COMMENTARY
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Developed Asia Outlook 2025: Diverging Fortunes

The year will bring many risks and few opportunities for high-income Asian economies.

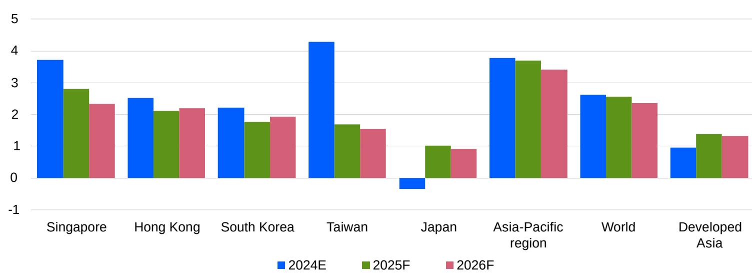
- Growth in developed Asian markets will pick up in 2025 as a belated recovery in Japan offsets slower growth in South Korea, Taiwan, Singapore and Hong Kong.
- Slowing inflation will lift real incomes and allow central banks to cut interest rates. The Bank of Japan is the exception; rates in Japan are headed higher.
- Exchange rates are a key concern for all central banks. With financial market trading jumpy, anything that changes the outlook for rate paths could trigger volatility.
- The prospect of intensifying trade friction following the re-election of Donald Trump as U.S. president overshadows the outlook.
- Political uncertainty at home adds to the headwinds facing developed Asian markets.

The coming year will challenge developed Asian markets. Political uncertainty at home and abroad, jumpy financial market trading, and intensifying trade friction overshadow the outlook. However, slowing inflation will lift consumer and business spending.

According to our December baseline forecast, developed Asian economies will grow 1.4% in 2025. This is an improvement over the estimated 1% expansion in 2024 but slower than the 1.6% growth recorded in 2023. It's also slower than the 1.6% growth rate projected in our November baseline. Most of the improvement stems from Japan, which, after a likely contraction in 2024, will make a modest, albeit incomplete recovery in the year ahead. Growth in other high-income Asian economies will slow. This includes South Korea, Taiwan, Singapore and Hong Kong, where soft domestic demand adds to volatile export growth.

Better, yet Weaker

Real GDP, % change, Moody's Analytics Dec 2024 baseline



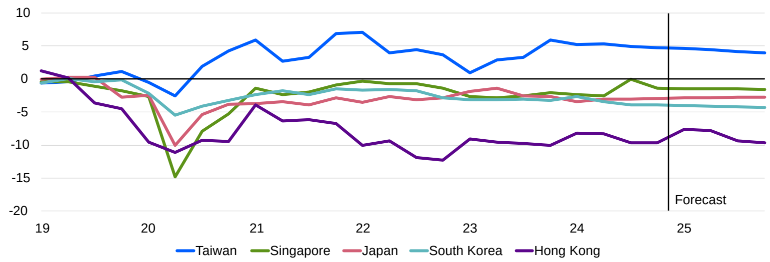
Sources: National statistical offices, Moody's Analytics

Developed Asia has performed well over the past two years, but some economies have fared better than others. Taiwan has thrived due to the global boom in artificial intelligence, which has boosted shipments of its primary export commodity—high-end semiconductors. Comparing Taiwanese GDP with its pre-pandemic trend, output is currently about 5% higher, making Taiwan one of the few places in the world performing better than it would have if pre-pandemic growth had continued.

The region's four other economies have been less fortunate. Although South Korea has similarly benefited from surging global chip demand, weakness in traditional manufacturing industries has marred its overall export performance. Exports from Japan, Singapore, and especially Hong Kong have struggled for similar reasons.

The Good, the Bad, and the Mediocre

Real GDP, % deviation from pre-pandemic trend, Moody's Analytics Dec 2024 baseline

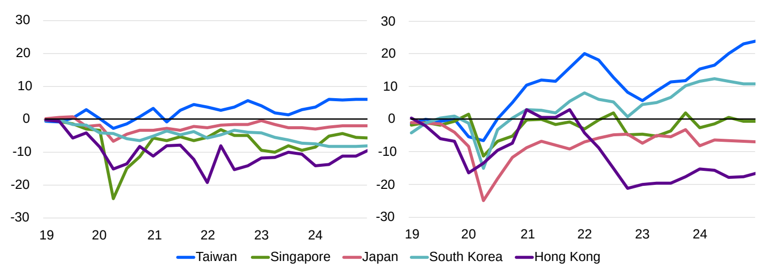


Sources: National statistical offices, Moody's Analytics

Domestic household and business spending has been a less reliable source of growth for most developed Asian economies. Excluding Taiwan, domestic demand is below where it would have been had the pre-pandemic trend continued, as inflation, higher interest rates, and stagnant incomes squeezed spending. With weak domestic growth adding to stuttering exports, GDP in Japan, South Korea and Singapore is about 2% to 3% below pre-pandemic trends. Meanwhile, Hong Kong's GDP is a whopping 7% below the pre-pandemic trend, highlighting its economic challenges from slow growth in China and unsteady global trade.

Two-Speed Economies

% deviation from pre-pandemic trends, domestic demand (L), exports (R)



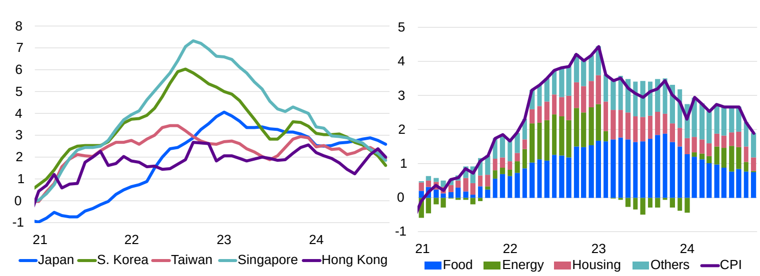
Sources: National statistical offices, Moody's Analytics

There are reasons to be more optimistic about household and business spending. Chiefly, inflation is slowing, which will help lift real incomes and consumer spending. A weakening contribution from food prices has slowed inflation in these advanced economies. Energy price inflation has also cooled, albeit less consistently. Policy shifts have removed some aid for household energy bills while introducing new ones. Inflation will likely keep tracking lower, even if the potential for a fresh surge in global commodity prices remains a risk. Asia's high-income economies import 50% to nearly 100% of the energy and food consumed domestically, making them uniquely vulnerable to trade disruptions, supply snags, or escalating military tensions abroad that affect global prices.

Inflation Is Cooling, Albeit Slowly

CPI, 3-mo MA, % change yr ago

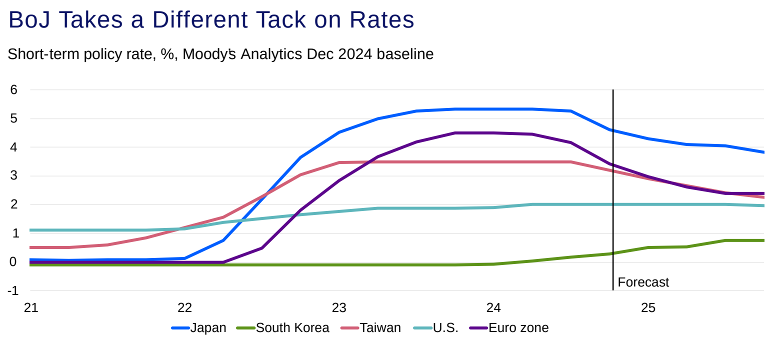
CPI, % change yr ago, ppt contribution by component



Sources: National statistical offices, Moody's Analytics

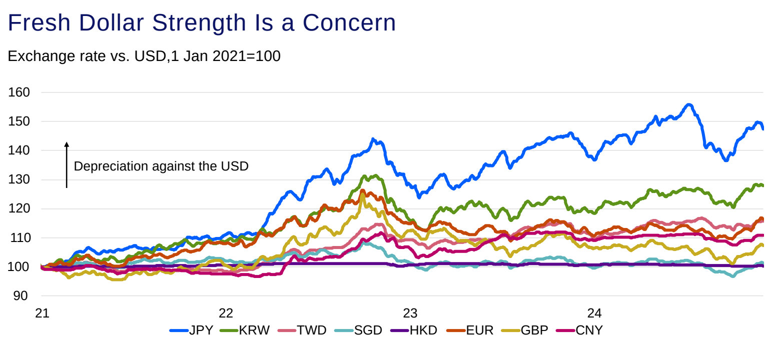
Slowing inflation will also allow central banks—other than the Bank of Japan—to cut interest rates, reducing debt servicing costs for loan-dependent businesses and households with large mortgages such as those in South Korea. We expect the Bank of Korea to cut interest rates in lockstep with the U.S. Federal Reserve to avoid widening the interest rate gap vis-à-vis the U.S. The Taiwanese central bank, the Central Bank of the Republic of China (Taiwan), will move more gradually to help narrow the spread with U.S. rates; its first rate cut will likely be in late 2025.

The Bank of Japan is continuing in the other direction, signalling that two rate cuts this year aren't the end of the matter. This is despite the shrinking economy. The central bank worries that the weak yen might push up inflation, eroding real wages and consumer spending. We think the odds of a BoJ rate hike in December compared with a rate hike in January are about 60-40.



Sources: Central banks, Moody's Analytics

Indeed, exchange rates are a key concern for all central banks in developed Asia. Unexpected depreciation would likely prompt a monetary policy response. In South Korea and Taiwan, central banks would pause rate cuts. In Japan, fresh yen depreciation could accelerate the timing of rate hikes. The currencies of developed Asia have all depreciated significantly against the U.S. dollar over the past three years, with the yen standing out. Although the Japanese currency has regained some ground against the greenback following the unwinding of the carry trade this past summer, it remains weak by historical standards and relative to rate spreads and economic fundamentals. With financial market trading still jumpy, anything that changes the outlook for rate paths could trigger volatility.

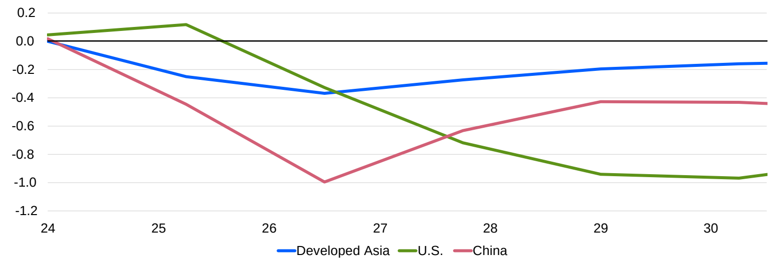


Sources: Federal Reserve, Moody's Analytics

Chief among the risks facing the growth outlook for 2025 and beyond is politics. Externally, the re-election of Donald Trump as U.S. president suggests a tumultuous period ahead for Asia's advanced economies. Trump's campaign promised higher tariffs, more-restrictive immigration policies, and broad changes to U.S. fiscal policy and regulation. The package, if enacted, will likely lead to higher inflation and slower growth in the U.S., China, and the broader world economy. Downward revisions to our December baseline forecast reflect that assessment. Japan, South Korea and Taiwan share important economic and security ties with the U.S. that will help minimise economic damage. All three economies are large international investors, and much of their investment goes to the U.S. In the past, investment has helped them avoid U.S. trade restrictions. But they won't come away unscathed in coming years: If tariffs go up, growth will slow.

Below the Line

Real GDP, Moody's Analytics Dec 2024 baseline deviation from Nov baseline, %



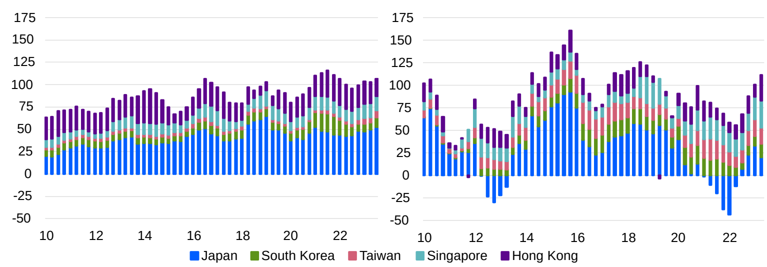
Sources: National statistical offices, Moody's Analytics

Conditions at home don't offer much reason for optimism. South Korean President Yoon Suk Yeol's unexpected declaration of emergency martial law in early December sparked domestic and international shock. The move, justified by unsubstantiated North Korean threats, appeared to be politically motivated amid Yoon's low approval ratings and recent controversies. Impeachment or resignation of the president seems inevitable amid widespread protests, despite efforts by the ruling party to delay the process. Although events have created volatility in financial markets, we expect conditions to stabilise as underlying economic fundamentals come back into focus. Direct economic implications are limited, but a possible delay in the budget approval process could compound sluggish consumer spending and weak business confidence, which are weighing on domestic demand and economic growth.

Developed Asian Economies Are Major International Investors

Direct investment asset acquisition, $ bil, 4qtr MA

Portfolio investment asset acquisition, $ bil, 4qtr MA



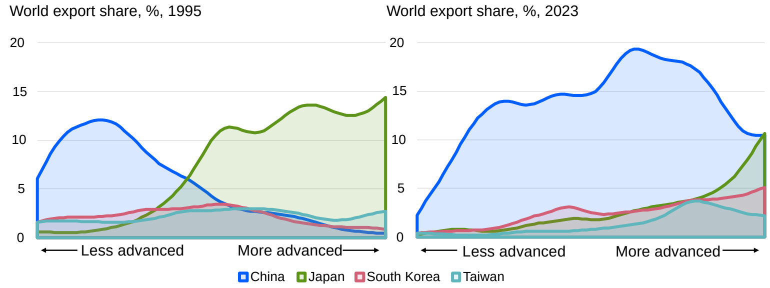
Sources: National statistical offices, Moody's Analytics

In Japan, the general election in late October cost the ruling Liberal Democratic Party-Komeito coalition its majority. Prime Minister Ishiba Shigeru is trying to stay in office with support from opposition parties, but the election setback casts doubt on the longevity of his government. The political instability and insecurity have led the government to ease its foot off the fiscal brake, but this won't materially change the economic outlook; Japanese fiscal packages tend to overpromise and underdeliver. Still, as different parties—and factions within parties—vie for power, the risk of an abrupt shift in policy increases. Japan has a history of ill-timed or ill-targeted fiscal pullbacks that have worsened economic and fiscal conditions.

Policy missteps are also a concern in Taiwan, where the government is divided. That said, Taiwan's three major political parties broadly align on domestic matters, including sensitive areas such as defence.

Beyond domestic political concerns, rising geopolitical tensions are a major concern for Asia's advanced economies as many key industries, including electronics and cars, are uniquely exposed to geopolitical risk. Carmakers in Japan and South Korea, for example, not only face the threat of higher U.S. tariffs but are increasingly under pressure from foreign competition, particularly China, which is fast becoming the world's largest car exporter thanks to an unparalleled ability to produce EVs at scale.

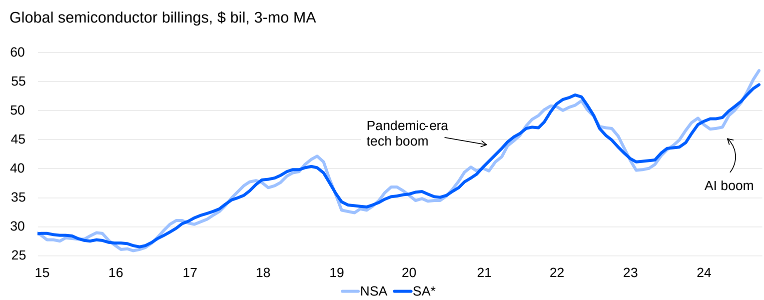
Competition From China Is Increasing



Sources: Atlas of Economic Complexity, U.N.Comtrade, Moody's Analytics

The crosscurrents facing electronics producers are no less significant. Makers of high-end chips such as Taiwan's TSMC and South Korea's Samsung Electronics have benefited from the global boom in artificial intelligence applications. But makers of mid- and low-tier chips in Singapore and Japan have not benefited from the boom to the same extent. Now, chipmakers and producers of chipmaking equipment are in the crosshairs as intensifying trade frictions between the U.S. and China raise the odds of fresh export restrictions. This will weigh on business sentiment and capital spending in coming quarters.

AI Has Boosted Global Chip Sales



* The data were seasonally adjusted by Moody's Analytics.
Sources: Semiconductor Industry Association, Moody's Analytics

The year ahead will bring many risks and few opportunities for high-income Asian economies. A belated recovery in Japan will come against slower growth in its neighbourhood peers. But economic and political risks cloud the outlook for all. Asia's high-income economies will navigate these challenges better than others, but there will be a noticeable impact on economic performances.