve collections. Accordingly, there are several recommended reforms the government could consider:

(i) fully implement the Non-Tax Revenue Administration Act 2022 by bringing forestry revenue under the central government account;
(ii) remove the adjustment factor from LED tax formula;
(iii) replace the fixed-rate regime with an ad-valorem rate regime for levies and royalties, enabling self-adjustment as wood prices change;
(iv) rationalize the number of levies and standardize levy and royalty rates across projects;
(v) discontinue in-kind premiums that distort the level playing field among forest industry participants;
(vi) continue to strengthen third-party monitoring of logging activities; and
(vii) mandate the Independent Consumer and Competition Commission to promulgate log prices monthly to inform revenue calculations.

SOLOMON ISLANDS

Growth improved in 2025, driven by mining, while inflation moderated as electricity tariffs fell and imported price pressures eased. External buffers remained strong, but fiscal deficits widened. The expansion should moderate in 2026 as mining growth eases, while higher oil prices from the Middle East conflict will likely dampen growth and raise inflation. Managing fiscal and debt risks will remain important amid heightened global uncertainty, while lowering energy costs can help support private development.

Economic Performance

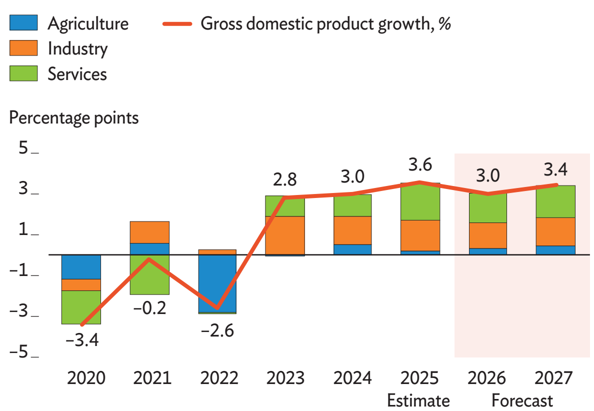
Mining was the main driver of growth in 2025, with the economy expanding by 3.6% (Figure 2.32.1). Mining provided the strongest boost to growth, reflecting a ramp-up in gold production and stronger nickel output. This aided other parts of the economy as higher mining income and the increased movement of goods supported trade, transport, and related services.

Increased mining production and processing along with ongoing infrastructure development supported industry. Gold production increased by 53.2% in the year to September 2025, while tuna and food processing underpinned manufacturing growth. Implementing major infrastructure projects supported construction. Tariff adjustments and fuel price movements continued to influence electricity costs and demand.

Services benefited from mining, tourism, and government spending. Wholesale and retail trade benefited from increased demand for imported fuel, machinery, and construction materials linked to mining production and infrastructure development, alongside steady domestic consumption. An increase in visitor arrivals, up by 12% in the first 3 quarters of 2025, increased demand for accommodation, transport, food, retail goods, and hospitality services. Public services continued to account for a large share of services output, reflecting the government's central role in employment and service delivery.

Figure 2.32.1 Supply-Side Contributions to Growth

Growth in mining is fueling industry and overall economic growth.



Sources: Solomon Islands National Statistics Office; Asian Development Bank estimates.

Weak forestry and fishing drag on the primary sector. Logging continued to decline, reflecting resource depletion and weaker external demand—particularly from the People's Republic of China—with output declining by 13.6% in the year to September 2025, weighing on exports and fiscal revenue. Fishing output also fell due to catch variability and weather conditions. By contrast, favorable weather supported crop production as copra output increased by 34.3% and cocoa by 25.8%.

This chapter was written by Resina Katafono of the Pacific Liaison and Coordination Office, ADB, Sydney; and Prince Cruz, consultant, Pacific Department, ADB, Sydney. The policy challenge section was co-authored with Roka Sanda of the Energy Sector, Sectors Department, ADB, Honiara.

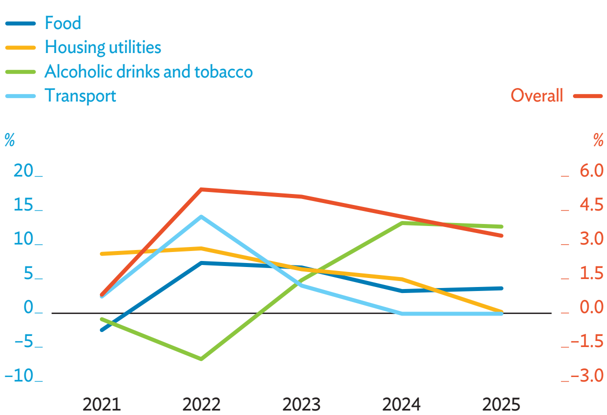
The current account recorded a surplus of 4.9% of GDP in 2025, a turnaround from the 4.2% deficit in 2024. This was supported by stronger export receipts from mining and agriculture, which underpinned a significant trade surplus, coupled with higher development partner inflows. At the end of 2025, gross foreign reserves were $810 million, equivalent to 12.0 months of imports.

The fiscal deficit likely widened in 2025 to 4.3% of GDP from 2.0% in 2024, as expenditure growth outpaced revenue gains. Revenue increased from higher tax collection, but spending rose more sharply, with increases across most expenditure categories. Higher payroll costs, spending on goods and services, and capital outlays contributed to the overall increase.

Inflation slowed to 3.4% in 2025 on electricity tariff reductions and easing imported price pressures. In line with government efforts to reduce electricity tariffs by 25% by 2027, Solomon Power reduced rates by 8.3% in 2025. At the same time, softer global fuel and food prices helped contain transport and imported food costs during the year (Figure 2.32.2). On the domestic side, inflation eased to 4.4% from 4.8% a year earlier.

Figure 2.32.2 Inflation

Global fuel and food prices along with steady domestic demand have driven inflation.



Source: Solomon Islands National Statistics Office.

Economic Prospects

Growth is projected to moderate in 2026 before picking up slightly in 2027 (Table 2.32.1). Gold mining growth should ease from 2025 levels, as output stabilizes following earlier expansion, reducing spillovers to services, while higher oil prices from the Middle East conflict raise transport and operating costs, further dampening services activity. Agriculture will likely provide modest but steady support to growth, supported by government initiatives to strengthen food security and value-added agricultural production. Ongoing development partner-financed infrastructure projects should support construction, transport, and related services. Logging is projected to continue declining.

Table 2.32.1 Selected Economic Indicators, %

Growth to moderate as inflation rises.

	2024	2025	2026	2027
GDP growth	3.0	3.6	3.0	3.4
Inflation	4.2	3.4	4.5	2.8

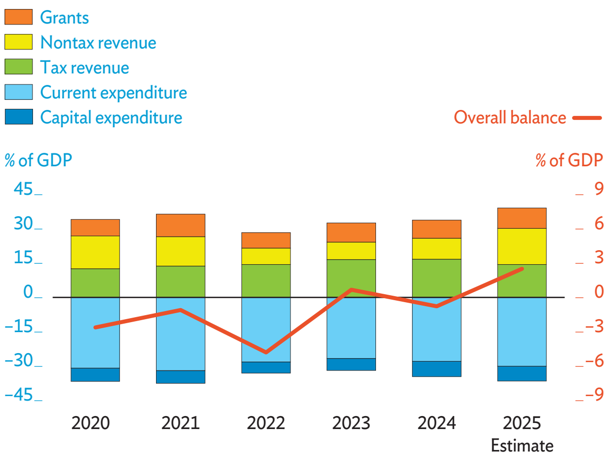
GDP = gross domestic product.
Sources: Solomon Islands National Statistics Office; Asian Development Bank estimates.

The fiscal deficit is projected at about 3.5% of GDP in 2026. Revenue is expected to increase, supported by higher domestic collection and increased grants and budget support from development partners. To broaden the tax base and offset revenue pressure from declining logging activity, legislation for a value-added tax will likely be adopted in 2026. However, a mass defection by cabinet ministers in March left the government in the minority—with the resulting political instability possibly delaying legislative approval. The proposed reform introduces a unified 15% value-added tax to replace the current fragmented sales tax system, with implementation targeted for 2028. The government has also set a target to rebuild cash reserves to SI$170 million by end-2026, in part to help restore buffers following large drawdowns for 2023 Pacific Games and the 2024 election. Expenditure remains high, reflecting rising payroll costs, increased debt servicing, and continued development spending.

Debt risks are emerging. Continued deficit financing and development borrowing have contributed to the steady increase in public debt (Figure 2.32.3). With an additional SI$1 billion borrowing within the 2026 budget, debt is close to the 35% of GDP ceiling set under the government's Medium-Term Debt Strategy.

Figure 2.32.3 Government Debt

Government debt is close to the 35% debt-to-GDP ceiling.



GDP = gross domestic product.

Sources: Central Bank of Solomon Islands; Solomon Islands Ministry of Finance & Treasury; Asian Development Bank estimates.

Inflation is projected to rise in 2026 before easing in 2027. The increase in 2026 reflects rising oil prices amid the conflict in the Middle East. External price pressures remain a key risk, given global fuel and food price volatility. As these pressures moderate, inflation will likely ease in 2027. Further electricity tariff reductions, if implemented, could add downward pressure on prices.

The central bank maintained an accommodative monetary policy stance in February 2026 and introduced a policy rate as a new operational tool. The policy stance, in place since September 2024, aims to support economic growth while keeping inflation within its target range. The newly introduced policy rate, set at 1.5%, serves as the main signaling instrument to guide monetary conditions and enhance the transmission of monetary policy. It is also designed to support the central bank's primary goal of price stability within the desired ranges of 2%-5% for headline inflation and 1%-3% for core inflation.

Downside risks dominate the outlook. An arson incident in January 2026 at the gold mine—reportedly involving unidentified illegal miners over longstanding issues with landowners—highlights the risk of disruptions to mining operations, which would hurt exports and lower fiscal revenue. A prolonged conflict in the Middle East could also add to inflation through higher global oil prices and further dampen growth. Fiscal pressures could intensify if expenditure continues to outpace revenue, which could accelerate debt accumulation given limited fiscal buffers. The economy remains vulnerable to natural hazards and political instability. On the upside, stronger-than-expected mining output, faster implementation of structural reforms, or additional concessional financing could support growth and strengthen fiscal and external positions.

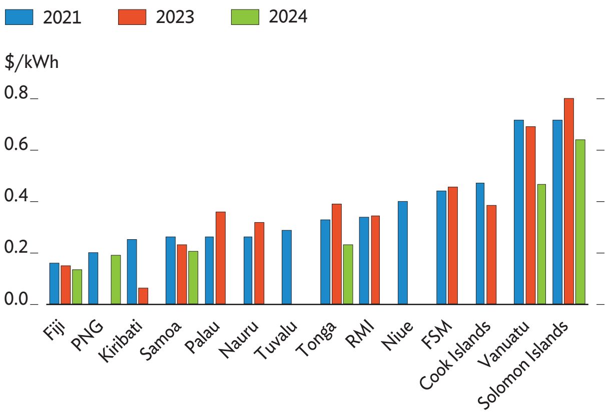
Policy Challenge—Reducing Energy Costs

Solomon Islands has the highest electricity tariffs in the Pacific, and among the highest globally, due to structural and institutional constraints (Figure 2.32.4). High costs are driven by heavy reliance on imported fuel, low renewable energy use, and the high operating costs associated with serving a geographically dispersed population under a uniform national tariff structure. These pressures are exacerbated by outdated electricity legislation and the absence of an independent energy regulator. While tariffs were reduced in 2025, sustaining lower tariffs will require reducing underlying generation and system costs while maintaining Solomon Power's financial viability.

The government is trying to make power more affordable. To reduce persistently high electricity tariffs, the government, with the support of development partners, has advanced several key interventions. The Tina River Hydropower Project will supply reliable cost-effective baseload renewable energy for the Honiara grid and significantly reduce dependence on costly diesel-fired power. Regulatory reforms, including the 2023 Electricity Act Amendments, clarify the role played by renewable energy, eliminate legal barriers, and shift tariff-

Figure 2.32.4 Average Electricity Tariff

Despite the 2025 reduction, electricity tariffs remain the highest in the Pacific.



$/kWh = United States dollar per kilowatt hour, FSM = Federated States of Micronesia, PNG = Papua New Guinea, RMI = Republic of the Marshall Islands.

Sources: ADB estimates; 2021 based on residential rates from Pacific Region Infrastructure Facility. 2022. Study on Pacific Clean Energy Financing Potential. 2023 calculated from 100kWh from Pacific Power Association. 2025. Benchmarking Report 2023 Fiscal Year. 2025 from Selectra. Electricity Prices in Oceania (2025).

setting authority to the Ministry of Mines, Energy and Rural Electrification. The National Grid Code in 2024 established clear technical and operational requirements for grid access, further encouraging private sector participation. Collectively, these measures will enhance tariff transparency, reduce regulatory uncertainties, foster competition, and scale up investments in cost-effective renewable energy.

Further steps are underway to reduce electricity tariffs. Ongoing efforts include integrating solar power generation with the main grid in Honiara and the rollout of provincial solar hybrid mini-grids. Renewable energy auctions are being held to select competitive private developers for solar photovoltaic expansion, supporting cost-effective deployment. In addition, introducing net metering for rooftop solar systems will allow customers to sell excess electricity back to the grid, increasing locally generated power and lowering overall costs. As the share of intermittent and variable renewable energy rises, targeted investment to upgrade transmission and storage will help ensure reliable power supply. Together, these measures should enhance affordability and make electricity services more accessible across Solomon Islands.

VANUATU

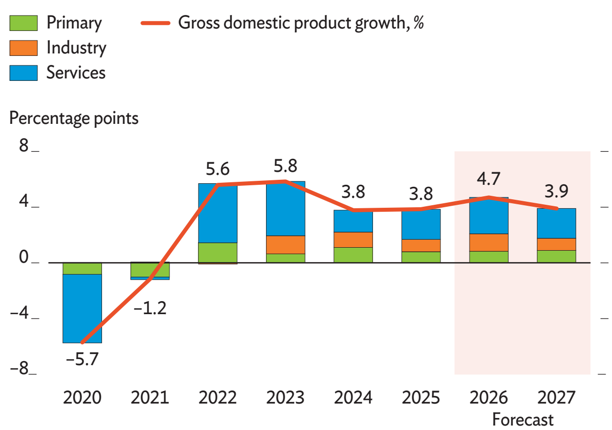
Recovery from the December 2024 earthquake continues with resilient growth expected in the near-term, driven by reconstruction and tourism. However, structural constraints, high disaster vulnerability and a prolonged Middle East conflict remain risks to the outlook. Fiscal pressures should ease gradually as reconstruction spending tapers and revenue strengthens. Debt remains sustainable with inflation contained, although forecasts are subject to considerable uncertainty. Strengthening private sector development is critical to sustain growth and increase resilience.

Economic Performance

Growth remained resilient in 2025 despite the December 2024 earthquake. The economy expanded by an estimated 3.8%, unchanged from 2024 (Figure 2.33.1 and Box 2.33.1). The impact of the earthquake on growth was offset by resilient tourism, a domestic rebound supported by government stimulus, and post-earthquake reconstruction.

Figure 2.33.1 Supply-Side Contributions to Growth

Growth continued in 2025 despite the 2024 earthquake, supported by tourism, government stimulus, and post-earthquake reconstruction.



Sources: Vanuatu National Statistics Office; Asian Development Bank estimates.

Despite lower arrivals, tourism remained key to growth, driving wider economic activity. The number of visitors declined by 1%, as a 66% increase in air arrivals to November 2025 was more than offset by a 19% drop in cruise ship tourists (Figure 2.33.2). Air arrival growth came largely from Australia—driven by pent-up demand, targeted marketing, competitive airfares, and expanded foreign carrier services following the 2024 suspension of Air Vanuatu's international operations. Cruise ship tourism, by contrast, remained subdued due to Port Vila's earthquake damage. International evidence suggests that air visitors typically spend more than cruise passengers as they stay longer and purchase more services from the local economy.

Reconstruction and infrastructure fueled industrial growth. Private construction expanded as buildings were repaired or rebuilt, while major infrastructure projects progressed. Manufacturing was mixed, with food and beverage production hurt by earthquake damage and handicrafts weakened by fewer cruise visitors. Conversely, demand for construction materials supported quarrying and utility output increased to cover rebuilding needs and rising household energy demand.

Government stimulus helped support economic activity. The stimulus package included loan guarantees to preserve credit flow, wage support, assistance for demolition and rebuilding, and grants for

This chapter was written by Resina Katafono of the Pacific Liaison and Coordination Office, ADB, Sydney and Prince Cruz, Pacific Department consultant.

Box 2.33.1 Vanuatu Adopts Chain-Linked GDP Estimates

In 2023, the Vanuatu Bureau of Statistics adopted chain-linking for estimating GDP at constant prices. This methodological shift will improve accuracy by updating price structures annually rather than relying on a fixed base year. This is particularly suitable for the small, open economy where frequent shocks—including natural hazards and shifts in key sectors like telecommunications—can cause relative prices to change rapidly, thus distorting fixed-base comparisons. As part of this update, 2023 was established as the new benchmark year.

While historical nominal trends remain broadly consistent, growth rates differ slightly. For example, nominal GDP for 2022 increased, reflecting improved coverage and valuations rather than any change in underlying economic activity. At constant prices, the chain-linking shift led to small differences in real growth rates for some years. Using this approach, estimates for 2024 and subsequent years reflect their relevant price structures.

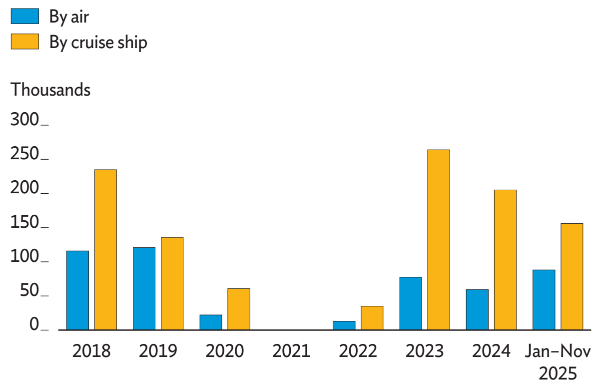
micro, small, and medium-sized enterprises (MSMEs). Together with remittance inflows, these measures helped stabilize demand and support household consumption during the recovery.

The fiscal position strengthened in 2025 to an estimated 2.5% of GDP surplus, as strong revenue growth outpaced the increase in expenditure. Revenue growth derived from higher citizenship receipts and stronger tax collection associated with sustained economic activity (Figure 2.33.3). Expenditure increased mainly due to the stimulus package.

Inflation remained subdued. Consumer prices rose by 0.7% in 2025, reflecting lower global commodity prices, moderating inflation among major trading partners, and periods of a strong currency. Vatu strength helped contain imported price pressures, particularly for fuel, utilities, and transport. These were partly offset by strengthening domestic demand linked to post-earthquake reconstruction and tourism activity, contributing to price increases in food and selected services.

Figure 2.33.2 Visitor Arrivals by Mode of Travel

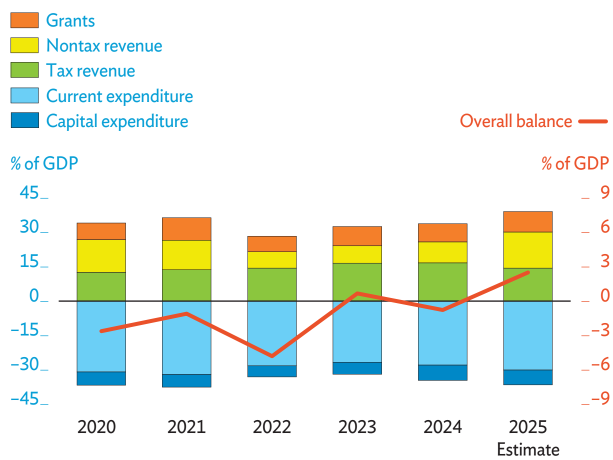
The recovery diverged in 2025 as air arrivals rebounded while cruise tourists declined.



Source: Vanuatu Bureau of Statistics.

Figure 2.33.3 Fiscal Balance

The fiscal surplus in 2025 was led by a steep increase in nontax revenue.



GDP = gross domestic product.

Sources: Vanuatu Department of Finance and Treasury; Asian Development Bank estimates.

Economic Prospects

Growth should increase to 4.7% in 2026 before moderating to 3.9% in 2027 (Table 2.33.1). The near-term forecast is supported by continued post-earthquake reconstruction, the public investment program, and a further uptick in tourism. Reconstruction of public infrastructure and private assets should sustain construction and related services. Tourism will likely strengthen further, supported by completed repairs to port infrastructure, with about 125 cruise ship calls between January and April across

Table 2.33.1 Selected Economic Indicators, %

The economy should expand; inflation rises.

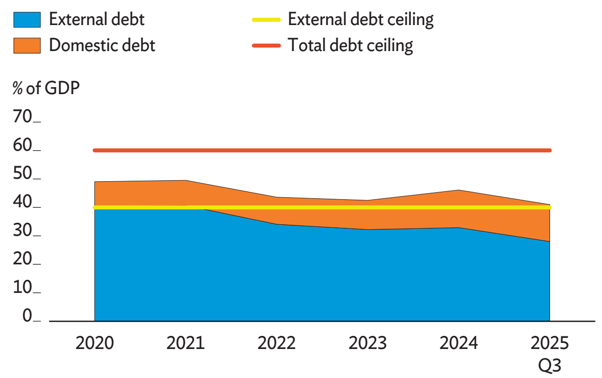
	2024	2025	2026	2027
GDP growth	3.8	3.8	4.7	3.9
Inflation	1.2	0.7	2.0	2.7

GDP = gross domestic product.

Sources: Vanuatu National Statistics Office; Asian Development Bank estimates.

Figure 2.33.4 Public Debt

Debt remains sustainable.



GDP = gross domestic product, Q = quarter.

Sources: International Monetary Fund; Vanuatu Department of Finance and Treasury.

Port Vila, Mystery Island, and Luganville. Remittance inflows and growth in private credit is expected to support domestic demand.

Growth will likely moderate in 2027 as reconstruction gradually tapers off and the post-earthquake rebound fades. Public investment should normalize following peak reconstruction, while tourism growth moves from post-earthquake recovery to more moderate trend growth.

Risks to the outlook are tilted to the downside, with forecasts subject to considerable uncertainty. Domestically, natural hazards could slow down recovery or reconstruction could be delayed by capacity and procurement constraints. Externally, slower global growth from geopolitical tensions and trade uncertainty could weaken demand from major tourism source markets. Rising global fuel prices, driven by the conflict in the Middle East, will likely affect oil supply and shipping routes. Higher food prices could raise import costs and inflation, while tighter global financial conditions could limit development partner support or development financing options. However, a stronger-than-expected tourism recovery or faster reconstruction could support higher near-term growth.

The fiscal position will likely remain stable. Stronger revenue, particularly from value-added tax and citizenship receipts, should cover recurrent expenditure. This is broadly consistent with strengthening economic activity and domestic demand, although revenue risks remain along with the timing and execution of capital spending.

Public debt remains sustainable. As of September 2025, public debt was 41% of GDP with external debt at 28%, well below government ceilings of 60% of GDP for total debt and 40% for external debt (Figure 2.33.4).

Fiscal consolidation and continued reliance on concessional external financing should support debt sustainability. In September 2025, the International Monetary Fund reduced Vanuatu's external risk of debt distress from "high" to "moderate", following the resolution of Air Vanuatu's debt restructuring.

The external balance should remain broadly stable. The current account deficit will likely persist as large imports of fuel and other goods are partially offset by tourism receipts and remittance inflows. The deficit is expected to be financed by secondary income inflows, including development partner financing and recovery-related insurance inflows—which should help maintain foreign exchange reserves at comfortable levels. Adequate reserve coverage will provide a buffer against external shocks.

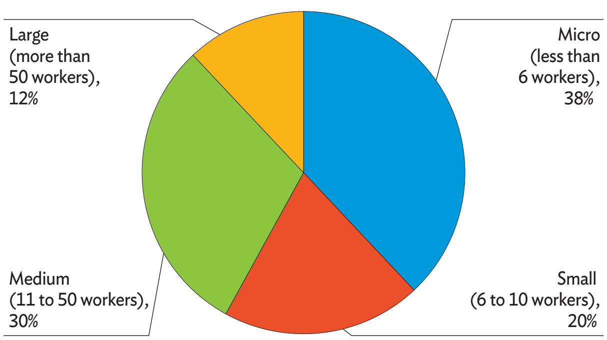
Inflation is projected to rise to 2.0% in 2026 and 2.7% in 2027. The 2026 increase reflects stronger domestic demand as economic activity expands, as well as higher oil prices due to the Middle East conflict. Inflation will likely rise further in 2027 as earlier increases in import costs and reconstruction-related demand continue to pass through to domestic prices even as economic growth moderates. Fuel and food prices remain key risks to the inflation outlook given global commodity price movements and weather-related supply disruptions. Overall, inflation should remain within the central bank's 0%–4% target range.

Policy Challenge—Strengthening Private Sector Growth

Harnessing private development is critical to sustaining growth and strengthening resilience. The private sector is dominated by MSMEs, with a 2022 skills survey of 478 firms identifying 88% as MSMEs (Figure 2.33.5). They play a central role in employment, income generation, and entrepreneurship, operating across sectors such as agriculture, services, trade, and light manufacturing, and supporting post-disaster recovery. However, MSME expansion and productivity remain constrained by structural barriers. These include limited access to finance—due to customary land tenure limiting collateral use, urban-rural disparity in accessing financial services, low financial literacy, and high financial service costs. Also, operating and logistics costs are high due to geographic fragmentation and limited transport and digital connectivity. Skills shortages—particularly in trade and tourism-related occupations affected by outward labor mobility—and exposure to natural hazards further weigh on business operations and investment.

Figure 2.33.5 Share of Entreprises, by Business Size

The private sector is dominated by micro, small, and medium-sized enterprises.



Note: Responses from 478 enterprises, survey conducted October–November 2022.

Source: Vanuatu Chamber of Commerce and Industry (VCCI). 2023. *Vanuatu Skills Needs Industry Survey Report*.

The government is strengthening the enabling environment for private development. Having implemented reforms targeting labor markets, financial inclusion, digitalization, and investment facilitation, efforts are underway to strengthen domestic workforce development and address labor shortages associated with overseas labor mobility, while strengthening skills development and reintegrating returning workers. Reforms targeting financial inclusion and resilience should improve access to domestic and international financial services. In addition, investments in digital public infrastructure—including the payments system—are helping reduce transaction costs and improve service delivery, particularly outside urban centers. Broader reforms, including modernizing tax administration, digitizing trade clearance services, promoting investment, and developing public–private partnerships aim to support private investment.

Further progress will require strengthening financial sector reform and the broader enabling environment. Priorities include improving access to the international payment system, strengthening contract enforcement, dispute resolution, and insolvency frameworks. Expanding digital tax and finance compliance systems are also priorities, along with operationalizing competition policy and building the institutional capacity to implement the 2024 Public-Private Partnerships Act. Continued investment in resilient transport and digital public infrastructure, as well as stronger alignment of skills development with private sector needs will support MSME growth and development. This will help diversify the economy beyond tourism-led growth, strengthen domestic value chains, and improve resilience to future shocks.

CENTRAL PACIFIC ECONOMIES

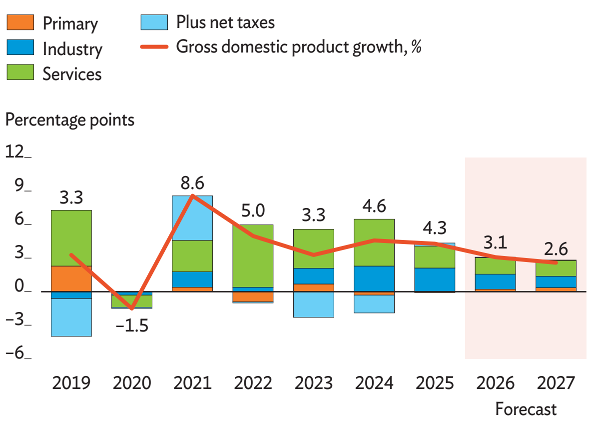
The economies of Kiribati, Nauru, and Tuvalu continued to grow in 2025. Kiribati's economy was supported by robust consumption and infrastructure investment, while government consumption drove expansion in Nauru and Tuvalu. Growth is projected to ease in Kiribati amid persistently weak exports, and Tuvalu as fiscal expansion slows. Growth in Nauru will likely remain stable, supported by development partner assistance. Inflation is forecast to moderate in Nauru and Kiribati as domestic price pressures ease, but accelerate in Tuvalu amid heightened global uncertainty. This chapter also highlights challenges to strengthening food and nutrition security in Kiribati, maintaining debt sustainability in Nauru, and ensuring sustainability of maritime assets in Tuvalu.

Kiribati

Growth was supported by services and infrastructure projects. The economy grew in 2025 by an estimated 4.3%, down slightly from 4.6% in 2024. On the supply side, growth was driven by trade and logistics services, along with construction on public infrastructure projects (Figure 2.34.1).

Figure 2.34.1 Supply-Side Contributions to Growth

Industry and services supported moderate growth.



Sources: Kiribati National Statistics Office; Asian Development Bank estimates.

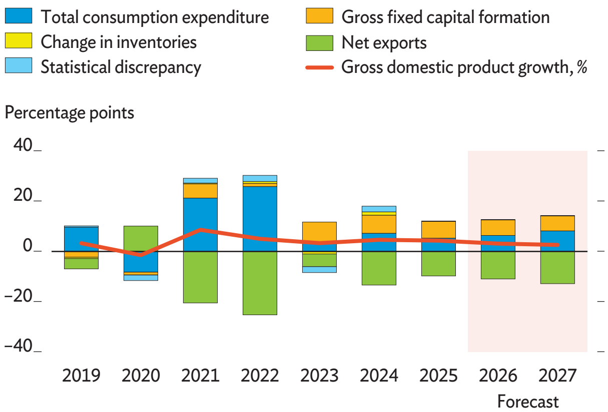
Robust consumption contributed to growth. On the demand side, household consumption and investment remained strong and continued as drivers of growth (Figure 2.34.2). Household spending benefited from fishing revenues reinvested into social protection programs and improved access to essential services, while government consumption declined due to a freeze on public wages and reduced subsidies to state-owned enterprises.

Construction investment backed infrastructure upgrades. Investment in construction and durable equipment contributed to growth, reflecting the continued rollout of public infrastructure projects. Current priorities include major investments in transport connectivity, water and sanitation systems in South Tarawa, hospital upgrades, outer island maritime access, and coastal protection. These came alongside initiatives supporting the transition to renewable energy along with improved digital connectivity and e-government systems.

This chapter was written by Resina Katafono of the Pacific Liaison and Coordination Office, ADB, Sydney; Jonathan Pryke, Tu'i Sikivou and Ilisapeci Vakaloloma of the South Pacific Subregional Office, ADB, Suva; and Prince Cruz, Pacific Department consultant.

Figure 2.34.2 Demand-Side Contributions to Growth

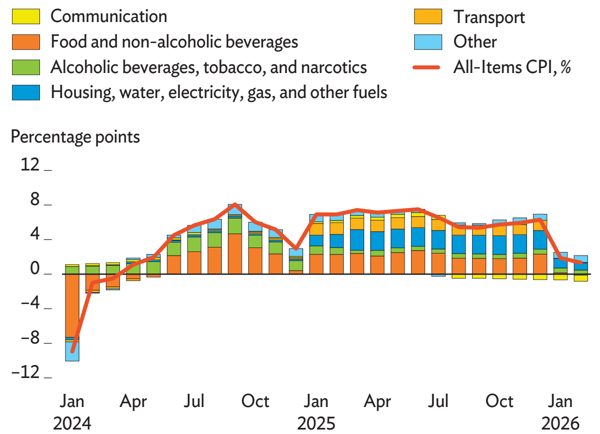
Consumption helped support growth.



Sources: Kiribati National Statistics Office; Asian Development Bank estimates.

Figure 2.34.3 Contributions to Inflation

Tariff adjustments drove inflation.



CPI = consumer price index.

Sources: Kiribati National Statistics Office; Asian Development Bank estimates.

Tariff adjustments drove inflation. In 2025, inflation rose by a moderately high 6.5%, primarily due to fuel and electricity tariff reforms in the first quarter of 2025 (Figure 2.34.3). The state-owned Kiribati Oil Company shifted to market-based pricing after fuel subsidies were removed in the 2025 budget. In addition, the Public Utilities Board raised electricity tariffs by 50% to strengthen financial sustainability and accommodate higher fuel costs. As a result, the year-on-year housing, water, electricity, gas and other fuels index increased by 38.9% with the transport index up by 13.2%.

The external sector continues to pose macroeconomic challenges. Kiribati's trade position remains structurally weak, with exports under 5% of GDP and imports above 100%, underscoring a heavy reliance on imported food, fuel, durable equipment, and other consumer goods. The resulting 18.8% current account deficit in 2025 reflects high transport costs and exposure to external price shocks, continuing to constrain growth and limit trade's contribution to domestic activity.

Fisheries revenue supported the fiscal position in 2025. Despite La Niña conditions—which typically result in poor fishing conditions within national waters—earnings from the sale of deep-water tuna fishery licenses exceeded A$200 million for the third consecutive year. In addition, revenue from coastal fisheries surpassed A$1 million for the first time. However, high recurrent spending, particularly from an incremental rise in social benefits over the past 5 years, drove the fiscal deficit to 16% of GDP. The deficit was financed by withdrawals from the Revenue Equalization Reserve Fund—similar to previous years—which originally derived from phosphate royalties and later supplemented by fishing license revenues. Public debt fell to 8% of GDP in 2025 and is assessed as sustainable, but the risk of debt distress remains high due to climate vulnerabilities.

Growth will likely moderate this year and next. Growth is projected to ease to 3.1% in 2026 and 2.6% in 2027, but will be supported by resilient household consumption and infrastructure projects financed by development-partners (Table 2.34.1). However, high import levels—driven by consumption and ongoing import-intensive construction—are expected to persist, while exports remain minimal, limiting trade's contribution to domestic economic activity. Rising oil prices, combined with a dependence on imported petroleum for transport, electricity generation, and shipping will likely further increase the trade deficit.

Investment spending should support domestic activity. Construction and related capital spending—including the Betio hospital upgrade and rollout of new renewable energy projects—will support near-term growth. Continued investment in outer island connectivity will further lift construction and services, although continuing delays in project execution may temper its overall contribution.

Table 2.34.1 Selected Economic Indicators, %

Growth is projected to ease in Kiribati and Tuvalu and remain stable in Nauru. Inflation is forecast to moderate across all three economies, but the conflict in the Middle East poses a significant risk to the outlook.

	2024	2025	2026	2027
Kiribati				
GDP growth	4.6	4.3	3.1	2.6
Inflation	2.6	6.5	5.3	4.2
Nauru				
GDP growth	1.6	2.1	2.5	2.5
Inflation	9.3	6.1	4.5	4.0
Tuvalu				
GDP growth	3.1	2.7	2.5	2.4
Inflation	0.4	2.8	3.1	1.0

GDP = gross domestic product.

Note: Years are fiscal years ending on 30 June of that year in Nauru and coinciding with the calendar year in Kiribati and Tuvalu.

Source: Asian Development Bank estimates.

Stronger governance will likely boost investment. Reforms to public financial management, stronger oversight of state-owned enterprises, and greater budget transparency will strengthen fiscal credibility and support investor confidence by reducing risks and improving public spending efficiency. At the same time, increased investment in primary and secondary education—through upgraded classrooms, digital learning, and stronger teacher training—will help strengthen human capital.

The inflation outlook remains highly exposed to external risks. Inflation is projected to fall from 6.5% in 2025 to 5.3% this year and moderate further to 4.2% in 2027. Inflation moderated to an average of 1.6% in the first 2 months of 2026. However, the dissipating effects of the one-off energy price adjustments that drove 2025 inflation will be offset by geopolitical tensions—particularly the conflict in the Middle East—which will affect global energy price fluctuations and increase costs of imported energy and producer goods for the remainder of the year.

Strong spending will rely on fiscal buffers. The 2026 budget estimates expenditure will reach $633.1 million, with one-third financed by development partners and more than half directed toward development spending. The copra price subsidy has been reduced from $40 million to $30 million, while cash reserves stand at $288.4 million—enough to cover 7 months of expenditure. Any fiscal shortfalls will be financed through reserve drawdowns and the Revenue Equalization Fund, which remains a substantial 356.6% of GDP.

Risks tilt to the downside. External risks include commodity price fluctuations and geopolitical tensions that raise import and shipping costs, as higher prices pass through quickly to domestic markets. Reliance on fishing revenues and withdrawals from the Revenue Equalization Reserve Fund also expose the economy to revenue volatility, complicating fiscal planning and broader economic management.

Policy Challenge—Strengthening Food and Nutrition Security

Food security is a problem driven by geography and arid land. As a low-lying coral atoll nation with poor soil quality, minimal freshwater, and highly limited land available, large-scale agriculture is nigh impossible. Just 2.5% of land, or about 340 square kilometers, is arable, making Kiribati one of the least fertile nations globally. Domestic food production cannot keep up with rising demand—particularly in South Tarawa—so imported foods continue to play a critical role in meeting consumption needs. In 2021, food accounted for 22.3% of merchandise imports, totaling $38.8 million, equivalent to 14% of GDP. Saltwater intrusion and regular droughts intensify pressures.

Poor diets continue to undermine nutrition. A weak food production system leads to poor diets, with very low fruit and vegetable intake and a heavy reliance on rice and sugar. Nutrition outcomes create a dual burden—high adult obesity (43.2% in 2022, down slightly from 46.3% in 2012) alongside persistent child undernutrition, with stunting falling modestly (from 16.2% to 14.2%). Outer island communities face greater risks due to isolation, transport constraints, water scarcity, and weak market access.

The government is actively pursuing policies and programs to strengthen food and nutrition security. The government promotes home gardening, small-scale livestock, poultry production, and sustainable fisheries. Complementary programs include community nurseries, composting, and school-based nutrition initiatives, though implementation is constrained by high transport costs, limited extension capacity, and fragile infrastructure.

More sustainable and adaptive solutions are needed. Policy measures that shape healthier food environments alongside targeted social protection programs can further help households adopt better diets. Sustained community engagement and stronger data systems can also support long term improvement in diet quality and nutrition. Further focus on atoll-appropriate design, durable materials, and better maintenance structures, such as salt-resistant water systems, modular nurseries, solar-powered units, and decentralized cold chain infrastructure, could support more adaptive food production.

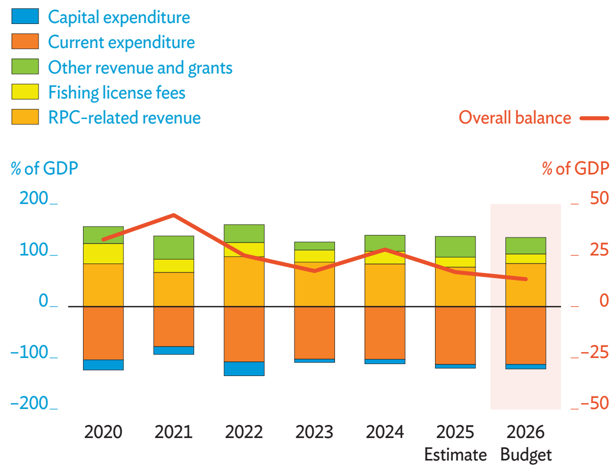
Nauru

Development partner inflows continue to support growth. The economy grew by 2.1% in fiscal year 2025 (FY2025, ended 30 June 2025) from 1.6% in FY2024 and is forecast to expand by 2.5% in FY2026 and FY2027. Higher government spending supported FY2025 growth, financed largely by inflows from the Australia-backed Regional Processing Centre (RPC) for hosting and processing asylum seekers—including Australia's Third Country Reception Arrangement where, since late 2025, Nauru has received certain noncitizens for long-term residence. Weaker trade and lower-than-expected capital expenditure moderated overall growth. Development partner grants will continue to help finance infrastructure projects—including port upgrades, solar energy, fiber-optic cables, housing, transport, and the 2028 Micronesian Games.

The fiscal surplus should narrow to 13.4% of GDP in FY2026 from 16.9% in FY2025 (Figure 2.34.4). Revenue is forecast to increase by 4.6% in FY2026 to A$381 million, supported by continued RPC receipts, including A$20 million linked to Australia's reception arrangement. In contrast, the citizenship-by-investment program, launched in November 2024, began slower than expected, with FY2025 receipts well below initial projections. While the government expects citizenship receipts of A$9 million in FY2026, the United Kingdom's suspension of visa-free access for Nauru in December 2025 could

Figure 2.34.4 Nauru Fiscal Components

The fiscal balance will remain in surplus.



GDP = gross domestic product, RPC = Regional Processing Centre.
Note: Years are fiscal years ending 30 June of that year.
Sources: Nauru Ministry of Finance; Asian Development Bank estimates.

slow uptake and revenue. Government expenditure should increase by 7.4% from RPC-related services and infrastructure spending.

The government met all three fiscal responsibility ratios in FY2025 and aims to comply again in FY2026, on track to reach its Nauru Intergenerational Trust Fund (NTF) goal. The budget stresses targeted fiscal responsibility ratios, which include maintaining a positive fiscal ratio, containing personnel costs, and ensuring an adequate fiscal cash buffer. The fiscal balance is estimated to have been positive over the 3 years to FY2026, meeting the fiscal target ratio. Personnel spending has remained comfortably below the 30% of current expenditure benchmark, while the fiscal cash buffer continues higher than the required 2 months of non-RPC expenditure. As of June 2025, the NTF had A$421.8 million in assets, on track to amass A$700 million by 2033. The government established a second trust fund to safeguard proceeds from the Third Country Reception Arrangement.

The inflation outlook remains subject to heightened external uncertainty. Consumer price inflation was 6.1% in 2025 and should moderate to 4.5% in 2026 and 4.0% in 2027. Inflation in recent years was driven largely by supply-side pressures, including a one-off increase in telecommunications subscription fees in 2024, higher import prices from Australia and shipping disruptions that raised transport costs. As these temporary factors ease and import price pressures stabilize, inflation is expected to moderate, although upside risks remain from higher global oil prices due to the Middle East conflict. Given high import dependence and use of the Australian dollar, inflation will likely remain driven largely by external price movements. Domestic demand pressures are expected to remain elevated as government spending increases.

Risks to the outlook continue on the downside. Growth and fiscal outcomes depend heavily on development partner support, RPC activity, and timely implementation of new revenue and investment initiatives. External risks include a prolonged conflict in the Middle East, which could keep oil prices elevated and increase import and transport costs, and potential changes in development partner support as tighter global financing conditions affect their own fiscal space and policy priorities. Domestic risks include capacity constraints, project delays, and fiscal changes associated with state-owned enterprises and new policy initiatives.

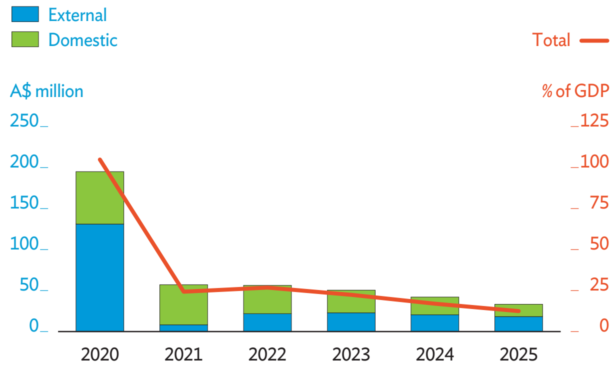
Policy Challenge—Ensuring Debt Sustainability

Overall debt has improved significantly in recent years, but a history of sovereign default and sensitivity to large new borrowings highlight the need for continued caution as financing options expand. In line with the Debt Action Plan in 2021, Nauru's public debt plummeted from 105.0% of GDP in FY2020 to 24.4% in FY2021 (Figure 2.34.5). External debt fell from 70.6% of GDP to 3.5%, while domestic debt declined from 34.4% to 20.9%. These liabilities originated largely from obligations assumed by the government following a sovereign default in 2004 from the collapse of state-linked financial institutions. External debt rose from defaulted yen-denominated bonds issued by the former Republic of Nauru Finance Corporation, while domestic liabilities came from the Bank of Nauru.

The government reduced debt by settling external obligations and gradually repaying domestic liabilities. A substantial amount of external debt was settled under the Debt Action Plan. Domestic debt

Figure 2.34.5 Public Debt

Debt is down sharply but risks remain.



GDP = gross domestic product.

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

Sources: Nauru budget documents; Asian Development Bank estimates.

fell by repaying depositors and the Nauru Phosphate Royalties Trust as resources became available. RPC-related revenue helped support debt repayment. After completing remaining repayments, the Bank of Nauru Liquidation Act was passed in January 2026, extinguishing all Bank of Nauru liabilities. While these restored fiscal space, the small economic base means that even one large borrowing could quickly increase debt ratios and weaken sustainability.

Strengthening the legal and institutional framework for borrowing will help safeguard recent gains and support sound management of future borrowing. Resolving legacy external debt improved Nauru's risk assessments, expanding access to concessional financing. However, it also increased debt exposure risk, including government guarantees or lending to state-owned enterprises, which contributed to past debt accumulation. As borrowing options increase, the government should strengthen its debt management to support prudent borrowing decisions and reduce the risk of renewed debt vulnerabilities. Modernizing the 1972 Government Loans Act and strengthening debt management practices will help clarify borrowing authority, improve oversight of public and publicly guaranteed debt, and support meeting fiscal responsibility ratios and the Medium-Term Debt Management Strategy 2023–2028. Strengthening oversight of state-owned enterprise borrowing and contingent liabilities should also help safeguard debt sustainability.

Tuvalu

High post-pandemic growth tapered. After averaging 3.4% per annum in 2023–2024 with the easing of pandemic restrictions, GDP growth is estimated to have slowed to 2.7% in 2025, as public spending eased by 14.5% in fiscal year 2025 (FY2025 ended 30 June 2025), showing only modest gains in domestic revenue and general budget support (Figure 2.34.6).

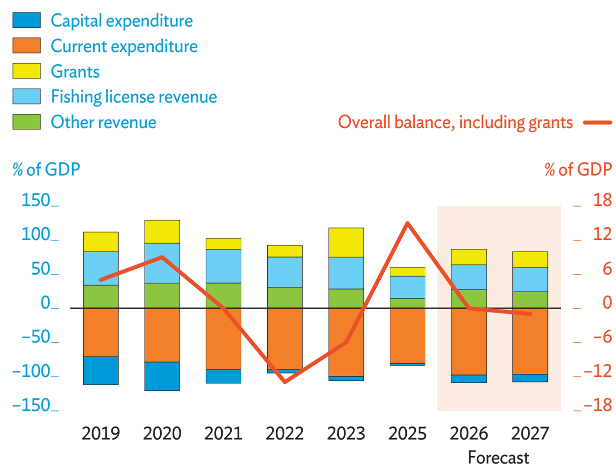
The budget shows a surplus. A fiscal surplus of 15% of GDP was estimated for FY2025 up from a deficit of 6% of GDP in 2023 (Figure 2.34.7). This reflects a 5.3% increase in domestic revenue (driven by higher fishing license collections), and a 12.4% drop in operating expenses, largely due to reduced spending on goods and services and the Tuvalu Overseas Medical Treatment Scheme. However, operating expenses will likely rebound this year driven by higher scholarships, grants, subsidies and donations, and operation and maintenance (O&M) costs—which remain high due to the upkeep of climate-vulnerable infrastructure, including marine vessels.

Inflation in 2025 rebounded on rising food and housing costs. After reaching 12.2% in 2022 amid constraints in key oil supplying economies, inflation fell to 7.0% in 2023 and 0.4% in 2024 as global food and commodity prices eased, shipping bottlenecks were removed, and domestic demand remained stable. Prices increased by 2.8% in 2025, finishing at 5.3% in the fourth quarter of 2025 on higher costs for food, housing maintenance and utilities (Figure 2.34.8).

Growth is forecast to moderate. GDP is projected to grow by 2.5% in 2026 and 2.4% in 2027. The outlook is due to the shift from fiscal surplus in FY2025 to a balanced budget projected for FY2026, with a 10.3% increase in revenue offset by lower budget support from development partners and significant growth in

Figure 2.34.7 Fiscal Position

A balanced budget is projected for FY2026.



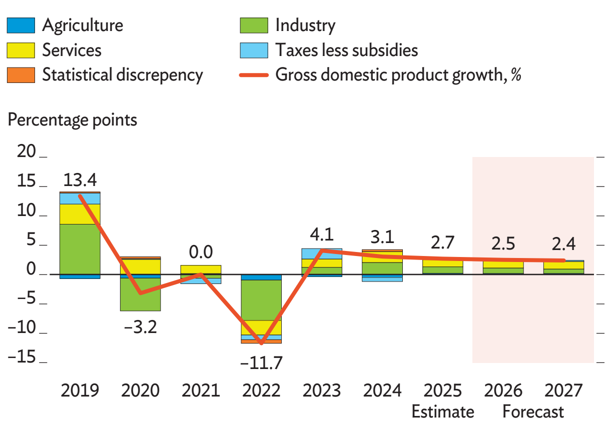
GDP = gross domestic product.

Note: Starting in 2025, years are fiscal years ending 30 June of that year.

Sources: Tuvalu Central Statistics Division; Asian Development Bank estimates.

Figure 2.34.6 Supply-Side Contributions to Growth

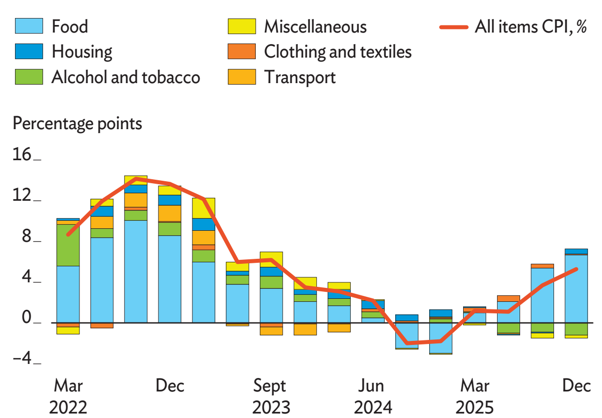
Growth eases.



Sources: Tuvalu Central Statistics Division; Asian Development Bank estimates.

Figure 2.34.8 Contributions to Inflation

Food and housing drove prices up in 2025.



CPI = consumer price index.

Sources: Tuvalu Central Statistics Division; Asian Development Bank estimates.

expenditure. In FY2027, a mild fiscal expansion is likely from a 1.3% drop in official development assistance and a slower 2.0% rise in both fishing license and internet domain revenue, along with the impact of outward migration on local capacity and climate vulnerabilities. On the downside, disruptions to business activity and public service delivery due to ongoing power rationing are expected to weigh on GDP growth. Moreover, the strong and fast developing transition from La Niña to El Niño could disrupt ocean temperatures and currents, posing risks to tuna migration patterns and potentially reducing Tuvalu's fishing revenue in 2026 and 2027. This underscores the importance of enhancing economic resilience and fiscal sustainability by diversifying income sources.

Inflation remains vulnerable to global commodity price pressures. Inflation is expected to be 3.1% in 2026 and 1.0% in 2027 reflecting heightened uncertainty surrounding the current conflict in the Middle East and its impact on global commodity prices, particularly pass-through effects of higher inflation among trading partners Fiji and Australia.

Policy Challenge—Operation and Maintenance of Maritime Assets

Tuvalu faces ongoing challenges sustaining its government-owned maritime fleet. The Nivaga III and the newer Manu Sina are vital for interisland connectivity. Aging, prolonged maintenance, and service disruptions have weakened fleet reliability. While the 2025 commissioning of Manu Sina improved capacity, the older vessels still require significant upkeep in a harsh marine environment that accelerates deterioration. Limited technical capacity, a small population, and out-migration of skilled workers further constrain vessel maintenance and asset management. The lack of a sustainable O&M framework risks undermining investments in maritime infrastructure, isolating outer islands. Addressing this requires institutional reforms, dedicated funding mechanisms, and capacity-building programs to build a culture of proactive asset management.

With a population of 10,643 dispersed across nine islands (with 62% living on Funafuti), the Manu Sina is currently the only reliable link for essential service delivery. Ship failure would severely disrupt connectivity and the economy. Skilled labor shortages hinder O&M capacity. Climate risks further strain infrastructure, increasing maintenance costs. Ensuring the ship's sustainable operation is critical for economic resilience.

The government has prioritized maritime connectivity through major investments. These include replacing the aging Manu Folau in 2025 with the Manu Sina, undertaking port upgrades in Funafuti and the outer islands, engaging consultants and development partners to strengthen O&M systems and embed preventive maintenance practices, along with building the technical capacity of crew and ministry staff.

Looking ahead, the government plans to institutionalize asset management and secure long-term financing. However, success will depend on consistent funding and regional cooperation. Future actions could include leveraging climate funds and donor contributions into establishing a maritime trust fund for sustainable O&M financing, bonded scholarships for crew certification to stem the outflow of qualified personnel, and regional partnerships for spare part procurement and knowledge sharing.

NORTH PACIFIC ECONOMIES

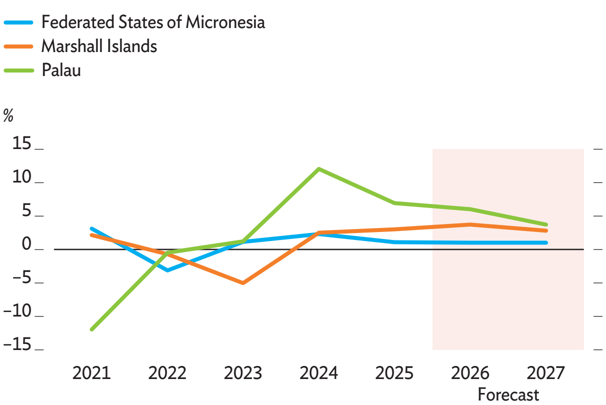
All three North Pacific economies expanded in fiscal year (FY) 2025 (ended 30 September 2025 for all three), driven by domestic consumption in the Marshall Islands, construction in the Federated States of Micronesia (FSM), and continued increases in tourist arrivals in Palau. Growth is forecast to continue, although prospects vary. Inflation is projected to rise in the near term before moderating. This chapter also examines the Marshall Islands' Universal Basic Income scheme, the FSM's efforts to strengthen infrastructure connectivity, and fiscal resilience in Palau.

Marshall Islands

Growth picked up due to increased domestic demand. The economy grew by 3.0% in FY2025 compared with 2.5% in FY2024 (Figure 2.35.1). The October 2024 rise in minimum wage together with implementation of the Income Tax (Amendment) Act 2024—which increased the number of taxpayers eligible for exemptions—boosted household consumption. Government spending, including public infrastructure, also increased given funding under the renewed Compact of Free Association (COFA) with the United States (US) and from other development partners. The resulting increase in demand drove growth in construction, trade, and transportation, offsetting lower fisheries output as stocks declined due to warmer ocean temperatures. Increased tourism, mainly from Marshallese living abroad visiting family and friends, further boosted growth in services.

Figure 2.35.1 Gross Domestic Product Growth

All three North Pacific economies continue to expand.



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

Sources: Asian Development Bank estimates; Republic of the Marshall Islands, Federated States of Micronesia, and Republic of Palau Economic Briefs and economic and fiscal updates; International Monetary Fund country reports.

Household and government spending will likely sustain economic growth. The economy is forecast to expand by 3.7% in FY2026 (Table 2.35.1). Disposable income continues to rise with the minimum wage hike and additional income tax relief that took effect in October 2025 along with payments under the Universal Basic Income (UBI) and Extraordinary Needs Distribution (END) programs that began in the first quarter of FY2026. Together with hosting regional events—such as the Forum Economic Ministers Meeting and major meetings of the Parties to the Nauru Agreement—and two new aircraft to boost domestic travel and goods transport, growth in key services will be sustained. Public infrastructure projects continue—including rebuilding the parliament building and construction of a government capital building and power station in Majuro. Growth should moderate to 2.8% in FY2027 with no major events scheduled and

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Table 2.35.1 Selected Economic Indicators, %

Growth will continue in North Pacific economies to varying degrees.

	2024	2025	2026	2027
Marshall Islands				
GDP growth	2.5	3.0	3.7	2.8
Inflation	5.7	5.6	5.7	4.0
Federated States of Micronesia				
GDP growth	2.3	1.1	1.0	1.0
Inflation	5.4	3.9	3.5	3.0
Palau				
GDP growth	12.0	6.9	6.0	3.7
Inflation	3.7	0.2	2.8	2.4

GDP = gross domestic product.

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

Sources: Graduate School USA Economic Monitoring and Analysis Program; International Monetary Fund Article IV staff reports; Asian Development Bank estimates.

the impact from the start of the UBI and END programs incorporated in the baseline. A further minimum wage hike scheduled for October 2026, continued UBI and END program and public infrastructure project implementation, and government spending ahead of the November 2027 general elections should support the FY2027 expansion. The outlook for fisheries over the forecast period remains subdued, with fish stocks in Marshallese waters remaining depleted due to ocean warming.

Inflation remains high. Prices grew by 5.6% in FY2025, broadly unchanged from 5.7% in FY2024. Although international commodity prices moderated, increased demand from the minimum wage hike helped push up food and utility prices, especially in the first half. Inflation will likely return to 5.7% in FY2026 before moderating to 4.0% in FY2027, following expected trends in global fuel prices and imported inflation. Higher domestic demand from additional minimum wage hikes as well as the start of UBI and END programs may add to domestic price pressures.

Substantial risks may affect growth and inflation forecasts. A prolonged conflict in the Middle East could disrupt international supply chains and keep global commodity prices high for longer than expected and more profoundly impact costs of imported consumer goods and production inputs. Against this backdrop, the government has declared a 90-day state of economic emergency to initiate a coordinated response to emerging energy supply and price pressures. More frequent and severe climate events could slow agricultural and fisheries activity—thereby affecting food security—and stall economic activity especially in construction and tourism.

Fiscal expansion will likely turn the budget surplus into deficit in the near term. The government had a surplus equivalent to 1.2% of GDP in FY2025, narrower than the 2.6% in FY2024, as capital expenditure drove spending up more than revenue. At the end of FY2025, the value of the Marshall Islands' Compact Trust Fund (CTF) was $1.4 billion, equivalent to 436.2% of GDP. Aircraft procurement in FY2026 will likely contribute to a fiscal deficit of 6.3% of GDP. In FY2027, key reforms will be implemented to begin the country's transition from a fragmented tax regime to a more streamlined and equitable system, which should enhance revenue collection and offset substantial election-related expenditure to reduce the deficit to 0.7% of GDP.

New debt and implementing novel initiatives could significantly impact the fiscal outlook. External debt was estimated to be equivalent to 13.4% of GDP in FY2025, down from 18.9% in FY2024, primarily due to substantial grant inflows. Going forward, however, grant access will likely narrow following the reclassification of the country's debt distress risk as "moderate." As the Marshall Islands may need to borrow more for future development needs, any added debt must be concessional to help keep the public debt burden sustainable. The government issued a "digital sovereign bond" (tokenized) as a stablecoin called USDM1, fully collateralized by US Treasury bills. This is intended to promote financial inclusion, especially in remote areas. However, there are concerns over capacity constraints along with fiscal and governance risks. UBI recipients could receive payments in USDM1. The UBI and END programs along with the innovative USDM1 issuance are largely untested and must be monitored closely for any excessive adverse fiscal impacts.

Policy Challenge—Maximizing the Benefits of the Universal Basic Income Program

On 26 November 2025, the Marshall Islands government paid about $200 to each of the 33,000 citizens registered under the UBI program. The program makes quarterly unconditional cash transfers to all citizens living in-country to ease cost-of-living pressures, providing an incentive not to migrate. By covering the non-working-age population and informal workers, the UBI program goes beyond the social security system. While other countries have introduced similar programs for selected groups of people, the Marshall Islands appears to be the first to cover all citizens.

Although there have been no reports of price spikes after its introduction, the UBI program could contribute to temporary demand surges. Spikes in demand can add significant price pressures on non-tradables such as food services, transportation, and housing—all major items in the consumer price index basket. Increased imports of tradable goods and better inventory management can limit price increases in other sectors.

In addition, the UBI program could come at a significant fiscal cost, diverting resources from other development needs. The government budgeted $27.6 million for the UBI program in FY2026, equivalent to almost 8% of GDP. Although the amounts paid—equal for all recipients—depends on the CTF performance, the cost will likely rise in FY2027 as more citizens register. Tying allowable CTF withdrawals to the program could reduce resources available for other public investments (for example climate adaptation) and countercyclical spending in case of a shock. These would be increasingly financed through debt. With the country's reduced access to grant financing, any subsequent debt service will stretch fiscal resources even further.

Close monitoring is critical to ensure the desired social impacts. The Trust Fund Committee will review implementation of both the UBI and END programs, including proposed budgets covering target populations and total payment amounts, with findings helping determine whether the programs will be adjusted or terminated. The review should be complemented by regular price monitoring and closer coordination with importers and retailers to ensure availability of goods and services and manage any inflationary impact.

Federated States of Micronesia

Growth moderated in FY2025. The economy expanded by 1.1% in FY2025, down from 2.3% in FY2024. Public spending—largely on construction projects funded by unspent grants under the previous COFA—supported growth. The larger states of Chuuk and Pohnpei were delayed in tapping additional resources under the renewed COFA due to a lack of project management capacity along with difficulties meeting COFA accountability and reporting requirements. Fisheries output remained muted as high ocean temperatures have reduced fish stocks.

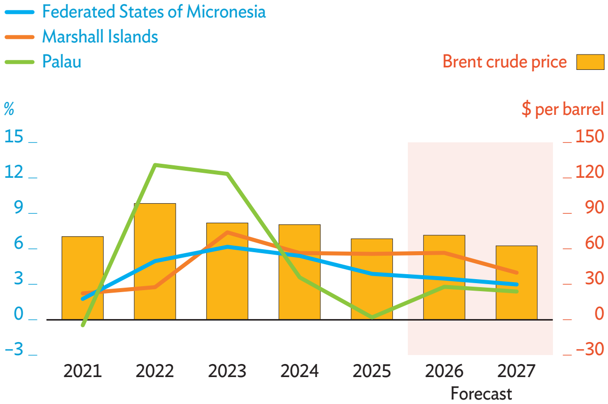
Gradual COFA use should support stable expansion. Growth is forecast to be 1.0% in both FY2026 and FY2027. A gradual increase in public spending is likely, keeping expansion steady as larger states slowly build their absorptive capacity of COFA grants. State elections in Yap are scheduled for November 2026, and preparations should provide some economic stimulus. Aside from the continued vulnerability to external shocks such as disasters, project delays and an inability to access COFA funds due to weaknesses in accountability and reporting practices could weigh on growth prospects.

External economic conditions continue to shape inflation prospects. Prices grew by 3.9% in FY2025, down from 5.4% in FY2024, following international commodity price movements and imported inflation along with lingering price pressures from public wage increases (Figure 2.35.2). Inflation is forecast to fall to 3.5% in FY2026 before moderating to 3.0% in FY2027, driven by anticipated trends in global commodity prices and inflation among key trading partners. Protracted commodity price volatility and international supply bottlenecks from extended geopolitical tensions remain the main risks to the outlook.

The fiscal balance is projected to fluctuate between surplus and deficit over the forecast period. The government had a consolidated fiscal deficit equivalent

Figure 2.35.2 Inflation

Inflation will likely moderate in the Marshall Islands and the FSM but rise in Palau.



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

Sources: Asian Development Bank estimates; Republic of the Marshall Islands, Federated States of Micronesia, and Republic of Palau Economic Briefs and economic and fiscal updates; World Bank commodity price data.

to 1.8% of GDP in FY2025, a reversal of the 1.0% surplus in FY2024. The first full year of financial assistance under the renewed COFA contributed to a substantial increase in grant inflows that, alongside a rise in tax revenue, boosted total receipts. However, this could not cover higher recurrent spending. At the end of FY2025, external debt stood at 10.7% of GDP, and preliminary assessments show the combined assets of the FSM Trust Fund and the country's CTF were $2.5 billion, equivalent to over 500% of GDP. In FY2026, revenue should remain stable while grants rise, contributing to a fiscal surplus equivalent to 0.7% of GDP. However, government expenditure will likely grow faster than revenue in FY2027, resulting in a deficit equivalent to 0.2% of GDP.

The possibility of further oil spills in Chuuk Lagoon poses a serious risk to the fiscal outlook. In September 2025, oil began leaking from a World War II-era shipwreck in the lagoon and quickly spread to nearby islands. Local agencies applied provisional containment and cleanup measures. However, specialized international help is needed to properly remove the oil and contaminants. A long-term solution may become a significant fiscal burden if the FSM is unable to secure development assistance. There are over 60 wrecks in Chuuk Lagoon, and additional, larger oil spills become more likely as hulls continue to erode.

Policy Challenge—Bridging the Transport Infrastructure Gap

Poor infrastructure connectivity is a barrier to increased economic activity. A January 2026 assessment by the Pacific Private Sector Development Initiative highlights that the lack of basic infrastructure or its poor-quality significantly limits business growth and foreign investment. Higher logistics costs, reduced service reliability, and poor market access—especially for micro, small, and medium-sized enterprises—resulting from these infrastructure gaps restricts interisland trade and needed development in agriculture, fisheries, and tourism.

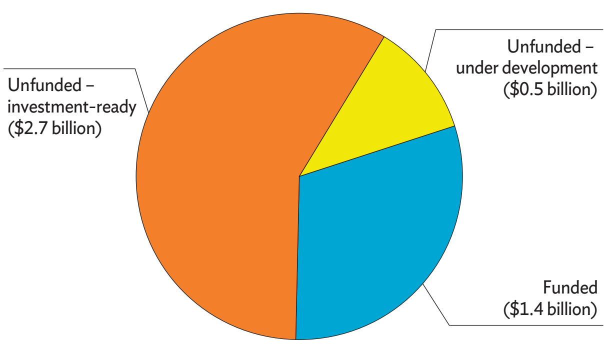
Transport connectivity faces major structural constraints, including extreme geographic dispersion, climate vulnerability, and limited institutional capacity. Weak coastal road networks deteriorate quickly from coastal exposure and insufficient maintenance. Maritime facilities—central for connecting the FSM's 607 islands spread over 2.6 million square kilometers of ocean—remain constrained by inadequate berthing structures, aging ports, and limited institutional and technical capacity to safely handle passengers and cargo. Aviation infrastructure, particularly on outer islands, must be upgraded to maintain safe and regular operations. These structural challenges are compounded by more frequent and severe weather events, which threaten all transport-related assets and widen the infrastructure gap.

The government of the FSM recognizes the need for sustained investment in climate resilient transport networks. The National Strategic Development Plan 2024–2043 outlines priorities that enhance accessibility and climate resilience of infrastructure services, expand and upgrade networks supporting economic activity, strengthen the institutional framework managing infrastructure services and maintenance, and digitalize and streamline public services. Its accompanying Infrastructure Development Plan (IDP) 2025–2034 identifies related spending that aligns transport investments with these strategic outcomes.

However, long-term infrastructure requirements far exceed available financing. Less than a third of the projects identified under the IDP can realistically be financed through COFA allocations and expected development partner contributions, as the government continues to develop the capacity to raise revenue collections and meet its own development needs (Figure 2.35.3). High construction costs, small markets with limited financing capacity, and accumulated maintenance backlogs further strain government capacity and raise long term funding needs. Using a multi-criteria analysis considering impact and feasibility, the IDP identifies $2.7 billion in "investment ready" projects that require funding, including major road, port, and airport upgrades.

Figure 2.35.3 Availability of Resourcing for Infrastructure Projects

Less than a third of projects identified under the IDP have funds committed or pending from the COFA or development partners.



COFA = Compact of Free Association, IDP = Infrastructure Development Plan.

Source: Pacific Region Infrastructure Facility. 2025. *Federated States of Micronesia: Executive Overview of the Infrastructure Development Plan*.

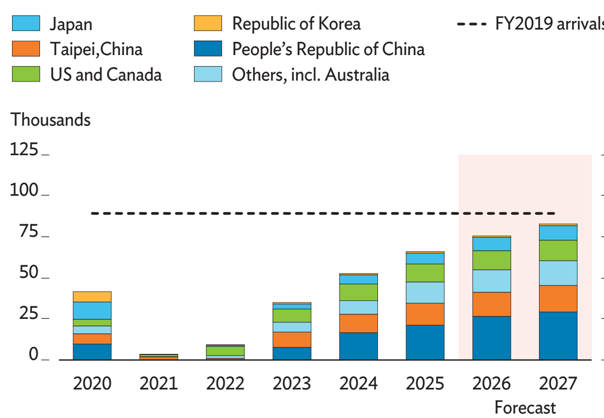
Strategic and efficient resource allocation is crucial to maximize the development impact of available resources for transportation networks and digitalization. Strengthening project prioritization and preparation, improving asset management, and targeting key corridors and maritime facilities must ensure that scarce resources deliver climate-resilient, safe, and inclusive connectivity across island states. Continued work with development partners should help ensure that the necessary assessments that inform investment planning are done, and that climate and gender considerations are embedded in project design and institutional capacity building measures. These would enable the FSM to establish sustainable, climate-resilient transport networks, connect widely dispersed communities with each other, and support economic growth.

Palau

The economy grew by 6.9% in FY2025 as international arrivals reached 73.3% of pre-pandemic (FY2019) levels. Incoming visitors rose by 25.4%, with visitors from the People's Republic of China accounting for 32.2% of the total and Taipei,China for 20.2% (Figure 2.35.4). Arrivals from Australia rose fastest, up by 72.7% from FY2024 with Europe increasing by 51.9%. Early data for FY2026 suggest a pickup in arrivals from Japan, which rose by 82.0% in the first four months of the fiscal year compared to the same period in FY2025, following the introduction of direct flights from Tokyo in October 2025.

Figure 2.35.4 Visitor Arrivals in Palau, by Source

Arrivals in FY2025 reached 73.3% of FY2019 levels.



US = United States.

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

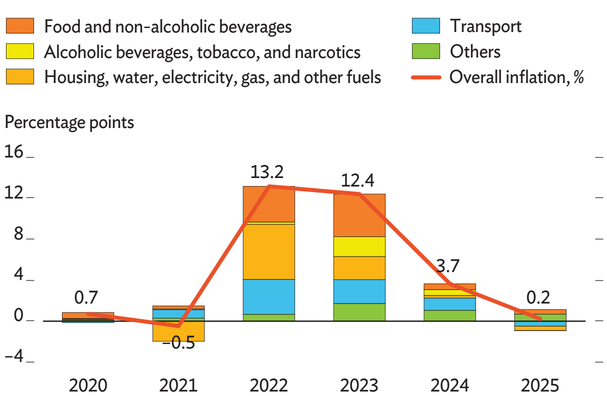
Sources: Palau Bureau of Budget and Planning, Palau Bureau of Immigration, and Palau Visitors Authority.

Following a strong FY2025 rebound, growth is forecast to moderate to 6.0% in FY2026 and 3.7% in FY2027. Even as overall growth eases, direct flights from Japan should further support the recovery of the Japanese tourist segment, a top source market before the pandemic which on average accounted for 21.7% of monthly arrivals in FY2019. New direct flights from the Philippines, beginning March 2026, along with weekly flights from Australia, should attract additional visitors from emerging source markets and strengthen the tourism recovery. Public infrastructure projects—including a major bridge repair, port rehabilitation, and sanitation upgrade—will also likely contribute to near-term economic growth. Upside risks include planned investments by major hotel chains and the opening of new accommodations, which could lift growth above the projection. In addition, the Pacific Islands Forum Leaders Meeting in August 2026 could further strengthen growth. However, the tourism-led recovery faces downside risks from the ongoing Middle East conflict, as elevated fuel costs and geopolitical uncertainty could raise airfares, constrain international travel, and weigh on visitor arrivals to Palau.

After falling to 0.2% in FY2025, inflation is projected to pick up. The further slowdown of inflation in FY2025 primarily reflected a 2.6% decline in utility prices, driven by the reduction in electricity tariffs at the start of the fiscal year, as well as a 2.6% decline in transport costs (Figure 2.35.5). These downward pressures more than offset sizable increases in the prices of food and non-alcoholic beverages (1.8%), communications (3.9%), and restaurants and hotels (10.8%). Domestic prices rose by a modest 0.6%, while imported prices were broadly unchanged. Inflation is projected to rise to 2.8% in FY2026 before easing to 2.4% in FY2027 on higher global food prices and inflation trends among major trading partners. Upside risks to the outlook have increased, as the conflict in the Middle East could substantially increase oil prices above forecasts, raising import and transport costs.

Figure 2.35.5 Contributions to Inflation, Palau

Lower utility and transport costs were behind the sharp inflation slowdown.

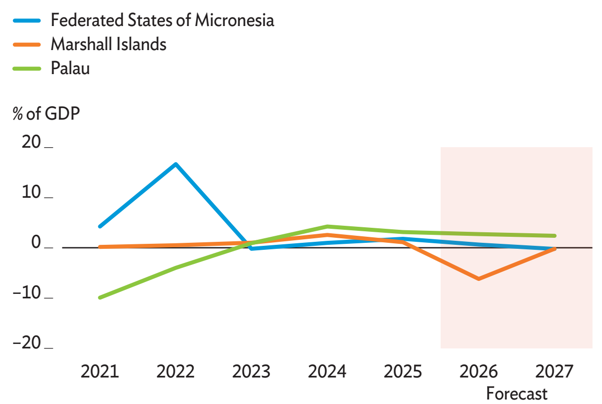


Note: Years are fiscal years ending on 30 September of that year.
Source: Graduate School USA Economic Monitoring and Analysis Program; Palau Bureau of Budget and Planning.

The fiscal position has strengthened with the economic recovery, supported by FY2023 tax reforms, fiscal consolidation, and continued Compact grants. The fiscal position strengthened in FY2025 as the economic recovery—along with FY2023 tax reforms, disciplined spending, and continued Compact grant inflows—supported a solid improvement in public finances. The tax reforms broadened the tax base and enhanced domestic resource mobilization, raising the tax-to-GDP ratio from 17.4% in FY2022 to an estimated 21.6% in FY2025. As a result, the fiscal position is strengthened markedly, with the fiscal surplus reaching about 3.1% of GDP in FY2025 (Figure 2.35.6). These helped reduce fiscal vulnerabilities, with the debt-to-GDP ratio down from 66.3% in FY2024 to about 56.1% in FY2025.

Figure 2.35.6 North Pacific Fiscal Positions

Fiscal positions returned to surplus across the North Pacific, supported by higher tax collections as well as the first full year of COFA grants.



COFA = Compact of Free Association, GDP = gross domestic product.
Note: Years are fiscal years ending on 30 September of that year.
Sources: Asian Development Bank estimates using latest data from the Republic of the Marshall Islands, Federated States of Micronesia, and Republic of Palau Economic Briefs and economic and fiscal updates, and International Monetary Fund country reports.

Policy Challenge—Enhancing Fiscal Resilience

As the tourism led recovery strengthens, maintaining fiscal resilience must safeguard these gains against emerging risks. Compact funds will likely continue to contribute to fiscal surpluses of 2.7% and 2.4% of GDP projected for FY2026 and FY2027. Sustaining this momentum will require careful management of rising fiscal risks—most notably from the social security and pension system—and a continued focus on strengthening spending efficiency and revenue mobilization. Ensuring that fiscal policy remains aligned with Palau's medium-term development and fiscal sustainability objectives is a central challenge.

The fiscal outlook for FY2026–FY2027 depends on availability of external grants as well as mounting contingent liabilities from state-owned enterprises (SOEs) and the pension system. To safeguard sustainability, fiscal policy should continue to follow the Fiscal Responsibility and Debt Management Act, including the 30% debt-to-GDP anchor. Linking fiscal rules more explicitly to the debt anchor would help strengthen fiscal discipline. Enhancing SOE oversight—through improved performance monitoring, targeted subsidies, and clearer regulatory arrangements—will be essential for reducing fiscal risks and improving service delivery.

Preserving fiscal buffers is critical, given heightened exposure to climate-related shocks and the growing need to finance climate-resilience investment. The tourism-dependent economy remains highly vulnerable to climate shocks. Recent improvements in fiscal outlook have expanded fiscal space. However, climate-related events combined with global uncertainty and price volatility could derail the tourism recovery and increase fiscal pressures. This raises the likelihood the government may need to draw on fiscal buffers to stabilize the economy. Considering climate adaptation needs, maintaining adequate fiscal space is essential to safeguard the fiscal outlook and ensure Palau can finance resilience investments without jeopardizing debt sustainability.

A significant fiscal challenge is the social security and pension system. Long-standing underfunding, demographic pressures from an aging population, and persistent outward migration —which has reduced the contributor base while increasing dependency ratios—have weakened the financial position of both the civil service pension plan and social security administration. Accelerating social security and pension reforms will help contain rising unfunded liabilities, protect long term fiscal stability, and help address out-migration. The planned update of actuarial assessments of the social security and pension system will help chart reform options based on changes to the retirement age, contribution rates, and the potential transition between defined benefit and defined contribution arrangements. Based on the option selected, it is important to adopt a reform roadmap to ensure that reform actions are well sequenced, financially sound, and socially sustainable. International financial institution technical and policy support can help promote timely implementation of the reform roadmap.

Overall, strengthening fiscal resilience will require a coordinated reform agenda. The agenda includes (i) accelerating social security pension reforms, (ii) improving public financial management systems and investment efficiency, (iii) enhancing SOE oversight, (iv) maintaining targeted subsidies, and (v) aligning fiscal policy with the Fiscal Responsibility and Debt Management Act. Advancing these reforms will help preserve fiscal buffers, manage emerging risks, and support more resilient and sustainable growth.

SOUTH PACIFIC ECONOMIES

Across the Cook Islands, Niue, Samoa, and Tonga, economies are shifting from strong post-pandemic rebounds to more moderate growth as tourism normalizes and major projects wind down (Table 2.36.1). Inflation remains vulnerable to external shocks, especially energy and import prices. Fiscal positions are broadly sound, though implementation capacity continues to limit the impact of public investment. Structural constraints—including small private sectors, limited production bases, infrastructure bottlenecks, and outward migration—continue to weigh on medium-term prospects. High exposure to climate and energy risks underscores the need for resilience-building, better business climates, and targeted, productivity-enhancing investment across the region.

Cook Islands

Growth momentum slowed in fiscal year 2025 (FY2025, ended 30 June for all South Pacific economies). GDP grew by 4.0% in FY2025 after expanding by 15.1% in FY2024 (Figure 2.36.1). The slowdown was due to moderation in services and industry, while agriculture declined compared to FY2024. As a result, the services sector contributed far less to growth than in FY2024, the industry's contribution also declined, and agriculture shifted from a small boost to a slight drag on growth.

Tourism remained the principal driver of growth. Visitor arrivals reached a record high, 8.9% above the pre-pandemic peak and 9.6% more than in 2024. New air routes and the 60th Te Maeva Nui celebrations attracted many visits from overseas Cook Islanders (Figure 2.36.2). Additional flights from Sydney lifted Australian arrivals by 26.8% in 2025, while New Zealand remained the largest source market with 63.7% of visitors.

Table 2.36.1 Selected Economic Indicators, %

South Pacific economies are shifting from strong post-pandemic rebounds to more moderate growth.

	2024	2025	2026	2027
Cook Islands				
GDP growth	15.1	4.0	2.7	3.0
Inflation	4.6	2.0	3.5	3.3
Niue				
GDP growth	8.7	2.7	2.5	2.5
Inflation	5.4	2.3	3.4	2.8
Samoa				
GDP growth	4.8	4.2	3.2	3.0
Inflation	3.6	1.9	1.8	4.0
Tonga				
GDP growth	1.8	2.5	2.3	2.3
Inflation	8.0	2.9	3.8	2.7

GDP = gross domestic product.

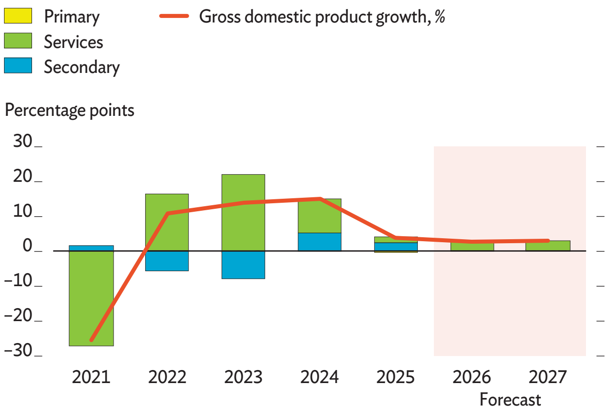
Note: Years are fiscal years ending on 30 June of that year.

Source: Asian Development Bank estimates.

This chapter was written by Emma Allen, Jonathan Pryke, Isoa Wainiqolo, and Ilisapeci Vakaloloma of the South Pacific Subregional Office, ADB, Suva.

Figure 2.36.1 Supply-Side Contributions to Growth

The economy shifted from a strong post-pandemic rebound to more moderate growth.

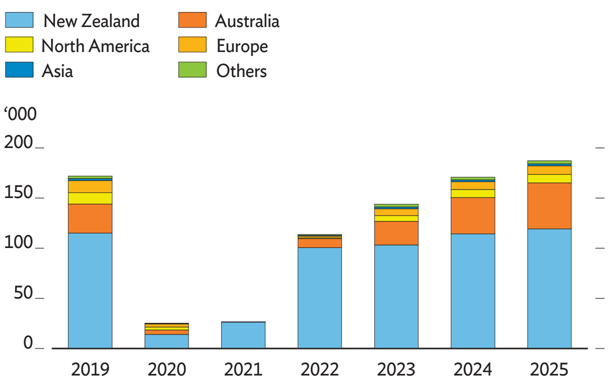


Notes: Years are fiscal years ending on 30 June of that year.

Sources: Cook Islands Statistics Office; Asian Development Bank estimates.

Figure 2.36.2 Visitor Arrivals by Source Market

Visitor arrivals continued to grow.



Note: Years are calendar years.

Sources: Cook Islands Statistics Office; Asian Development Bank estimates.

Tourism stimulated growth in construction. Accommodation and transport led the expansion in services, coupled with stronger bank lending to real estate, finance, and insurance. New building approvals for residential and short-term accommodation increased by 23% in FY2025.

Domestic demand remained buoyant. Newly registered vehicles, an indicator of demand for luxury goods, increased by 12.2% in FY2025 compared to a decline of 3.3% in FY2024. Imports for consumption increased by 16.7% and investment by 11.6%.

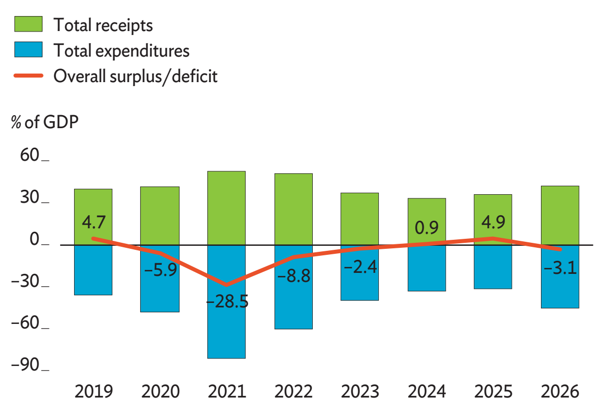
Import growth continued to outpace exports, widening the goods trade deficit in FY2025. Imports, increased by 18.7%, reaching more than 13 times the value of exports. Fish remains the main export commodity, accounting for more than 90% of exports, while food along with machinery and transport equipment account for almost half of goods imports.

Inflation fell sharply as import prices stabilized. Inflation rose by 2.0% in FY2025, less than half the rate recorded in FY 2024. Lower import prices, especially from New Zealand, helped offset higher fuel and shipping costs during the fiscal year.

Fiscal results remained stable despite some temporary deviation. The government recorded a strong fiscal surplus of 4.9% of GDP in FY2025 from 0.9% in FY2024 (Figure 2.36.3). Revenue rose as tax collection increased by more than 30% from higher value-added tax receipts, offsetting weaker fisheries and dividend revenue. Operating expenditure increased by 4.1% in FY2025, but limited implementation capacity continues to affect planned capital expenditure.

Figure 2.36.3 Fiscal Position

Increased revenue contributed to a fiscal surplus in FY2025.



GDP = gross domestic product.

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

Sources: Cook Islands Statistics Office; Asian Development Bank estimates.

Growth should ease. Economic growth is forecast to slow to 2.7% in FY2026 before rising to 3.0% in FY2027. Tourism will remain the key driver, but limited flights and accommodation will likely be binding constraints. The current dengue fever outbreak may also temporarily affect the outlook for visitor arrivals in the coming months.

Tourism will likely face headwinds due to the ongoing crisis in the Middle East. Visitor arrivals increased by 9.9% in the first 7 months of FY2026, supported by strong growth from key source markets Australia (with arrivals up by 19.7%) and New Zealand (6.7%). Australian arrivals are expected to remain robust in FY2027, following direct Jetstar Airways flights from Brisbane beginning May 2026, provided the plan remains in place despite the Middle East crisis. Operating three times a week, they will add more than 50,000 seats annually to and from Rarotonga, further supporting tourism and related services. However, these projections are subject to high degree of uncertainty, given the risk of a prolonged Middle East conflict and its potential impact on airfares, connectivity, and travel demand.

Construction should strengthen with increase in climate- and investment-related financing. The approval of $44.2 million in financing from the Green Climate Fund in October 2025, equivalent to about 10.5% of GDP, will support construction activity through investments that strengthen resilience of homes, public buildings, and vulnerable communities against tropical cyclones and other extreme climate events.

External partnerships also support longer-term investment prospects. The Cook Islands and the United States have agreed to increase cooperation to strengthen supply chains for critical minerals and rare earth elements—including collaboration on deep-sea mineral development—which may support future industrial activity subject to environmental and regulatory safeguards.

Fiscal consolidation faces near-term financing risks. The government hopes to rebuild fiscal buffers by returning to modest surpluses during FY2027–FY2029. However, this depends on securing development partner grants, which remain uncertain given the pause in New Zealand financing. Estimated at NZ$30 million, equivalent to about 10% of GDP, the pause pressures government finances, which—coupled with a carryover of NZ$25.3 million in unspent funds related to ongoing work programs and projects—prompted the passing of a supplementary budget in December 2025 to address new funding needs and adjust revenue forecasts. The carryover may temporarily push the budget into a 3.1% of GDP deficit in FY2026 instead of the planned 0.3% surplus. However, the government remains committed to its fiscal rules under its Medium-term Fiscal Framework, which target continued fiscal consolidation with caps on liquidity, debt, and expenditure. Cash reserves, which were equivalent to 6 months of cover at the end of June 2025, will likely decline slightly in FY2026 but remain well above the government's 3-month reserve requirement.

Inflation is projected to increase. Price pressures are expected to pick up in FY2026 amid heightened external risks, including the ongoing Middle East conflict, alongside increases in domestic shipping costs and water tariffs. Nonetheless, consumer prices should remain broadly contained in FY2027, reflecting moderating global commodity prices and inflationary trends among major trading partners. Inflation eased in the first half of FY2026 mainly due to lower prices for selected food items and alcoholic beverages. Increases in shipping costs from May 2025 and water tariffs from October 2025 will place some upward pressure on prices in FY2026 through indirect cost channels. These are expected to ease by FY2027.

Risks are tilted on the downside. The growth outlook remains vulnerable to external shocks, including any impact from the current Middle East conflict, given the economy's heavy reliance on tourism and concentration on just a few source markets. Capacity constraints in infrastructure and accommodation may limit further tourism expansion despite improving connectivity. The dengue fever outbreak poses a near-term risk to visitor arrivals and tourism-related activity.

Policy Challenge—Strengthening Water Security

Water security remains a major constraint on sustainable growth and resilience in the Cook Islands. Water supply varies by geography. In the Southern Group, which includes the main island Rarotonga, several islands mainly draw water from springs and streams, while the smaller islands depend on rainwater collection. In the Northern Group's coral atolls, households rely on rainwater and groundwater. During dry periods or periods of high demand, many households outside of Rarotonga revert to rainwater collection or portable desalination units. Climate variability and extreme events continue to disrupt water services and increase risks of drought and contamination. Infrastructure and asset management limitations reduce system efficiency and compromise water quality, particularly during peak demand and adverse weather. The Pa Enua, which refers to the 14 outer islands, excluding the main island of Rarotonga, remain particularly vulnerable, given their heavy reliance on rainwater harvesting and household storage, leaving them exposed to prolonged dry spells and service interruptions.

Household and service-level data highlight these risks. The National Sustainable Development Agenda indicator report shows that approximately 40% of households rely on rainwater as the primary drinking water source, with only 22% having access to filtered piped water. Rainwater dependence is much higher in the Pa Enua than on Rarotonga. The 2023–2024 Climate Change Survey indicates that households are investing in private coping measures—with 38% using installed water tanks or capture systems and 20% installed filtration systems. The need for private storage and treatment leaves vulnerable households at higher risk during droughts and after heavy rainfall.

Infrastructure constraints continue to affect service reliability. The Water Supply Master Plan for Rarotonga expects demand will reach 11,200 cubic meters per day by 2031, with an additional 1,120 cubic meters per day required to account for nonrevenue water (NRW). This highlights the need for effective leakage control and NRW management, especially as demand grows. The National Infrastructure Investment Plan also stresses the importance of rainwater harvesting across Rarotonga and Pa Enua, given the continuing need for climate-resilient storage.

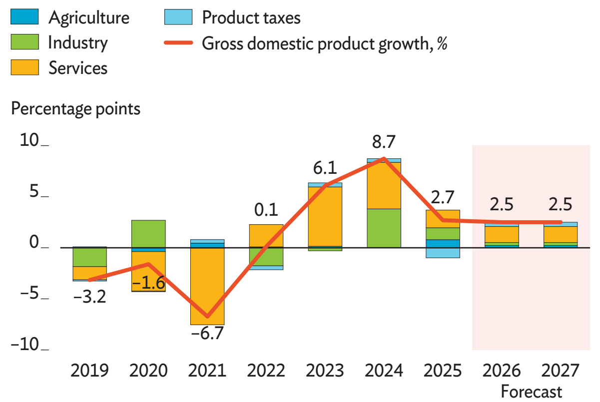
Targeted policy reforms and investment are essential to strengthen water security and reduce systemic risk. The government, with development partner support, has made progress through policy frameworks and major infrastructure initiatives, including the National Sustainable Development Agenda monitoring framework and the Te Mato Vai water supply program. Further improvement will require structured NRW reduction and asset management programs, climate-resilient rainwater storage standards for the Pa Enua, and strengthened water safety planning supported by better monitoring to address contamination risks following extreme rainfall events.

Niue

Economic growth softened in FY2025 with infrastructure projects finished and the slow recovery in tourism continuing (Figure 2.36.4). The completion of the airport runway and road project reduced construction activity, moderating growth to 2.7%. A slow rebound in visitor arrivals, along with structural limits on tourism capacity further constrained output.

Figure 2.36.4 Supply-Side Contributions to Growth

Economic growth softened.



Note: Years are fiscal years ending on 30 June of that year.
Sources: Niue Statistics Office; Asian Development Bank estimates.

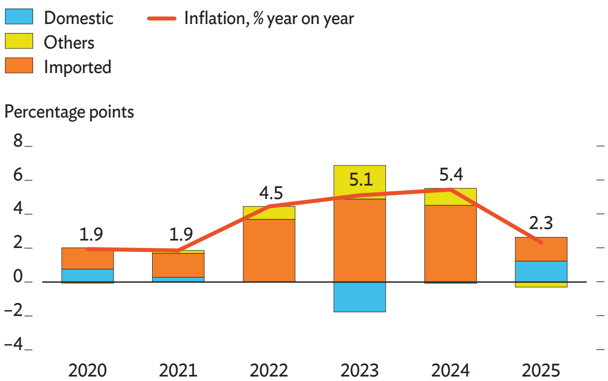
Early 2025 visitor survey results showed a continued reliance on the New Zealand market and shifting travel patterns. The main purposes of travel were holidays, visiting friends and relatives, and business or conference activities. The average length of stay declined to 8.3 nights from 8.8 nights in 2024. Notably, the share of first-time visitors increased from 49% to 56%, signaling growing interest in Niue.

Inflation dropped sharply to 2.3% in FY2025. Inflation was less than half its FY2024 level, supported by a modest 2.0% increase in imported prices (Figure 2.36.5).

Fiscal results remained broadly aligned with the government's balanced budget policy (Figure 2.36.6). The government will likely have a balanced budget in FY2025. Revenue fell by 23.3% from FY2024, but lower capital project spending should keep the budget balanced over the medium term.

Figure 2.36.5 Contributions to Inflation

Inflation fell on lower prices for imported goods.



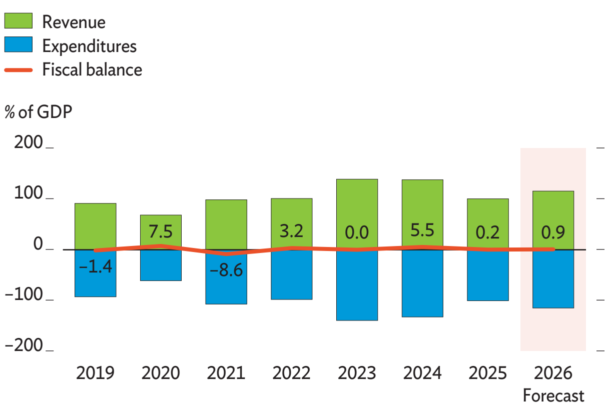
yoy = year on year.

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

Sources: Niue Statistics Office; Asian Development Bank estimates.

Figure 2.36.6 Fiscal Position

The fiscal position remains largely balanced.



GDP = gross domestic product.

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

Sources: Niue Statistics Office; Asian Development Bank estimates.

Growth is projected to stabilize at 2.5% this year and next (see table 2.36.1). Deeper cooperation with New Zealand on regional security, climate action, and economic development—along with a supportive fiscal stance, positive business sentiment, and private investment in tourism—will support growth.

Business sentiment surveys show both structural challenges and emerging opportunities. A business confidence survey found labor mobility constraints and limited access to finance as major challenges, followed by difficulties with air and freight services and high operating costs. Nonetheless, many businesses were optimistic, citing opportunities in enhanced business support, product development, sustainability initiatives, and improved income. They also emphasized the need for stronger media engagement to support long-term tourism growth and resilience.

Private investment in tourism will support growth. New financing initiatives targeting micro, small, and medium-sized enterprises (MSMEs) may help expand accommodation capacity in the coming months. Seasonal Air New Zealand flights from May 2025 should temporarily boost tourism in FY2026, although construction of new tourist facilities may take longer to materialize. Visitor arrivals are not projected to return to pre-pandemic levels until FY2027.

The government will continue prudent fiscal management. The government is committed to adhere to its fiscal balance rule in FY2026 and FY2027. Despite a budgeted 18% increase in FY2026 expenditure, labor and capital capacity constraints will likely limit actual spending and dampen the growth impact.

Inflation is projected to increase. The ongoing Middle East crisis will raise imported inflation in the coming months. Domestic price pressures are also likely to rise in FY2026, driven by capacity constraints in tourism and rising wages.

Risks are tilted to the downside. Key risks include, labor and skills shortages, coupled with climate and environmental threats, negative impacts from the current conflict in the Middle East and an economic downturn in tourism source markets.

Policy Challenge—Strengthening the Business Environment

The private sector continues to face structural and operational constraints that limit its capacity to support inclusive and sustainable development. The 2024 Business Establishment Census shows that accommodation and food services (comprising 21% of respondents) and wholesale and retail trade (17%) dominate the business landscape, underscoring the economy's heavy reliance on tourism and local commerce. Systemic inefficiencies—including delays in government services (57%), unreliable electricity supply (45%), and slow payment processing (31%)—weaken business confidence and increase transaction costs. Limited foreign investment participation (2.4% of establishments) and weak inventory management—with 67% of businesses not doing any stocktaking—further constrain competitiveness and resilience.

The business structure is characterized by small, informal operations with limited scope for expansion. Sole proprietorships account for 70.2% of all establishments, followed by partnerships and family businesses (15.5%), while only 9.5% operate as limited liability companies. Resolving limited formalization and restricted access to finance are essential for both growth and risk management. While local ownership dominates business, attracting foreign investors in niche sectors such as ecotourism and specialty products, geographic isolation, high transport costs, and a small labor pool hinder competitiveness.

Tourism remains the central pillar of economic development, offering substantial opportunities to drive growth and employment. In 2024, visitor arrivals rose by 28%, led by New Zealanders (82%), followed by visitors from Australia (10%) and other Pacific Island countries (3%). International visitors incurred an average of NZ$818 in prepaid costs and contributed about NZ$1,566 in local spending per trip—generating an estimated 40% return to the domestic economy. High visitor satisfaction—with 98% willing to recommend Niue—and a rising interest in ecotourism and cultural experiences (cited by 49% of first-time visitors) highlight the potential to expand foreign exchange earnings. Targeted investments in infrastructure, digital connectivity, and hospitality services would help unlock this potential and stimulate wider economic activity.

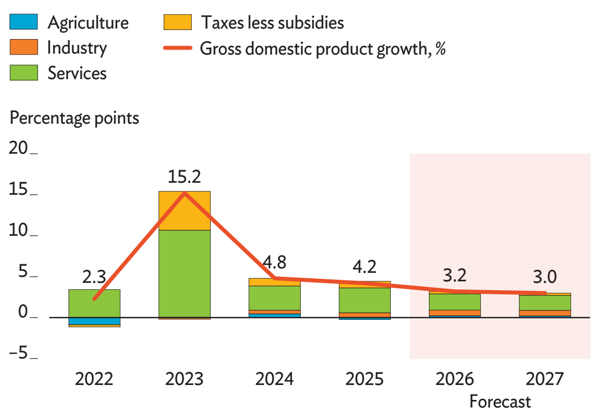
Strengthening the enabling environment for business development is essential to address structural constraints and accelerate private sector-led growth. The government plans to institutionalize the Business Establishment Census and develop a Business Register to strengthen policy design. Integrating business data with the tax system and promoting evidence-based decision-making will support more efficient resource allocation. Priority reforms include streamlining government services and payments using digital platforms, investing in reliable infrastructure and digital connectivity to facilitate e-commerce, and promoting foreign direct investment through targeted incentives and ease-of-doing-business measures. Enhancing financial management and inventory control capabilities—together with efforts to diversify the economy through innovation and niche sector development—will be crucial to reducing structural vulnerabilities and positioning Niue for more sustainable, inclusive growth.

Samoa

Growth eased but remained resilient. The economy grew by 4.2% in FY2025, slightly down from 4.8% in FY2024, partly due to the March 2025 energy crisis that disrupted business activity. Nonetheless, growth continued to be supported by remittance inflows that boosted household incomes and spending, government consumption, and rising tourist arrivals that stimulated services (Figure 2.36.7).

Figure 2.36.7 Supply-Side Contributions to Growth

Economic growth softened.

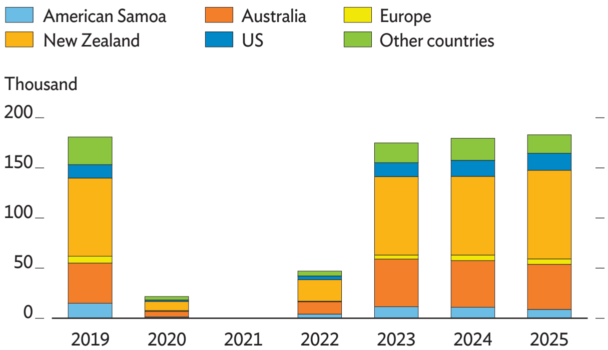


Note: Years are fiscal years ending on 30 June of that year.
Sources: Niue Statistics Office; Asian Development Bank estimates.

A robust services recovery and higher inflows from services trade supported growth. FY2025 growth was supported by a strong 18.7% rise in transport services from tourist arrivals, freight activity linked to higher imports, and Samoa Airways restructuring. Visitor arrivals increased by 2.0% in 2025 (Figure 2.36.8). Earnings from tourism expanded by 4.6% in FY2025. However, the economy continues to be constrained by limited port capacity, which contributed to low fisheries output.

Figure 2.36.8 Visitor Arrivals by Source Market

Visitor arrivals continued to grow.

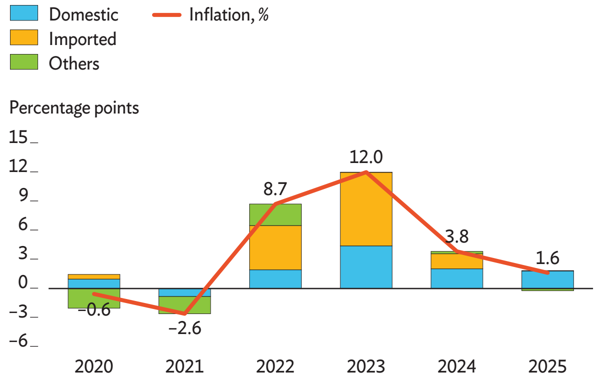


Note: Years are calendar years.

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

Figure 2.36.9 Contributions to Inflation

Inflation fell on lower prices for imported goods.



Note: Years are calendar years.

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

Household consumption was supported by remittances and credit growth. Private remittance inflows increased by 2.9% to $902.8 million in FY2025, highlighting the critical role played by diaspora transfers in sustaining household spending and providing external buffers. Private sector credit for investment and consumer lending grew by 3.7% in FY2025. Household expenditures contributed to consumption-related trade, with merchandise imports up by 3.8% to $954.4 million in FY2025. Remittances helped narrow the primary income deficit, resulting in the current account surplus rising to $198.6 million, up from $142.1 million in FY2024.

Inflation softened as price pressures eased. Inflation eased to 1.9% in FY2025 from 3.6% in FY2024 on muted imported inflation driven by softer global commodity prices. Subdued domestic cost pressures, as prices for local agricultural commodities such as vegetables eased, also contributed (Figure 2.36.9).

The fiscal position is in surplus with public debt moderating. In FY2025, the government had a fiscal surplus of 4.7% of GDP rather than the targeted 2.1% deficit due to stronger than expected tax collection and poor execution of approved budget spending. Public external debt fell to the equivalent of 21.6% of GDP in FY2025 from 25.9% in FY2024.

Economic growth is projected to ease. GDP is projected to grow by 3.2% in FY2026 and 3.0% in FY2027 due to budget delays, moderate growth in consumption, and the ongoing Middle East crisis that drive up prices for key commodities. Infrastructure upgrades, improved energy reliability, and a better business climate will support the economy, but overall growth will ease.

Trade and commerce will likely moderate. Wholesale and retail trade is expected to soften due to moderating domestic consumption. Real GDP contracted by 1.5% in the first quarter of FY2026, driven by a downturn in commerce from weaker trade. However, this softening is expected to be offset by continued growth in tourist arrivals, related earnings, and remittances. Given the heavy reliance on fuel and merchandise imports, the goods trade deficit is likely to widen.

Fresh investment is needed to support growth. New investment in renewable energy generation, particularly a planned expansion of solar parks and system upgrading should help stabilize power supply and boost growth. Continued investments in flood management and natural resource development along with completion of the Apia port upgrades by 2027 should boost construction. The port upgrade will also enhance logistics and connectivity, improve freight efficiency, and reduce turnaround times.

The ease of doing business should improve. Tax administration system upgrades should increase compliance, while easier bank settlements will likely increase investor confidence. To manage excess financial liquidity, the central bank has expanded open market operations, issuing larger securities volumes and introducing longer term paper (182 day and 364 day maturities). The resulting weighted average yield rose from less than 1% in March to 2.95% in January 2026, with the financial sector expected to remain stable with adequate liquidity.

Imported inflation to add to domestic prices. Consumer prices are projected to rise by 1.8% in FY2026 and 4.0% in FY2027. In the first 8 months of FY2026, inflation averaged 1.5%, driven by lower prices of imported goods partially offset by higher domestic prices for items such as coffee and coconut. However, the heavy reliance on imported fuel and rising global oil prices will likely feed domestic inflation in the final months of FY2026 and into FY2027—raising the cost of food and fuel for transport of imported goods. The conflict in the Middle East will continue to increase price pressures into the first quarter of FY2027 and gradually normalize thereafter.

Budget delays and weak execution weigh on growth. Delays in passing the budget have slowed major spending that will reduce public spending's contribution to growth in FY2026. Operationalizing asset management plans should help improve future service provision.

Risks tilt to the downside. Risks to the forecast stem from continued exposure to climate-related shocks, shifts in migration policies among key destination countries, slow public investment project implementation, and spillovers from the ongoing Middle East crisis that could disrupt global supply chains and weigh on the economic outlook.

Policy Challenge—Improving Energy Resilience

The energy system remains vulnerable due to heavy dependence on imported fossil fuels and climate-related disruptions. Fuel imports accounted for one fifth of imports. Despite progress in renewable energy, the country continues to depend heavily on diesel generation for more than half of its electricity supply. To comply with its Second Nationally Determined Contribution under the Paris Agreement, Samoa aims to achieve 70% renewable electricity generation by 2030.

Financial pressures combined with maintenance and investment backlogs create a nationwide power crisis. A 20% electricity tariff reduction introduced in November 2021—to ease household financial pressures—created financial sustainability problems for the Electric Power Corporation (EPC). Rising global fuel prices between 2022 and 2024 significantly weakened EPC finances, government continue to keep tariff adjustments on hold. In addition, higher diesel generation costs widened operating losses and strained liquidity. The situation culminated in March 2025, when the government declared a 30-day state of emergency after faults in the main underground cable, weather-related damage to power lines, and backup generator failures triggered a power crisis.

The government is pursuing major energy reforms to expand renewables, modernize the grid, and strengthen EPC finances. Immediate actions include upgrading the Fiaga Power Station and reinforcement of the Upolu grid, as well as strengthening EPC finance and operations through improved cost recovery, upgraded billing systems, and more effective maintenance. In the medium term, the government plans to meet its 70% renewable electricity generation commitment by 2030, with measures outlined in the Samoa Energy Sector Plan. To do this it will diversify the energy mix through solar, hydropower, wind, and biomass investments and upgrade battery storage systems to manage intermittency.

Greater energy resilience can be accelerated through reforms and strengthened institutions. Further actions such as smart metering, establishment of dedicated operation and maintenance funds, and technical certification programs can help improve the energy sector's overall sustainability . A tariff and price structure review is also needed to balance EPC's financial sustainability with household affordability.

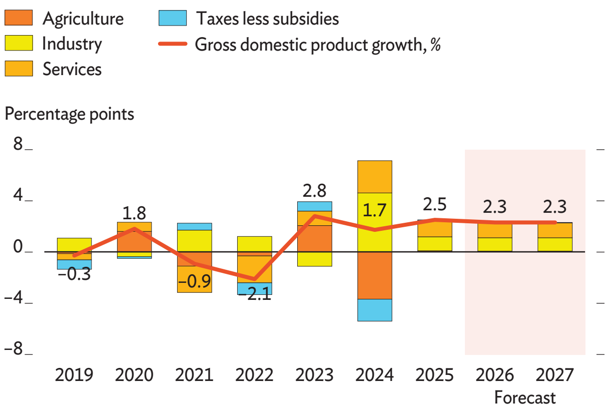
Tonga

The economy grew by 2.5% in FY2025, up from 1.8% in FY2024. The main drivers of growth were agriculture and construction (Figure 2.36.10). Root crop exports rose by 39.2% and vegetable exports by 21.5%, reflecting favorable weather associated with an improved El Niño cycle.

Construction expanded on the back of major public projects. The completion of the Tonga High School Complex, a wind power project, and coastal resilience

Figure 2.36.10 Supply-Side Contributions to Growth

Economic growth picked up.



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

Sources: Tonga Statistics Department; Asian Development Bank estimates.

investments lifted construction. Indicators such as construction-related imports (up by 42.9%), electricity consumption (6.4%), and housing loans (4.6%) all increased in FY2025.

Services also improved, supported by major national and regional events. Hosting the Pacific Islands Forum and the 150th anniversary of the Constitution boosted accommodation, transport, and wholesale and retail trade. Container registrations rose in FY2025, with 9 out of 10 registrations linked to business activity. Import payments and travel receipts (21.5%) also increased.

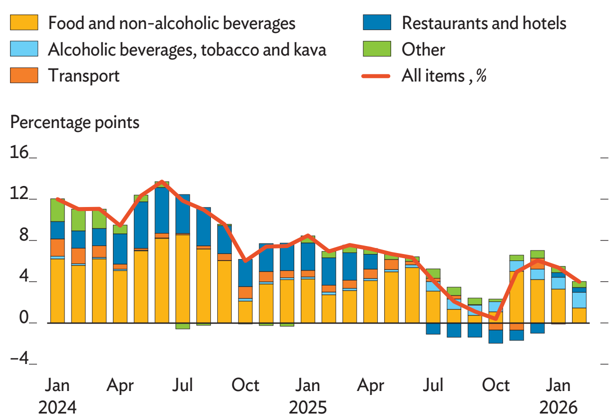
Domestic demand was reinforced by strong credit growth and remittance inflows. Private credit expanded by 13.4% in FY2025, driven by lending to public enterprises, private businesses in distribution and tourism, and households, particularly for housing. Despite a narrowing lending rate and high commercial bank liquidity, credit to sectors such as agriculture, construction, and manufacturing remained limited. Remittances, equivalent to 30% of GDP, rose by 3.7% in FY2025 and by 8.1% year on year from July to November 2025, supporting both household consumption and investment.

Monetary policy was strengthened with the introduction of a new framework. In August 2025, the central bank established an interest rate corridor centered on a 2.0% policy rate, with a marginal deposit rate of 0% and a marginal lending rate of 4%. The framework intends to improve monetary policy transmission, improve liquidity management, develop the domestic money market, and enhance monetary policy signaling and communications. This is important, as high liquidity among commercial banks and an inactive interbank market have remained bottlenecks to economic development.

Inflationary pressures eased significantly during FY2025. Inflation moderated to 2.9% in FY2025 from 8.0% in FY2024 on increased domestic production of key crops (Figure 2.36.11). Rebasing the consumer price index from 2018 to 2021 substantially increased the weight of restaurants and accommodation services, making inflation more sensitive to domestic supply-side pressures and non-tradable prices.

Figure 2.36.11 Contributions to Inflation

Inflation fell on improved domestic production.



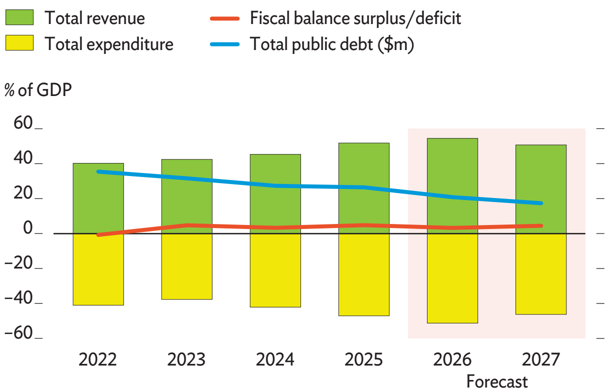
Sources: Tonga Statistics Department; Asian Development Bank estimates.

Fiscal performance remained prudent in FY2025. The government recorded a fiscal surplus of 4.8% of GDP in FY2025, up from 3.5% the previous year, supported by higher grants and domestic revenue and lower expenditures (Figure 2.36.12). Public debt declined to 26.5% of GDP in FY2025 from 28.8% in FY2024, reflecting sustained fiscal consolidation and nominal GDP growth.

External buffers remain strong, although reserves declined slightly. Gross international reserves were equivalent to 10.6 months of imports in FY2025, down from 11.9 months in FY2024, reflecting unfavorable terms of trade, elevated import prices, and volatility in

Figure 2.36.12 Fiscal Position

The fiscal position remained prudent.



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

Sources: Tonga Statistics Department; Asian Development Bank estimates.

offshore investment flows. Despite the decline, reserve coverage remains well above adequacy benchmarks. Tourism receipts increased by 21.5% year on year in FY2025.

Growth is expected to moderate toward its long-term trend of around 2.0%. Growth is projected to ease in FY2026 as reconstruction spending following the 2022 Hunga Tonga–Hunga Ha'apai eruption and tsunami tapers. The economy should grow by about 2.3% in both FY2026 and FY2027. Ongoing projects—including the new parliament building, the Fanga'uta Lagoon Bridge and associated works, coastal resilience investments, and the Fua'amotu Airport upgrade—will likely sustain industry and construction in the near term. The new government, which took office at end-2025, has vowed to continue the focus on growth.

Inflation is projected to increase. Consumer prices will likely rise in FY2026 on higher oil prices, due to the conflict in the Middle East, before stabilizing in FY2027. Annual average inflation was 2.6% in January 2026, driven by a sharp 14.5% year on year decline in domestic food prices. This offset higher imported inflation. However, core inflation remained at 5.0%, suggesting potential second-round effects from earlier import price increases.

Fiscal policy should remain prudent over the medium term while the surplus moderates. The FY2026 budget signals a more expansionary stance with capital expenditure projected to increase by 6.9%, including investment in an evacuation bridge over the Fanga'uta Lagoon, and current expenditure up by 18.2%. With expenditure growth outpacing revenue in FY2026, the fiscal surplus is anticipated to narrow to 3.2% of GDP and 3.1% in FY2027, supported by stable grant inflows and continued improvements in domestic revenue mobilization. The budget also introduces a domestic bond market policy to support private development through concessional lending to businesses. Maintaining fiscal discipline will be important to preserve buffers, safeguard debt sustainability, and strengthen resilience to external shocks.

The external sector is projected to remain stable in FY2026 and FY2027. As of the end of December 2025, reserves increased to 11.2 months of imports and shoud remain broadly stable in FY2026 and FY2027, supported by continued remittance inflows and external financing. Remittances between July and November 2025 increased by more than 8%.

Risks tilt to the downside. Despite steady growth supported by reconstruction, remittances, and the tourism recovery, Tonga remains highly vulnerable to continued conflict in the Middle East, disasters stemming from natural hazards, and external shocks, due to its heavy reliance on remittances, fuel, and other imports.

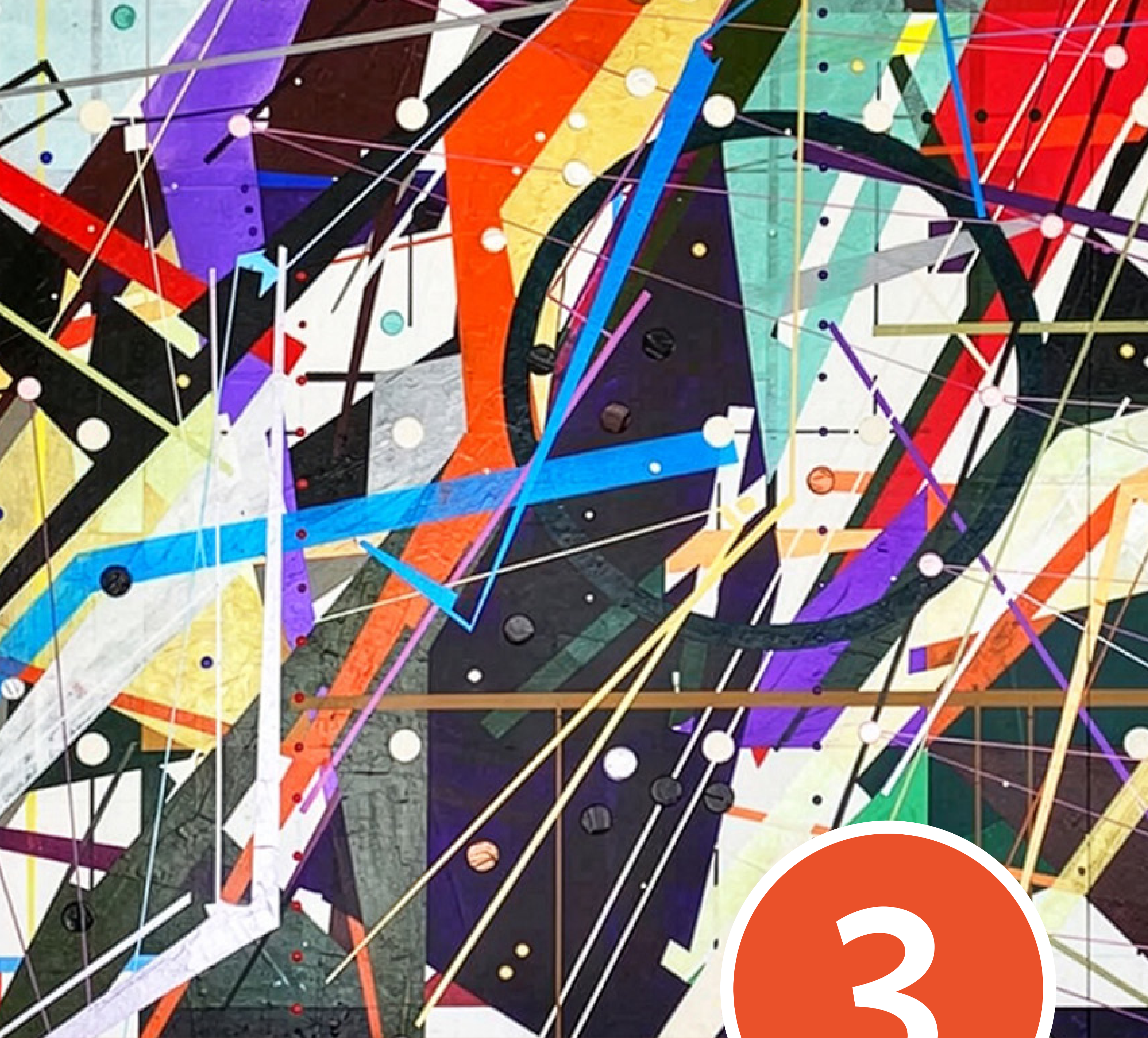
Policy Challenge—Improving Access to Finance

Limited access to finance remains a binding constraint on private-sector development and inclusive growth. Credit for MSMEs, which make up a significant portion of Tonga's private sector, is constrained by conservative lending practices and limited use of collateral beyond land, thereby reducing potential investment and productivity gains. Although basic financial access has improved, the use of formal and digital financial services remains low, reducing financial intermediation and efficiency. Gaps in financial capability and underdeveloped credit infrastructure disproportionately affect informal businesses, women, and rural households, limiting opportunities for entrepreneurship and economic participation.

Firm-level evidence highlights the depth of these constraints. Access to finance is consistently ranked among the most significant obstacles to business growth, with lending concentrated among borrowers with titled collateral and established credit histories. For women-owned or -led MSMEs, land ownership is a challenge further exacerbating their access to finance. As a result, many MSMEs and informal enterprises rely on their own savings or informal sources of finance, constraining expansion and resilience. While about 70% of adults hold an account, usage for savings, borrowing, and digital payments remains limited, and cash continues to dominate transactions. These challenges are compounded by uneven financial and digital literacy, limited credit information coverage, and underutilized secured transaction frameworks.

The government, with support from development partners, has taken important steps to address these challenges. Initiatives include the National Financial Inclusion Strategy (2023–2027), financial literacy programs, and introducing a regulatory sandbox to support financial innovation. Development partners have supported diagnostics, policy reforms, digital finance initiatives, and women entrepreneurs' access to finance. Despite these efforts, systemic gaps remain, requiring targeted interventions to strengthen credit infrastructure and expand access to finance.

Improving financial access through targeted reforms and investments is essential to unlock private sector potential and foster inclusive growth. Priority actions include (i) strengthening credit information systems and promoting the use of movable collateral to broaden lending opportunities, (ii) strengthening local financial institutions, (iii) accelerating adoption of digital financial services through interoperable payment systems, and (iv) providing targeted support for MSMEs and women-owned enterprises. Complementary measures to enhance financial literacy, improve the availability and effectiveness of business advisory services, and expand secured transactions frameworks can reduce lending risk, lower borrowing costs, and deepen financial intermediation across the economy.



3

STATISTICAL APPENDIX

STATISTICAL NOTES AND TABLES

The statistical appendix presents in 18 tables selected economic indicators for the 50 Asian Development Bank (ADB) member economies. Regional ADB member economies are split into two groups: advanced Asia and the Pacific (AAP) and developing Asia and the Pacific (DAP). AAP comprises Australia; Hong Kong, China; Japan; the Republic of Korea; New Zealand; Singapore; and Taipei,China. This edition also includes Türkiye, which joined the bank in 1991 as a nonregional member and, since 2025, has become an ADB regional member. Including Türkiye, the Caucasus and Central Asia subregion has been renamed the Caucasus and Central and West Asia (CCWA). DAP includes all remaining regional members from CCWA, developing East Asia, South Asia, developing Southeast Asia, and the Pacific. Most tables contain historical data from 2021 to 2025, with some including forecasts for 2026 and 2027.

The data were standardized to the degree possible to allow comparability over time and across economies, but differences in statistical methodology, definitions, coverage, and practices make full comparability impossible. The national income accounts section is based on the United Nations System of National Accounts, while the data on the balance of payments use International Monetary Fund (IMF) accounting standards. Historical data were obtained from official sources, statistical publications, and databases, as well as documents from ADB, the IMF, and the World Bank. For some economies, 2025 data were estimated from the latest available information. Projections for 2026 and 2027 are generally ADB estimates based on available quarterly or monthly data.

Most economies report by calendar year. The following record their government finance data by fiscal year: Brunei Darussalam; Bhutan; Fiji; Hong Kong, China; Singapore; Tajikistan; Thailand; and Tuvalu (starting 2025). Reporting all variables by fiscal year are South Asian countries (except Bhutan, Maldives, and Sri Lanka), the Cook Islands, the Marshall Islands, the Federated States of Micronesia, Myanmar, Nauru, Niue, Palau, Samoa, and Tonga.

Regional and subregional averages or totals are provided for in seven tables: A1, A2, A6, A11, A12, A13, and A14. For tables A1, A2, A6, A11, A12, and A14, averages were weighted by purchasing power parity gross domestic product (GDP) in current international dollars. Purchasing power parity GDP data for 2021–2024 were obtained from the IMF World Economic Outlook Database, October 2025 edition. Weights for 2024 were carried over to 2027. For Table A13, regional and subregional totals were computed using a consistent sum, which means that if economy data were missing for a given year, the sum excluded that economy.

Tables A1, A2, A3, A4, and A5: National Accounts. These tables show data on output growth, production, and demand. Changes were made to the national accounts series for some economies to accommodate a change in source, methodology, and/or base year. Constant factor cost measures differ from market price measures in that they exclude taxes on production and include subsidies. Basic price valuation is the factor cost plus some taxes on production, such as property and payroll taxes, and less some subsidies, such as for labor but not products. The series for Afghanistan, Bangladesh, the Cook Islands, India, the Marshall Islands, the Federated States of Micronesia, Myanmar, Nauru, Nepal, Niue, Pakistan, Palau, Samoa, and Tonga reflect fiscal year data rather than calendar year data, and those for Timor-Leste reflect GDP excluding the offshore petroleum industry. Some historical data for Turkmenistan are not presented for lack of uniformity.

Table A1: Growth Rate of GDP, % per year. The table shows annual growth rates of GDP valued at constant market prices, factor costs, or basic prices. GDP at market prices is the aggregate value added by all resident producers at producers' prices including taxes less subsidies on imports plus all nondeductible value added or similar taxes. Most economies use constant market price valuation. Pakistan uses constant factor costs.

Table A2: Growth Rate of GDP Per Capita, % per year. The table provides the growth rates of real GDP per capita, which is defined as GDP at constant prices divided by population. Also shown are data on gross national income per capita in US dollar terms (Atlas method) for 2024 sourced from the World Bank's World Development Indicators online.

Table A3: Growth Rate of Value Added in Agriculture, % per year. The table shows the growth rates of value added in agriculture at constant prices and agriculture's share of GDP in 2024 at current prices. The agriculture sector comprises plant crops, livestock, poultry, fisheries, and forestry.

Table A4: Growth Rate of Value Added in Industry, % per year. The table provides the growth rates of value added in industry at constant prices and industry's share of GDP in 2024 at current prices. This sector comprises manufacturing, mining and quarrying, and, generally, construction and utilities.

Table A5: Growth Rate of Value Added in Services, % per year. The table gives the growth rates of value added in services at constant prices and services' share of GDP in 2024 at current prices. Services generally include trade, banking, finance, real estate, and similar businesses, as well as public administration. For Malaysia, electricity, gas, water supply, and waste management are included under services.

Table A6: Inflation, % per year. Data on inflation rates are period averages. Inflation rates are based on consumer price indexes. The consumer price indexes of the following economies are for a given city only: Cambodia is for Phnom Penh, the Marshall Islands for Majuro, and Sri Lanka for Colombo.

Table A7: Change in Money Supply, % per year. This table tracks the annual percentage change in broad money supply at the end of the period, M2 for most economies. M2 is defined as the sum of currency in circulation plus demand deposits (M1) plus quasi-money, which consists of time and savings deposits including foreign currency deposits. For the Kyrgyz Republic broad money is M2X. For Azerbaijan; the Cook Islands; Georgia; Hong Kong, China; India; Kazakhstan; and Solomon Islands, broad money is M3, which adds longer-term time deposits. For Sri Lanka, broad money is M2b, or M2 plus bond funds.

Tables A8, A9, and A10: Government Finance. These tables give central government revenue, expenditure, and fiscal balance expressed as percentages of GDP in nominal terms. Where full-year data are not yet available, GDP shares are estimated using available monthly or quarterly data. For Cambodia, the People's Republic of China, Georgia, India, Kazakhstan, the Kyrgyz Republic, Mongolia, and Tajikistan, transactions are those reported by the general government. For the Federated States of Micronesia, government financial data comprises national and state government data.

Table A8: Central Government Revenue, % of GDP. Central government revenue comprises all nonrepayable receipts, both current and capital, plus grants. These amounts are computed as a percentage of GDP at current prices. For the Republic of Korea, revenue excludes social security contributions. For Azerbaijan and Kazakhstan, revenue includes transfers from the sovereign wealth fund. Grants are excluded for Malaysia and Thailand. Revenue from disinvestment is included for India. Only current revenue is included for Bangladesh.

Table A9: Central Government Expenditure, % of GDP. Central government expenditure comprises all nonrepayable payments to meet both current and capital expenses, plus net lending. These amounts are computed as shares of GDP at current prices. For Thailand, expenditure refers to budgetary expenditure excluding externally financed expenditure and borrowing. For Tajikistan, expenditure includes externally financed public investment programs. One-off expenditures are excluded for Pakistan.

Table A10: Fiscal Balance of the Central Government, % of GDP. Fiscal balance is the difference between central government revenue and expenditure. The difference is computed as a share of GDP at current prices. Data variation may arise from statistical discrepancy when, for example, balancing items for general governments (central plus selected subnational governments), and from differences between coverage used in individual revenue and expenditure calculations and fiscal balance calculations. For Fiji, the fiscal balance excludes loan repayment. For Georgia, the fiscal balance is calculated according to the IMF Government Finance Statistics Manual 2021 format, as is the Cambodia general government fiscal balance using the 2014 manual. For Hong Kong, China, the consolidated fiscal balance for FY 2025 is an estimate, which accounts for both government bond issuance and repayments. For Solomon Islands, fiscal balance does not include balance of payment grants. For Thailand, the fiscal balance is the cash balance of combined budgetary and nonbudgetary balances. For Turkmenistan, the fiscal balance does not include off-budget accounts. For Singapore, fiscal balance includes special transfers (top-ups to endowment and trust funds) and contributions from net investment returns. For the Republic of Korea, funds related to social security are excluded.

Tables A11, A12, A13, and A14: Balance of Payments. These tables show the annual flows of selected international economic transactions of economies as recorded in their balance of payments. Some historical data for Turkmenistan are not presented for lack of uniformity.

Tables A11 and A12: Growth Rates of Merchandise Exports and Imports, % per year. These tables show the annual growth rates of exports and imports of goods. Data are in US dollar millions, primarily obtained from the balance-of-payments accounts of each economy. Export data are reported free on board. Import data are reported free on board except for the following economies which value them based on cost insurance and freight: Afghanistan; Hong Kong, China; Georgia; India; the Lao People's Democratic Republic; Maldives; Myanmar; Singapore; and Thailand.

Table A13: Trade Balance, $ million. The trade balance is the difference between merchandise exports and imports. Figures are based on the export and import amounts used to generate tables A11 and A12.

Table A14: Current Account Balance, % of GDP. The current account balance is the sum of the balance of trade in merchandise, net trade in services and factor income, and net transfers. The values reported are divided by GDP at current prices in US dollars.

Table A15: Exchange Rates to the US Dollar, annual average. Annual average exchange rates are quoted as the local currency per US dollar.

Table A16: Gross International Reserves, $ million. Gross international reserves are defined as the US dollar value at the end of a given period of holdings in foreign exchange, gold, special drawing rights, and IMF reserve position. For Taipei,China, this heading refers to foreign exchange reserves only. In some economies, the rubric is foreign assets plus the reserves of national monetary authorities (the net foreign reserves of, for example, the State Bank of Pakistan) plus national funds for earnings from oil or other natural resources.

Table A17: External Debt Outstanding, $ million. For most economies, external debt outstanding includes short-, medium-, and long-term debt, public and private, as well as IMF credit. For Armenia, Azerbaijan, Cambodia, and Maldives, only public external debt is reported. Intercompany lending is excluded for Georgia.

Table A18: Debt Service Ratio, % of exports of goods and services. This table generally presents the total debt service payments of each economy, which comprise principal repayments (excluding short-term debt) and interest payments on outstanding external debt, given as a percentage of exports of goods and services. For Armenia and Cambodia, debt service refers to external public debt only. For the Philippines, income and exports of goods and services are used as the denominator. For Bangladesh, the ratio presents debt service payments on medium- and long-term loans as a percentage of exports of goods, nonfactor services, and overseas worker remittances.

Table A1 Growth Rate of GDP, % per year

	2021	2022	2023	2024	2025	2026	2027
Developing Asia and the Pacific (DAP)	**7.9**	**4.7**	**5.4**	**5.3**	**5.4**	**5.1**	**5.1**
DAP excluding the PRC	**7.2**	**6.3**	**5.5**	**5.6**	**5.9**	**5.5**	**5.8**
Caucasus and Central and West Asia	**9.7**	**5.4**	**5.2**	**4.3**	**4.6**	**4.2**	**4.4**
Armenia	5.8	12.6	8.3	5.9	7.2	5.5	5.7
Azerbaijan	5.6	4.6	1.1	4.1	1.4	2.0	1.8
Georgia	10.6	11.0	7.8	9.7	7.5	5.5	5.2
Kazakhstan	4.3	3.2	5.1	5.0	6.5	4.8	4.5
Kyrgyz Republic	5.5	9.0	9.0	11.5	11.1	8.9	8.4
Tajikistan	9.4	8.0	8.3	8.4	8.4	7.3	6.8
Türkiye	11.8	5.4	5.0	3.3	3.6	3.6	4.0
Turkmenistan	5.0	6.2	6.3	6.3	6.3	6.5	6.2
Uzbekistan	8.2	6.1	6.3	6.7	7.7	6.7	6.8
Developing East Asia	**8.5**	**3.1**	**5.4**	**5.0**	**5.0**	**4.6**	**4.5**
People’s Republic of China	8.6	3.1	5.4	5.0	5.0	4.6	4.5
Mongolia	1.6	5.0	7.4	5.1	6.8	5.7	6.0
South Asia	**8.9**	**6.8**	**6.2**	**6.4**	**6.8**	**6.3**	**6.8**
Afghanistan	–2.1	–20.7	–6.2	2.3	1.9	2.3	2.8
Bangladesh	6.9	7.1	5.8	4.2	3.5	4.0	4.7
Bhutan	4.4	5.2	4.6	7.5	8.5	6.9	7.2
India	9.7	7.3	7.2	7.1	7.6	6.9	7.3
Maldives	37.5	13.8	4.9	3.5	5.4	1.0	3.0
Nepal	4.8	5.6	2.0	3.7	4.6	2.7	5.0
Pakistan	5.8	6.2	–0.2	2.6	3.1	3.5	4.5
Sri Lanka	4.2	–7.3	–2.0	5.0	5.0	4.0	4.2
ASEAN	**3.6**	**5.7**	**4.1**	**5.0**	**4.8**	**4.6**	**4.6**
Developing Southeast Asia	**3.1**	**5.8**	**4.4**	**4.9**	**4.8**	**4.7**	**4.8**
Brunei Darussalam	–1.6	–1.6	1.1	4.1	0.7	1.6	1.9
Cambodia	2.9	5.1	5.0	6.0	5.2	4.5	5.0
Indonesia	3.7	5.3	5.0	5.0	5.1	5.2	5.2
Lao People’s Democratic Republic	2.3	2.5	3.7	4.0	4.4	4.0	4.5
Malaysia	3.3	9.0	3.5	5.1	5.2	4.6	4.5
Myanmar	–5.9	2.0	0.8	–0.7	–2.2	2.4	2.7
Philippines	5.7	7.6	5.5	5.7	4.4	4.4	5.5
Thailand	1.5	2.6	2.2	2.9	2.4	1.8	2.0
Timor-Leste	3.0	4.0	2.4	4.3	3.9	3.8	4.1
Viet Nam	2.6	8.0	5.1	7.1	8.0	7.2	7.0
The Pacific	**–1.4**	**7.6**	**5.3**	**3.9**	**4.2**	**3.4**	**3.2**
Cook Islands	–25.5	10.9	14.0	15.1	4.0	2.7	3.0
Fiji	–4.3	17.7	9.4	3.5	3.0	2.9	2.7
Kiribati	8.6	5.0	3.3	4.6	4.3	3.1	2.6
Marshall Islands	2.1	–0.7	–5.0	2.5	3.0	3.7	2.8
Federated States of Micronesia	3.1	–3.1	1.1	2.3	1.1	1.0	1.0
Nauru	7.2	3.0	0.6	1.6	2.1	2.5	2.5
Niue	–6.7	0.1	6.1	8.7	2.7	2.5	2.5
Palau	–11.9	–0.5	1.2	12.0	6.9	6.0	3.7
Papua New Guinea	–0.5	5.7	3.8	3.9	4.7	3.6	3.4
Samoa	–5.1	2.3	15.2	4.8	4.2	3.2	3.0
Solomon Islands	–0.2	–2.6	2.8	3.0	3.6	3.0	3.4
Tonga	–0.6	–2.4	2.6	1.8	2.5	2.3	2.3
Tuvalu	1.8	0.7	3.7	3.1	2.7	2.5	2.4
Vanuatu	–1.2	5.6	5.8	3.8	3.8	4.7	3.9
Advanced Asia and the Pacific	**4.9**	**2.1**	**1.3**	**1.5**	**2.5**	**2.2**	**1.8**
Australia	5.4	4.2	2.1	1.1	2.0	2.0	2.9
Hong Kong, China	6.5	–3.7	3.2	2.6	3.5	2.6	3.0
Japan	3.6	1.3	0.7	–0.2	1.2	0.7	0.6
Republic of Korea	4.6	2.7	1.6	2.0	1.0	1.9	1.9
New Zealand	5.5	2.6	2.2	–0.3	0.2	1.9	2.8
Singapore	10.1	4.0	1.5	5.3	5.0	3.0	2.3
Taipei,China	6.7	2.7	1.1	5.3	8.7	7.6	4.0
Asia and the Pacific	**7.3**	**4.3**	**4.7**	**4.7**	**4.9**	**4.6**	**4.6**
Developing Asia	**7.2**	**4.3**	**5.3**	**5.2**	**5.4**	**5.0**	**5.0**

ASEAN = Association of Southeast Asian Nations, PRC = People’s Republic of China, GDP = gross domestic product.

Note: Developing Asia refers to the old classification that includes all the ADB regional member economies except Australia, Japan, New Zealand, and Türkiye.

Table A2 Growth Rate of Per Capita GDP, % per year

	2021	2022	2023	2024	2025	2026	2027	Per capita GNI, $, 2024
Developing Asia and the Pacific (DAP)	**7.6**	**4.3**	**5.2**	**5.0**	**5.1**	**4.3**	**4.3**	
DAP excluding the PRC	**6.6**	**5.5**	**5.0**	**5.0**	**5.1**	**3.6**	**3.8**	
Caucasus and Central and West Asia	**9.3**	**6.1**	**7.5**	**5.1**	**4.9**	**4.8**	**3.5**	
Armenia	5.6	12.3	8.1	4.1	4.4	4.8	5.6	7,810
Azerbaijan	5.1	4.3	0.7	3.6	1.0	1.8	1.6	7,330
Georgia	10.3	12.2	6.5	10.7	7.3	5.3	5.1	8,110
Kazakhstan	7.3	13.9	24.1	13.5	13.5	12.7	...	12,090
Kyrgyz Republic	3.6	7.0	7.1	9.7	9.3	7.4	6.8	2,190
Tajikistan	7.0	5.7	6.1	6.3	6.2	5.9	5.9	1,650
Türkiye	10.8	4.4	4.6	3.1	2.9	3.2	3.2	13,460
Turkmenistan	3.5	4.8	4.9	5.1	5.3	5.3	5.0	6,510
Uzbekistan	6.1	4.1	4.3	4.5	5.8	4.0	4.7	3,020
Developing East Asia	**8.4**	**3.2**	**5.5**	**5.1**	**5.1**	**4.7**	**4.6**	
People's Republic of China	8.5	3.2	5.5	5.1	5.1	4.7	4.6	13,660
Mongolia	−0.1	3.5	6.0	3.8	5.6	4.5	4.8	5,380
South Asia	**8.4**	**5.6**	**5.2**	**5.4**	**5.8**	**2.7**	**3.4**	
Afghanistan	...	8.9	−22.3	−8.2	0.3	1.7	0.8	...
Bangladesh	5.8	5.9	5.2	4.1	2.6	2.8	3.7	2,820
Bhutan	3.4	4.2	3.6	6.5	7.7	6.0	6.4	...
India	8.6	6.3	6.3	6.1	6.6	...	...	2,650
Maldives	43.1	11.3	3.2	0.8	3.7	−0.6	1.5	11,640
Nepal	3.9	4.7	1.0	2.9	3.4	4.2	...	1,470
Pakistan	10.9	2.7	−2.4	1.1	1.8	2.0	2.9	1,430
Sri Lanka	3.1	−7.5	−1.4	5.6	5.7	4.5	4.7	3,860
ASEAN	**3.4**	**4.7**	**2.9**	**4.0**	**4.0**	**3.2**	**3.9**	
Developing Southeast Asia	**2.5**	**5.0**	**3.4**	**4.1**	**4.0**	**3.3**	**4.0**	
Brunei Darussalam	−1.3	−2.7	0.0	2.9	−1.7	0.9	1.2	36,020
Cambodia	1.2	2.2	3.5	5.3	3.5	3.2	3.2	2,550
Indonesia	2.8	4.1	3.9	3.9	4.0	4.1	4.2	4,910
Lao People's Democratic Republic	6.6	3.0	2.8	3.1	3.4	2.9	3.7	2,000
Malaysia	2.9	8.6	1.4	3.1	4.6	3.5	3.4	11,650
Myanmar	−6.6	1.4	−0.1	−1.5	−2.9	1.7	2.0	1,210
Philippines	4.9	6.7	4.6	4.8	3.5	3.5	4.9	4,470
Thailand	2.1	2.8	2.2	3.1	2.6	−1.5	1.8	7,100
Timor-Leste	1.4	2.5	0.8	2.9	2.7	2.8	3.0	1,650
Viet Nam	1.6	7.0	4.3	6.5	6.8	6.2	6.0	4,490
The Pacific	**−3.4**	**5.5**	**3.2**	**1.9**	**2.1**	**1.3**	**1.2**	
Cook Islands	−25.1	11.5	14.5	15.6	4.5	3.2	...	...
Fiji	−4.9	17.1	8.8	2.9	2.4	2.3	2.1	5,820
Kiribati	6.8	3.3	1.6	2.9	3.1	1.9	...	3,660
Marshall Islands	5.8	1.7	−2.7	5.1	4.6	5.5	2.9	8,500
Federated States of Micronesia	2.9	−3.3	1.0	2.1	0.9	0.8	0.8	4,240
Nauru	6.6	2.1	0.0	1.7	1.4	1.9	1.8	20,400
Niue	−6.7	0.3	6.1	8.7	2.7	2.5	...	...
Palau	−11.9	−0.4	1.3	12.1	7.0	6.0	3.8	...
Papua New Guinea	−3.1	3.0	1.2	1.2	2.0	0.9	0.8	2,900
Samoa	−5.8	1.5	14.3	3.9	3.4	2.4	2.2	5,040
Solomon Islands	−2.6	−4.9	0.4	1.8	1.2	0.7	1.1	1,910
Tonga	−0.4	−2.0	3.1	2.1	2.9	2.8	2.7	...
Tuvalu	1.0	−2.3	8.8	5.7	1.8	1.6	1.5	...
Vanuatu	−4.9	1.8	2.1	0.3	0.4	1.4	0.7	3,890
Advanced Asia and the Pacific	**5.3**	**2.2**	**0.7**	**1.1**	**2.4**	**2.3**	**1.9**	
Australia	3.4	3.8	−0.2	−2.1	−0.4	0.7	1.2	62,680
Hong Kong, China	7.4	−2.8	0.5	2.8	3.8	2.9	3.4	57,070
Japan	4.1	1.8	1.2	0.2	1.7	1.1	1.1	36,000
Republic of Korea	4.7	2.9	1.5	1.9	1.1	2.1	2.0	36,750
New Zealand	4.0	2.5	1.8	−2.8	−1.1	0.4	1.8	47,580
Singapore	14.6	0.6	−3.4	3.3	3.9	2.2	2.1	74,750
Taipei,China	7.6	3.2	0.4	5.4	9.1	8.5	4.5	...
Asia and the Pacific	**7.2**	**3.9**	**4.4**	**4.4**	**4.7**	**3.9**	**3.8**	

... = not available, ASEAN = Association of Southeast Asian Nations, PRC = People's Republic of China, GDP = gross domestic product, GNI = gross national income.

Table A3 Growth Rate of Value Added in Agriculture, % per year

	2021	2022	2023	2024	2025	Sector share, 2024, %
Caucasus and Central and West Asia						
Armenia	−0.8	−2.8	−0.4	1.5	5.3	8.4
Azerbaijan	3.3	3.4	3.0	1.4	0.9	6.3
Georgia	2.3	−1.8	−3.4	13.5	−6.1	6.3
Kazakhstan	−2.2	9.1	−7.4	13.7	5.9	4.1
Kyrgyz Republic	−4.5	7.3	0.6	6.2	2.2	10.1
Tajikistan	6.6	8.0	11.6	5.7	9.7	22.8
Türkiye	−2.5	1.2	0.4	5.1	−8.8	6.6
Turkmenistan	4.0	5.7	4.4	...	...	...
Uzbekistan	4.0	3.6	4.1	3.4	4.4	18.5
Developing East Asia						
People's Republic of China	7.1	4.2	4.1	3.7	3.9	6.8
Mongolia	−5.5	12.0	−8.9	−28.7	33.2	8.1
South Asia						
Afghanistan	4.4	−9.8	−6.6	2.2	2.6	36.7
Bangladesh	3.2	3.1	3.4	3.3	2.4	11.5
Bhutan	1.4	−1.1	1.4	3.7	2.4	14.5
India	4.6	6.3	2.6	4.2	2.4	19.4
Maldives	−0.8	6.2	3.2	−25.9	42.1	4.5
Nepal	2.8	2.4	3.0	3.4	3.3	26.4
Pakistan	3.5	4.2	2.2	6.4	1.5	25.0
Sri Lanka	1.0	−4.1	0.1	0.6	1.4	8.4
Developing Southeast Asia						
Brunei Darussalam	16.9	−3.3	−11.6	1.2	0.1	1.2
Cambodia	1.5	0.6	1.1	0.9	1.0	16.3
Indonesia	1.9	2.3	1.3	0.7	5.3	13.2
Lao People's Democratic Republic	1.7	3.4	3.7	1.4	2.9	24.4
Malaysia	−0.3	1.3	0.2	3.1	2.2	8.2
Myanmar	1.0	−3.5	−1.8	−2.3	−0.2	21.4
Philippines	−0.3	0.5	1.2	−1.5	3.1	9.1
Thailand	2.2	2.3	2.4	1.9	3.6	8.9
Timor-Leste	5.5	5.3	2.9	0.6	2.8	19.2
Viet Nam	3.3	3.4	3.8	3.3	3.8	12.9
The Pacific						
Cook Islands	−7.3	3.9	−3.9	3.2	−7.7	2.6
Fiji	9.8	3.4	4.5	4.4	4.2	16.7
Kiribati	1.4	−3.9	2.9	−1.2	...	22.7
Marshall Islands	11.4	−15.4	−13.0	21.5	−3.5	19.6
Federated States of Micronesia	−3.6	...	...	...	...	...
Nauru	...	...	...	...	...	...
Niue	5.2	0.9	1.5	0.1	1.0	...
Palau	−3.8	−0.1	0.5	−2.2	...	3.1
Papua New Guinea	1.1	3.1	1.0	2.1	1.8	17.8
Samoa	0.9	−9.4	0.8	6.4	−3.2	10.9
Solomon Islands	0.7	−9.2	−0.2	1.8	0.7	29.7
Tonga	−6.1	−1.8	11.8	−19.4	−3.2	21.6
Tuvalu	...	...	...	...	...	...
Vanuatu	2.3	4.0	2.3	3.9	2.8	28.5
Advanced Asia and the Pacific						
Australia	25.5	7.4	3.0	−0.3	−26.3	2.2
Hong Kong, China	−2.5	−15.7	1.5	1.5	−1.0	0.0
Japan	5.7	3.5	−4.0	0.9	...	1.0
Republic of Korea	3.4	0.8	−1.8	0.6	1.4	1.6
New Zealand	0.8	−1.9	3.5	2.5	1.0	...
Singapore	10.8	−7.4	3.5	2.0	−3.0	0.0
Taipei,China	−4.1	−4.2	−0.9	−1.0	−1.7	1.5

... = not available.

Table A4 Growth Rate of Value Added in Industry, % per year

	2021	2022	2023	2024	2025	Sector share, 2024, %
Caucasus and Central and West Asia						
Armenia	2.6	9.8	2.0	6.8	9.3	24.7
Azerbaijan	3.0	0.2	0.0	2.1	–0.7	47.2
Georgia	1.0	15.1	4.3	5.4	1.4	22.5
Kazakhstan	4.4	2.7	6.0	5.4	9.0	34.2
Kyrgyz Republic	2.5	11.1	10.0	15.3	14.0	28.8
Tajikistan	19.1	7.5	9.8	9.6	17.6	31.5
Türkiye	13.7	–0.7	3.3	2.1	4.6	28.7
Turkmenistan	4.0	6.3	4.3	...	...	...
Uzbekistan	21.5	18.5	17.1	19.1	26.3	33.3
Developing East Asia						
People's Republic of China	8.2	2.3	4.4	5.0	4.5	36.4
Mongolia	–2.2	–4.5	12.9	6.0	11.0	42.5
South Asia						
Afghanistan	–5.6	–12.8	–5.7	1.8	1.9	14.2
Bangladesh	10.3	9.9	8.4	3.5	3.7	35.3
Bhutan	3.9	5.6	–0.8	7.0	14.0	32.5
India	12.0	2.8	10.9	8.3	9.3	27.7
Maldives	–4.6	19.6	3.2	0.8	7.4	10.8
Nepal	6.9	10.7	1.3	0.1	4.5	14.3
Pakistan	8.2	7.0	–3.9	–0.9	5.3	21.5
Sri Lanka	5.7	–16.0	–9.2	11.1	7.8	25.5
Developing Southeast Asia						
Brunei Darussalam	–4.2	–4.9	–1.9	5.6	1.9	60.7
Cambodia	8.4	8.2	5.4	9.2	9.3	47.9
Indonesia	3.4	4.1	5.0	5.2	3.7	41.1
Lao People's Democratic Republic	11.1	4.4	3.1	4.7	5.1	35.3
Malaysia	6.0	6.9	1.2	5.0	4.8	34.9
Myanmar	–9.6	5.0	2.2	–0.1	–2.7	36.6
Philippines	8.5	6.5	3.6	5.6	1.5	27.7
Thailand	3.6	0.4	–1.6	1.0	0.8	31.8
Timor-Leste	–11.2	7.9	–2.0	10.7	6.9	12.4
Viet Nam	3.6	7.8	3.7	8.2	8.9	41.0
The Pacific						
Cook Islands	20.5	–37.8	–98.0	4,135.6	49.6	5.5
Fiji	–8.5	9.5	–0.2	2.6	–1.7	16.4
Kiribati	15.0	2.9	14.5	21.1	...	11.6
Marshall Islands	–0.1	9.6	5.8	4.2	5.7	13.2
Federated States of Micronesia	–0.9	...	...	...	...	...
Nauru	...	...	...	...	...	...
Niue	–0.2	–13.2	–2.5	35.9	1.0	...
Palau	0.8	–19.2	–19.7	37.2	...	14.7
Papua New Guinea	–7.9	6.6	1.6	3.7	5.9	38.2
Samoa	–7.9	–0.1	–1.8	4.6	6.1	11.8
Solomon Islands	3.1	2.1	12.5	8.3	8.6	23.4
Tonga	11.8	7.4	–6.3	28.3	12.7	20.6
Tuvalu	...	...	...	...	...	...
Vanuatu	–0.4	–0.8	14.9	11.0	8.4	10.8
Advanced Asia and the Pacific						
Australia	0.9	0.4	0.7	0.0	–25.8	26.4
Hong Kong, China	1.2	5.2	6.9	3.6	–5.0	6.3
Japan	4.8	1.3	–1.2	–4.4	...	27.0
Republic of Korea	5.0	2.3	0.9	3.0	0.3	36.5
New Zealand	2.2	–0.8	2.2	–3.7	–2.7	...
Singapore	15.5	3.9	–1.9	4.0	7.8	22.7
Taipei,China	14.9	2.3	–6.7	9.8	14.9	40.3

... = not available.

Table A5 Growth Rate of Value Added in Services, % per year

	2021	2022	2023	2024	2025	Sector share, 2024, %
Caucasus and Central and West Asia						
Armenia	7.6	17.8	13.1	8.3	6.9	66.9
Azerbaijan	7.8	9.7	1.8	6.4	3.1	46.5
Georgia	17.1	9.9	10.8	11.2	10.8	71.2
Kazakhstan	4.4	2.5	5.5	4.6	5.2	61.7
Kyrgyz Republic	6.9	6.8	7.9	9.8	10.9	61.1
Tajikistan	7.9	13.4	7.6	15.7	11.4	36.3
Türkiye	13.5	10.5	5.0	3.3	4.2	64.7
Turkmenistan	5.0	7.0	9.0	...	...	...
Uzbekistan	9.5	8.5	7.1	7.7	14.7	48.2
Developing East Asia						
People’s Republic of China	9.0	3.5	6.3	5.1	5.4	56.8
Mongolia	3.9	6.9	9.9	11.0	2.0	49.4
South Asia						
Afghanistan	−4.6	−30.1	−6.5	1.5	0.5	49.0
Bangladesh	5.7	6.3	5.4	5.1	4.3	53.2
Bhutan	4.4	21.8	7.9	8.8	5.1	52.9
India	8.6	10.2	7.0	7.9	8.7	52.9
Maldives	43.0	14.3	5.1	6.0	3.8	84.7
Nepal	4.7	5.3	2.2	4.4	4.2	48.8
Pakistan	5.9	6.7	0.0	2.3	3.1	53.5
Sri Lanka	3.4	−2.6	0.5	2.4	3.3	57.5
Developing Southeast Asia						
Brunei Darussalam	2.5	3.8	5.9	1.9	−1.1	38.3
Cambodia	−1.8	3.6	6.0	4.5	4.4	35.8
Indonesia	3.5	6.5	6.1	6.2	6.3	45.7
Lao People’s Democratic Republic	5.5	5.0	5.6	5.1	5.2	40.2
Malaysia	2.2	11.3	5.1	5.3	5.5	56.9
Myanmar	−6.3	2.6	1.0	−0.5	−2.8	42.1
Philippines	5.4	9.2	7.1	6.7	5.9	63.2
Thailand	0.2	4.1	4.7	3.3	2.6	59.3
Timor-Leste	6.4	2.4	3.4	3.4	3.8	68.6
Viet Nam	1.6	10.0	6.8	7.4	8.6	46.1
The Pacific						
Cook Islands	−29.1	16.0	21.7	10.2	1.8	91.9
Fiji	−6.9	25.1	13.5	3.6	3.2	66.9
Kiribati	5.6	8.2	2.4	6.0	...	65.7
Marshall Islands	−0.8	2.0	−3.8	−3.9	2.9	67.2
Federated States of Micronesia	−1.8	...	...	...	...	...
Nauru	...	...	...	...	...	...
Niue	−12.0	3.7	9.5	7.2	3.4	...
Palau	−12.8	1.3	4.7	8.9	...	82.3
Papua New Guinea	4.5	6.3	5.0	5.2	4.8	43.9
Samoa	−4.7	4.4	13.5	4.2	4.8	77.3
Solomon Islands	−1.3	−0.1	1.7	1.9	3.3	46.9
Tonga	−3.0	−4.4	2.1	4.8	3.1	57.8
Tuvalu	...	...	...	...	...	...
Vanuatu	0.2	5.8	6.8	2.6	3.5	60.7
Advanced Asia and the Pacific						
Australia	5.5	5.8	3.0	1.6	−24.2	71.4
Hong Kong, China	5.9	−3.4	3.4	2.3	3.2	93.6
Japan	3.5	2.5	1.7	0.9	...	72.0
Republic of Korea	4.3	3.8	2.7	1.6	1.7	61.9
New Zealand	6.6	3.9	2.2	0.6	1.0	...
Singapore	8.6	4.9	2.6	5.8	4.3	77.3
Taipei,China	1.5	3.2	4.9	4.4	3.6	58.2

... = not available.

Table A6 Inflation, % per year

	2021	2022	2023	2024	2025	2026	2027
Developing Asia and the Pacific (DAP)	**3.4**	**7.7**	**5.7**	**5.3**	**3.0**	**3.6**	**3.4**
DAP excluding the PRC	**6.2**	**13.6**	**11.3**	**10.5**	**6.1**	**6.8**	**5.8**
Caucasus and Central and West Asia	**16.0**	**51.1**	**38.3**	**41.1**	**25.6**	**20.6**	**16.3**
Armenia	7.2	8.6	2.0	0.3	3.3	3.8	3.2
Azerbaijan	6.7	13.9	8.8	2.2	5.6	5.7	4.9
Georgia	9.6	11.9	2.5	1.1	3.9	3.8	3.3
Kazakhstan	8.0	15.0	14.5	8.7	11.4	10.4	9.5
Kyrgyz Republic	11.9	13.9	10.8	5.0	8.2	10.3	8.5
Tajikistan	7.8	4.2	3.8	3.6	3.5	4.0	4.5
Türkiye	19.4	72.0	53.4	60.0	35.2	27.7	21.5
Turkmenistan	21.1	3.0	1.4	5.5	5.5	6.0	6.0
Uzbekistan	10.7	11.4	10.0	9.8	7.3	6.5	5.0
Developing East Asia	**0.9**	**2.0**	**0.2**	**0.2**	**0.0**	**0.6**	**1.0**
People's Republic of China	0.9	2.0	0.2	0.2	0.0	0.6	1.0
Mongolia	7.4	15.1	10.4	6.2	8.6	7.8	6.8
South Asia	**5.8**	**7.8**	**7.9**	**6.4**	**2.9**	**5.0**	**4.6**
Afghanistan	5.8	7.8	10.6	−7.7	−4.2	4.6	3.2
Bangladesh	5.6	6.2	9.0	9.7	10.0	9.0	8.5
Bhutan	7.3	5.6	4.2	2.8	3.5	3.9	3.2
India	5.5	6.6	5.4	4.6	2.1	4.5	4.0
Maldives	0.5	2.3	2.9	1.4	4.0	5.0	4.0
Nepal	3.6	6.3	7.7	5.4	4.1	3.7	4.5
Pakistan	8.9	12.2	29.2	23.4	4.5	6.4	6.5
Sri Lanka	6.0	46.4	17.4	1.2	−0.5	5.2	4.0
ASEAN	**2.0**	**5.2**	**4.2**	**3.0**	**2.2**	**3.1**	**2.8**
Developing Southeast Asia	**2.0**	**5.2**	**4.1**	**3.0**	**2.3**	**3.2**	**2.8**
Brunei Darussalam	1.7	3.7	0.4	−0.4	−0.3	0.9	0.4
Cambodia	2.9	5.3	2.1	0.8	2.5	2.8	2.5
Indonesia	1.6	4.1	3.7	2.3	1.9	2.5	2.5
Lao People's Democratic Republic	3.8	23.0	31.2	23.1	7.7	9.8	6.7
Malaysia	2.5	3.4	2.5	1.8	1.4	1.8	1.9
Myanmar	3.7	27.2	27.5	29.6	25.2	24.0	16.0
Philippines	3.9	5.8	6.0	3.2	1.7	4.0	3.5
Thailand	1.2	6.1	1.2	0.4	−0.1	1.3	1.0
Timor-Leste	3.8	7.0	8.4	2.1	0.5	1.7	2.0
Viet Nam	1.8	3.2	3.3	3.6	3.3	4.0	3.8
The Pacific	**3.0**	**5.6**	**3.2**	**1.7**	**3.0**	**4.2**	**3.5**
Cook Islands	1.8	3.6	13.2	4.6	2.0	3.5	3.3
Fiji	−0.7	6.1	2.9	3.9	−1.4	3.3	1.9
Kiribati	2.1	5.3	9.3	2.6	6.5	5.3	4.2
Marshall Islands	2.2	2.8	7.4	5.7	5.6	5.7	4.0
Federated States of Micronesia	1.8	5.0	6.2	5.4	3.9	3.5	3.0
Nauru	1.1	3.6	4.8	9.3	6.1	4.5	4.0
Niue	1.9	4.5	5.1	5.4	2.3	3.4	2.8
Palau	−0.5	13.2	12.4	3.7	0.2	2.8	2.4
Papua New Guinea	4.5	5.3	2.3	0.6	4.4	4.6	4.0
Samoa	−3.0	8.8	12.0	3.6	1.9	1.8	4.0
Solomon Islands	0.8	5.4	5.1	4.2	3.4	4.5	2.8
Tonga	−3.2	6.8	12.6	8.0	2.9	3.8	2.7
Tuvalu	6.7	12.2	6.8	0.4	2.8	3.1	1.0
Vanuatu	2.3	6.7	11.2	1.2	0.7	2.0	2.7
Advanced Asia and the Pacific	**1.3**	**3.9**	**3.6**	**2.6**	**2.5**	**2.6**	**1.9**
Australia	2.9	6.6	5.6	3.2	2.9	5.1	2.6
Hong Kong, China	1.6	1.9	2.1	1.7	1.4	1.7	1.5
Japan	−0.2	2.5	3.3	2.7	3.2	2.4	1.8
Republic of Korea	2.5	5.1	3.6	2.3	2.1	2.3	2.0
New Zealand	3.9	7.2	5.7	2.9	2.8	3.8	1.6
Singapore	2.3	6.1	4.9	2.4	0.9	1.6	1.7
Taipei,China	2.0	2.9	2.5	2.2	1.7	1.8	1.5
Asia and the Pacific	**3.0**	**7.0**	**5.3**	**4.8**	**2.9**	**3.5**	**3.1**
Developing Asia	**2.6**	**4.4**	**3.3**	**2.5**	**1.4**	**2.4**	**2.4**

ASEAN = Association of Southeast Asian Nations, PRC = People's Republic of China.

Note: Developing Asia refers to the old classification that includes all the ADB regional member economies except Australia, Japan, New Zealand, and Türkiye.

Table A7 Change in Money Supply, % per year

	2021	2022	2023	2024	2025
Caucasus and Central and West Asia					
Armenia	13.1	16.1	17.4	13.7	17.8
Azerbaijan	18.7	23.6	5.3	3.2	7.2
Georgia	11.3	11.6	14.5	14.5	16.6
Kazakhstan	20.8	13.9	11.7	19.2	1.2
Kyrgyz Republic	19.1	30.6	15.0	31.9	43.3
Tajikistan	8.6	40.4	–0.8	28.8	19.0
Türkiye	52.2	62.3	65.8	28.2	40.7
Turkmenistan	18.1	19.9	...	...	...
Uzbekistan	29.7	30.2	12.2	30.6	36.6
Developing East Asia					
People's Republic of China	8.7	11.2	11.2	7.3	8.0
Mongolia	13.8	6.5	24.2	15.5	10.6
South Asia					
Afghanistan	9.4	–4.9	2.5	0.6	...
Bangladesh	13.6	9.4	10.5	7.7	7.0
Bhutan	13.1	9.2	0.2	11.5	25.4
India	8.8	9.0	11.6	9.4	16.2
Maldives	26.2	6.0	7.0	–0.1	21.4
Nepal	21.8	7.6	11.4	12.9	12.5
Pakistan	16.1	13.6	15.6	16.0	13.7
Sri Lanka	13.2	15.4	7.3	8.6	11.5
Developing Southeast Asia					
Brunei Darussalam	2.7	1.3	2.7	3.6	...
Cambodia	16.3	8.3	12.5	17.5	–10.1
Indonesia	14.0	8.4	3.5	4.8	9.6
Lao People's Democratic Republic	24.0	36.9	33.3	17.8	19.1
Malaysia	6.3	4.3	5.9	3.7	4.2
Myanmar	11.4	12.7	15.9	20.0	16.5
Philippines	7.9	6.9	6.3	7.7	7.2
Thailand	4.8	3.9	1.9	3.4	4.4
Timor-Leste	28.7	8.6	2.7	7.3	–0.7
Viet Nam	10.7	6.2	12.5	12.0	15.0
The Pacific					
Cook Islands	–6.6	14.6	2.2	4.8	...
Fiji	11.9	3.8	12.2	8.2	...
Kiribati	...	...	...	...	...
Marshall Islands	...	...	...	...	...
Federated States of Micronesia	...	...	...	...	...
Nauru	...	...	...	...	...
Niue	...	...	...	...	...
Palau	...	...	...	...	...
Papua New Guinea	11.7	14.8	11.5	–6.4	...
Samoa	8.1	2.2	16.3	7.7	...
Solomon Islands	1.9	5.3	6.1	3.8	...
Tonga	26.0	10.7	–0.6	7.6	...
Tuvalu	...	...	...	...	...
Vanuatu	8.9	7.3	5.9	9.6	9.9
Advanced Asia and the Pacific					
Australia	9.5	6.7	4.9	5.4	7.2
Hong Kong, China	4.3	1.6	4.0	7.4	11.6
Japan	3.2	2.5	2.0	1.3	1.0
Republic of Korea	11.7	7.5	2.6	4.3	5.2
New Zealand	7.1	1.8	3.6	4.1	4.1
Singapore	7.2	7.8	3.2	6.7	6.4
Taipei,China	7.3	6.7	5.6	5.4	5.2

... = not available.

Table A8 Central Government Revenues, % of GDP

	2021	2022	2023	2024	2025
Caucasus and Central and West Asia					
Armenia	24.1	24.3	24.8	25.3	25.5
Azerbaijan	28.3	22.9	28.9	29.4	30.3
Georgia	25.1	26.6	27.4	27.7	27.1
Kazakhstan	18.9	19.5	20.9	19.8	18.7
Kyrgyz Republic	26.8	29.5	29.4	29.3	33.9
Tajikistan	29.7	30.5	33.1	30.6	29.9
Türkiye	18.9	18.3	19.2	19.4	20.4
Turkmenistan	13.9	16.4	13.8	14.4	13.8
Uzbekistan	20.7	27.5	25.5	24.6	23.3
Developing East Asia					
People's Republic of China	17.3	16.5	16.8	16.3	15.4
Mongolia	32.8	34.4	34.6	39.0	36.3
South Asia					
Afghanistan	...	...	15.2	15.6	19.2
Bangladesh	9.3	8.4	8.2	8.2	7.9
Bhutan	30.9	25.1	25.4	26.5	27.3
India	10.0	9.4	9.6	9.7	9.7
Maldives	26.4	30.5	33.5	32.3	34.1
Nepal	23.3	21.4	17.9	16.8	17.7
Pakistan	12.4	12.1	11.5	12.6	15.8
Sri Lanka	8.3	8.4	11.2	13.6	16.7
Developing Southeast Asia					
Brunei Darussalam	24.3	27.7	18.1	17.4	...
Cambodia	16.1	18.3	16.2	14.5	15.0
Indonesia	11.8	13.5	13.3	12.9	11.6
Lao People's Democratic Republic	14.7	14.8	17.3	19.4	19.4
Malaysia	15.1	16.4	17.3	16.8	16.6
Myanmar	14.3	17.1	14.3	14.7	15.9
Philippines	15.5	16.1	15.7	16.7	15.9
Thailand	15.1	14.7	14.8	15.0	14.9
Timor-Leste	45.4	43.6	40.5	41.5	42.0
Viet Nam	18.8	19.0	17.3	16.3	20.6
The Pacific					
Cook Islands	52.5	50.9	37.1	33.5	36.1
Fiji	23.6	21.8	23.5	28.0	29.0
Kiribati	92.0	90.9	94.5	94.9	89.1
Marshall Islands	69.3	66.3	68.5	72.3	65.3
Federated States of Micronesia	71.0	76.1	61.9	63.4	63.2
Nauru	137.7	159.8	126.1	139.2	136.8
Niue	99.1	101.7	139.9	138.6	101.1
Palau	55.1	56.8	50.6	55.6	54.9
Papua New Guinea	15.1	16.7	17.9	17.2	18.1
Samoa	35.8	35.6	31.5	35.6	31.1
Solomon Islands	35.1	40.9	39.9	28.8	...
Tonga	43.7	44.5	46.7	47.8	51.9
Tuvalu	102.6	92.4	117.9	60.1	86.6
Vanuatu	36.4	28.2	32.5	33.8	...
Advanced Asia and the Pacific					
Australia	23.1	17.2	23.9	24.2	24.4
Hong Kong, China	24.2	22.1	18.4	17.7	20.7
Japan	12.2	13.2	13.0	12.9	13.8
Republic of Korea	20.7	21.7	18.9	18.3	...
New Zealand	38.4	37.6	37.7	38.3	37.4
Singapore	11.4	11.6	13.3	13.5	14.6
Taipei,China	15.3	16.2	16.5	16.3	14.8

... = not available.

Table A9 Central Government Expenditures, % of GDP

	2021	2022	2023	2024	2025
Caucasus and Central and West Asia					
Armenia	28.7	26.4	26.8	29.0	29.2
Azerbaijan	29.4	23.9	29.6	29.9	29.9
Georgia	31.1	28.9	29.8	29.9	28.3
Kazakhstan	21.9	21.6	23.2	22.5	21.5
Kyrgyz Republic	27.0	30.5	28.4	27.0	31.3
Tajikistan	29.0	29.9	32.4	29.8	31.1
Türkiye	21.6	19.2	24.3	24.2	23.2
Turkmenistan	13.4	13.0	13.7	14.5	13.8
Uzbekistan	25.1	30.9	30.2	28.3	26.0
Developing East Asia					
People's Republic of China	20.9	21.1	21.2	21.1	20.5
Mongolia	35.9	33.7	32.0	37.9	34.8
South Asia					
Afghanistan	...	...	16.1	17.0	19.7
Bangladesh	13.0	13.0	12.8	12.2	11.4
Bhutan	36.6	32.1	28.9	28.2	30.0
India	17.2	16.1	15.3	14.6	14.1
Maldives	40.7	42.1	44.1	44.4	37.1
Nepal	27.2	23.5	22.8	19.6	19.7
Pakistan	18.5	19.9	19.3	19.4	21.2
Sri Lanka	20.0	18.6	19.5	20.4	19.0
Developing Southeast Asia					
Brunei Darussalam	29.4	26.6	30.0	30.8	...
Cambodia	21.4	18.5	19.1	16.4	18.0
Indonesia	16.4	15.8	14.9	15.2	14.5
Lao People's Democratic Republic	16.0	15.0	16.6	17.1	16.8
Malaysia	19.0	20.2	22.3	20.9	20.3
Myanmar	22.4	19.2	16.2	17.6	19.9
Philippines	24.1	23.4	21.9	22.4	21.5
Thailand	19.8	18.1	18.1	19.0	19.6
Timor-Leste	97.2	109.1	85.5	95.2	94.7
Viet Nam	20.1	22.6	18.9	19.8	18.7
The Pacific					
Cook Islands	81.0	59.7	39.5	32.6	31.2
Fiji	35.1	33.9	30.7	31.4	31.4
Kiribati	100.7	109.1	90.0	100.8	88.6
Marshall Islands	69.2	65.8	67.5	69.8	64.1
Federated States of Micronesia	66.7	59.4	62.1	62.4	61.4
Nauru	93.1	134.8	108.7	111.4	120.0
Niue	107.7	98.4	139.9	133.2	100.9
Palau	65.0	60.7	49.6	51.3	51.8
Papua New Guinea	22.0	21.9	22.3	20.4	20.8
Samoa	34.1	30.6	28.8	26.3	26.4
Solomon Islands	36.3	44.0	44.2	30.8	...
Tonga	44.5	45.3	41.5	44.3	47.1
Tuvalu	116.4	106.4	112.4	68.1	90.3
Vanuatu	37.5	33.0	31.9	34.5	...
Advanced Asia and the Pacific					
Australia	24.6	16.3	22.5	23.3	24.9
Hong Kong, China	24.2	28.9	24.2	23.6	23.7
Japan	20.1	21.3	18.8	16.8	16.1
Republic of Korea	25.6	28.1	24.1	23.6	...
New Zealand	41.9	41.8	41.2	41.9	41.5
Singapore	14.6	13.4	15.3	13.8	14.2
Taipei,China	15.4	16.0	17.1	15.8	15.6

... = not available.

Table A10 Fiscal Balance of Central Government, % of GDP

	2021	2022	2023	2024	2025
Caucasus and Central and West Asia					
Armenia	−4.6	−2.1	−2.0	−3.7	−3.7
Azerbaijan	−1.1	−1.0	−0.7	−0.4	0.4
Georgia	−6.0	−2.3	−2.4	−2.2	−1.2
Kazakhstan	−3.0	−2.1	−2.4	−2.6	−2.7
Kyrgyz Republic	−0.2	−1.0	0.9	2.4	2.5
Tajikistan	0.7	0.6	0.7	0.8	−1.2
Türkiye	−2.7	−0.9	−5.1	−4.7	−2.9
Turkmenistan	0.6	3.4	0.1	−0.1	0.1
Uzbekistan	−4.3	−3.4	−4.7	−3.7	−2.7
Developing East Asia					
People's Republic of China	−3.7	−4.6	−4.5	−4.8	−5.1
Mongolia	−3.0	0.7	2.7	1.1	1.5
South Asia					
Afghanistan	−2.2	...	−1.0	−1.4	−0.5
Bangladesh	−3.7	−4.6	−4.6	−4.0	−3.5
Bhutan	−5.7	−7.0	−3.5	−1.6	−2.7
India	−7.2	−6.7	−5.7	−5.0	−4.4
Maldives	−14.2	−11.6	−10.5	−12.1	−3.0
Nepal	−4.0	−3.2	−5.8	−2.8	−2.0
Pakistan	−6.1	−7.9	−7.8	−6.8	−5.4
Sri Lanka	−11.7	−10.2	−8.3	−6.8	−2.3
Developing Southeast Asia					
Brunei Darussalam	−5.2	1.1	−11.9	−13.4	...
Cambodia	−5.3	−0.3	−2.8	−1.9	−3.0
Indonesia	−4.6	−2.4	−1.6	−2.3	−2.9
Lao People's Democratic Republic	−1.3	−0.2	0.6	2.3	2.7
Malaysia	−3.9	−3.8	−5.0	−4.1	−3.7
Myanmar	−8.1	−2.2	−1.9	−2.8	−4.0
Philippines	−8.6	−7.3	−6.2	−5.7	−5.6
Thailand	−4.7	−3.4	−3.3	−4.0	−4.7
Timor-Leste	−51.8	−65.5	−45.0	−53.7	−52.1
Viet Nam	−1.4	−3.6	−1.6	−3.5	1.9
The Pacific					
Cook Islands	−28.5	−8.8	−2.4	0.9	4.9
Fiji	−11.5	−12.1	−7.2	−3.4	−2.4
Kiribati	−8.7	−18.2	4.6	−5.9	0.5
Marshall Islands	0.2	0.5	1.0	2.6	1.1
Federated States of Micronesia	4.2	16.7	−0.2	1.0	1.8
Nauru	44.6	25.0	17.4	27.9	16.9
Niue	−8.6	3.2	0.0	5.5	0.2
Palau	−9.9	−4.0	0.9	4.2	3.1
Papua New Guinea	−6.8	−5.3	−4.3	−3.2	−2.6
Samoa	1.7	5.0	2.7	9.3	4.7
Solomon Islands	−1.2	−3.1	−4.2	−2.0	...
Tonga	−0.9	−0.8	5.3	3.5	4.8
Tuvalu	−13.9	−14.0	5.4	−8.0	−3.7
Vanuatu	−1.1	−4.8	0.7	−0.8	...
Advanced Asia and the Pacific					
Australia	−1.6	0.8	1.5	0.8	−0.4
Hong Kong, China	0.0	−6.7	−5.8	−5.9	−3.0
Japan	−7.9	−8.0	−5.7	−3.9	−2.3
Republic of Korea	−4.9	−6.4	−5.2	−5.3	...
New Zealand	−3.5	−4.2	−3.5	−3.6	−4.1
Singapore	−3.2	−1.7	−2.0	−0.2	0.4
Taipei,China	−0.2	0.2	−0.6	0.4	−0.8

... = not available.

Table A11 Growth Rate of Merchandise Exports, % per year

	2021	2022	2023	2024	2025
Developing Asia and the Pacific (DAP)	**29.8**	**8.9**	**−5.0**	**4.7**	**5.2**
DAP excluding the PRC	**31.5**	**13.8**	**−4.9**	**2.1**	**3.8**
Caucasus and Central and West Asia	**13.8**	**20.2**	**1.2**	**2.3**	**2.2**
Armenia	20.7	83.9	50.0	49.1	−30.8
Azerbaijan	72.3	94.6	−30.8	−11.0	−7.4
Georgia	27.4	35.8	7.7	6.2	10.8
Kazakhstan	49.3	30.2	−6.3	−1.6	−1.9
Kyrgyz Republic	37.9	−18.9	50.0	52.0	...
Tajikistan	53.4	−18.9	20.1	−0.8	−5.3
Türkiye	...	12.9	0.6	2.4	4.4
Turkmenistan	...	...	...	...	...
Uzbekistan	10.2	12.4	22.2	1.7	...
Developing East Asia	**28.1**	**4.1**	**−4.9**	**7.2**	**6.6**
People's Republic of China	28.1	4.1	−5.0	7.2	6.6
Mongolia	16.4	21.1	41.2	6.0	1.2
South Asia	**38.3**	**10.9**	**−4.7**	**0.6**	**1.5**
Afghanistan	−10.1	36.2	73.5	−3.2	−2.1
Bangladesh	12.4	33.4	−11.9	−5.9	7.7
Bhutan	21.2	−8.8	−9.3	12.9	9.2
India	44.8	6.3	−3.2	0.1	0.4
Maldives	10.8	40.1	5.4	−9.2	16.5
Nepal	30.0	43.9	−19.9	−2.5	7.0
Pakistan	13.7	26.7	−14.2	11.1	4.4
Sri Lanka	24.4	4.9	−9.1	7.2	6.3
ASEAN	**28.4**	**16.0**	**−8.4**	**4.7**	**8.6**
Developing Southeast Asia	**28.8**	**15.8**	**−8.5**	**4.6**	**8.6**
Brunei Darussalam	68.3	28.4	−20.5	...	...
Cambodia	5.4	18.7	1.7	13.5	10.9
Indonesia	42.5	25.6	−11.9	2.1	6.6
Lao People's Democratic Republic	25.8	6.5	2.1	18.5	25.4
Malaysia	30.7	15.8	−17.5	7.0	9.4
Myanmar	−2.6	−2.6	−2.8	6.0	21.0
Philippines	12.5	6.4	−4.3	−0.4	15.2
Thailand	19.2	5.4	−1.5	3.1	−2.5
Timor-Leste	80.1	−35.9	−64.8	−69.0	−35.5
Viet Nam	18.9	10.6	−4.4	14.3	17.0
The Pacific	**14.3**	**28.5**	**−6.7**	**8.0**	**4.3**
Cook Islands	−12.3	−40.5	−19.5	−7.8	69.0
Fiji	6.1	21.0	1.6	5.8	5.6
Kiribati	1.4	−14.8	−4.2	−0.7	10.9
Marshall Islands	51.8	−18.1	−8.7	23.1	...
Federated States of Micronesia	−7.0	25.6	−13.6	...	...
Nauru	126.4	156.8	−26.4	−19.7	8.2
Niue	−81.7	163.1	108.2	−12.0	...
Palau	−72.7	66.8	30.9	62.6	...
Papua New Guinea	19.6	34.8	−12.2	9.0	3.1
Samoa	−23.1	−8.6	37.0	−13.1	−0.4
Solomon Islands	−2.0	−8.5	26.8	18.4	...
Tonga	−9.8	−6.4	−14.2	−16.7	42.2
Tuvalu	201.4	−64.6	8.4	...	...
Vanuatu	3.2	36.3	−18.4	23.4	...
Advanced Asia and the Pacific	**24.8**	**5.7**	**−7.0**	**1.5**	**8.2**
Australia	37.6	19.8	−10.0	−8.2	−1.2
Hong Kong, China	24.7	−8.1	−6.2	9.8	16.3
Japan	19.1	0.3	−4.9	−3.0	3.8
Republic of Korea	25.9	6.4	−8.0	9.6	2.1
New Zealand	8.0	14.1	−4.8	3.3	13.5
Singapore	23.0	18.9	−6.1	5.2	8.5
Taipei,China	33.5	5.8	−10.4	8.1	40.4
Asia and the Pacific	**28.9**	**8.3**	**−5.3**	**4.2**	**5.7**

... = not available, ASEAN = Association of Southeast Asian Nations, PRC = People's Republic of China.

Table A12 Growth Rate of Merchandise Imports, % per year

	2021	2022	2023	2024	2025
Developing Asia and the Pacific (DAP)	**34.5**	**10.5**	**–4.5**	**3.1**	**3.1**
DAP excluding the PRC	**36.5**	**20.4**	**–5.5**	**4.1**	**7.6**
Caucasus and Central and West Asia	**4.7**	**31.8**	**6.5**	**–1.6**	**5.7**
Armenia	16.7	63.4	46.4	36.5	–23.8
Azerbaijan	3.4	29.7	21.4	4.7	3.1
Georgia	24.2	35.3	12.4	7.0	7.7
Kazakhstan	9.2	21.8	19.3	2.3	6.7
Kyrgyz Republic	50.4	76.4	27.2	0.0	...
Tajikistan	36.2	23.5	12.7	25.0	2.6
Türkiye	...	34.0	–0.5	–5.0	6.2
Turkmenistan	...	...	...	...	...
Uzbekistan	21.0	24.1	20.5	2.2	...
Developing East Asia	**32.7**	**1.1**	**–3.6**	**2.2**	**–1.2**
People's Republic of China	32.7	1.1	–3.6	2.2	–1.2
Mongolia	29.2	27.4	8.6	24.6	–5.1
South Asia	**48.2**	**19.0**	**–7.4**	**4.5**	**9.2**
Afghanistan	–4.5	–16.6	45.1	13.5	36.6
Bangladesh	19.7	35.9	–14.2	–10.6	1.8
Bhutan	29.9	25.6	–13.9	9.4	57.7
India	55.3	16.6	–4.9	6.2	9.4
Maldives	40.0	38.7	–0.6	5.0	–2.7
Nepal	25.7	21.9	–22.0	–2.5	19.0
Pakistan	24.3	31.8	–26.3	0.9	11.2
Sri Lanka	28.5	–11.4	–8.1	12.1	14.0
ASEAN	**31.6**	**17.1**	**–8.0**	**6.2**	**6.2**
Developing Southeast Asia	**32.2**	**17.3**	**–8.0**	**6.3**	**5.8**
Brunei Darussalam	60.8	7.9	–17.1	...	...
Cambodia	45.9	4.2	–17.0	17.7	11.7
Indonesia	39.9	21.6	–8.0	5.6	3.3
Lao People's Democratic Republic	16.8	15.4	5.6	14.8	16.0
Malaysia	30.7	19.3	–14.8	9.8	10.1
Myanmar	–22.8	17.7	–8.5	–25.1	18.0
Philippines	30.6	19.0	–4.8	2.2	5.0
Thailand	27.9	13.8	–3.8	2.3	–5.7
Timor-Leste	16.0	40.7	–1.6	8.6	0.3
Viet Nam	26.7	7.2	–9.2	16.7	19.4
The Pacific	**19.2**	**37.0**	**–2.6**	**–4.7**	**–8.8**
Cook Islands	–12.4	19.7	25.4	2.3	15.5
Fiji	16.6	57.2	5.8	0.4	–1.9
Kiribati	35.0	22.0	8.6	3.1	3.0
Marshall Islands	18.1	12.7	–11.4	14.7	...
Federated States of Micronesia	8.7	11.2	–0.5	...	...
Nauru	24.8	8.4	–12.8	4.1	1.5
Niue	1.1	5.9	25.2	–37.7	...
Palau	–16.9	24.4	3.0	1.5	...
Papua New Guinea	22.0	34.6	–8.1	–7.0	–12.8
Samoa	0.9	7.9	28.2	–0.1	0.6
Solomon Islands	15.8	16.7	15.2	–3.5	...
Tonga	2.6	1.0	7.8	–0.9	17.1
Tuvalu	–219.2	–25.3	47.1	5.3	7.5
Vanuatu	11.4	26.9	6.4	–2.2	...
Advanced Asia and the Pacific	**26.1**	**16.4**	**–11.5**	**–0.6**	**5.4**
Australia	22.7	16.3	–4.2	3.1	4.0
Hong Kong, China	22.9	–6.9	–4.4	7.1	17.4
Japan	21.6	18.5	–12.4	–5.8	1.1
Republic of Korea	31.3	18.0	–12.1	–0.7	–2.1
New Zealand	23.0	22.3	–5.3	–2.4	6.1
Singapore	24.7	14.1	–8.2	4.6	10.8
Taipei,China	39.0	13.4	–19.9	9.5	28.8
Asia and the Pacific	**33.0**	**11.6**	**–5.7**	**2.5**	**3.5**

... = not available, ASEAN = Association of Southeast Asian Nations, PRC = People's Republic of China.

Table A13 Trade Balance, $ million

	2021	2022	2023	2024	2025
Developing Asia and the Pacific (DAP)	**344,227**	**301,405**	**239,856**	**391,316**	**578,065**
DAP excluding the PRC	**−218,479**	**−363,644**	**−354,185**	**−376,660**	**−445,335**
Caucasus and Central and West Asia	**−28,904**	**−74,296**	**−108,661**	**−85,046**	**−101,500**
Armenia	−1,505	−1,803	−2,428	−2,195	−2,600
Azerbaijan	11,274	28,697	12,806	8,825	6,379
Georgia	−3,793	−5,108	−6,097	−6,591	−6,832
Kazakhstan	24,228	34,997	19,863	17,214	11,548
Kyrgyz Republic	−2,420	−6,919	−8,286	−6,534	...
Tajikistan	−1,712	−2,960	−3,322	...	...
Türkiye	−46,210	−109,541	−106,339	−82,230	−92,004
Turkmenistan	...	...	...	...	...
Uzbekistan	−8,766	−11,660	−14,859	−13,534	−17,990
Developing East Asia	**564,076**	**666,282**	**598,590**	**771,058**	**1,027,264**
People's Republic of China	562,706	665,049	594,041	767,976	1,023,400
Mongolia	1,370	1,233	4,549	3,081	3,864
South Asia	**−269,106**	**−364,041**	**−321,472**	**−358,074**	**−433,539**
Afghanistan	−5,096	−3,837	−5,267	−6,289	−9,978
Bangladesh	−23,778	−33,250	−27,384	−22,433	−20,389
Bhutan	−384	−753	−615	−650	−1,381
India	−189,459	−265,291	−244,911	−286,948	−353,549
Maldives	−2,105	−2,916	−2,874	−3,076	−2,921
Nepal	−11,510	−13,759	−10,701	−10,431	−10,651
Pakistan	−28,634	−39,050	−24,819	−22,177	−26,771
Sri Lanka	−8,139	−5,185	−4,900	−6,069	−7,899
ASEAN	**196,391**	**234,689**	**232,663**	**233,814**	**255,016**
Developing Southeast Asia	**76,518**	**73,237**	**71,522**	**62,013**	**78,743**
Brunei Darussalam	2,483	5,046	3,757	3,950	...
Cambodia	−11,205	−8,826	−2,986	−4,504	−5,230
Indonesia	43,806	62,672	46,269	39,839	49,822
Lao People's Democratic Republic	1,420	954	721	1,143	2,266
Malaysia	42,873	42,552	28,701	25,011	25,886
Myanmar	−1,216	−3,415	−2,586	942	1,406
Philippines	−52,806	−69,701	−66,036	−68,863	−66,670
Thailand	31,945	13,543	19,379	21,907	30,085
Timor-Leste	2,248	1,012	−140	−643	−715
Viet Nam	16,971	29,400	44,443	43,232	41,893
The Pacific	**4,127**	**5,269**	**3,634**	**5,315**	**7,096**
Cook Islands	−90	−119	−154	−159	−179
Fiji	−842	−1,638	−1,778	−1,728	−1,610
Kiribati	−135	−169	−184	−190	−195
Marshall Islands	−42	−81	−69	−73	...
Federated States of Micronesia	−170	−184	−189	−192	−193
Nauru	−77	−59	−57	−67	−66
Niue	−10	−11	−13	−8	...
Palau	−127	−157	−161	−162	...
Papua New Guinea	6,474	8,734	7,434	8,969	10,041
Samoa	−284	−313	−398	−403	−406
Solomon Islands	−97	−207	−199	−98	...
Tonga	−199	−202	−221	−221	−256
Tuvalu	−32	−24	−35	−37	−40
Vanuatu	−242	−302	−339	−316	...
Advanced Asia and the Pacific	**387,461**	**225,817**	**311,151**	**393,799**	**502,214**
Australia	86,069	112,243	83,686	44,303	28,596
Hong Kong, China	3,174	−5,167	−16,132	−1,847	−9,394
Japan	16,055	−118,016	−47,055	−24,170	−5,671
Republic of Korea	79,659	18,335	44,631	110,910	138,073
New Zealand	−5,332	−11,728	−10,735	−6,561	−1,713
Singapore	119,873	161,452	161,140	171,800	176,274
Taipei,China	87,963	68,699	95,617	99,363	176,050
Asia and the Pacific	**734,171**	**532,268**	**554,764**	**789,065**	**1,080,279**

... = not available, ASEAN = Association of Southeast Asian Nations, PRC = People's Republic of China.

Table A14 Current Account Balance, % of GDP

	2021	2022	2023	2024	2025
Developing Asia and the Pacific (DAP)	**0.5**	**0.3**	**0.4**	**1.0**	**1.8**
DAP excluding the PRC	**–1.0**	**–1.8**	**–0.7**	**–0.3**	**–0.2**
Caucasus and Central and West Asia	**–0.5**	**–1.7**	**–3.3**	**–1.2**	**–1.7**
Armenia	–3.4	0.7	–2.8	–4.6	–5.4
Azerbaijan	15.1	29.8	11.5	6.3	4.6
Georgia	–10.3	–4.4	–5.6	–5.3	–2.6
Kazakhstan	–1.4	2.9	–3.6	–2.7	–3.9
Kyrgyz Republic	–8.0	–42.1	–45.0	–23.4	...
Tajikistan	8.2	15.3	4.8	6.2	15.5
Türkiye	–0.8	–5.0	–3.6	–0.8	–1.6
Turkmenistan	6.6	9.7	5.9	4.4	2.3
Uzbekistan	–6.3	–3.2	–7.6	–5.0	–4.5
Developing East Asia	**1.9**	**2.4**	**1.4**	**2.2**	**3.7**
People's Republic of China	1.9	2.4	1.4	2.2	3.7
Mongolia	–13.8	–13.4	0.6	–10.4	–8.6
South Asia	**–1.4**	**–2.6**	**–0.9**	**–0.6**	**–0.7**
Afghanistan	...	...	...	...	...
Bangladesh	–1.1	–4.0	–2.6	–1.5	0.0
Bhutan	–19.9	–36.0	–27.5	–14.3	–28.0
India	–1.3	–2.1	–0.7	–0.6	–1.0
Maldives	–8.6	–16.9	–21.2	–18.7	–6.9
Nepal	–7.7	–12.6	–0.9	3.9	6.7
Pakistan	–0.8	–4.7	–1.0	–0.6	0.5
Sri Lanka	–3.7	–2.0	1.7	1.2	1.6
ASEAN	**1.1**	**1.0**	**2.0**	**2.1**	**2.5**
Developing Southeast Asia	**–0.5**	**–0.5**	**0.8**	**0.8**	**1.3**
Brunei Darussalam	11.1	19.5	12.7	14.6	...
Cambodia	–30.1	–19.2	1.3	0.5	–3.5
Indonesia	0.3	1.0	–0.1	–0.6	–0.1
Lao People's Democratic Republic	2.3	–3.0	2.8	3.5	11.9
Malaysia	3.9	3.2	1.1	1.4	1.6
Myanmar	–1.3	–3.6	–3.1	4.8	1.2
Philippines	–1.5	–4.5	–2.8	–4.0	–3.3
Thailand	–2.1	–3.5	1.4	1.9	3.9
Timor-Leste	104.6	24.3	–9.8	–31.1	–35.7
Viet Nam	–2.0	0.3	6.0	6.4	6.5
The Pacific	**6.5**	**5.4**	**4.1**	**9.0**	**12.4**
Cook Islands	–16.1	–7.0	5.1	...	...
Fiji	–7.1	–15.4	–6.6	–7.4	–7.8
Kiribati	7.1	–12.0	–1.8	–2.0	–0.6
Marshall Islands	27.4	6.8	15.7	21.0	...
Federated States of Micronesia	9.9	16.5	5.5	3.1	...
Nauru	3.1	–0.6	1.3	6.3	2.7
Niue	8.7	0.3	0.3	33.6	...
Palau	–58.9	–44.6	–37.8	–19.8	...
Papua New Guinea	12.6	14.5	9.1	16.1	20.7
Samoa	–14.2	–10.6	–3.0	4.4	5.7
Solomon Islands	–5.0	–14.8	–11.5	–4.2	...
Tonga	–6.0	–5.8	–5.1	–5.7	–3.6
Tuvalu	23.5	4.9	39.8	6.9	12.5
Vanuatu	–10.2	–16.1	–6.2	–15.2	...
Advanced Asia and the Pacific	**6.0**	**4.0**	**4.6**	**5.9**	**6.9**
Australia	2.3	0.2	–0.4	–2.3	–2.6
Hong Kong, China	11.8	10.2	8.4	13.1	12.2
Japan	3.8	2.0	3.6	4.6	4.8
Republic of Korea	4.3	1.3	1.8	5.3	6.6
New Zealand	–6.0	–9.2	–6.9	–6.1	–4.7
Singapore	19.3	18.9	16.4	17.2	16.7
Taipei,China	15.1	13.2	14.0	14.1	19.7
Asia and the Pacific	**1.6**	**1.0**	**1.1**	**1.8**	**2.7**

... = not available, ASEAN = Association of Southeast Asian Nations, PRC = People's Republic of China, GDP = gross domestic product.

Table A15 Exchange Rates to the United States Dollar, annual average

	Currency	Symbol	2021	2022	2023	2024	2025
Caucasus and Central and West Asia							
Armenia	Dram	AMD	503.77	435.67	392.48	392.73	387.01
Azerbaijan	Azerbaijan new manat	AZN	1.70	1.70	1.70	1.70	1.70
Georgia	Lari	GEL	3.22	2.92	2.63	2.72	2.74
Kazakhstan	Tenge	T	425.91	460.10	456.17	468.96	521.59
Kyrgyz Republic	Som	Som	84.64	84.12	87.86	87.15	87.36
Tajikistan	Somoni	TJS	11.30	11.03	10.84	10.81	10.04
Türkiye	Turkish lira	TL	8.89	16.55	23.71	32.81	39.48
Turkmenistan	Turkmen manat	TMM	3.50	3.50	3.50	3.50	3.50
Uzbekistan	Sum	SUM	10,611.36	11,045.33	11,735.75	12,652.43	12,940.42
Developing East Asia							
People's Republic of China	Yuan	CNY	6.45	6.73	7.05	7.12	7.14
Mongolia	Togrog	MNT	2,849.32	3,140.68	3,467.40	3,389.98	3,545.08
South Asia							
Afghanistan	Afghani	AF	76.92	87.74	88.53	78.76	70.98
Bangladesh	Taka	Tk	84.81	86.30	99.46	111.06	120.82
Bhutan	Ngultrum	Nu	73.94	78.60	82.60	83.70	87.20
India	Indian rupee/s	Re/Rs	74.50	80.36	82.79	84.63	87.67
Maldives	Rufiyaa	Rf	15.39	15.40	15.40	15.40	15.40
Nepal	Nepalese rupee/s	NRe/NRs	117.87	120.84	130.75	133.00	136.29
Pakistan	Pakistan rupee/s	PRe/PRs	160.00	177.50	248.04	282.90	279.34
Sri Lanka	Sri Lanka rupee/s	SLRe/SLRs	198.88	324.55	327.53	302.12	300.95
Developing Southeast Asia							
Brunei Darussalam	Brunei dollar	B$	1.34	1.38	1.34	1.34	1.31
Cambodia	Riel	KR	4,095.00	4,115.00	4,110.00	4,071.00	4,069.00
Indonesia	Rupiah	Rp	14,310.00	14,849.92	15,236.83	15,855.42	16,477.83
Lao People's Democratic Republic	Kip	KN	9,737.25	14,305.80	18,660.00	21,553.00	21,501.00
Malaysia	Ringgit	RM	4.14	4.40	4.56	4.58	4.28
Myanmar	Kyat	MK	1,490.40	2,100.00	3,105.00	4,550.00	4,081.40
Philippines	Peso	P	49.26	54.48	55.63	57.29	57.51
Thailand	Baht	B	31.98	35.06	34.80	34.37	34.97
Timor-Leste	US dollar	US$	1.00	1.00	1.00	1.00	1.00
Viet Nam	Dong	D	23,159.72	23,271.48	23,794.63	24,167.78	24,963.81
The Pacific							
Cook Islands	New Zealand dollar	NZ$	1.44	1.47	1.62	1.65	1.69
Fiji	Fiji dollar	F$	2.07	2.20	2.25	2.27	2.27
Kiribati	Australian dollar	A$	1.33	1.44	1.51	1.52	1.55
Marshall Islands	US dollar	US$	1.00	1.00	1.00	1.00	1.00
Federated States of Micronesia	US dollar	US$	1.00	1.00	1.00	1.00	1.00
Nauru	Australian dollar	A$	1.33	1.44	1.51	1.52	1.55
Niue	New Zealand dollar	NZ$	1.44	1.47	1.62	1.65	1.69
Palau	US dollar	US$	1.00	1.00	1.00	1.00	1.00
Papua New Guinea	Kina	K	3.51	3.52	3.58	3.90	4.10
Samoa	Tala	ST	2.57	2.61	2.73	2.76	2.78
Solomon Islands	Sol. Islands dollar	SI$	8.03	8.16	8.38	8.45	8.33
Tonga	Pa'anga	T$	2.28	2.28	2.36	2.37	2.37
Tuvalu	Australian dollar	A$	1.33	1.44	1.51	1.52	1.55
Vanuatu	Vatu	Vt	109.45	115.35	119.11	119.17	120.42
Advanced Asia and the Pacific							
Australia	Australian dollar	A$	1.33	1.44	1.51	1.52	1.55
Hong Kong, China	Hong Kong dollar	HK$	7.77	7.83	7.83	7.80	7.80
Japan	Yen	¥	109.75	131.50	140.49	151.37	149.66
Republic of Korea	Won	W	1,144.54	1,291.88	1,306.14	1,363.51	1,421.73
New Zealand	New Zealand dollar	NZ$	1.41	1.58	1.63	1.65	1.72
Singapore	Singapore dollar	S$	1.34	1.38	1.34	1.34	1.31
Taipei,China	NT dollar	NT$	27.93	29.80	31.16	32.10	31.16

Table A16 Gross International Reserves, $ million

	2021	2022	2023	2024	2025
Caucasus and Central and West Asia					
Armenia	3,230	4,112	3,608	3,685	5,086
Azerbaijan	7,075	8,996	11,613	10,959	11,515
Georgia	4,300	4,900	5,000	4,500	6,200
Kazakhstan	34,378	35,076	35,944	45,823	65,414
Kyrgyz Republic	2,978	2,798	3,236	5,088	8,603
Tajikistan	2,499	3,803	3,607	4,485	4,677
Türkiye	156,686	166,412	180,523	194,672	227,940
Turkmenistan	...	...	...	...	...
Uzbekistan	35,139	35,768	35,600	41,200	43,100
Developing East Asia					
People's Republic of China	3,250,166	3,127,691	3,237,977	3,202,357	...
Mongolia	4,366	3,400	4,921	5,510	7,005
South Asia					
Afghanistan	...	...	...	...	...
Bangladesh	46,391	41,827	31,203	26,714	31,772
Bhutan	970	767	607	893	1,116
India	607,309	578,449	646,419	668,326	...
Maldives	806	832	591	674	983
Nepal	...	...	...	...	...
Pakistan	17,299	9,815	4,445	9,390	14,506
Sri Lanka	3,139	1,898	4,392	6,122	6,838
Developing Southeast Asia					
Brunei Darussalam	3,959	4,050	3,452	3,322	4,104
Cambodia	20,265	17,805	19,998	22,500	23,064
Indonesia	144,905	137,233	146,384	155,719	156,471
Lao People's Democratic Republic	1,737	1,480	1,677	2,102	3,545
Malaysia	117,503	114,365	114,209	113,654	118,985
Myanmar	7,800	8,182	9,338	...	...
Philippines	108,794	96,149	103,753	106,256	110,833
Thailand	256,812	213,442	220,600	233,191	241,860
Timor-Leste	20,496	18,121	19,024	18,998	19,395
Viet Nam	109,439	86,694	92,302	83,135	86,996
The Pacific					
Cook Islands	...	...	...	...	...
Fiji	1,546	1,558	1,494	1,625	1,684
Kiribati	139	116	...	...	...
Marshall Islands	...	...	...	...	...
Federated States of Micronesia	...	...	...	...	...
Nauru	...	...	...	...	...
Niue	...	...	...	...	...
Palau	...	...	...	...	...
Papua New Guinea	3,290	4,132	3,957	3,616	3,616
Samoa	285	312	402	491	568
Solomon Islands	694	659	679	683	...
Tonga	314	383	390	389	409
Tuvalu	126	112	124	106	128
Vanuatu	662	637	643	613	663
Advanced Asia and the Pacific					
Australia	57,846	56,705	61,742	60,403	72,631
Hong Kong, China	496,867	424,029	425,554	421,503	427,934
Japan	1,405,750	1,227,576	1,294,637	1,230,715	1,369,775
Republic of Korea	463,118	423,164	420,148	415,604	428,055
New Zealand	16,113	14,415	15,519	22,084	28,166
Singapore	417,904	289,484	351,031	371,433	409,276
Taipei,China	548,408	554,932	570,595	576,677	602,553

... = not available.

Table A17 External Debt Outstanding, $ million

	2021	2022	2023	2024	2025
Caucasus and Central and West Asia					
Armenia	6,648	6,445	6,501	6,454	7,037
Azerbaijan	8,100	6,693	6,461	5,130	4,814
Georgia	18,358	18,731	20,467	22,517	24,526
Kazakhstan	164,131	161,144	163,732	164,683	183,622
Kyrgyz Republic	7,667	7,813	7,980	8,375	...
Tajikistan	3,747	3,653	3,640	3,574	3,241
Türkiye	427,960	450,245	491,930	517,175	564,897
Turkmenistan	...	...	...	...	...
Uzbekistan	42	49	58	75	79
Developing East Asia					
People's Republic of China	2,746,559	2,452,765	2,447,537	2,419,835	...
Mongolia	33,806	33,345	34,569	37,237	40,460
South Asia					
Afghanistan	...	...	...	...	...
Bangladesh	50,880	55,602	62,406	68,822	77,279
Bhutan	3,012	3,023	3,049	3,152	3,045
India	619,076	623,928	668,837	736,337	...
Maldives	2,068	2,149	2,474	2,742	2,829
Nepal	7,832	8,026	8,918	9,409	10,239
Pakistan	122,294	130,196	126,141	131,045	135,049
Sri Lanka	51,775	49,667	54,257	57,133	...
Developing Southeast Asia					
Brunei Darussalam	...	...	...	...	...
Cambodia	9,505	9,969	11,188	11,917	13,243
Indonesia	412,025	394,763	406,722	425,118	432,965
Lao People's Democratic Republic	10,426	10,517	...	...	...
Malaysia	258,706	259,617	275,389	302,058	343,803
Myanmar	13,759	12,538	12,162	11,175	...
Philippines	106,428	111,268	125,394	137,628	147,651
Thailand	196,870	201,426	196,547	195,433	...
Timor-Leste	237	254	259	269	286
Viet Nam	139,853	146,627	...	...	...
The Pacific					
Cook Islands	115	148	139	131	127
Fiji	1,170	1,528	1,590	1,641	1,646
Kiribati	39	34	31	29	...
Marshall Islands	66	63	60	55	42
Federated States of Micronesia	58	50	54	49	51
Nauru	6	15	15	14	12
Niue	...	...	...	...	...
Palau	165	171	211	213	...
Papua New Guinea	6,531	7,428	7,862	7,602	7,488
Samoa	389	364	312	276	255
Solomon Islands	152	151	195	272	...
Tonga	193	192	181	156	140
Tuvalu	4	3	3	2	2
Vanuatu	387	360	360	367	...
Advanced Asia and the Pacific					
Australia	931,420	833,648	799,741	925,669	956,721
Hong Kong, China	1,870,855	1,780,876	1,846,218	1,888,781	2,062,658
Japan	4,826,363	4,429,613	4,538,558	4,522,264	4,850,711
Republic of Korea	630,694	673,296	677,324	672,903	766,867
New Zealand	341,368	328,749	347,073	345,259	375,844
Singapore	1,881,330	1,910,420	2,055,046	2,233,986	2,342,639
Taipei,China	213,592	202,146	206,499	219,947	243,950

... = not available.

Table A18 Debt Service Ratio, % of exports of goods and services

	2021	2022	2023	2024	2025
Caucasus and Central and West Asia					
Armenia	7.9	3.8	3.8	3.5	4.4
Azerbaijan	4.3	1.8	2.4	4.4	2.4
Georgia	24.2	23.1	24.1	16.3	13.1
Kazakhstan	44.6	45.1	53.7	56.0	66.0
Kyrgyz Republic	26.7	44.7	15.3	15.4	...
Tajikistan	10.7	14.5	14.7	16.1	22.7
Türkiye	26.3	19.5	21.2	23.4	...
Turkmenistan	...	...	...	...	...
Uzbekistan	38.3	35.3	33.1	43.8	40.2
Developing East Asia					
People's Republic of China	5.9	10.5	7.6	6.5	...
Mongolia	29.9	36.4	32.6	33.1	53.7
South Asia					
Afghanistan	...	...	...	...	...
Bangladesh	4.3	3.5	5.3	7.2	8.1
Bhutan	10.8	15.8	13.1	11.9	12.8
India	5.2	5.3	6.7	6.6	...
Maldives	7.2	5.2	4.2	4.2	5.6
Nepal	13.2	11.1	11.4	11.5	10.5
Pakistan	42.5	38.1	58.7	43.8	44.3
Sri Lanka	30.7	15.3	15.9	21.1	...
Developing Southeast Asia					
Brunei Darussalam	...	...	...	...	...
Cambodia	1.9	1.8	1.8	1.7	1.7
Indonesia	22.1	16.6	17.7	18.6	14.4
Lao People's Democratic Republic	29.5	15.7	...	...	...
Malaysia	10.8	11.4	13.3	14.6	15.6
Myanmar	5.3	6.6	7.0	7.4	...
Philippines	7.5	6.3	10.3	11.5	8.3
Thailand	6.4	7.3	7.8	7.1	...
Timor-Leste	0.3	0.9	3.3	8.5	9.6
Viet Nam	6.1	6.8	7.6	5.7	...
The Pacific					
Cook Islands	9.8	–15.5	–1.8	38.6	24.4
Fiji	16.3	1.5	2.9	4.3	4.6
Kiribati	20.0	11.7	12.9	11.5	...
Marshall Islands	5.6	6.9	7.2	6.1	...
Federated States of Micronesia	7.1	7.4	7.0	...	...
Nauru	0.8	0.7	4.3	2.6	2.1
Niue	...	...	...	...	...
Palau	46.6	25.6	22.6	20.1	...
Papua New Guinea	0.8	0.8	1.7	2.0	2.1
Samoa	25.6	23.7	12.7	10.0	9.6
Solomon Islands	1.6	0.4	0.8	0.7	...
Tonga	16.2	20.8	15.7	21.5	20.3
Tuvalu	...	...	...	...	...
Vanuatu	36.3	23.7	12.2	15.1	...
Advanced Asia and the Pacific					
Australia	3.2	2.1	3.8	3.9	4.7
Hong Kong, China	...	...	...	...	...
Japan	...	...	...	...	...
Republic of Korea	...	...	...	...	...
New Zealand	5.6	6.6	10.1	12.5	12.2
Singapore	...	...	...	...	...
Taipei,China	1.2	1.6	3.9	3.5	2.7

... = not available.

Asian Development Outlook April 2026

The Middle East Conflict Challenges Resilience in Asia and the Pacific

The conflict in the Middle East has placed geopolitical tensions and energy market disruptions at the center of the global economic outlook. This report's key assumptions, finalized on 10 March, envisage an early stabilization scenario, with disruptions gradually easing from April 2026. Under this scenario, growth in developing Asia and the Pacific is projected to moderate in 2026–2027, with inflation rising this year and easing slightly next year. Economic activity will be supported by resilient domestic demand, steady labor markets, and public infrastructure investment. However, uncertainty remains exceptionally high, as the risk that tensions in the Middle East could persist longer than anticipated looms large. Other downside risks include renewed tariff increases and an abrupt tightening in global financial conditions.

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