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## Global Economic Scenarios

Our baseline “TACOil” scenario incorporates de-escalation in the US-Iran conflict and a continued tailwind from AI capex. Global growth is close to trend, there is a temporary inflation increase, but the Fed is on hold this year and cuts next year. Our scenario distribution includes “closure risk dominates” and a residual risk of “stagflation”, as the energy shock could return. AI is the other key risk dimension, with possible downsides both from “AI and capex collapse” and “AI eats all the jobs”, but an important upside in “productivity rebound”. We also consider the downside risks of “bond market rout” and a US-China “technological decoupling” and the upside of “fiscal expansion”.

Our baseline scenario, “TACOil”, involves a continued de-escalation in the US-Iran conflict, with the Strait of Hormuz gradually reopening over the coming months. We have conditioned on oil prices falling back through the second half of the year, ending 2026 around \$70 per barrel.

The initial energy shock has already pushed headline global inflation higher, and some modest second round effects are likely. Inflation therefore remains somewhat elevated in the near term, weighing on real incomes, but without triggering a broader de-anchoring of expectations (see Figure 1).

The drag from higher energy prices is sufficient to slow activity, but not to derail the expansion (see Figure 2). Several offsetting forces keep global growth around trend. AI-related capex remains strong in the US, supporting exports in parts of Asia. Fiscal policy is a tailwind in the US, Japan, and Europe. At the same time, the fading of US tariff uncertainty, a broadly resilient Chinese economy, and still-accommodative financial conditions all help underpin demand.

In this environment, the Federal Reserve (Fed) and Bank of England (BoE) remain on hold this year, with a return to rate cuts next year. The European Central Bank (ECB) does not deliver any further hikes this year, while the

Bank of Japan (BoJ) lifts rates twice more in October and January. Overall, we give this scenario a 65% probability.

Despite the latest diplomatic progress, we continue to assign material probability to scenarios in which the Iran-related energy shock proves more persistent.

In “closure risk dominates”, negotiations stall and the strait remains effectively closed, even in the absence of renewed escalation. We have conditioned on oil prices grinding higher, potentially back towards \$120.

In this scenario, the inflation shock is both larger and more persistent, making it harder for central banks to look through it, with the Fed hiking once this year. We give this scenario a 25% probability.

A more extreme version of this dynamic is captured in our “stagflation” scenario. Here, a prolonged disruption to flows through the Strait of Hormuz, potentially amid a return to hot conflict, generates acute commodity shortages, pushing oil prices to around \$150.

The shock propagates through global supply chains, creating a sharp inflationary impulse alongside a contraction in activity. The global economy falls into recession even as inflation rises materially.



This is a particularly adverse combination for risk assets, given the limited scope for monetary policy support.

We think the probability of this outcome has declined in recent weeks, in line with signs of de-escalation, but it remains a key tail risk given the non-linear nature of energy markets. We give it a 10% probability.

Alongside geopolitics, the other main axis of uncertainty in our scenarios is AI (see Figure 3).

In "AI and capex collapse", spending on AI-related investment falls sharply, triggering a reassessment of valuations in the technology sector. Tech equities decline, financial conditions tighten, and private credit defaults increase. This could be because of weaker-than-expected monetisation, a reassessment of competitive moats, regulatory intervention, or investors becoming concerned about exuberance following the recent blockbuster tech IPOs.

Ultimately the shock causes a US economic downturn, similar to the dotcom bust, with the Fed easing policy materially. We give this scenario a 15% probability, and it is a key risk given current market pricing.

At the other end of the spectrum, our "productivity boom" scenario sees AI deliver a meaningful uplift to potential growth, particularly in the US. Firms successfully deploy AI without significant labour market disruption, allowing unit labour costs to fall and profit margins to expand.

The result is a combination of stronger growth and lower inflation. This creates space for a larger central bank easing cycle, justified by improved supply-side performance rather than cyclical weakness. Early evidence on the productivity gains from AI is somewhat encouraging, and we increased the probability of this scenario to 25%.

We also consider a more disruptive downside in "AI eats all the jobs". In this scenario, the pace and breadth of automation are sufficient to generate a sustained rise in unemployment. The policy response is slow or insufficient, and the hit to household income leads to weaker demand, which in turn causes a rise in cyclical unemployment. Overall, the economy enters a prolonged economic downturn with significantly elevated unemployment.

Economic history suggests such outcomes are unlikely absent major policy errors, which is why we assign it a probability of only 5%. But the scenario does highlight the potential for AI to create adverse distributional dynamics even as aggregate productivity rises.

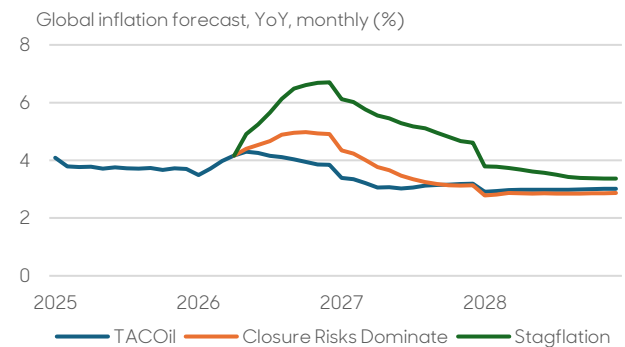
Away from the energy and AI dimensions, several additional scenarios shape the wider distribution.

In "technological decoupling", a sharper fragmentation between the US and China leads to a more bifurcated global economy, with efficiency losses and upward pressure on costs. We give this a 10% probability.

In "fiscal expansion", expansionary fiscal policy across the major economies boosts growth, but also raises inflation and pushes up both policy rates and term premia. We assign a 10% probability to this scenario, as the path to fiscal easing in some countries, the US in particular, has narrowed.

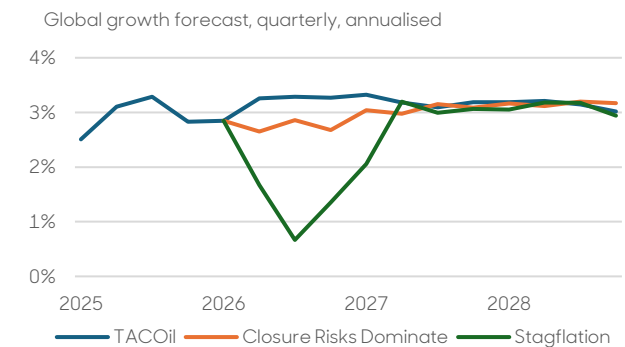
And in "bond market rout", a combination of more aggressive balance sheet reduction from the Fed and concerns around fiscal sustainability in the UK and Japan leads to a sharp rise in yields, tightening financial conditions independently of central bank rate moves. We put a 10% probability on this scenario as Kevin Warsh is unlikely to be able to push through aggressive balance sheet reduction in the near term.

**Figure 1: Inflation has a temporary bump higher in TACOil but would be much higher if the energy shock re-erupts**



Source: Aberdeen, Haver, June 2026

**Figure 2: Global growth will be around or even slightly above the 3% trend rate in TACOil**



Source: Aberdeen, Haver, June 2026

**Figure 3: AI is the other key risk dimension, with various equity and economic outcomes possible**

		Equity market impact	
		Positive	Negative
Productivity impact	High	Productivity boom	AI eats all the jobs
	Low	-	AI equity and capex collapse

Source: Aberdeen, June 2026



## TACOil – 65%

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

There is a near-term deal between the US and Iran to extend the ceasefire and re-open the Strait of Hormuz to shipping traffic, or markets retain a substantial hope thereof, even in the absence of a signed agreement.

Either way, the conflict-related peak in oil prices is in the past. The specific conditioning path, for the purposes of generating a set of economic forecasts, is for oil to be around \$90 per barrel in June, around \$70 by the end of 2026, and in the \$60s during 2027 (see Figure 4).

But adverse economic impacts, relative to the no-war counterfactual, are already baked in. Headline inflation has increased in many economies due to higher energy prices, and there are likely to be some modest second-round effects. But the extent of the shock is not enough to de-anchor inflation expectations (see Figure 5).

The squeeze on real incomes and higher input costs weighs on global economic activity over H2. But there are still significant tailwinds to activity from: AI-related capex supporting the US and Asia; fiscal expansion in the US, Japan and Europe; fading US tariff uncertainty and the recent bounce in the US labour market; a resilient China drawing on its significant oil reserves and benefiting from stronger green tech demand; and accommodative financial conditions globally.

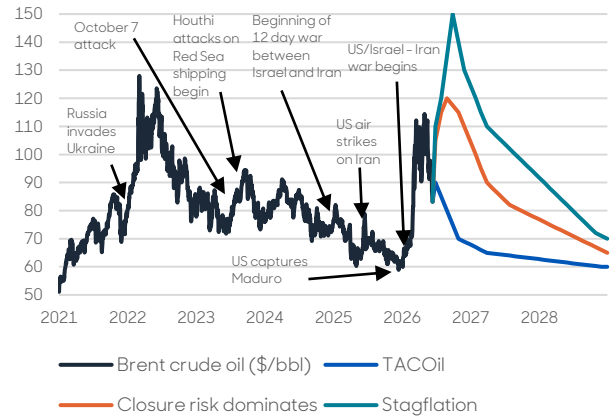
### Indicative economic and market shocks:

In short, global growth is 3.2% over 2026, close to our estimate at the start of the year, because upgrades from the various tailwinds have broadly offset downgrades from the energy shock. Global inflation is 4.3% over 2026, up from the 3.4% we forecast pre-war.

The path of monetary policy is tighter than what it looked likely to be at the start of the year. But for the likes of the Fed and BoE, this means delaying additional rate cuts into 2027, given that policy is still tight relative to neutral. There are no further hikes from the ECB over H2 2026, because of the growth deterioration that is also occurring alongside the inflation increase. But after the June hike, the BoJ hikes again in late 2026 and early 2027.

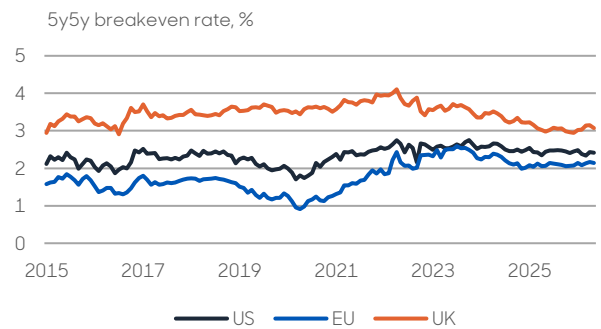
Inflation expectations moderate, oil prices fall, and risk sentiment is positive. However, markets continue to adapt to the underlying changes in the macro environment, including structurally higher geopolitical risk (see Figure 6), more inflation volatility, higher defence spending, and shortening supply chains. Bond term premia keep rising, while bond-equity correlations are increasingly positive.

Figure 4: Oil prices could decline back to the \$70s next year



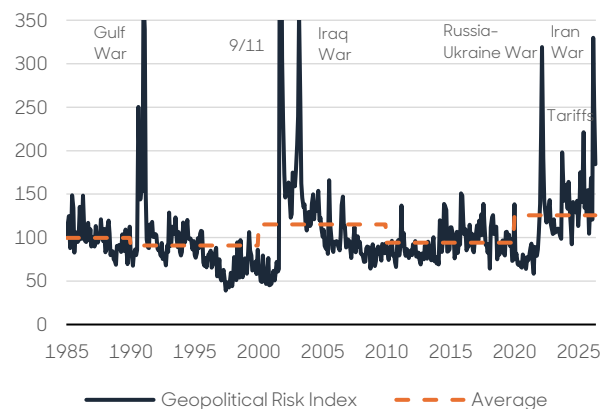
Source: Aberdeen, Factset, June 2026

Figure 5: Inflation expectations remain well anchored, which should allow the Fed and BoE to 'look through' the shock



Source: Aberdeen, Haver, June 2026

Figure 6: Geopolitical risk will remain structurally higher, influencing asset prices and correlations



Source: Aberdeen, Haver, June 2026



## Closure risks dominate – 25%

US-Iran negotiations hit a diplomatic impasse, keeping the strait closed even if the ceasefire holds. Markets discount talk of a deal, and oil moves higher

Negotiations between the US and Iran fail to deliver a meaningful reopening of the Strait of Hormuz to shipping traffic (see Figure 7).

This could be because Israel continues attacks against Hezbollah, Iran is unwilling to scale back its nuclear programme or relinquish control over the Strait of Hormuz, or the Trump administration cannot sell a deal as a "win" domestically. Either way, recent diplomatic progress breaks down.

Alternatively, diplomatic progress could be sustained, but the actual re-opening of the strait itself is virtually non-existent, amid concerns about mines, ships being out of place, or a lack of Middle East oil and gas production due to lasting infrastructure damage.

Oil prices grind higher from \$100 to \$120 per barrel over coming months, with the futures path remaining high, as market hopes for diplomatic progress wane (see Figure 8) and strategic reserves run out. That said, there is some increase in Russian and US shale production that prevents an even bigger rise in prices (see Figure 9).

Eventually, economic pressures could create the conditions for a deal, either by a return to diplomatic compromise, or via a return to hot conflict.

### Indicative economic and market shocks:

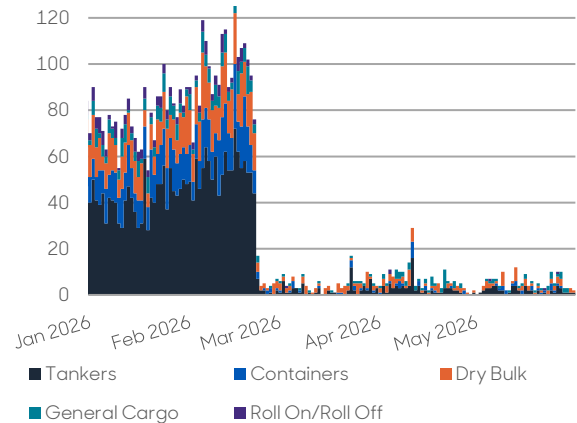
Headline global inflation is around 50-70 basis points higher over 2026 and 2027 as a whole relative to the "TACOil" scenario. There is also slightly more in the way of second round effects.

Higher energy inflation, lingering uncertainty, higher risk premia and more adverse debt dynamics all make it harder for central banks to "look through" this prolonged shock, delaying a return to rate cuts or hastening hikes. The Fed hikes once this year, and only returns to cuts late in 2027.

Global growth is 20-30 basis points weaker in 2026 and 2027 compared to "TACOil", as real incomes are squeezed, and uncertainty and higher rates constrain investment.

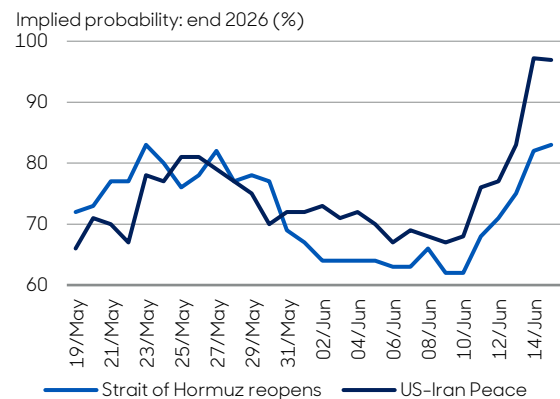
Equities decline, particularly in energy-importing regions, while bond yields rise at the front end and curves flatten as policy remains tight. Volatility rises as markets grapple with ongoing uncertainty and conflicting headlines. The US dollar strengthens versus cyclical, and energy prices remain elevated.

**Figure 7: Strait traffic is likely to recover only slowly even in the best case, and this process could be much slower**



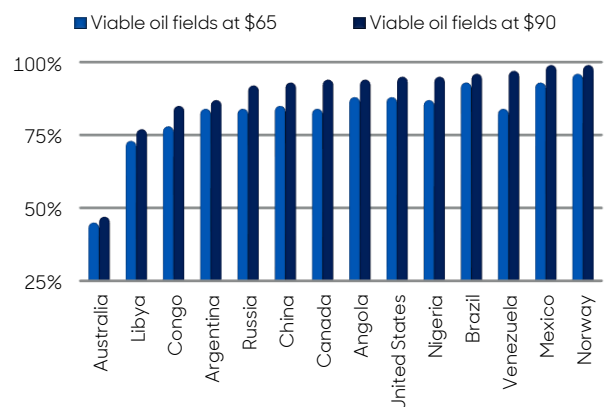
Source: Aberdeen, IMF PortWatch, Morgan Stanley, June 2026

**Figure 8: Prediction markets think Strait reopening is less likely than peace, and could become more concerned**



Source: Aberdeen, Polymarket, Kalshi, Bloomberg, June 2026

**Figure 9: More elastic supply and demand could help delay a bigger reckoning in the oil market**



Source: Aberdeen, ObservableHQ, The Economist, June 2026



## Stagflation – 10%

Oil spikes to \$150 and stays elevated, transmitting a stagflationary shock as supply chains break down. Rates are hiked, cementing a global recession

The US-Iran conflict resumes, additional damage occurs to Middle East oil and gas production facilities, and the Strait of Hormuz remains closed for a long time.

The factors that have kept oil prices relatively contained during the conflict so far fade. Strategic petroleum reserves in the US, China and elsewhere are exhausted (see Figure 10). The substantial hopes of eventual de-escalation and reopening of the strait embedded in oil futures markets evaporate.

A big non-linear increase in oil prices occurs, with prices rising as high as \$150 dollars per barrel.

Even if sharply higher prices prove the pre-condition for an eventual diplomatic off-ramp, infrastructure damage, a heavily mined strait and the need to rebuild oil reserves mean the eventual fall in prices is gradual.

Supply shortages bind across transport, chemicals, fertilisers and other products. Our Supply Chains Conditions Index rises close to the peaks following the pandemic (see Figure 11).

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.

The spike in oil prices causes second round effects as inflation expectations are weakly anchored given the recent period of high inflation and the salience of energy and food prices in forming household expectations.

Average inflation over 2026 is over 100 basis points higher than the "TACOil" base case in the US, and more than 200 basis points higher in the UK and Eurozone.

Governments are under pressure to deliver energy support packages. But stretched sovereign balance sheets add to bond market concerns.

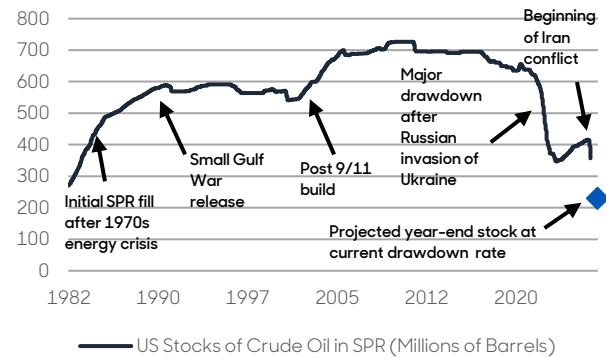
### Indicative economic and market shocks:

The oil shock is more than sufficient to tip the global economy into recession. Inflation spikes and does not return sustainably to 2% for several years.

Central banks are unable to look through the inflation shock given the size of the hit and risk of second round effects (see Figure 12), so start tightening policy, once again pushing rates well above the equilibrium rate.

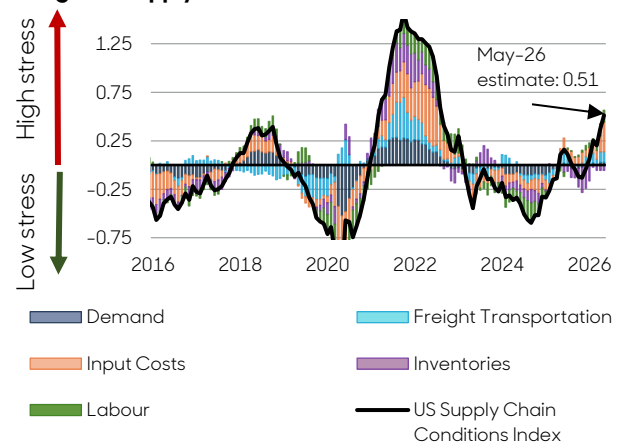
Financial conditions tighten. Term premia increase in response to investors becoming more concerned about long-run inflation, inflation volatility and fiscal trajectories. Equity prices are hit by higher discount rates, weaker risk sentiment and earnings, although energy stocks significantly outperform. The dollar appreciates sharply.

**Figure 10: Strategic oil reserves could be insufficient to offset a prolonged closure of the Strait of Hormuz**



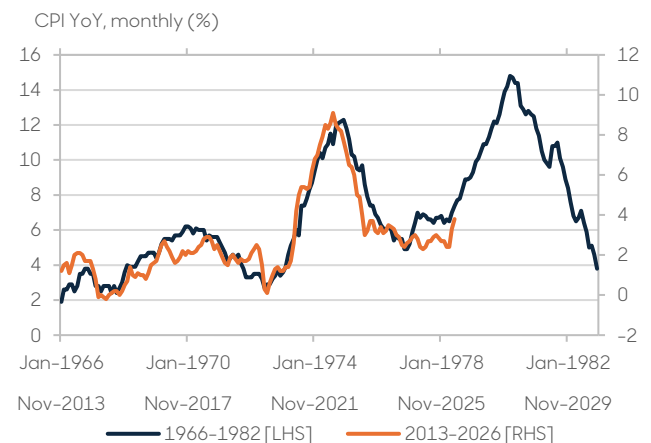
Source: Aberdeen, US Department of Energy, June 2026

**Figure 11: A very prolonged closure of the strait would strain global supply chains**



Source: Aberdeen, Haver, June 2026

**Figure 12: A huge increase to energy prices could see "history rhyme" as inflation picks-up significantly again**



Source: Aberdeen, Haver, June 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 due to a variety of reasons: AI adoption is more limited and monetisation more difficult than investors currently assume; large tech IPOs trigger investor worries about market exuberance and having to digest additional issuance (see Figure 13); model breakthroughs reduce compute requirements making hyper-scaler capex look excessive; the sudden loss of perceived moats around software companies as the "SaaSacre" deepens; or adverse regulatory intervention.

Either way, mega-cap AI equities correct violently, which leads to wider contagion across equity markets, many sectors of which have been supported by the broader AI build-out (see Figure 14). Private credit defaults increase, venture financing freezes up, and credit spreads widen significantly.

Investment in servers, fabs, data centre construction, and power infrastructure falls off a cliff, leading to a sudden stop in the flow of investment that had previously helped support US GDP growth (see Figure 15). Hiring freezes first hit tech, professional services and specialised construction. This leads to wider layoffs as weakness in these high-wage sectors means 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.

However, the AI bust does not cause a systemically threatening financial crisis like 2008, given that losses faced by equity funds, venture capital and private credit sit outside the core nodes of the banking system. Instead, the resulting recession looks more like the 2001 dotcom bust.

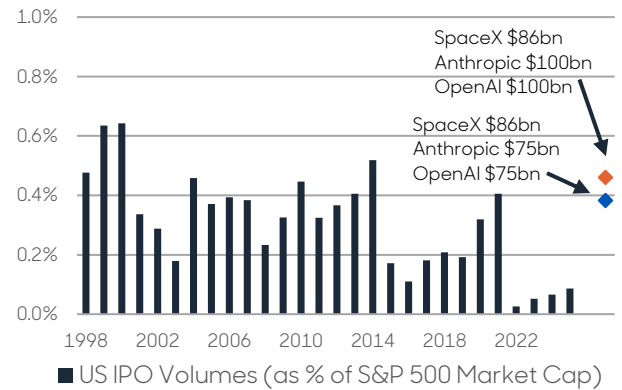
### Indicative economic and market shocks:

US GDP declines around 1.5% over three quarters, unemployment rises 2ppts, and sequential core inflation falls below 1% as demand weakens and excess capacity emerges.

The Fed eases policy sharply in response to the weaker growth environment, taking the fed fund rate down to 2%, which is well below neutral.

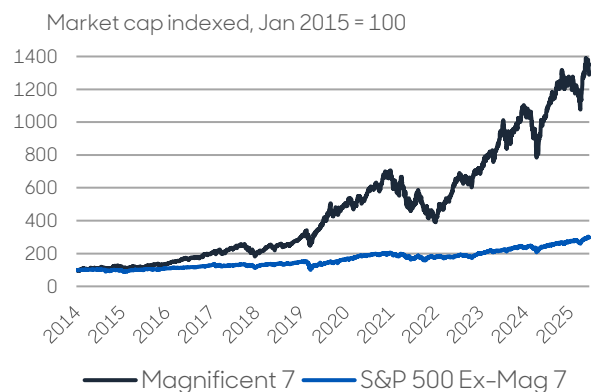
Equities decline sharply, particularly in technology sectors, while bond yields fall and curves steepen. Safe-haven currencies strengthen, and industrial commodity prices decline.

**Figure 13: 2026 IPO volumes will be much higher than recent years, and could cause a reassessment of the AI trade**



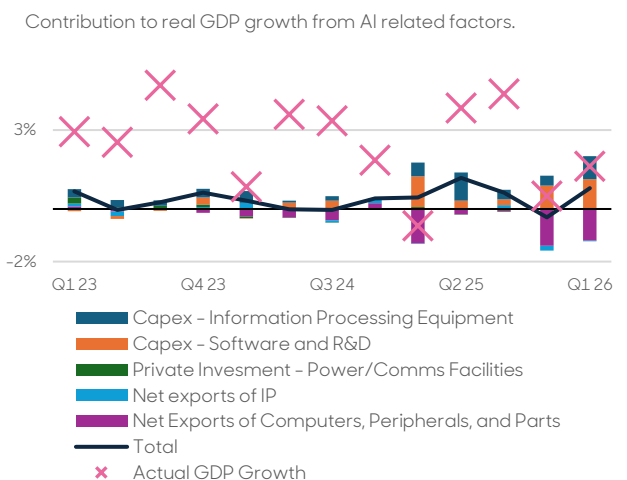
Source: Aberdeen, ASR, June 2026

**Figure 14: The "Magnificent 7" tech stocks have supported US equities, but this could reverse**



Source: Aberdeen, FactSet, June 2026

**Figure 15: AI investment (properly accounted for) has boosted US GDP growth, so a collapse would be a big drag**



Source: Aberdeen, Haver, June 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 agentic AI mean it can substitute for a wide variety of service-sector work, including high-paid knowledge-intensive employment (see Figure 16).

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

The rise in graduate unemployment (see Figure 17) broadens into generalised technological unemployment among previously well-paid and high-spending households. Aggregate demand weakens, 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. Private credit lenders with large exposure to software and datacentres see a big rise in defaults.

Central banks are slow to react, 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 rates fall to the effective lower bound, but this is insufficient to adequately stimulate demand.

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 fiscal stimulus to support demand. Labour market retraining and reallocation mechanisms are too slow for the speed of technological transition.

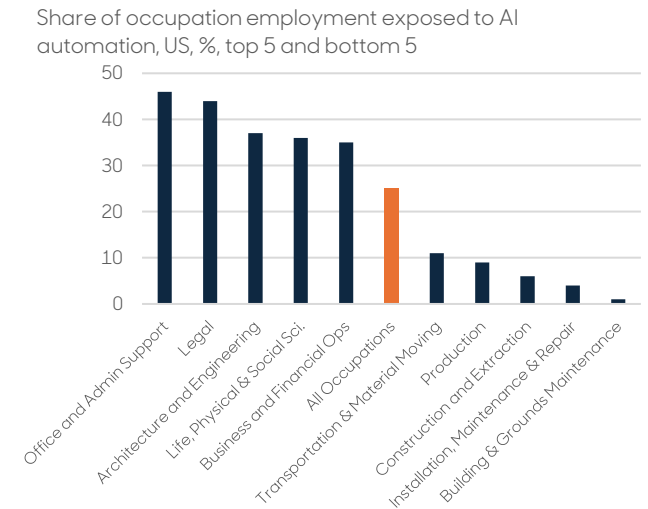
Low marginal propensities to consume mean the higher wealth and real incomes of capital owners are not spent sufficiently to create new employment and industries. The economy moves from being extremely "K-shaped" to being characterised by widespread weakness. "Creative destruction" which has in the past seen productivity shocks translate into improvements in living standards does not operate (see Figure 18).

### Indicative economic and market shocks:

US unemployment rises to 10%, and GDP contracts 3%-5%. Inflation turns negative. The fed funds rate is ultimately cut to zero. Other service-heavy economies such as in Europe and the UK are hit hard, while manufacturing-intensive economies are relatively more resilient but still worse off.

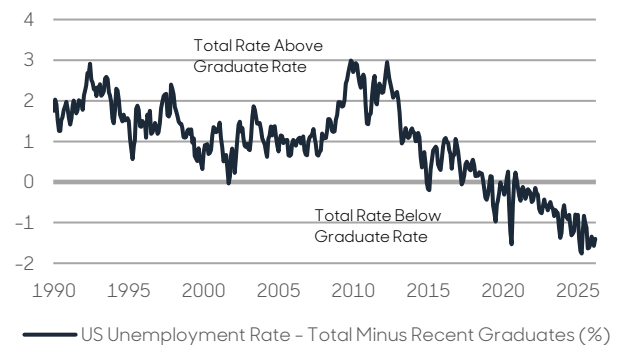
Equities sell-off, with consumer and labour-exposed sectors particularly underperforming, while yields fall sharply and commodities decline.

**Figure 16: The range of tasks amenable to rapid replacement by AI could turn out to be extremely wide**



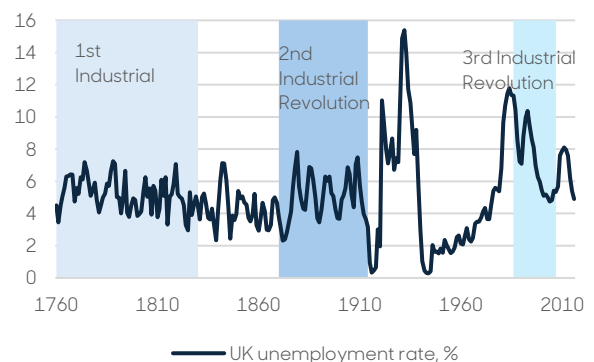
Source: Aberdeen, Goldman Sachs, June 2026

**Figure 17: The relative rise in graduate unemployment could become more pronounced and then spread elsewhere**



Source: Aberdeen, Capital Economics, Haver, June 2026

**Figure 18: No structural rise in unemployment from past innovations, but AI could be different**



Source: Aberdeen, Bank of England, March 2026



## Bond market rout – 10%

There is a sharp rise in bond yields, as the Warsh Fed moves to rapidly shrink the balance sheet. Fiscal easing in Japan or the UK could be further kickers

With Kevin Warsh at the helm, the Fed accelerates efforts to deliver the institutional and regulatory changes required to sustain a materially smaller balance sheet (see Figure 19). So, while reduced demand for reserves means money markets remain stable, investors begin to anticipate significant Treasury and agency securities sales, tightening financial conditions.

Attention quickly shifts to the broader implications. Markets grow uneasy that the Fed may be less willing to expand its balance sheet in response to future crises. This perceived reduction in the Fed's backstop raises equity risk premia.

Warsh maintains that any drag from bond sales can be offset through lower policy rates, reinforcing a steeper yield curve. However, markets view this mix as lacking credibility. Inflation expectations drift higher, adding further upward pressure to term premia and yields.

In Japan, long-end JGBs sell off sharply due a combination of government spending plans that are expected to worsen the already elevated debt/GDP ratio (see Figure 20), weak demand at super-long JGB auctions and a faster-than-expected reduction in BoJ bond purchases. Investors question the outlook for absorbing any additional issuance as the structural demand base continues to erode, while the yen weakens further.

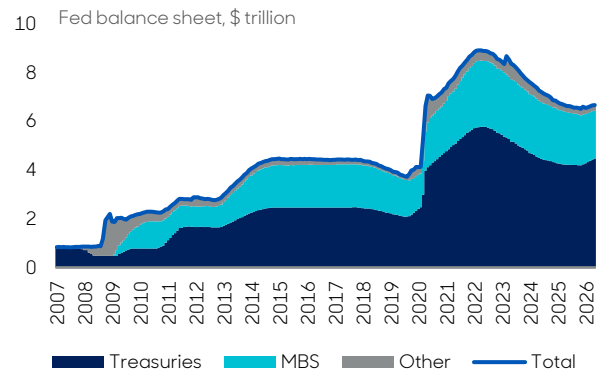
Verbal intervention by Japanese policymakers is insufficient to support the yen and the Ministry of Finance (MoF) is forced to sell Treasuries from reserves, exacerbating the rise in US yields.

A final kicker may come from the UK, where the prospect or reality of a shift to deficit-financed fiscal easing causes a sharp rise in gilt yields amid the UK's precarious international financing position. Pension funds face renewed pressure to sell liquid assets to meet margin calls, amplifying the bond and broader risk asset sell-off.

### Indicative economic and market shocks:

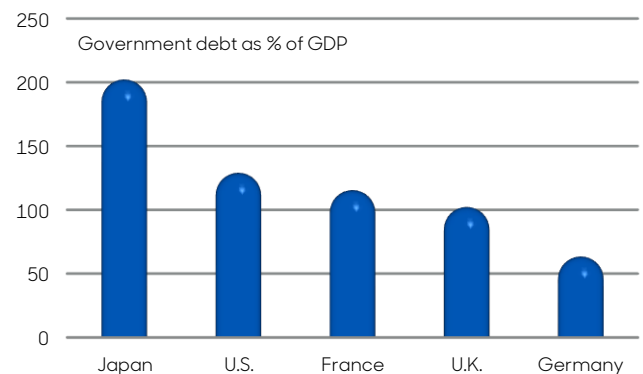
Long-end bond yields in the US and other developed markets (DMs) rise sharply (see Figure 21) and remain elevated beyond the initial shock. Equities sell-off. The tightening in financial conditions weighs on growth and inflation.

**Figure 19: The Fed balance sheet has started to expand again, but this could reverse under Warsh**



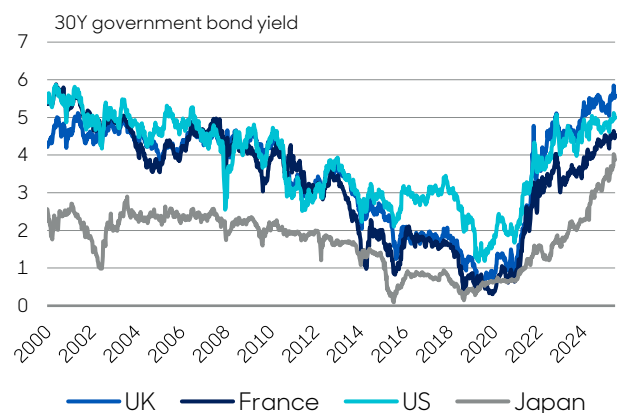
Source: Aberdeen, Haver, June 2026

**Figure 20: Countries with higher debt/GDP ratios may be the most vulnerable to sudden shifts in investor sentiment**



Source: Aberdeen, Haver, June 2026

**Figure 21: Reduced inflation credibility and fiscal pressures could cause long-dated yields to rise further**



Source: Aberdeen, Haver, June 2026



## Technological decoupling – 5%

There is a more abrupt decoupling of the US and China amid a potential “Sputnik moment”, balkanising the global economy along technological lines

The US and Chinese economies abruptly decouple, perhaps caused by Chinese technological progress triggering a policy backlash in the US.

This would be analogous to the “Sputnik moment” in the late 1950s, when Soviet technological advances forced a rapid shift to a security-driven policy footing in the US.

In the scenario, Chinese tech increasingly becomes the gold standard (see Figure 22), and so a significant commercial threat to US tech firms and the US’ geopolitical standing.

This could happen via breakthroughs in quantum computing that bypass the need for advanced semiconductors and threaten US encryption and security protocols. Alternatively, China could gain a lead in frontier large language models (see Figure 23) and close in on artificial general intelligence (AGI).

US politics and policy shifts to a “wartime footing” amid fears that China’s technological lead could become insurmountable. Policy drives a rapid buildout of power capacity, data centres and military spending to harden systems. Key tech firms are nationalised, and trade barriers are raised. This includes export restrictions on supply chain inputs and critical technology at both the hardware and software level, and higher tariffs.

China also tightens export controls. And the US uses the dollar-based financial system to try to slow China, while forcing other countries to choose a side. The global economy increasingly shifts into opposing blocs, as the global balance of power abruptly shifts (see Figure 24).

Threats of sanctions and the freezing of assets results in a violent repatriation of capital within these blocs.

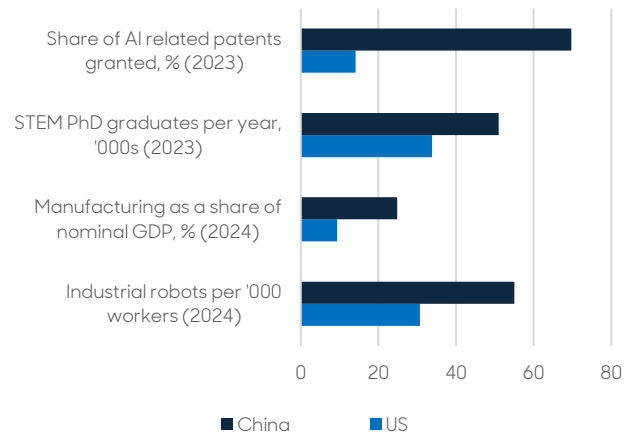
### Indicative economic and market shocks:

Global growth weakens amid fragmentation and less efficiency. Inflation rises initially on supply disruption, before easing later as weaker demand and excess capacity across blocs take hold.

Central banks are constrained by higher inflation, limiting scope for easing. DM financial conditions tighten as capital flows fragment, including China selling Treasuries. EM yields could decline amid Chinese productivity growth but declining export markets.

US tech equities come under pressure, so do those of globally integrated sectors. Currency markets fragment, with USD weakening versus RMB. Commodity prices are mixed, with higher costs linked to fragmentation but weaker global demand.

**Figure 22: China may have the skills to create a ‘Sputnik’ moment, which could cause a sudden shift in US policy**



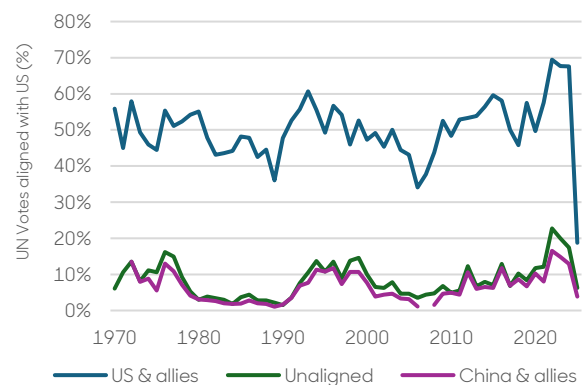
Source: Aberdeen, Haver, International Federation of Robotics, Stanford AI Index 2025 Annual Report, June 2026

**Figure 23: Chinese models have broken into the top 10 LLMs, which could threaten US commercial and security interests**

Nationality	Company	LLM	Type
US	OpenAI	GPT-5	Closed
US	OpenAI	o3-high	Closed
China	ByteDance	Doubao-Seed-1.6	Closed
US	xAI	Grok-4	Closed
China	Alibaba	Qwen3-23B	Open
China	DeepSeek	DeepSeek-R1	Open
US	OpenAI	o4-mini-high	Closed
US	Google	Gemini-2.5-Pro	Closed
China	Zhipu AI	GLM-4.5	Open
China	Tencent	Hunyuan-T1	Closed

Source: Aberdeen, DW, OpenCompass Leaderboard, March 2026

**Figure 24: The US could become less influential on the global stage as the world balkanises and countries ‘pick sides’**



Source: Aberdeen, Capital Economics, June 2026



## Productivity boom – 25%

US potential growth is boosted by AI and other supply-enhancing aspects of Trump's agenda. Growth is higher, but inflation and interest rates are lower

The US enjoys a positive supply shock, pushing up on growth and down on inflation pressures. A key driver of this are the productivity gains from AI starting to hit the economy more rapidly than expected (see Figure 25).

Output rises faster than hours worked, both through automation of existing roles and boosting the productivity of workers. Job creation is strong in sectors involved in the data centre build-out and in AI-complementary roles, while admin, support, and repeatable tasks see layoffs.

But, at the aggregate level, there is no material increase in unemployment. A growing share of corporates integrates AI into existing workflows (see Figure 26), allowing productivity gains to be realised without a corresponding collapse in employment. Indeed, vacancy durations might shrink, as AI raises the matching efficiency of the labour market. And higher real incomes are recycled into new wants and needs.

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.

This validates the argument that Fed Chair Kevin Warsh has made that the productivity boost from AI is disinflationary, increasing his credibility with both the rest of the FOMC and financial markets. The Fed has more confidence in looking through energy-related inflation pressure and easing policy this year and next.

The supply-boosting aspects of Trump's policy agenda could also be supportive. Deregulation of financial services, the anti-trust regime, and the permitting system all help to boost corporate profitability and investment (see Figure 27). Domestic energy production increases, putting downward pressure on prices. Personal and business tax cuts provide incentives to increase labour supply and the capital stock.

### Indicative economic and market shocks:

US potential growth rises from under 2% to more than 3%. Unemployment remains around 4%. Underlying inflation falls back to target supported by lower unit labour costs and efficiency gains. Central banks respond by easing policy more than in the baseline, with the Fed funds rate declining to 3.0%, although over the medium term, higher productivity growth puts upward pressure on  $r^*$ .

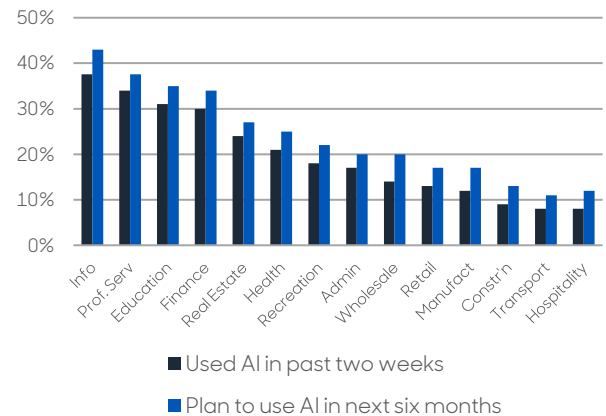
There is a significant equity rally, while the dollar strengthens given the US is at the technological frontier, and inflation expectations fall.

**Figure 25: Productivity growth could strengthen if the benefits of AI are realised more rapidly**



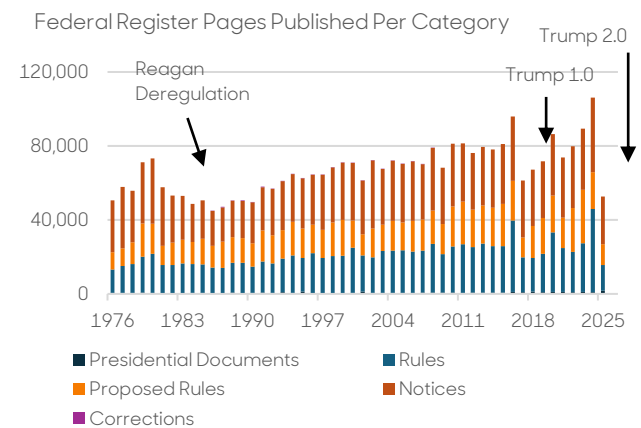
Source: Aberdeen, FRBSF, Haver, June 2026

**Figure 26: AI usage across the economy is increasing, but could rise substantially further**



Source: Aberdeen, Capital Economics, June 2026

**Figure 27: Trump's supply-side agenda, including deregulation, could also boost the supply-side**



Source: Aberdeen, Federal Register, June 2026



## Fiscal expansion – 10%

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

The Iran war prompts governments to redouble their focus on defence and resilience.

Europe, Japan, and the US use debt to finance the restocking and buildout of their military capabilities.

Fiscal stimulus then broadens beyond defence into targeted strategic investment in dual-use infrastructure and supply-chain hardening, lifting business confidence and supporting a stronger capex cycle. But large-scale direct household energy relief is avoided, which helps side-step market concerns about fiscal profligacy.

German fiscal easing comes online quicker than expected (see Figure 28), and across Europe there is an even greater emphasis on keeping the spending within Europe to boost its strategic autonomy.

In Japan, the deflationary mindset is firmly banished, so consumers boost consumption, and a tight labour market pushes up further on wage growth.

The experience of the energy cost shock also strengthens the case for investment in renewable technologies. A green investment boom led by China ensues (see Figure 29).

Globally, the result is firmer domestic demand, stronger growth and a more durable positive impulse to activity.

The boost to demand is greater than any improvement in the supply-side from higher investment *in the short term*, so there is an increase in inflation pressures.

But domestic demand strengthens in a way that is less mechanically inflationary than a pure cash-transfer or tax-cut package. Nominal activity rises without the same degree of concern that fiscal policy is simply worsening debt dynamics.

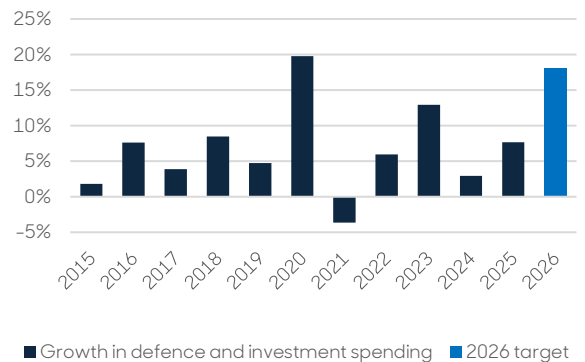
### Indicative economic and market shocks:

Stronger growth and inflation mean there is pressure on central banks to run a more restrictive policy stance. The Fed's next move is a hike later this year. Both the ECB and BoJ hike multiple more times in 2026 and into 2027.

Bond yields move higher, but in an orderly way, because markets see the spending mix as supportive of potential growth and broader economic resilience rather than as a simple loss of fiscal credibility. The yield curve steepens (see Figure 30).

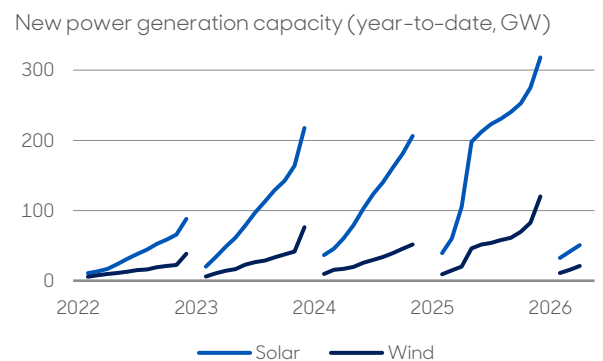
Stronger US, Japanese, Chinese and European growth and inflation boost risk sentiment and equities despite higher debt issuance. Commodities also rise.

**Figure 28: If delivery risks are avoided, then German government spending would be set to increase significantly**



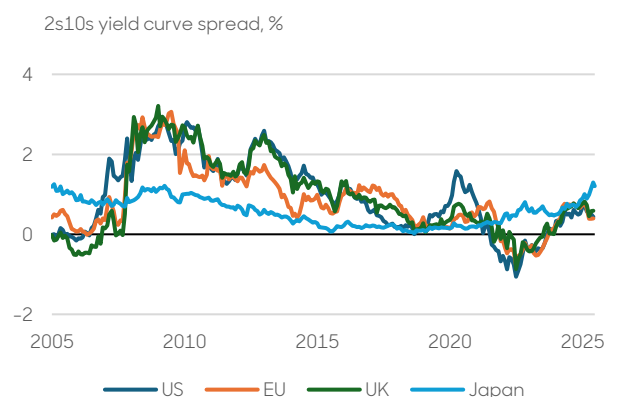
Source: Aberdeen, Haver, June 2026

**Figure 29: China could further accelerate its investment in renewable energy**



Source: Aberdeen, Haver, June 2026

**Figure 30: Bond yield curve would steepen in the event of a marked fiscal expansion**



Source: Aberdeen, Bloomberg, June 2026



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