



# Global Macro Research – Global Economic Outlook

Q1 2026

#Global

/

#Forecasts

/

#Scenarios

## The cycle rolls on – for now

The US economy will reaccelerate modestly next year, as the tariff shock fades and the AI buildout continues. Interest rates will be cut further under a new Fed chair. Chinese growth will slow, but by less than we previously thought. Despite the anti-involution campaign, inflation will remain soft. European prospects are supported by coming fiscal expansion, so no further ECB rate cuts will occur.

We have raised our US GDP forecasts to an above-consensus 2.2% in 2026 and 1.9% in 2027. US activity is being boosted by the investment spend of the AI buildout (see Figure 1) and the wealth effect from the stock market boom. We are incorporating an ongoing tailwind from AI capex spending in coming years into our forecasts.

Elevated equity valuations carry the risk that an unsustainable bubble bursts. While not our baseline, should any AI bubble burst, we would expect the US economy to fall into recession. This would look more like the 2001 recession following the bursting of the dotcom bubble, than the 2008 “great recession” following the housing collapse.

We expect fiscal policy to become more of a tailwind to US growth in 2026, as the tax reliefs and investment incentives in the One Big Beautiful Bill Act impart a positive impulse.

The US labour market has moderated, reflecting a step-down in labour supply but a larger reduction in demand, amid elevated trade uncertainty and tight interest rates. With these headwinds reducing, we don't expect the softening to spiral into a larger downturn. But because our US growth forecasts are below trend, unemployment will creep higher.

We expect a continued reduction in trade uncertainty, even as the overall US weighted tariff rate settles at 15%. But should the Supreme Court rule President Donald Trump does not have tariff powers under the International Emergency Economic Powers Act, then trade uncertainty could spike. We think the president will find alternative means to re-build tariff levels. However, there is a risk the loss of tariff revenue triggers broader concerns about the fiscal trajectory.

The tariff impact on prices has not yet peaked, and we expect US inflation to reach 3.4% in Q1 2026. But with underlying inflation pressures contained and expectations

anchored, the tariff hit looks like a one-off increase to the price level. Inflation should ease to 2% by the end of 2026.

Federal Reserve (Fed) policymakers are divided about the appropriate policy path given this backdrop. We expect the Fed to deliver one more cut under Powell, most likely in December, before the next chair takes over in May 2026 and cuts twice more (see Figure 2).

An upside scenario is of a dovish but credible Fed chair taking policy down towards the reasonable lower end of neutral estimates, leading to stronger nominal growth and risk sentiment. However, if the nominee is not credible, this could be the trigger for a bond market rout scenario, where inflation expectations and term premia move higher.

The US-China trade détente removes some of the downside risks to the Chinese growth outlook. Admittedly, the average US tariff on China is a still high 30%, and tensions around tariffs, technology restrictions, and critical minerals exports could flare up again. But Chinese exports have held up well over the period of trade uncertainty, as trade has been re-routed to Asian and European economies.

We still expect challenges to Chinese growth. The housing market will still weigh on growth next year, while the anti-involution campaign may introduce a new drag on investment. Consumer confidence is subdued, albeit past its trough helped by the performance of the equity market.

So, we forecast further stimulus. But this will remain focused on investing in strategically important sectors on the supply-rather than demand-side. Therefore, it won't do much to boost ingrained low inflation.

All told, we have raised our 2026 Chinese GDP forecast to 4.5%. That would still be a step down from this year, and we



are forecasting a further deceleration in 2027. And we've lowered our inflation forecasts in both years.

In Europe, growth will be supported by easier fiscal policy for the next several years, although this shows up most sharply in our 2027 numbers. This support is most striking in Germany, where the budget implies a fiscal impulse of 1.5%. France will continue to run a large deficit, but this reflects a failure to make progress towards the European Commission's Excessive Deficit Procedure targets.

Headline inflation will drop below the European Central Bank (ECB)'s target in early 2026 due to energy base effects, but the ECB is likely to look through this and keep policy on hold given fiscal support. Indeed, we expect the ECB to resume rate hikes by late 2027.

Despite US efforts at a peace deal in Russia-Ukraine, our base case is for continued fighting in 2026. That will keep up the impetus behind European re-armament.

The UK budget included tax increases to finance higher spending and an increase in the government's fiscal headroom. Because the spending increases are front-loaded and the tax increases backloaded, the budget imparts a very modest boost to near-term growth, although any hit to confidence and sentiment may undermine this.

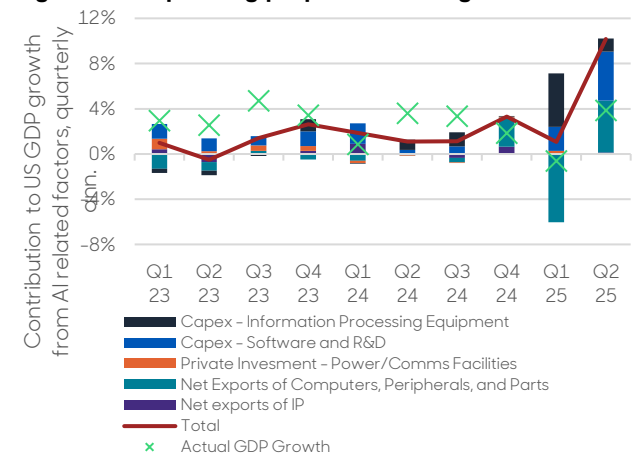
The budget also includes measures that push down inflation, which should speed the progress of inflation to 2%, reinforcing our forecast for Bank Rate to fall to 3% next year.

In Japan, the new government has announced a fiscal package worth 3.4% of GDP, which imparts a 1% fiscal impulse. This should support growth. Tensions between Japan and China remain a major downside risk to growth.

Headline inflation remains elevated, but food price growth should moderate, and while wage growth has strengthened, real wage growth remains negative.

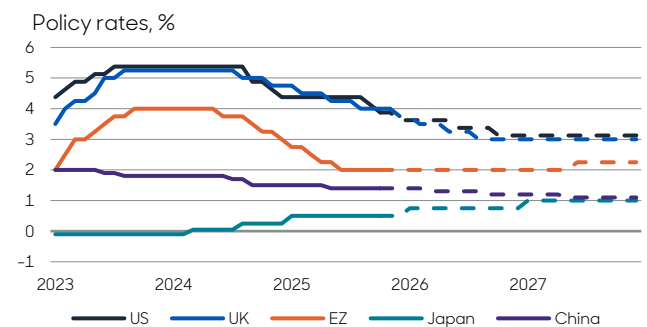
With JGB yields rising and the yen depreciating, the Bank of Japan is likely to continue its very gradual hiking cycle. We expect the next hike in December.

**Figure 1: AI spending propels US GDP growth**



Source: Aberdeen, Haver, Goldman Sachs, November 2025

**Figure 2: Rate cuts loom for the US and UK, Japan to raise**



Dotted lines indicate Aberdeen forecasts

Source: Aberdeen, Haver, November 2025

**Figure 3: Global economic forecasts**

	GDP (%)				CPI (%)				Policy Rate (% , year end)			
	2024	2025	2026	2027	2024	2025	2026	2027	2024	2025	2026	2027
US	2.8	2	2.2	1.9	3	2.8	2.7	2	4.375	3.625	3.125	3.125
UK	1.1	1.4	1.1	1.6	2.5	3.4	2.4	2.1	4.75	3.75	3	3
Japan	-0.2	1.5	0.9	1	2.8	3.2	1.6	2.1	0.25	0.75	0.75	1
Eurozone	0.8	1.3	1.1	1.5	2.4	2.1	1.9	2	2	2	2	2.25
Brazil	3.0	2.2	1.4	2.2	4.4	5.1	4.3	4.1	12.25	15	12.25	10
India	6.7	7.2	6.4	6.4	4.9	2.2	3.4	4.9	6.5	5.25	5.5	5.5
China	4.9	4.9	4.5	4.1	0.2	-0.1	0.6	1	1.5	1.4	1.2	1
Global	3.3	3.3	3.1	3.2	5.9	4.1	3.4	3.4				

Source: Aberdeen, November 2025

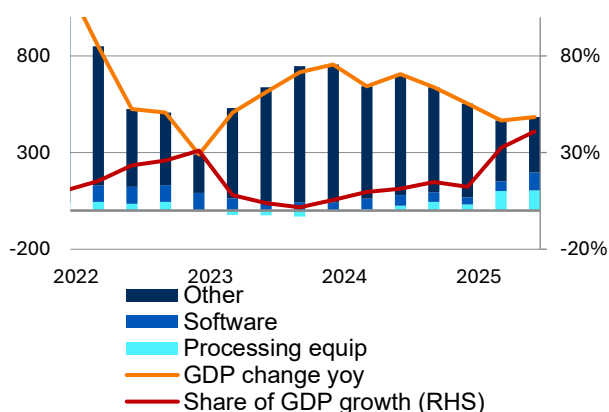
## US

**Activity:** Growth has accelerated in H2 as tariff-driven uncertainty fades and AI-related investment and equity prices boom (see Figure 4). This has unleashed the consumer, with high-income households in particular spending strongly. We expect strength in consumption to gradually ease through 2026 due to the combination of a sluggish jobs market with slowing wage growth and inflation remaining above target. Growth will continue to be supported by robust investment in tech and related sectors. A collapse in AI related investment and equity prices is the principal risk to the outlook, tipping the economy into recession.

**Inflation:** Consumer price inflation has accelerated since Q1. While tariffs have pushed up prices, the passthrough to final consumer prices has been less than anticipated. We expect to see that passthrough increase and inflation to peak around 3.4% in Q1 2026. However, the impact of tariffs should be a one-off shock, with inflation easing towards the Fed's 2% target by the end of next year. Changing tariff policies continue to be a key source of risk to inflation, both to the upside and downside, while a more dovish Fed under a new leadership could see inflation expectations pick up.

**Policy:** We expect one further rate cut from the Fed under Powell's leadership. While delayed data releases could see a pause until January when a clearer picture of the economy emerges, we see the balance of risks as still being tilted towards labour market downside, prompting a December cut. Further cuts in 2026 look highly likely, but the timing and magnitude may depend on who is appointed as the next Fed chair starting May. Our view is for two further cuts later in the year (June and September) as inflation approaches the 2% target, taking the target range to 3.0-3.25%.

**Figure 4: Investment in AI-related areas accounted for 40% of US GDP growth in Q2**



Source: Aberdeen, Haver, November 2025

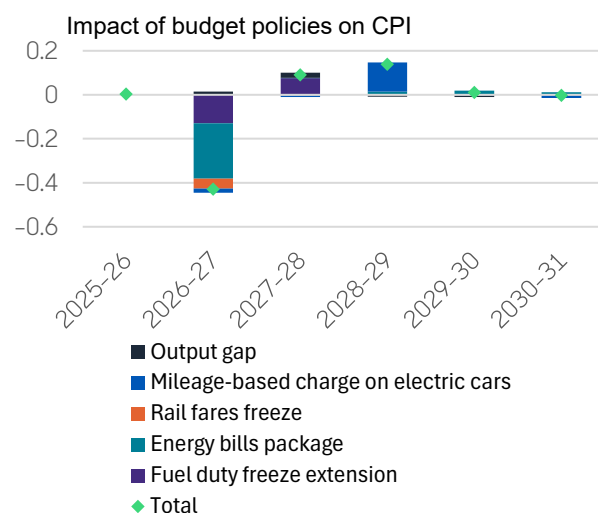
## UK

**Activity:** Q3 GDP expanded by just 0.1%, and, while some modest bounce back in Q4 is likely following the reopening of production at Jaguar Land Rover, the underlying fundamentals remain weak. The labour market has deteriorated significantly over the last year, with unemployment increasing to 5%, which is now starting to weigh heavily on real incomes growth. Sentiment is also weak, in part due to speculation about the budget. The budget very modestly supports growth in the near term due to the backloaded nature of the tax increases, but this may store up future fiscal concerns.

**Inflation:** Headline inflation has peaked and is set to gradually return towards target next year. This may not be a linear process, with some modest pickup from October's 3.6% plausible as energy base effects work through. But, as steep price increases in H1 this year drop out of the annual comparison next year, the progress towards 2% should accelerate. And the sharp moderation of private sector wage growth should help further bring services inflation towards a target consistent rate. The budget included measures that should push down on inflation in the near term, especially on household energy prices (see Figure 5).

**Policy:** With the labour market deteriorating and inflation pressures finally fading, the pieces are in place for further Bank of England (BoE) easing. The close vote at the November BoE meeting has set up a cut in December. We expect this to be followed by further easing next year, taking Bank Rate down to 3%. This is below market pricing, although there are upside risks to our forecast especially if inflation is stickier. But there are downside risks if the budget leads to a bigger hit to activity and sentiment that requires policy to fall into accommodative territory.

**Figure 5: The budget pushes down on inflation, but only temporarily**



Source: Aberdeen, OBR, November 2025



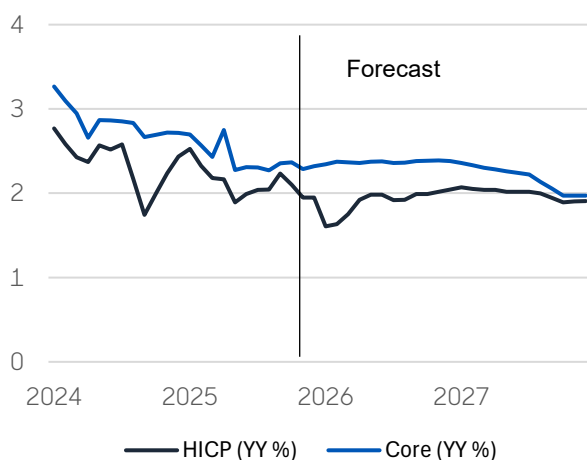
## Eurozone

**Activity:** GDP growth is set to receive a modest boost from fiscal easing in 2026. This will be especially pronounced in Germany, where the budget implies a fiscal impulse of 1.5% of GDP. But infrastructure projects and defence procurement could face delays. Moreover, despite the easing of the EU's fiscal rules and new requirements for NATO states to increase defence spending, stimulus will be limited elsewhere. Most significantly, France will face a negative fiscal impulse even if a budget containing tightening is not passed. Overall, we expect growth to gradually accelerate as fiscal easing starts to build, reaching 1.5% in 2027.

**Inflation:** Big increases in energy prices at the beginning of 2025 are unlikely to be repeated in 2026. So headline inflation should drop below the European Central Bank (ECB)'s 2% inflation target in January. Over the medium term, however, inflation is on track to settle near target. That's because services prices are likely to continue to increase at an above-target rate throughout 2026. And fiscal easing should eventually push up on prices, if only modestly. We therefore expect inflation to average 1.9% over 2026, before nudging up to 2.0% in 2027 (see Figure 6).

**Policy:** Markets continue to price a significant possibility of further ECB cutting. We think this is unlikely, given how strongly an extended hold has been telegraphed. Admittedly, further easing is possible if, for example, a political crisis in France leads to the ECB providing liquidity support. But some comments by Governing Council members hint that the balance of risks around our expectation for rates to be held at their current level throughout 2026 are becoming more balanced. We continue to expect the next ECB move to be a hike, likely in mid-2027.

**Figure 6: An undershoot is likely, but it won't be protracted enough to prompt an ECB response**



Source: Aberdeen, Haver, November 2025

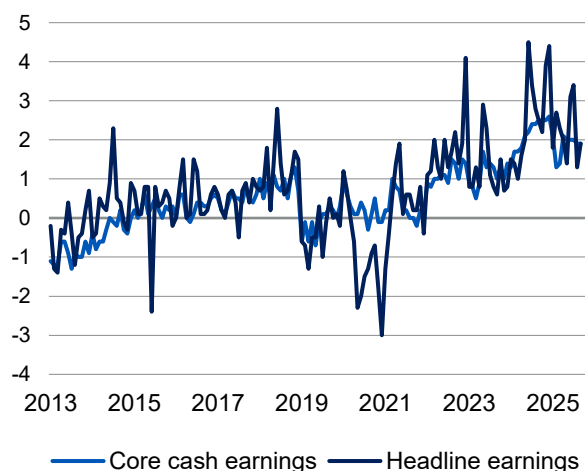
## Japan

**Activity:** Consumption growth has held up well recently, rising for six straight quarters despite low real wages and high food inflation. Upcoming tax cuts and income subsidies should help to further support consumer spending next year. However, the multiplier on recently announced fiscal easing is likely to be low. Net trade has hindered growth, with exports to the US suffering, especially due to tariffs. Next year may see a slight improvement, as Japan could benefit from a weaker yen and increased AI-related trade. However, ongoing tensions with China could negatively impact the outlook especially around tourism flows.

**Inflation:** National CPI remains elevated, but food inflation should continue to decelerate from record highs, pulling headline inflation lower through Q1 2026. Inflation pressures are set to be stronger across certain service sectors, which will somewhat offset the reduced contribution from food. Indeed, the Bank of Japan (BoJ) will be watching core services inflation closely for signs of sustained domestically generated inflation (see Figure 7). Wage growth has slowly improved over the past two years, with core base pay stabilising around 2% year on year, although real income growth remains negative.

**Policy:** The cabinet approved a JPY21.3 trillion stimulus package (3.4% of GDP), including JPY 11.7 trillion in price relief subsidies. This is up from JPY 13.9 trillion last year, meaning a potential fiscal impulse of around 1% of GDP. However, the impact will largely depend on the multipliers of the spending measures. PM Sanae Takaichi noted additional bonds may be issued to finance spending if necessary, but she expects new issuance to be less than last year. We think the BoJ will probably continue with its gradual rate hiking cycle with the next rate increase likely in December.

**Figure 7: BoJ monitoring wage growth and “Shunto” negotiations ahead of policy decision**



Source: Aberdeen, Haver, November 2025

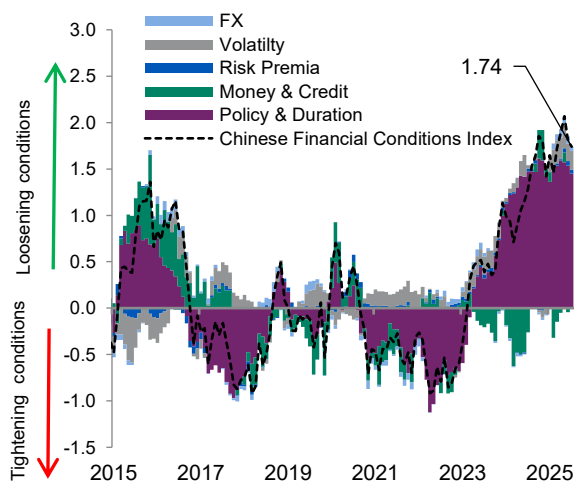
## China

**Activity:** The US-China trade truce, which cut the average tariff rate faced by 10ppts to 30%, reduces one headwind to growth. Relations remain fragile, but risks of another spiral have fallen alongside the recognition of China's control of critical minerals. More policy support will be necessary to arrest the investment slowdown, even if the drag from real estate gradually abates. Household balance sheets continue to be hit by falling house prices while government support remains lacklustre, but the stabilisation of future employment and income expectations is more reassuring. Overall, we increased our growth forecasts by 0.3ppts to 4.5% in 2026.

**Inflation:** China's anti-involution campaign should help deal with pockets of excess capacity, for example within electric vehicles and solar. But it is unlikely to be forceful enough to return inflation to the PBOC's 2% target. The policy mix outlined by the 15<sup>th</sup> five-year plan retains a supply-side bias. This is effective at supporting real GDP, but it risks embedding tepid inflation or even deflation. Indeed, 2025 will be the third year of near-zero CPI inflation and we now expect CPI inflation to rise to only 0.6% in 2026, while the GDP deflator may extend its record-breaking 10-quarter run below zero.

**Policy:** A smaller drag from tariffs, lower trade uncertainty and an easy to achieve 2025 growth target have reduced the urgency to ease. Indeed, the PBOC struck a somewhat less supportive tone in its latest policy report, seemingly content to target lending to strategic sectors and downplaying the slowdown in credit growth. That said, we still expect more steps aimed at loosening financial conditions in early 2026 (see Figure 8). More details about the 15th five-year plan will be released in March, but we expect geopolitics to reinforce policies aimed at strengthening resilience and technological self-sufficiency rather than significantly boosting consumption.

**Figure 8: Chinese policy makers remain attentive to the risk of a sharper slowdown**



Source: Aberdeen, Haver, Bloomberg, November 2025

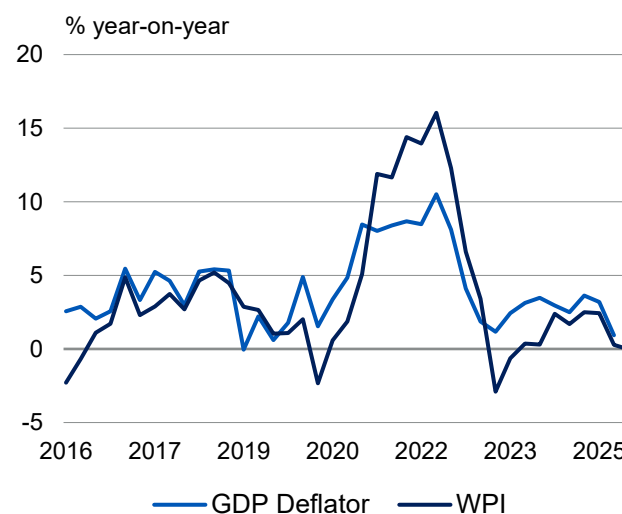
## India

**Activity:** India's economy will continue to be an outperformer in 2026, albeit growing at a slower pace of 6.4%. The consumer sector has improved, supported by looser credit conditions, higher real incomes and Goods & Services Tax (GST) reforms. Moreover, we expect India and the US to come to an agreement that sees the tariff rate imposed on India's goods lowered to a more competitive rate. That said, stalling external demand growth in the services sector poses downside risks. And we remain sceptical of a significant pickup in private investment to offset the slowing of government capital expenditure.

**Inflation:** India's inflation undershoot will fade in 2026, but we expect consumer price growth to remain contained. Headline inflation hit a multi-decade low of 0.3% year on year in October, but base effects should see it rebound (see Figure 9). Lower GST rates and softer inflation expectations should curb the extent of acceleration. Unless food or energy prices surge, we see risks skewed to the downside to our forecast for headline inflation to average 3.8% through 2026. Indeed, if gold prices retreat, inflation may remain below the mid-point of the Reserve Bank of India (RBI)'s 4%+/-2 percentage points target range.

**Policy:** The RBI decision in December is a close call. We expect a final 25bps cut to bolster growth after inflation undershot the RBI's forecasts. Still, the central bank could hold, conserving firepower and focusing on transmitting the 100bps of easing already delivered this year. Beyond December, policy is likely to stay on hold through most of 2026, with a hike late in the year as inflation returns to target. This path reflects our view of a pro-growth policy stance under Governor Sanjay Malhotra, balanced by the need to prevent an overshooting of inflation.

**Figure 9: India's inflation to modestly rebound in 2026**



Source: Aberdeen, Haver, November 2026



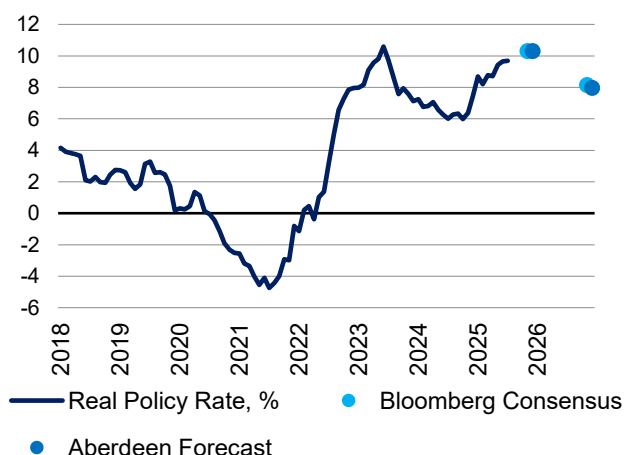
## Brazil

**Activity:** High real interest rates are increasingly weighing on domestic demand. But strong wage gains, low unemployment and upcoming tax relief for lower- and middle-income households will buoy activity over 2026. A broadening of US tariff exemptions to include agricultural products further mitigates the trade war's impact. Fiscal policy should have a broadly neutral impact next year. But the post-2026 outlook heavily depends on the outcome of the October general and presidential elections, which is too early to call. A victory for incumbent President Luiz Inácio Lula da Silva would likely see only modest fiscal consolidation in the medium term.

**Inflation:** Inflation will remain around the upper portion of the BCB's target range (3% +/- 1.5pts) over 2026. Food inflation has eased as base effects from prior drought conditions have passed, and wholesale agricultural prices signal further cooling. But core inflation, particularly services, has stayed sticky due to labour market tightness, and will only moderate gradually over the short term. Upside risks to our forecasts stem from potential for pre-election fiscal stimulus to raise demand-side pressures, or for political uncertainty to underpin renewed *real* depreciation that raises import prices.

**Policy:** The BCB faces a delicate balancing act. Activity is cooling amid tight financial conditions. But core inflation remains above target, while consumption will receive tailwinds from income tax changes. After being forced to tighten policy once more from 2024, in contrast to other EM central banks, rate cuts over 2026 will be cautious to mitigate risks to its inflation credibility (see Figure 10). Risks to our end-2026 Selic rate forecast of 12.25% are tilted slightly to the upside. Indeed, possible *real* or yield volatility ahead of the October elections could easily reduce scope for easing.

**Figure 10: Inflation concerns and high yields will limit the extent of the BCB's monetary easing over 2026**



Source: Haver, Bloomberg Aberdeen, November 2025

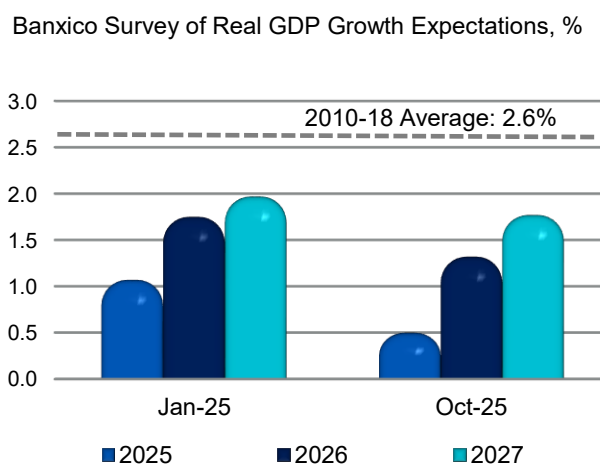
## Mexico

**Activity:** US trade uncertainty stymied Mexican growth over 2025 (see Figure 11) and will remain a headwind in 2026, as the USMCA review is due to commence in July. If trilateral talks secure an extension to 2036, Mexico is well placed to benefit from US nearshoring efforts. However, a move towards serial annual reviews (like the US-China détente) is currently looking more probable, with Washington seeking to maintain leverage on trade and other issues including border security. In such a scenario, Mexico would retain favourable access to the US versus other EMs, but uncertainty would persist and cap potential investment.

**Inflation:** Mexico's disinflation has stalled in recent months due to stickiness in services and core goods. As such, headline price growth remains within the upper portion of Banco de Mexico's target range (3% +/- 1ppt). A gradual downtrend should resume over 2026, as muted economic momentum and fiscal consolidation contain demand-side inflation pressures. However, upside risks stem from the potential for renewed swings in agricultural prices, or for tensions in the USMCA review to flare and weigh on the peso. Respondents to Banxico's survey expect core inflation of 3.8% in 2026, down from 4.2% in 2025.

**Policy:** President Claudia Sheinbaum's government will continue with efforts to narrow the fiscal deficit inherited from the AMLO administration. Meanwhile, a more cautious tone from Banxico in November suggests it is nearing the end of its easing cycle, having cut its policy rate by 375bps since August 2024. However, we still expect it to cut more than the Fed over H1 due to prevailing weakness in Mexico and still high real rates. Peso volatility has been little deterrent for rate cuts this cycle, and this would likely remain the case. Risks to our end-2026 rate forecast of 6.25% are broadly balanced.

**Figure 11: USMCA-related uncertainty remains a headwind for Mexico, with its 2026 review in focus**



Source: Banxico, Haver, Aberdeen, November 2025



## **Alternative global macro scenarios**



## AI equity and capex collapse

AI-related spending collapses, while tech stocks fall sharply, triggering a US recession similar in magnitude and effect 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, adverse regulatory intervention, the sudden loss of a perceived moat for AI capital intensive firms, or major AI “names” missing earnings expectations by a wide margin.

Mega-cap AI equities correct violently, which leads to wider contagion across equity markets (see Figure 12). 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 13). 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.

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 14). That's because the previous boom was largely funded through retained earnings and equity, not highly levered debt issuance or bank-funded credit more generally.

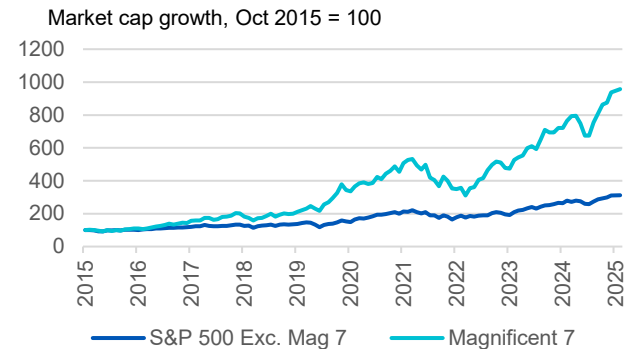
The losses faced by equity funds, venture capital and private credit are all significant, but these all sit outside the core nodes of the banking systems. So, there is not widespread maturity mismatch or destruction of value on the balance sheet of money-creating entities. And the collateral in wholesale 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%.

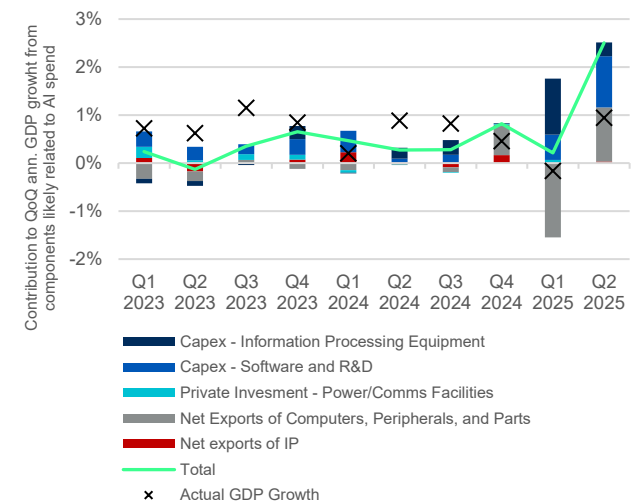
The Fed eases policy sharply in response to the weaker growth environment, taking interest rates well below neutral. The yield curve steepens. The dollar may depreciate despite a global downturn due to capital outflow from the US.

**Figure 12: The “Magnificent 7” tech stocks have supported US equities, but this could reverse**



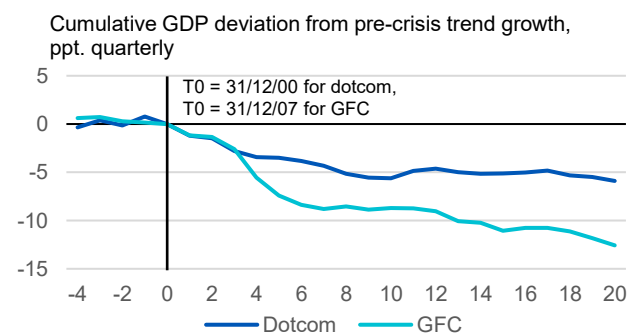
Source: Aberdeen, FactSet, November 2025

**Figure 13: AI investment spending has boosted US GDP growth, meaning a collapse would weigh on growth**



Source: Aberdeen, Haver, Goldman Sachs, November 2025

**Figure 14: The macro effects of a bursting of any AI bubble would probably look more like 2001 than 2008**



Source: Aberdeen, Haver, November 2025





## Tariff uncertainty returns

Trump reintroduces intense trade policy uncertainty, raising tariffs to shore up political support and tackle trade deficits. Growth is lower and inflation is higher

Several factors combine to motivate sharply higher US tariffs, roiling financial markets in a similar pattern to the “liberation day” moves.

The Supreme Court rules President Trump’s use of IEEPA for tariffs is partially or wholly lawful, bestowing substantial latitude on the president to raise tariffs beyond current levels. Alternatively, the administration successfully uses other statutes, such as Section 338, to raise tariffs again.

The president leans further into the revenue-raising aspects of tariffs. A higher baseline tariff is imposed to finance cheques to households ahead of the mid-term elections (see Figure 15), where polling and prediction markets flag meaningful probability that Republicans lose the House.

In such an event, passing domestic legislation becomes significantly harder. Trump then focuses on foreign policy, using tariffs to press trade and non-trade issues. For example, the president’s aim of securing a ceasefire between Russia and Ukraine could see him follow through on threats to tariff purchasers of Russian commodities.

With migration and narcotics sticking points within USMCA, there could be significant doubts around its renewal.

And US-China relations could deteriorate again, ushering in higher tariffs on China and transshipment tariffs on major trading partners in APAC. China would react by restricting access to critical minerals, amplifying the shock to global supply chains (see Figure 16).

Relations with Europe could also take a turn down. Issues like the continued use of digital services taxes by some countries could lead to heightened trade tensions.

These developments would push the US weighted average tariff rate sharply higher towards immediate post-liberation day levels (see Figure 17), while substantial trade uncertainty would return to haunt corporate decision making, markets and the Fed.

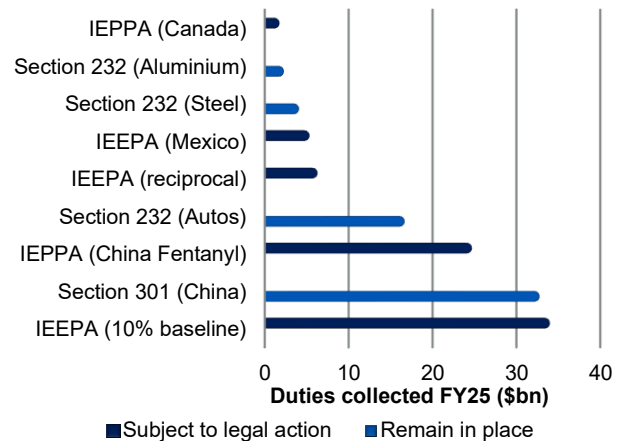
### Indicative economic shocks:

Trade policy uncertainty shoots higher, weighing on equities, Treasuries and the dollar, in a repeat of the “sell America” trade in April.

US inflation increases, with the price level around 2% higher than otherwise (and 0.5% lower in the rest of the world). The level of global GDP is 1.0% lower than the base case.

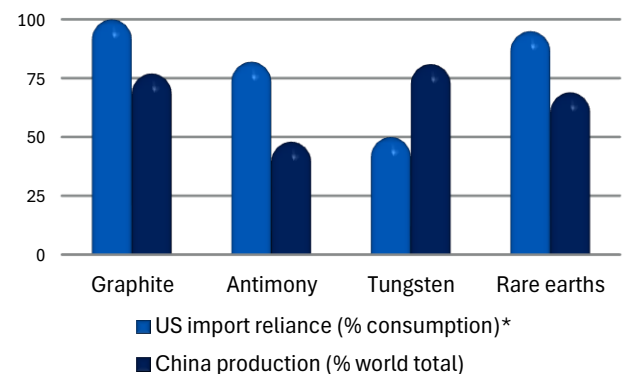
The Fed would be grappling with stronger inflation but weaker growth. On balance, we would expect them to be cutting interest rates, but more slowly than might be optimal given the growth shock.

**Figure 15: External revenue may be legally precarious, but it remains a temptation**



Source: Aberdeen, US Customs and Border Security, November 2025

**Figure 16: China’s control of critical minerals could amplify the shock of an abrupt decoupling**



\*Figure shows commodities where China is the primary import source for US and largest global producer

Source: Aberdeen, Mineral Commodity Summaries 2024, November 2025

**Figure 17: The US weighted average tariff rate could return to immediate post “liberation day” highs**



Source: Aberdeen, White House, November 2025

## Conflict risks dominate

### A flare-up in geopolitical tensions shocks energy markets, pushing up on inflation and depressing private sector animal spirits

US and European frustration at slow progress in Russia-Ukraine peace negotiations, and increased hybrid attacks on NATO members in Europe (see Figure 18), lead to efforts to more forcefully cut Russia out of the global oil and gas markets via secondary sanctions and tariffs.

Alternatively, a re-eruption of tensions in the Middle East, such as renewed conflict between Israel and Iran, disrupts oil flows through the Strait of Hormuz (Figure 19).

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

Either way, energy markets and broader global supply chains convulse. Oil prices rise above \$100 per barrel. Global shipping, trade and supply-chain disruptions amplify the price shock.

This 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 to the upward pressure on yields.

Heightened uncertainty (see Figure 20) weighs on corporate capital spending and hiring, while defence spending crowds out government expenditure elsewhere, 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.

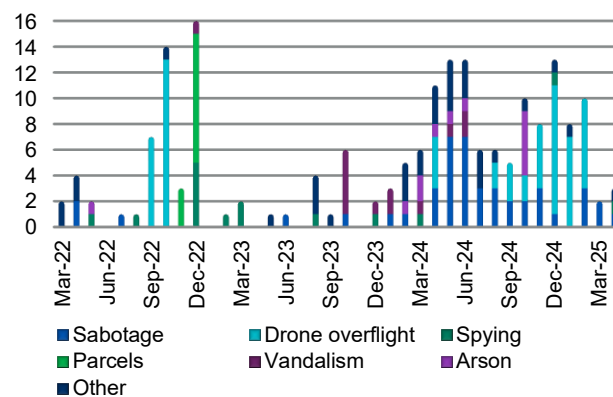
The recent experience of high inflation means that inflation expectations are less well anchored than normal. As such, central banks do not feel comfortable “looking through” this shock, limiting the scope for rate cuts in the near-term.

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

#### Indicative economic shocks:

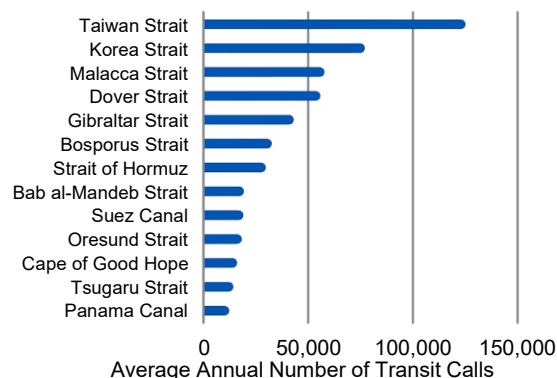
The global price level is 1.5% higher than otherwise, while the level of global GDP is 1.0% lower. Oil prices rise above \$100 per barrel. Central banks are constrained in the amount of offsetting rate cuts they can provide to support the economy.

**Figure 18: Russian sabotage attacks and drone incursions in Europe have been increasing**



Source: Aberdeen, ACLED, November 2025

**Figure 19: Many important maritime chokepoints are in geopolitically fraught locations**



Source: Aberdeen, Haver, November 2025

**Figure 20: Conflict and fiscal spending uncertainty often spike at the same time**



Source: Aberdeen, Haver, Economic Policy Uncertainty, November 2025

## Bond market rout

A Trumpified Fed, the loss of tariff revenue, or European and Japanese debt concerns, lead to an increase in inflation expectations and term premia

The combination of personnel changes and pressure from the president leads to a significant reduction in monetary policy independence at the Fed.

Through the appointment of a new chair, and turnover and firing on the Board of Governors, the administration creates a majority of sympathetic policymakers.

This new Fed cuts interest rates much more rapidly than implied in the current “dots”, or by standard monetary policy rules given prevailing macroeconomic conditions. Trump praises these moves in terms of how much they are saving the US government in debt servicing costs, emphasising the fiscal justification for this policy stance (see Figure 21).

Markets start to discount the policy rate falling towards the 1% level that Trump has previously indicated he considers appropriate. At the same time, inflation expectations increase significantly in response to the expectation of this inappropriate policy. The Treasury yield curve steepens, with long-dated bond yields rising materially (see Figure 22).

An alternative source of pressure on long-term bonds could be the Supreme Court striking down the IEEPA tariffs, with a ruling that makes it difficult to reconstruct tariffs under new powers. This leads to concerns about the lost tariff revenue causing an expansion of the deficit.

Meanwhile, investor concerns about the European and Japanese fiscal outlooks could increase. In the UK, the unwillingness to cut spending or increase income tax in the budget leads to concerns about fiscal credibility. The possibility of a more left-wing Labour leader or Reform government also puts upward pressure on term premia.

In France, the new government is unable to pass a budget even with very modest consolidation. French funding costs continue to widen relative to Germany (see Figure 23), and investors contemplate the possibility of a RN presidency.

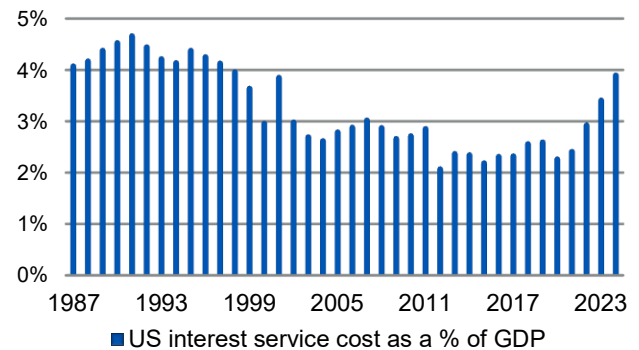
And in Japan, the fiscal expansion of PM Takaichi in the supplementary budget is followed with even more in the main budget, reviving debt sustainability concerns and causing JGB markets to sell off.

### 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 depreciates against safe-haven currencies. Gold performs very well.

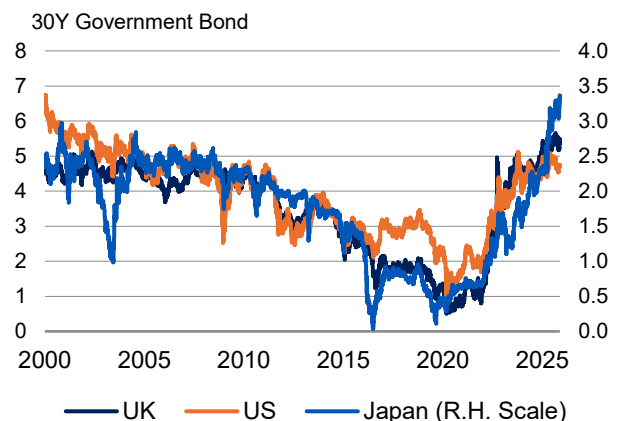
In a full fiscal dominance scenario, the Fed may eventually move to pin down longer maturity bond yields.

**Figure 21: US debt service costs have increased, providing one motivation for politicisation of the Fed**



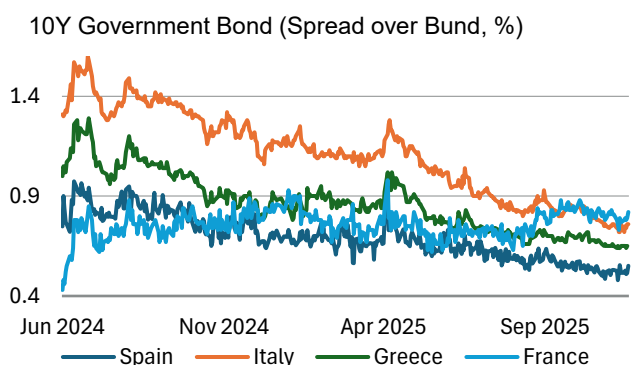
Source: Aberdeen, Haver, November 2025

**Figure 22: Reduced inflation credibility and fiscal pressures could cause long-dated yields to rise further**



Source: Aberdeen, Haver, November 2025

**Figure 23: French spreads over Germany would remain under sustained upward pressure**



Source: Aberdeen, Haver, November 2025



## Supply-side upswing

US potential growth is boosted, either by AI, or the 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. This could be because the productivity gains from AI start to hit the economy more rapidly than expected (see Figure 24). This would involve output starting to rise much faster than hours worked, both through automation of existing roles and through boosting the productivity of workers.

Hiring shifts towards AI-complementary roles, while admin, support, and repeatable tasks see lay-offs. But at the aggregate level, employment remains strong, in part due to the boost to incomes creating new wants and needs in the economy. Indeed, vacancy durations might shrink, as AI raises the matching efficiency of the labour market.

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.

Alternatively, the supply boost occurs due to policy changes from the Trump administration.

Deregulation of financial services, the anti-trust regime, and the permitting system all help to boost corporate profitability and investment (see Figure 25). 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.

The Supreme Court strikes down the tariffs imposed under IEEPA, but crucially markets take this as a positive sign about likely lower tariff rates and institutional constraints on more market unfriendly aspects of the Trump administration. Those tariffs that stay in place prove to be less distortionary and inflationary than expected, as US market power and lack of retaliation from trading partners means most of the burden of higher tariffs is felt overseas.

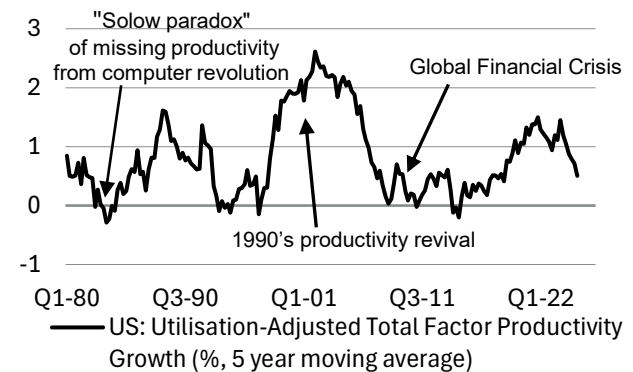
The inflationary impact in the labour market of reducing migration is more than outweighed by lower demand in the housing market. Housing supply is relatively inelastic, so lower demand leads to downward pressure on house prices.

### Indicative economic shocks:

US potential growth rises from under 2% to more than 3% (see Figure 26).

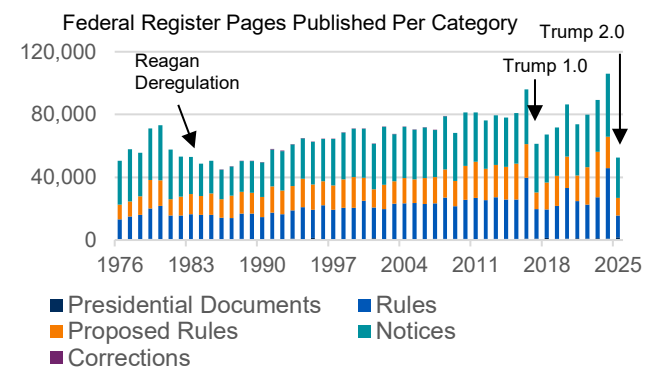
But the lower inflationary impulse allows the Fed to cut more rapidly, further boosting activity growth as demand expands into the extra supply capacity. Over the medium term, higher productivity growth puts upward pressure on  $r^*$ .

**Figure 24: Productivity growth could strengthen if the benefits of AI are realised more rapidly**



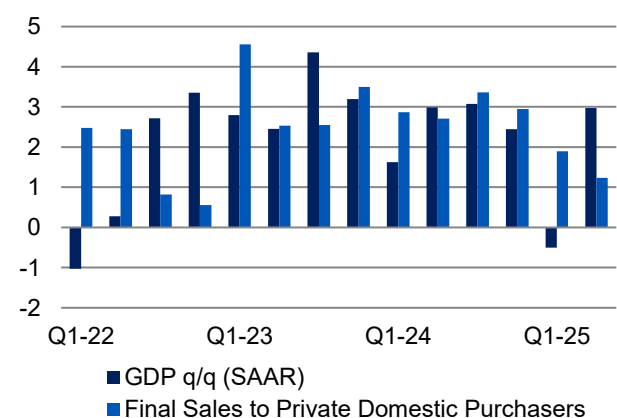
Source: Aberdeen, FRBSF, Haver, November 2025

**Figure 25: Alternatively, Trump's supply-side agenda, including deregulation, could be supply expanding**



Source: Aberdeen, Federal Register, November 2025

**Figure 26: Either way, trend growth in the US would pick up from the recent slowdown**



Source: Aberdeen, Haver, November 2025

## Dovish but credible new Fed chair

A new dovish Fed chair frontloads rate cuts, boosting demand and risk sentiment. Inflation expectations manage to remain anchored due to the credibility of the chair

President Trump announces a new Fed chair who is widely seen as dovish but credible in terms of both expertise and independence. The dovishness is perceived as being due to a reasonable view about potential risks to the labour market and the level of  $r^*$ , rather than less reasonable views about possible supply side boosts from Trump's broader policy agenda or simply lacking independence from the White House.

The individual most likely to fit this bill is Governor Chris Waller, but it is possible other candidates could be perceived this way based on their early rhetoric and signalling (see Figure 27).

After being appointed but before formally taking office, the appointee makes clear that when they start, monetary easing will restart, perhaps with an initial 50bps cut to make up for "foregone" past easing. This is framed as insurance easing given the underlying state of the economy.

The fed funds rate is taken rapidly to the bottom of the range of estimates of neutral, with this range itself coming down (see Figure 28). Ultimately rates end up around 100bps lower than they otherwise would have been.

Real rates fall, helping to boost activity above potential and push downwards on unemployment. Households and corporates are willing to take more risk. There is some endogenous supply response to this stronger demand growth via increased labour supply and stronger productivity growth, which means inflation only nudges modestly higher.

Indeed, inflation expectations remain anchored (see Figure 29), and the term premium is largely unmoved due to the Fed still being perceived as independent.

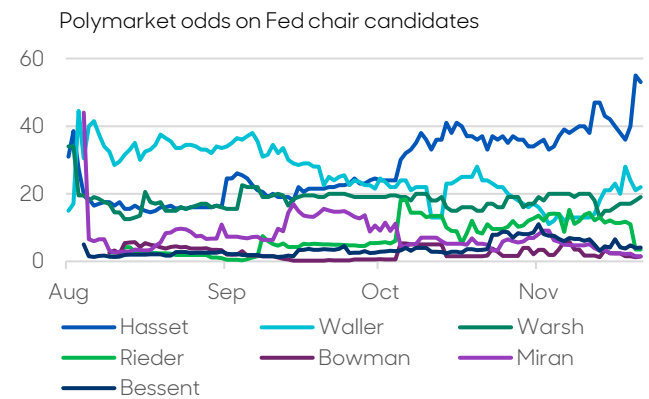
This perception of independence could perhaps be aided by the new chair explicitly arguing for measures to reduce the deficit because the Fed itself will not be able to use policy to make the deficit easier to finance.

### Indicative economic shocks:

Financial conditions ease materially, with equities higher (particularly cyclical stocks and tech stocks due to their duration sensitivity) and the dollar modestly weaker. The weaker dollar supports global risk appetite, especially in emerging markets.

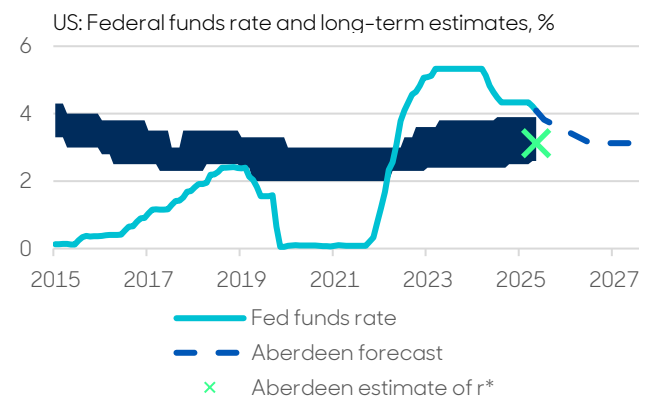
The yield curve steepens in response to lower policy rates, but the long end is not under material pressure beyond the normal sell-off in response to a risk-on environment. Financials benefit from the steeper curve.

**Figure 27: Waller would probably be the most credible pick for the next Fed chair**



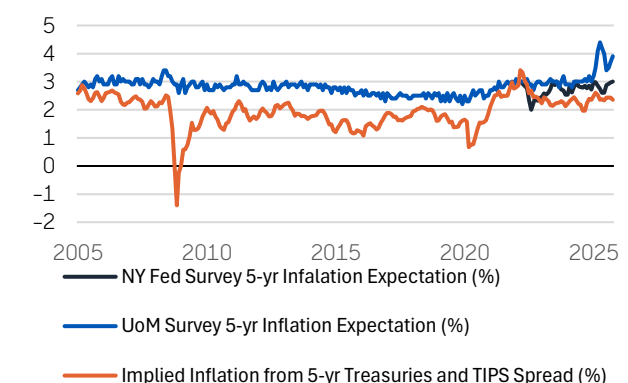
Source: Aberdeen, Polymarket, November 2025

**Figure 28: If estimates of  $r^*$  fall, there is scope for significant further policy rate cuts**



Source: Aberdeen, Haver, November 2025

**Figure 29: As long as the next Fed chair is credible, then inflation expectations should stay anchored**



Source: Aberdeen, Haver, November 2025





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