



Quarterly Economic Outlook

Summary

- We see the global economy as undergoing a period of “global rewiring” on a number of fronts—evolving patterns and relationships that we anticipate affecting certain economies and markets for some time to come. Such rewiring could cover relationships between countries or developments within particular regions or economies.
- Our core themes of improving emerging market (EM) fundamentals, US dollar (USD) weakening and geopolitically-induced shifts in global supply chains remain intact, with recent events providing further support to our views.
- Uncertainty remains elevated. Final tariff levels are still not decided for a number of countries. Risks from US tariff and trade policy encompass growth, inflation and/or geopolitical implications and vary by country. Domestic political developments in some countries raise fiscal and other policy concerns. Finally, the current lack of US data as the government shutdown continues and questions over the independence of traditionally non-partisan government institutions further increase uncertainty.

Economic and market prospects

Where we stand now. The change in tariff and trade policy from the United States, following President Trump’s re-election to a second term starting in January, was possibly the most significant shift in the economic landscape this year. This has reverberated throughout world trade with knock-on effects on growth and inflation, albeit with the full impact likely yet to come. Moreover, tariff rates are still not settled in a number of countries. Growth data to date has held up relatively well, but that is partly due to frontloading of economic activity ahead of tariff impositions, and the fuller effects on activity are likely to become more evident as time goes on. Similarly, while there has been a somewhat limited effect on inflation rates in certain countries so far where retailers have absorbed some cost increases, this is not a sustainable situation, and we believe inflation rates—already moving higher in some developed markets—are therefore likely to rise further for some time. This is also indicated by recent surveys showing higher consumer inflation expectations. Political uncertainty has also increased this year, with factors including elections, the loss of confidence votes impacting prime ministers in a number of countries, and the US government shutdown (which started at midnight on September 30).

The tariff landscape has affected other geopolitical outcomes, accelerating some rewiring trends that were already underway.¹ The relationship between the United States and China has turned adversarial again, after a brief period of thawing relations during part of the Biden administration. The latest developments include new Chinese restrictions on rare earths exports, and the US administration’s threat to impose higher tariffs in return. However, the fractious relationship and souring trade ties between the United States and China means that there is scope for other EMs to step into the gap including countries such as Malaysia and India which are well-placed in terms of global supply chains (and, often, they can take advantage of trade with both the United States and China). There is opportunity beyond EMs too—for example, the United States and Australian governments recently signed a US\$8.5 billion deal for critical minerals, with significant agreements also made in defense cooperation and some trade deals. Other deals seem to have geopolitical objectives, such as the US-Argentina currency swap deal in October designed to support the Argentine peso.² That said, even as trade agreements between the United States and other countries are being signed, there are also an increasing number of bilateral and multilateral agreements that exclude it. Some ties are also deepening between non-Western centers; recent examples include some agreements and discussions around cooperation on various issues between some African countries (such as Ethiopia and Kenya) with China and/or Russia.

Domestic politics in various countries remains a key source of uncertainty.

- In the United States, Congress was unable to agree on measures to avert a government shutdown, which began at midnight on September 30 and is still ongoing as of the time of writing (October 27).
- Japanese Prime Minister Shigeru Ishiba announced his resignation on September 7, following elections in which the then-ruling coalition (comprised of the Liberal Democratic Party (LDP) and Komeito) lost its majority in the Upper House. The LDP elected Sanae Takaichi as its new leader in October, and the Japanese parliament subsequently voted her in as Prime Minister.
- In France, the government collapsed after Prime Minister François Bayrou lost a confidence centered on unpopular budget cuts in September; his successor Prime Minister Sebastien Lecornu then resigned in October after a deadlock on budget issues but President Emmanuel Macron reappointed him to the post. There is concern over the pace of fiscal consolidation in France amid the fractious budget negotiations.
- There have also been the “Gen Z” protests across a number of countries and regions (including Asia, Africa and South America) and with a range of causes cited, with the most common protest reason cited as government corruption; in a couple of countries, leaders have resigned in the wake of the protests.
- Looking forward, elections are due to be held in a number of countries over the next few months, mostly among emerging markets.

However, there are also more positive outcomes of rewiring in domestic politics in certain places. A key example is the European Union (EU), where the internal political landscape has shifted in a way that seems set to support a new level of growth in the region. Governments at the EU and national level have agreed to loosen fiscal limits, thus facilitating the spending required by the “ReArm Europe” and infrastructure plans. As part of this inward turn, European suppliers will also be preferred—implying that much of the spending (and use of European savings to fund it) will be kept within the bloc, rather than being spent on imports from outside it as may have been the case in the past. We have also for some time been commenting on the internal rewiring in Japan, where we see a reflationary shift away from the prior few decades including important corporate and labor market policy reforms and monetary policy normalization.

The International Monetary Fund (IMF) released its October World Economic Outlook (WEO). Global growth has been revised slightly higher compared to the April WEO and is expected to expand by 3.2% in 2025 and 3.1% in 2026. The IMF highlights that the overall environment remains volatile, and temporary factors that supported activity in the first half of 2025—such as front-loading—are fading. The IMF sees growth risks still tilted to the downside, with a number of factors of concern: It cited prolonged uncertainty, more protectionism, labor supply shocks, fiscal vulnerabilities, potential financial market corrections and erosion of institutions. The IMF’s gross domestic product (GDP) growth forecasts are summarized in Exhibit 1, indicating that EMs, particularly in Asia, are still likely to outperform advanced economies. China released its 15th five-year plan. It aims to ensure domestic demand through consumption, effective investment and development of a unified national market. In addition, the plan emphasizes that the share of manufacturing in the national economy should be kept at an appropriate level, and advanced manufacturing as the backbone in the industrial system. The goal is that by 2035, the country’s GDP per capita will be at par with that of a mid-level developed country.

Exhibit 1: IMF WEO Growth Projections

Real Gross Domestic Product Growth, Percent Change Year-over-Year

	2024	2025	2026
World	3.3	3.2	3.1
Advanced Economies	1.8	1.6	1.6
United States	2.8	2.0	2.1
Euro Area	0.9	1.2	1.1
Japan	0.1	1.1	0.6
Emerging and Developing Economies	4.3	4.2	4.0
Emerging Asia	5.3	5.2	4.7
China	5.0	4.8	4.2
India	6.5	6.6	6.2
Latin America	2.4	2.4	2.3

Source: International Monetary Fund. There is no assurance that any estimate, forecast or projection will be realized.

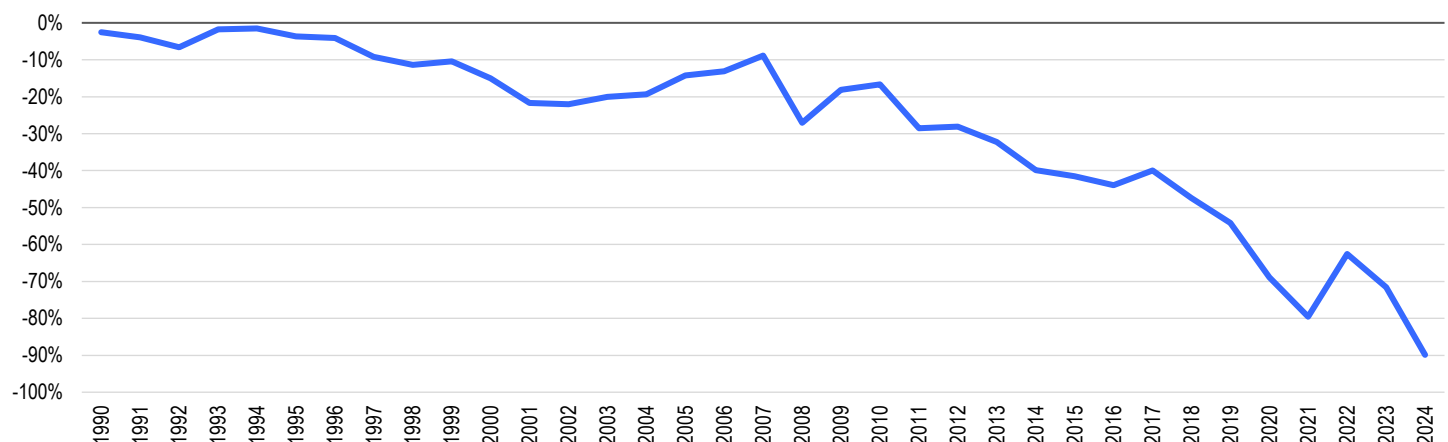
In developed markets, the prior disinflation trend largely stalled, with inflation rates even rising again in some countries. The dissipation of base effects and stickiness in services prices are among general reasons for sideways or higher inflation during the year so far; there is also starting to be some early evidence of tariff effects. In the United States, we expect near-term pressures from tariffs but anticipate inflation will be trending back toward target by mid-to-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 little evidence that foreign exporters will absorb much of the costs of the tariffs, and we ultimately expect US consumers to bear the brunt of them. In addition, we think the US fiscal situation may complicate the medium-term inflation outlook in the United States.

Tariffs continue to present risks for inflation outcomes, with implications for the path of monetary policy in various countries. While much of the past couple of years has represented a global monetary easing cycle, it is possible that divergence could become more evident going forward, possibly exacerbated by differing tariff effects. Brazil had already raised interest rates earlier this year, and various central banks have signaled caution around rate cuts and possibly even a reversal of that trend. Others are likely to continue easing (albeit perhaps more modestly than before) or pause. We anticipate that the Fed, which only renewed easing in September after being on hold since the end of last year, is likely to continue easing in coming months, but we expect the Bank of Japan to continue a gradual tightening cycle.

The USD has depreciated somewhat this year to date, but we believe it remains overvalued against a range of currencies.

- Exhibit 2 illustrates the net international investment position (NIIP) in the United States, which reflects the cumulative amount of investment by foreigners on a net basis relative to GDP. At around 90% of GDP, this reflects that the United States has absorbed a very large amount of foreign capital — and the position has roughly doubled over the past decade, as the United States has continued to represent an attractive investment destination for both home and foreign investors. This has been a key reason that the USD has remained so strong, even in the face of the large US current account and fiscal deficits (the “twin deficits”). It also presents a potential vulnerability, in that if there is any halt to inflows, the underlying downward pressure on the greenback from the twin deficits would be more exposed. In this regard, a factor to watch is a possible pivot in financial asset flows away from the United States, as investors react to the US administration’s tariff and trade policies and decelerating growth. This could be further accelerated if US investors themselves start looking for more diversification outside of the United States.
- We will monitor investment inflows into the United States in terms of the agreements reached as part of the tariff deals as potentially mitigating some of the expected USD weakness.
- We also note that developments elsewhere have been driving some of the anticipated currency move. For example, as discussed earlier, the European defense and infrastructure plans favor European suppliers. In the past, US suppliers would have been a significant beneficiary of defense spending in Europe, but that seems unlikely to be the case this time.
- We highlight that the expected move is largely cyclical with some structural (twin deficit) undertones. We do not expect any change to the USD’s role as the dominant reserve currency. Its proportion of reserves has gradually declined over the years but remains over 56% of global reserves, more than double the next largest holding (the euro).

Exhibit 2: US Net International Investment Position
Percentage of GDP (Year-End, 1990–2024)



Source: Bureau of Economic Analysis.

Strategy and portfolio positioning

Tariff policy is changing trade patterns; globalization is still proceeding, but in a different way from the past couple of decades. We are seeing bilateral and multilateral trade agreements between EMs and between non-US developed nations and EMs. In other words, the trend of deepening global trade networks mostly remains in place, but even as the United States concludes more of its own deals, we see a tendency for other agreements to exclude it. We also note, however, that trade volumes overall have suffered in the new environment. The World Trade Organization raised its latest forecast for world trade volume growth to 2.4% for 2025 (partly due to frontloading) but cut its 2026 forecast sharply from 1.8% to 0.5%, as the global economy slows and as the full impact of tariffs for a full year becomes felt.

The tariff and policy outlook emanating from the United States somewhat dampens—but in our view does not remove—the generally positive conditions for EMs. Sounder policies and reforms in a number of EMs have led to improved economic fundamentals, as illustrated by their resilience against repeated stresses of the past few years (including the pandemic and the rising US interest rate cycle). They are also less directly exposed now to trade with the developed world than a couple of decades ago. Furthermore, we expect various EMs to benefit from reshoring initiatives. So while tariffs will undoubtedly have some cost for EMs, we also believe that many EM countries are well-positioned to navigate this new environment. We further expect that the deteriorating relationship between the United States and China will open up opportunities for other EMs. As the face of global trade shifts more toward regional and bilateral relationships, ensuring security in supply chains and ensuring security between allies, those EMs that can pivot to align with these objectives should benefit from the global trade rewiring currently underway. In general, we think the imposition of tariffs should further underpin the current global trend of regionalization and reshoring. We closely monitor idiosyncratic factors in different countries to identify relative valuation opportunities, with some countries more vulnerable to weaker fundamentals and/or the effects of tariffs and changing US foreign policy.

Structurally, fiscal outcomes—especially in the developed world—remain a concern, as debt levels are set to rise further.

Some EU countries (such as Germany) have more scope than others to raise debt levels, but those for the region as a whole are expected to rise, as are those in the United States and Japan. This makes us wary of longer-term bonds, which we would expect to bear the brunt of the implications of fiscal loosening (and could also be affected by inflation increases related to tariffs).

On a regional basis:

Within the **Asia-Pacific region**, where we have our largest regional exposure, we focus on countries with positive fundamentals and undervalued currencies, as well as those we expect to be more insulated from tariff effects.

- We continue to see evidence gradually building up in support of Japan's structural reflationary shift. We also expect Japan to benefit from reshoring, given its geopolitical position and specialization in certain sectors such as robotics. Our Japan view is expressed through currency exposure only, due to concern about the effects of Japan's fiscal situation on its bond market.
- Australia has solid macroeconomic fundamentals, including a resilient consumer sector, which we believe should provide upside potential while limiting downside risk. A relatively low share of exports to the United States should also help limit the impact of tariffs, and recent agreements with the United States should be beneficial.
- In India, strong demographics, continued progress with structural reforms and benefits from reshoring and diversification underpin our positive view. There has been a significant increase in foreign direct investment, while a large increase in India's services exports means, for example, that the balance of payments and currency should not be as sensitive to oil price swings as they used to be. However, tariff risks remain elevated.
- Malaysia is well-entrenched in the global supply chain, particularly in the electronics sector, with an increasingly business-friendly environment (including the new special economic zone). It is also likely to benefit from reshoring, where its neutral position between the United States and China should be an advantage. GDP grew a robust 5.2% year-over-year in the third quarter of 2025.
- In South Korea, although growth has been relatively weak, the trade surplus remains robust and there is renewed optimism about the implementation of structural reforms to encourage capital expenditure. Political uncertainty decreased after the recent presidential election.
- We expect China's authorities to continue to support domestic growth as needed, which in turn should help support its Asian neighbors and trading partners. Growth continues to be targeted around the 5% level.

In **Latin America**, we favor countries with prudent macroeconomic policies (including proactive monetary policy), relatively high yields and undervalued currencies.

- Brazil is a key example of proactive monetary policy; it was early to raise interest rates as inflation pressures emerged after the pandemic and the Russia-Ukraine war, and it was proactive again recently by raising rates in the face of renewed inflation pressures. Brazil's growth has also generally surprised to the upside since the COVID-19 shock.
- Colombia's central bank remains prudent, we believe, and the government has reaffirmed its commitment to its fiscal rule and fiscal sustainability despite some recent deterioration.
- Mexico's geographic proximity to the United States makes it an attractive destination for nearshoring, despite current trade tensions. Reshoring in Mexico has been underway for around a decade now, originally driven by cost and then by supply-chain issues (which first manifested during the pandemic, and are now more geopolitically influenced). The current government has demonstrated a willingness to work with the United States and we believe that the close ties between the two nations are still relevant.

Beyond these two regions, we also see opportunities in select **African and European countries**, as well as in frontier markets in Asia.

- In South Africa, we think the formation of the Government of National Unity (GNU) in 2024 represents a landmark political shift. While progress may be uneven, we anticipate the coalition will continue to advance toward implementing key reforms in areas such as energy and transport infrastructure, reversing course from years of structural decline. There are also moves toward formally lowering the inflation target to 3% (the lower bound of the current official 3%-6% range).
- In some portfolios, we hold Egypt, whose strategic geopolitical position in the Middle East is an asset. Additionally, key economic reforms and pledged foreign assistance have strengthened the country's fiscal and economic outlook. Similarly, in some portfolios we hold Kazakhstan, where growth has been robust, debt is low and the central bank has been proactive.
- In non-euro area (EA) Europe, we have positive views on Norway, which has a healthy external and fiscal position due to prudent management of its energy exports as well as ongoing investment in the sector, and Serbia, which has higher growth relative to core Europe and what we consider more attractive yields, as well as strong investment.
- Within the EA, we favor Spain and Greece—economies where we see credit quality improving. Spain has relatively strong growth, a reduced debt ratio since the pandemic-related increase, a stable fiscal deficit and relatively higher yields. Greece exhibits a commitment to fiscal discipline (with less pressure to increase defense spending as it is already high), lower exposure to US tariff effects and, as with Spain, relatively strong growth and higher yields compared to core EA countries.

We have shifted some of our developed market duration exposure. We extended both currency and duration exposure in the EA, reflecting a more constructive economic view due to the expected growth boost from defense and infrastructure spending, as well as an expected positive effect on the currency for reasons mentioned earlier. In line with the rationales above, we take our euro exposure through Spain and Greece. We reduced duration exposure in the United States on continued concerns about the fiscal outlook and expected inflation effects from tariffs, as well as continued heightened policy uncertainty.

The country discussion above illustrates that we remain highly selective at the sovereign level, taking account of idiosyncratic variations in economic fundamentals and policy responses. Overall, in local-currency positions, we favor select countries across developed markets and EMs where we see value in their currencies, bonds or both. Where we view currencies as undervalued against the USD, we position for upside. In currencies, we tend to prefer long positions in countries with robust trade dynamics, sustainable current account positions and stronger growth potential. In bonds, we hold positions in select countries where we are constructive on a range of factors, including inflation and interest-rate outlooks, sound fiscal policy (or reforms in that direction), and/or reshoring. We aim at a relatively high overall portfolio yield by holding higher-yielding, local-currency positions in specific EMs and (where relevant) frontier markets that we view as having resilient fundamentals and attractive risk-adjusted yields. We hold a net-negative position against the Chinese yuan, which provides positive carry and which we also expect should help hedge our portfolios against potential risks to other EM currencies.

Given improving fundamentals and policy responses in some EMs and frontier markets, we have expanded our holdings in **select hard-currency-denominated sovereign credit**.

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Endnotes

1. These trends are discussed in detail in ["Can emerging markets navigate a fragmented world?"](#) Global Macro Shifts Issue 16, June 2025
2. Source: "Scott Bessent confirms Argentina-US currency swap has been signed." Buenos Aires Herald. October 21, 2025.

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