COMMENTARY
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Developed Asia Mid-2025 Outlook: Whiplashed

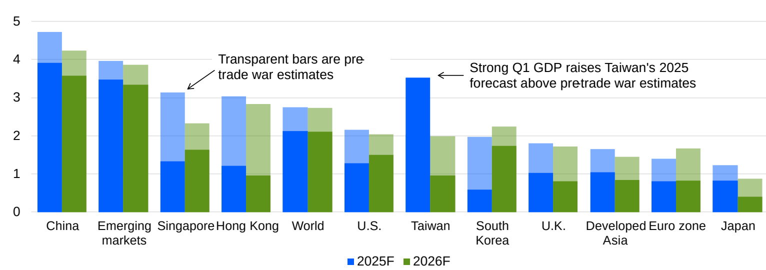
Growth prospects have faded after a brief boost from tariff front-loading.

- Developed Asia faces a tough stretch. After front-loading temporarily boosted exports, tariff pain, jittery financial markets, and soft home demand are dragging on growth.
- We have cut our forecast for real GDP growth to 1% in 2025 and 0.8% in 2026, down 0.6 and 0.7 percentage point, respectively, from our pre-tariff baseline.
- Trade risks aren't going away. Last week's threat of a 50% U.S. tariff on EU goods snuffed out the notion that trade deals with China and the U.K. might signal Washington's desire to de-escalate trade tensions.
- With the outlook for trade shifting weekly, supply chains are vulnerable to policy whiplash. Financial market volatility could trigger fresh shocks.
- The picture isn't all doom and gloom. Soaring artificial intelligence demand is boosting chip exports and investment, particularly in Taiwan and South Korea.

Developed Asian economies are enduring a rough ride as tariff pain, jittery financial markets, and sputtering domestic demand weigh on the outlook. Our May baseline sees the region's growth slowing to just 1% in 2025 and 0.8% in 2026, down from 1.6% and 1.5% just six months ago. Growth in all developed Asian economies will slow compared with last year, except in Japan, where modest real wage growth will drive a tepid and partial recovery after a disappointing 2024.

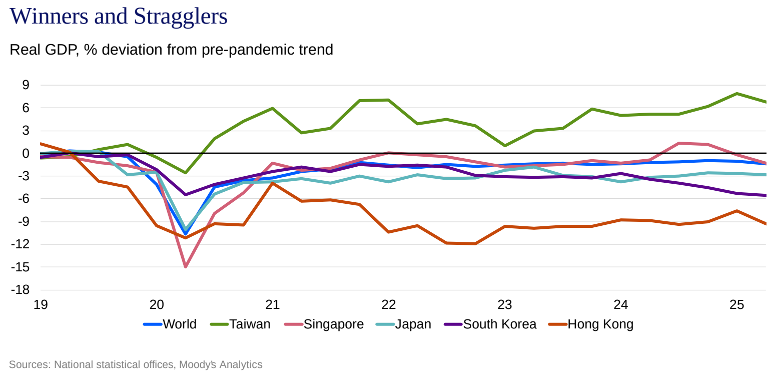
Growth Will Slow

Real GDP, % change, Moody's Analytics May 2025 baseline



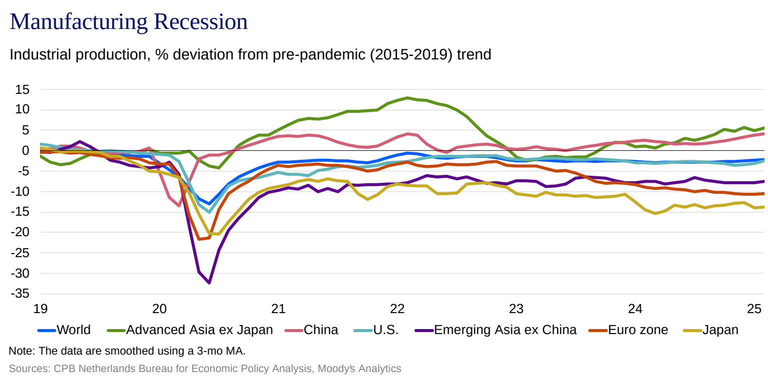
Source: Moody's Analytics

Developed Asia had a decent post-pandemic run, but momentum has faded. Comparing GDP to pre-pandemic trends shows that output is at or below the world average for Singapore, Japan, South Korea and Hong Kong. A temporary boost from front-loading ahead of U.S. tariffs briefly lifted electronics exports and, in Singapore's case, pharmaceutical shipments in mid-2024. But that front-loading fizzled from late 2024. Taiwan is the exception, as the AI boom supercharged shipments of advanced semiconductors. Taiwan's GDP has been surpassing the pre-pandemic trend, one of the few economies to pull that off.



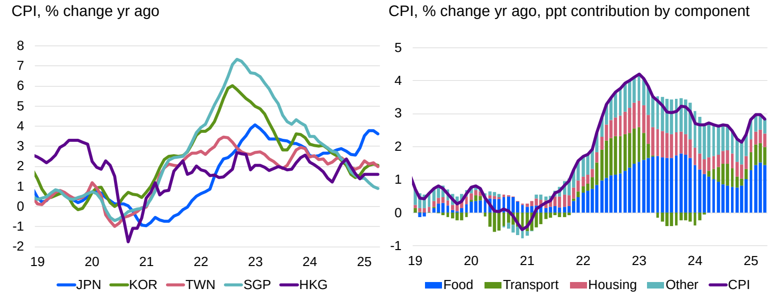
Weakness in traditional manufacturing and anaemic domestic demand are holding back developed Asian economies. Apart from makers of bleeding-edge chips, manufacturers are struggling against higher U.S. import tariffs and softening global demand. Tariffs are a particular problem for Japanese and South Korean makers of cars and car parts, which are up against a 25% levy in the U.S. Adding pressure, Chinese firms are stepping into territory that developed Asia once dominated, from autos to high-end machinery.

In Singapore and Hong Kong, where manufacturing represents a smaller share of their economies, the key challenge is that strong exchange rates are sapping their competitiveness on the international market. With the front-loading boost behind it, Singaporean industrial production slumped back to mid-2024 levels in March, its sputtering order books pointing to weakness.



Domestic conditions aren't helping. Inflation has eased but is still high in some pockets of developed Asia, and wage growth is patchy. Inflation is proving particularly sticky in Japan, where reduced government support and a surge in staple food prices such as rice have blunted the benefits of a record shunto pay hike. South Korea and Taiwan are seeing inflation at rates central banks can tolerate, even if they are above historical norms. High housing costs across large parts of developed Asia are an added drag, and high household debt levels in South Korea, Taiwan and Hong Kong are limiting spending capacity. Taiwan is the strongest of the bunch in terms of consumer demand, but even there, consumer sentiment dipped in April. Worsening trade could sap wage growth, weighing on spending and easing inflation pressures.

Inflation's Slow Retreat

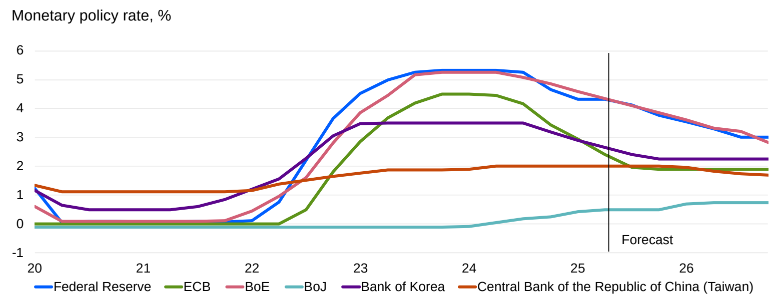


Note: The data are smoothed using a 3-mo MA.

Sources: National statistical authorities, Moody's Analytics

Lower inflation rates would make monetary easing, well, easier. The Bank of Korea is meeting Thursday and will likely cut rates by 25 basis points. The Monetary Authority of Singapore is looking more dovish in response to a darkening trade outlook and a first-quarter contraction in GDP. In Hong Kong, a currency peg to the U.S. dollar effectively prevents the Hong Kong Monetary Authority from easing out of step with the cautious U.S. Federal Reserve, and the Central Bank of the Republic of China (Taiwan) looks set to stay on hold until early 2026. The Bank of Japan, a perpetual outlier, isn't done hiking, but tariff haze and an exceptionally dovish monetary policy meeting in May suggest policy will stand pat until a rate hike in January.

The Long Road Back to Normal

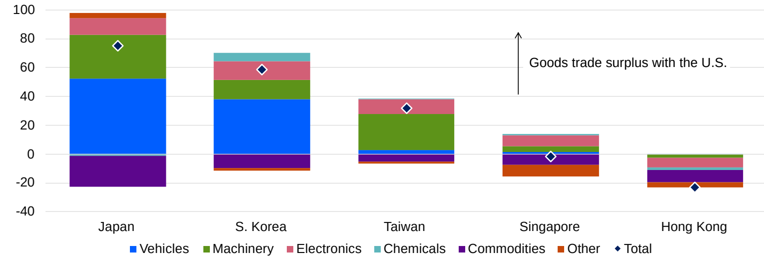


Sources: Central banks, Moody's Analytics

The outlook hinges on what happens outside Asia. Since the start of the year, the U.S. has targeted friend and foe with tariffs and tariff threats. Japan, South Korea and Taiwan were caught in the crosshairs due to their hefty trade surpluses with the U.S. Hong Kong was swept up, too, receiving the same treatment as China in accordance with the U.S.'s view of Hong Kong as a limb of China. Singapore's modest deficit with the U.S. didn't save it from incurring a 10% tariff. Asia's developed economies are lobbying hard to secure relief, pledging to buy more U.S. energy and food, expand market access for American manufactured goods (think U.S. cars headed to Japan), scale up investments stateside (such as TSMC's $100 billion pledge for U.S. chip plants, packaging facilities, and research and development), and even partner on shipbuilding (Japan and South Korea have proposed shipbuilding tie-ups to counter China's naval expansion). The goal is to persuade Washington to eliminate tariff hikes, or to at least scale them back and broaden exemptions.

Developed Asia in the Crosshairs

Goods trade balance with the U.S., $ bil, 2023

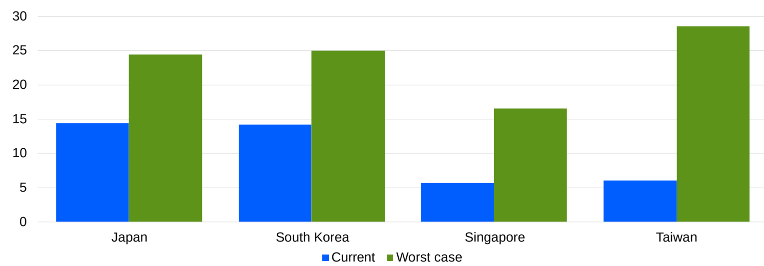


Sources: Atlas of Economic Complexity, Moody's Analytics

Will it work? Maybe. Deals with China and the U.K. suggested that Washington was looking to de-escalate trade tensions, and Hong Kong has already seen some relief from lower China-linked tariffs. But the White House hasn't budged on its 25% tariffs on cars, steel and aluminium, spelling trouble for Japan and South Korea. A threat from U.S. President Donald Trump last week to up tariffs on EU goods to 50% and the subsequent concession for more negotiation time show that trade risks aren't going anywhere. Our baseline forecast assumes that, with the exception of Hong Kong, tariffs on developed Asian economies will stay put—a blanket 10% levy on most goods; 25% on autos, steel and aluminium; and exemptions for electronics. Deals may curtail some of the harshest tariffs, but a return to pre-Trump terms is not on the table. Indeed, things could get worse. Trump may reinstate the tougher tariff hikes detailed on 2 April.

Things Could Get Worse

Average effective tariff rate, %

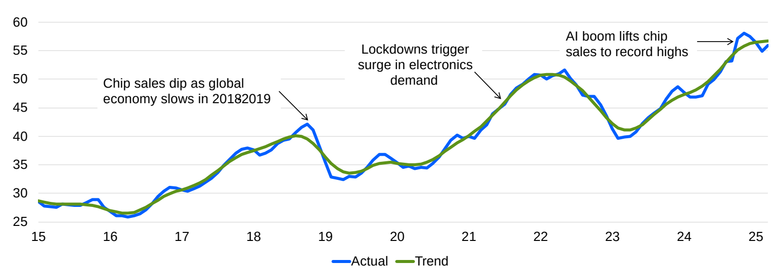


Source: Moody's Analytics

Amid the trade noise, the electronics sector is thriving. The global AI boom is fuelling demand for high-end chips, lifting exports and investment in Taiwan and South Korea.

Chips Go From Strength to Strength

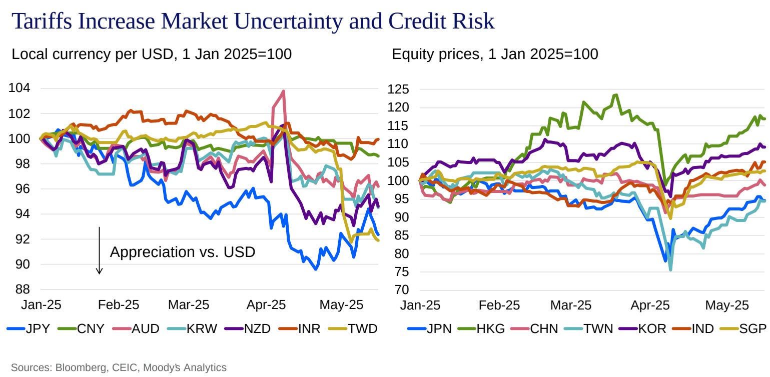
Global semiconductor billings, $ bil, NSA, 3-mo MA



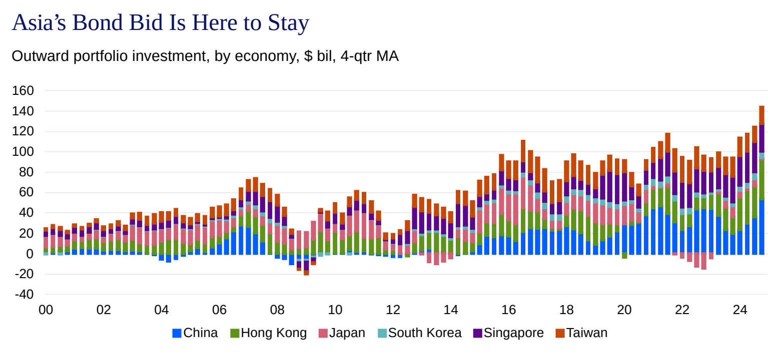
Sources: Semiconductor Industry Assn., Moody's Analytics

But risks are significant. The biggest is policy whiplash. U.S. trade policy flip-flops risk creating a stop-start cycle where exporters scramble to front-load ahead of tariffs, then pull back once threats ease, only for the cycle to repeat when new tariffs are threatened. This is a recipe for bottlenecks and idle lines in supply chains. Asia's developed economies, especially small and trade-open economies such as Singapore and Hong Kong, are vulnerable. Even Japan, a less trade-dependent economy, would suffer, having little domestic growth to fall back on.

Trade volatility is spilling into financial markets. Over the past six to nine months, foreign exchange, equity and bond markets have become more volatile. The New Taiwan dollar spiked in early May as insurers rushed to hedge and the central bank hung back. The rally reverberated across Asia; the South Korean won surged, and the Hong Kong Monetary Authority was forced to defend its peg in its first intervention to curb Hong Kong dollar strength since 2020. And last month, U.S. Treasury markets saw a sharp selloff amid speculation of Asian selling, echoing the yen carry trade unwind in August 2024.



These market swings are a reminder that East Asia's financial plumbing matters. Developed Asian economies are some of the world's biggest net international investors. Although we expect them to keep buying foreign currency-denominated assets, given their large current account surpluses, the fact is that most of their currencies are heavily undervalued—particularly the yen and the won—creating potential for corrections that would ripple across global markets.



But not all risks are made abroad. Domestic politics could tip the scales, too. Japan's ruling Liberal Democratic Party-Komeito coalition is bracing for a rough upper house election in July. Prime Minister Ishiba Shigeru has dug in against fiscal support for the struggling economy, a strategy that looked untenable even before the trade war ramped up. With his approval ratings cratering, a policy pivot may prove unavoidable, but it would likely arrive too late to make a difference. Japan is not alone in its austerity lean. Hong Kong's government is out to rebuild reserves, signalling that public spending won't rise even if growth falters. Policy could shift in South Korea, where voters head to the polls to choose a new president on 3 June after a turbulent six months that saw Yoon Suk Yeol impeached after a shock martial law declaration in December 2024. In Singapore, votes swung towards the ruling People's Action Party at the 3 May general election. A bigger majority won't make it easier to solve the economy's challenges.

All told, developed Asian economies face a tough stretch.