Quarterly Outlook

New Year, New Rules? Reassessing the Economic Landscape

December 2025

Market developments and other events

US and global equities rose in Q4 to near record highs driven by sustained optimism about AI investment, resilient corporate earnings, and expectations of further easing in monetary policy. Uncertainty about tech stock valuations and concerns about growth pains of the AI ecosystem triggered some equity market volatility in Q4, but this quickly receded towards year-end.

Global corporate credit spreads remained historically tight through Q4, driven by strong risk appetite, limited defaults, and expectations of liquidity support and easing of monetary policy. Government bond long term yields remained elevated in Q4 across developed economies, amid inflation concerns, deteriorating fiscal positions, and continued geopolitical uncertainty. Notably, Japan saw a sharp rise in long-term rates through Q4, driven by BoJ policy normalization and fiscal concerns.

Precious metal prices continued to surge through Q4, amid a combination of inflation worries and expected rate cuts, deteriorating fiscal positions, as well as geopolitical uncertainty driving safe-haven flows.

Global growth remained resilient but uneven, with moderate growth in Europe and the UK, while remaining relatively strong in the US benefitting from continued strength in consumer spending, ongoing fiscal stimulus, and business investment in technology.

Inflation remained stable and close to central bank targets in Europe, while it declined but remained above target in the US and UK. Inflationary pressures - particularly in services in the US and UK - sustain.

Outlook for growth, inflation, and interest rates

The outlook for global growth is moderate and below trend, as increased global economic and geopolitical fragmentation is unlikely to boost global productivity in the medium term. On the other hand, fiscal stimulus, easier financial conditions, and AI-driven investment could provide short-term tailwinds for growth. Still, the overall impact of AI on global productivity remains uncertain, and heightened geopolitical tensions raise downside risks. For the US economy, a softening labor market, persistent inflation, and the risk of weaker consumer spending is expected to present headwinds, while growth in Europe and the UK is expected to remain modest.

Short-term expected inflation remains above target in most regions, while medium-term expected inflation has been revised upward and is expected to stabilize somewhat above central bank targets. Inflation is expected to remain above target for most regions due to anticipated fiscal spending pressures, sustained geopolitical uncertainty, and the risk of fiscal dominance on monetary policy.

Long-term interest rates are expected to remain elevated across developed economies. Deteriorating fiscal positions, persistent inflation, and accommodative monetary policy suggest long rates will likely remain elevated. For the US, the risk of fiscal dominance and softer labor markets raise concerns about the Fed's ability to tackle inflation, fueling higher for longer rate expectations. More specifically, long rates are expected to rise moderately in the US and Europe and more significantly in Japan, while UK long rates are expected to see a slight moderation.

Outlook for financial assets

The current and short-term economic cycle improves on positive investor sentiment and improved purchasing power respectively, despite continued fiscal concerns and sustained inflation risks. The outlook balances, on the one hand, the downward pressure from increased policy uncertainty and, on the other hand, the potential for robust growth amid accommodative fiscal and monetary policy.

Equity returns are expected to improve in the short term against the background of continued monetary easing paired with global fiscal support, despite somewhat stretched valuations.

The short-term outlook for government bond returns is mixed. For the UK the decline in long rates led to a deterioration in expected gilt returns.

The outlook for corporate credit IG and HY returns remains stable for most countries. The UK IG corporate credit outlook weakens in line with lower expected gilt returns.

The outlook for financial assets exhibits downside risks from a sharper than expected growth slowdown and stretched valuations in tech stocks. Conversely, easy financial conditions and ongoing investments in technology, defense, and infrastructure could provide a boost for the outlook.

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