

ASIAN DEVELOPMENT OUTLOOK

SEPTEMBER 2025

GROWTH SLOWS AS A NEW GLOBAL
TRADE ENVIRONMENT TAKES SHAPE

HIGHLIGHTS

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ASIAN DEVELOPMENT BANK





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ADO SEPTEMBER 2025

HIGHLIGHTS

United States (US) tariffs have now settled at historically high rates, even as trade uncertainty remains highly elevated. The impact is shaping the outlook for developing Asia and the Pacific. Export front-loading anticipating the tariffs, particularly of artificial intelligence equipment and electronics, underpinned growth acceleration in the region in the first half of 2025. However, higher US tariffs will weigh on external demand and activity going forward. Alongside fiscal support, looser monetary policy as inflation eases will partly offset trade headwinds, sustaining growth. This report trims the region's growth forecasts to 4.8% in 2025 and 4.5% in 2026, from 4.9% and 4.7% in April. The revisions reflect downgrades for India, hit by steep tariff hikes, and Southeast Asia, driven by a worse and more uncertain global environment. In contrast, the People's Republic of China's (PRC) growth forecasts are unchanged, with policy support and export diversification expected to cushion tariff and property market challenges. Inflation in developing Asia and the Pacific will fall to 1.7% in 2025 as energy and food prices moderate further, before increasing modestly to 2.1% in 2026 as food prices normalize. Trade risks pose the main threats to the outlook. To varying degrees, unresolved US-PRC tensions, sectoral duties on semiconductors and pharmaceuticals, and further tariff hikes could all impact economies in the region.

In this edition of the *Asian Development Outlook*, the analytical chapter examines the sensitivity of capital inflows in emerging market economies to global factors and domestic fundamentals during the period 1990 to 2024. The chapter identifies a structural shift in emerging market foreign capital inflows around the end of 2008 when the US Federal Reserve introduced its quantitative easing (QE) policy. A further shift is identified after QE concluded in 2014. During the QE period, ample global liquidity and highly accommodative US monetary policy triggered a surge in capital flows into emerging market economies. Focusing on the current post-QE period, when global financial conditions started to tighten, the chapter finds that US monetary policy and trade policy uncertainty significantly drive emerging market economy portfolio debt and equity inflows. Geopolitical risk, meanwhile, is a key global factor influencing both cross-border loans and foreign direct investment flows. While capital flows into these economies remain sensitive to global factors, the chapter finds that strong domestic fundamentals can provide a stabilizing role. Robust growth prospects can boost investor confidence, while trade openness, well-developed financial markets, and sound institutions enhance resilience, mitigating the impacts of volatile foreign capital flows and negative shifts in global factors.



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Growth Slows as a New Global Trade Environment Takes Shape

- **United States (US) tariffs have soared to historic heights amid continued elevated trade policy uncertainty.** Though generally lower than announced on 2 April, the additional tariffs that took effect in August are historically high. From 2.4% in 2024, the average effective US tariff rate has surged to 17.4%, the highest since the Great Depression of the 1930s. Trade policy uncertainty remains at very high levels, despite easing from April's peak. Uncertainty is fueled by announcements of several bilateral US trade agreements without finalized terms, the prospect of new US sectoral tariffs on pharmaceuticals and semiconductors, and possible revisions to tariffs already in place.
- **Growth in developing economies in Asia and the Pacific (developing Asia) accelerated in the first half of 2025, driven by strong exports.** Growth picked up to 5.4% in the first half of 2025, compared to 4.9% in the second half of 2024, as strong external demand offset weaker investment. In the People's Republic of China (PRC), growth strengthened on resilient export growth and supportive monetary and fiscal policies. India's growth also accelerated, as strong public capital spending outweighed easing net exports and consumption. In the high-income technology exporters and larger Association of Southeast Asian Nations economies, higher net exports offset declines in investment and consumption, amid trade and tariff uncertainties and weaker consumer and business confidence.
- **Disinflation continued amid falling global energy and food prices, declining prices in the PRC, and moderate core inflation.** Energy-related inflation continued to decline in January to August 2025, mirroring lower oil prices. Food inflation also decreased, due to better harvests and crop production boosting supply. In the PRC, average inflation fell into negative territory, to -0.1%, in the first 8 months of the year. This was driven by weak demand, ample pork supply, and factory-gate deflation, partly due to intense price competition. Elsewhere, regional inflation eased to 2.2% in August, as food price inflation in India and other economies likewise slipped into negative territory. Excluding volatile components, underlying price pressures remain moderate. In August, core inflation in the PRC was 0.9%, edging up slightly on rising services prices. In the rest of the region, the contribution of core price pressures to overall headline inflation has stabilized at about 1.6–1.7 percentage points since mid-2024.
- **Tariff frontrunning supported an 8.1% rise in developing Asia's exports in the first half of the year.** This was mainly driven by electronics, with rising global demand for AI-related equipment boosting the region's exports—notably semiconductor chips. Hong Kong, China; Singapore; and Taipei, China were major contributors, while Southeast Asia's exports also saw strong growth, particularly in Cambodia, Malaysia, and Thailand. The PRC recorded milder but still positive export growth, at 5.3%, as rising exports to other markets largely offset lower shipments to the US. In contrast, exports from the Republic of Korea declined slightly, dragged down by the new US tariffs on automobiles and automobile parts.
- **Tourist arrivals continued to rise toward pre-pandemic levels, albeit more slowly.** Visitors to the region reached 94% of 2018–2019 average levels in the first half of 2025, compared to 88% in the same period last year. Tourist numbers surpassed pre-pandemic levels in several destinations, including Armenia, the Cook Islands, Fiji, Maldives, and Sri Lanka. However, other economies continue to lag behind, particularly in Southeast Asia, where arrivals fell short in Indonesia, Singapore, and Thailand—Asia's largest tourism destination.

- **Financial conditions improved in the third quarter despite uncertainty over trade and US monetary policy.** Investors remained cautious given uncertainty over trade negotiations and the risk of higher tariffs. Nevertheless, the recent trade agreements and the continued US-PRC trade talks have supported investor sentiment, moderating volatility. Weak US labor market data and steady inflation figures released in August boosted market expectations of a policy rate cut by the US Federal Reserve. Against this backdrop, most Asian equities rose, risk premiums narrowed, long-term bond yields declined, and portfolio inflows rose. Regional currencies depreciated modestly against the US dollar.
- **Central banks in much of developing Asia continued loosening monetary policy, and current conditions may support further easing.** In July 2025, inflation was at or below target in 11 of the 17 inflation-targeting economies, while 10 out of 15 non-inflation targeting economies with available data had lower inflation than at the beginning of the year. This supported monetary policy easing, with 11 economies lowering their policy rates over January to August. Growing expectations of US Federal Reserve rate cuts, continued disinflation, and stable exchange rates are also creating room for further rate cuts across the region.
- **Debt ratios remain contained, although debt service is a growing concern in some economies.** Robust growth and higher inflation have helped limit debt-to-GDP ratios across the region, despite rising government debt stocks during and after the COVID-19 pandemic. However, high debt service relative to revenues may present challenges for some economies if global economic volatility results in slower growth and higher interest rates.
- **Growth forecasts for major advanced economies are reduced to 1.4% for both 2025 and 2026, reflecting higher tariffs and trade uncertainty.** In the US, persistently high inflation and policy uncertainty are weighing on private consumption and investment, prompting downgrades for 2025 and 2026. The euro area's 2025 forecast is unchanged and the 2026 projection is cut marginally, as robust domestic demand offsets external headwinds. Japan's growth forecasts are lowered for both years, as higher US tariffs are expected to dampen export growth and manufacturing activity. Among commodities, oil prices are expected to decline due to greater global supply and reduced demand as the world economy slows. Rice prices are also projected to ease amid favorable weather conditions and record harvests in India.
- **Developing Asia's growth forecasts are trimmed to 4.8% in 2025 and 4.5% in 2026, down by 0.1 and 0.2 percentage points from April.** The revisions reflect offsetting factors. The updated trade agreements and tariffs led to a broad shift toward higher US tariffs, which will weigh on the region's exports and growth. However, fiscal and monetary policy responses are expected to cushion the impact. East Asia's growth forecast for 2025 remains unchanged as fiscal policy and robust AI-related exports are, respectively, expected to sustain growth in the PRC and Taipei, China. The 2026 projection is lowered as the broader impact of higher tariffs weakens export demand in the subregion. South Asia's growth projections for both years are revised down due to the impact of US tariff hikes, especially in India. Southeast Asia's growth forecasts are also reduced for both years, due to weak global demand and heightened trade uncertainty. In contrast, the Caucasus and Central Asia's forecast is revised up for 2025 due to higher oil production and increased public infrastructure investment in Kazakhstan. However, the 2026 outlook is lowered, primarily due to declining hydrocarbon production in Azerbaijan. The Pacific's growth forecast for 2025 is raised mainly on stronger mining and liquified natural gas output in Papua New Guinea (PNG), the subregion's largest economy. The 2026 projection is lowered on expectations of moderating resource output and a worse external environment denting commodity exports from PNG.

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- **Inflation in developing Asia is projected to ease further in 2025, driven by lower energy and food prices, before edging up in 2026.** The region's 2025 inflation forecast is revised down to 1.7%, from 2.3% in April. Easing food and oil prices prompted downward revisions to inflation forecasts in East Asia, South Asia, and Southeast Asia. In the Pacific, the outlook is revised down, mainly due to reduction in value-added tax in Fiji and lower food prices in some economies. These outweighed upward revisions in the Caucasus and Central Asia, where rising utility costs and currency depreciation in some economies will push inflation higher. For 2026, inflation is expected to edge higher to 2.1%, albeit marginally slower than April's forecast of 2.2%, partly due to normalization of food prices.
- **Trade agreements have eased tensions, but unresolved US-PRC negotiations and elevated uncertainty keep risks elevated.** Major trading partners, including several developing Asian economies, agreed to new trade deals with the US before the 1 August deadline. This has reduced but not removed global trade risks. Following a 3-month extension, US-PRC trade negotiations are ongoing. Thus, while tensions have subsided somewhat since April, the risk of renewed tariff escalation persists. Additionally, trade policy uncertainty remains high. Although the specifics are still unclear, the expected US sectoral tariffs on semiconductors and pharmaceuticals could be particularly high. And while US tariffs settled at new, higher levels on 7 August, some economies risk even steeper US duties related to transshipment and other factors. If these risks were to materialize, growth in the region could be dented.
- **Other risks include geopolitical tensions, further deterioration in the PRC's property market, and possible financial market volatility.** Geopolitical risks remain elevated. Renewed escalation in the Middle East could increase oil and food prices, disrupt supply chains, and dampen growth. The outlook regarding Russia's war in Ukraine is also uncertain; if a peace deal emerges it could bring greater stability, but the potential timing and terms remain unclear. Despite government support measures and the sector's declining economic weight, a further deterioration in the PRC's property market could increase default risks for property developers and dampen growth. A stronger-than-expected US growth slowdown could heighten global market volatility, raise risk aversion, and tighten financial conditions. Developing Asia, particularly regional economies with fragile fundamentals, could be affected through various channels, including weaker trade, currency depreciation, imported inflation, reduced confidence, and lower capital inflows—as discussed in this report's analytical chapter.

Capital Inflows to Emerging Market Economies: Global Factors and the Role of Fundamentals

- **The ADO analytical chapter presents new empirical evidence on the sensitivity of foreign capital inflows to emerging market economies to global factors, and the role of domestic fundamentals.** The topic is especially timely given heightened global risks including trade policy uncertainty and geopolitical risks. While capital inflows (i.e., purchases of emerging market assets by non-residents) are an important source of financing for these economies, they continue to exhibit recurring boom-bust cycles, with foreign capital outflows from emerging market economies associated with currency depreciations and macroeconomic and financial instability. Global shocks and changes in global conditions can impact different types of emerging market capital inflows to varying degrees, depending on the nature of the global factors as well as the domestic fundamentals of individual emerging market economies. The responsiveness of emerging market capital inflows to global drivers is also likely to change over time, reflecting evolving structural features in those economies such as increasing integration into global financial markets and stronger macro-prudential frameworks. The chapter investigates the sensitivity of four different emerging market economy capital inflows—portfolio debt, portfolio equity, cross-border loans, and foreign direct investment (FDI)—to global risk aversion, trade policy uncertainty, geopolitical risk, and US monetary policy. The analysis also examines the role of domestic fundamentals in emerging market economies in attracting foreign capital inflows and the extent to which these act as a counterweight to the effects of negative shifts in global factors.
- **Global factors have emerged in recent literature as the dominant drivers of emerging market economy capital flows.** The concept of a global financial cycle gained traction following the seminal work of Rey (2013), who argued that a global financial cycle drives asset prices, credit growth, and capital flows. More specifically, the concept holds that a large share of the variation in risky assets and capital flows can be explained by a single global factor, and that this factor is highly correlated with the volatility index (VIX, a common measure of global risk aversion) and US monetary policy. Empirical evidence indicates that the global financial cycle mainly affects portfolio debt, portfolio equity, and cross-border investment flows, with a more limited impact on FDI. However, even for FDI, which is long-term investment, global financial conditions and the cost of capital still matter. While pointing to the key role of global risks as drivers of fluctuations in emerging market economy capital flows, the literature also highlights the importance of fundamentals in these economies in attracting long-term stable capital flows and enhancing resilience to external shocks. The analytical chapter contributes to this strand of the literature by systematically examining shifts in the influence of both the VIX and US monetary policy, as well as two other, less researched global risk factors on emerging market economy capital flows—trade policy uncertainty and geopolitical risk.
- **Capital flows to emerging market economies go through recurring boom bust-cycles.** Capital flows to these economies have shown strong cyclical around major global shocks. While periods of abundant global liquidity and low interest rates have led to foreign capital inflows to emerging market economies, shifting global financial conditions have triggered reversals. Surges of foreign capital inflows to emerging market economies preceded abrupt withdrawals during the Asian financial crisis (1997–1998) and the Russian default (1998). A similar pattern was observed in the run-up to the global financial crisis (2008–2009), when capital inflows collapsed as global liquidity and risk sentiment tightened, and then rebounded strongly during the US Federal Reserve's (Fed) quantitative easing period. More recently, emerging market economies experienced sudden stops during the taper tantrum (2013), the COVID-19 shock (2020), and bouts of volatility tied to US monetary tightening (2022–2023).

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- **The US Federal Reserve's quantitative easing (QE) policy, which began at the end of 2008 and ended at the end of 2014, coincided with a structural shift in emerging market capital flow dynamics.** For a panel of 36 emerging market economies over 1990–2024, formal statistical tests identify structural breaks across the four types of capital flow around the beginning and end of the QE period. The QE period was characterized by ample global liquidity, resulting from large scale purchases of long-term securities by the US Fed. As the Fed injected liquidity into the financial system, long-term interest rates in the US and other advanced economies fell to historic lows, triggering capital inflows to emerging market economies as investors searched for yield.
- **Empirical analysis reveals that emerging market economies foreign capital inflows remain significantly influenced by global shocks.** Findings for the current post-QE period show that emerging market economy portfolio debt and equity inflows from abroad are negatively associated with US Fed rates and, to a lesser extent, trade policy uncertainty. The uncertainty over the future trajectory of US Fed rates thus poses a risk to emerging market capital flows—lower Fed rates in response to a US slowdown could trigger portfolio inflows into these economies, but tighter monetary policy in response to continued US inflationary pressure is likely to lead to foreign outflows. In addition, elevated and volatile trade policy uncertainty poses significant risks to emerging market economy portfolio flows. Meanwhile, geopolitical risk emerges as a key global risk factor affecting cross-border loans and FDI.
- **While emerging market capital inflows remain vulnerable to shifts in global factors, analysis in the chapter indicates that strong macroeconomic fundamentals can play an important stabilizing role.** In particular, robust growth prospects in emerging market economies can help strengthen investor confidence, thereby sustaining capital inflows. Trade openness also reinforces foreign capital inflows, with open trade regimes signaling integration into global value chains. Well-developed domestic financial markets and sound institutions further help to support the resilience of the capital flows. While global factors will continue to influence capital flow dynamics in these economies, policymakers can mitigate the negative impacts through reforms that strengthen domestic fundamentals. These should be complemented with effective macroprudential and capital flow management frameworks to better manage capital flow volatility during surges or sudden stops.

Gross Domestic Product Growth Rate, % per year

	2024	2025		2026	
		April	September	April	September
Developing Asia	5.1	4.9	4.8	4.7	4.5
Developing Asia excluding the PRC	5.1	5.0	4.9	5.1	4.8
Caucasus and Central Asia	5.7	5.4	5.5	5.0	4.9
Armenia	5.9	5.0	5.0	4.7	4.7
Azerbaijan	4.1	3.4	2.4	3.3	2.0
Georgia	9.4	6.0	7.0	5.0	5.0
Kazakhstan	5.0	4.9	5.3	4.1	4.3
Kyrgyz Republic	9.0	8.5	8.3	8.6	8.4
Tajikistan	8.4	7.4	7.4	6.8	6.8
Turkmenistan	6.3	6.5	6.3	6.0	6.0
Uzbekistan	6.0	6.6	6.6	6.7	6.7
East Asia	4.7	4.4	4.4	4.0	3.9
People's Republic of China	5.0	4.7	4.7	4.3	4.3
Hong Kong, China	2.5	2.3	2.2	2.5	2.0
Republic of Korea	2.0	1.5	0.8	1.9	1.6
Mongolia	5.1	6.6	5.7	5.9	5.7
Taipei, China	4.8	3.3	5.1	3.0	2.3
South Asia	5.9	6.0	5.9	6.2	6.0
Afghanistan	2.3	2.6	1.8	2.2	1.7
Bangladesh	4.2	3.9	4.0	5.1	5.0
Bhutan	7.5	8.5	8.1	6.0	6.0
India	6.5	6.7	6.5	6.8	6.5
Maldives	3.3	5.0	5.0	4.8	4.9
Nepal	3.7	4.4	4.6	5.1	3.0
Pakistan	2.5	2.5	2.7	3.0	3.0
Sri Lanka	5.0	3.9	3.9	3.4	3.3
Southeast Asia	4.8	4.7	4.3	4.7	4.3
Brunei Darussalam	4.2	2.5	1.0	2.0	1.5
Cambodia	6.0	6.1	4.9	6.2	5.0
Indonesia	5.0	5.0	4.9	5.1	5.0
Lao People's Democratic Republic	4.0	3.9	3.7	4.0	3.8
Malaysia	5.1	4.9	4.3	4.8	4.2
Myanmar	-0.7	1.1	-3.0	1.6	2.0
Philippines	5.7	6.0	5.6	6.1	5.7
Singapore	4.4	2.6	2.5	2.4	1.4
Thailand	2.5	2.8	2.0	2.9	1.6
Timor-Leste	4.1	4.0	3.8	3.8	3.4
Viet Nam	7.1	6.6	6.7	6.5	6.0
The Pacific	3.8	3.9	4.1	3.6	3.4
Cook Islands	14.0	8.1	10.4	2.9	2.5
Fiji	3.5	3.0	3.0	3.2	3.0
Kiribati	5.3	4.1	3.9	3.3	3.3
Marshall Islands	3.0	2.5	3.0	3.0	3.5
Federated States of Micronesia	1.7	1.7	0.8	1.1	1.1
Nauru	1.8	2.5	2.3	2.5	2.5
Niue	8.7	3.4	3.4	3.0	3.0
Palau	6.6	9.5	8.2	4.5	3.9
Papua New Guinea	4.0	4.2	4.6	3.8	3.6
Samoa	4.6	5.5	4.0	3.0	2.7
Solomon Islands	2.5	2.9	2.9	3.2	3.2
Tonga	1.4	2.5	2.5	2.3	2.3
Tuvalu	3.3	2.7	2.7	2.5	2.5
Vanuatu	1.0	2.0	1.5	2.5	2.5

ADB = Asian Development Bank, PRC = People's Republic of China.

Notes: ADB placed on hold its regular assistance to 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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Inflation, % per year					
	2024	2025		2026	
		April	September	April	September
Developing Asia	2.6	2.3	1.7	2.2	2.1
Developing Asia excluding the PRC	4.8	4.0	3.3	3.7	3.7
Caucasus and Central Asia	6.8	6.9	7.7	5.9	6.6
Armenia	0.3	3.0	3.5	2.8	2.8
Azerbaijan	2.2	4.2	4.2	3.5	3.5
Georgia	1.1	4.0	4.0	3.5	3.5
Kazakhstan	8.7	8.2	10.5	6.5	8.4
Kyrgyz Republic	5.0	6.0	7.0	7.8	8.0
Tajikistan	3.6	5.0	4.5	5.8	5.2
Turkmenistan	5.5	6.0	4.0	6.0	5.0
Uzbekistan	9.4	8.0	8.0	7.0	7.0
East Asia	0.5	0.6	0.3	0.9	0.6
People's Republic of China	0.2	0.4	0.0	0.7	0.4
Hong Kong, China	1.7	1.9	1.6	2.0	1.6
Republic of Korea	2.3	1.9	1.9	1.9	1.9
Mongolia	6.2	9.1	8.6	7.0	7.2
Taipei, China	2.2	2.0	1.8	1.8	1.5
South Asia	6.5	4.9	3.7	4.5	4.7
Afghanistan	-7.7	-5.3	-4.2	5.0	1.0
Bangladesh	9.7	10.2	10.0	8.0	8.0
Bhutan	2.8	3.4	3.2	3.5	3.7
India	4.6	4.3	3.1	4.0	4.2
Maldives	1.4	4.7	4.5	2.2	3.5
Nepal	5.4	5.2	4.1	5.0	4.5
Pakistan	23.4	6.0	4.5	5.8	6.0
Sri Lanka	1.2	3.1	0.5	4.5	4.5
Southeast Asia	3.0	3.0	2.5	2.8	2.7
Brunei Darussalam	-0.4	0.5	-0.3	-0.2	0.5
Cambodia	0.8	3.7	2.0	2.4	2.0
Indonesia	2.3	2.0	1.7	2.0	2.0
Lao People's Democratic Republic	23.3	13.5	9.5	10.4	8.5
Malaysia	1.8	2.5	1.8	2.5	2.2
Myanmar	27.8	29.3	30.0	20.0	23.0
Philippines	3.2	3.0	1.8	3.0	3.0
Singapore	2.4	2.0	1.0	1.7	1.2
Thailand	0.4	1.0	0.5	1.1	0.8
Timor-Leste	2.1	2.9	1.2	2.6	1.9
Viet Nam	3.7	4.0	3.9	4.2	3.8
The Pacific	1.9	3.4	3.0	3.7	3.4
Cook Islands	4.6	2.3	2.0	2.0	2.8
Fiji	4.5	2.6	0.5	2.4	1.0
Kiribati	2.5	2.5	7.8	2.2	3.5
Marshall Islands	5.7	3.6	3.8	3.0	3.4
Federated States of Micronesia	5.4	3.0	3.9	2.7	3.2
Nauru	11.6	3.5	6.5	2.5	5.0
Niue	5.4	3.7	2.3	3.2	3.2
Palau	3.7	2.5	2.5	2.6	2.7
Papua New Guinea	0.6	3.8	3.8	4.3	4.3
Samoa	3.6	3.0	1.9	2.7	2.7
Solomon Islands	4.2	2.7	3.8	2.5	2.5
Tonga	8.0	3.2	3.0	3.0	3.0
Tuvalu	1.2	2.5	2.5	2.0	2.0
Vanuatu	1.1	3.5	1.5	2.4	2.4

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