



Global Macro Research – Global Economic Outlook

Q1 2025

#Global

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#Forecasts

/

#Scenarios

What is the impact of Trump 2.0 on the global economy?

We expect higher US growth and inflation, and fewer Fed rate cuts, as a result of the incoming Trump presidency. For the rest of the world, we've revised our growth forecasts down and inflation forecasts up and expect more monetary policy divergence. But these impacts are likely to be smaller than many seem to fear.

The precise contours of the coming policy shifts under president-elect Donald Trump remain uncertain. Nonetheless, our “working assumptions” include:

a sharp increase in the average tariff on China from 15% to 40% starting early in 2025, and isolated spats with other trade partners, but the avoidance of a global baseline tariff;

the extension of the Tax Cuts and Jobs Act in late 2025, with some additional measures including taking corporation tax from 21% to 20%, and 15% for some companies, increased defence spending, and modest spending cuts elsewhere, such that fiscal policy is loosening by 0.5% of GDP in 2026;

a large rise in deportations to 750,000 per annum, which alongside border restrictions and deterrence means net migration falls from 3mn per annum now to essentially flat;

deregulation including a relaxation of anti-trust measures and more lenient bank capital requirements.

We expect US GDP growth to remain robust in 2025 at 2.0%, reflecting a cooling but still solid labour market and strong corporate profitability. We've upgraded our 2026 forecast by 0.2% to 2.2% because we expect fiscal loosening and deregulation to more than offset tariffs. But this boost is likely to fade as the immigration changes have more impact, and the level of real GDP could be lower than otherwise by the end of Trump's term (see Figure 1).

Higher tariffs, strong demand, and lower labour supply mean we've increased our US inflation forecasts. We see core PCE inflation about 0.2% and 0.4% higher in 2025 and 2026 respectively, leaving it stuck around 2.5%.

We therefore expect the Federal Reserve (Fed) to deliver fewer rate cuts than previously. We forecast just three in 2025, with the fed funds rate target range settling at 3.5-3.75% (see Figure 2). Additional rate reductions in 2027 and 2028 are possible as the economy eventually slows.

While these are our base case assumptions, it is possible the Trump administration proves more disruptive. We've specified a 'Trump unleashed' scenario, in which trade policy is more restrictive and deportations higher.

Alternatively, in 'Trump delivers for markets', the policy mix is more supportive, helped by a net boost to aggregate supply.

On foreign policy, US military support for Ukraine is set to reduce significantly under Trump. We now think some form of de-facto partition or negotiated settlement next year is the most likely outcome. In the Middle East, we expect Trump to be a less restraining influence on Israel and adopt a more hawkish approach to Iran. There could be an escalation in military activity in the short-term, and we've specified an 'oil price surge' scenario as an important risk to our forecasts.

In China, tentative green shoots in the activity data mean we forecast GDP growth of 4.8% in 2024. However, we have made meaningful downgrades to our 2025 (to 4.3%) and 2026 (to 4.1%) numbers, totalling 1% off the level of GDP. This would be around double the estimated impact from the first trade war, reflecting the sharper increase in tariffs.

Chinese tariff retaliation is almost certain, although we do not expect it to match the size of US measures given China's cyclical weakness. Instead, we anticipate targeted measures such as agricultural tariffs, critical mineral export restrictions, and action against US companies in China.

Policy stimulus is likely to continue as the trade war intensifies. But it could continue to fall short of market expectations. Large-scale consumption support does not align with policymakers' read of the economy or derisking agenda. And currency depreciation may not match the increase in tariffs because of financial stability risks.

China is therefore also a source of important risks to our forecasts. In our 'China opens the floodgates' scenario, the authorities deliver big-bazooka stimulus that lifts Chinese and global demand. By contrast, in 'China balance sheet recession', the policy response falls well short, and China becomes trapped in a very weak growth environment.

Heightened trade uncertainty and a more inflationary backdrop in the US will be difficult for emerging markets (EMs) to navigate. EMs with large trade surpluses (Mexico, Vietnam, Korea and Taiwan), those re-exporting Chinese goods (Vietnam, Malaysia, Mexico), or countries with high



tariffs on their imports of US goods (Brazil, India) are likely to face at least periodic market pressure.

Mexico's deep economic links with the US make it very vulnerable, but we think threatening a renegotiation of the United States-Mexico-Canada Agreement is a way of pressuring Mexico to stem migration into the US. Ultimately, the more the US decouples from China, the more it will need other countries – Mexico and India in particular appear well placed to benefit from reshoring.

Trump's reflationary policy agenda will put some pressure on the Fed-sensitive EM central banks (Mexico, Indonesia) and those where concern about fiscal policy is highest (Brazil), but the second-round effects from trade actions on China may trouble more countries in the long-run. Weaker Eurozone growth and the risk of more marked competition from China may hurt Eastern Europe in particular.

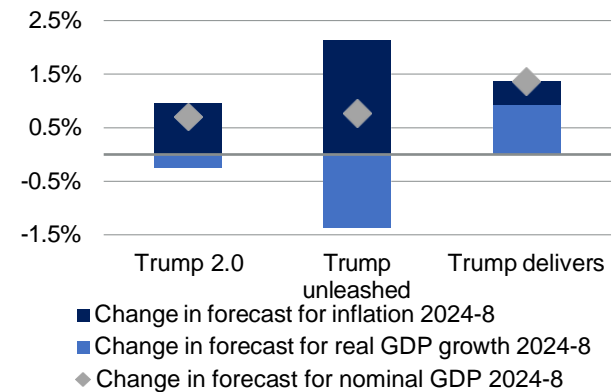
Indeed, heightened trade uncertainty means we have lowered our Eurozone GDP forecasts by 0.2-0.3% in 2025 and 2026. And we've increased our inflation forecasts by slightly less than 0.1% each year. We expect the ECB to pursue a slightly more aggressive easing path than previously, lowering the policy rate to 2% in the second half of 2025.

Underneath these relatively limited aggregate effects, there are important divergences. In particular, the German auto industry could suffer from trade measures, while broader headwinds from global industrial weakness and unnecessarily tight fiscal policy will remain in place.

The UK's exports are services dominated, and therefore less likely to see tariffs. In fact, we increased our growth forecast for 2025 after the budget delivered easier fiscal policy. But higher gilt yields have removed the government's fiscal headroom, so further tax increases are possible.

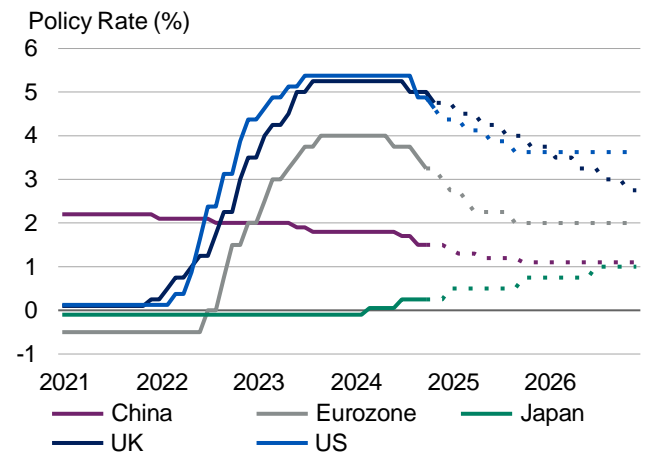
Finally, the Bank of Japan (BoJ) should continue slowly increasing interest rates. We expect the next hike in January. With US rates higher, more of the work supporting the yen via closing US-Japan rate differentials will now fall on the BoJ, which may encourage more rapid hiking.

Figure 1: Higher US nominal growth, but split between real growth and inflation will turn on Trump's policies



Source: abrdrn November 2024

Figure 2: We now expect less policy easing in the US, and slightly more in the Eurozone



Dotted lines indicate abrdrn forecasts
Source: Haver, November 2024

Figure 3: Global economic forecasts

	GDP (%)				CPI (%)				Policy Rate (% , year end)			
	2023	2024	2025	2026	2023	2024	2025	2026	2023	2024	2025	2026
US	2.9	2.7	2.0	2.2	4.1	2.9	2.3	2.6	5.375	4.375	3.625	3.625
UK	0.3	0.9	1.6	1.4	7.3	2.5	2.3	2.3	5.25	4.75	3.75	2.75
Japan	1.7	-0.2	1.3	0.9	3.3	2.5	1.7	1.7	-0.10	0.25	0.75	1.00
Eurozone	0.5	0.7	1.1	1.2	5.4	2.4	2.2	1.9	4.00	3.00	2.00	2.00
Brazil	2.9	3.2	2.4	1.7	4.6	4.4	4.1	3.6	11.75	11.75	10.75	9.25
India	7.8	6.4	6.1	5.7	5.7	5.0	4.4	4.8	6.50	6.50	6.00	6.00
China	5.4	4.8	4.3	4.1	0.3	0.8	1.5	1.5	1.80	1.40	1.10	1.10
Global	3.3	3.2	3.1	3.1	6.8	5.9	4.4	3.7				

Source: abrdrn, November 2024



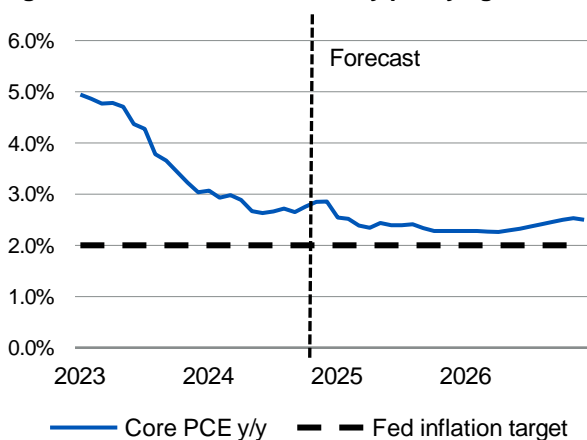
US

Activity: US growth is being supported by a resilient consumer, a labour market which, while cooling, remains solid, and strong corporate profitability. Trump's second term will see tax cuts, higher defence spending and looser regulatory policy, which should further boost growth as the policies take effect mostly in 2026. However, these tailwinds will be dampened by rising tariffs and slower net migration, which constitute negative supply shocks. Indeed, we think these will weigh on growth in 2027 and 2028. There is a risk the policy mix is more disruptive, with broader tariffs and large-scale deportations, or of a growth-friendly mix which focusses less on these policies and more on deregulation.

Inflation: We think the combination of demand-side stimulus, in the form of looser fiscal policy, and shocks to the supply side, via tariff hikes and deportations, will leave inflation stuck near 2.5% (see Figure 4). Moreover, risks of a reacceleration have increased, especially in the case of large rises in tariffs, or aggressive deportations. Indeed, the pandemic illustrates how swings in aggregate demand and supply can trigger rapid prices adjustments. So only a more toned-down version of Trump's policy agenda would leave the current trend of disinflation towards target intact.

Policy: The Fed looks set to cut in December, even if recent firm inflation data have cast some doubt over this move. Assuming no nasty surprises in November CPI, a 25bps move would take the reduction in rates to 100bps over the past three meetings. This adjustment will slow in 2025, when we expect the Fed to cut by just 75bps, reflecting a careful approach as rates get closer to equilibrium levels and inflation progress is interrupted by Trump's policy agenda. Thereafter, we think rates will remain on hold at 3.5-3.75% through 2026, before cuts resume as growth and inflation slow.

Figure 4: US core PCE set to remain stubbornly above target in the face of an inflationary policy agenda.



Source: abrdrn, Haver, November 2024

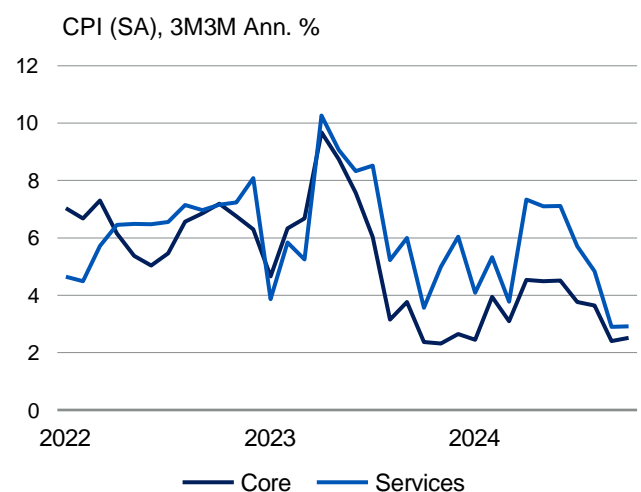
UK

Activity: The UK economy has slowed, perhaps due to heightened uncertainty into the run-up to the budget, and activity surveys have weakened significantly. The budget delivered a material increase in spending and investment, financed by an increase in tax and borrowing. This will support growth in the near term compared to the previous fiscal plans, but a sustained boost to potential growth requires supply-side reforms. The recent rise in gilt yields has already wiped out the government's limited headroom against the new fiscal rules, so further tax increases are likely.

Inflation: Headline inflation, which hit 2.3% in October, is likely to continue increasing in coming months, in part due to unfavourable base effects. But underlying inflation pressures are gradually receding (see Figure 5). The labour market appears to be cooling, with private sector wages evolving in line with the Bank of England (BoE)'s forecast, although methodological issues around the unemployment rate mean there is still some uncertainty. However, the fiscal policy shifts are inflationary, while the increase in the minimum wage next year may keep wage growth elevated. So, a sustainable return to target-consistent inflation may take longer than previously expected.

Policy: We think the UK's front-loaded fiscal easing means the BoE will continue to cut gradually. The most likely near-term effect of the US policy shift on the UK is via sustained moves in financial conditions. These effects may push in opposite directions, with the rise in gilt yields a constraint on the economy, but depreciation of sterling a boost. But, with the pace of UK and US easing likely to be similar over the next 12 months, and the UK avoiding the brunt of Trump's tariffs, we don't expect the US to place a significant constraint on UK policy settings.

Figure 5: Underlying inflation pressure in the UK is gradually moderating



Source: abrdrn, Haver, November 2024



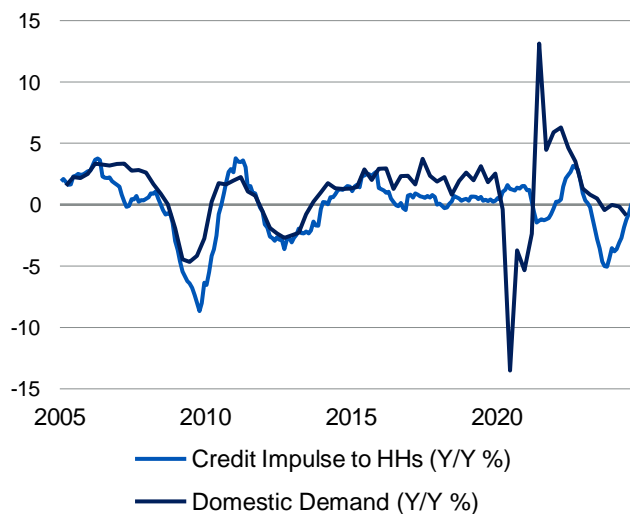
Eurozone

Activity: Weak activity data confirm that the Eurozone recovery is in a fragile state, and Q4 growth will likely be very slow at best. Uncertainty arising from Trump's trade measures will pose a further headwind to growth. We don't expect the Eurozone's economy to drop into recession, though risks remain. Household balance sheets are fairly strong, and, with the restrictiveness of European Central Bank (ECB) policy is being rapidly reduced. This is already reflected in bank lending data (see Figure 6). The negative fiscal impulse should also moderate over 2025. In all, we expect GDP growth of 1.1% next year.

Inflation: Eurozone headline inflation rose to 2.0% in October, and energy base effects may push this higher in coming months. However, with the labour market loosening, we expect domestically generated inflation pressures to ease. Eventually, this will be reflected in a broadening of the Eurozone's already-advanced disinflationary process, including a moderation in the so-far sticky core services component. While targeted tariff measures by the US on the Eurozone are likely to be inflationary, we think the impact will be small. But if severe tariffs are imposed and the EU responds in kind, trade disruption could push up on inflation more markedly.

Policy: We think a consensus in favour of rapidly moving monetary policy settings to a neutral stance has formed among ECB officials. Two questions now remain live: How quickly will rates be lowered? Will policy need to become outright accommodative? We think the ECB is more likely to keep lowering rates in 25bps rather than 50bps steps, given persistence in underlying inflation. We don't think the economy warrants outright accommodation, as we expect stronger growth in 2025. However, worse than expected growth, for example if the impact of trade disruption is large, could prompt this.

Figure 6: Lending data suggest ECB cuts are beginning to have an impact



Source: Haver, abrdrn, November 2024

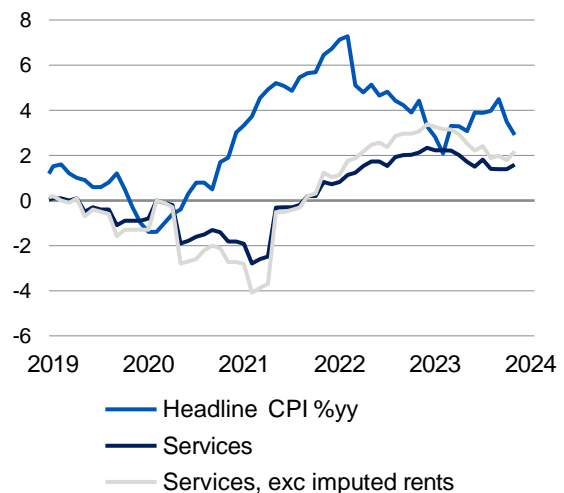
Japan

Activity: Although GDP growth slowed to 0.2% in Q3, the economy is reasonably robust under the surface. In particular, consumption has been strengthening. This trend is likely to continue through 2025 given the combination of rising real incomes, fiscal support measures including one-off tax cuts, and the temporary return of electricity and gas subsidies. The weak external demand backdrop and the risk of increased global trade tensions may act as a drag. But Japan's critical role in the global value chain and track record of being adept at negotiating exemptions to Trump's previous tariffs means we aren't expecting a large hit.

Inflation: The steady decline in inflation in Japan is still largely a story of pandemic-era shocks unwinding. But, with the labour market tight, underlying domestically generated inflation pressures may yet stabilise at broadly target-consistent rates (see Figure 7). The strong Shunto wage negotiations of last spring have finally filtered into higher realised earnings, with core base pay growth close to 3%. The president of the Rengo Trade Union Confederation aims to secure wage increases averaging 5% in 2025. Recent weakness in the yen should also push up on imported goods costs.

Policy: The ruling LDP-led coalition lost its majority in the lower house election. Nonetheless, PM Shigeru Ishiba was quickly sworn in to focus on geopolitical negotiations following the US election. The government plans to boost fiscal spending. We think price and wage data support a 25bps BoJ hike in January, with December live. However, with the futures curve not pricing a hike until March, the BoJ will need to communicate carefully to avoid surprising investors and triggering volatility. We expect another rate hike later in 2025, as the BoJ does some of the work closing the rate differential with the US.

Figure 7: Japan's services inflation is showing signs of resilience



Source: Haver, Bloomberg, abrdrn, November 2024



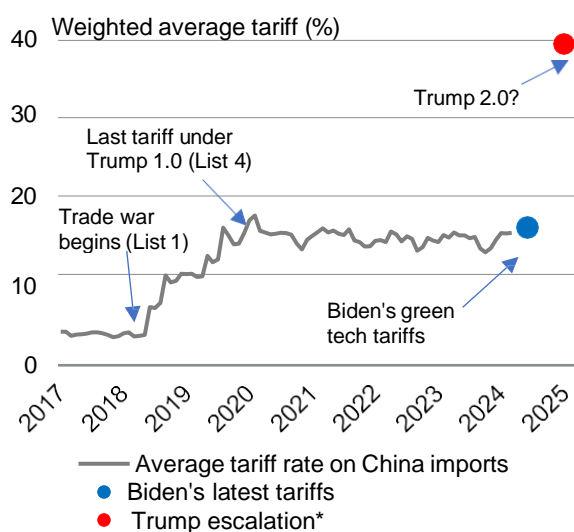
China

Activity: The strong start to Q4 activity data, as the authorities' policy pivot starts to gain traction, means the 2024 growth target of 'around 5%' should be achieved. However, policymakers need to ramp up stimulus more conclusively to counter a second trade war (see Figure 8), while weakness in property and consumption remain major domestic challenges. Absent an opening of the policy floodgates, we expect that a more than doubling of the average bilateral tariff rate facing Chinese exports to the US will depress Chinese GDP by 1%, pushing 2025 and 2026 GDP growth down to 4.3% and 4.1% respectively.

Inflation: The nominal environment is likely to remain weak. Core CPI inflation has slipped close to zero, and will remain low due to falling producer prices, particularly within durable consumer goods. Additional fiscal easing should help to support consumption and therefore prices. But the bigger policy pivot coming from rising tensions with the US is likely to be further investment in strategic industries, rather than reforms to support rebalancing. Even assuming the authorities condone FX depreciation to offset some of the shock from higher tariffs, we forecast annual CPI inflation of only 0.8% for 2025, well below consensus of 1.2%.

Policy: Markets were shocked in late September by policymakers announcing a raft of new support measures, breaking from a long period of incremental and piecemeal easing. We think further measures will follow in time, especially as US tariffs on China increase. These are likely to include fiscal measures to support consumption, and currency depreciation. However, a pattern of announcements coming more slowly, and in underwhelming size, appears to be setting in, as illustrated by the RMB 10 trillion debt swap. We don't think that easing will be sufficient to fully offset the growth hit from tariffs.

Figure 8: Tariffs facing Chinese exports are likely to more than double as a second trade war unfolds



Source: US Census Bureau, USTR, WITS, abrdrn, November 2024

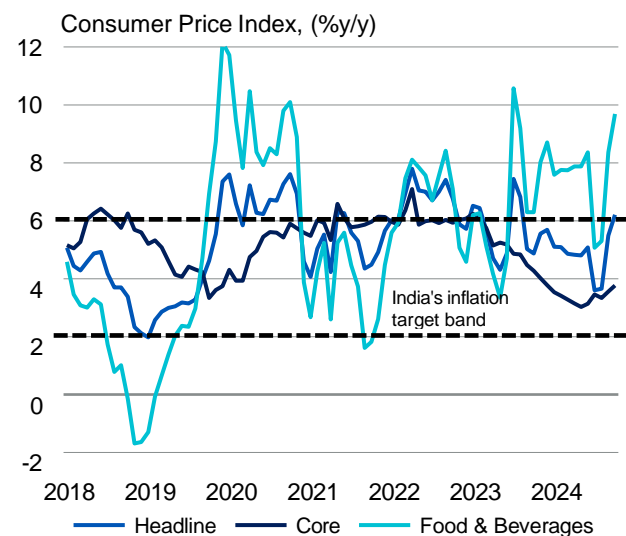
India

Activity: Indian economic indicators, such as PMIs and domestic sales, cooled over the third quarter. There are some signs of stronger momentum in October, and post-election government spending should help offset some of the squeeze on demand from higher food inflation. However, through 2025, fiscal consolidation and softer private investment will prove drags. And, while India should be less affected by the incoming Trump administration than other major economies, given its relatively low exposure to US goods demand, tighter external financial conditions will still weigh modestly on growth.

Inflation: Food prices continue to prove the major driver of inflation in India, delaying the disinflation process (see Figure 9). We forecast headline inflation to average 5.3% through the final quarter of 2024, as food price pressure has shown limited signs of abating. Other price indicators, such as PMI sub-indices, have also picked up, challenging our prior expectation for cooling inflation. However, in 2025, softer growth momentum and the boost to food supply from the strong harvest in 2024 should lower inflation, to an average of 4.4% through the year.

Policy: The Reserve Bank of India (RBI) will keep its policy rate on hold at 6.5% through 2024, despite the recent pivot to a neutral policy stance. The RBI remains focused on the upward pressures from food prices, despite limited signs of pass-through to other parts of the economy. And with the monetary policy committee optimistic on growth momentum, we see limited scope for a cut in December. Inflation is likely to overshoot the RBI's projections and as such, we think the RBI may opt to hold off cutting in February as well, instead beginning easing in April.

Figure 9: India's food inflation problem



Source: Haver, abrdrn, November 2024



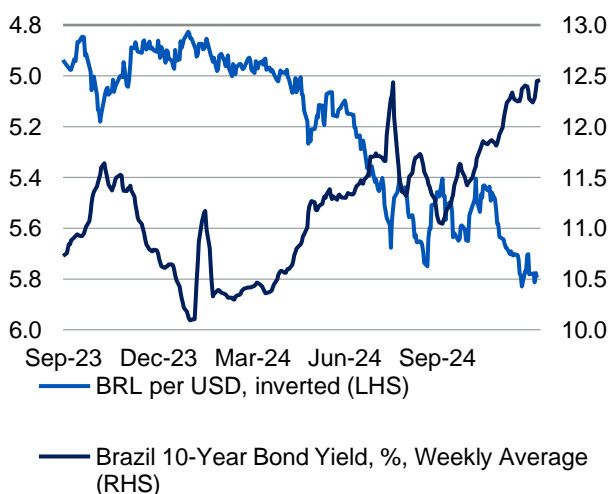
Brazil

Activity: After real GDP growth surprised to the upside over H1, supported by accommodative fiscal policy, high frequency indicators signal another above-trend print for Q3. Brazil's economy will likely enter 2025 running hot. The lagged effects of the Banco Central do Brasil (BCB)'s hawkish pivot should help moderate growth next year, but much depends on a still very vague plan to curtail the budget. Substantial and targeted spending cuts could cool demand more immediately than expected. However, political reluctance to reduce expenditure could force the BCB to tighten beyond our baseline.

Inflation: Disinflation has stalled in Brazil. Headline price growth of 4.8% in October breached the upper bound of the BCB target range (of 3% +/-1.5ppts) for the first time since January. Resilient demand and a tight labour market will keep core inflation sticky through to Q1/Q2. Meanwhile, resurgent food and hydropower-related energy prices following drought conditions, alongside the depreciation of the *real*, are further upside risks for headline inflation over the coming months. The trajectory of inflation in 2025 and 2026 will depend on how much the BCB and government tighten their respective policy stances.

Policy: The BCB raised the Selic rate by 50bps to 11.25% in November, a sharper hike than its initial 25bps increase in September. Despite this hawkish pivot, investor concerns regarding fiscal policy continue to drive up Brazilian yields and weigh on the *real* (see Figure 10). Our forecast is for the Selic rate to peak around 12% in Q1 and be gradually lowered over H2 2025. Risks are however weighted towards a longer period of tighter financial conditions, should fiscal retrenchment disappoint. Incoming BCB Governor Gabriel Galipolo may also lean towards a more hawkish stance to defend the BCB's policy credibility.

Figure 10: BCB will retain hawkish stance through to mid-2025, but markets await clarity on fiscal tightening



Source: Haver, abrdn, November 2024

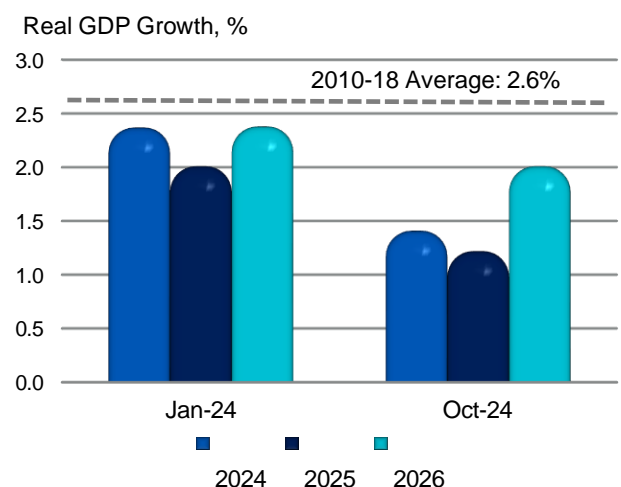
Mexico

Activity: Consensus expectations for growth have fallen further below trend (see Figure 11). Uncertainty regarding the government's reform agenda and its trade relationship with the US means limited scope for a meaningful short-term rebound in domestic demand. Slower Fed easing will also restrict how much Banco de Mexico (Banxico) can lower rates. Trump's threats to renegotiate (rather than review) the USMCA pose significant risks to the outlook, which could further delay FDI and 'nearshoring' gains. But, assuming these threats are not followed through, Trump's expansionary agenda should actually buoy Mexican exports. Indeed, Mexico remains well placed to benefit from US-China tensions.

Inflation: Mexico's headline inflation rate averaged 4.8% in the year to October. Disinflation has been hindered by agricultural prices as well as sticky services inflation. However, core inflation has maintained a downtrend since early 2023 and is now running at annualised rates broadly consistent with Banxico's 3% target. Headwinds to growth should provide a cap on inflation over the coming quarters. But upside risks from service and food prices, as well as the peso's depreciation, remain.

Policy: Banxico implemented three consecutive 25bps rate cuts in August, September, and November, despite domestic political risk and external market volatility having weighed heavily on the peso. The latest policy statement retained a dovish tone, owing to ongoing core disinflation and a tepid growth outlook. After an expected 25bps cut to 10% in December, we expect Banxico will gradually lower its policy rate to around 8.75-9% by end-2025 (consensus: 8%). The main constraints on the cutting cycle will be the Fed easing more slowly, alongside potential peso volatility due to domestic political risk or perceived spikes in US-Mexico tensions.

Figure 11: Weak domestic demand in Mexico and cross-border uncertainty have dampened growth forecasts

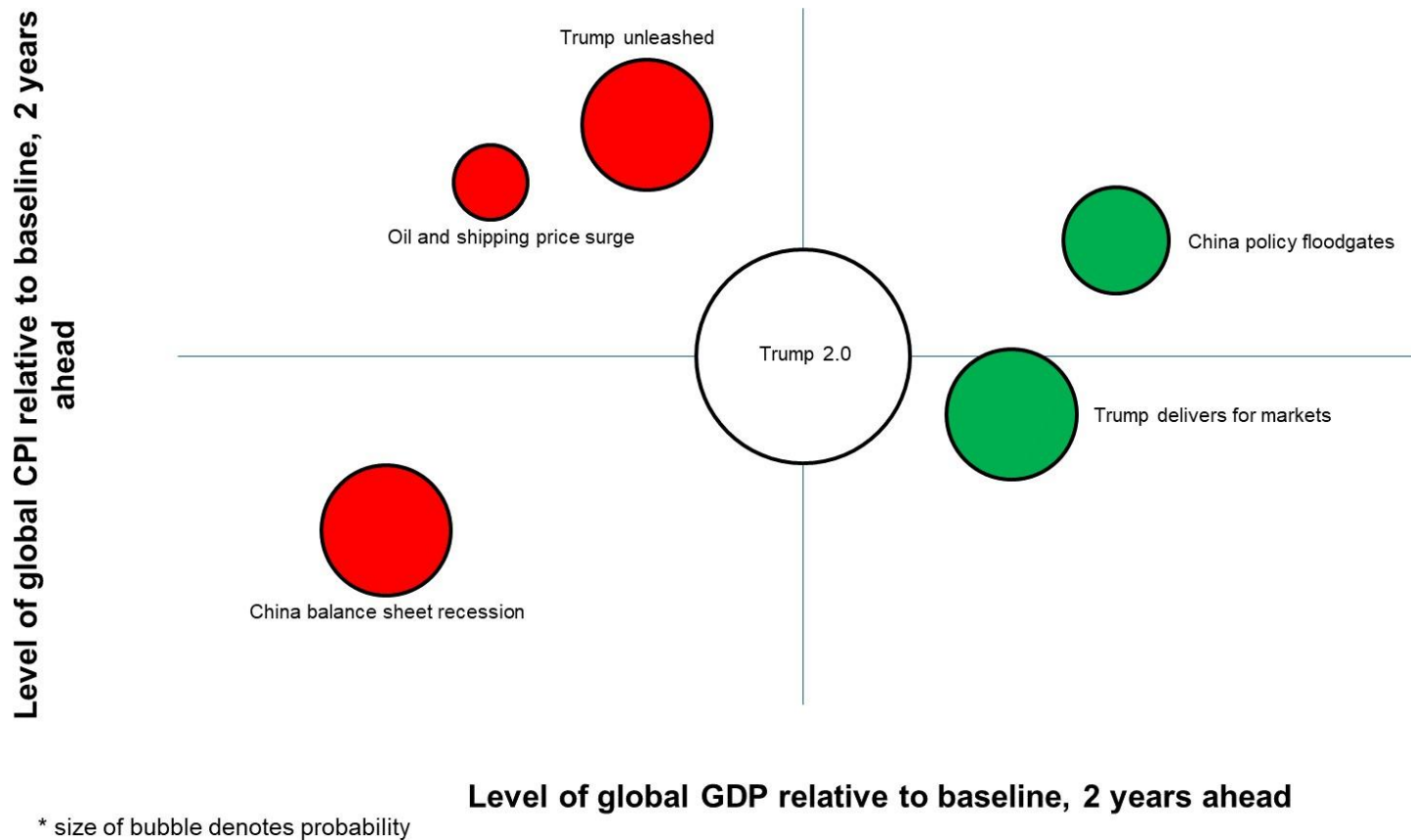


Source: Banxico survey of expectations, Haver, abrdn, November 2024



Global scenarios overview¹

Figure 12: Global activity and price level in key alternative scenarios, relative to baseline, 2 years ahead



Source: abrdn, November 2024

¹ These scenarios reflect our subjective assessment of the uncertainties around the key judgements in our forecasts, with the probabilities capturing our view of the *importance of the risk* for the global economy and markets embodied in the different scenarios. We run a separate ad hoc event risk-driven scenarios process which attempts to capture the *likelihood* of specific events occurring. As such, there can be differences between our global scenario probabilities and these ad-hoc scenario specifications.



Trump 2.0: 40%

Spillovers from adverse US supply shocks push up on US inflation and interest rates, causing greater divergence around growth and policy

The new Trump administration delivers a sharp increase in the tariff rate on China but not a global baseline tariff, eases fiscal policy by around 0.5% of GDP per annum in 2026, sees net migration fall from 3 million people per year to flat, and relaxes anti-trust and banking regulation.

The US economy continues on its current robust growth path in 2025, with looser fiscal policy deregulation providing a moderate boost to demand over 2026. However, as these tailwinds fade, immigration changes become more of a drag, such that the level of GDP at the end of Trump's presidency is lower than it would have been previously.

The combination of stronger aggregate demand and a negative supply hit means inflation is higher, with core PCE stuck around 2.5% for the next few years. This means the Fed cuts only three times in 2026, before keeping policy unchanged for at least a year (see Figure 13).

In China, growth just about hits the "around 5%" target in 2024, but is weaker in 2025 and 2026 given the impact of higher US tariffs and the inevitable Chinese retaliation.

Chinese policy stimulus increases as the trade war intensifies, including fiscal stimulus and meaningful depreciation of the renminbi. But overall, stimulus falls short of market expectations in both its speed and size.

Emerging market rate cutting cycles slow down as they struggle to navigate higher US rates, a stronger dollar and greater trade frictions.

US tariffs also hit Eurozone growth (see Figure 14), although at the aggregate level the impact is relatively modest. However, Germany is particularly badly affected. The ECB delivers a slightly more aggressive easing path than we previously thought, lowering the policy rate to 2% in the second half of 2025.

The UK avoids the brunt of targeted US tariffs, while easier fiscal policy boosts growth and inflation over the next year. This keeps Bank of England easing slower than in the Eurozone.

With US rates likely to remain higher, more of the burden of supporting the yen via closing US-Japan rate differentials falls on the Bank of Japan. This may encourage a more rapid or sustained hiking cycle.

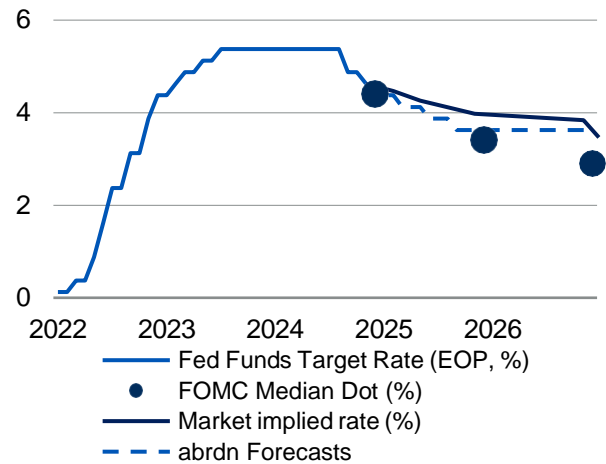
All told, global GDP growth is just above 3% per annum in coming years, around trend (see Figure 15).

Global economic forecasts

Growth: 2024 3.2%, 2025 3.1%, 2026: 3.1%

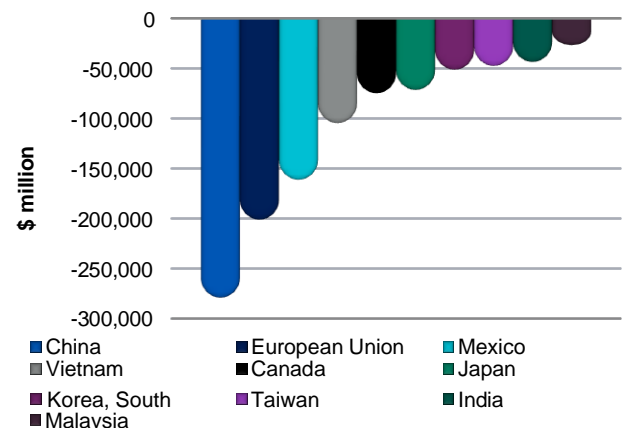
Inflation: 2024 5.9%, 2025 4.4%, 2026 3.7%

Figure 13: We now expect a relatively shallow Fed easing cycle



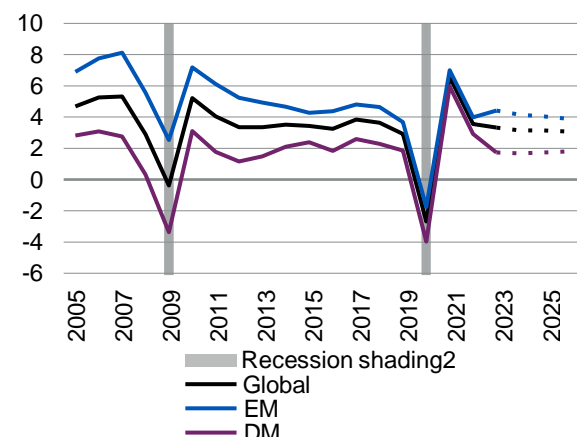
Source: abrdn, Bloomberg, November 2024

Figure 14: Economies with large goods trade deficits with the US will be singled out by trade measures



Source: abrdn, Haver, US Department of Commerce, November 2024

Figure 15: We forecast global GDP growth just above 3% in coming years



Source: abrdn, Haver, November 2024



Trump unleashed: 15%

The Trump administration and Congress deliver aggressive policy changes, that materially damage aggregate supply and so boost inflation and interest rates

The US policy mix changes dramatically under the Trump administration, as the president delivers fully on the trade and immigration commitments made during the campaign. This leads to a large negative hit to supply that is not fully offset by easier fiscal policy. Indeed, fiscal largesse leads to renewed concerns about US fiscal sustainability.

The US pursues rapid decoupling from China, with an effective tariff rate of 50-60% and limits on technology and financial flows. Trade policies are also designed to target countries rerouting trade from China or hosting Chinese corporates. A 10% global baseline tariff on all imports is imposed, with additional tariffs on strategically or politically significant trade partners or products. The US' effective tariff rate revisits levels last seen in the 1930s (see Figure 16).

Trade partners retaliate, leading to a material increase in global tariff rates. This increased protectionism sees global trade volumes decline, leading to a large cyclical slowdown that tips Europe back into recession. Global potential growth slows due to less specialisation.

US immigration policy is tightened significantly, with deportations totalling 8 million (3% of the US population) over the next four years. This sees net migration fall deeply negative (see Figure 17) causing a large fall in labour supply. Sectoral shortages in agriculture and construction are particularly acute, leading to wage and price pressure.

Fiscal policy is eased inefficiently. The US corporate tax is cut to 15%, federal taxes on tips are abolished, the SALT cap is removed, and there is a more generous child tax credit. Higher tariff revenue would offset some of these cuts. But alongside higher defence spending, the deficit would be 7.6% of GDP by 2028. This puts upward pressure on the term premium, crowding out private sector investment, while fiscal sustainability concerns become increasingly pressing.

Monetary policy needs to remain much tighter than the base line. There are no interest rate cuts in 2025, 2026 or 2027. This lack of monetary easing leads to criticism of the Fed from the Trump administration. The president may attempt to fire Jay Powell, triggering a legal standoff and institutional uncertainty. This prompts significant market volatility and even higher inflation expectations and term premia.

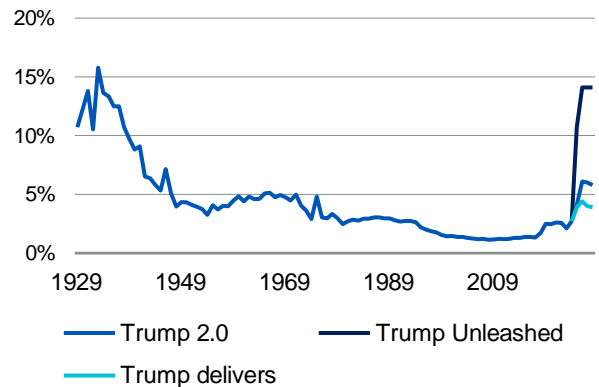
All told, US GDP is lower and inflation higher than in the baseline (see Figure 18).

Global economic forecasts relative to baseline, 2 years ahead:

Activity: -1.0%

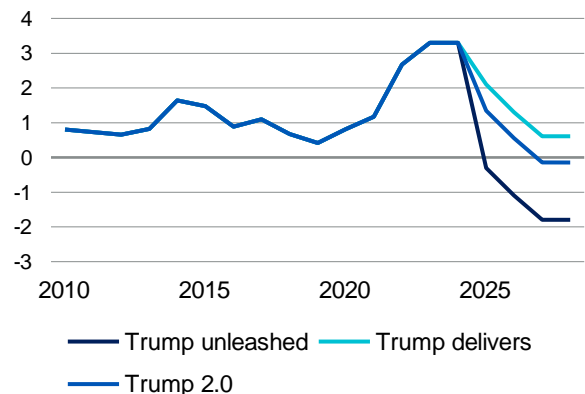
Price level: 2.0%

Figure 16: Full implementation of the Trump tariffs would take the US effective tariff rate to 100-year highs



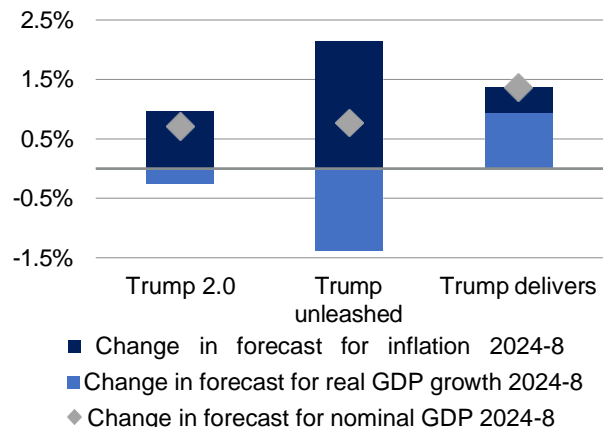
Source: abrdrn, Haver, Yale University, November 2024

Figure 17: US net migration would be deeply negative if deportations reach the level Trump has talked about



Source: abrdrn, CBO, November 2024

Figure 18: US growth would be lower, and inflation higher, under this policy mix



Source: abrdrn, November 2024



Trump delivers for markets: 15%

Trump focuses on the most market friendly aspects of his agenda, while pulling back from more growth-damaging and inflationary policies

The Trump administration governs far more conventionally than campaign rhetoric suggests, stepping back from many of the more disruptive aspects of his agenda. Meanwhile, material deregulation and reform of the tax code help to boost potential growth.

The administration pursues a systematic, coherent strategy of deregulation, using the end of Chevron deference to dismantle aspects of the regulatory state. The Federal Trade Commission (FTC) returns to a much more permissive approach to merger activity. Bank capital requirements are eased rapidly. And executive orders are used to significantly increase oil and gas permitting.

The turn to protectionism is much less pronounced, as the risk of higher inflation, political unpopularity and market weakness stay Trump's hand. Nonetheless, there is still a small rise in the effective tariff rates on China to 25-30%. But aside from some product-centric measures, there are no major tariff announcements on other trading partners, while the USMCA is renewed.

Fiscal policy is more focused on reforming the tax code than passing large-scale further stimulus. The fiscal cliff is avoided, and there is a small corporate tax cut, alongside even more favourable treatment of investment and R&D. This would see the deficit broadly moving sideways at around 6.6% of GDP in 2028 (see Figure 19). This means there is limited crowding out of private sector capital formation compared to the base case.

A pared back version H.R.2 is passed, and net migration is lower. But deportations remain in line with norms from previous administrations (see Figure 20). Labour supply is higher than in the base case.

Trump restrains from criticising Fed policy, and when Powell's term expires in 2026, he is replaced by a highly credible individual. Staffing choices for other economic policy positions are similarly technocratic.

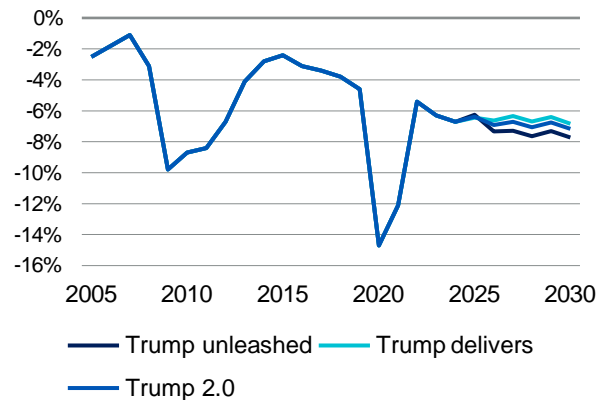
This policy mix supports aggregate supply growth, without a large aggregate demand injection. This means the boost to nominal GDP occurs mostly via stronger real growth rather than inflation. The Fed eases policy more rapidly than in the base case (see Figure 21). In the long run, stronger potential growth could push up on equilibrium rates. Reduced inflation risk and debt issuance compared to the base case means term premia are lower.

Global economic forecasts relative to baseline, 2 years ahead:

Activity: 1.0%

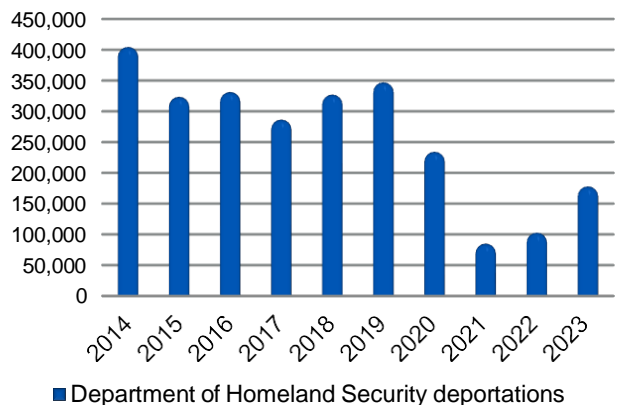
Price level: -0.5%

Figure 19: With the deficit so large already, the upside scenario for markets would involve avoiding the fiscal cliff rather than further large-scale stimulus



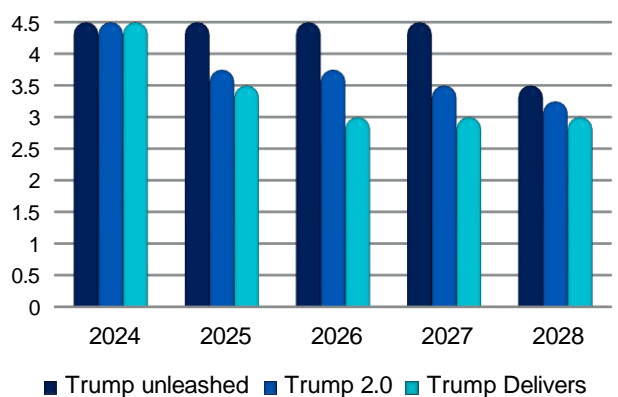
Source: abrdn, CBO, Haver, November 2024

Figure 20: Past administrations have seen deportations of 100-400k, rather than the millions Trump proposes



Source: abrdn, Office of Homeland Security Statistics, November 2024

Figure 21: The fed funds rate would come down more rapidly under a more orthodox Trump presidency



Source: abrdn, November 2024



China balance sheet recession: 15%

The policy response falls substantially short of what is necessary, so the economy becomes trapped at much lower rates of growth and inflation

China's cyclical and structural headwinds intensify. There is further retrenchment in the property market and consumer sentiment, exacerbated by a sharp rise in US tariffs on

China to the full 60% promised by Trump on the campaign trail and new 'rules of origin' stipulations, which damage demand for Chinese exports. Policy support is entirely inadequate to the headwinds, causing China to become trapped in a low growth, low inflation "Japanification" scenario.

Policy announcements continue to significantly disappoint expectations even as activity deteriorates and pressure from US trade policy mounts. In particular, policymakers remain deeply averse to supporting household consumption due to 'welfarism' fears and worry that support to the housing market and local governments will cause progress on deleveraging and derisking to be lost.

House prices continue to fall, leading to further declines in already depressed consumer confidence indices (see Figure 22). The number of new housing starts falls further

as the authorities attempt to tackle a large overhang of vacancies (see Figure 23).

Industrial production contracts as domestic growth stutters and Western-owned manufacturers begin to move operations out of China under pressure from US policy. Exports fall sharply, but the authorities do not condone a sufficient FX depreciation due to fears of exacerbating capital flight. Consensus expectations for Chinese growth are marked down to below 2.5%.

CPI inflation moves back into negative territory, while the GDP deflator continues to fall (see Figure 24). Combined with sharp declines in industrial metals and energy prices, this transmits a disinflationary impulse around the globe.

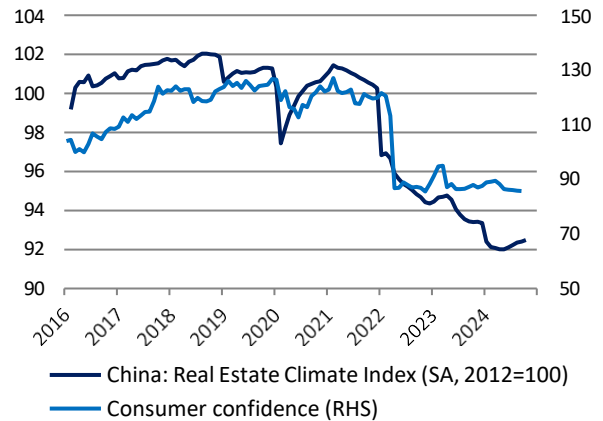
International investor sentiment sours and capital outflows intensify, sparking fears of capital controls being enacted. The RMB reprices lower in a disorderly manner.

Global economic forecasts relative to baseline, 2 years ahead:

Activity: -2.0%

Price level: -1.5%

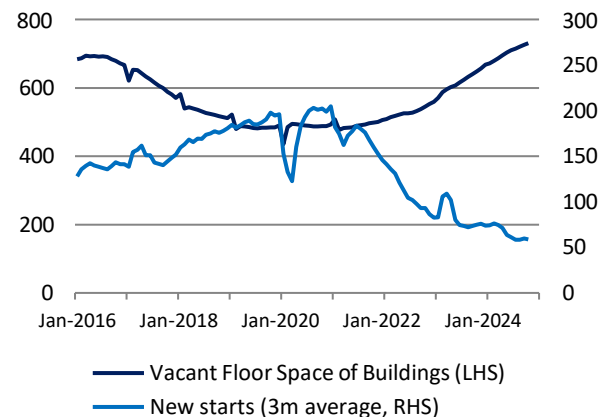
Figure 22: Consumer confidence has been hit by falling house prices and troubled property developers



Source: abrdrn, Haver, November 2024

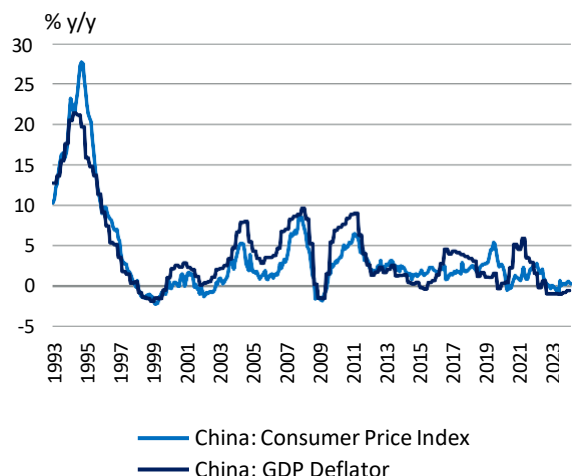
Figure 23: Property remains a key pillar of vulnerability

Million square meters, SA



Source: abrdrn, Haver, November 2024

Figure 24: Deflation could become embedded



Source: abrdrn, Haver, November 2024



China opens the policy floodgates: 10%

Policy is eased significantly, with housing developer bailouts and a credible plan to boost household consumption. International investor sentiment turns positive

Chinese policymakers become more concerned with the cyclical economic slowdown and the headwinds from Trump's tariff threats. Meanwhile, the de-risking agenda is deprioritised, while ideological concerns about supporting consumption and "welfarism" are put aside.

Policymakers therefore deliver a bigger and better-targeted package of stimulus and reform than we are expecting in the base case.

This includes sizeable fiscal stimulus to directly support household consumption, housing developer bailouts, a concerted effort to complete unfinished properties, and additional central government support for local government public finances.

Chinese financial conditions become much more accommodative, as ample liquidity combines with rate cuts and strong credit growth (see Figure 25).

Consumer confidence improves significantly due to direct government transfers, rising house prices, higher income growth and improved employment prospects (see Figure 26).

Expanding the social safety net reduces the need for precautionary saving, so households tap the excess savings built up over the pandemic (see Figure 27). This provides a large boost to the service sector, both at home and abroad as tourism takes off.

Nominal growth picks up sharply, and China's disinflationary impulse to the rest of the world fades, as export deflators move back into positive territory. Commodity prices also increase as domestic investment spurs demand for raw materials.

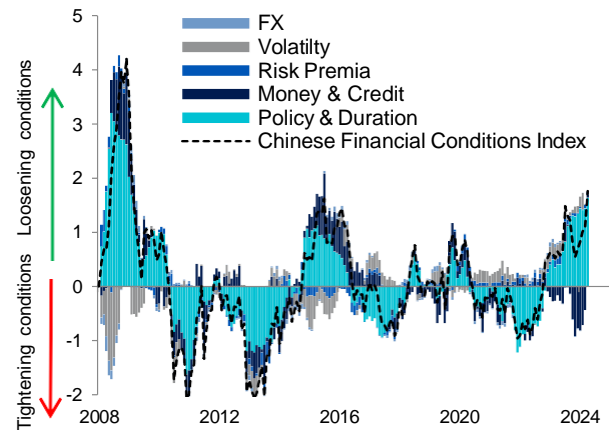
Rebalancing helps to diffuse trade tensions with the US and international investor sentiment improves significantly, resulting in capital flows returning to China. Global equilibrium interest rates modestly increase as reforms translate into stronger potential growth in China.

Global economic forecasts relative to baseline, 2 years ahead:

Activity: 1.5%

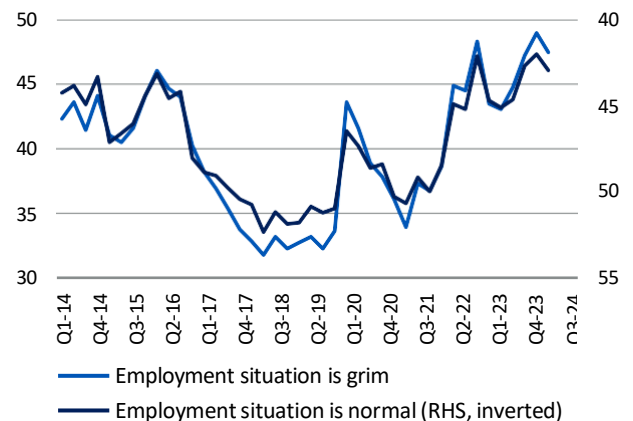
Price level: 1.0%

Figure 25: China's policy 'bazooka' could be brought out of retirement, which would see our financial conditions index loosening significantly



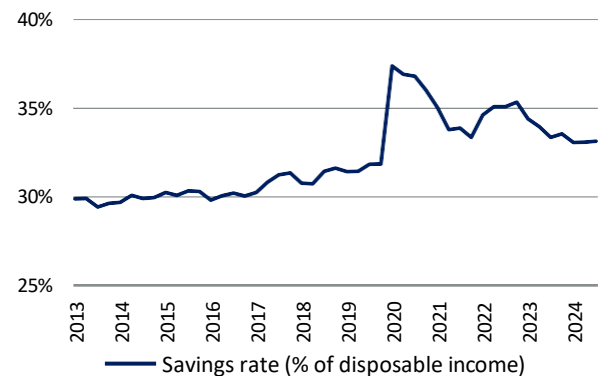
Source: abrdn, Bloomberg, Refinitiv, November 2024

Figure 26: The labour market is close to 'peak misery', which could prompt bigger stimulus



Source: abrdn, Haver, November 2024

Figure 27: If the need for precautionary saving is reduced, savings would boost consumption



Source: abrdn, Haver, November 2024



Oil price surge: 5%

Conflict in the Middle East escalates, causing a surge in oil prices. Inflation jumps, and central banks start tightening policy again

Israel steps up its military action across the Middle East, notably striking military and energy infrastructure in Iran. The new US administration does not seek to moderate Israel's actions.

Iran in turn responds in force against Israel, potentially misjudging the severity of its response such that further escalation occurs. Ultimately, Israel and Iran are brought into outright and large-scale conflict.

Iranian oil supply to the global economy is effectively cut-off. Broader Middle East oil supply is disrupted as traffic through the Strait of Hormuz faces periods of closure.

In addition to the supply disruptions, meaningful geopolitical risk premia are added to oil and other asset prices. All told, this takes oil prices well above \$100 per barrel, with peaks around \$120 per barrel plausible in this scenario (see Figure 28).

This large increase in energy prices represents a significant negative supply shock to the global economy, pushing

inflation higher and growth lower (see Figure 29).

This causes renewed downturns in the Eurozone and UK, while the US economy also weakens.

The recent experience of high inflation means that inflation expectations are less well anchored than normal (see Figure 30). Indeed, inflation expectations move higher as households lose confidence in inflation stabilising at target.

Central banks do not feel comfortable "looking through" this shock. The current global interest rate cutting cycle stops as central banks need to signal inflation credibility in response to higher inflation expectations. In some cases, monetary policy is tightened again despite the weaker growth environment and increased financial stress, which pushes down further on growth.

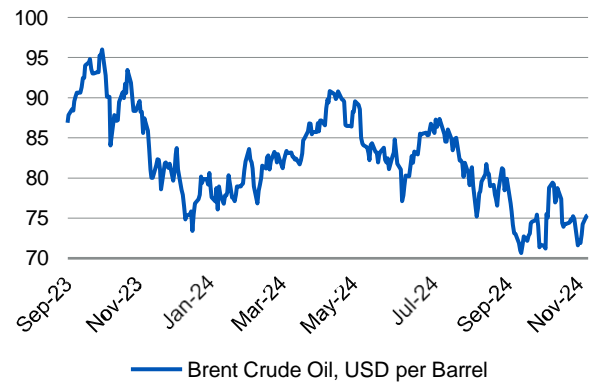
Longer maturity rates could settle higher if an increased inflation risk premia and higher policy rates dominate, or lower if weaker growth and flight to quality prove more important.

Global economic forecasts relative to baseline, 2 years ahead:

Activity: -1.5%

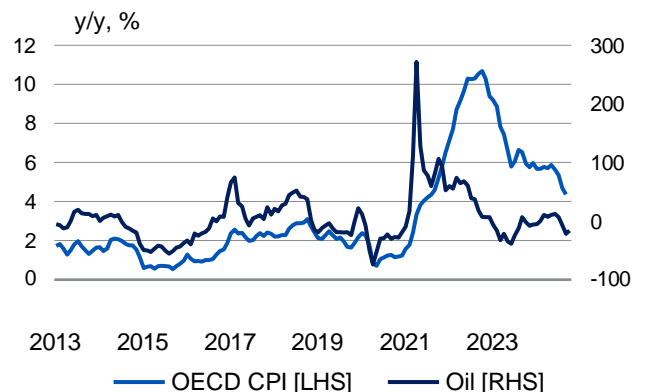
Price level: 1.5%

Figure 28: Oil prices could increase well above \$100 if significantly supply disruptions occurred



Source: Haver, abrdrn, November 2024

Figure 29: The sharp rise in oil prices would push up on global headline and core inflation



Source: Haver, abrdrn, November 2024

Figure 30: Higher inflation expectations would mean central banks are unable to look through the shock



Source: Haver, abrdrn, November 2024



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