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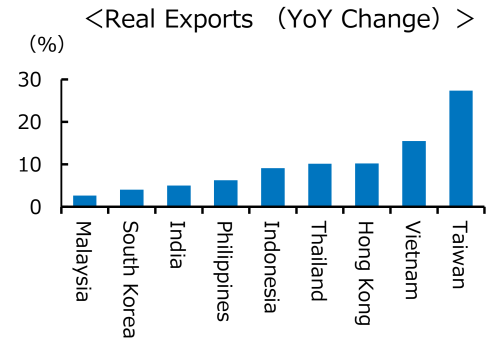
Asia: Asian economies facing domestic and external challenges

Asian economies have been performing strongly recently but face the prospect of a sharp slowdown with both domestic and external demand decelerating significantly. In addition, vigilance is needed against downside risks such as the U.S. toughening transshipment penalties and currency depreciation destabilizing financial systems.

1. Asian economies to see slower growth

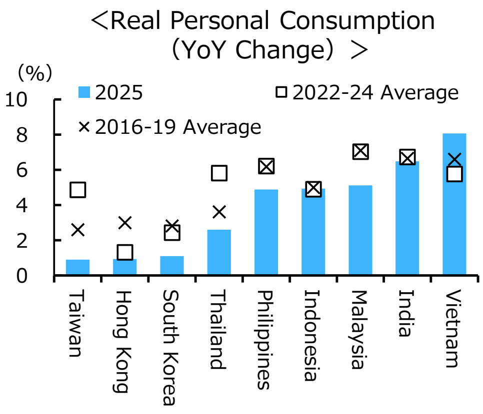
(1) Economic performance in 2025 was unexpectedly strong

In 2025, Asian economies continued to show signs of recovery. A rush of U.S.-bound exports boosted external demand after the U.S. pushed back the implementation of its reciprocal and semiconductor tariffs into the second half of the year or later. Export growth in Taiwan and Vietnam, countries for which electronic devices are a key export product, was particularly notable.

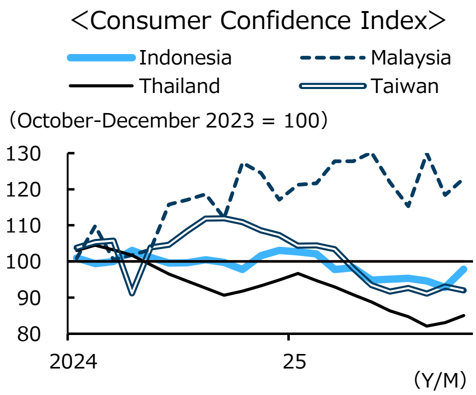


Source: JRI based on CEIC
Note: Figures for 2025 are cumulative totals from the start of the year to the latest quarter for which statistics have been published.

On the other hand, domestic demand lost momentum compared to external demand. Consumption growth was sluggish in almost all countries/ territories in 2025 when compared with the averages before and after the COVID-19 pandemic (2016-19 and 2022-24). This was the case even in Taiwan and Thailand, where exports were strong. While the employment environment was generally favorable, with low unemployment rates, consumer confidence has been low in some countries/ territories. This seems to have depressed consumption. This was partly due to increased uncertainty about the economic outlook given the U.S.'s protectionist foreign policy. In addition, the boost from the rush of exports has been limited to certain industries, so may not have led to a broad-based improvement in incomes. In fact, 62.1% of the 63.5% growth in Taiwanese exports to the U.S. in 2025 (cumulative from January to October) came from electronic devices and components.



Source: JRI based on CEIC
Note: Figures for Vietnam are total consumption. Figures for 2025 are cumulative totals from the start of the year to the latest quarter for which statistics have been published.



Source: JRI based on CEIC

Growth for Asia overall is projected to be 5.2% in 2025, up from the JRI's previous forecast of 4.8% issued in July. In particular, the projected growth rates of Taiwan and Vietnam, where exports to the U.S.

have continued to increase significantly, have been raised substantially to 6.9% (previous forecast: 3.1%) and 7.7% (previous forecast: 6.6%), respectively. In India, too, a large tax cut in September has boosted consumption, and growth in FY2025 is expected to be 6.7%, higher than the previous year. As for China, the economy has decelerated in the second half of the year as policy effects have faded out. Nonetheless, it looks set to see growth of 4.9% for the full year of 2025, almost reaching the government's target of around 5%.

(2) Three factors to impede Asian economies in 2026

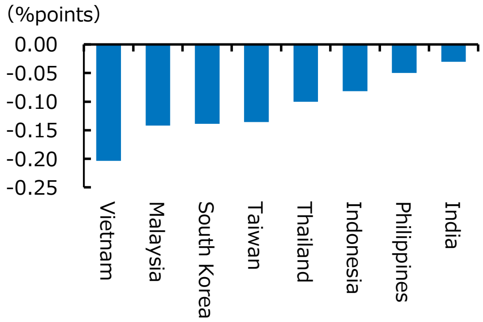
The recovery that Asian economies enjoyed in 2025 is expected to be replaced by a clear deceleration in 2026, prompted by the following three factors pushing down domestic and external demand.

The first is a slowdown in the Chinese economy. Chinese economic growth is expected to slip to 4.2% in 2026, down 0.7 percentage points from 2025. The main reason for the slowdown will be a deterioration in domestic demand. The policy effect of subsidies for replacing consumer durables will fade, and continued sluggishness in employment, income, and the real-estate market will push down consumption. Prices of housing, which accounts for 50% of household assets in China, are expected to continue to decline throughout 2026 due to tepid sales. This is expected to push down China's real personal consumption by about 0.2%.

On the investment side, capital investment in the manufacturing industry also looks likely to be subdued given government guidance for industry to eliminate overcapacity and subsidies for upgrading equipment becoming less effective. In addition, the recently released draft of the 15th Five-Year Plan (economic and social development plan for 2026-30) does not mention any specific measures to stimulate consumption and investment, so policy factors are currently not expected to increase the growth rate in 2026.

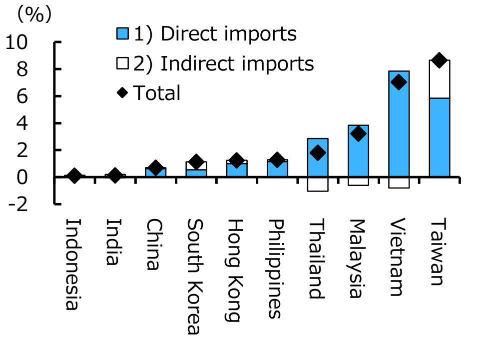
China's slowdown will also have a negative impact on other Asian economies by reducing imports from them. If China's growth rate falls by 0.7 percentage points, the growth rates of these other economies will drop. Vietnam, whose China-bound exports account for over 10% of its GDP, would be hit especially hard.

<Impact of Chinese Economic Slowdown on GDP Growth>



Source: JRI based on ADB
Note: Estimates of changes in GDP growth if China's real GDP growth fell by 0.7 points. Estimates are based on input-output tables for 2023 and 2024.

<Exports of Semiconductor-related Products to The U.S. (Share of GDP) >



Source: JRI based on Shota Muromoto [2025]
Note: 1) is direct export demand from the U.S. for semiconductor-related products (total of semiconductor chips and electronic products) from each country/ territory. 2) is indirect demand resulting from 1).

The second factor is the full impact of U.S. tariffs materializing. The impact of the reciprocal duties implemented in August will become apparent as exports fall back following the pre-tariff rush, pushing down Asia's exports to the U.S. until around the first half of 2026. In addition, semiconductor tariffs, which the Trump administration has repeatedly hinted at, are also expected to be introduced by early 2026, following the completion of an investigation under the Trade Expansion Act. According to reports, not only will a 100% tariff be imposed on semiconductor chips, but electronic products containing them are also likely to be subject to duties. This would deal a major blow to the Taiwanese, Vietnamese, Malaysian, and Thai economies, which rely heavily on direct and indirect exports of semiconductor-related products to the U.S.

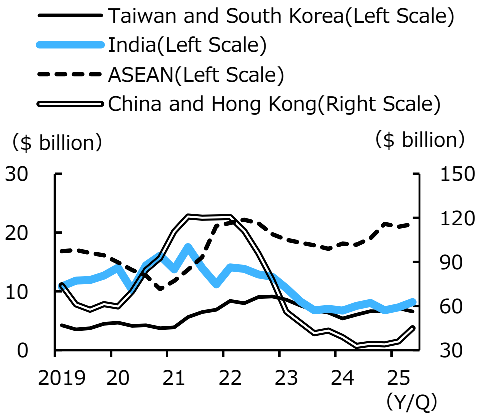
The third factor is persistent uncertainty and the rise of protectionism. While indicators of uncertainty about the future of the global economy and economic policy have declined since the first half of this year when the U.S. announced high tariffs on the entire world, they have remained elevated compared with normal times. This is due to concerns about the possible introduction of further tariffs and renewed tensions between the U.S. and China. As a result, consumer confidence in Asian countries/territories will probably remain under downward pressure going forward. Moreover, in countries/territories with high dependence on external demand such as Taiwan, Vietnam, Malaysia, and Thailand, exporting companies' worsening performance is expected to depress employment and wages, further cooling consumption.

The worldwide rise of protectionism is also expected to depress investment in Asia. Inward direct investment in ASEAN countries and the NIEs has been solid since the end of the COVID-19 pandemic. Behind this is the fact that intensifying U.S.-China animosity has made these economies destinations for global companies relocating production from China. This supply chain restructuring trend is expected to falter going forward. Reasons include the imposition by the second Trump administration of high tariffs not only on China but also on other Asian economies, and the fact that uncertainty surrounding U.S. tariff policy will continue in the near term.

In light of the above, Asia as a whole is expected to see economic growth of 4.6% in 2026, significantly lower than the rate in 2025. Notably, overall growth of the NIEs will be 2.0%, a sharp drop from the previous year's figure of 3.3%. In particular, Taiwan's growth will slow rapidly due to the export rush fading and the full impact of tariffs materializing. Growth in the ASEAN zone will also decline due to slower growth in Vietnam, Malaysia, and Thailand, which are highly dependent on external demand. While India is also expected to see slower growth, mainly due to a slump in external demand resulting from the imposition of the additional 50% tariff by the U.S., it will maintain stable growth in the 6% range. Government assistance will support consumption and investment, and domestic demand should remain robust.

Asian economies are expected to start recovering in 2027. This is because external demand will begin to pick up as the impact of U.S. tariffs lessens, while China's growth rate will improve due to a bottoming out of its housing market.

<Inward Foreign Direct Investment (Net)>



Source: JRI based on CEIC
Note: 4-quarter trailing moving averages.

<Growth Projections for Asian Economies>

(%)

	2023 (Actual)	2024 (Actual)	2025 (Forecast)	2026 (Forecast)	2027 (Forecast)
Asia Total	**5.8**	**5.2**	**5.2**	**4.6**	**4.9**
Northeast Asia	4.9	4.7	4.7	3.9	4.2
China	5.4	5.0	4.9	4.2	4.5
South Korea	1.6	2.0	1.1	2.0	1.8
Taiwan	1.1	4.8	6.9	2.1	2.2
Hong Kong	3.2	2.5	3.3	1.9	2.2
ASEAN 5	4.4	5.0	4.9	4.6	4.8
Indonesia	5.0	5.0	4.9	4.8	4.9
Malaysia	3.5	5.1	4.8	4.3	4.5
Philippines	5.5	5.7	4.8	5.1	5.4
Thailand	2.0	2.5	2.1	1.7	1.9
Vietnam	5.1	7.1	7.7	6.8	7.2
India (Fiscal Year)	9.2	6.5	6.7	6.3	6.7

Sources: JRI based on IMF and national statistics and central bank data from each country

2. U.S. measures to tackle transshipments warrant vigilance and Currency depreciation

The main scenario for Asian economies in 2026 is a slowdown, but vigilance is needed against other downside risks such the U.S. toughening transshipment penalties and currency depreciation destabilizing financial systems.

(1) Tougher U.S. measures against transshipments

When it imposed reciprocal tariffs in August, the U.S. announced that it would slap additional tariffs of 40% on transshipments aimed at avoiding tariffs. So far, the criteria for determining transshipped exports have remained unclear, but if products containing a lot of raw materials and components produced in China are targeted, there would be concerns about the impact on other Asian countries, particularly ASEAN economies.

In the ASEAN zone, the share of intermediate goods procured from China in industrial production has long been rising. Alongside this, value added in China as a proportion of the value of exports to the U.S. has also climbed. Given the intensifying U.S.-China rivalry, production of final products such as electronic devices has shifted from China to ASEAN, and a supply chain has been established whereby intermediate goods necessary for production are supplied to ASEAN countries by China. For this reason, ASEAN economies, especially Vietnam, rely heavily on Chinese raw materials and components in the electronic device field. If this sector becomes a target for transshipment tariffs, ASEAN countries' exports will be dealt a further blow, compounding the impact of semiconductor tariffs.

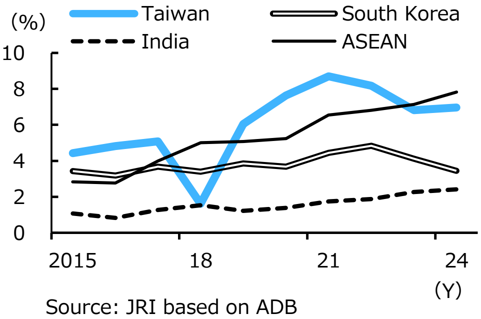
(2) Financial system instability

Attention also needs to be paid to the risk that Asian currency market movements will adversely affect real economies. Some currencies have been losing value in the wake of the disruption caused by U.S. tariff policy. The currencies of India, Indonesia, and the Philippines, which have current account deficits and are debtor nations, have been on a gradual downward trend due to rising selling pressure in the market. Regarding the stability of the monetary and financial systems of these countries, the risk of sharp currency depreciations and accompanying financial instability is basically small because they have sufficient levels of foreign exchange reserves and the low ratios of non-performing loans to total bank lending. Vietnam is also experiencing currency depreciation, but the risks are limited as the government is guiding the currency lower to maintain export competitiveness and selling pressure in the market is low given the country’s current account surplus.

However, if the degree of currency depreciation goes beyond the level the authorities can control, financial stability may suffer due to an expansion of external debt and non-performing loans, so vigilance is needed against the following possibilities.

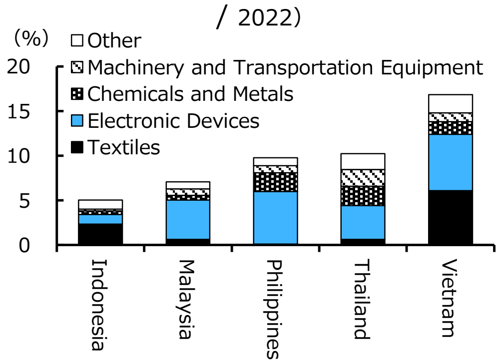
The first is a sharp deterioration in current account balances. For example, a rapid drop in exports due to

<Share of Intermediate Goods Originating from China (Industrial Products)) >



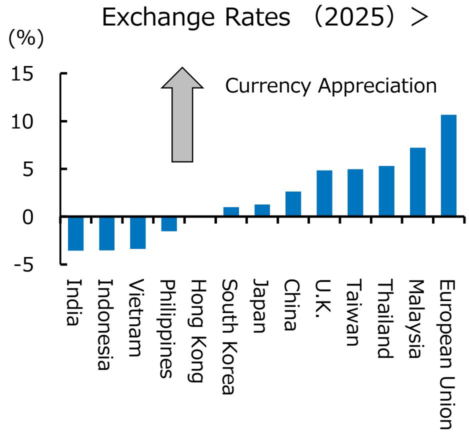
Source: JRI based on ADB
Note: Aggregated from industrial input-output tables.

<Share of Value Added in China in Exports to The U.S.>
(Contribution by Type of Industrial Product / 2022)



Source: JRI based on OECD

<Percentage Changes in Exchange Rates (2025) >



Source: JRI based on Bloomberg L.P.
Note: Rates of change from January 1 to November 17.

more protectionist trade policies around the world or an unexpected end to the AI boom could lead to a worsening in current account balances. In addition, tighter immigration rules, particularly in Western countries, may make it more difficult for people from these countries to work overseas. There is a risk of this pushing down foreign currency inflows, causing Asian countries' current account balances to deteriorate. The latter requires particular caution in countries where private remittances from overseas account for a large proportion of GDP, such as the Philippines (6.7% in 2024) and India (3.2% in 2024).

The second is side effects from aggressive fiscal expansion and monetary easing. Indonesia, Malaysia, and Thailand, among others, have been making large fiscal expenditures in 2025 to support their economies, and this may increase market concerns surrounding their fiscal health. In addition, central banks have adopted looser monetary policy stances, including India and the Philippines, which have lowered interest rates by a cumulative 1% since the beginning of the year. With a full-scale economic slowdown expected in the future, if interest rate gaps with the U.S. widen due to additional rate cuts, the possibility of currency depreciation through capital outflows cannot be ruled out.

＜Indicators of Currency and Financial System Stability＞

	Current Account Balance (share of GDP, %)			Net Foreign Assets (share of GDP, %)		Assessing Reserve Adequacy Metric (%)			Non-performing Loan Ratio (%)	
	2019	2024	2025 (IMF Projections)	2019	2024	2019	2024	2025 (IMF Projections)	2019	Most Recent
China	0.7	2.3	3.3	15.8	17.6	135.8	103.4	104.9	1.9	1.5
Hong Kong	5.9	13.0	12.5	434.9	502.4				0.5	2.1
Taiwan	10.7	14.1	13.8	224.1	195.2				0.2	0.2
South Korea	3.4	5.3	4.8	29.6	58.8				0.6	0.5
India	-0.9	-0.6	-1.0	-15.2	-9.5	171.2	110.5	111.2	8.2	2.8
Indonesia	-2.7	-0.6	-1.1	-30.2	-17.6	115.4	125.1	124.4	2.5	2.2
Malaysia	3.5	1.4	1.5	-2.6	-0.4	114.1	106.7	104.1	1.5	1.4
Philippines	-0.8	-4.0	-3.8	-10.3	-12.3	200.9	194.4	185.5	2.0	3.3
Thailand	7.0	2.5	1.7	-4.3	8.5	218.2	212.4	219.4	3.0	2.8
Vietnam	3.8	6.6	4.0						1.6	4.8

Sources: Prepared by JRI based on data from IMF and CEIC

Note: The Assessing Reserve Adequacy Metric (ARA Metric, latest values as of October 29) presents actual foreign exchange reserves of a country as a percentage of the appropriate level of foreign exchange reserves for that country estimated by IMF based on its exports, broad liquidity, short-term external debt, and other liabilities. 100-150% is considered appropriate. China's ARA Metric is based on the assumption that it has a fixed exchange rate system with capital controls. The most recent figures for the non-performing loan ratio are for FY2023 for India, for January-March 2024 for Vietnam, and for the latest quarter of 2025 for which statistics have been published for other countries/ territories.

(Tomohiro Hosoi)

NIEs *U.S. semiconductor tariffs to weigh down economies in 2026*

■ Economic growth in 2025 has varied by country/territory

The real GDP growth rate of the NIEs (South Korea, Taiwan, and Hong Kong) in 2025 is expected to be 3.3%, which is higher than last year (3.0%). However, there are variations across countries/territories and sectors.

＜NIEs Growth Projections （South Korea, Taiwan, and Hong Kong）＞

(%)

	2023 (Actual)	2024 (Actual)	2025 (Forecast)	2026 (Forecast)	2027 (Forecast)
NIEs	1.6	3.0	3.3	2.0	2.0
South Korea	1.6	2.0	1.1	2.0	1.8
Taiwan	1.1	4.8	6.9	2.1	2.2
Hong Kong	3.2	2.5	3.3	1.9	2.2

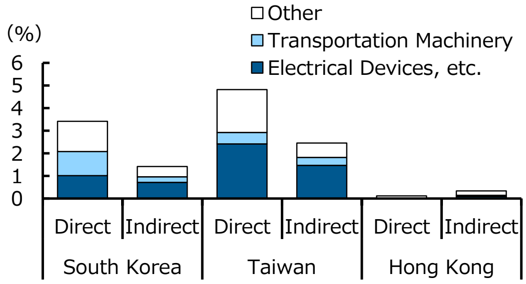
Sources: JRI based on IMF and national statistics and central bank data from each country

Taiwan, which is expected to achieve by far the fastest growth among the NIEs this year, has seen exports of high-performance semiconductors and electronic devices expand rapidly. This was in response to a switch in U.S. procurement of electronic devices and other goods from China to Taiwan, a rush to buy ahead of the introduction of semiconductor tariffs, and the momentum of the AI boom. Meanwhile, in Hong Kong, large IPOs by Chinese companies and a sharp drop in market interest rates had a positive impact on the economy. South Korea, however, is expected to see growth of only around 1%. Compounding continued sluggishness in domestic demand until the middle of the year, external demand continued to underperform given the introduction of a flat tariff on automobiles by the U.S. and the fact that export competitors Japan and Europe won low tariff rates through negotiations with the U.S. Even in Taiwan, which enjoyed high growth, domestic demand has been weak and exports of goods other than semiconductors and information/communications equipment have been lackluster.

■ The introduction of semiconductor tariffs will depress economies both directly and indirectly

Looking ahead, the NIEs are expected to see growth decelerate overall, though the worst is over for South Korea. The country should return to a typical rate of growth because of a recovery in consumption resulting from the distribution of consumer vouchers by the government, the bottoming out of construction investment, which has been sluggish for a long time, and improved competitiveness from lower automobile tariffs. Taiwan, on the other hand, is unlikely to see a repeat of the high growth it experienced this year as the effect of the electronic product export rush fades. The same can be said for Hong Kong as the impact of special factors such as large IPOs and falling interest rates disappears.

＜Value-added Exports to The U.S. (Ratios to Total Value Added) ＞



Source: JRI based on OECD
Note: Figures are for 2022. The indirect export component is the value added by the country/ territory in question in exports to the U.S. from other countries/ territories.

The imposition of semiconductor tariffs is also expected to depress these economies. A U.S. national-security-related investigation into semiconductor and related imports must be concluded early next year, and additional tariffs are expected to be imposed on these products. South Korea exports semiconductors and Taiwan exports both semiconductors and final products such as computers to the U.S. Furthermore, South Korea and Taiwan also supply semiconductors for final products destined for the U.S. that are produced in ASEAN countries. In fact, 1.7% of the value added in South Korea and 3.9% of the value added in Taiwan is directly or indirectly driven by electrical device exports to the U.S., and the share of indirect exports is large compared to other sectors. For this reason, the introduction of semiconductor tariffs that also cover final products will directly and indirectly depress the economies of the NIEs. Given these factors, real GDP growth in 2026 is expected to slow significantly to 2.0%.

(Shotaro Muromoto)

ASEAN5 Growth to decelerate due to semiconductor tariffs

■ Economic performance in 2025 was strong overall

Real GDP growth of the ASEAN5 in Q2 2025 was 4.8% year over year (YoY), slightly down from the 5.2% YoY recorded in the previous quarter. Against the backdrop of the rush of exports of IT-related goods ahead of the anticipated introduction of U.S. semiconductor tariffs, exports overall stayed on a recovery track. However, domestic demand did not exhibit as much momentum as external demand, especially in Indonesia, the Philippines, and Thailand, where political unrest and protests weighed it down.

The economies have performed solidly of late, with external demand the primary driver. Exports of IT-related goods are showing signs of peaking, but they remain at high levels, supporting overall exports. Malaysia, Vietnam, and Thailand made progress in their trade negotiations with the U.S., winning agreements to exempt some items from tariffs, though reciprocal tariff rates were maintained. Indonesia has concluded negotiations on a Comprehensive Economic Partnership Agreement (CEPA) with the EU, and the Philippines has stepped up measures to expand sales channels for its products, including applying for membership of the Trans-Pacific Partnership (TPP).

As for domestic demand, economic stimulus measures implemented by governments have proved successful, and personal consumption is expected to pick up soon. In addition, central bank interest rate cuts should support the economies as the overall inflation rate of the ASEAN5 is stable.

<Economic Stimulus Measures by Country>

Country/ Territory	Month Implemented	Details
Malaysia	August	Implemented economic stimulus measures including cash payments and fuel price reductions.
Indonesia	October	Implemented economic stimulus measures worth approximately one billion U.S. dollars, including direct cash assistance and food support. New support measures for the year-end and New Year period under consideration.
Thailand	October	Implemented consumption stimulus measures subsidizing half the cost of purchasing food and daily necessities. Planning to implement a second phase in December.

Source: JRI based on various media reports

<ASEAN5 Growth Projections>

(%)

	2023 (Actual)	2024 (Actual)	2025 (Forecast)	2026 (Forecast)	2027 (Forecast)
ASEAN 5	4.4	5.0	4.9	4.6	4.8
Indonesia	5.0	5.0	4.9	4.8	4.9
Malaysia	3.5	5.1	4.8	4.3	4.5
Philippines	5.5	5.7	4.8	5.1	5.4
Thailand	2.0	2.5	2.1	1.7	1.9
Vietnam	5.1	7.1	7.7	6.8	7.2

Source: JRI based on national statistics from each country

Taking the above into account, real GDP growth is expected to come in at +4.9% in 2025, more or less unchanged from the 5.0% recorded in 2024.

■ Economies to slow in 2026

In 2026, real GDP growth is projected to be 4.6% for the ASEAN5 as a whole, slower than in 2025. Overall, the economies are expected to decelerate due to the impact of economic stimulus measures fading in each country and the imposition of U.S. tariffs on semiconductor-related items. Export declines are expected to be particularly significant for Vietnam, Malaysia, and Thailand, which depend heavily on U.S. semiconductor demand.

However, economic performance looks set to vary from country to country. For example, in the Philippines, where the issue of political corruption weighed heavily on the economy, domestic demand is expected to recover slowly as progress in an ongoing investigation gradually eases public anxiety. In addition, the Philippines and Indonesia are relatively less dependent on external demand, so the impact of the U.S. tariffs on their economies will probably be limited.

Downside risks going forward include 1) a deterioration of the profits of ASEAN companies due to an influx of cheap products from China, 2) political instability in some member countries, and 3) currency depreciation. Notably, if the Chinese economy worsens further and Chinese companies intensify their moves to redirect surplus output to exports, ASEAN companies will face severe price competition, which could lead to significant economic downturns.

(Wu Zijing)

India Domestic demand-driven growth to continue

■ The economy has remained solid in FY2025

The Indian economy recovered moderately in the first half of FY2025 (April-September 2025). The driving force was domestic demand, and growth was balanced between consumption and investment.

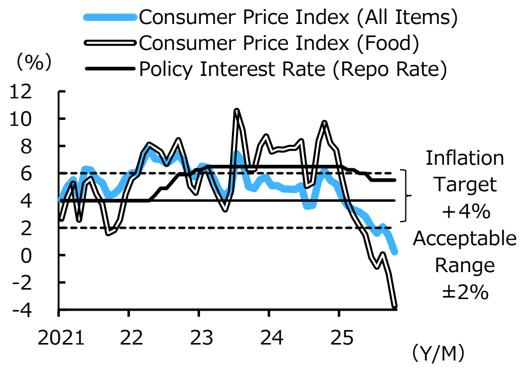
Price stability provided a tailwind for consumption. Inflation has dropped sharply as a result of falling food prices, and aggressive interest rate cuts by the Reserve Bank of India, the country's central bank, have boosted people's purchasing power. Investment was driven by massive infrastructure development expenditures of around 11 trillion rupees (about 20 trillion yen), which amounted to more than 20% of central government spending in FY2025, and this led to a significant increase in gross fixed capital formation.

Looking ahead to the second half of FY2025, the economy is expected to continue recovering, though the situations on the domestic and external demand fronts will differ. The strong growth in the first half of the fiscal year will lift the full-year figure, with the real growth rate for FY2025 looking set to come in at 6.7%, higher than in the previous fiscal year.

Slowing external demand is probably inevitable, due to lower exports to the U.S., which account for 20% of total goods exports. Total exports to the U.S. were already down 10.2% YoY in September and October, a substantial drop. The additional 50% tariff imposed by the U.S. in August (total of reciprocal tariff and punitive tariff for oil imports from Russia) led to a sharp reduction in key exports such as jewelry, linen products, machinery, and marine products. In addition, exports of electronic devices such as mobile phones, which are not currently subject to tariffs, are also expected to fall significantly with the introduction of tariffs on them in the future.

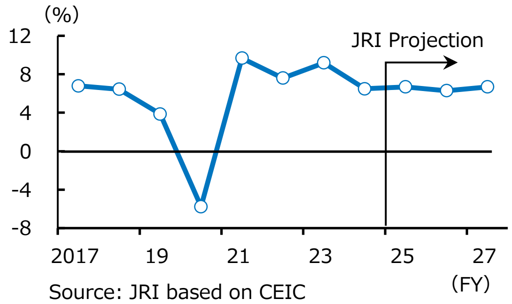
Domestic demand, in contrast, should keep recovering. This is because in addition to benefiting from continued low inflation and low interest rates, personal consumption will be boosted by policy effects. In September, the Indian government slashed the Goods and Services Tax (GST), the counterpart to Japan's consumption tax, on around 400 items. If the reduction in the tax rate is 100% reflected in selling prices (100% pass-through), this should boost personal consumption and GDP by 1.1% and 0.6%, respectively, in real terms.

<Inflation Rate and Policy Interest Rate>



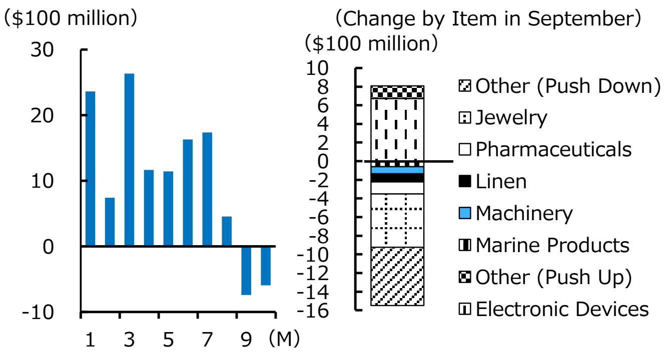
Source: JRI based on CEIC

<Real GDP Growth Rate (YoY) >



Source: JRI based on CEIC

<U.S.-bound Exports (Change from Previous Year / 2025) >



Source: JRI based on CEIC

■ Continued expansion of demand in rural areas to drive stable growth going forward

The growth rate in FY2026 will be lower than in the previous fiscal year, but it is still expected to register 6.3%, a high level among major countries.

On the demand side, while external demand will weaken due to a decline in exports to the U.S., domestic demand will continue to recover.

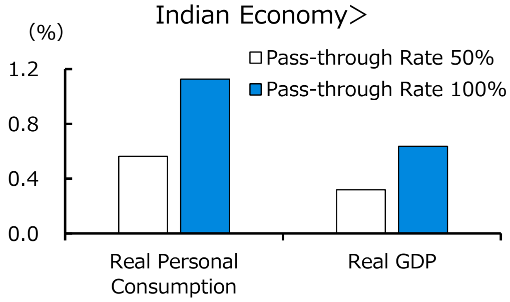
Consumption is expected to continue to expand at a rapid pace, driven by rural areas, where 60% of the population lives. In rural areas, the income and employment environment is improving. In addition to strong wage growth in agriculture, forestry, and fisheries, which employ 40% of the working population, the rural unemployment rate (for persons over 15 years old) also fell from an average of 4.8% in Q1 to an average of 4.4% in Q2. This was due to higher agricultural production as a result of stable weather and generous policy support from the government. The government increased its budget for agricultural and rural development in FY2025 to around 4.4 trillion rupees (about 7.7 trillion yen), a rise of 32% over the previous fiscal year. It used the money to strengthen programs to boost agricultural productivity and create jobs and businesses in rural areas. Behind these measures was Prime Minister Modi's ruling party losing a significant number of seats in rural areas in last year's general election.

Looking ahead, the income and employment environment in rural areas will continue to improve which, coupled with the GST reduction, will boost consumption in India as a whole. The reasons for the improvement are that agricultural production should expand next year due to the above-average rainfall recorded during the monsoon period (June-September) this year, and that the Modi government is expected to maintain its policy approach of focusing on agriculture and rural areas going forward.

Investment also looks set to continue growing rapidly, driven by industrial and infrastructure investment by the public and private sectors. In particular, the shipbuilding and shipping sectors are expected to become an increasingly major presence. In September, the Indian government announced plans to attract investment of 80 trillion rupees (about 140 trillion yen) in the maritime industry, including ports, shipbuilding, and ship repair, over the next 22 years. It also pledged to spend around 700 billion rupees (about 1.2 trillion yen) to strengthen shipbuilding capabilities. In response to these developments, November saw a UAE company declare that it would invest $5 billion in India's shipping system, and both domestic and foreign companies are expected to continue expanding their investments in this sector.

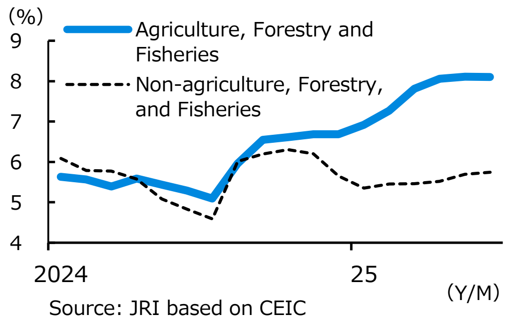
On the supply side, the service sector should play a leading role. The service sector's presence in the Indian economy has been expanding year by year, and it contributed 70% to Q1 GDP growth. Professional services, real estate, and other service sub-sectors are propelling growth amid strong IT/AI demand and favorable housing market conditions. In the future, alongside these sub-sectors, growing demand for services supported by growing purchasing power in rural areas is expected to increase service provision in a wide range of fields such as retail, transportation, and telecommunications.

<Impact of GST Reduction on Indian Economy>



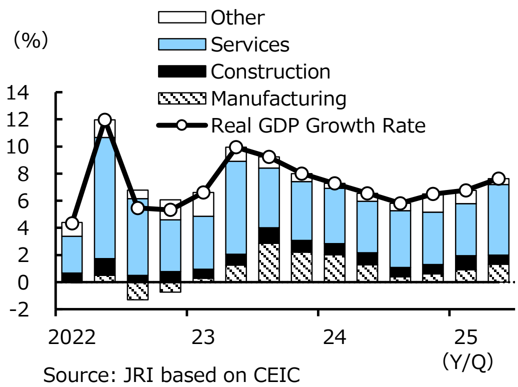
Source: JRI based on Reserve Bank of India (RBI) and Kumar, P., A. Kumar, S. Parappurathu, and S. S. Raju[2011]. "Estimation of Demand Elasticity for Food Commodities in India," Agricultural Economics Research Review, Vol. 24 January-June 2011, pp.1-14.
Note: The weights for the affected components of the CPI are those used by the RBI, while the figures for price elasticity are those given by Kumar et al. [2011].

<Rural Wage Growth Rate>



Source: JRI based on CEIC

<Real GDP Growth Rate (YoY)>



Source: JRI based on CEIC

■ Changes in U.S.-India relations are a risk factor

There are both upside and downside risks to the Indian economy going forward. Both fronts are related to policy changes in the U.S.

First, an upside risk is a lowering of punitive tariffs due to improved relations with the U.S. India has significantly expanded its imports of Russian crude oil, taking advantage of the lower prices caused by the war in Ukraine, and this triggered U.S. punitive tariffs of 25%. The Indian government has indicated that it will continue to buy Russian crude oil from a security standpoint, but there have been reports that India's major oil refiners are moving to reduce purchases of Russian crude oil and secure alternative suppliers. The U.S. lowering these tariffs in exchange for reduced purchases of Russian crude oil would considerably ease the downward pressure on India's U.S.-bound exports. In addition, currency depreciation amid fears of an Indian economic downturn due to Trump tariffs would also be mitigated, and the central bank could go further with monetary easing. In this case, both domestic and external demand would be higher than under the main scenario. FY2026 GDP growth would then likely be in the upper half of the 6% range.

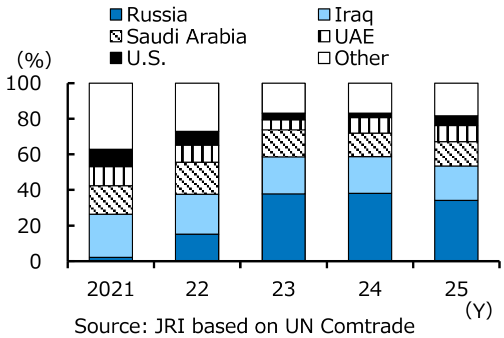
Next, growth of the digital industry stalling represents one downside risk. India's cumulative service exports during January-October 2025 were up 11.1% YoY, but the IT and BPO (business process outsourcing) sectors, which account for 60% of this, may be adversely affected by tougher U.S. rules. More than 50% of India's IT and BPO exports go to the U.S.

In October, the following rule changes impacting overseas IT companies were implemented or initiated in the U.S. First, the Trump administration significantly increased fees for H-1B visas (temporary work visas for professionals, including IT engineers). Second, a Republican senator introduced a bill to the Senate that would impose a 25% excise tax on outsourcing to foreign service providers.

Almost all of India's IT and BPO exports are off-site services provided from within India, and thus do not involve engineers being sent to the export destination. This means that tighter visa rules will only have a limited impact, but taxes targeting outsourcing, regardless of the form of the service provided, would deal a significant blow. Although the bill has yet to be passed, the 25% tax will inevitably hit India's exports to the U.S. if it is passed. In addition, there is the danger that IT and BPO investment in India by U.S. firms could decrease because of overseas outsourcing becoming more expensive for companies in the U.S. Since the IT/BPO sector accounts for about 20% of total inward direct investment in India, a decline in investment from the U.S. could strip away some of the Indian economy's growth potential over the medium to long term.

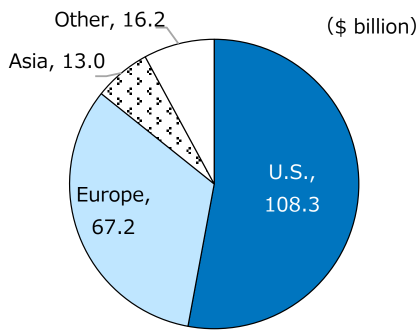
(Tomohiro Hosoi)

<Suppliers of India's Crude Oil Imports (by Volume)>



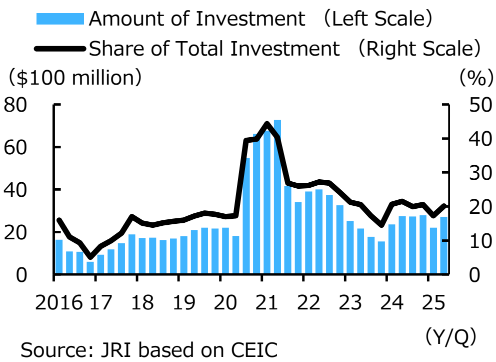
Source: JRI based on UN Comtrade
Note: Data for 2025 is until June.

<Destinations for Indian IT/ BPO Exports (FY2024) >



Source: JRI based on RBI

<FDI in India's IT/ BPO Industry>



Source: JRI based on CEIC
Note: Total amount of investment in software, consulting, and outsourcing fields. Equity investments (actual) only. 4-quarter trailing moving averages.

China Growth rate expected to fall to low 4% range in 2026

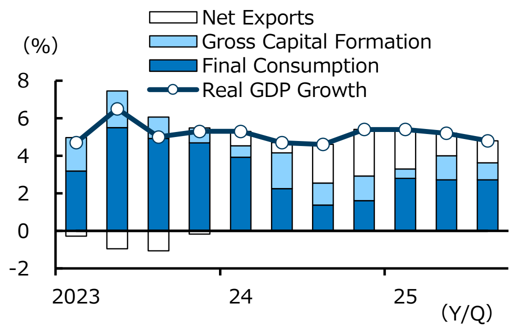
■ The economy slowed down in H2 2025

Although the Chinese economy remained solid in the first half of 2025, it slowed in the second half of the year. While real GDP growth in H1 was high, topping 5% YoY, it fell to 4.8% in Q3, dipping below 5% for the first time in four quarters.

Breaking it down by demand component, although domestic demand-related components saw fairly strong growth in the first half of the year, this gradually faded in the second half of 2025. This was the main cause of the economic slowdown.

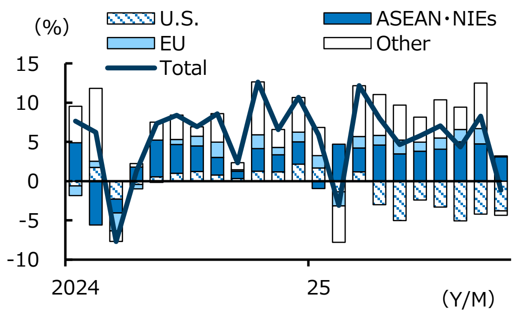
Subsidies for the replacement of consumer durables boosted retail sales, particularly of automobiles and home appliances, in the first half of the year. This lifted consumption. An increase in the amount of subsidies (2024: 150 billion yuan → 2025: 300 billion yuan) and an expansion of the range of products covered, - smartphones were added for instance - proved successful in stimulating consumption. However, consumption growth slowed in the second half of the year partly due to a reduction in the amount of subsidies granted from 162 billion yuan in the first half to 138 billion yuan in the second half. Another factor was the government tapering off the replacement of home appliances such as refrigerators, televisions, and air conditioners, which have been eligible for subsidies since last year.

<Real GDP Growth (YoY) >



Sources: JRI based on National Bureau of Statistics of China and CEIC

<Chinese Exports (YoY) >



Sources: JRI based on CEIC

Fixed asset investment expanded in the first half of the year amid growing capital investment in the manufacturing sector due to an increase in the amount of subsidies for equipment upgrades (2024: 150 billion yuan → 2025: 200 billion yuan) and a rise in infrastructure investment for priority projects. However, in the second half of the year, fixed asset investment fell back as such policy effects faded.

On the other hand, external demand continued to grow. By region, exports to the U.S. have been in continuous decline since April due to the impact of Trump tariffs, dropping by about 30% YoY. However, exports to other regions, such as ASEAN, the NIEs, and the EU, generally grew steadily, so external demand continued to expand overall.

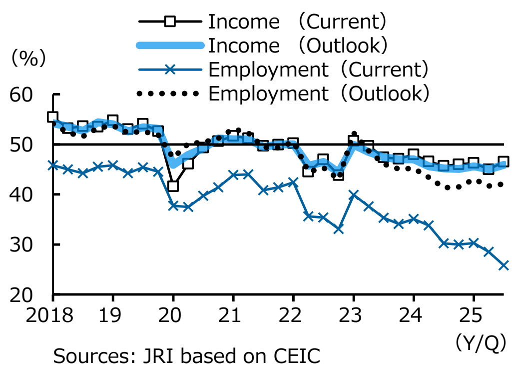
The slowdown in domestic demand is continuing to resonate in Q4, and the growth rate is expected to keep falling. Nevertheless, thanks to the strong growth in the first half of the year, China looks set to see growth of 4.9% over 2025 as a whole, almost reaching the government's target of around 5%.

■ Growth to slow further in 2026

Going into 2026, both domestic and external demand will decelerate, and growth is expected to slow further. The following three factors can be pointed to as being behind the domestic demand drop.

The first factor is that the consumption-boosting effects of government policies will fade further. Home appliances have already been replaced, and digital products such as smartphones, which have been newly added to the subsidy scheme, and automobiles, for which eligibility (based on service life and emission standards) has been expanded, will

<Consumer Confidence (People's Bank of China) >



Sources: JRI based on CEIC

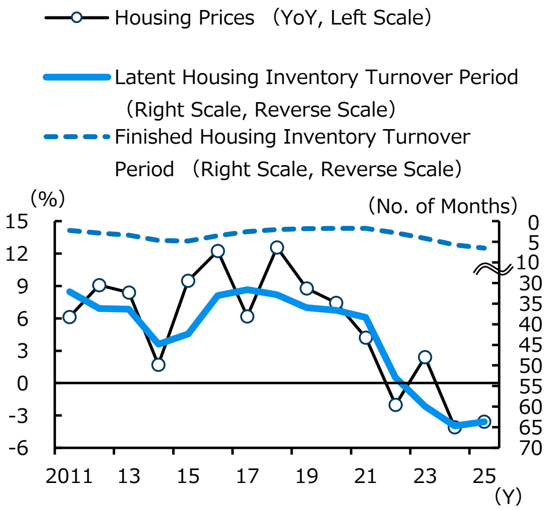
also face pullbacks from the beginning of the year. Since key consumer durables are already covered by the subsidies, even if the government expands the scale of subsidies and products covered in the future, the effect in boosting consumption is expected to be limited. This trend will also be exacerbated the dim prospect of a self-sustaining recovery in consumer confidence, given the lackluster employment and income environment and the low expectations for improvement in the future.

The second factor is the reverse wealth effect of the real-estate recession. Since autumn 2024, the government has taken steps to prop up the real-estate market, such as lowering mortgage interest rates and reducing or exempting taxes on home purchases. Since housing sales have recovered in some cities as a result, the measures have been effective to some degree. However, these policy effects have been fading recently, and the problems of a deteriorating housing demand-supply balance and falling home prices have become more serious. Since 50% of household assets in China are residential assets, the reverse wealth effect of a sagging housing market is expected to push down personal consumption.

The third factor is weak fixed asset investment. Capital investment in the manufacturing sector is expected to remain soft partly because the effects of subsidies for upgrading equipment have petered out, meaning that a pullback will be seen going forward. Another factor is the government and companies announcing a series of measures to eliminate excess production capacity. In addition, real-estate investment is unlikely to recover due to the floundering housing market. All that remains is infrastructure investment, which should pick up in the future due to a new policy-based financing tool worth 500 billion yuan that the government announced in September. However, the likelihood of this recovery offsetting the negative impact of tepid capital investment and real-estate investment is low, so fixed asset investment is expected to be stagnant overall.

External demand is also expected to decelerate. Compounding the continued negative impact on exports to the U.S. of the fentanyl-related tariffs and reciprocal tariffs (total: 20%) implemented in the first half of 2025, the U.S. is expected to bring in semiconductor tariffs soon, and these will depress exports overall. Export growth was maintained in 2025 mainly due to 1) the growing rush of exports of electronic devices (smartphones, computers, etc.) and semiconductors from ASEAN countries and the NIEs to the U.S., and 2) rising exports of intermediate goods from China to ASEAN countries and the NIEs, ahead of the anticipated introduction of semiconductor tariffs. The U.S. is mulling

<Housing Inventory and Prices (YoY) >



Sources: JRI based on Muromoto and Hosoi [2025]
Note: Figures for 2025 are JRI estimates based on actual data for January-September. Latent housing inventory = finished housing inventory + unsold housing under construction.

<New Policy-based Financing Tool>

Participating Financial Institutions	・Three policy banks: China Development Bank, Agricultural Development Bank of China, and Export–Import Bank of China
Method	・Subsidiaries of the policy banks will invest funds they have procured in companies conducting important projects (equity investment)
	・This will help the companies to attract additional financing through bank loans, etc.
Total Financing	・500 billion yuan
Financed Projects	・Urban infrastructure (transportation, underground
	・Digital economy, AI
	・Commercial malls
Total Project Investment	・7 trillion yuan

Sources: JRI based on the National Development and Reform Commission and various media reports
Note: Total project investment is the amount mentioned by the National Development and Reform Commission.

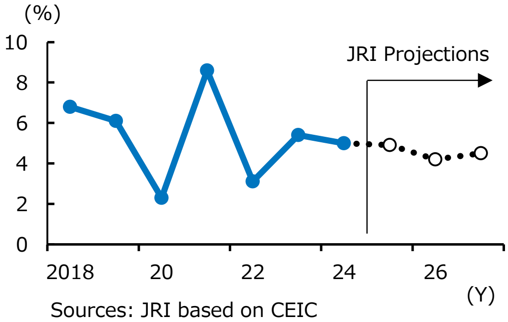
higher tariffs on both semiconductors and electronic devices, which, if implemented, would push down exports from ASEAN countries and the NIEs to the U.S. An inevitable consequence of this would be Chinese exports to these economies losing momentum.

Putting all this together, real GDP growth in 2026 is expected to be 4.2%, significantly lower than the previous year's figure. From the second half of the year, some of the negative effects on the economy, mainly those related to external demand, will ease as the impact of the 20% tariffs imposed by the U.S. runs its course. But even so, this will probably not be enough to trigger an economic upturn.

As for 2027, domestic demand is expected to recover amid improving consumer confidence due to the housing market bottoming out. Real GDP growth is expected to accelerate to 4.5%.

The draft of the 15th Five-Year Plan, released in October 2025, did not include a numerical target for economic growth, instead declaring a goal of getting GDP per capita to reach that of a "mid-level developed country." In connection with this, on November 5, 2025, the South China Morning Post newspaper reported that the Communist Party had stated in the guidebook for the draft of the 15th Five-Year Plan that, given factors such as population decline, it would be necessary to achieve average economic growth of 4.17% per year from 2026 to 2035. In light of this, policy management in the 10-year period from 2026 to 2035 is expected to be oriented toward achieving an annual average growth rate at the lower end of the 4% range.

<Real GDP Growth Rate (YoY)>



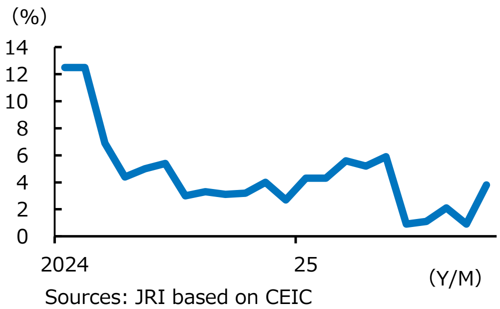
Sources: JRI based on CEIC

<Resolutions from The Fourth Plenum (Economy Related)>

Near-term economic administr	・Focus on achieving economic and social goals for the full year of 2025
	・Steady implementation of "plan on special initiatives to boost consumption"
Draft of the 15th Five-Year Plan (2026-30)	・Maintenance of economic growth within a reasonable range
	・Domestic-demand-led economic growth and strengthening of drivers
	・Development of new productive forces through self-reliance and self-effort in science and technology
	・Correction of "involutionary" competition (overproduction and excessive competition)

Sources: JRI based on the "Communist Party of China News Network" and various media reports

<Catering Sales in China (YoY)>



Sources: JRI based on CEIC
Note: Based on retail sales.

■ Two downside risks to the economy

The Chinese economy is subject to various downside risks, and if the growth rate falls below expectations, the government can be expected to take economic measures centered on the expansion of subsidies, investment, and loans. The following two downside risks would likely trigger stimulus measures.

The first is the risk of a re-ignition of the U.S.-China trade war. Although a sharpening of tensions was avoided following a meeting between the leaders of the two countries in October 2025 that resulted in an agreement on tariffs, this only marked a temporary truce. The possibility of another flare-up is by no means small. For example, China has only postponed for one year the activation of curbs on exports of rare earths to the U.S. Therefore, there is no denying the possibility that China will trigger the rare-earth controls for some reason, and that global trade will cool rapidly as a result, with the U.S. responding with punitive tariffs and China retaliating with additional import duties, for example.

The second is the risk of economic stagnation as a result of the policies of the Xi Jinping administration. Tougher anti-corruption measures and opaque application of the law are of particular concern. The Xi Jinping administration has stepped up its crackdown on corruption among party and government officials, but in May 2025, when it strengthened its "frugality edict" to curb banquets and dinners, it was interpreted as a total ban on dining out, causing sales for restaurants and other businesses to falter. Under a system where Xi Jinping has total power, there is a risk that free economic activity will be suppressed as a result of the tendency to defer to and over-interpret instructions from the top. In addition, the continued application of ambiguous laws related to national security and the preferential treatment of domestic products in government procurement may cause foreign companies to scale back their operations in China.

(Junya Sano)