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Fog of war

Our baseline scenario, “Everything everywhere all at once”, sees the Iran conflict impart a large but short-lived shock, with inflation slightly higher, growth slightly lower, and the path of interest rates modestly tighter than otherwise would have occurred. However, now more than ever, we stress the risk distribution around this baseline. On top of “conflict risk dominates”, we add an even worse “stagflation” scenario. We keep “bond market rout”, “AI and capex collapse”, and add a new “AI eats all the jobs” downside. Alongside the existing “productivity rebound” upside, we add a new “fiscal expansion” scenario.

We would normally be issuing our Global Economic Outlook (GEO) at this point in the quarter, with detailed baseline economic forecasts and alternative scenarios. We have to condition on an oil futures curve to help generate the economic forecasts. We’ve gone through two sets of baseline re-specifications in the past week and then ripped them up. So rather than continue the fool’s game of writing down baseline economic numbers (even more than it normally is!) during a fast-moving geopolitical shock, we are instead sharing just the scenarios section of our usual GEO.

Our baseline scenario, “Everything everywhere all at once”, sees the Iran conflict impart a large but short-lived geopolitical shock lasting two to four weeks. We’ve conditioned on the average oil price over March being \$90 per barrel (which allows for spot to remain volatile in the coming days), falling to \$70 by the end of the year. As a result, 2026 average global inflation is 40bps higher, global growth 30bps lower, and a single rate cut for the likes of the Federal Reserve (Fed) and Bank of England (BoE) is taken out, relative to what would otherwise be the case. Once the geopolitical shock abates, the macro narrative returns to being one of decent-enough

growth, slightly above-target inflation, and modest further central bank easing in some economies. We put a 40% probability on this scenario playing out over our three-year forecast horizon.

Our “conflict risk dominates” scenario sees oil and gas flows through the Strait of Hormuz disrupted for months rather than weeks. We’ve conditioned on oil prices averaging \$120 over March, remaining above \$100 for six months, and still above \$80 by year-end. The recent experience of high inflation means inflation expectations are less well anchored than normal. So, central banks do not “look through” this shock, with cutting cycles abandoned and rate hikes in some cases, including in the Eurozone. We put a 30% probability on this scenario, but that may change rapidly.

We’ve added a “stagflation” scenario, which is an even larger oil price and broader supply chain shock. Non-linear oil price dynamics kick in, with limited storage capacity used up and production shutdowns not easy to reverse. We are using a \$180 average oil price over March, and a forward path that is still above \$100 by year-end.



Transport, chemical, fertilisers, and food production all experience a significant cost shock. Inflation spikes into the high single digits and doesn't return to 2% for several years. This tips the global economy into recession. Central banks are hiking rates multiple percentage points.

We are currently putting a 20% probability on this scenario, which is very large given the magnitude of the shock. However, if the conflict ends in the coming weeks, this downside risk could just as quickly drop out of our distribution.

Away from the Middle East, there are several other upside and downside scenarios we are considering.

In "AI and capex collapse", AI-related spending collapses, tech stocks fall sharply, and private credit defaults surge, triggering a US recession similar to the dotcom bust. US unemployment rises 2ppts, GDP declines 1.5% over three quarters, and sequential core inflation falls below 1%. The Fed eases policy sharply in response to the weaker growth environment, taking interest rates well below neutral. We give this a 15% probability.

Sharp-eyed readers may note this takes us above 100% – that's because we are no longer thinking of these scenarios as mutually exclusive, so they don't need to sum to 100%. Multiple shocks could play out at points over our three-year forecast horizon.

We've added a new downside called "AI eats all the jobs". This takes inspiration from the recent Citrini memo, but grounds the scenario in more internally coherent economic dynamics. Rapid advances in AI mean it substitutes for a wide variety of service-sector work, raising unemployment. Central banks are slow to react, perhaps because of a misdiagnosis that rising unemployment reflects a higher natural rate. Eventually, policy rates fall to the effective lower bound, but the economy is already in a liquidity trap. Fiscal positions deteriorate, as income tax takes decline. Low marginal propensities to consume mean the higher incomes enjoyed by capital owners are not spent on new wants and needs that would create new employment. US unemployment rises to 10%, GDP is contracting, and the fed funds rate is ultimately cut to zero. We put only a 5% probability on this scenario, because of the strong economic conditions that have to hold for it to occur.

In "bond market rout", the Warsh Fed rapidly shrinks the balance sheet, while fiscal easing in Japan and the

prospect of a new UK government cause market concerns. Active Fed bond sales start again, and investors become concerned that it will no longer backstop the market in future crises. In Japan, fiscal policy is eased significantly, while moral suasion to discourage the BoJ from tightening is interpreted as politicisation. And in the UK, a shift in fiscal strategy to allow for more deficit-financed government spending causes serious concerns about fiscal sustainability. All of this causes a large increase in term premia, with the yield curve aggressively steepening. We give this scenario a 10% probability because, while certain aspects of the scenario are plausible, it requires a much more dramatic shift in policy that does not itself respond to the market signal of higher yields.

In "productivity boom", US potential growth is boosted by AI and perhaps the supply-enhancing aspects of President Donald Trump's agenda. But there is no material increase in technological unemployment. Unit labour costs shrink, reducing inflationary pressures, and firms' profit margins widen, encouraging further investment in AI. US potential growth rises from under 2% to more than 3%. But the lower inflationary impulse allows the Fed to cut more rapidly. We have put a 20% probability on this scenario, as there are some early signs of AI boosting productivity, but the speed and extent of the boost would need to be much greater than currently visible in the data.

In our new "fiscal expansion" scenario, easier fiscal stances in the US, Eurozone, and Japan boost global growth and inflation, but also push up on policy interest rates and term premia. In the US, easier fiscal policy comes from corporates receiving rebates for the IEEPA tariffs, while the administration fails to rebuild the tariff wall to the pre-IEEPA strike-down level due to opposition in Congress. Stronger nominal US growth and labour market outcomes mean there are no Fed rate cuts this year. In Japan, Prime Minister Sanae Takaichi delivers a two-year suspension of the consumption tax on food. The Bank of Japan (BoJ) hikes rates four times this year. German fiscal easing comes online quicker than expected, and there is even higher defence spending with a greater emphasis on keeping the spending within Europe. We give this scenario a 15% probability, in part because it requires a relatively benign market reaction to more aggressive fiscal policy.



Everything everywhere all at once (base case) – 40%

The Iran conflict imparts a large but short-lived hit, with growth still solid, but inflation higher and the path of rates modestly tighter than it would have been

The Iran conflict lasts for two to four weeks, with the Strait of Hormuz closed for a relatively short period. This may be because the US and Israel are able to achieve their military objectives relatively quickly and declare victory, as in the case of the 12 Day War last year, or the prospect of a prolonged spike to energy prices means the US reins in its ambitions and is prepared to draw the conflict to a resolution quickly to avoid a large hit to the economy in the run-up to the mid-terms.

Elevated and volatile energy prices persist for the duration of the conflict, with oil prices around \$90 lasting for around a month or so (and temporary spikes higher possible), before returning to pre-conflict levels in the second half of the year (see Figure 1).

This puts upward pressure on inflation via fuel and household energy prices, but the extent of the shock is not enough to de-anchor inflation expectations, and corporates generally wear the hit to margins, while growth in energy importing countries in particular is weaker (see Figure 2).

Before the conflict, US growth looked to strengthening, with fiscal stimulus, still robust capex, and the impact of past monetary easing helping to boost consumption and sentiment. And this broad theme continues once the energy shock fades. Labour market data remain volatile, in part reflecting methodological changes, but also genuine underlying weakness.

But this weakness is not a trigger of recession, because it reflects weaker labour supply, ongoing post-pandemic labour market shedding, cuts to public sector employment, and early signs of AI productivity growth.

Meanwhile, the Trump administration manages to largely rebuild the tariff wall that existed prior to IEEPA strike-down through sections 301 and 122, so headline inflation takes time to return to 2%.

The Fed cuts once this year, with solid growth and higher inflation pressure. And Warsh makes very little progress on reducing the size of the balance sheet given institutional and behavioural hurdles in changing bank demand for reserves.

Chinese GDP growth comes in at 4.7%, in the middle of the new growth target. The anti-involution campaign deals with pockets of excess supply, but inflation remains weak due to supply bias of policy, and a stronger RMB and reserves offsetting the impact of the global energy price shock. Gradual policy easing continues.

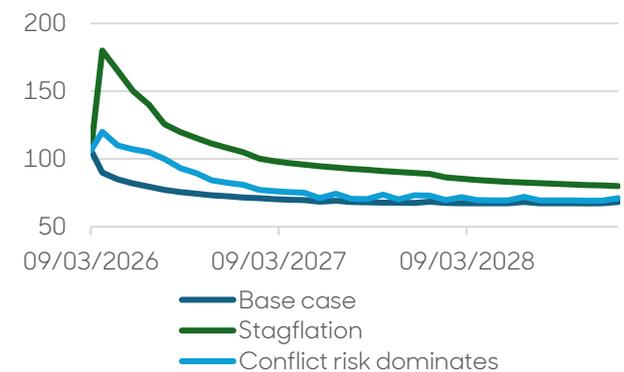
In Japan, the Takaichi government delivers less fiscal easing than promised during the election campaign or feared by the market, while continuing with supply enhancing reforms. Wage growth is solid, but the BoJ

remains somewhat concerned about underlying inflation pressures, so continues to tighten policy only modestly.

In the Eurozone, fiscal stimulus and strong real wage growth were set to boost growth this year. Higher energy prices mean that Eurozone inflation will no longer undershoot the European Central Bank (ECB)'s target but is set to rise to 2.4% this year. This is probably soft enough for the ECB to look through, so we continue to expect a hike in 2027, but hawkish dissent is likely to grow louder.

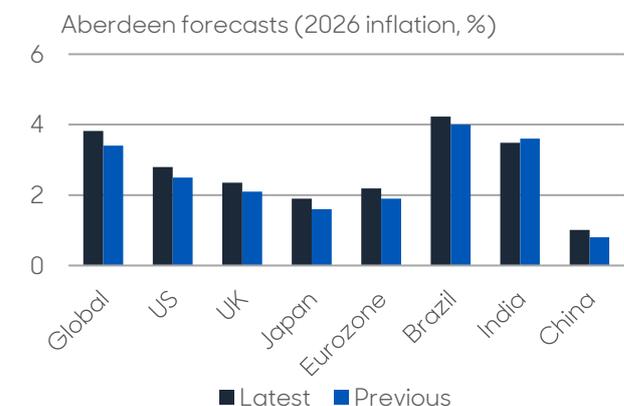
In the UK, inflation pressures from the energy shock are more acute given the structure of the market. So, despite the ongoing weakness in the labour market, BoE cuts are curtailed, with only two 25bps cuts this year. Meanwhile the prospect of a shift in fiscal strategy towards more deficit financed spending keeps upward pressure on gilt term premia.

Figure 1: In this scenario, we condition on oil prices remaining elevated for a month or so before gradually declining



Source: Aberdeen, Bloomberg, March 2026

Figure 2: The hit to energy prices from the Iran conflict puts upward pressure on our inflation forecasts



Source: Aberdeen, Haver, UBS, March 2026



Conflict risk dominates – 30%

The scale and duration of the US-Israel-Iran conflict shocks energy markets, pushing up on inflation and depressing private sector animal spirits

Financial markets are caught out by a much longer and far-reaching Middle East conflict or hit by other plausible spikes in geopolitical risk.

Oil and gas flows through the Strait of Hormuz are severely disrupted for months (see Figure 3), pushing oil prices above \$120pb. Global shipping, trade and supply-chain disruptions amplify the shock, amid re-routing, withdrawal of insurance, and cyberattacks.

A sustained conflict has spillovers for the Russia-Ukraine conflict too. Higher oil prices see Russian oil revenue increase. And Ukrainian allies find weapons stocks more constrained, limiting deliveries to the front line. An emboldened Russia increases hybrid attacks on NATO members, risking further sanctions in the process (see Figure 4).

Another possibility is that heightened tensions over Taiwan and the South China Sea, and a renewed deterioration in US-China relations, lead to shortages of semi-conductors, rare earths, and critical manufacturing components.

At its core this scenario represents a significant negative supply shock to the global economy, pushing inflation higher and growth lower.

The geopolitical shock also motivates rapid increases in defence spending, adding upward pressure on yields.

Heightened uncertainty (see Figure 5) weighs on corporate capital spending and hiring, while defence spending crowds out other government expenditure, contributing to a tepid growth backdrop.

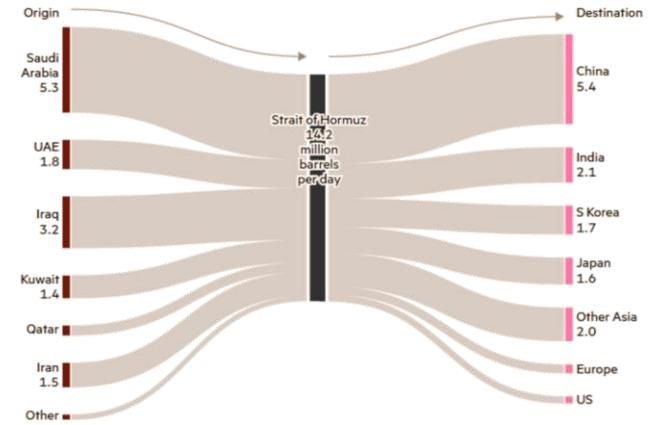
Higher inflation, risk and term premia more than offset the effects of weak growth, pushing yields higher while straining debt sustainability metrics.

The recent experience of high inflation means inflation expectations are less well anchored than normal. As such, central banks do not "look through" this shock, with cutting cycles abandoned and the return to rate hikes in some cases, including in the Eurozone.

Indicative economic shocks:

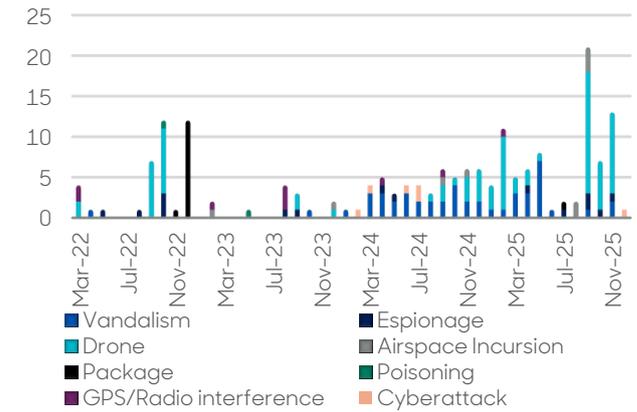
The US dollar and other safe-haven currencies strengthen, while emerging markets are put under pressure. In some cases, EM monetary policy is tightened despite the weaker activity backdrop and increased financial stress, which pushes down further on global growth.

Figure 3: The 14 mn barrels of oil per day transported through the Strait of Hormuz could be suspended for longer



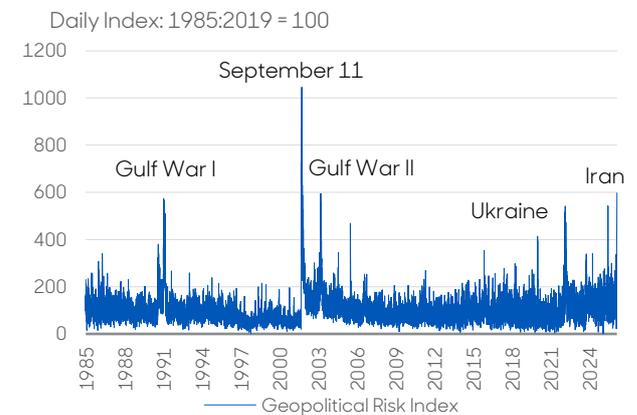
Source: Financial Times, March 2026

Figure 4: Suspected Russian sabotage attacks and drone incursions in Europe could increase further



Source: Aberdeen, ACLED, March 2026

Figure 5: Geopolitical risk has spiked and could move higher still in this scenario



Source: Aberdeen, Caldara & Iacoviello, March 2026



Stagflation – 20%

Oil spikes to \$180 and stays elevated, transmitting a profound stagflationary shock to the global economy. Renewed rate hikes despite global recession

The Strait of Hormuz remains closed for a sustained period, perhaps several months. Non-linear dynamics kick-in, with limited storage capacity used up and production shutdowns not easy to reverse in the short term. Strategic reserves are tapped but these are insufficient to the scale of the shock (see Figure 6), with countries scrambling for limited global supplies. Rationing and much higher prices persist for an extended period.

The initial spike in oil prices by itself pushes US headline inflation around 3ppts higher, with similar moves in other markets, albeit mediated through different fuel, household, and corporate energy pricing mechanisms.

Transport, chemical, fertilisers, and food production all experience a significant cost shock, with firms pushing through higher prices where they can, albeit in a less hot economy than was the case following the Ukraine shock in 2022, so margins are squeezed.

Inflation expectations are relatively weakly anchored given the relatively recent period of high inflation and the high salience of energy and food prices in forming household inflation expectations.

The US is a net energy producer, but any positive terms of trade hit is swamped by the hit to sentiment, real incomes, and corporate costs. For energy importing countries like Europe and Japan, the hit is even bigger.

Governments are under pressure to deliver energy support packages. But given stretched sovereign balance sheets this is much less comprehensive than in 2022 and instead focuses on supporting low-income households. Even these more limited policies lead to some concerns about fiscal trajectories.

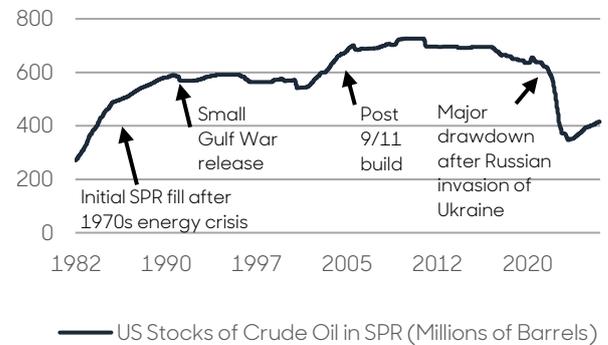
Central banks are unable to look through the inflation shock given the size of the hit and risk of sustained second round effects (see Figure 7). Central banks globally are forced to start tightening policy, once again pushing rates well above the equilibrium rate.

Indicative economic shocks:

Given the already somewhat weak position of the cycle and higher starting interest rates; the shock is more than sufficient to tip the global economy into recession. Inflation spikes and is not expected to return sustainably to 2% for several years.

Financial conditions tighten. Term premia increase in response to investors becoming more concerned about long run inflation and inflation volatility (see Figure 8). Equity prices hit by higher discount rates, weaker risk sentiment and earnings, although energy stocks significantly outperform. Dollar appreciates sharply.

Figure 6: Strategic oil reserves would be insufficient to offset a prolonged closure of the Strait of Hormuz



Source: Aberdeen, US Department of Energy, March 2026

Figure 7: A huge increase to energy prices could see "history rhyme" as inflation picks-up significantly again



Source: Aberdeen, Haver, March 2026

Figure 8: A sustained pick-up in inflation volatility would see investors demand higher term premia to hold bonds



Source: Aberdeen, Haver, March 2026



AI equity and capex collapse – 15%

AI-related spending collapses, tech stocks fall sharply and private credit defaults surge, triggering a US recession similar to the dotcom bust

After several years of intensive capital spend in AI infrastructure, including data centres, chips, and power projects, there is a collapse in investment spending as sentiment sharply reverses.

This could be because of mounting evidence that AI adoption is much slower and more limited in scope than assumed, an inability of AI hyper-scalers to continue earning positive returns on capital intensive spending, the sudden loss of a perceived moat in software companies as the so-called "SaaSacre" ramps up further, major AI "names" missing earnings expectations by a wide margin, or adverse regulatory intervention.

Mega-cap AI equities correct violently, which leads to wider contagion across equity markets (see Figure 9). Private credit and venture financing freeze, and credit spreads widen significantly.

Investment in servers, fabs, data centres, and power infrastructure falls off a cliff, leading to a sudden stop in the flow of investment which had previously helped support US GDP growth (see Figure 10). Hiring freezes first hit tech, professional services and specialised construction. This leads to wider layoffs as weakness in these high-wage sectors leads to weaker income growth and so adverse feedback loops throughout the rest of the labour market. Wealth destruction and weaker confidence lead to falls in durable and discretionary consumption.

Private credit funds, which have been an important financier of software and data centre capex, are particularly badly hit.

However, the AI bust does not cause a systemically threatening financial crisis like 2008. Instead, it is more like the 2001 dotcom bust (see Figure 11).

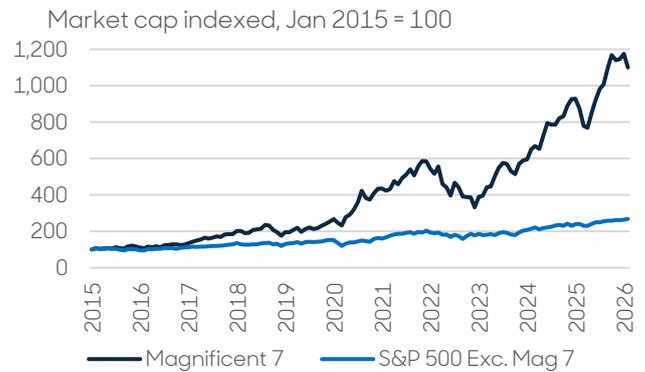
The losses faced by equity funds, venture capital and private credit are all significant, but these all sit outside the core nodes of the banking systems. So, there is not widespread maturity mismatch or destruction of value on the balance sheet of money-creating entities. And the collateral in wholesale funding markets is largely untouched by the shock, so there is no reassessment of what constitutes a safe asset.

Indicative economic shocks:

US unemployment rises 2ppts, GDP declines 1.5% over three quarters, sequential core inflation falls below 1%.

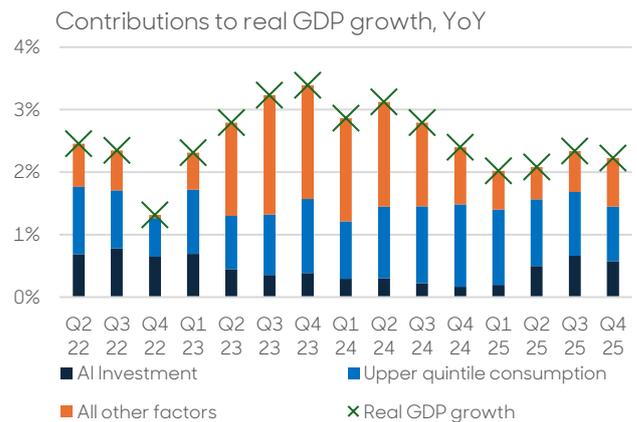
The Fed eases policy sharply in response to the weaker growth environment, taking interest rates well below neutral. The yield curve steepens. Dollar depreciates.

Figure 9: The "Magnificent 7" tech stocks have supported US equities, but this could reverse



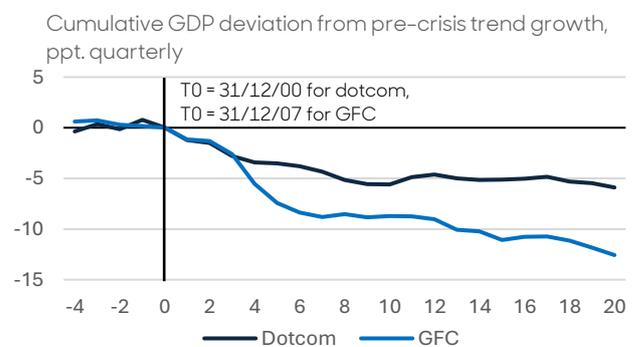
Source: Aberdeen, FactSet, March 2026

Figure 10: AI investment and wealth effects have boosted US GDP growth, so a collapse would weigh on growth



Source: Aberdeen, Haver, UBS, March 2026

Figure 11: The macro effects of a bursting of any AI bubble would probably look more like 2001 than 2008



Source: Aberdeen, Haver, March 2026



AI eats all the jobs – 5%

Rapid advances in agentic AI leads to widespread job losses. Inadequate policy responses mean this becomes a sustained downturn

Rapid advances in the abilities of agentic AI means that it can increasingly substitute for a wide variety of service-sector work, including high-paid knowledge-intensive employment (see Figure 12).

The corporate moats of software firms evaporate as AI allows companies to develop systems in-house at much lower cost. But across customer service, legal, finance, marketing, and other sectors, AI systems increasingly synthesise data, generate outputs, and take decisions with minimal human oversight.

The rise in technological unemployment among previously well-paid and high-spending households sees demand weaken, in turn causing more widespread cyclical unemployment even in industries not directly exposed to AI automation.

Delinquencies on mortgages and other household borrowing increase, impairing bank balance sheets and limiting their ability to provide credit. Meanwhile, private credit lenders with large exposure to software and datacentres see a big rise in defaults (see Figure 13).

Central banks are slow to react in the short-term, perhaps because of a misdiagnosis that rising unemployment reflects a higher natural rate of unemployment, or uncertainty about the sign of the move in equilibrium interest rates. Eventually, policy interest rates fall to the effective lower bound, but this is insufficient to adequately stimulate demand because the economy is already in a liquidity trap.

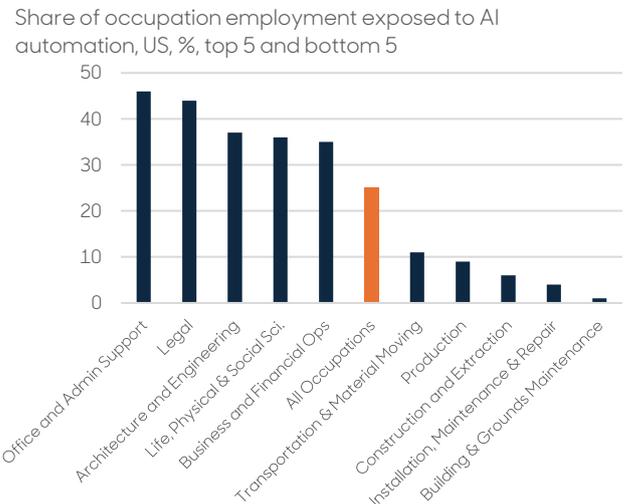
Government fiscal positions deteriorate, as income tax takes decline. The tax base does not pivot quickly enough to capital amid lobbying and vested interests. This prevents material fiscal stimulus to support demand. Meanwhile, labour market retraining and reallocation mechanisms are too slow for the speed of this technological transition.

Low marginal propensities to consume mean that the higher wealth and real incomes enjoyed by capital owners are not spent on new wants and needs that would then create new employment and industries. Therefore, the process of "creative destruction", which has in the past seen productivity shocks translate into widespread improvements in living standards, does not operate (see Figure 14).

Indicative economic shocks:

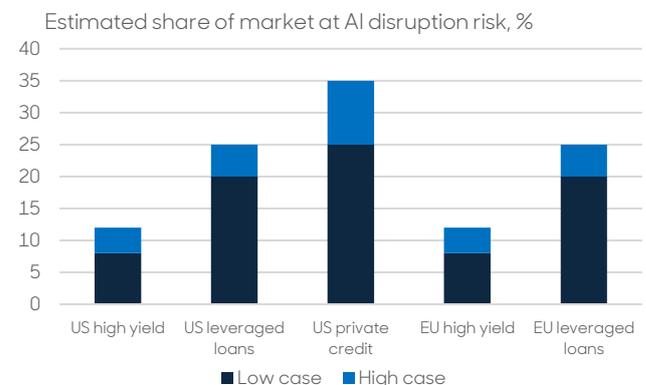
US unemployment rises to 10%, GDP is contracting, and the fed funds rate is ultimately cut to zero. Other service-heavy economies such as in Europe and the UK are hard hit, while manufacturing-intensive economies are relatively more resilient but still worse off.

Figure 12: The range of tasks amenable to rapid replacement by AI could turn out to be extremely wide



Source: Aberdeen, Goldman Sachs, March 2026

Figure 13: Private credit exposed to data centres and software would be hit heavily in this scenario



Source: Aberdeen, UBS, March 2026

Figure 14: No structural rise in unemployment from past innovations, but AI could be different



Source: Aberdeen, Bank of England, March 2026



Bond market rout – 10%

The Warsh Fed moves to rapidly shrink the balance sheet, while fiscal easing in Japan and prospect of a new UK government causes market concerns

Under Kevin Warsh, the Fed rapidly moves to deliver the regulatory and institutional shifts needed for the Fed to be able to manage policy with a radically smaller balance sheet. So, while money markets remain under control, investors start to anticipate the prospect of significant treasury sales by the Fed, causing financial conditions to tighten (see Figure 15).

Indeed, the market becomes concerned that the Fed will not only pursue a smaller balance sheet in current conditions, but will also be unwilling to use its balance sheet to cushion the shock of future crises. The increased probability of a more limited Fed backstop causes the equity risk premia to rise, even if there is no immediate need for such a backstop.

Warsh argues that the impact of bond sales can be offset by lower policy rates, causing the yield curve to steepen further. The market interprets this as a policy mix lacking credibility. Inflation expectations increase, putting further upward pressure on term premia and yields.

Meanwhile, the prospect of Christine Lagarde's term as ECB president coming to a premature end leads to speculation about the next ECB president also having hawkish views on the balance sheet. This causes the bond curve to steepen and peripheral spreads to widen sharply as markets come to doubt the future of the ECB's various crisis fighting tools (see Figure 16).

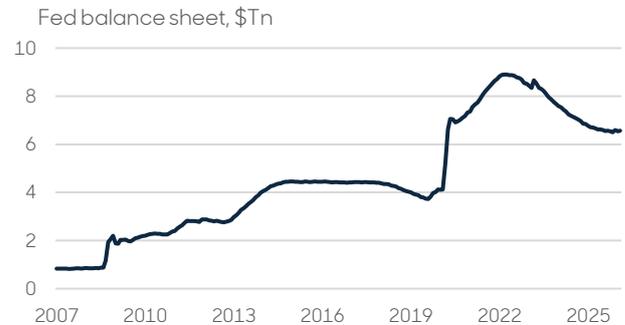
In Japan, the government delivers the full consumption tax cut promised in the recent election campaign and significantly increases defence spending in light of elevated geopolitical risk. Through a combination of appointments and moral suasion, the BoJ is put under major pressure to not increase interest rates. Long-end JGBs sell off sharply in response to higher inflation and deficits (see Figure 17), while verbal intervention by policymakers is insufficient to support the yen.

Finally, in the UK the prospect of a shift towards deficit-financed fiscal easing under the current or future Labour government leads to a sharp rise in gilt yields and investors become concerned about the UK's precarious international financing position.

Indicative economic shocks:

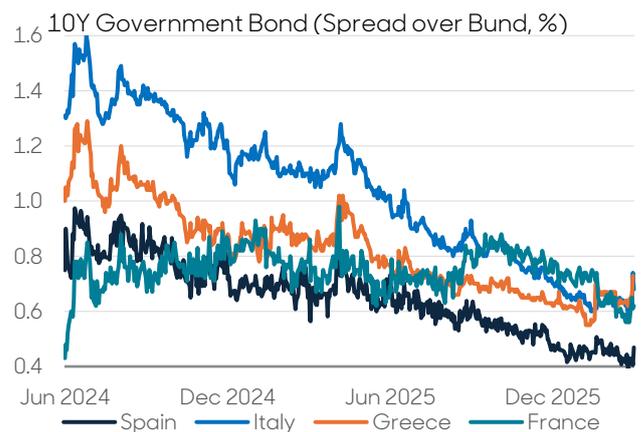
Front-end yields fall in the US, but long-end yields in the US and other developed markets rise sharply. Financial conditions tighten. Dollar appreciates.

Figure 15: The Fed balance sheet has started to expand again, but this could reverse under Warsh



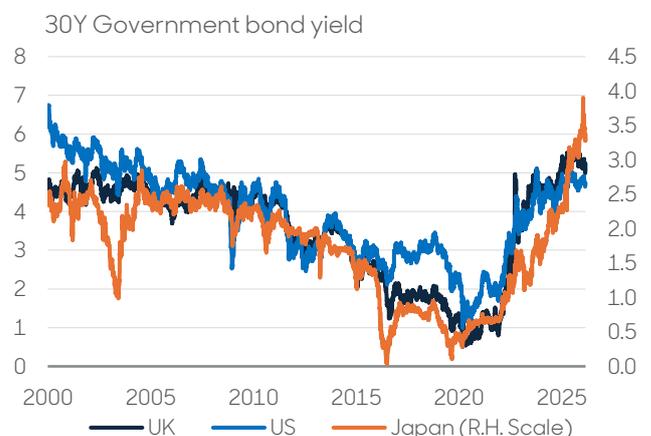
Source: Aberdeen, Haver, March 2026

Figure 16: Peripheral spreads would widen sharply if markets came to doubt ECB backstop



Source: Aberdeen, Haver, March 2026

Figure 17: Reduced inflation credibility and fiscal pressures could cause long-dated yields to rise further



Source: Aberdeen, Haver, March 2026



Productivity boom – 20%

US potential growth boosted by AI and perhaps the supply enhancing aspects of Trump’s agenda. Growth higher, but inflation and interest rates lower

The US enjoys a positive supply shock, pushing up on growth and down on inflation pressures. A key driver of this is the productivity gains from AI starting to hit the economy more rapidly than expected (see Figure 18).

Output rises much faster than hours worked, both through automation of existing roles and boosting the productivity of workers. Hiring shifts towards AI-complementary roles, while admin, support, and repeatable tasks see layoffs.

But at the aggregate level, there is no material increase in technological unemployment. Indeed, vacancy durations might shrink, as AI raises the matching efficiency of the labour market (see Figure 19). And higher real incomes are recycled into new wants and needs, creating new industries and jobs.

Unit labour costs shrink, reducing inflationary pressures, and firms’ profit margins widen, encouraging further investment in AI. There is a boom in intangible capex demand including on software and R&D, while demand for data centres, chips, and energy picks up further.

Supply boosting aspects of Trump’s policy agenda are also supportive.

Deregulation of financial services, the anti-trust regime, and the permitting system all help to boost corporate profitability and investment (see Figure 20). Domestic energy production increases, putting downward pressure on energy prices. Personal and business tax cuts provide greater incentives to increase labour supply and the capital stock.

Tariff rates fall over time as the Trump administration fails to fully rebuild the tariff wall in place prior to the IEEPA strike-down. This may be because the administration struggles to find a legal basis for sustainably higher tariffs or lacks the political will in the context of rising cost-of-living concerns in the run-up to the midterms.

The inflationary impact in the labour market of reducing migration is more than outweighed by lower demand in the housing market.

Indicative economic shocks:

US potential growth rises from under 2% to more than 3%.

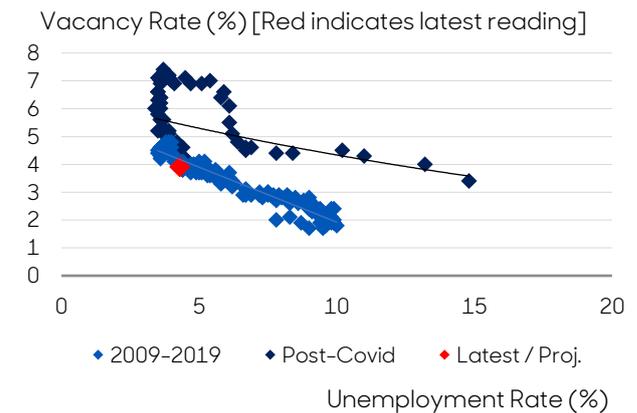
But the lower inflationary impulse allows the Fed to cut more rapidly, further boosting activity growth as demand expands into the extra supply capacity. Over the medium term, higher productivity growth puts upward pressure on r^* .

Figure 18: Productivity growth could strengthen if the benefits of AI are realised more rapidly



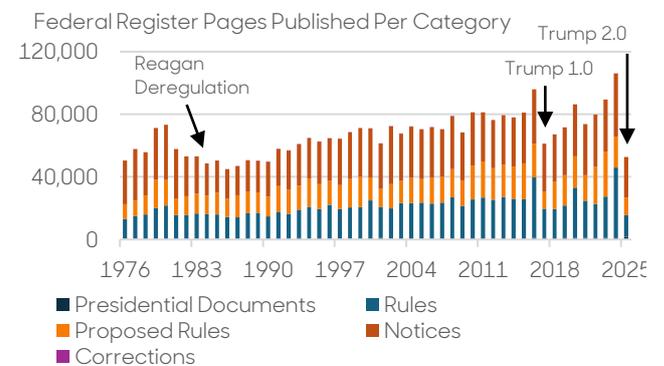
Source: Aberdeen, FRBSF, Haver, March 2026

Figure 19: No sign of technological unemployment in labour market efficiency, and AI could improve matches



Source: Aberdeen, Haver, March 2026

Figure 20: Trump’s supply-side agenda, including deregulation, could also boost supply



Source: Aberdeen, Federal Register, March 2026



Fiscal expansion – 15%

Easier fiscal stances in the US, Japan and Europe boost growth, but also raise inflation and interest rates

US tariff rates never return to the pre-IEEPA strike-down levels (see Figure 21). Section 122 tariffs are allowed to lapse after 150 days due to lack of political support in Congress. And section 301 investigations take longer and lead to narrower tariffs than expected.

Meanwhile firms receive rebates from previously paid IEEPA tariffs. This amounts to a fiscal stimulus of around \$200 billion (0.8% GDP). And, while the demand multipliers on corporate tax cuts are typically small, buoyant investment sentiment and reduced tariff uncertainty cause a large pick-up in capex and hiring.

The boost to demand is much greater in the short term than any increase in supply from lower tariffs and higher investment, leading to an increase in inflation pressures.

Stronger growth and higher inflation assuage any lingering Fed concerns about the labour market, while making it harder for Warsh to argue that there is a disinflationary supply shock. No Fed rate cuts this year.

In Japan, the Takaichi government delivers the proposed two-year suspension of the 8% consumption tax on food (0.7% of GDP). Other cost-of-living support measures are announced, and defence spending increases.

Cutting consumption tax mechanically reduces headline inflation but boosts underlying inflation pressures. With the deflationary mindset firmly banished, consumers boost consumption and a tight labour market pushes up further on wage growth.

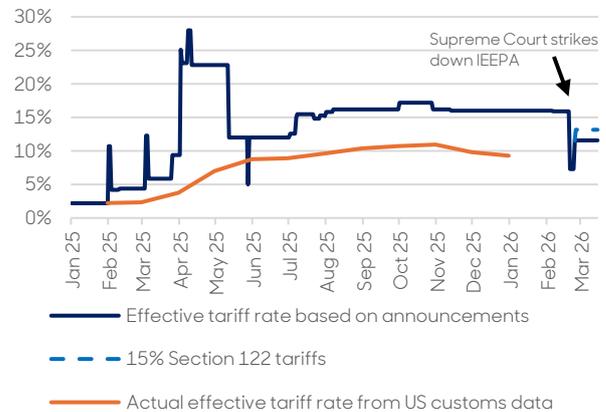
Expectations of stronger nominal GDP growth sees the Japanese bond curve steepen and cause the BoJ to hike rates four times this year (see Figure 22).

German fiscal easing comes online quicker than expected, boosting growth this year (see Figure 23). Broader geopolitical concerns mean Europe increases defence spending more than currently planned, with even greater emphasis on keeping the spending within Europe to boost its strategic autonomy.

Indicative economic shocks:

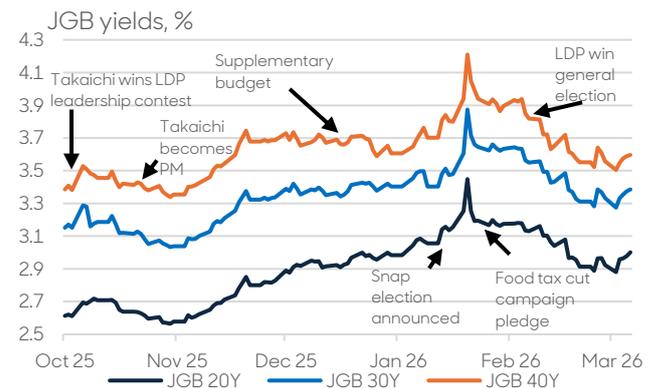
Stronger US, Japanese and European growth and inflation. This boosts risk sentiment and equities despite higher debt issuance. Commodities are also higher. Front end yields up and curves bear steepen.

Figure 21: Political and legal concerns could stop tariff rates from returning to pre-IEEPA strikedown levels



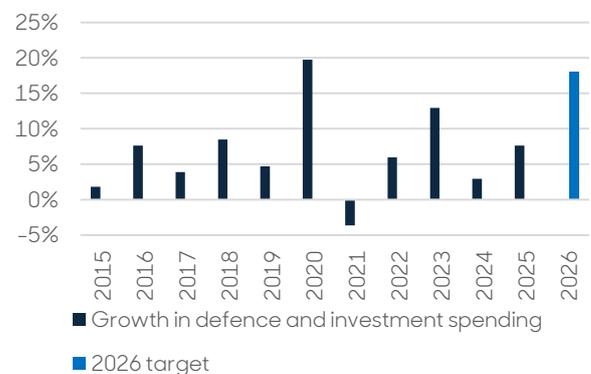
Source: Aberdeen, The White House, US Census Bureau, March 2026

Figure 22: JGB curve would likely steepen on easier fiscal policy, but rate hikes could contain the move



Source: Aberdeen, Haver, March 2026

Figure 23: If delivery risks are avoided, then German government spending set to significantly increase



Source: Aberdeen, Haver, March 2026



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