Foreword

The global economy has been battered by large, unpredictable shocks. In 2025, sweeping US tariff measures pushed trade policy uncertainty to historic highs, marking the most significant global trade disruption in decades. Despite this, the ASEAN+3 region expanded by 4.3 percent – performing much better than projected immediately after the April tariff shock.

Why has the region outperformed forecasts? Cyclically, semiconductor exports and AI-related investments provided a strong offset. The region's policy buffers and capacity to respond flexibly to shocks also served it well. Structurally, the region has undergone a fundamental transformation compared to two decades ago, challenging the common characterization of the region as primarily a manufacturing location serving external demand.

On the supply side, regional production networks have evolved from a Japan-centered hub into a dense, interconnected architecture anchored by China. Trade is now concentrated in the intermediate and capital goods that underpin this integrated network.

On the demand side, ASEAN+3 now accounts for 28 percent of global final demand, surpassing the United States. The region is now more regionally focused and less dependent on extraregional markets than at any point in the last two decades. Twenty years ago, nearly a third of ASEAN+3 exports serving final demand went to the United States. By 2022, that share fell to 20 percent, while intraregional demand rose to nearly 30 percent. Increasingly, the region is producing for itself.

This transformation offers a buffer against external volatility but also means regional business cycles are more synchronized. Shocks within the region now propagate faster, making sound domestic management a matter of shared regional importance. Consequently, regional cooperation mechanisms – like policy dialogue, mutual surveillance, and the financial safety net – are more valuable than ever.

Fresh volatility arrived in 2026 with military conflicts in the Middle East. As ASEAN+3 sources over a third of its oil and gas from that region, the risks of higher energy bills and inflation are significant. However, the region entered this period from a position of strength – in its macroeconomic conditions, the policy space available to respond, and in how the structure of its economies has changed. We are now more energy-efficient, more diversified in power sources, and less oil-dependent in transport. Still, the job is not done, and the case for accelerating green transition is now considerably stronger. The 2026 oil shock reminds us that the energy transition is a macroeconomic resilience imperative, not just an environmental one.

In this highly uncertain environment, preserving policy flexibility is the central challenge. The range of plausible outcomes is wider than usual, and confidence in any single projection is lower. Key risks – severe energy disruptions, renewed trade tensions, and global financial market volatility – are plausible scenarios requiring careful contingency planning.

The nature of the shock and its persistence must determine the nature of the response. Getting the diagnosis right – in real time, under uncertainty – is what separates effective policy from costly mistakes.

Consider a supply shock, like a prolonged surge in global energy prices. For a region of energy importers, this creates a difficult trade-off between growth and inflation while triggering capital flow pressures and market volatility. The right response hinges on assessing the shock's persistence in real time. If the disruption seems temporary, policymakers should "look through" the price spike to avoid damaging growth. However, if inflation pressures broaden, decisive action is needed to anchor expectations. Fiscal policy should focus on targeted support for the vulnerable rather than broad subsidies that distort prices and erode fiscal space.

A demand shock, such as escalating trade tensions or a technology-led global slowdown, presents a different challenge: the case for accommodative policy is more straightforward. If the shock is temporary, policymakers can wait and assess, especially if policy space is judged to be limited. If it appears sustained, early action is vital to prevent a collapse in confidence and investment and a further erosion of policy space. Coordinated monetary easing and targeted fiscal support can then work together to stabilize the economy.

Beyond cyclical shocks, the region must sustain long-term resilience in a more regionally anchored landscape. Concentration risks have risen in some economies as they moved up value chains. To get the balance right, we must prioritize upgrading domestic capabilities, diversifying to reduce vulnerabilities, and ensuring inclusive participation. For ASEAN, those efforts would require deepening integration and moving beyond trade liberalization to promote denser intraregional investment.

Despite years of policy work, intra-ASEAN integration remains shallow. Intraregional trade and investment shares have slipped since 2010, with goods trade falling to 22.5 percent and services to 13.8 percent by 2024. Even as total FDI into ASEAN doubled, the intraregional share dropped to 14.1 percent. We need deeper ties to buffer against geopolitical fragmentation and trade uncertainty. Strengthening these internal connections isn't just about ASEAN; it bolsters the entire ASEAN+3 architecture. A denser regional network creates a more balanced, resilient production engine, helping the whole region thrive in a fragmented world.

This year's *AREO* addresses these themes. Chapter 1 assesses the macroeconomic outlook and the policy trade-offs ahead, with a special feature examining how central banks can navigate monetary policy when the nature and persistence of shocks are difficult to diagnose in real time. Chapter 2 traces the structural transformation of the region's economic linkages and its implications, with a special feature exploring pathways for deeper integration within the ASEAN community.

Through our continuous surveillance and analytical work, AMRO is committed to supporting the region's capacity to diagnose shocks, understand spillover dynamics, and calibrate policy responses. We hope this publication serves as a useful resource – for policymakers navigating difficult trade-offs, and for all who seek to understand the forces shaping the region's economic prospects.

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