



Global Fixed Income Strategy

JANUARY 2026

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Macro conclusions from the year-end 2025 IFI Summit

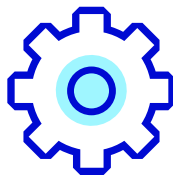
We share the macro conclusions from the Invesco Fixed Income year-end Global Investors' Summit. Investors discussed macroeconomic trends in the US, Europe, the UK, China and emerging markets.



15 Rates and currency outlook

Major rates and currencies 3-month outlook

We are overweight UK and Australian interest rates. We are neutral on US, European and Chinese rates, and underweight Japanese rates. We are overweight the euro, Chinese renminbi, Japanese yen and Australian dollar. We are underweight the US dollar and British pound.



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Private credit: The next frontier for investment grade portfolios

AI underpinned many Summit discussions, including its economic and capital market implications. In a Q&A with the Investment Grade Team, we delve into the topic of how AI is melding public and private credit.

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Global macro strategy

Macro conclusions from the IFI Summit: US, Europe, the UK, China and EM

Executive summary

US

Tariffs dominated 2025, driving cost-push inflation and weakening business confidence. In 2026, fiscal stimulus and monetary easing will likely aim to restore growth but could be complicated by persistent inflation near 3%.

Europe and UK

Eurozone fiscal policy has shifted to expansion, aided by defense-related budget exemptions and remaining COVID recovery grants. Germany's stimulus could modestly lift growth, but execution risks and fiscal multipliers remain uncertain.

UK inflation stems from indexation and fiscal choices, not demand. Budget measures support disinflation, however, enabling gradual Bank of England easing, despite ongoing wage pressures.

China

Official growth targets emphasize quality of growth over speed. We maintain a 4.5% GDP forecast and expect policy pivots toward economic opening, advanced manufacturing, and deeper capital account liberalization under the Five-Year Plan.

Emerging markets

EM growth is stabilizing near potential, supported by AI-driven investment spillovers and resilient domestic demand. Disinflation has aided policy normalization, though services inflation remains sticky.

EM structural trends—Latin America's political realignment, youth-led anti-corruption movements, and AI-linked capital flows—create selective opportunities amid trade fragmentation and shifting global investment patterns.

Macro themes play an important role in Invesco Fixed Income's (IFI) investment process. Our framework of "macro factors" focused on growth, inflation and policy, helps us project macro trends and interpret market movements. At our year-end 2025 Global Investors' Summit, investors from across the IFI platform gathered to discuss and debate their views on global macroeconomic trends. Below we share their main conclusions on the US, Europe, the UK, China and emerging markets (EM).

What's going on in the US economy? Key themes and forward-looking insights

The US economy has been shaped by major policy shifts and structural changes in 2025. While multiple factors have influenced the macro landscape, four stand out: tariffs, immigration and labor supply, artificial intelligence (AI), and policy measures. Each will likely play a distinct role in shaping growth, inflation, and monetary policy over the next 18 months.

Tariffs: The dominant force in 2025

If there is one defining feature of 2025, it is tariffs. Tariff rates surged from under 5% early in the year to a peak of 25%, finally stabilizing near 14–15%—the highest in nearly 90 years. This represents a fiscal tightening equivalent to roughly 1% of GDP, as annualized tariff revenues approach USD250–USD300 billion. Beyond the direct cost impact, tariffs have triggered a sharp deterioration in business confidence since March, as reflected in surveys and the Fed's Beige Book.

The uncertainty surrounding trade policy has led firms to pause hiring and defer major investments. While headline investment figures appear resilient, they are skewed by concentrated AI-related spending among large tech firms. Broader capital expenditure outside the tech sector remains subdued. We expect this cautionary stance to persist into early 2026, though some clarity is emerging as trade negotiations progress.

Tariff pass-through to consumer prices has been gradual but evident, particularly in sectors with limited competition (e.g., specialty electronics and furniture). This marks a structural shift: the era of sustained goods-price deflation is over. Core goods inflation will likely remain elevated, complicating the Fed's path to its 2% target.

Immigration and labor supply: Misunderstood dynamics

Contrary to popular narratives, the slowdown in hiring is not primarily driven by immigration constraints, in our view. Net immigration in 2025 is roughly in line with pre-pandemic norms—about 500–550 thousand people year-to-date, and around 1 million over the past 12 months. While the post-pandemic surge has moderated, immigration remains positive.

Moreover, the US labor market has flexibility beyond immigration. With a civilian population of 270 million and labor force participation around 62%, cyclical improvements in the economy can mobilize millions of workers. A one percentage-point rise in participation adds approximately 2.7 million workers—while such an increase may be optimistic, just half of that is a historically plausible scenario during periods of strong growth. Thus, short-term labor constraints are unlikely unless deportations accelerate dramatically.

Therefore, our baseline assumption for the labor market is: modest participation gains and continued net immigration will prevent the labor supply from becoming a binding constraint on the economy in the near term. However, we expect the economy to gain momentum in 2026, and as it does, firms will likely begin hiring a bit more, gradually absorbing the current slack. Wage growth should begin to pick up in the second half under the baseline outlook.

Artificial intelligence: Investment boom, productivity lag

AI is reshaping investment patterns, though its macro effects remain nuanced, in our view. Spending on equipment and intellectual property tied to AI is strong, contributing to GDP through capital deepening. However, aggregate productivity gains have yet to materialize; labor productivity growth has shown no structural break from historical levels.

Historical precedent suggests that technology-driven productivity gains lag adoption, as firms reconfigure processes. While AI diffusion may be faster than past innovations (electricity, internet) due to existing infrastructure and widespread accessibility, its impact is currently concentrated in large firms with implementation capacity. Sectors such as healthcare, education, and small businesses, have exhibited limited transformation.

Near-term implication: AI will likely boost growth mechanically via investment, not efficiency. Broad-based productivity gains—and associated disinflationary effects—are unlikely before late 2026 or beyond.

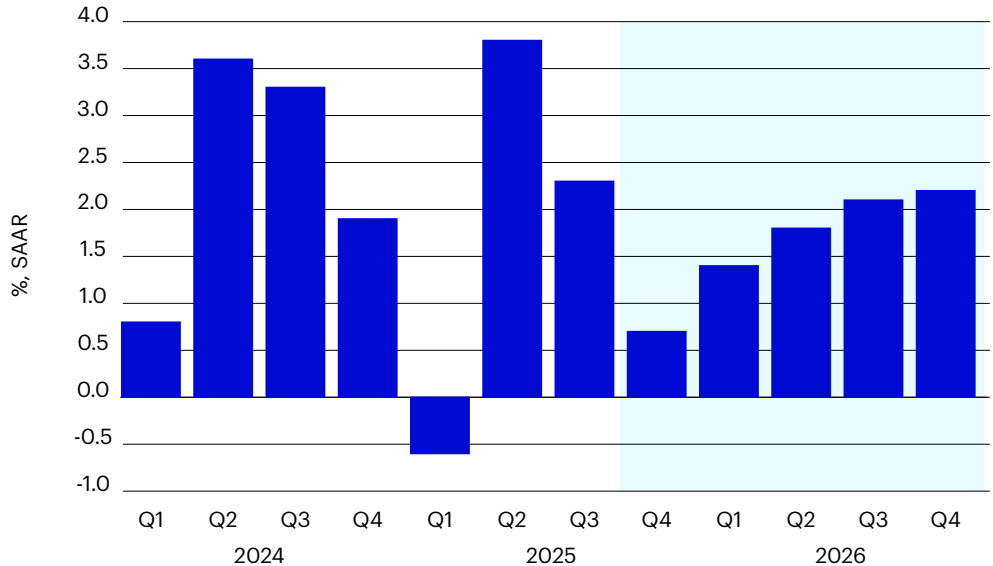
Policy landscape: Fiscal stimulus and monetary easing

Policy will likely pivot from headwind to tailwind in 2026. Fiscal measures—including tax rebates and capital expenditure incentives—are slated for rollout by Q1–Q2, reinforcing growth momentum. Concurrently, the Fed delivered “insurance cuts” in late 2025 amid labor market softness (private job creation near zero), with a final cut in December. Looking ahead, markets anticipate additional easing in 2026—three cuts, possibly in June, July, and December. Are they necessary? Perhaps not. By mid-2026, GDP should be back at potential and inflation should still be sticky near 3%. A textbook Fed would probably hold steady, but political dynamics may override economics. Leadership changes and pressure for accommodative policy could drive moves toward further policy easing.

Growth and inflation outlook

Growth: We expect a Q4 2025 slowdown, reflecting tariff adjustment and a hiring freeze. We expect growth to reaccelerate post-Q1 2026 as trade uncertainty fades, fiscal stimulus materializes and financial conditions ease. Our baseline forecast is for 2.1%–2.2% growth in H2 2026, with upside risk if policy transmission is swift.

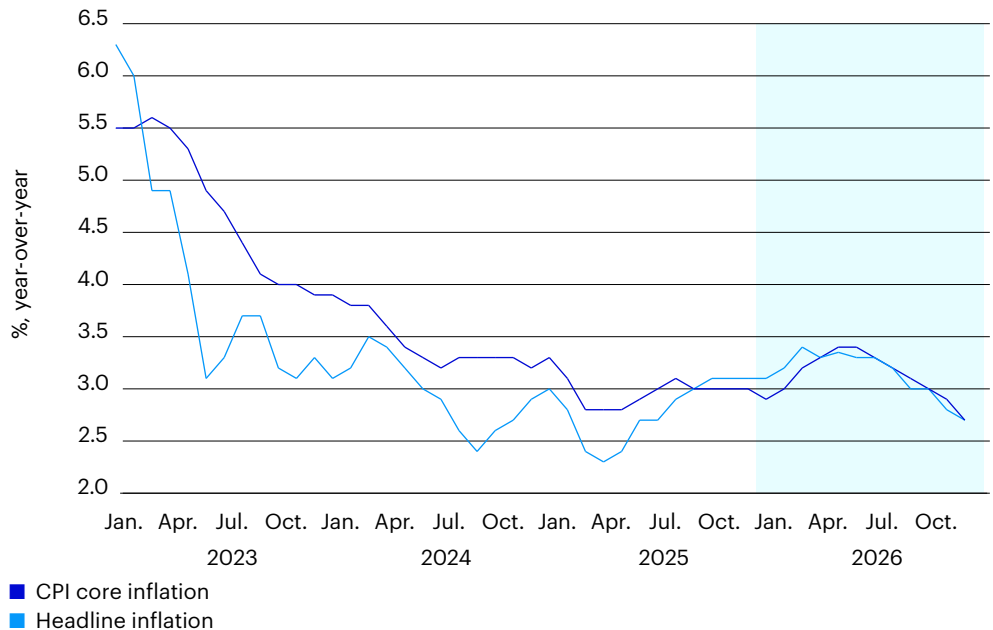
Figure 1: IFI US GDP projections



Source: Invesco, Bureau of Economic Analysis. Data as of Nov. 5, 2025. Forecasts from Q4 2025 to Q4 2026.

Inflation: We expect core PCE to end 2025 at 3.1% and rise to around 3.4% in 2026 before it gradually moderates to end the year at 2.7%. Structural factors—tariffs, deglobalization, potential wage pressures from immigration tightening—will likely anchor inflation above target through mid-2026. Goods disinflation, a hallmark of the 2010s, is unlikely to return and services inflation remains sticky. Against this backdrop, the Fed faces a potential credibility challenge amid political interference and evolving supply-side constraints.

Figure 2: IFI US CPI projections



Source: Invesco, Bureau of Labor Statistics. Data as of Nov. 5, 2025. Forecasts from Dec. 1, 2025 to Dec. 1, 2026.

Risks to monitor

1. **Trade policy volatility:** Renewed tariff escalations or failure to secure agreements with Europe and the pharmaceutical sector could prolong uncertainty.
 2. **Labor market shocks:** Aggressive deportation policy could tighten the labor supply, amplifying wage inflation.
 3. **AI adoption curve:** Faster-than-expected productivity gains could ease inflation sooner than anticipated.
 4. **Policy slippage:** Political influence on the Fed risks premature easing, fueling inflation persistence and financial imbalances.
-

Conclusion

2025 underscored the primacy of trade shocks in shaping US macro conditions, with tariffs exerting both direct (cost-push) and indirect (confidence-driven) effects. Immigration and AI, while significant, operate on different temporal horizons—labor supply risks are more medium-term, in our view, and AI's transformative potential is real but likely deferred. We believe policy will dominate the 2026 narrative: fiscal stimulus and accommodative monetary policy will likely aim to restore momentum, but structural inflation pressures and governance challenges will likely complicate the path to equilibrium.

For economists and policymakers, the interplay of these forces signals a regime shift: from a globalization-driven low inflation regime to episodic trade frictions, and more challenging labor supply dynamics.

Europe and the UK: Fiscal shifts, inflation challenges, and policy outlook

The Summit discussion on Europe and the UK revolved around three major themes: the eurozone's fiscal pivot, Germany's ambitious spending plans, and the UK's persistent inflation puzzle. These developments are likely to shape growth, inflation, and monetary policy over the next two years.

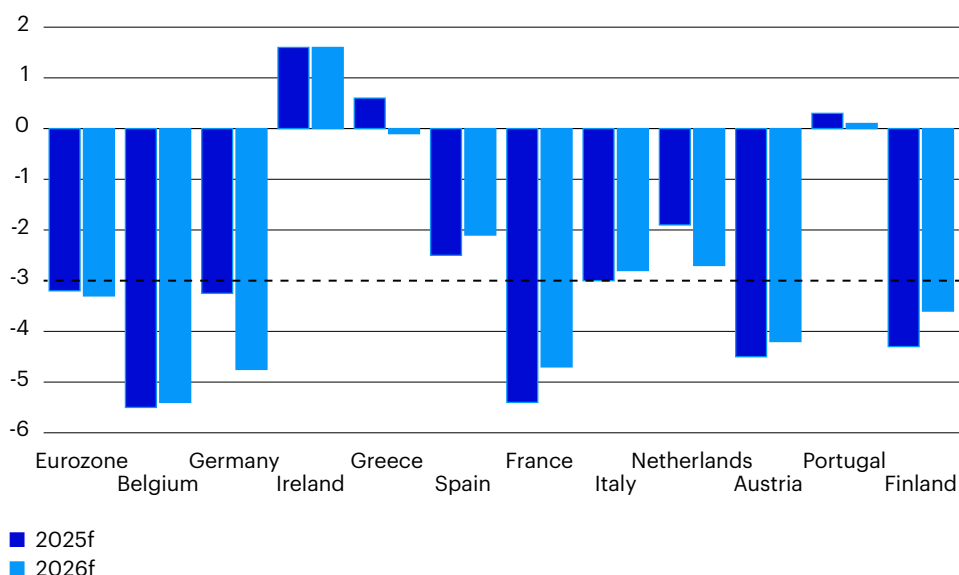
Eurozone: From tightening to loosening

Nine months ago, the general expectation was that fiscal policy in the eurozone would tighten. The Stability and Growth Pact rules—deficits capped at 3% of GDP—were set to return after being relaxed during COVID. Countries like France and Belgium were preparing for austerity.

That outlook has changed dramatically. Why? The introduction of the “defense escape clause”, which allows member states to spend an additional 1.5% of GDP over four years compared to 2021 levels. Officially, this is for defense, but in practice, it's broader. Germany is using some of this allocation for infrastructure upgrades—reinforcing bridges—while Italy even attempted to fund a bridge to Sicily under “defense spending.” It didn't succeed, but it illustrates how the scope could widen.

Figure 1: 75% of eurozone countries have activated the Defense Escape Clause

Budget balance estimates based on Draft Budget Plans



Source: European Commission, Draft budgetary plans 2025. f=forecast. Data as of Dec. 15, 2025.

The result: fiscal tightening in some countries is more than offset by loosening elsewhere, particularly in Germany. Add to that the remaining recovery and resilience grants from the COVID era—two-thirds spent so far, with the rest due by end-2026—and there is a meaningful fiscal tailwind. In fact, 2026 looks like a sweet spot: extra defense spending plus leftover grants.

To put numbers on it: Under the German government's Draft Budget Plan—and accounting for EU grants—Germany's fiscal impulse could be as high as 1.7% of GDP, while the eurozone overall could see around 0.3%. That may seem small, but it can move the needle when potential growth is barely above 1%.

Germany: Ambitious plans, realistic outcomes

Germany is the anchor of the European growth story. Its stimulus plan rests on three pillars:

- **Infrastructure SPV:** €500 billion over 12 years.
- **Defense spending:** Targeting 3.5% of GDP by 2029—faster than peers.
- **State borrowing:** Up to 0.35% of GDP.

When aggregated these initiatives and their GDP impact over two years could be as high as 3.2%. But two uncertainties loom large:

- **Execution risk:** Germany's official plan front-loads spending into 2026. That seems optimistic. The International Monetary Fund (IMF) and Bundesbank expect a slower rollout.
- **Fiscal multiplier:** Defense spending typically has a low multiplier because money leaks abroad (for example, spending on US weapons). But Germany is trying to keep expenditure local—€377 billion in planned equipment purchases, with only €14 billion tied to foreign projects. Plus, the EU's Security Action for Europe (SAFE) Fund adds incentives for domestic procurement.

So, while traditional multipliers suggest modest growth effects, this time could be different. In our view, a best case could see fiscal policy boost German GDP by as much as 1.4 percentage points in 2026. A more realistic assumption may see German growth boosted by around 0.7–0.8 percentage points in 2026. Even a conservative 0.5 percentage point boost matters when Germany's potential growth is as low as 0.75%.

The UK: An inflation problem—but not what you think

Turning to the UK the big question is: does the UK have a unique inflation problem? Yes—and it's not about demand.

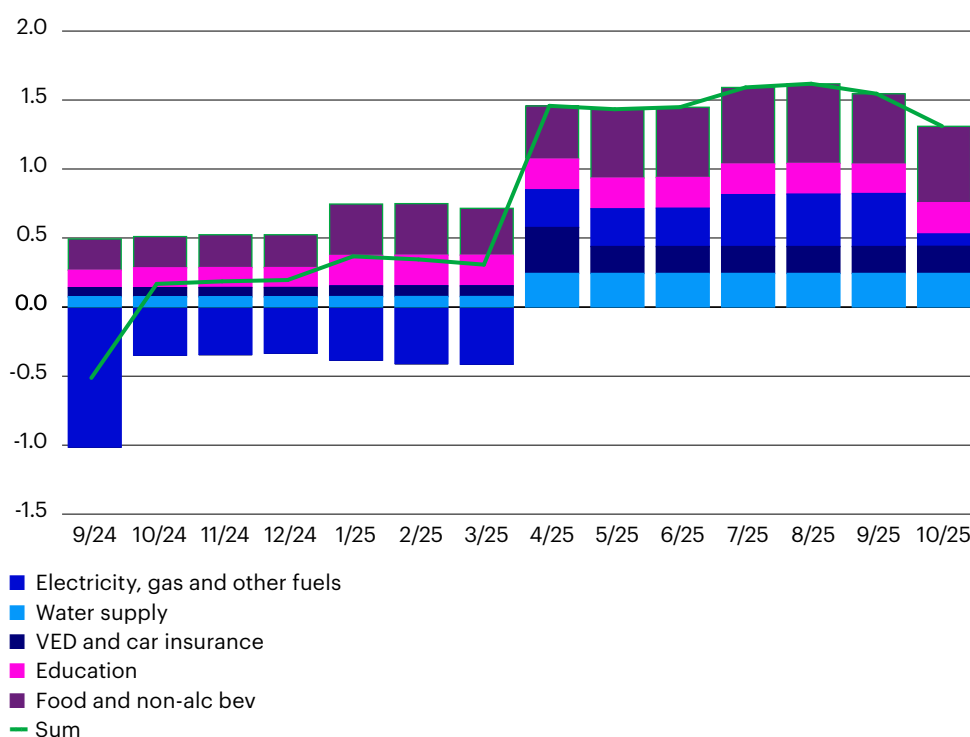
If we break inflation down by category, two areas stand out: housing and transport. Inflation in these segments is more than double that of peers, and they carry heavy weights in the CPI basket. Add alcohol and tobacco, and there are the UK's problem zones.

What is driving this? It is not booming consumption—UK spending has been weak for years. Real consumption per capita is still below pre-pandemic levels. People are cautious, saving more and spending less. So, this is not classic demand-pull inflation.

Instead, it's about policy choices:

- **Energy bills and water costs** (housing)
- **Vehicle excise duty** (transport)
- **Education costs** (policy-driven)

Figure 2: Sum of bills, contribution to CPI



Source: Macrobond, Office for National Statistics. Data from Sept. 1, 2024 to Oct. 1, 2025. VED is vehicle excise duty.

There is also indexation—automatic price adjustments tied to inflation. Indexation is everywhere in the UK CPI basket, especially in categories influenced by government decisions: alcohol/tobacco duties, energy bills, social rents and transport costs. Indexation accounts for over 10% of the basket. In short, this is a fiscal problem, not a private-sector pricing issue. This suggests that government policy can have a material impact on the path of inflation.

UK wages and policy interactions

Government-mandated wage hikes have added complexity to the UK inflation picture. According to Organization for Economic Cooperation and Development (OECD) data since 2015, real minimum wages have risen 20%, far faster than peers. Recent increases are also sizable: 9.7% in 2023, 9.8% in 2024, and 6.7% in 2025. The 2026 hike looks more modest—in the low 4% range—which is good news. But public-sector wages (16–17% of jobs) are still growing by around 7%, well above the 3.5% wage growth that the Bank of England thinks is consistent with the inflation target.

Private-sector wage growth is cooling, which helps. But the indexation issue means inflation will likely not fade until the government changes how it raises revenue.

The UK budget

The success of the Budget ultimately depends on three factors: whether policy decisions mitigate the risks to future fiscal consolidation, reduce inflation risks, and whether the planned consolidation is delivered. In our view, the Budget delivered on two of these three fronts.

Headroom against the fiscal rule more than doubled, from £9.9bn to £21.7bn. Combined with downward forecast revisions that now align more closely with peers, this suggests that, while fiscal consolidation remains possible, the risk is lower than before. The Budget also addressed inflation concerns. Unlike last year's highly inflationary package, this year's measures largely avoided tax rises that would have fuelled price pressures. In fact, policies are expected to reduce inflation by as much as 0.4% by spring 2026, which should help pave the way for further Bank of England rate cuts.

Where the Budget fell short, in our view, was credibility. Spending is heavily frontloaded, while offsetting consolidation is backloaded toward the end of the parliament. We also anticipate some slippage in spending during the final two years of the forecast. For these reasons, we expect some fiscal term premia will continue to be priced into longer-duration gilts.

UK monetary policy outlook

For the Bank of England, the outlook hinges on the budget. The Bank cut rates by 25 bps in December, with two more penciled in for 2026. But if the government mishandles taxes, expect more cuts—or fewer—depending on the inflationary impact.

We believe the Budget will support disinflation, which should help—rather than hinder—the Bank of England's ability to ease monetary policy. In our baseline scenario, we expect a rate cut in December, followed by two additional cuts in 2026.

Conclusion

Eurozone: Fiscal policy is looser than expected, thanks to defense exemptions and leftover recovery grants. Germany's stimulus could give growth a modest lift, though delivery and multipliers are wild cards.

UK: Inflation isn't about demand—it's about indexation and fiscal choices. Wages and duties matter, and the Budget has taken steps to address some of this. Productivity might be turning a corner, offering a glimmer of hope.

We believe the next year will be all about execution: how fast Germany spends, how the UK structures taxes, and whether central banks can navigate sticky inflation without overreacting. For now, Europe's story is about fiscal tailwinds and cautious optimism. For the UK it's about tightening fiscal policy in a way that reestablishes credibility without hindering the disinflation process.

China's economic outlook: Growth targets, policy shifts, and market dynamics

The Summit's China discussion centered on China's 15th Five-Year Plan, its growth objectives, evolving policy priorities, and implications for inflation, financial markets, and global trade. Several themes stand out for 2026: moderate economic growth targets, structural shifts in trade and income sources, inflation trends, high-level market opening and the renminbi's trajectory.

Growth targets and policy assumptions

China's authorities have clarified that annual growth needs to average only 4.17% over the next decade to achieve its goal of doubling GDP per capita to move toward being a moderately developed market country. This calculation might not have considered currency effects, meaning that if the renminbi appreciates—as many expect—the required growth rate could be even lower.

For 2026, our baseline forecast is 4.5% real GDP growth, a slightly more conservative view than some market expectations of 5%. The difference reflects assumptions about fiscal policy: while some anticipate more aggressive fiscal measures, our view assumes a more moderate fiscal push. Importantly, policymakers highlight Gross National Income (GNI) alongside GDP, signaling attention to income generated by Chinese entities globally. This aligns with guidance on cross-border supply chain configuration, which indicates the potential build-up of Chinese companies' manufacturing capabilities overseas and hence a potential shift from the current export model.

Trade competitiveness and price dynamics

China's export pricing remains highly competitive. Chinese export prices have fallen sharply over the past four years, so even if the Chinese currency strengthens, the impact on global price competitiveness will likely be limited. We expect Chinese goods to continue to exert downward price pressures globally.

Figure 1: Export price index



Source: CPB, HSBC. Data from Jan. 1, 2021 to Aug 31, 2025

Inflation outlook: CPI and PPI trends

After prolonged softness, core CPI began rising in early 2025, and markets are pricing in a recovery for both the CPI and PPI in 2026. We expect CPI to hover around 0.5%, reflecting stability in the major components. PPI, currently near -1.2%, could return to zero as commodity prices—particularly metals—recover. Supply-side constraints from anti-pollution campaigns and stronger demand may further support price gains.

Structural reforms and capital market opening

The Five-Year Plan emphasizes technology and advanced manufacturing as growth drivers, alongside accelerated high-level opening, in which China aims to transition from “following the lead” to “taking the lead” globally, with reforms designed to make its level of openness comparable to top international players.

Key developments could include, in our view:

- Gradual and partial removal of restrictions on renminbi internationalization.
- Further opening of the capital account, enabling significantly higher cross-border flows.
- Increased use of the renminbi in commodity trading and infrastructure projects across Central Asia, the Middle East, and beyond.

If these reforms materialize, overseas investment in China will likely be significantly easier, and renminbi demand will likely rise globally.

Currency outlook: Renminbi strength ahead

Renminbi appreciation is our central expectation. Current levels near 7.1 could strengthen to 6.8 in 2026, 5.8 within two to three years and potentially 4.0–5.0 over the longer term. While ambitious, this trajectory reflects our confidence in China’s structural reforms and global integration: looking back, few anticipated the success of “Made in China 2025” a decade ago, yet China has achieved remarkable progress in advanced manufacturing.

Key takeaways

- **Growth:** We expect moderate but steady growth, supported by high-quality developments rather than aggressive fiscal stimulus.
- **Inflation:** We expect gradual normalization, with a PPI rebound driven by commodities and supply restraints.
- **Policy direction:** We expect policy to pivot toward global leadership in finance and technology with deeper capital account liberalization. A renminbi cross-border payment system is expected to be built with Shanghai as the financial center for this system.
- **Currency:** We expect renminbi strength, driven by China’s role in global trade and investment.

Conclusion

We believe China’s next phase is not about chasing high growth at all costs but about quality, integration, and global influence. The combination of paced fiscal support, competitive export pricing, continued opening and currency appreciation positions China for transformative years ahead, in our view.

Emerging markets: Resilience, shifting dynamics and structural themes

Emerging markets (EM) have navigated the past five years of global shocks with surprising resilience. While risks remain primarily external—largely driven by US policy volatility—domestic factors such as elections and political shifts continue to shape outcomes. The Summit discussion highlighted EM's cyclical backdrop, inflation trends, monetary and fiscal policy, and three structural themes: political realignment in Latin America, youth-driven anti-corruption movements and capital allocation shifts amid trade fragmentation and AI opportunities.

Growth and cyclical positioning

EM growth has exceeded expectations, supported by stronger-than-feared external performance and robust domestic demand. The AI-driven investment cycle has been a key contributor, with spillovers beyond semiconductors into lower-value components and equipment. This has benefited ASEAN economies linked to Taiwan and Korea, as well as resource-rich EMs supplying critical minerals for advanced manufacturing.

Domestic demand has held up thanks to falling inflation, wealth effects from buoyant equity and housing markets, and policy support through monetary easing and gradual fiscal consolidation. Growth is now stabilizing near potential, suggesting a more balanced economic outlook for 2026.

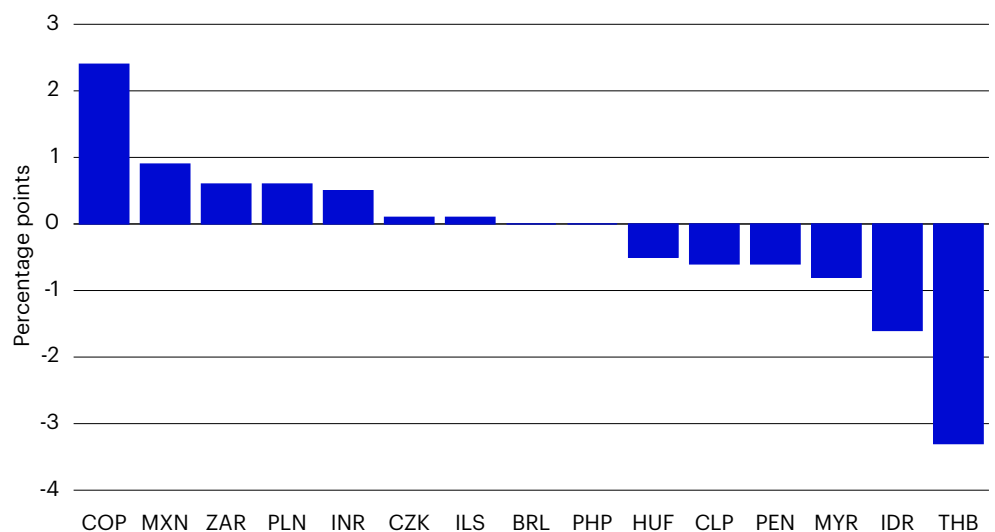
Inflation and monetary policy

Disinflation has brought most EM economies within central bank target ranges. However, services inflation—a proxy for non-tradable components—remains sticky, reflecting strong domestic demand. This persistence complicates policy normalization.

Nevertheless, monetary easing cycles are in their late stages. Most high-grade EM central banks have completed rate cuts, while a few (e.g., Colombia) may still hike. Policy rates remain conservative, particularly in countries with large fiscal deficits and external funding needs—mainly in Latin America and parts of CEEMEA. Real rates are elevated, creating risk premiums and potential investment opportunities.

Figure 1: Most EM core inflation rates are within target ranges

Core CPI-inflation, last observation less central bank target



Source: Macrobond, Invesco calculations. Data as of Dec. 10, 2025.

Fiscal policy: Mixed progress

Fiscal consolidation has been uneven. Some governments have delayed adjustment where financing conditions allow, while others are pursuing structural reforms. Central Europe and parts of Latin America have exhibited widening deficits despite prior commitments to consolidate. Elevated real rates underscore fiscal vulnerabilities, especially in regions reliant on external funding.

Structural themes shaping EM

Theme 1: Latin America's political realignment ("second Pink Tide" reversal)

Latin America is entering a pivotal phase. Historically, the region oscillated between liberal reforms (1980s–1990s) and left-leaning populism (early 2000s "Pink Tide"), supported by high commodity prices. The mid-2010s commodity slump triggered a conservative wave, but recent years saw a resurgence of leftist leadership (e.g., Petro in Colombia, Lula's return in Brazil).

Now, signs point to another shift—toward right-wing populism, driven by anti-incumbent sentiment and voter frustration over crime, economic stagnation, and governance failures. Recent presidential elections in Argentina (Milei), Ecuador (Noboa), and Bolivia signal this trend, with Chile's election results reinforcing the narrative.

Key observations:

- **Issue-based politics dominate:** Party ideology matters less than addressing voter concerns—crime, violence, and economic insecurity top polls across Peru, Chile, Mexico, and Colombia.
- **Electoral volatility ahead:** 65% of Latin America GDP faces elections within 12 months, creating headline risk through Q1–Q2 2026.
- **Policy implications:** There is potential for market-friendly reforms if new governments prioritize fiscal discipline and security, offering alpha opportunities amid volatility.
- **The external backdrop favors Latin America:** US tariff policy has been relatively supportive, with recent exemptions for staples (e.g., Ecuadorian bananas, Argentine beef). In addition, China's supply-chain shifts pose less risk to commodity exporters, reinforcing Latin America's resilience.

Theme 2: Youth-led anti-corruption movements

A demographic shift is reshaping EM politics. The youth bulge—especially Gen Z—is reaching voting age, fueling demand for cleaner governance. Corruption has long constrained fiscal capacity, limiting tax collection and debt sustainability. Now, younger electorates are challenging entrenched elites, even in countries with historically low accountability.

Case study: Sri Lanka illustrates the cycle. Corporate tax cuts in 2019, perceived as corrupt, increased fiscal fragility. COVID amplified revenue collapse, triggering a balance-of-payments crisis and mass protests (including the storming of the presidential residence). Subsequent IMF-led reforms restored stability, and elections delivered an anti-corruption candidate—ironically from a leftist party—which has since adhered to orthodox policies.

Implications:

- Countries undergoing youth-driven reform often experience spread compression post-crisis, while those resisting change face widening risk premiums.
- Political volatility remains high, but structural improvements in governance could enhance long-term creditworthiness.

Theme 3: Trade fragmentation, capital flows, and AI opportunities

Global trade patterns are shifting—not toward full deglobalization, but toward a realignment of partners. China's share of global exports remains stable, yet its exports to the US have declined sharply, offset by gains in EM. EM dependency on China has therefore deepened, but US foreign direct investment (FDI) continues to dominate capital inflows.

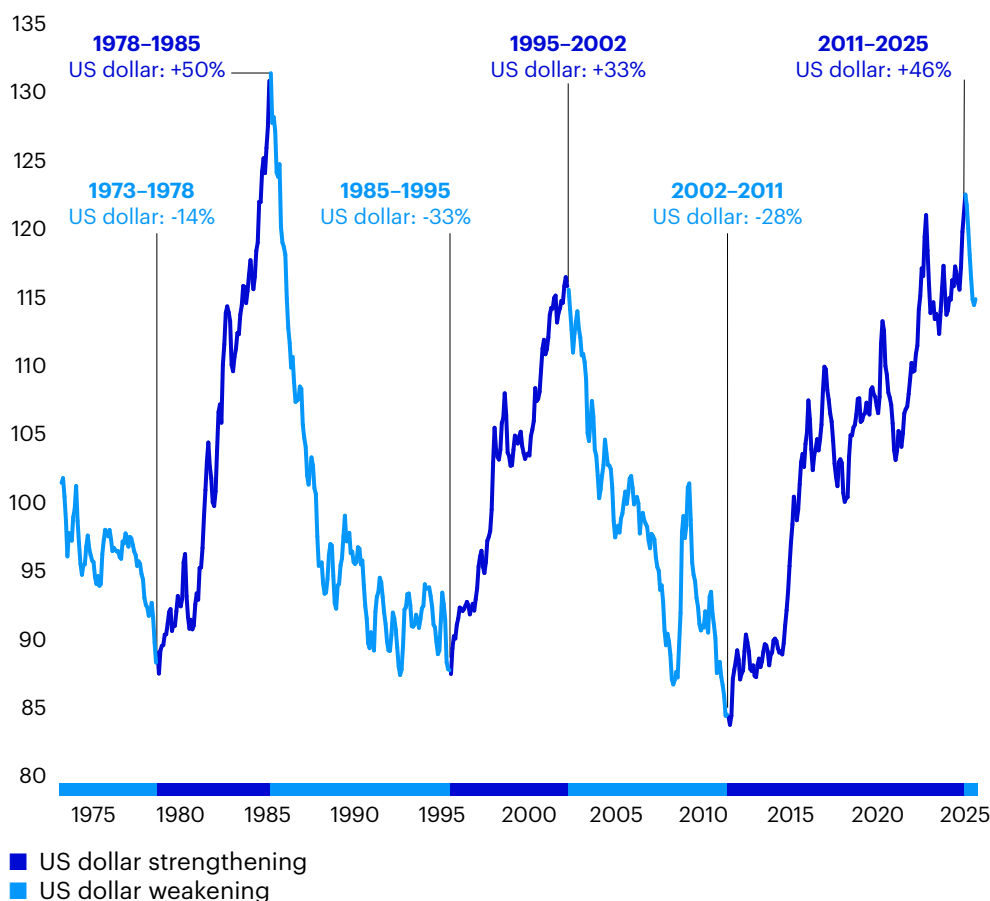
Key trends:

- **FDI realignment:** US and Canada lead greenfield investment growth, driven by advanced manufacturing reshoring. Conversely, FDI from China and EM Asia is declining.
- **AI as a game-changer:** Beyond semiconductors, AI is reshaping capital expenditure and research and development priorities. Latin America shows notable AI adoption—e.g., Brazil ranks high in usage metrics. EMs also hold strategic advantages in rare earth production, critical for AI hardware.
- **Data center expansion:** Emerging hubs in São Paulo, Brazil, Querétaro, Mexico, Santiago, Chile and Bogotá, Colombia highlight infrastructure opportunities linked to AI-driven digitalization.

Financial markets reflect these dynamics: EM equities and debt have outperformed, supported by improving fundamentals and renewed bond inflows post-US tariff stabilization. US dollar strength—a key headwind for EM over the past 15 years—has shown signs of reversal, potentially amplifying returns.

Figure 2: US dollar strength has shown signs of reversal

Real Broad Trade-Weighted US Dollar Index



Source: CPB, HSBC. Data from Jan. 1, 2021 to Aug 31, 2025

Strategic takeaways

- **Macro resilience persists:** EM growth is near potential, supported by AI spillovers and stable external balances.
- **Inflation risks are localized:** Services inflation warrants caution despite headline disinflation.
- **Policy divergence matters:** Elevated real interest rates and uneven fiscal consolidation create selective opportunities.
- **Political shifts are investable:** Latin America's electoral cycle and youth-driven reforms could unlock alpha amid volatility.
- **Structural trends favor EM:** Trade realignment, AI adoption, and capital inflows position EM for medium-term outperformance, in our view.

Conclusion

EM countries are not merely recovering—they are adapting. From political realignments to technological integration, EM economies are leveraging structural shifts to strengthen resilience. For investors and policymakers, we believe the challenge lies in navigating short-term volatility while capturing this long-term transformation.

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Interest rate outlook

US: Neutral

We are neutral on the US yield curve and overall duration. The Fed delivered a rate cut in December and is likely to implement several additional cuts in 2026; however, these expectations are largely reflected in current market pricing. As a result, risks to both higher and lower rates appear broadly symmetric. The upside risk to rates is primarily driven by debt-related increases in the term premium, while the downside risk reflects the potential for economic growth to come in weaker than expected.

Europe: Neutral

The euro area economy is stabilizing after a period of weak global demand and geopolitical tensions. PMIs show modest improvement, led by services. Recovery is supported by the European Central Bank's (ECB) earlier 200 basis points of rate cuts, rising real wages, and easing trade uncertainty following a provisional EU-US tariff deal. Fiscal loosening next year should further aid growth. The ECB has paused its easing cycle to assess policy transmission, emphasizing data dependency and flexibility. While markets have priced in rate hikes for late next year, we believe this is premature as inflation remains below expectations and growth risks persist.

China: Neutral

We maintain a neutral stance on onshore Chinese rates for the months ahead and continue to expect a steeper curve especially at the long end. Local expectations that inflation may return to more positive territory in the coming year, and more proactive asset reallocation by households, may set a floor under onshore yields. On the other hand, the central bank's relatively loose monetary policy and proactive liquidity and funding cost management should help limit a move up in yields.

UK: Overweight

The UK's key year-end event was the November 26 Budget. For gilts, the most notable elements were the near doubling of the Chancellor's fiscal headroom and the Debt Management Office's (DMO) cut in long-end issuance for FY2025. These developments, alongside softer growth and inflation data versus market and Bank of England (BoE) forecasts, have driven gilts' outperformance versus US Treasuries and German bunds, led by the 30-year sector. The DMO's reduction in 30-year issuance was more impactful than the fiscal buffer increase, which relied on optimistic Office for Budget Responsibility revisions and delayed tax hikes. Fiscal risk remains, as Prime Minister Starmer and Chancellor Reeves face potential Labour Party challenges. Beyond fiscal concerns, conditions favor lower UK rates. The BoE cut by 25 bps to 3.75% at the December meeting. Although the vote was close, the consensus on the Monetary Policy Committee was toward a gradual further easing of rates. In this context, pricing of just 35 bps of easing in 2026 doesn't look excessive, with risk likely skewed to further cuts toward a 3% terminal rate.

Japan: Underweight

10-year Japanese government bond (JGB) yields rose sharply in the November-December period, driven by a larger-than-expected supplementary budget and sharply higher expectations of a Bank of Japan (BoJ) December rate hike. Prime Minister Takaichi's budget adds stimulus equal to nearly 3% of GDP, though the actual fiscal impulse will likely be smaller, as some measures roll over from FY2025. While the budget increases JGB issuance, the Ministry of Finance has concentrated new supply in short maturities and reduced 20-year-plus issuance, limiting the near-term market impact. Still, concerns linger about further stimulus and issuance ahead of the 2026 budget and a possible general election, as Takaichi may seek to capitalize on her popularity to regain the LDP majority. Political momentum favors fiscal easing to offset rising household costs. Capping off what has been a dramatic shift in market expectations, the BoJ finally decided to raise rates by 0.25% to 0.75% at its December meeting. Policymakers are now more confident that the economy has weathered the

impact of tariffs and that upside risks to prices are building. The statement suggests further rate hikes are likely if the BoJ's baseline scenario plays out. In addition, it continued to suggest that rates are still accommodative overall, indicating that policy still has a tightening bias. The role of the weak yen in boosting inflation also received more attention, which is significant, given the currency weakened further after the BoJ meeting, potentially increasing upward pressure on JGB yields.

Australia: Overweight

Australian government bonds have sharply repriced over the November-December period, with 10-year yields rising and underperforming US Treasuries. The move was driven by stronger-than-expected October CPI and employment data and a hawkish December Reserve Bank of Australia (RBA) meeting, where Governor Bullard ruled out cuts and hinted at hikes if Q4 CPI exceeds forecasts. However, further selloff risk appears limited, as markets have already priced 35 bps of hikes in 2026 and 20 bps by May. Forward rates now sit between 4.5%–5%, compared to the post-COVID peak of 4.37%, despite current upside surprises being modest and wages and employment still soft. Domestic demand has improved, possibly reflecting a shift toward private sector-led growth and better productivity, which could support stronger growth without significant inflation. At current valuations, we believe Australian rates look attractive both outright and relative to other markets.

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Currency outlook

USD: Underweight

We continue to favor an underweight position in the US dollar over the medium term. Our view is underpinned by a narrowing growth differential between the US and the rest of the world, and the delivery of Fed rate cuts while other central banks pause (from earlier cutting). We also believe the current US administration favors a weaker currency in support of its domestic manufacturing and reshoring agenda. While we maintain a long-term bearish outlook on the US dollar, we expect short-term volatility.

EUR: Overweight

We remain constructive on the euro, supported by our expectations of continued US dollar weakness and a near-term narrowing of interest rate differentials. The region stands to benefit from low interest rates and a supportive fiscal environment. We also anticipate a gradual reallocation by international investors away from US dollar denominated assets. In this context, the euro is well-positioned to benefit from these flows, in our view.

RMB: Overweight

We are overweight the renminbi over the medium term. We expect continued momentum in US dollar selling by exporters as the trade surplus surpassed USD1 trillion in the first 11-months of the year and further progress was made in the renminbi's internationalization process. The substantial growth in China's trade surplus, exporters' sizable holdings of foreign currency and the development of China's cross-border renminbi payment system are likely to support the renminbi's performance over the medium term. Recent central bank actions in major developed markets are likely to further support the renminbi's outperformance.

GBP: Underweight

The benign reception to the November budget led to a rebound in the British pound, as short positions have been scaled back. However, the outlook for the pound into 2026 is relatively poor, in our view. BoE cuts are likely to narrow the interest rate differential, especially relative to the eurozone, undermining the carry that has supported the pound for last three years. In addition, the political/fiscal risk premium may re-emerge, as Prime Minister Starmer's popularity has collapsed and polls are showing Labour losing ground increasingly to the left wing Green party. Unlike the eurozone, the US and Japan, the UK is unique in having a negative fiscal impulse over the coming years. This should weigh on growth, reduce interest rates and ultimately lead to a weaker currency.

JPY: Overweight

The yen has recently underperformed the euro and US dollar, driven by rising global yields, improving risk sentiment, and concerns that the Takaichi administration's resistance to BoJ rate hikes and large-scale fiscal stimulus signals a shift toward fiscal dominance. Reduced tariff fears and stronger fiscal support could boost global growth in 2026, limiting yen upside, especially if the Fed and ECB fail to ease rates further or hike. However, global growth risks remain skewed lower, likely capping external rate increases. In Japan, the BoJ appears less constrained in normalizing policy, and the yen is already cheap relative to rate differentials, in our view. Authorities are increasingly vocal against further yen weakness, while Japanese investors have yet to increase hedging or repatriate assets. Improved hedging terms and attractive JGB valuations should incentivize these moves, supporting the yen over time.

AUD: Overweight

The Australian dollar has strengthened against the US dollar, supported by improved risk sentiment and higher domestic interest rate expectations. Despite this, it remains undervalued relative to interest rate differentials, equities, and commodities, in our view. A stronger global growth outlook and recovery in key commodity prices like iron ore, coal, and gas could further boost the currency in 2026. Moreover, negative carry on unhedged US dollar positions may prompt Australian superannuation funds to hedge foreign currency exposure, adding further support for the Australian dollar.



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Global credit strategy

Private credit: The next frontier for investment grade portfolios

IFI's year-end Global Investor's Summit was filled with interesting discussions, from macroeconomic outlooks to explaining nuanced approaches to credit research. That said, the "800-pound gorilla" and consistent discussion topic was AI, its economic and capital market implications, and more. With some of the world's largest companies deploying historic volumes of capital into this new technology, IFI is focused on AI's near-term investment opportunity and market ramifications. As hyperscalers tap credit markets to fund the AI buildout, we discuss the convergence of public and private credit as we prepare for an increasingly dynamic investment opportunity set in 2026.

We speak with Todd Schomberg, Head of Investment Grade Portfolio Management, Bixby Stewart, Head of US Investment Grade Research, and Michael Breuer, Senior Credit Analyst, about their take on the rising interest in private credit in the investment grade space.

Q: Why are public credit managers talking about private credit?

Bixby: Private credit has traditionally been the domain of high yield investors and direct lenders—investors have considered it to be illiquid, bespoke and held to maturity. But that's changing. Over the past few years, we've seen a convergence between public and private credit markets, driven by investor demand for yield and issuers' need for flexible financing. In our view, a long-term trend toward private/public credit market integration seems well underway. For institutional investors, this evolution is positive, in our view, because it expands the investable universe and creates unique investment opportunities to capture incremental yield while enhancing portfolio diversification.

Q: How is liquidity in the private credit market?

Todd: Liquidity is coming—but slowly. While there isn't yet a fully liquid secondary market for private credit, the trajectory is somewhat reminiscent of the syndicated loan market's development in the 1980s and 1990s. Occasional secondary trades are already happening, and the push for more transparency and liquidity is underway. Previously fully private and tightly held, transactions are now being syndicated to and traded with larger public investors, a welcome shift. For now, these deals remain bespoke and complex—but that complexity can be a competitive advantage for managers with the resources to navigate it.

Q: How do you use private credit in liquid strategies?

Todd: Incorporating private credit into daily-liquidity strategies requires prudence, a deep analytical credit research approach, multi-team collaboration and strict process adherence. We typically keep our total private credit exposure very limited, ensuring adequate portfolio liquidity and prudent asset class and deal-level exposure while adding yield and diversification to portfolios. Across strategies, that proportion translates into hundreds of millions of dollars in private credit exposure—enough to matter, but small enough to maintain flexibility.

Q: Where are the private credit opportunities?

Mike: One word: technology. The AI-driven buildout of data centers and infrastructure is creating unprecedented financing needs. Consider that capital expenditure for five of the "Mag 7" tech giants is projected to be USD370 billion this year, and more than USD425 billion in 2026.¹ For perspective, that's more than China's annual military budget. While much of this will likely be either cash flow and/or equity funded, a substantial portion will likely require debt financing. Needless to say, this represents a huge opportunity for sophisticated credit investors.

1. Source: Bloomberg L.P. (reflects total consensus capital expenditure expectations as of Nov. 30, 2025 for the "Mag 7" cohort. Mag 7 are Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla.). This does not represent a recommendation to buy/hold/sell the securities.

Q: Why don't issuers just issue public bonds?

Bixby: While public bonds will likely continue to be an important source of financing, private deals offer issuers off-balance-sheet financing and diversify funding sources, both enhancing strategic and capital structure flexibility for these businesses. For companies facing multi-year, multi-billion-dollar capital programs, this flexibility is critical as companies seek to optimize their cost of capital without sacrificing balance sheet health.

Q: How does the team manage the complexity of private credit deals?

Todd: Private credit deals are not plug-and-play. They require a high level of sophistication and collaboration with various institutional experts:

- Deep fundamental research on transaction details, credit quality and bespoke deal structures.
- Legal diligence to analyze credit documents, manage portfolio compliance and navigate process risk.
- Specialized trading and settlement processes.

Invesco's fully integrated credit team comprised of credit research, portfolio management, settlements, legal and trading, provides the expertise and depth of resources to navigate these hurdles. These capabilities, along with key relationships with Wall Street counterparties, are differentiators, in our view, allowing Invesco to access opportunities others may not.

Q: What is the likely impact of private deals on public market technicals?

Mike: Far from hurting public market technicals, we believe private credit may actually help. By diversifying funding sources, private issuance may reduce pressure on public issuance. For investors, this may mean a more balanced supply-demand dynamic—and for us, the flexibility to choose between public and private investment opportunities. In our view, private credit is no longer just a niche. For fixed income investors, we believe it represents an opportunity to enhance returns and diversify portfolios—for investors with the expertise to navigate its complexity.

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Non-investment grade bonds, also called high yield bonds or junk bonds, pay higher yields but also carry more risk and a lower credit rating than an investment grade bond.

The risks of investing in securities of foreign issuers, including emerging market issuers, can include fluctuations in foreign currencies, political and economic instability, and foreign taxation issues.

The performance of an investment concentrated in issuers of a certain region or country is expected to be closely tied to conditions within that region and to be more volatile than more geographically diversified investments.

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