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Asia: AI-led growth drives the region’s outperformance

Asia continues to outperform as AI-related investment, intra-regional trade and supply chain diversification support growth across both North and Southeast Asia. At the same time, rising inflation pressures are prompting central banks, particularly the Bank of Korea and Bank of Japan, to move further along the policy normalisation path

Strong domestic demand continues to power India’s economy

AI, intra-Asia trade and supply chain diversification support growth

GDP growth remains strong across Asia. Not only is North Asia benefitting from AI-related capex, but the rise in intra-regional AI trade is also supporting Southeast Asian economies as they become increasingly integrated into regional supply chains. Interestingly, China+1 is no longer just a strategy adopted by the US and Europe, but is also increasingly visible within Asia itself. While China remains deeply integrated into regional supply chains, larger economies such as Japan and Korea are expanding their manufacturing footprint elsewhere in the region.

For example, Korea is increasingly investing in Indonesia's battery sector, Vietnam's electronics industry and Singapore's role as a regional logistics hub, while Japanese investment has become more focused on India. Overall, the combination of AI-driven trade, stronger intra-regional investment and supply-chain diversification is helping support growth across the region and has kept Asia outperforming most other major economies.

Moreover, countries such as India, which are more dependent on domestic consumption, are also delivering strong growth. India's GDP growth accelerated to 7.8% year-on-year in the second quarter, exceeding expectations and highlighting the resilience of domestic demand. Despite headwinds to global trade, export growth has also strengthened significantly, driven by greater export diversification and a broader-based expansion across sectors and markets.

Inflation pressures are building across Asia

Inflation is gradually ticking higher across Asia, driven by a combination of higher fuel prices and firmer demand-side pressures, particularly in Korea, Japan and Singapore. In Japan, rising crude oil prices are increasingly being passed through to consumer goods, while in Singapore, higher fuel costs are feeding into services inflation, especially airfares and food services.

Looking ahead, we see upside risks to the inflation outlook and expect core inflation to accelerate further in the coming months. The growing risk of El Niño could raise imported food costs, adding to inflationary pressures in Singapore given its heavy reliance on food imports. At the same time, robust AI-related investment and data centre activity should continue to support domestic demand and keep services inflation firm. As such, we believe the October Monetary Authority of Singapore meeting remains live and cannot rule out further modest policy tightening.

Korea and Japan remain on a faster-than-expected tightening path

We now expect the Bank of Japan to deliver a 25bp rate hike to 1.25% at its 18 September meeting, reflecting growing confidence that underlying inflation pressures will persist. Beyond September, we continue to see scope for further tightening, with core CPI likely to remain elevated and peak only in 1Q27 before gradually moderating.

While the export-led growth story remains intact across Asia, central banks are increasingly looking for signs that external demand is feeding through to domestic consumption. Korea is emerging as one of the clearest examples of this dynamic, with strong export growth spilling over into domestic demand and driving a sharp pickup in core inflation. This has already prompted the Bank of Korea to deliver back-to-back rate hikes in July and August to the current 3.0%.

While recent BoK communication suggests an October move is unlikely, the sharp upward revisions to GDP growth forecasts point to a stronger growth backdrop than previously anticipated. We therefore continue to expect a further 50bp of tightening, taking the terminal rate to 3.5% in 1Q27.

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