Global Macro Insights

Summary

September overview: Politically influenced actions, mostly out of the United States, continued their influence on global economies and markets during September. Tariff negotiations continued with a number of countries and concerns about a possible US government shutdown increased as the month progressed (the shutdown went into effect at midnight at month-end). Growth-related data releases during the month in the major economies continue to indicate some weakness in activity, seemingly partly related to tariffs and policy uncertainty, but still indicating recession should likely be avoided. Global inflation data have been somewhat mixed, trending modestly higher in developed economies but flat to lower across a number of emerging markets (EMs). As widely anticipated, the US Federal Reserve (Fed) resumed its easing cycle during September, but many other central banks paused during the month. The US dollar (USD) showed mixed performance against various currencies in September, resulting in the USD Index (DXY) ending unchanged in September (it is down almost 10% year-to-date). Bond markets mostly gained in September, across developed and emerging markets as well as sovereign credit.

Outlook: Uncertainty continues to cloud the outlook as tariff and trade negotiations drag on, while other politically related challenges for financial markets (such as the US government shutdown and political issues in various countries) also contributed to uncertainty. Fiscal policy across a range of countries remains a key structural concern, and there are indications that decisively correcting fiscal issues may be politically problematic (for example, the French confidence vote/government collapse in September was centered on budget cuts). We believe the USD remains broadly overvalued and we continue to expect weakening over the medium term. We are positive on select EMs, even within the new global trade landscape, but are carefully monitoring which countries we think are best placed to navigate this environment. We also remain constructive on select developed markets.

General market and economic overview

In the major developed markets, growth data has been tending toward somewhat softer outcomes. In the United States, manufacturing data has been mixed, while labor market and housing data have generally been weaker, partly driving softer consumer sentiment. In addition, revisions to the payrolls data indicate employment was lower than previously estimated. Gross domestic product (GDP) growth in the second quarter of 2025 was revised higher to 3.8% (quarter-over quarter, annualized), from an earlier estimate of 3.3%, representing a significant rebound from -0.6% recorded in the first quarter. Some promising signs were seen in the euro area, with increases in manufacturing and improvements in sentiment surveys. In Japan, data has shown mixed economic outcomes; for example, services-oriented companies are doing well but manufacturing companies are slowing. Auto exports to the United States have slowed, but a tariff cut from 27.5% to 15% announced in mid-September may help arrest this decline. The Bank of Japan's (BoJ's) Tankan survey noted positive signals for manufacturing—sentiment rose slightly, and large firms across all industries plan to increase capital expenditure by an average 12.5% in the current fiscal year. **Among EMs,** a number of negative developments of late have affected India, including the Trump administration's doubling of tariffs on India from 25% to 50% as pressure for India to stop importing (cheaper) oil from Russia, and the possible effect of fee changes to H1B visas in the United States (around 70% of H1B visa holders are Indian citizens; the higher fees could also affect the profitability of some Indian IT companies). India has indicated that it wants to increase energy imports from the United States in a bid to get tariff levels reduced.

The effects of tariffs on a number of countries are showing up in various ways that may not yet be reflected in data releases. For example, the Bank of Korea indicated tariffs would shave 0.45% off growth this year and 0.6% in 2026. In the euro area, a European Central Bank (ECB) survey found that trade issues were "significantly affecting the behavior and expectations" of households, who indicated they were both shifting away from American-made goods and reducing spending overall. Meanwhile, on the **trade** side, the United States continues to negotiate various bilateral trade deals with an eye on lowering tariffs in exchange for promoting investment in the United States. It has now reached such deals with two large trading partners, the European Union (EU) and Japan. During September, the European Commission approved a trade deal between the Latin American grouping Mercosur and the EU. It now awaits ratification by EU member states, which could happen by the end of the year.

Some major economies are dealing with political issues. In the United States, Congress was unable to agree on measures to avert a government shutdown, which began at midnight on September 30. Japanese Prime Minister Ishiba announced his resignation on September 7, and the ruling LDP party is expected to hold a leadership election in early October. In France, the government collapsed after Prime Minister Bayrou lost a confidence vote. **Emerging and frontier markets, meanwhile, have seen protests across a range of countries,** including Indonesia, Nepal, Philippines, Morocco and Serbia.

Global inflation outcomes have been mixed recently, with developed markets generally showing flat-to-higher inflation while EM rates have slowed in a number of instances. Among major economies, the latest consumer price index (CPI) inflation data show increases in the United States (2.9% in August from 2.7% in July) and the euro area (preliminary 2.2% in September from 2.0% in August), but a slowdown in Japan (2.7% in August from 3.2% in July). Other developed economies have mostly seen higher inflation rates recently. Among EMs, most Latin American inflation rates are generally moving sideways to slightly lower. Inflation in emerging Europe has mostly moved sideways recently. Inflation rates generally remain quite subdued in Asia, and even those that have ticked up recently remain low. The latest inflation rate in South Africa dipped slightly.

A cautious easing bias continues to characterize most developed market central banks. The Fed reduced the federal funds rate target range by 25 basis points (bps) to 4.0%-4.25%, while the “dot plot” of individual committee member expectations indicates that the median participant expects two more cuts in 2025, two cuts in 2026 and one in 2027. However, Fed Chairman Powell downplayed those forecasts somewhat given the current high level of uncertainty. The ECB left the refi rate unchanged at 2.15% (after a series of reductions), and simply noted that inflation is around the target, and the assessment of the inflation outlook is broadly unchanged. Japan (the exception to the global easing trend) and Australia also kept rates unchanged during September, while Norway reduced rates by 25 bps—only its second cut in this cycle. **EMs mostly remain in easing cycles,** with many in the late stages of these cycles. In September EM central bank policy meetings, Mexico lowered rates by 25 bps while Brazil, Colombia, South Africa, China and Malaysia left rates unchanged.

USD performance was mixed in September and the DXY was flat over the month. The DXY has lost 9.9% year-to-date. Within developed markets, the Japanese yen fell slightly against the USD, while the euro, Norwegian krone and Australian dollar gained. In Asia ex Japan, the Malaysian ringgit appreciated against the USD while most other currencies depreciated. Latin American currencies were generally stronger against the dollar, as was the South African rand.

Movements in developed market sovereign bond yields were mixed in September. While fiscal and inflation outlooks remain of concern, the Fed rate cut and dot plot outcome saw the yield on the US 10-year Treasury note fall by eight bps over the month to 4.15%. Most EA bond yields were slightly down, with the exception of France, where they rose modestly (following a larger rise in August). Meanwhile, 10-year yields rose in Norway and Australia, as well as in Japan, where some concern over fiscal outcomes ahead of the new LDP leadership election may have contributed to this outcome. **Among EMs,** local-currency bond yields were generally lower in Latin America and Eastern Europe but mostly higher in Asia. Overall, local-currency EM indexes were stronger in September. **EM sovereign credit was also higher over the month,** with the JP Morgan EMBI Global Index rising 1.6%, bringing its year-to-date return to a little over 10%.

Outlook and positioning

Policy uncertainty remains high as financial markets digest some tariff policy developments but still await clarification on a number of issues. While we expect **global growth** to be weaker than we had expected prior to tariff imposition, we anticipate a recession is likely to largely be avoided. We are cognizant that some of the higher growth recorded in some countries during the past few months could be frontloading ahead of tariffs, and we are watchful for signs of possible payback through lower growth in coming quarters. The current government shutdown in the United States is adding to uncertainty, including due to data releases being delayed.

Inflation risks remain skewed to the higher side. While inflation outcomes have been relatively contained so far, tariffs are expected to push inflation higher across a range of countries, and we are monitoring outcomes to watch for whether, and where, such increases become more permanently embedded in inflation. Surveys across a range of countries show higher inflation expectations compared to before tariff announcements, and central banks have highlighted the potential risks to inflation. In the United States, we expect near-term pressures from tariffs, but anticipate inflation will be trending back toward target by mid-end 2026. The impact of tariffs has been somewhat delayed because companies built inventories in anticipation of tariff imposition, and thus have delayed passing on costs to consumers. There is not much evidence that foreign exporters are bearing much of the costs of the tariffs, and we ultimately expect US consumers to bear the brunt of thems. In addition, we think the US fiscal situation may complicate the medium-term inflation outlook in the United States.

Global monetary policy remains in a broad easing cycle, but policymakers have highlighted the risks arising from tariffs and trade policy. Tariff impacts on inflation, growth or both have the potential to affect interest rates. Central banks have hinted that some easing has been delayed around inflation concerns; if tariff-related inflation effects prove short-lived, authorities may shift their focus to growth risks. The main outlier in the global monetary policy landscape is the BoJ, which is gradually normalizing policy in response to structural reflationary conditions; it too has cited tariff risks as affecting the timing of policy decisions. Although inflation has eased in recent months, part of that is due to energy and childcare subsidies, and inflation remains well above target. We thus anticipate the BoJ to continue gradually removing monetary accommodation.

Fiscal positions in a number of countries, mainly among developed markets, remain a key concern. Already-high debt levels in major economies, such as the United States and the EA, are set to rise further—in the case of the EA, this is largely to provide fiscal room for the "ReArm Europe" plan and should be growth-positive. Pension reform approved in Germany in August is also likely to pressure government finances there. Following the collapse of the French government in September following a confidence vote centered on unpopular budget cuts, there is concern over the pace of fiscal consolidation in France. Debt in Japan remains at very high levels, and regardless who is elected the new prime minister there, we think there may be modestly more accommodative fiscal policy. In our view, such fiscal burdens raise risks for longer-dated maturities in the bond market.

We remain constructive on select EMs, despite rising risks of tariffs. Sounder policies and reforms across a range of countries have strengthened their fundamentals. We expect differentiated impacts among countries from tariff changes as well as shifts in US foreign policy. In general, we think the imposition of tariffs is likely to underpin the current global trend of regionalization and reshoring, a trend which we expect to benefit select countries. In terms of the countries in our portfolio, we believe the trade deals struck or proposed with the United States are manageable, and we are comfortable with our positions, though we continue to monitor risks on this front. As an example, the recent US tariff announcement on India may have an impact on its attractiveness as a foreign direct investment destination, and negotiations with South Korea remain fraught following the detention of hundreds of Hyundai factory workers (who were later returned to South Korea) at a plant in the United States during September.

Even with the depreciation so far this year, in our view, the USD remains broadly overvalued and we expect further depreciation over the medium term. This view factors in both cyclical and structural factors and is underpinned more recently by a pivot in financial asset flows away from the United States. Consequently, we see opportunity in non-dollar assets in select countries within both developed markets and EMs.

Regionally, our two main focus areas are the Asia-Pacific region and Latin America. In Asia, we focus on countries with positive fundamentals and undervalued currencies, as well as those we expect to be more insulated from tariff effects. We have exposure to both developed and emerging markets in this region. In Latin America, we favor countries with prudent macroeconomic policies (including those where central banks have proved to be independent and proactive), relatively high yields and undervalued currencies.

Beyond these two broad regions, we also see opportunities in certain emerging and frontier markets in both local-currency and hard-currency assets. In our assessment, fundamentals have improved notably in certain African countries which offer attractive opportunities for potential yield pickup. We therefore have increased exposure in some portfolios in select African countries, as well as certain countries in frontier Asia.

Recent actions in our portfolios include increasing exposure to the euro. We expect the "ReArm Europe" program to support medium-term growth in the region and believe a positive effect on the currency is likely as pension funds move assets back home. We increased exposure in the past few months by buying relatively high-yielding bonds issued by Spain and Greece, which also have stronger growth than core EA countries. During September, Moody's upgraded Spain's credit rating to A3. We moved to shorter duration in the United States on our expectation of a combination of lower growth and higher inflation. The Congressional Budget Office revised down its forecast for 2025 GDP growth by 0.5pp to 1.4% due to tariffs and lower migration.

In local-currency positions, we hold select countries in both developed markets and EMs. Our currency positions continue to center around our assessment of undervaluation against the USD. These countries also tend to have robust balances of payments and growth fundamentals. In bonds, we hold positions in select countries where we identify supportive fundamentals. These might cover a range of factors, including inflation and interest-rate outlooks, fiscal progress and other economic reforms, and/or reshoring. We aim for a relatively high overall portfolio yield by holding higher-yielding local-currency positions in specific emerging and (where relevant) frontier markets that we view as having attractive risk-adjusted yields. **In hard-currency-denominated sovereign credit positions,** we favor emerging (and, where relevant) frontier markets with improving fundamentals and policy responses.

In all positions, we closely monitor idiosyncratic factors in different countries to identify relative valuation opportunities. We remain highly selective at the sovereign level, given significant variations in economic fundamentals and policy responses.

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