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AI tailwinds and inflation risks shape Asia's outlook

Asia's economy remains supported by a robust AI investment cycle, keeping growth stronger than expected despite soft underlying domestic demand. At the same time, broadening inflation pressures are reinforcing the case for further monetary tightening across most Asian economies



Asia's economy remains supported by a robust AI investment cycle

AI tailwinds continue, but momentum is moderating

Asia's growth has remained resilient this year, outperforming expectations, largely driven by a stronger-than-expected AI investment cycle. The AI-related upswing has provided a significant boost to trade, manufacturing activity, and exports, particularly in the region's semiconductor and electronics supply chains. Economies with greater exposure to the AI ecosystem, including Taiwan, Korea, Malaysia and Singapore, have been among the key beneficiaries, with strong external demand helping offset still-soft domestic demand.

The AI boost is still supporting growth, but momentum is beginning to moderate, with AI-related export growth showing early signs of cooling. At the same time, the benefits of the AI cycle remain concentrated in a relatively narrow set of sectors, limiting the extent to which

stronger external demand has translated into a broader domestic growth recovery across the region.

Looking ahead to 2027, growth could soften if the AI tailwind fades and weak domestic consumption becomes a more visible drag on activity. Household spending across much of Asia remains constrained by still-high interest rates, soft labour income growth, and weak consumer confidence. As the boost from AI-led exports gradually normalises, underlying domestic demand conditions are likely to play a larger role in determining growth outcomes.

Inflation dynamics point to further policy tightening across Asia

Inflation is accelerating across most of Asia. Food and fuel inflation has begun to accelerate in more import-dependent economies, notably the Philippines. Across most of North Asia, fuel and food inflation remain relatively contained, except for Taiwan.

Hence, the impact of higher food and fuel prices is uneven across Asia. What is most relevant for central bankers is the transmission of these inflation pressures into core inflation. Core inflation has strengthened, especially in economies such as Taiwan, Singapore, and the Philippines, pointing to firmer underlying price pressures. While in the Philippines and Singapore, the large transmission of global oil prices to domestic prices is the key driver, in Taiwan, the pressures appear more AI-driven.

Looking ahead, El Niño and elevated fuel prices remain key upside risks to inflation. While the impact has been limited so far, signs are emerging that food and fuel price pressures are becoming more broad-based, particularly in the Philippines and Taiwan. Overall, headline inflation remains below central bank targets in Japan and China, but continues to exceed targets in Korea, Taiwan, and most Southeast Asian economies. As a result, we expect rate hikes in all Asian economies under our coverage, including Australia, with China the exception.

FX implications – AI exporters vs oil importers

On currencies, we remain bearish on those where the negative impact of higher oil prices outweighs the positive effects, if any, from the AI boom. South Asian currencies remain vulnerable to higher oil import costs and weaker current account balances. Hence, we expect depreciation pressures to persist for the Indian rupee, Philippine peso, and Indonesian rupiah.

By contrast, we are mildly bullish on the Korean won, Singapore dollar, and Taiwanese dollar, which continue to benefit from strong AI-related exports and rising trade surpluses. These economies have seen external balances strengthen as demand for semiconductors and other technology products remains robust.

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