Quarterly Outlook

Steady Growth Amid Persistent Policy Risks

September 2025

Market developments and other events

In Q3, risk sentiment improved owing to easing trade tensions, increased market expectations of US monetary easing, prospective fiscal expansionary policy, and optimism surrounding AI, collectively providing a boost to capital markets. US equities rallied following the Fed's first rate cut in a year, with markets pricing in further easing ahead. Japanese equities benefited from yen weakness, while emerging market equities gained on the US-China trade truce extension. Additionally, corporate credit spreads tightened across regions as improved risk sentiment drove positive bond returns for both IG and HY.

Long rates increased in the UK, Japan, and Eurozone amid political and fiscal concerns. Gold prices surged, on track for the strongest annual performance since 1979 amid expansionary policies and stubborn core inflation. UK and US core inflation has proven stubbornly high mainly owing to elevated housing costs, while disinflation seems to have stopped in the euro area.

Economic activity remains mixed across regions, with growth in the US remaining strong, while growth in the euro area and the UK remains sluggish. However, some signs of labor market softening is emerging in the US, which is yet to be reflected in strong consumer spending so far.

Outlook for growth, inflation, and interest rates

The fragile calm in global trade relations that began in Q2 persisted through Q3, as the US reached trade agreements with key trading partners (UK, Europe, and Japan). The stance of the new US administration seems to signal a more durable increase in global economic and geopolitical fragmentation, which is unlikely to boost global productivity in the medium term. While the impact of AI developments remains highly uncertain, they may help to partially offset some of the former productivity losses. Moreover, the prospective boost to public and private investments in key domestic industries could provide further upside for short-term economic cycle expansion.

The short-term outlook points towards below-trend growth owing to headwinds from ongoing trade and policy uncertainty. Additionally, in the US, inflation pressures could re-emerge as the passthrough effects of tariffs on prices continues to unfold. In the medium term, inflation is expected to stabilize somewhat above central bank target owing to anticipated upward fiscal spending pressures associated with increased economic and geopolitical fragmentation. Consequently, long rates for most developed markets are expected to move around their recent levels over the medium term.

Outlook for financial assets

The short-term economic cycle improves on positive investor sentiment despite fiscal concerns and potential re-emergence of inflation risks. The improvement in the economic cycle is expected to boost short-term equity returns, despite somewhat stretched equity valuations following strong realized equity returns over the past two quarters.

The government bond return outlook has improved for the UK, Germany, and Japan driven by higher initial yields amid expansionary fiscal policy. The short-term outlook for corporate credit returns deteriorates in some countries due to lower initial spreads, particularly for US and Canadian investment-grade, and European high-yield corporate credits.

The outlook for financial assets remains vulnerable to downside risks from policy uncertainty and geopolitical tensions. Although recent trade agreements have eased some immediate uncertainty, the absence of a trade deal with China suggests a renewed escalation cannot be precluded. Additionally, stalled peace negotiations with Russia suggests a quick resolution of the war in Ukraine remains unlikely, pointing towards undiminished scope for future escalation and the potential for further geopolitical instability.

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