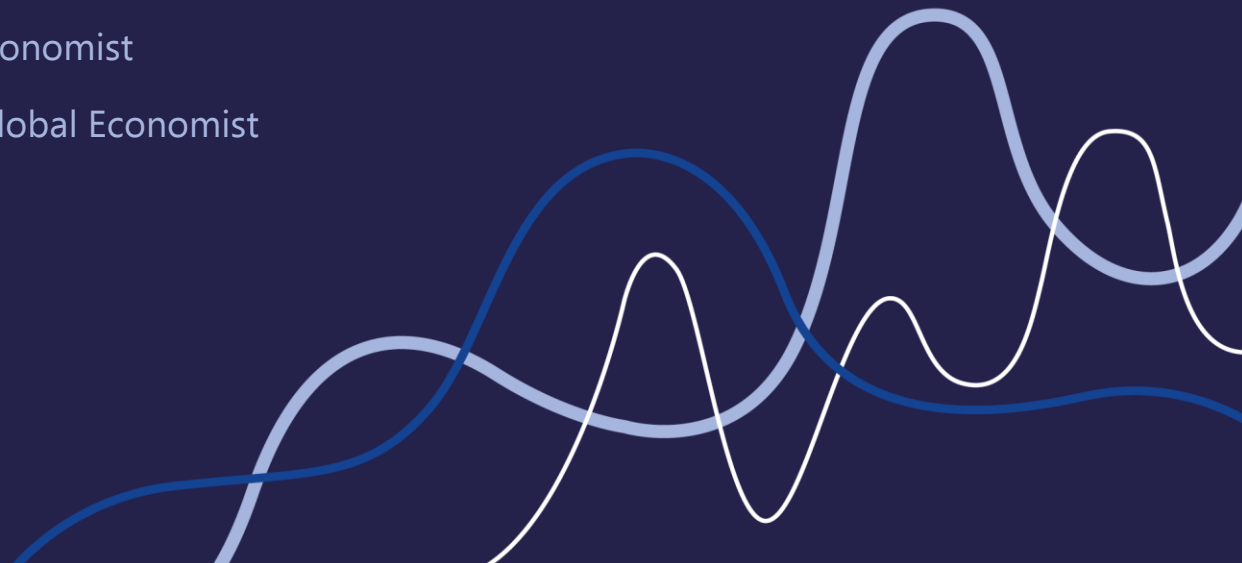


DECEMBER 2025

# The World in 2026

Jennifer McKeown, Chief Global Economist

Jonas Goltermann, Deputy Chief Global Economist



DECEMBER 2025

# Economic Outlook

Jennifer McKeown, Chief Global Economist

[jennifer.mckeown@capitaleconomics.com](mailto:jennifer.mckeown@capitaleconomics.com)



# Key Questions About the Global Economy in 2026

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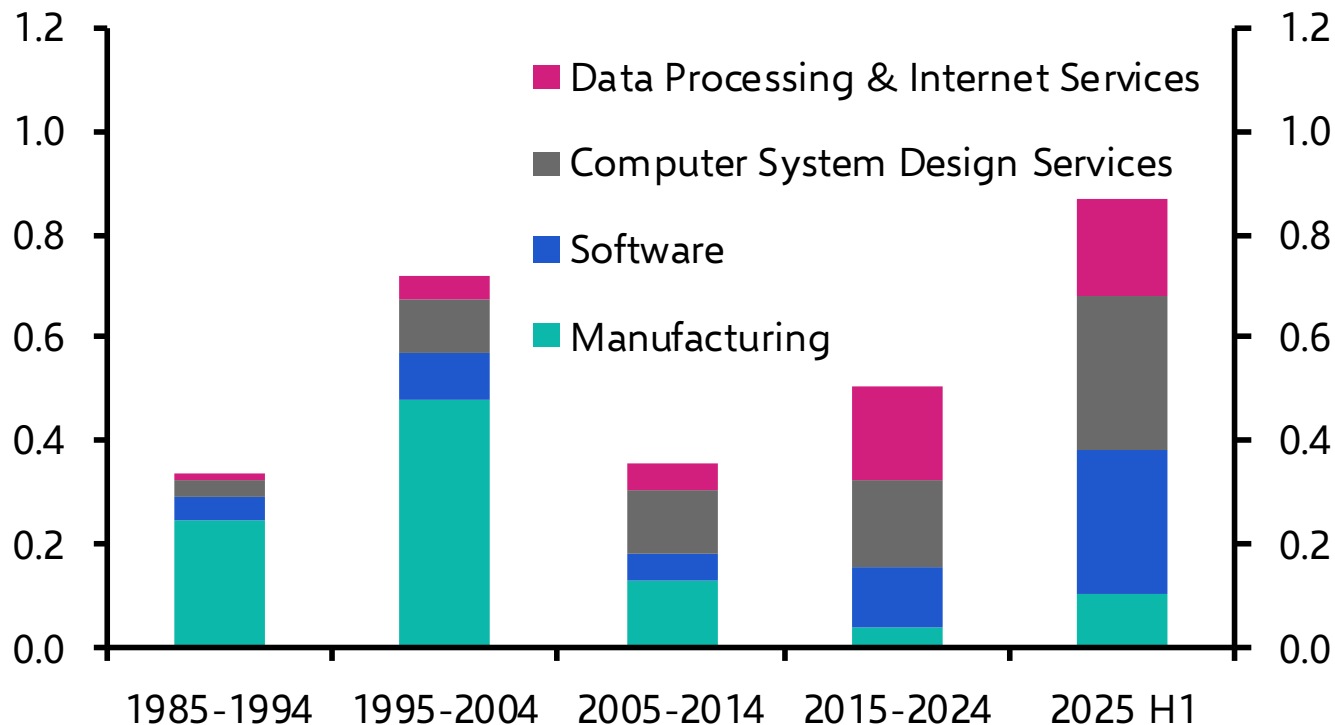
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- How will the trade war and US-China relations evolve?
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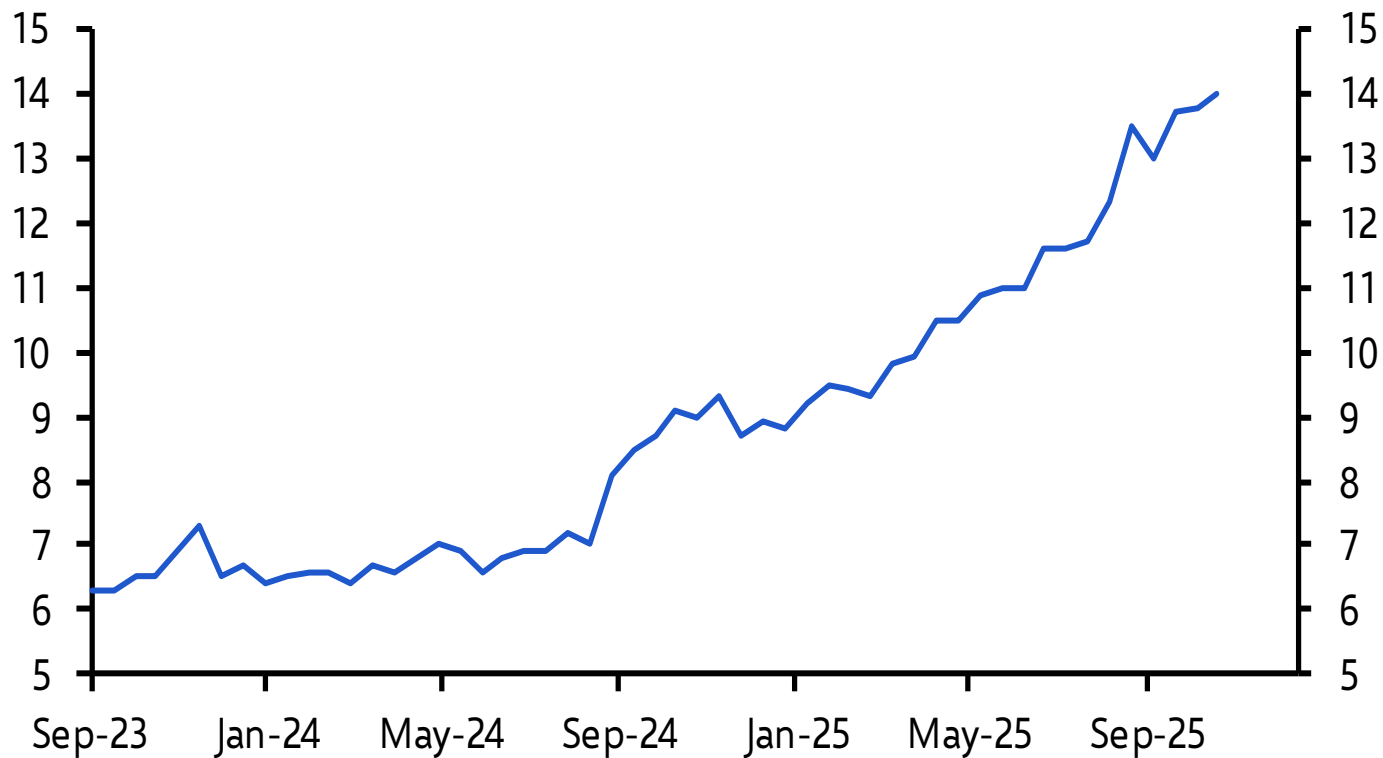
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# US ICT Contributions to Real GDP Growth (annualised % pt)



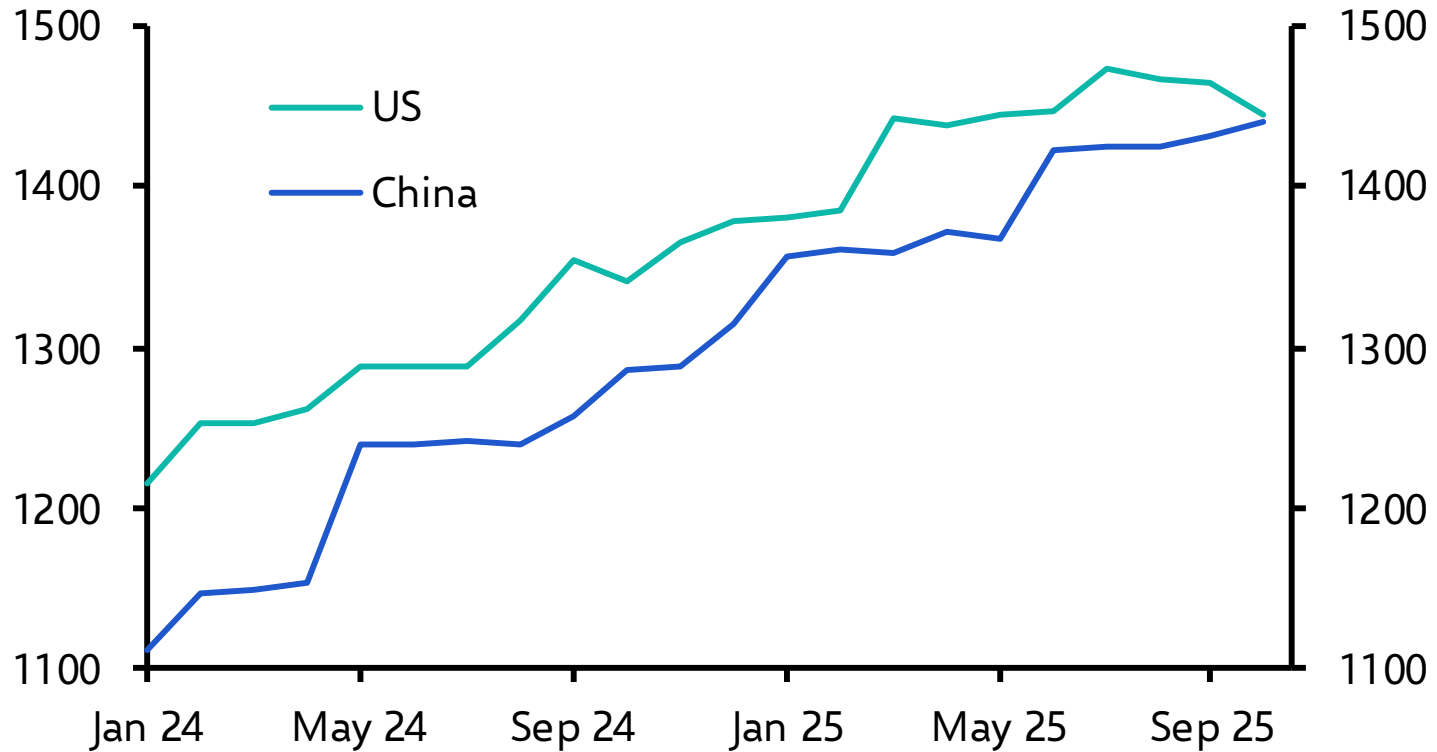
Sources: BEA, Capital Economics

# US Firms Planning to Use AI in Next 6 Months (%)



Sources: Census Bureau, Capital Economics

# Performance of Top Large Language Models\*



\*Chatbot Arena Elo points

Sources: Stanford AI Index 2025 Annual Report, Internet Archive, OpenLM AI, Capital Economics

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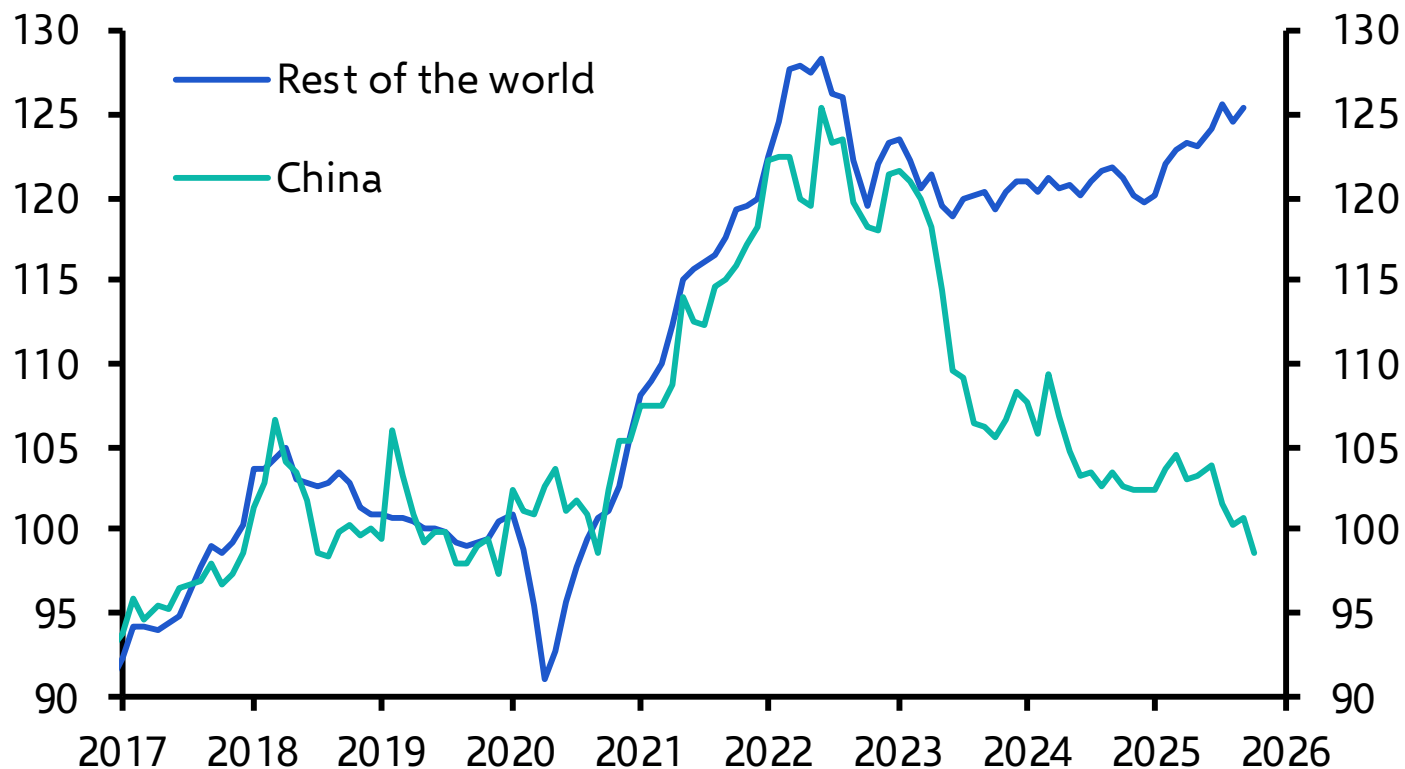


# China's Five-Year Plan Proposals

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- Pledged greater use of government funds for social welfare.
- Proposed expansion of free education, public healthcare, and gradual increase in pensions and unemployment support.
- If implemented, this should pave the way for a shift towards consumption.
- But the leadership's main priority is still industrial policy, which promotes investment and a drive to technological self-reliance.
- It will probably be many years before consumption and investment reaches a more sustainable equilibrium.

# Goods Export Prices (USD, 2019 = 100)



Sources: LSEG, Capital Economics

# CE China Activity Proxy & Official GDP (% y/y)



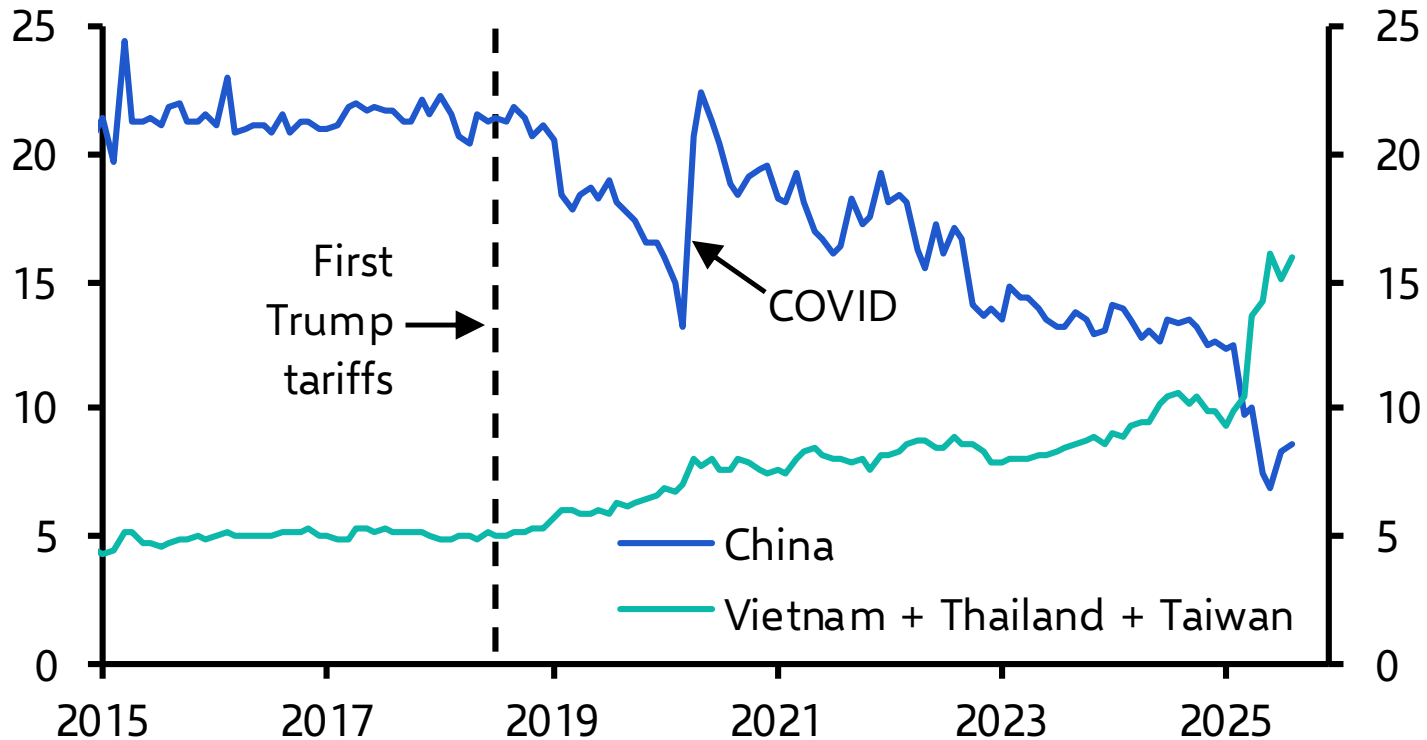
Sources: CEIC, WIND, Capital Economics

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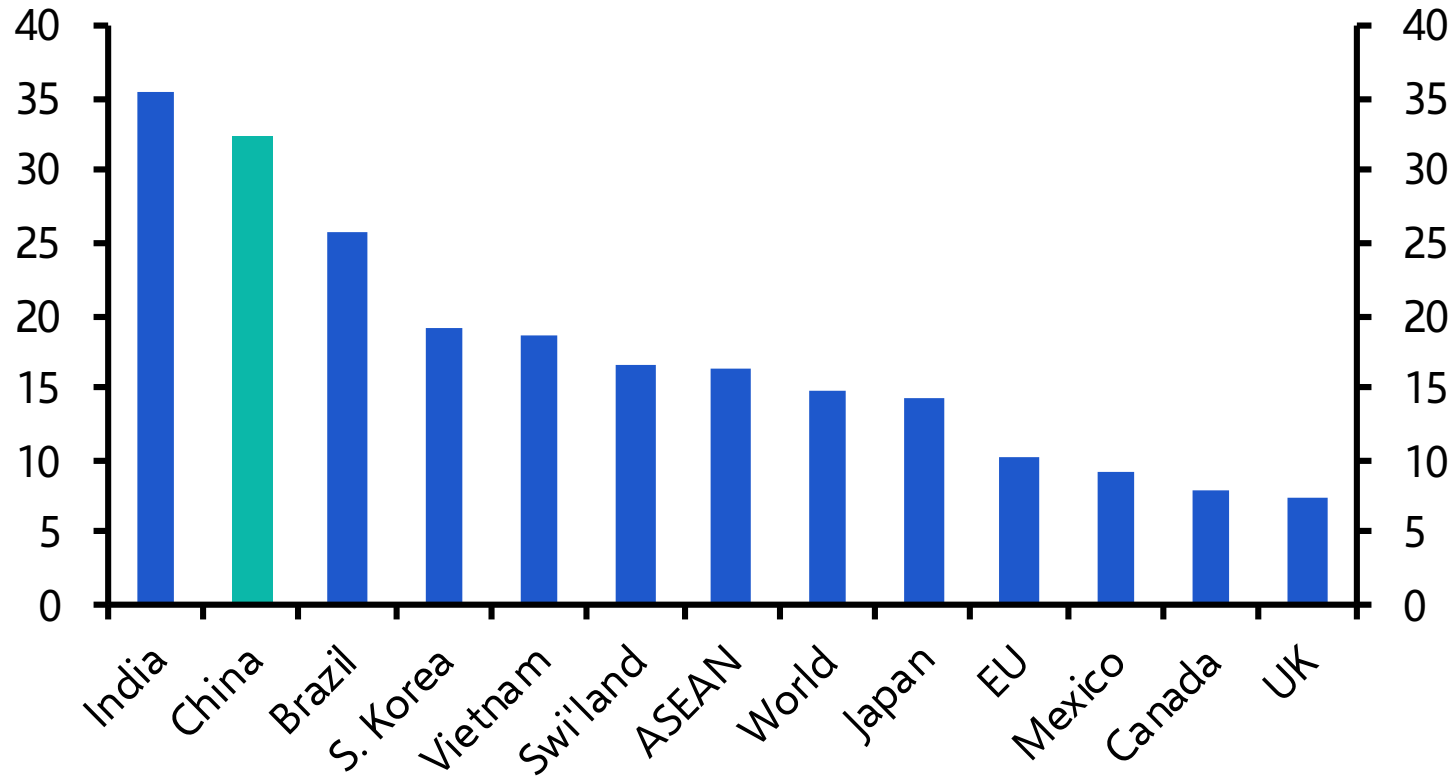
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# Shares of US Imports (%)



# Weighted Average US Tariff Rates (% , 2024 import weights)



Sources: US Federal Register, USITC, CE Trade Hub

# The shifting nature of the trade war

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- Investment flows will continue to bifurcate as the US and China pull back from cross-border deals.
- US capital curbs on China's tech sectors to strengthen or remain in place.
- China to freeze approvals for US deals and pare back US asset holdings.
- US to keep encouraging allied investment...
- ... including coordinated funding for alternative sources of rare earths, benefiting resource-rich economies like Australia and Brazil.

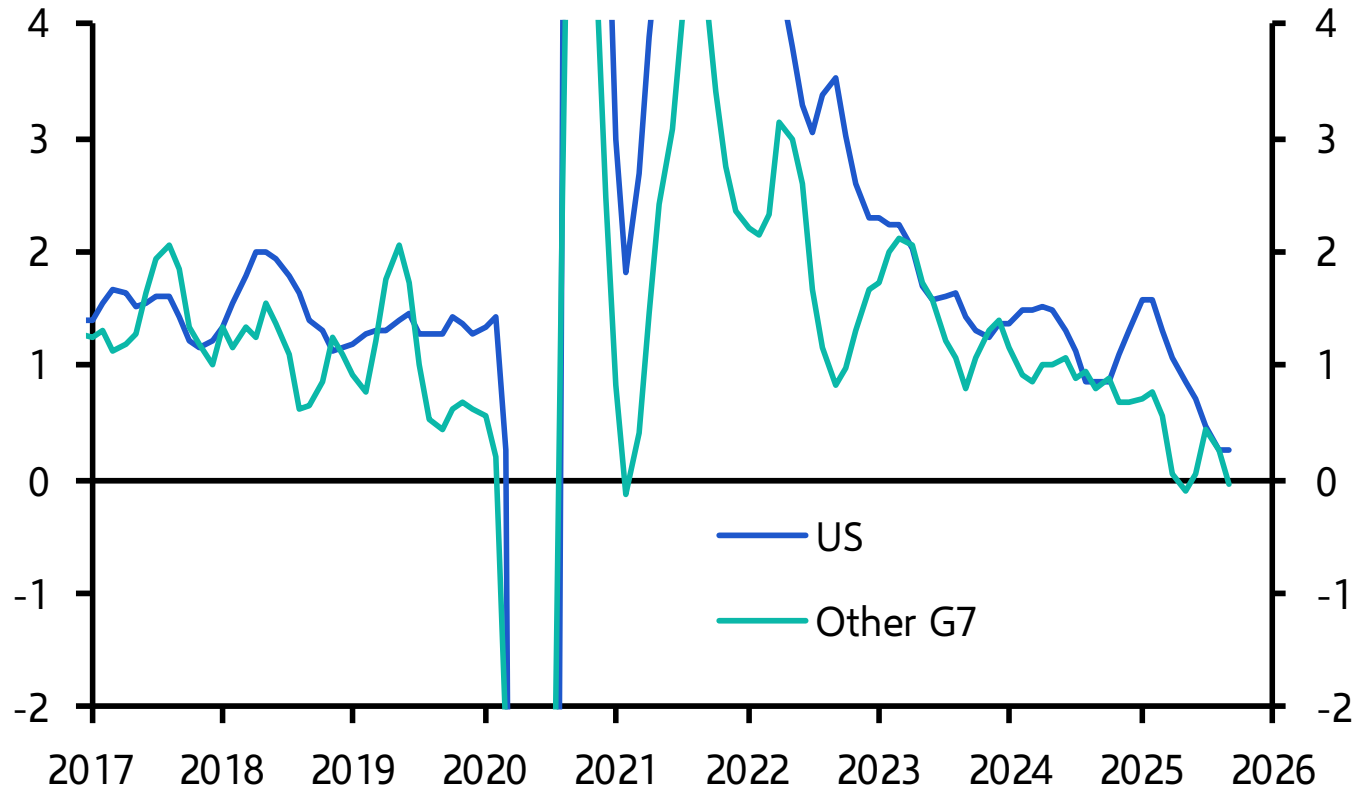
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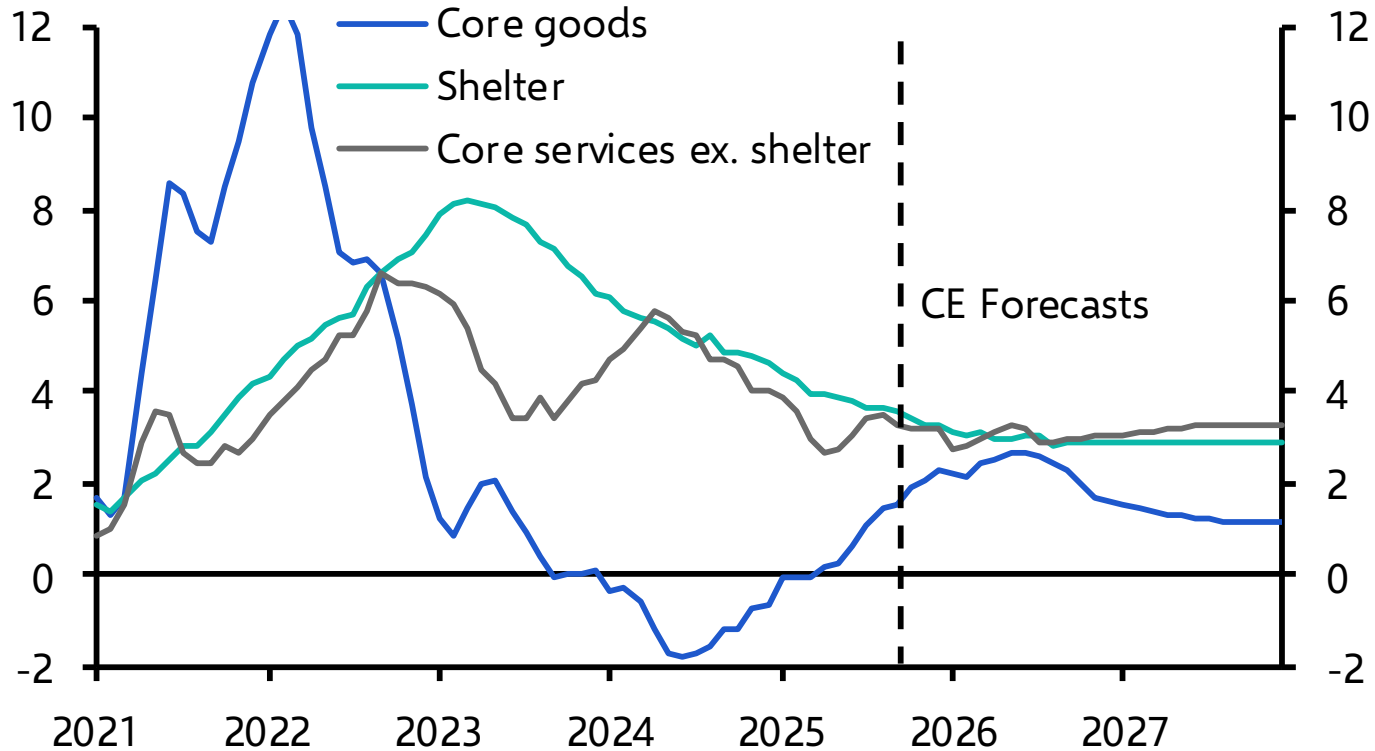


# Employment (% 3m/3m ann.)



Sources: LSEG, Capital Economics

# US Core Goods and Services CPI (% y/y)



Sources: LSEG, Capital Economics

# Fed's independence under threat

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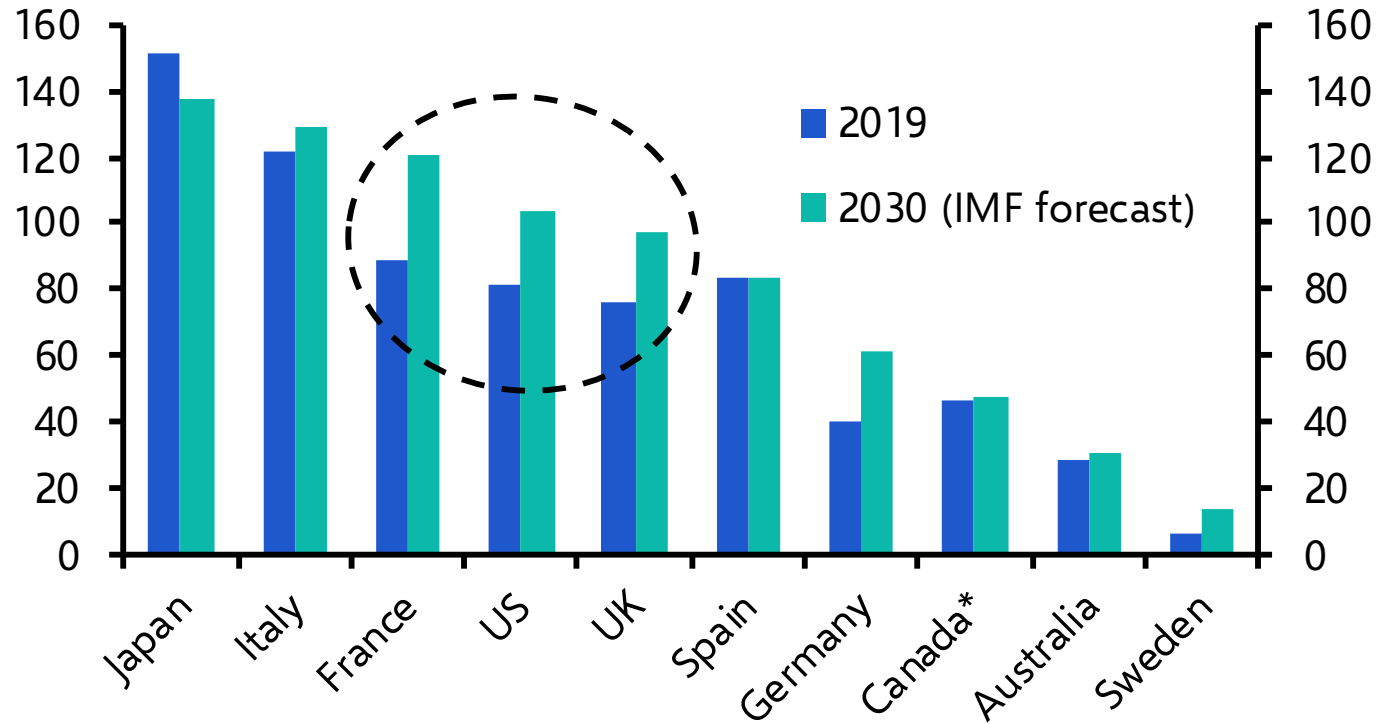
- The case against Board Governor Lisa Cook will be adjudicated in January. Jerome Powell's term as Fed Chair is due to end next May.
- Kevin Hassett the front-runner to replace Powell. Christopher Waller and Kevin Warsh still contenders. All would presumably vote for lower rates.
- But the Trump contingent would still lack a majority on the FOMC.
- And Board of Governor members would be unlikely to vote for extreme measures to block reappointment of regional Fed Presidents or fire them.
- **Trump gains influence, but Fed independence should stay broadly intact.**

# Key Questions About the Global Economy in 2026

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- **Will we reach a fiscal breaking point?**

# General Government Net Debt (% of GDP)



\*Adjusted for CPP/QPP assets

# Fiscal Risks

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- US is not immune from fiscal concern. Supreme Court ruling on tariffs could force deficit even wider.
- France stuck in stalemate with deficit above 5% of GDP and debt rising. Risk of far-right presidency in 2027.
- UK fiscal headroom doubled, but risk of tax U-turns, political pressure to spend more and weak growth all mean public finances are precarious.
- **Fiscal fears will remain prominent in markets.**

# Key Messages

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- Global growth will be a little slow and uneven, but no recessions.
- The macro benefits of AI will continue to build.
- China will remain stuck in low growth and deflation.
- US-China fracturing will continue to shape trade, capital and technology flows.
- Most central banks will loosen policy further - but Trump won't get the major cuts that he wants.
- Fiscal risks will continue to stalk markets.

DECEMBER 2025

# Financial Markets Outlook

Jonas Goltermann, Deputy Chief Markets Economist

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# Key Questions About Financial Markets in 2026

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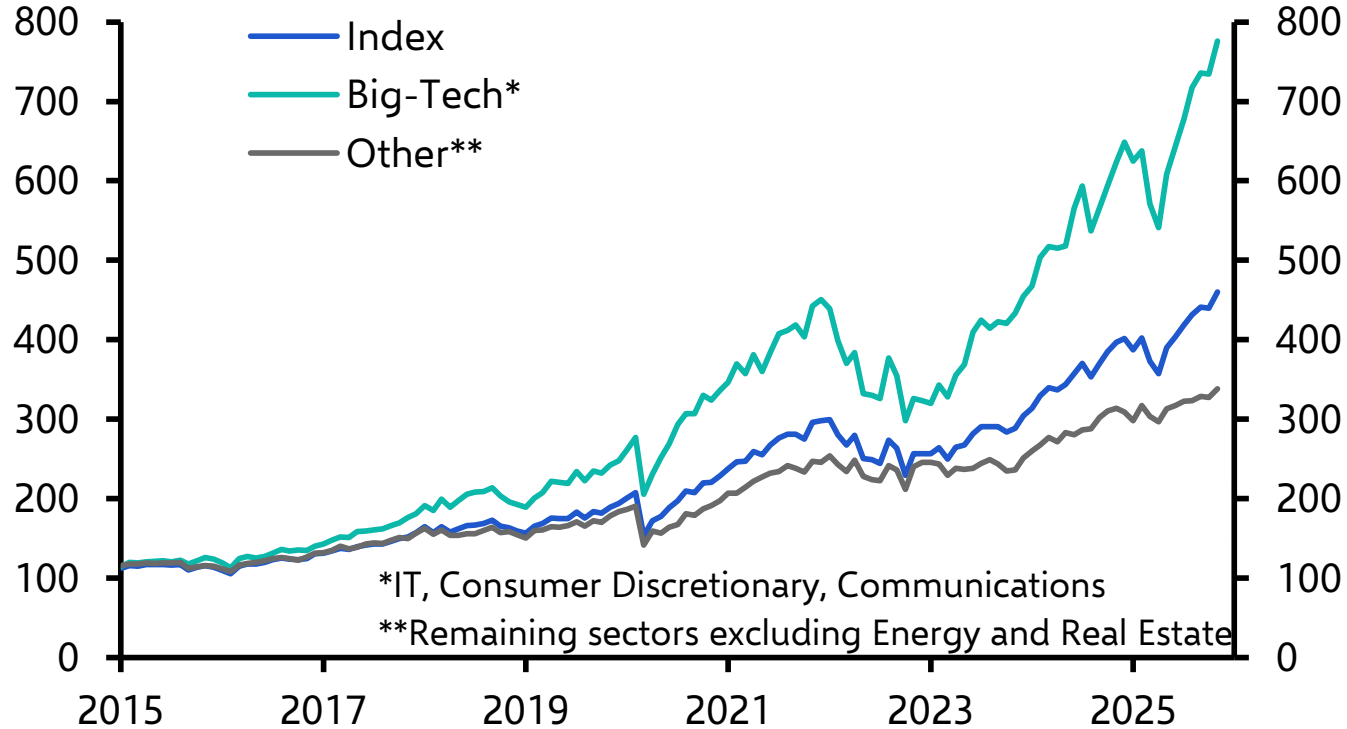
- Will the AI boom/bubble in equity markets burst?
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- How much further will the US dollar rebound go?

# Key Questions About Financial Markets in 2026

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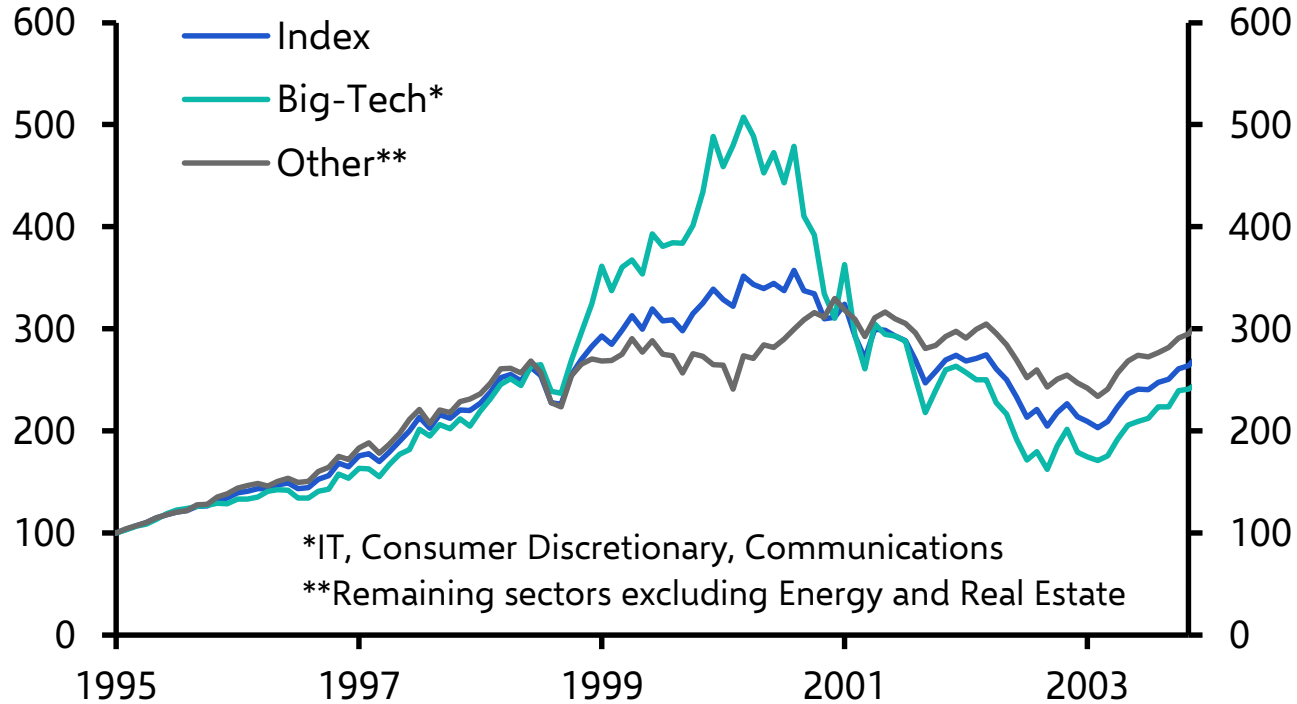
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# S&P 500 Total Return (1<sup>st</sup> Jan. 2015 = 100)



Sources: LSEG, Capital Economics

# S&P 500 Total Return (1<sup>st</sup> Jan. 1995 = 100)



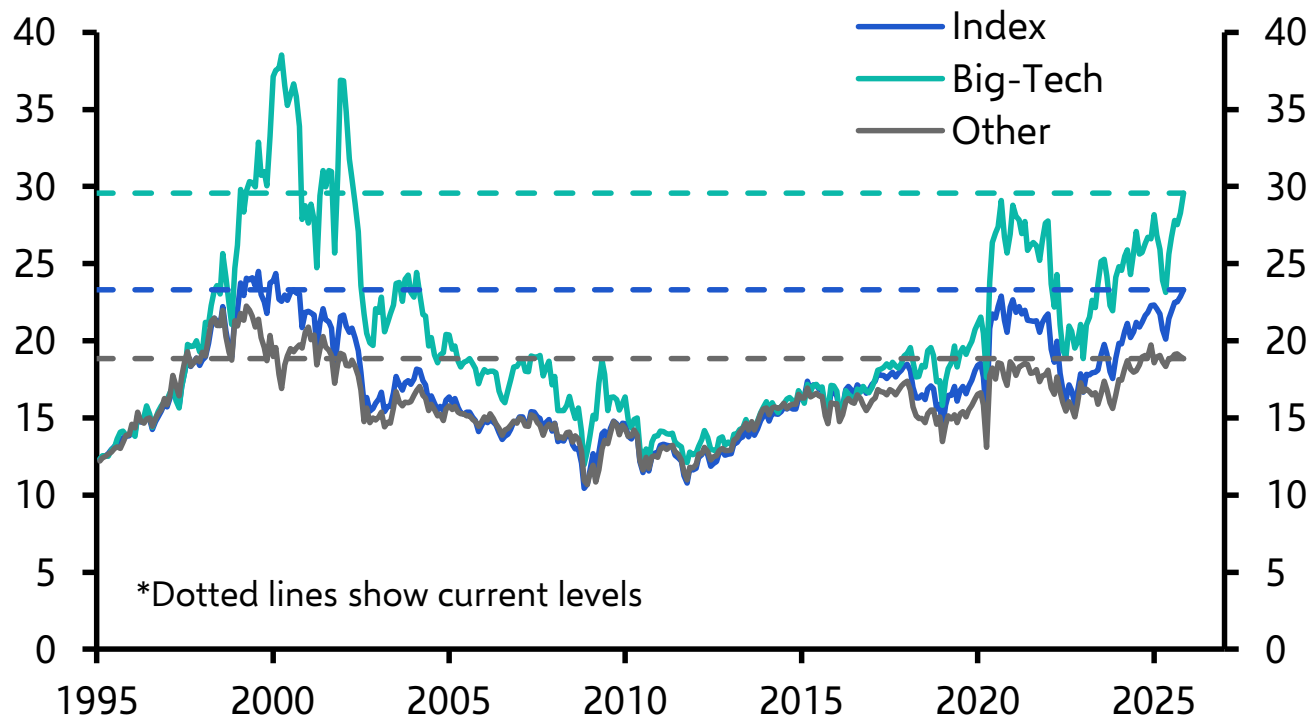
Sources: LSEG, Capital Economics

# Why the bubble can keep inflating

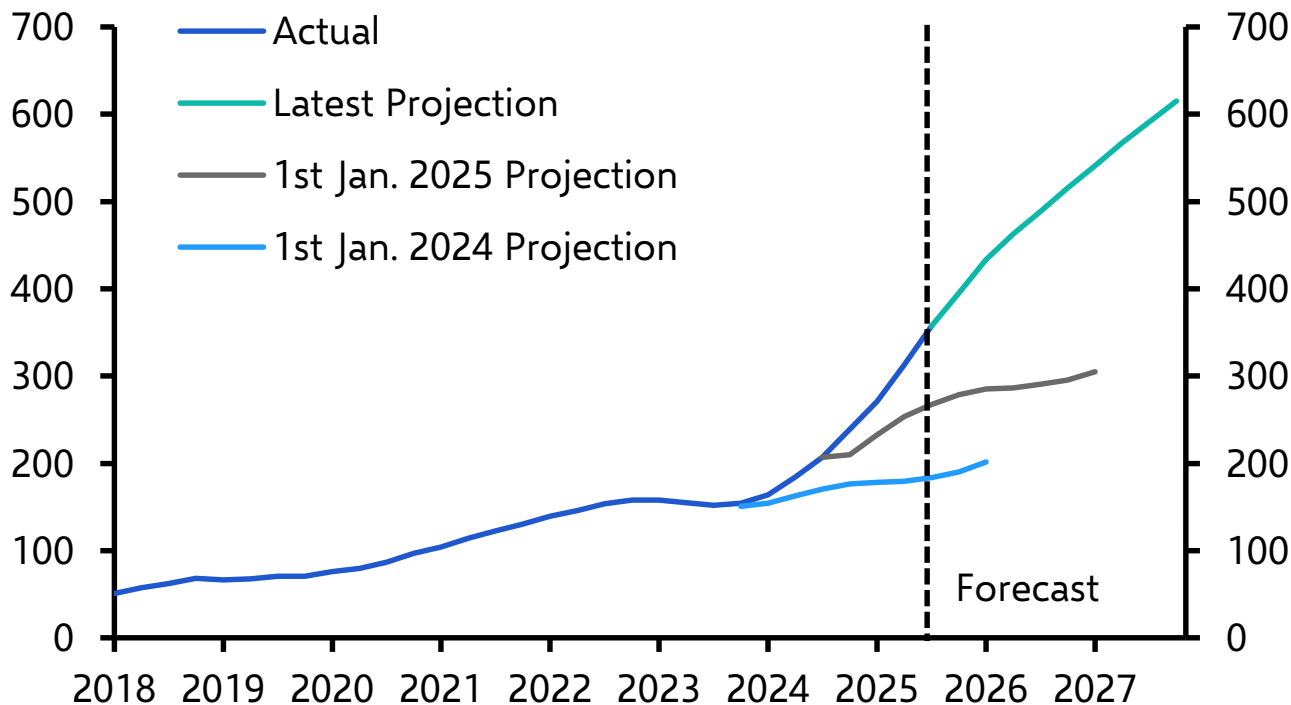
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- Tech sector earnings momentum is still strong. Both actual and expected earnings have risen more rapidly than in the 1990s.
- Valuations are high in the US equity market, but not unprecedented. We think they have scope to stretch further before the bubble bursts.
- The AI data centre investment boom continues to exceed expectations.

# S&P 500 Index & Sector FTM Price/Earnings Ratios



# Actual & Projected Capex Of Top 5 “Hyper-scalers” (USDbn)



# Key Forecasts: Equities

---

	Latest (as of 1 <sup>st</sup> Dec)	End-2026
S&P 500	6,812	8,000
FTSE 100	9,713	10,700
Eurostoxx50	5,657	6,400
Topix	3,338	3,400
MSCI EM (USD)	1,367	1,526

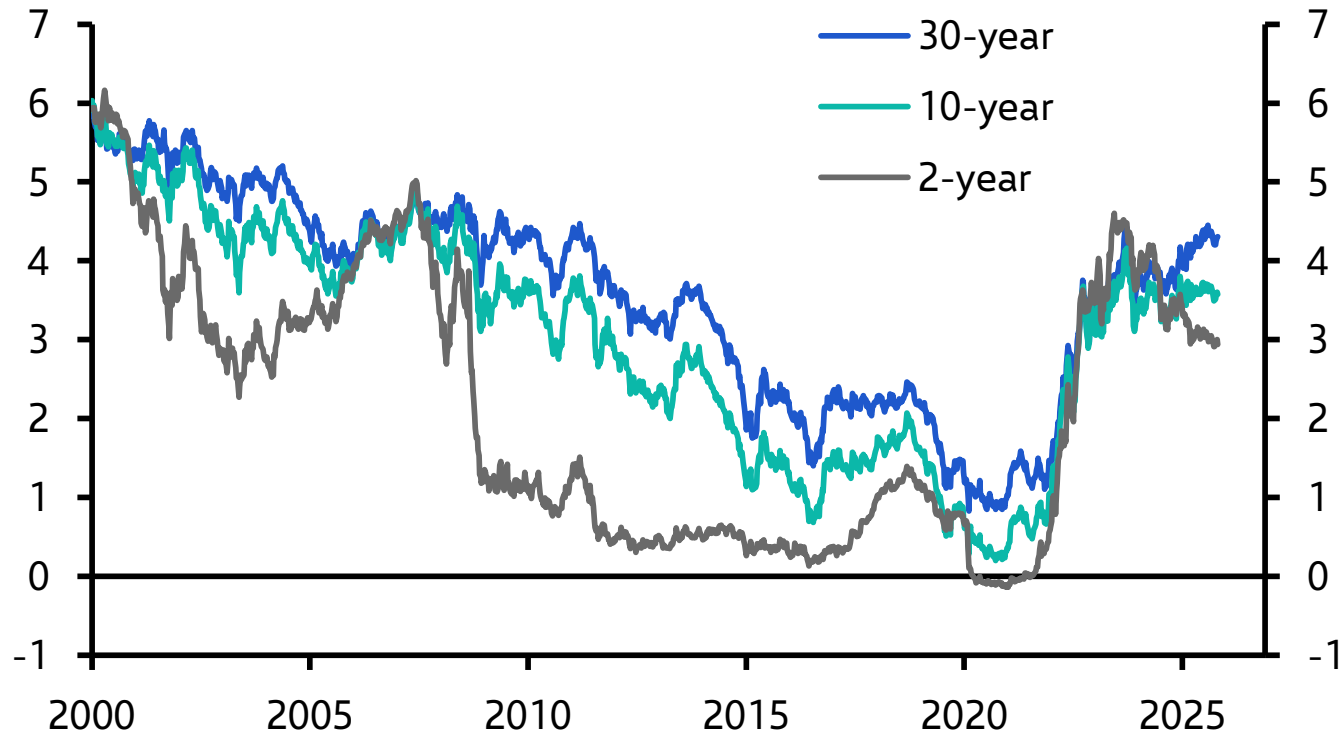


# Key Questions About Financial Markets in 2026

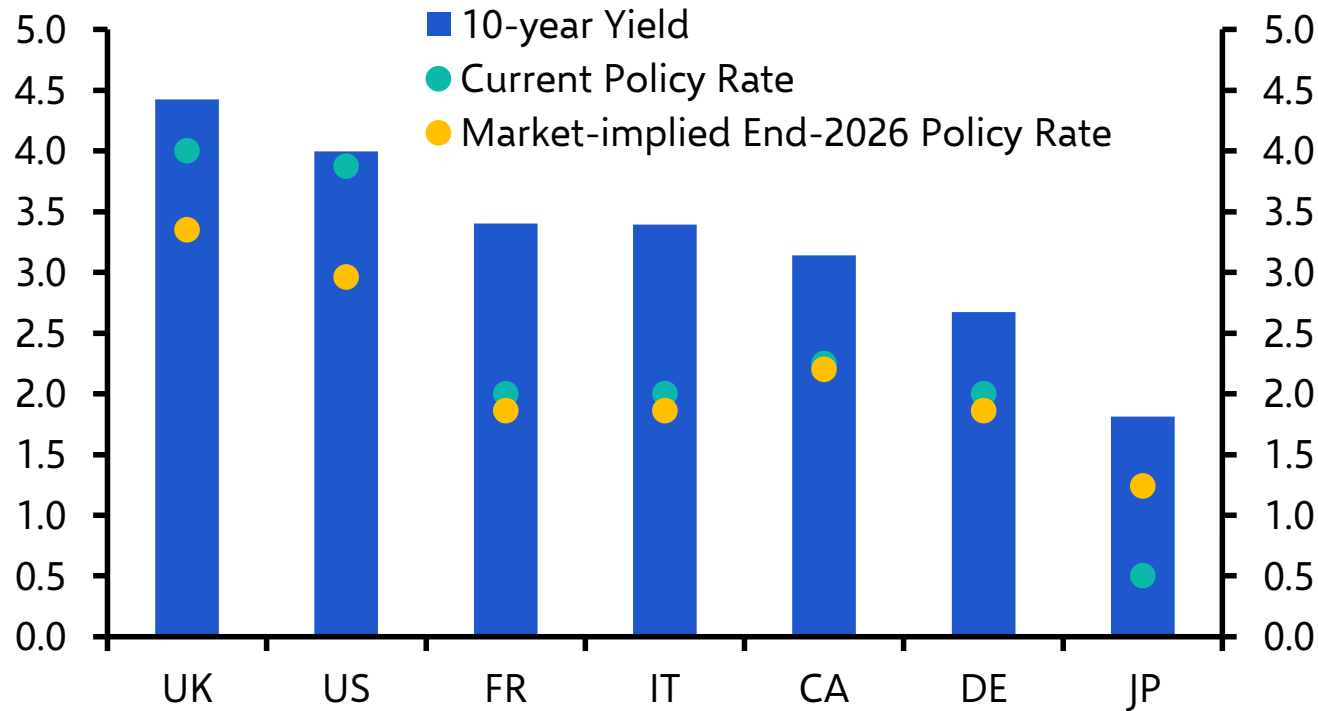
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- Will the AI boom/bubble in equity markets burst?
- **Are government bond yields trending higher or are we hitting the ceiling?**
- How much further will the US dollar rebound go?

# Government Bond Yields (G7 ex-Japan average, %)



# 10-year Gov't Bond Yields & Policy Rates (%)

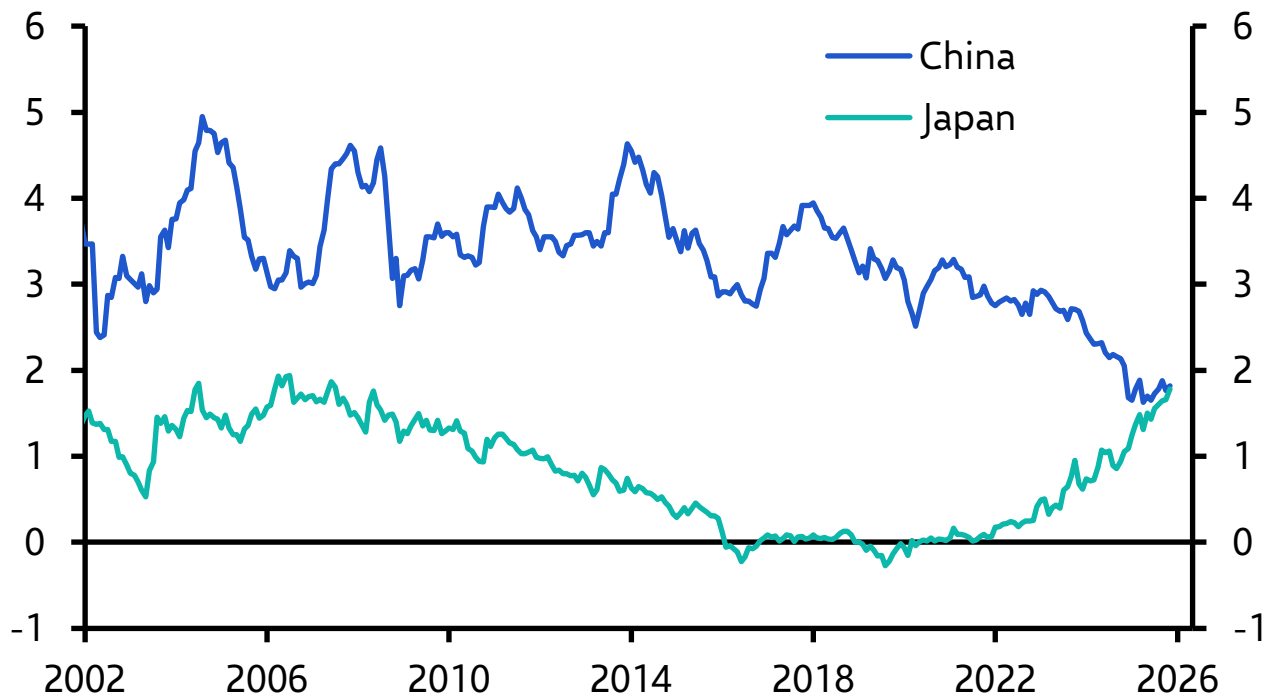


# Key Forecasts: 10-year Government Bond Yields (%)

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	Latest (as of 1 <sup>st</sup> Dec)	End-2026
US	4.08	4.25
UK	4.48	4.25
Germany	2.75	2.50
France	3.48	4.00
Italy	3.47	3.75
Japan	1.88	2.00
Canada	3.21	2.75

# 10-year Government Bond Yields (%)

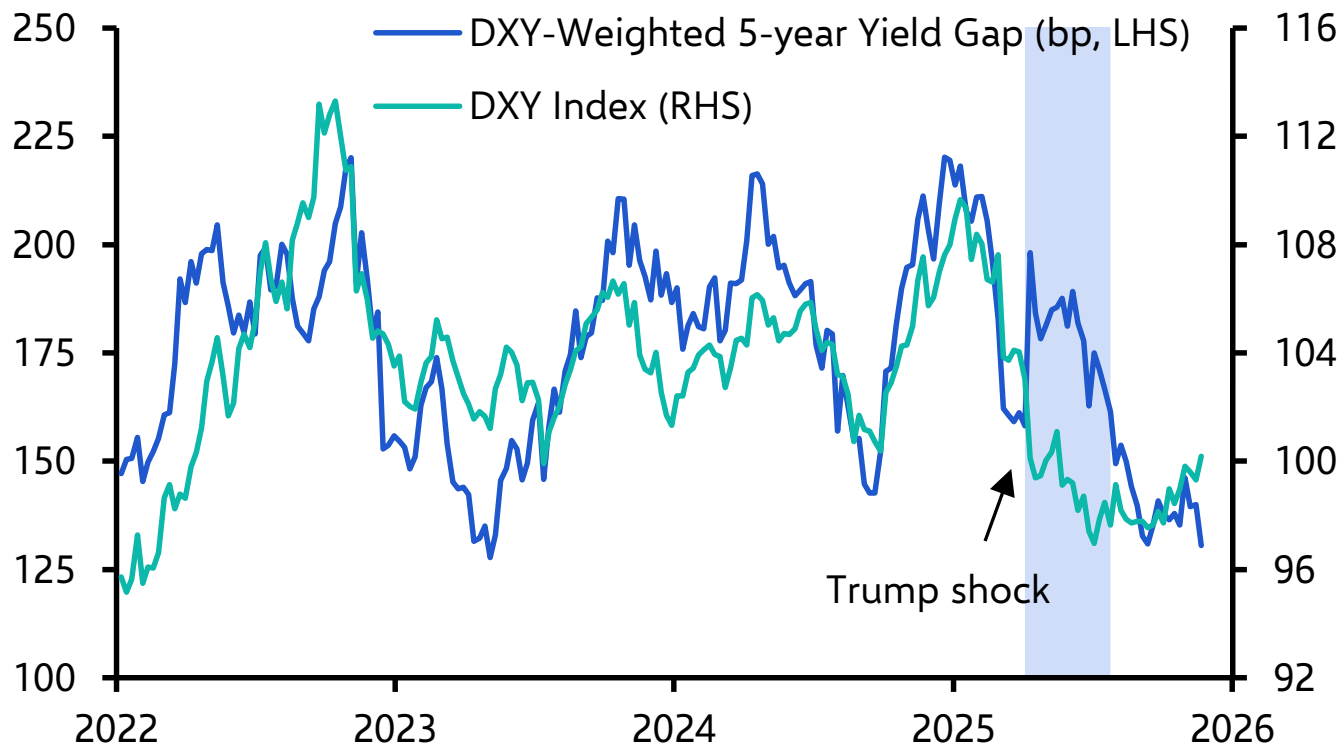


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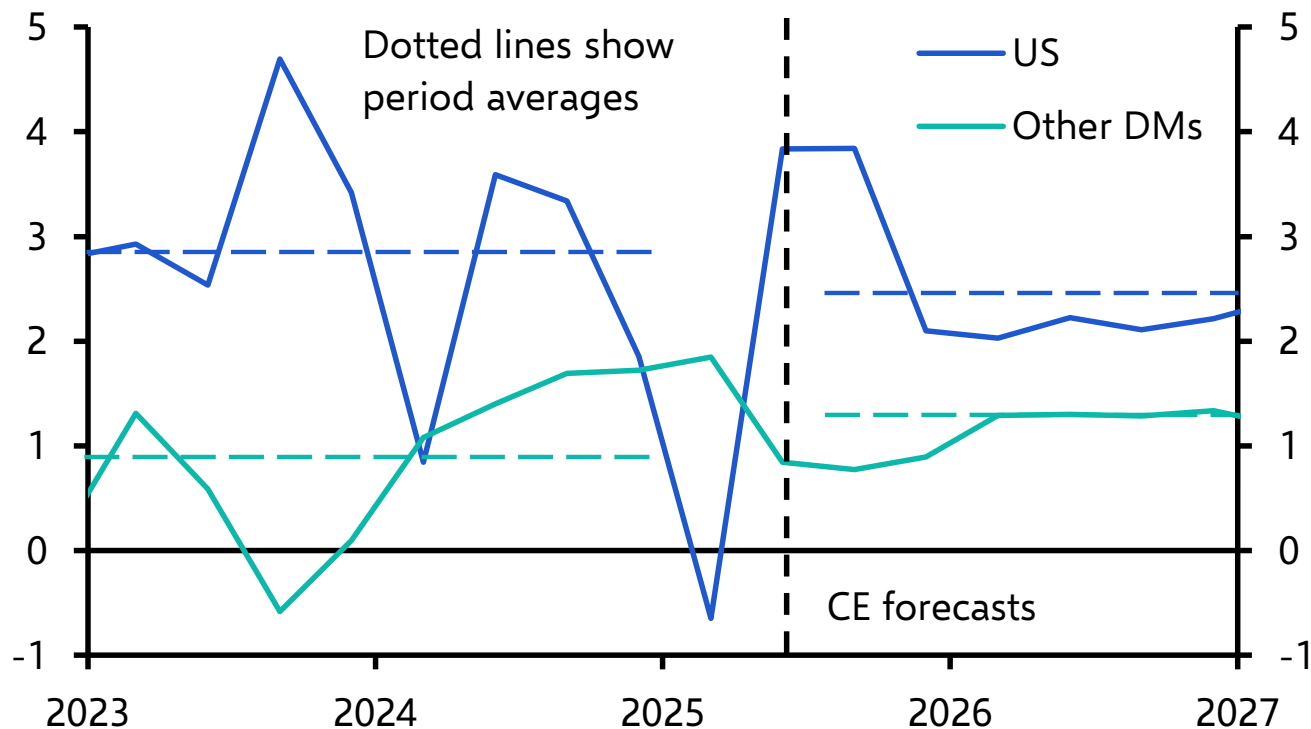
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- Will the AI boom/bubble in equity markets burst?
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# DXY Index & 5-Year Yield Gap

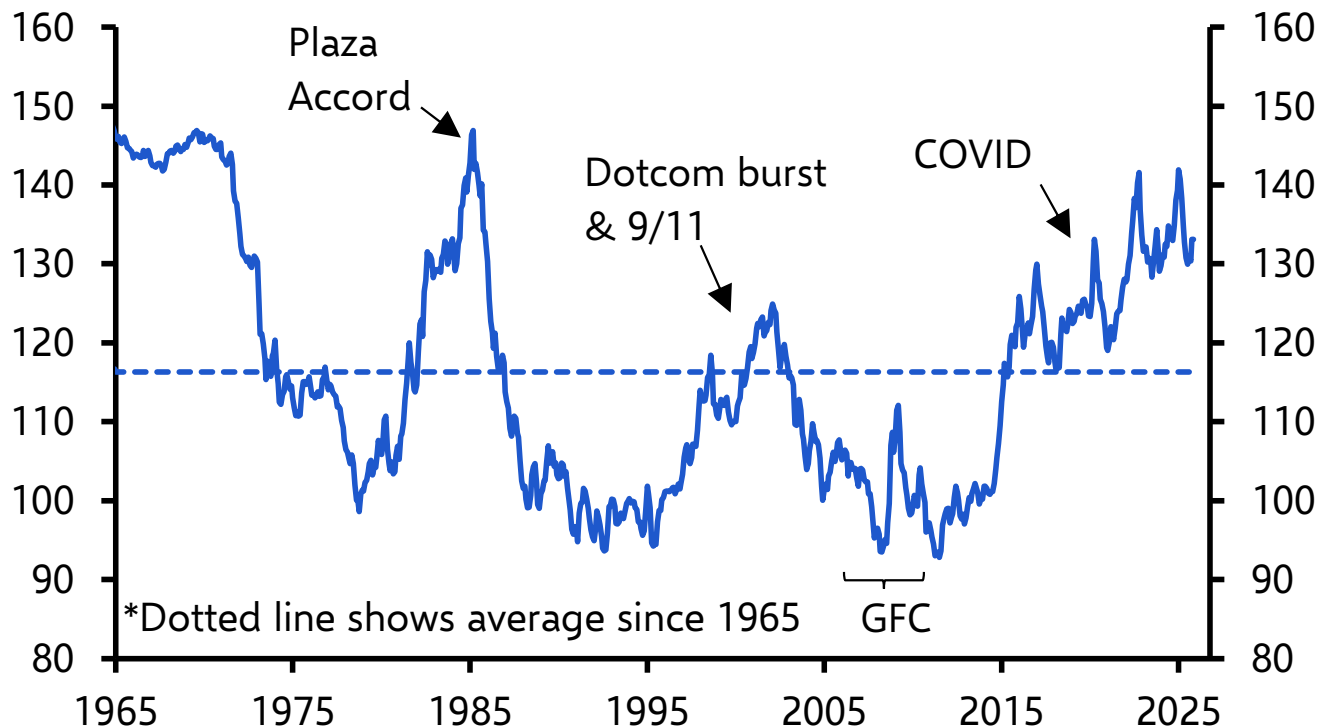


# US & Other DM GDP (% q/q annualised)





# BIS Real Trade-weighted US Dollar (Jan. 1994 = 100)



# Key Forecasts: FX

---

	Latest (as of 1 <sup>st</sup> Dec)	End-2026*
DXY	99.2	102.9
EUR/USD	1.16	1.10
GBP/USD	1.32	1.25
USD/JPY	155	145
USD/CNY	7.07	7.00

\*Provisional

# Key Questions About Financial Markets in 2026

---

- Will the AI boom/bubble in equity markets burst?
  - **Not yet; the AI boom has further to run in 2026.**
- Are government bond yields trending higher or are we hitting the ceiling?
  - **US & Europe in a new range; Japan still trending higher, China down.**
- How much further will the US dollar rebound go?
  - **Resurgent US exceptionalism will keep the dollar on the front foot.**

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