Global Macro Research

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#Global / #Growth / #Monetary policy

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Eight key questions for 2026

We consider key questions facing the global economy and markets in 2026, including the outlook for US growth and the labour market, monetary policy under the next Fed chair, whether there is an AI bubble that bursts, if China's anti-involution campaign will raise inflation, and a big year for Latin American politics.

Key questions (and very short answers!)

- Will stronger US economic growth lead to a labour market rebound? Yes.
- How will the next Fed chair affect monetary policy? Dovishly.
- Is there an AI bubble, and will it burst? Not yet.
- Will China's anti-involution campaign banish low inflation? No.
- Will fiscal tailwinds boost Eurozone growth? It's mainly a 2027 story.
- How will Japan's monetary and fiscal policy outlook shift under Prime Minister Takaichi? Gradually.
- How will the election cycle, and US foreign policy, shape Latin America in 2026? Significantly.
- Is there political leadership change coming in the UK? May elections are a danger point for Prime Minister Starmer.

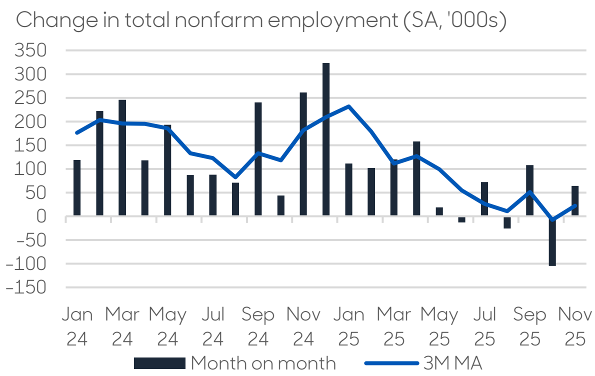
Will stronger US growth lead to a labour market rebound?

Yes.

We are forecasting US GDP growth to accelerate modestly in 2026, from 2.0% this year to 2.2% next year – slightly above consensus. This will be driven by capital expenditure from the AI build-out, wealth effects from the stock market, lower tariff uncertainty, fiscal easing, and further rate cuts.

However, the US enters 2026 with the labour market looking weak. Average monthly payroll growth over the three months to November was just 22,000 (see Figure 1) and the unemployment rate has risen from 4.2% a year ago to 4.6% now.

Figure 1: The US labour market has been subdued, but should improve as growth picks up in 2026



Source: Aberdeen, Haver, December 2025

Activity growth and the labour market have somewhat decoupled, leading to a "jobless recovery", for a few reasons.

The sharp increase in tariff uncertainty saw firms pause hiring but not necessarily reduce output. The surge in AI-capex has boosted GDP but is not labour-intensive. Productivity growth has improved, which may reflect early benefits from AI, but is also an endogenous response to the reduction in labour supply amid the fall in net migration. More workers are holding multiple jobs. And firms are still working through the post-pandemic over-hiring.

However, several developments should support a gradual labour market recovery. Easing monetary conditions should broaden business investment beyond AI and large-cap tech.

And the passing of peak tariff uncertainty should allow small businesses to resume hiring.

So, we are forecasting the US unemployment rate to decline to 4.2% by the end of 2026.

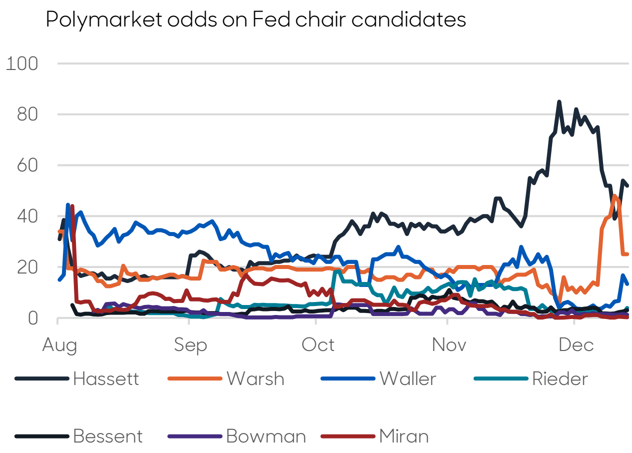
How will the next Fed chair affect monetary policy?

Dovishly.

Jay Powell's term as Federal Reserve (Fed) chair expires in May 2026, and regardless of whether he also steps down from the Board of Governors, he will be replaced as chair by a new Trump appointee.

The administration is likely to announce its candidate for chair in late December or early January. Betting markets view Kevin Hassett, the director of Donald Trump's National Economic Council, as the most likely candidate (see Figure 2). But both Kevin Warsh and Christopher Waller are still in the running.

Figure 2: Betting markets view Hassett as most likely to be next Fed chair, but it's still a three-horse race



Source: Aberdeen, Polymarket, December 2025

We expect rate cuts to continue under whoever is the next chair, with two 25 basis point cuts, in June and September, our baseline. But the pace of, and justification for, easing may differ under different candidates.

For example, Hassett would likely make the case that rates need to fall as stronger supply growth means activity can run hotter without generating inflation. Meanwhile, Warsh may attempt to shift the Fed towards a much smaller balance sheet and argue this creates space for lower policy rates.

Either way, the next chair will need to work hard to demonstrate independence from the Trump administration, given the president's well-known preference for lower rates.

It is possible slightly more aggressive easing would still be credible and could support an even stronger upswing in growth. But significantly more easing would lead to questions about the Fed's independence, and so the outlook for inflation, becoming much more pressing.

Is there an AI bubble, and will it burst?

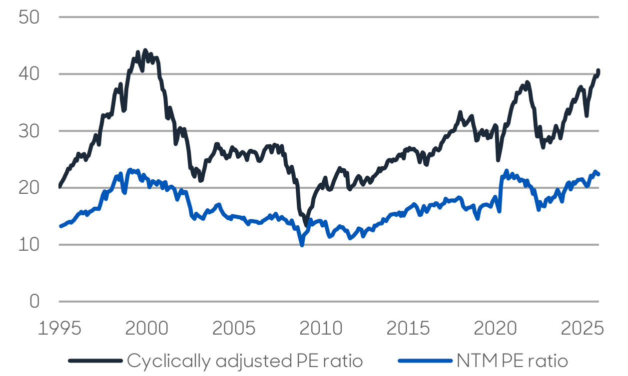
Not yet.

There are certainly some bubble-like signs in AI-related equities.

The S&P500, and the Magnificent 7 technology stocks specifically, have had a very strong run. The former is up 80% over the past three years, and the latter by more still.

That has left certain valuation metrics extended. The Shiller cyclically adjusted price earnings ratio is around 40-times, close to dotcom excesses (see Figure 3). Market concentration is high. And US GDP growth has been very dependent on AI-related capital expenditure recently.

Figure 3: S&P500 valuations are elevated on backward-looking measures but less so on forward measures



Source: Aberdeen, Bloomberg, December 2025

However, our base case judgement is that there is *not* an AI bubble that will burst in 2026. That's because US tech companies' rapid share price appreciation has been justified by robust forward earnings growth, such that price-to-*forward*-earnings ratios in the mid-20s do not look excessive.

Of course, that could just mean the bubble is in earnings expectations. But the current environment is characterised by high hardware utilisation and broadening use cases for AI.

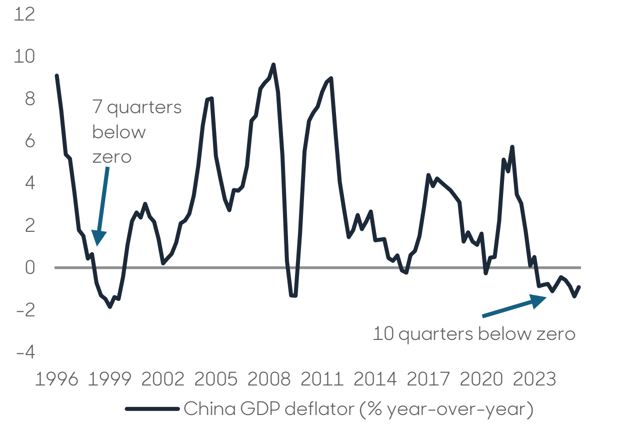
Nevertheless, the risk scenario of an AI bubble bursting is realistic enough that investors should build diversification. Aberdeen's risk teams are using multiple scenario stress tests involving a rapid sell-off in AI stocks, a liquidity crunch triggered by this selling that spills into other assets, and all this causing a recession in the real economy.

Will China's anti-involution campaign banish low inflation?

No.

China enters 2026 with inflation still weak. 2025 marks the third year of near-zero CPI inflation and 10 quarters of the GDP deflator in negative territory (see Figure 4). This reflects persistent excess capacity and intense price competition – what policymakers call involution.

Figure 4: China is experiencing sustained low inflation, which anti-involution is unlikely to fully relieve



Source: Aberdeen, Haver, December 2025

Authorities have launched an anti-involution campaign to curb destructive competition, with a particular focus on autos, batteries, and solar manufacturing. There are early signs of success: car prices have firmed, and some producers have scaled back output and investment.

However, we do not expect this to deliver a sustained inflation pickup. Excess capacity is deeply entrenched across most industries, and firms retain strong incentives to cut prices to gain market share. Local governments are reluctant to allow widespread bankruptcies. And geopolitical priorities continue to favour investment in strategic sectors, reinforcing a supply-side bias.

So our forecast is for Chinese inflation to average 0.7% in 2026.

Moreover, persistent excess capacity will weigh on global goods prices and intensify competitive pressures for manufacturers elsewhere.

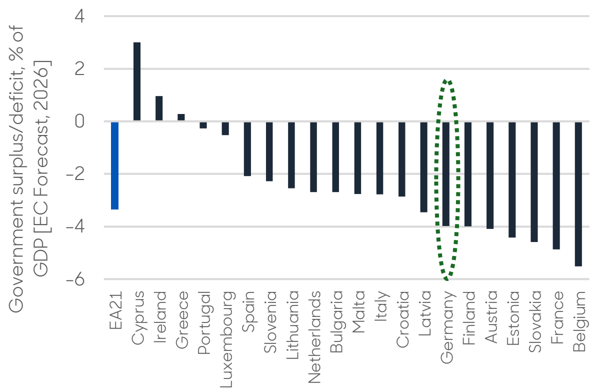
Will fiscal tailwinds boost Eurozone growth?

It's mainly a 2027 story.

Europe certainly enters 2026 with a more supportive fiscal backdrop: NATO defence spending commitments have been raised; the EU fiscal rules have loosened via activation of the escape clause; and Germany has reformed its debt brake and announced a large infrastructure package.

Indeed, Germany will be the engine of fiscal easing in 2026 (see Figure 5). The draft budget implies a fiscal impulse of 1.5% of GDP.

Figure 5: Germany is taking off the fiscal brakes



Source: Aberdeen, Haver, December 2025

However, we do not expect this to translate into a significant boost to Eurozone growth in 2026. Procurement bottlenecks and project readiness will slow the implementation of infrastructure spending. In defence, much of the additional funding will go to topping up existing contracts rather than new production. Meanwhile, France faces the opposite dynamic: a large deficit with political and market pressure to consolidate.

Overall, Eurozone fiscal policy will be a net positive, but concentrated in a few economies and slow to materialise. Our forecast is that the growth impact will be modest in 2026, with the bulk of benefits coming in 2027 and 2028 as projects ramp up.

How will Japanese monetary and fiscal policy shift under Prime Minister Takaichi?

Gradually.

The initial market reaction to Sanae Takaichi becoming prime minister of Japan was to price in "Abenomics 2.0" – a combination of aggressive monetary and fiscal easing. But political and market constraints mean policy will evolve more slowly in practice.

On monetary policy, the Bank of Japan (BoJ) of course *hiked* in December. It starts 2026 with the policy rate at a 30-year high of 0.75% and bond yields higher still (see Figure 6). We expect further, but very gradual, rate hikes. Headline inflation, which has been above 2%, will fall back as goods prices normalise. That will put more onus on wage growth, although early signs are for the spring wage negotiations to be a little weaker than last year. Our baseline is for the next hike to come in October 2026.

Figure 6: JGB yields are back to pre-GFC highs, suggesting market patience for fiscal easing not infinite

Source: Aberdeen, Haver, December 2025

Fiscal policy expansion will provide support, although multipliers are modest. A JPY21 trillion supplementary budget was approved in November, with the fiscal impulse about 1% of GDP. But most funds are directed at household price relief rather than growth-enhancing investment. The FY2026 budget in March is likely to prioritise strategic sectors – AI, semiconductors, quantum computing, advanced manufacturing, and defence – amid rising tensions with China and US tariff uncertainty. However, minority status in both houses and bond market sensitivity will constrain ambitions.

How will the election cycle, and US foreign policy, shape Latin America in 2026?

Significantly.

Latin America enters 2026 facing two key dynamics: a busy electoral calendar, and an increasingly interventionist US. Both will influence trade, fiscal policy, and market sentiment across the region.

Mexico was an early target for tariffs in 2025, but exports to the US have held up thanks to exemptions for USMCA-compliant goods and strong supply-chain integration. The trilateral USMCA review begins in July. Our base case is that the agreement, and Mexico's preferential access to the US market, will remain intact. But serial annual reviews, which would allow Trump to maintain pressure on the US' neighbours, are looking more likely than a secure long-term extension.

Brazil's October presidential election will likely be between incumbent Luiz Inácio Lula da Silva and Flávio Bolsonaro, son of the former president. Lula's popularity has rebounded after securing tariff relief for key sectors, but concerns remain around the cost of living and security. A Bolsonaro victory would likely shift fiscal policy toward tighter spending and market-friendly reforms.

More broadly, it would not be surprising to see Trump push for electorates to back ideological allies in the elections in Brazil, Peru and Colombia. This reflects a revived "Monroe Doctrine" under which Trump conceives of the Western Hemisphere as the US' sphere of influence.

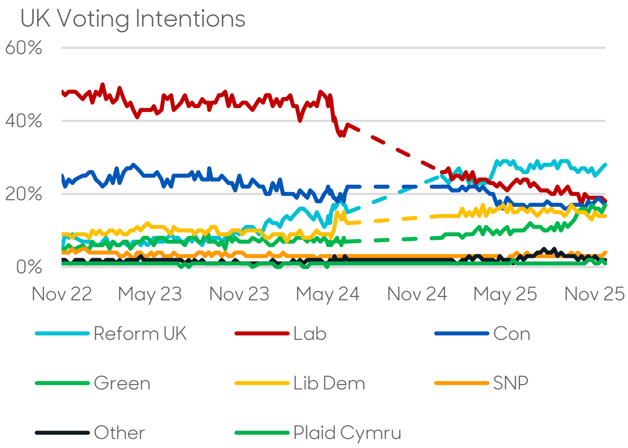
Recent US naval deployments in the Caribbean, which we expect to come to a head with military intervention in Venezuela, are another critical flashpoint.

Is there political leadership change coming in the UK?

May elections are a danger point for Prime Minister Keir Starmer.

The UK local and devolved elections will be a critical test for the government. Labour's polling has deteriorated, with the party losing half of the coalition that brought it to power last year (see Figure 7).

Figure 7: The UK Labour party has slipped significantly in the polls



Source: Aberdeen, Haver, December 2025

Our current expectation is that Labour underperforms but avoids full-scale collapse. However, a leadership challenge against Starmer (and by extension Chancellor Rachel Reeves) is a real risk, particularly if Reform performs well.

That would inject political uncertainty into the UK macro and market outlook. Some of the candidates to replace Starmer – such as former Deputy Prime Minister Angela Rayner or Mayor of Greater Manchester Andy Burnham (should he secure a parliamentary seat) – are perceived by markets as less committed to fiscal credibility, which could lead to an increase in gilt yields.

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