FRANKLIN TEMPLETON

Perspective from Templeton Global Macro

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Global Macro Insights

Summary

December overview: In economic news, data in developed markets generally remained somewhat mixed but with a softer undertone, and there are continued signs of moderation in the US economy. Across a number of economies, there is some evidence of unwinding of previous front-loading ahead of tariffs, particularly with respect to exports. Monetary policy actions across the globe included the US Federal Reserve (Fed) cutting interest rates and the Bank of Japan (BoJ) raising rates, while some emerging markets eased policy. Inflation data was somewhat mixed, with a downside surprise in the United States—possibly affected by data collection issues stemming from the government shutdown—but with some other developed economies continuing to show some pricing pressures. Inflation remains fairly contained among a variety of emerging markets (EM). The US dollar (USD) was weaker against most currencies in December, with the exception of the Japanese yen and a handful of EM currencies. Bond yields were generally higher during the month. Geopolitical news took center stage just after month-end, when US troops entered Venezuela and captured President Nicolás Maduro to stand trial in the United States.

Outlook: The recent geopolitical developments in Venezuela add to the global uncertainty that tariff policy initially sparked. Some market participants have raised questions about the implications for similar unilateral actions elsewhere (whether on the part of the United States or other countries). Financial markets also still await the Supreme Court ruling on the legality of tariffs imposed by the president rather than Congress; the ruling may take some months yet. While uncertainty remains on a number of fronts, in general we see global growth as being quite resilient. Over the medium term, our core themes of improving EM fundamentals, USD weakening and global rewiring (such as geopolitically induced shifts in global supply chains) remain intact. Although data has been fairly resilient to date, risks remain from US tariff and trade policy. In addition to this, domestic political developments are of potential concern in some countries, particularly with respect to fiscal policy outcomes. Elections are due in a number of countries this year, including Brazil, Colombia and Hungary.

General market and economic overview

Global growth-related data releases continue to show resilience but with some underlying softness present in certain countries.

- In the **United States**, some official data releases resumed after the government shutdown. Key among these was the employment report, which covered data for both October and November. While employment is still growing overall, there are clear signs of moderation. The unemployment rate rose to 4.6%—still low by historical standards but representing the highest level since September 2021. Consumer confidence improved somewhat, according to the University of Michigan survey. Third quarter (Q3) gross domestic product (GDP) grew 4.3% quarter-over-quarter seasonally adjusted and annualized (q/q saar), compared to 3.8% in the second quarter. Most of the acceleration came from services consumption. Notably, artificial intelligence (AI) accounted for almost all of the growth in capital expenditure during the quarter. Net exports contributed 1.6 percentage points to GDP growth as previous front-loading was unwound.

- **Euro-area** (EA) Q3 2025 GDP growth was revised slightly higher to 1.4% year-over-year (y/y) from a preliminary estimate of 1.3%, with momentum particularly evident in investment spending as well as government spending. Purchasing managers' indexes remain in positive territory overall, with services performing better than manufacturing, where some slowdown is evident. Germany passed a pension reform package to take effect in January 2026.

- In **Japan**, Q3 growth—affected by some unwinding of front-loading—was revised downwards to -2.3% q/q saar, compared to a preliminary reading of -1.8%; revisions to business spending and housing investment accounted for the change. That said, underlying economic conditions do appear to be resilient. The fourth quarter Tankan survey showed that business sentiment remains solid, with the all-industry business conditions index rising to its highest level since 2018 and capital expenditure plans remaining firm.

- The readout from **China's** December Politburo meeting seemed relatively optimistic, stating that major goals will be met for 2025 and that the 15th Five-Year Plan should be off to a strong start. The authorities emphasized domestic demand as a main driver of growth, while the fiscal stance is set to remain proactive and the monetary stance moderately loose. Additionally, the International Monetary Fund (IMF) revised its 2025 estimate of Chinese growth higher to 5% (in line with the government target).
- **Exports** rebounded in some Asian countries, including China (after holiday-affected October data) and South Korea.

There were a number of geopolitical developments around the end of 2025.

- Just after month-end, US troops captured President Nicolás Maduro and his wife in Venezuela and brought him back to the United States to stand trial. Vice President Delcy Rodríguez has now been sworn in as President. US President Donald Trump has indicated that the United States is "in charge" in Venezuela, and that further military action remains on the table. The situation remains fluid.
- The 2025 US National Security Strategy, released by the Trump administration in December 2025, signifies a major shift to "America First," prioritizing domestic strength, economic leverage and "strategic selectivity" over broad international engagement, thus moving away from traditional multilateralism.
- In trade news, China published an updated policy framework for increasing cooperation with Latin America (the last update had been in 2016). The trade deal between the European Union (EU) and Mercosur, originally set to be finalized during December, was delayed due to opposition from some EU member states, but at the time of writing it appears there will be enough consensus to finalize this during January.
- China discouraged group travel to Japan, which we estimate could have a negative effect of around 0.2% on Japanese GDP.
- The EU has reached a deal to phase out Russian gas faster than originally planned, aiming to sever ties with its once-primary energy supplier. This is part of the plan known as REPowerEU to remove reliance on Russia and reduce risks to EU energy security, following the crisis triggered by the Russia-Ukraine war.
- Thailand and Cambodia agreed to a new ceasefire during December 2025 after weeks of intense border clashes.

Global inflation outcomes continue to diverge, with developed markets generally seeing some pressure on inflation while EM inflation rates have largely moved sideways. The October US Consumer Price Index (CPI) was not released due to the government shutdown. November CPI was measured at 2.7% y/y, compared to 3.0% y/y in September, but this data likely reflected distortions stemming from the shutdown. In the EA, November inflation was revised to 2.1% y/y, 0.1% below the preliminary inflation figure and unchanged from October. Inflation in Japan ticked lower to 2.9% in November from 3.0% in October, but pricing pressures remain robust. Other developed economies have mostly seen continued inflationary pressures, with notably higher moves in some countries (for example, Australia). Among EMs, many inflation rates are generally moving sideways to slightly lower, with the occasional exception. However, among major EMs, even rates that have ticked up recently remain relatively low and a significant number of EMs have inflation within their target ranges.

A late-cycle easing bias continues to characterize much of global monetary policy. In the United States, the Fed cut the federal funds rate target range by 25 basis points (bps) to 3.50%–3.75% at its December meeting. There were three dissents to this vote, with one governor voting for a 50-bps cut and two others preferring to keep rates on hold. The European Central Bank kept rates on hold at its December meeting, as did Norway and Australia. The BoJ raised its policy rate by 25 bps to 0.75%, and indicated that further gradual tightening was likely forthcoming, citing the wage and inflation outlook as well as a stronger assessment of economic conditions. The BoJ meeting minutes also showed concern over the low level of real interest rates. Among EMs in December, central banks in India, Mexico and Poland each lowered rates by 25 bps while Brazil, Colombia and China left rates unchanged.

The USD was weaker against most currencies during December, other than the Japanese yen and a handful of EM currencies. The US Dollar Index (DXY) index fell by 1.1% over the month, bringing its cumulative decline in 2025 to 9.4%.[1] Within developed markets, the Japanese yen depreciated against the USD, while the euro, Norwegian krone and Australian dollar gained. Most emerging market currencies were stronger against the greenback, with the main exceptions of the Brazilian real, Colombian peso and Indian rupee.

Most sovereign bond yields rose over the month, as inflation outlooks and fiscal concerns remained top of mind. The yield on the 10-year US Treasury note rose by 15 bps to 4.17% over December, while the benchmark for the EU, the German Bund yield, was 17 bps higher. Other developed market bond yields rose too, and notably the 10-year Japanese bond yield breached the 2% level for the first time since late 1998 as the BoJ rate hike and inflation and fiscal outlooks put pressure on rates. Local-currency bond yields were also mostly higher in emerging markets, with the main exceptions being some African countries, including South Africa, where the 10-year yield declined by 30 bps over the month. EM sovereign credit overall was modestly higher during December, with the total return on the J.P. Morgan EMBI Global Index (JPM EMBIG) rising 0.5%.[2]

Outlook and positioning

Policy uncertainty remains relatively high on a number of fronts. Some tariff policies are still to be finalized, and the situation remains fluid. The US Supreme Court ruling on tariffs will be an important factor to watch, although it may take some months for the court to reach a decision. However, even as uncertainty around tariffs and their global impacts appears to have retreated somewhat recently, other factors giving rise to uncertainty have emerged. In the United States, higher uncertainty surrounds monetary policy—stemming both from the divergence of views within the Fed mentioned earlier, as well as the prospect of a new Fed chairman. Geopolitically, the recent events in Venezuela have raised some concerns about possible further unilateral actions around the globe. In terms of domestic politics, there are elections in a number of countries this year, including Brazil, Colombia and Hungary.

We expect **global growth** to be weaker than we had expected prior to tariff imposition, but we anticipate a recession is likely to be avoided. We are cognizant that some of the higher growth recorded in some countries earlier in 2025 was likely front-loading ahead of tariffs, and we are watchful for further signs of possible payback through lower growth in coming quarters (as was seen in Japan's Q3 data).

- Increased optimism on growth in the **EU** appears supported by various recent developments, including the Security Action for Europe (SAFE) fund being fully subscribed and various countries adopting the escape clause to allow for higher fiscal spending. These broad intentions are being supported by specific country developments—for example, Germany approved a €50 billion package for military spending in December, one of the largest single waves of military spending since World War II.
- **AI spending** is increasingly a factor to watch in growth outcomes. We noted above the role of AI in US Q3 growth. In China, regional provinces now have AI plans for the next five years, with a key point being that the government is trying to prevent domestic competition through coordinating different provinces to focus on different types of AI. In South Korea, President Lee Jae-Myung called the 2026 budget "Korea's first budget for the AI era," highlighting the government's plan to allocate KRW10 trillion to AI, a threefold increase from 2024.

Inflation remains of some concern for now, particularly in developed markets. We continue to monitor outcomes to discern whether, and where, tariff increases might become more permanently embedded in inflation, especially as surveys across a range of countries still show higher inflation expectations compared to before tariff announcements. In the United States, we expect near-term pressures from tariffs but anticipate inflation will likely be trending back toward target by the second half of 2026. In addition, we think the US fiscal situation may complicate the medium-term inflation outlook in the United States.

Many countries are at a late stage in their monetary policy easing cycles. A significant number of EMs are now nearing the end of their rate reductions, while inflation outcomes complicate the outlook for meaningful further easing in developed markets. We highlight Australia, where central bank officials have noted that they would raise rates if needed given higher recent inflation outlooks (though that is not currently our base case). For now, the main outlier in the global monetary policy landscape is the BoJ, which remains committed to gradually normalizing policy in response to structural reflationary conditions. The BoJ has indicated that wage negotiations will be an important signal for future inflation outcomes and, hence, potential tightening moves.

The fiscal outlook in a number of countries remains concerning. Already-high debt levels in major economies are set to rise further, while some political developments also complicate efforts to consolidate fiscal expenditures. The IMF estimates G7 gross government debt at 126% of GDP in 2025 and projects an increase to 137% by 2030. In our view, such fiscal burdens raise risks for longer-dated maturities in the bond market. EM fiscal positions have also deteriorated since the pandemic. The IMF estimates average EM gross government debt-to-GDP at just under 74% in 2025 and projects it to rise further, to around 84% by 2030, compared to 55% in 2019.

- **Japan** plans to unveil a record initial budget for the fiscal year starting in April, with spending increasing faster than inflation. The budget for the fiscal year beginning April 2026 will represent a 6.3% increase from the current fiscal year. Bond issuance as well as tax receipts are anticipated to finance the spending.
- In **France**, the fragile political situation has resulted in the government suspending pension reform until after the 2027 presidential election, with the aim of preventing the current fragile minority government from being toppled again following the government collapse last year.

We remain constructive on select EMs, despite risks from tariffs. We believe sounder policies and reforms across a range of countries have strengthened their fundamentals. We expect differentiated impacts among countries from tariff changes and other 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. We continue to monitor risks around potential negative implications from US tariff and trade policy.

We maintain the view that the USD is broadly overvalued and we expect further depreciation over the medium term for both cyclical and structural reasons, though we note that the magnitude of further weakness may not be as much as was seen during 2025. Consequently, we also look to carry as a source of return, which underpins our view of select opportunities in non-dollar assets in EMs in particular. We are also constructive on select developed market currencies.

Regionally, our two main focus areas currently remain the Asia-Pacific region and Latin America. In Asia, we generally focus on countries with positive fundamentals and undervalued currencies, as well as those we expect to be more insulated from tariff effects. In Japan, we continue to see evidence of a structural reflationary shift. 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 particular, we have exposure in some portfolios in select African countries where we believe reform efforts have resulted in notable improvements in fundamentals and the economic outlook. We also have some holdings in select frontier Asian markets. These all also offer attractive opportunities for potential yield pickup. South African GDP grew by 2.1% y/y in Q3, which is significantly higher compared to the history of the past few years; notably, investment made an important contribution. We also note continued improvements at state-owned enterprises. Elsewhere in Africa, reforms are reaping rewards with improving economic conditions and growth prospects in a number of countries. South Africa and some other African countries benefited from credit ratings upgrades last year.

Our EA exposure is mainly through Spain and Greece. In Greece, the target for the primary surplus was raised, and the government's cash buffers mean that some early debt repayment is expected. Both countries are expected to grow above 2% this year, well above the overall EA growth rate.

In local-currency positions, we hold select countries in both developed markets and EMs. Our currency positions focus on potential upside based on our assessment of undervaluation against the USD. These countries tend to have robust balances of payments and growth fundamentals. In bonds, we hold positions in countries where we identify supportive fundamentals. These might cover a range of factors, such as inflation and interest-rate outlooks, fiscal progress and other economic reforms, and/or anticipated economic benefits from 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.

For a more detailed outlook, please refer to our Quarterly Economic Outlook, Fourth Quarter 2025.

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Endnotes

1. Source: Bloomberg. The DXY is a measure of the value of the dollar against six foreign currencies: the euro, Swiss franc, Japanese yen, Canadian dollar, British pound and Swedish krona. **Past performance is not an indicator or a guarantee of future performance.** Indexes are unmanaged and one cannot invest directly in an index. Important data provider notices and terms available at www.franklintempletondatasources.com.
2. Source: Bloomberg. The JPM EMBIG tracks total returns for US dollar-denominated debt instruments issued by emerging market sovereign and quasi-sovereign entities. **Past performance is not an indicator or a guarantee of future performance.** Indexes are unmanaged and one cannot invest directly in an index. Important data provider notices and terms available at www.franklintempletondatasources.com.

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