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2025 Q4 DEVELOPED ECONOMIES OUTLOOK

Key Messages

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Resilience in 2025, fragility ahead in 2026

The global economy outperformed expectations in 2025, growing close to 3% despite restrictive monetary policy, trade tensions, and tightening fiscal constraints. Activity was supported by three temporary forces: front-loaded trade and investment ahead of tariff deadlines, continued fiscal support, and strong AI-related investment. These factors sustained demand but were transitional, leaving fewer buffers for 2026.

As the world enters 2026, the outlook is for a controlled deceleration, not a recession. Growth is expected to remain positive across major advanced economies. However, the risk balance has shifted decisively from cyclical slowdown to market-driven instability.

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Why the slowdown is controlled

- Core macro fundamentals are stable: output, inflation, and near-term policy trajectories remain predictable.
- The U.S. benefits from monetary easing and ongoing high-productivity investment.
- The Eurozone is supported by real income recovery and public investment.
- The UK slows but avoids recession; Japan continues gradual policy normalization.

Bottom line: the global cycle is holding up, but with a narrowing margin for error.

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The new vulnerability: liquidity, not growth

The defining feature of 2026 will be tight liquidity conditions amid steady growth—a combination historically associated with market stress rather than macro contraction.

Key drivers:

1. Long-term yields remain elevated due to fiscal uncertainty, political fragmentation, and reduced institutional credibility.
2. Term premia dominate borrowing costs, weakening the transmission of central-bank easing.
3. Market depth in sovereign bonds has declined, increasing volatility and the sensitivity of yields to political or fiscal headlines.

This marks the end of the “free liquidity” decade and ushers in a phase where financial markets police policy in real time.

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Divergent monetary policies amplify tension

Global monetary policy enters an asynchronous cycle:

- Federal Reserve: most aggressive easing → funds rate 3.00–3.25% by mid-2026.
- ECB: likely on hold through 2026 as inflation lands near target.
- BoE: moderate cuts constrained by market credibility concerns.
- BoJ: gradual normalization with one additional hike.

FX outlook:

- USD weakens through mid-2026 before strengthening again later.
- EUR remains range-bound; GBP underperforms; JPY appreciates temporarily.

These divergences reinforce the high global cost of liquidity and rising cross-asset volatility.

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2026 Outlook & risk balance

- Global GDP: ~2.9%, slightly below 2025 but consistent with a soft landing.
- Inflation: continues to moderate, close to targets across advanced economies.
- Financial conditions: ease only marginally despite rate cuts.

Main risks are financial, not macroeconomic:

- Disorderly fiscal events
- Liquidity shocks in sovereign or credit markets
- Renewed trade tensions
- Politically driven volatility

Structural vulnerabilities have shifted to the public sector—fiscal sustainability, political cohesion, and institutional trust are now the most binding constraints on global stability.

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