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Wear an extra vest

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Monthly Outlook

"Buckle up" was our main message last month. Events since early December have only reinforced that view. A cold Arctic wind may require an extra vest this year, too. The breakdown of the global rules-based order is accelerating, giving way to a world where "might is right."

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The US removal of Venezuelan President Maduro may have drawn few tears in the West, but the underlying message is clear: this administration is willing to use all powers at its disposal. The intervention aligns with Washington's National Security Strategy (NSS), emphasizing hemispheric "pre-eminence" and "energy dominance." Trump's interest in Venezuela's oil reserves is obvious. So is pushing back against Iran, Russia, and China. Yet, markets remain calm, as we predicted. Venezuela currently accounts for only a small share of global output and restoring capacity to what it once was would require vast investment over years, limiting near-term price impact.

But Latin America is only part of the story. **Trump has openly floated adding Greenland to US territory**, even hinting at military options – a stance that strains already fragile transatlantic ties (the Arctic also featured in the NSS). While military intervention seems unlikely, financial incentives and strategic leverage remain on the table. For Europe, this is another wake-up call: strengthen defence and economic resilience or stay vulnerable. Realpolitik is replacing idealism. This could speed up European reforms and bring nations closer together. Or drive them apart.

Greenland's reserves of critical minerals – essential for renewable energy and advanced manufacturing – make it a strategic prize, as does its location. US FDI there may even benefit Europe. Still, US talk could unsettle markets, raise risk premiums, and reshape NATO dynamics. In the worst case, a clash could unravel the alliance, embolden Russia, and trigger (much more severe) market shocks. Geopolitics is back – and it's about power, resources, and leverage.

Iran is also in chaos, with real questions over whether the regime will survive the mass protests being seen. While Europe doesn't seem to be focusing much on this given everything else on its plate, Trump has told protestors "Help is coming." What that means for them, the country, and the volatile, energy-rich region remains to be seen. Europe will have to deal with that too.

Despite these developments, markets have had a strong start to the year. Equities are up, the dollar has been firm since mid-December, and risk premiums have fallen. European markets have focused more on lower inflation prints and growth concerns than on geopolitical drama. The dollar got dented, though, when Fed Chair Powell explicitly warned in a video message that DOJ subpoenas reflect an attempt to undermine the Fed's independence, i.e., to influence rate policy.

The disconnect between geopolitical developments and markets isn't new. Geopolitical flashpoints often spark initial risk-off moves, but they typically fade as markets reassess the likelihood of extreme outcomes. Over time, this has fostered a degree of market numbness. Investors still watch for economic consequences, but absent clear impacts on supply-demand balances, growth, inflation, or monetary policy, shocks are discounted quickly. That doesn't mean, of course, that the risks of a collapsing world order aren't there. Venezuela, Greenland, Iran… the long-term consequences could be profound.

Where geopolitics has lasting market impact, it's usually because physical constraints change: sustained output losses, destroyed infrastructure, or prolonged supply disruptions, as in 2022. Outside such circumstances, a structurally bearish stance on risk assets looks misplaced, especially while growth and earnings expectations remain resilient – and the US clearly wants to 'run it hot'.

Our core theme nevertheless remains: buckle up for 2026 – and wear a vest. The US has ended the global order as we knew it. Tensions will persist, alliances will strain, and institutions will be tested. Yet markets will watch for evidence that turbulence is bleeding into supply chains, prices, or growth data. Until then, they are likely to stay anchored to what can be measured – not what can be imagined. But it's not hard to think things that were unimaginable a few years ago.

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USD rates: The tone for 2026 has been set

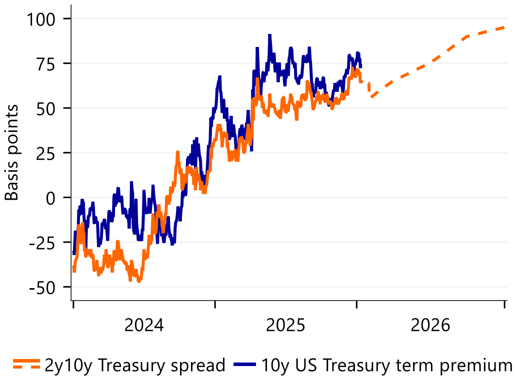
The US military operation in Venezuela, leading to the capture of Maduro, has set the tone for 2026. The arrest warrant for Maduro may have been the official reason for the attack, but President Trump was not afraid to call a spade a spade: he is also interested in the country's resources. The US attack sent tremors through international political circles, as we summarized in the editorial of this Monthly Outlook.

By contrast, the markets' response was very muted. That's not a reflection of traders' indifference to the events, but rather the fact that low-probability, high-impact events are inherently difficult to price. Knee-jerk, risk-off reactions triggered by such events generally fade as traders reassess the probability. Over time, that may have fostered some market numbness to events themselves, even if investors still pay close attention to the potential economic consequences.

In that light, the impact Trump's attempts to undercut Fed independence have on yields is all the more remarkable. The US president has repeatedly attacked the US central bank last year, including an attempt to remove Governor Cook from office. The president has upped his attacks since then: this week, the Department of Justice served the Fed with grand jury subpoenas, threatening a criminal indictment against the Fed Chair over Powell's semi-annual testimony before the Senate Banking Committee (see page 17).

That seems to have been a step too far, even for a usually soft-spoken Powell. The Chair released a statement saying what markets had already concluded: "this new threat is not about my testimony last June or about the renovation of the Federal Reserve buildings [... it] is a consequence of the Federal Reserve setting rates on our best assessment of what will serve the public, rather than following the preferences of the President."

Figure 1: 2s10s to steepen further on Fed and fiscal concerns?



Source: Bloomberg, RaboResearch

Indeed, doubts about Fed independence had already driven US term premia higher, and these latest developments have only added to the pressure on long-term yields.

Add to that concerns about the sustainability of US public finances. Trump wants to increase defence spending by 50% to $1.5 trillion. The president argues tariff revenues can "easily" cover these costs, but the Congressional Budget Office estimated that tariffs would only generate about half of Trump's planned increase in military expenditures – assuming that the Supreme Court does not rule against Trump's authority to impose global tariffs, which could require the US to refund the tariffs that were levied over the past couple of months.

Budget cuts elsewhere might be an option on paper, but Trump does need congressional support for this. And the House of Representatives has just advanced a spending bill that waters down many of Trump's budget cuts – including restoring Obamacare subsidies for three years – as lawmakers seek to avoid another shutdown by the end of the month. Plus, Trump has pledged households $2,000 "tariff dividend" cheques. And he announced a $12 billion aid programme for US farmers affected by retaliatory tariffs. This aid is already being rolled out, with applications for USDA's "bridge" payments set to open soon and disbursements expected by the end of February.

All in all, these developments fit with the views we expressed in previous editions of this Monthly Outlook. We therefore continue to favour a steeper curve as the Fed is seen resuming its cutting cycle later this year. This month's employment report may have provided some respite: the labour market does not warrant urgent follow-up cuts. Therefore, we expect the next cut in March at the earliest.

However, we don't think that such delay in the cutting cycle necessarily warrants a more constructive view of the longer-end of the curve. Further rate cuts are expected, and a delay pushes those cuts more into the remit of Powell's successor. That could exacerbate the markets' concerns that the new composition of the FOMC may be inclined to set rates somewhat lower than economic data warrants.

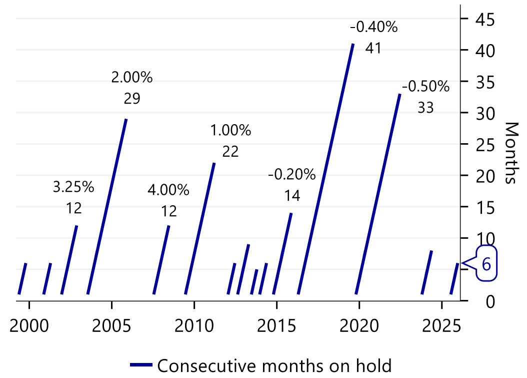
EUR rates: In for a long hold?

EUR swap curve steepening persisted through the end of 2025. The 2y10y spread reached 69bp on January 2. However, since then, the curve has flattened again to levels seen in early December. A similar flattening move can be seen in the longer end of the curve, with the 10y30y spread retracing to early-December levels.

This is potentially driven by traders abandoning their positioning for significant paying flow from Dutch pension funds that transitioned to the new scheme at the start of the year. Paradoxically, though, the result is a slightly more favourable environment for these pension funds to actually carry out their unwinds. So, we continue to favour a slightly steeper 10y30y spread.

For shorter maturities, we could actually see some bear flattening this year. The ECB's cutting cycle has probably ended, unless a significant downside shock hits the economy. We believe the Eurozone will hit a soft patch in the coming months. This could revive rate cut bets to some extent. However, we believe this weakness will be short-lived and we do not think that it this is enough to trigger further policy easing.

Figure 2: In for a long hold? The ECB has left policy rates unchanged for long periods before



Note: Based on the refi rate until 2014, and the deposit facility rate after that date. Source: ECB, RaboResearch

President Lagarde stressed that the ECB does not run a static monetary policy, but we argue that unusually high uncertainty about the economic outlook does effectively act as a hurdle for further policy action. The ECB needs compelling evidence that the current policy stance is no longer appropriate. That also goes for rate hikes. Thus, the ECB may be in for a long hold.

We forecast activity will pick up again in the second half of the year, boosted by fiscal spending on defence and infrastructure and by domestic consumer demand. We have therefore pencilled in two hikes, but not before March 2027. This should not necessarily be seen as the start of a bigger hiking cycle. We see these hikes as a recalibration of the policy stance, which we currently see at the lower end of a 'neutral' range, to account for the building economic momentum and to avoid that this translates into inflationary pressures.

Although the actual hikes are probably a story for next year, this could lead to some flattening of the 2y5y segment of the swap curve through the end of 2026 as short-dated swaps start to price in the possibility of rate hikes in more earnest.

Foreign Exchange

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EUR/USD: choppy

The news flow since the start of the year has been fast and furious. While the USD suffered a setback on a step-up in concerns regarding Fed independence, the DXY index had been trending higher since late December. After the huge position adjustment last spring, the market appears to have started 2026 short USDs. In our view this should offer it some protection against bad news going forward. In contrast to the consensus view which points to a progressive uptrend in EUR/USD in the year ahead, we favour choppy range trading.

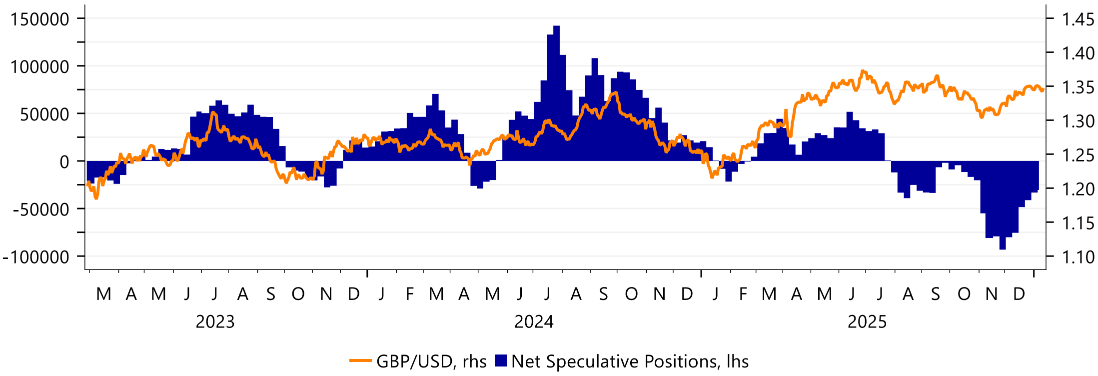
While 2025 will be remembered by many as the year in which the USD's value tanked, these losses were particular to the first part of the year. In H2 the USD was one of the better G10 performers, ending the period behind only the SEK and the AUD. That said, the USD's drop in 2025 led to widespread questioning as to whether the USD has lost its safe haven status. In our view, the USD's decline in 2025 was mostly the result of position adjustment after the long-standing 'buy America' trade came to an abrupt halt. Looking ahead, the US economy is widely forecast to be on course to grow faster this year than many of its G10 peers. In terms of AI investment, in respect of both opportunity and the potential for this to translate into productivity gains, US companies are likely to remain well positioned. This backdrop is USD positive and suggests there is potential for USD support as longs as investors are not spooked by issues around US fiscal policy, inflation and Fed independence.

While the issue of Fed independence is of considerable concern to the markets, to date the impact on the USD has been limited. This is partly because of the raft of bi-partisan support in favour of an independent Fed but also because of the possibility that the FOMC may be able to provide some degree of balance against a dovish chair. This outlook has found support in the wide range of policy views recently expressed by members of the FOMC. Also, since all the candidates that have been mooted for the job of the next Fed Chair have credibility as potential monetary policy makers, many commentators have maintained the view that evidence and economics will in any case continue to dominate the decisions of the Fed going forward. Others have argued that while the Fed may tolerate slightly higher inflationary pressures going forward, this will not translate to a complete loss of credibility for the central bank. In short, there is a spread of potential outcomes regarding the Fed credibility issue which may imply the potential for some downside pressure on the USD without sending it into free-fall.

EUR/GBP – fresh start or same old?

The market continued to cover its short GBP positions through into the start of this year in the wake of Chancellor Reeve's November budget. While business groups have continued to lament the lack of economic growth in the UK, the budget at least failed to trigger a sell-off in the gilts market. Reflecting the recent position adjustment, EUR/GBP has pushed down to levels last held in September in the absence of fresh trading incentives. Most recent retail surveys have not produced good news about the strength of consumer demand over the holiday period. This will likely dampen the recent debate about whether business surveys have been understating optimism in the UK economy. There are a few bright spots in the most recent UK business surveys. The Lloyds Business barometer staged a post budget rebound. However, while the IoD Directors' Economic Confidence Index also ticked higher in December on post budget relief, most underlying economic measures were either stable or lower in December compared with directly before Reeves' address. The IoD point out that despite the December improvement, confidence is still around the record lows reached in the first Covid lockdown. Barring an upward surprise in the UK monthly November GDP report, the market is likely to look to further BoE easing in the coming months. By contrast, market pricing is pointing to scope for an ECB rate hike potentially before the end of this year. Against this backdrop, we expect EUR/GBP to edge higher this year.

Figure 1: CFTC speculators' GBP net positioning



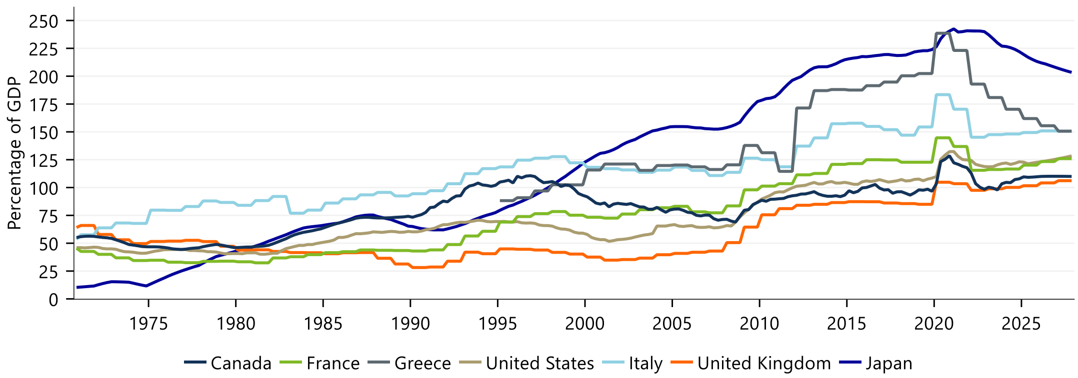
Source: Macrobond

JPY: back foot (again)

It was not just the USD that was suspected of losing its safe-haven appeal last year. The JPY also saw its safe haven reputation under pressure. By contrast the CHF, the other traditional safe haven currency, was the second best performing G10 currency last year after the SEK. A notable difference between the CHF and the JPY and is that Switzerland, unlike Japan, maintains a strong fiscal position. When Takaichi won the LDP leadership election in early October, the market carried two main assumptions about her. The expectation that she would lean on the BoJ not to hike rates has faded following the BoJ's December rate cut and hawkish commentary from BoJ Governor Ueda, though it still forms part of the 'Takaichi trade.' The other element of this 'trade' is PM Takaichi's reputation as a fiscal dove. At the end of December Takaichi's cabinet approved a record USD785 bln budget for the next fiscal year. In a nod to last year's moves in JGB yields, reassurances were issued that the government would not be irresponsible with either debt issuance or tax cuts. However, in view of Japan's huge public debt and the BoJ's policy of buying less JGBs as part of its normalisation process, the market remains uncertain. Reassuringly, despite the increased size of the budget for the next fiscal year, bond issuance is forecast to increase only a little due to a higher tax take. Also, the results of last week's 20 yr and 30 yr JGB auctions were decent. That said, the rise in Japan's debt-servicing costs, in addition to higher expenses implied by the ageing population and rising defence spending is clearly still a worry for investors.

The current weakness of the JPY has sparked speculation of FX intervention by the MoF. This, however, is likely to be far more successful if joined by hawkish BoJ actions. Market pricing is still focused on the middle of the year for the next hike, though guidance provided by the BoJ at its January 23 policy meeting will be closely watched. While we expect that a hawkish BoJ can help the JPY regain some ground in the year ahead, Japan's poor fiscal position may limit the currency's recovery potential. We forecast USD/JPY145 on a 12-month view.

Figure 2: Debt%GDP (OECD)



Source: Macrobond

Energy Markets

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Crude Oil & Refined Products

The oil market in 2026 will be shaped once again by a combination of supply-side factors, including OPEC+ decisions, non-OPEC supply growth, and geopolitical fragmentation, as well as demand-side factors such as economic growth, EV adoption, and regional demand variations. Our overall price outlook is negative from oversupply, but not as negative as many other banks or institutions.

Brent will average around $60 in Q1 2026, the oversupply narrative will continue and inventories will build, pushing prices to average $55-$60 for the rest of 2026, averaging about $57/bbl. We expect a few steep, short selloffs sub-$55 throughout the year as the narratives around oversupply panic and overshoot. We do not see it likely that Brent trades for any extensive time, if at all, in the $40s. For WTI, we expect the discount to stay around $4/bbl less than Brent, only strengthening later in 2026 to -$3.6/bbl as US production slows down. Thus we estimate that WTI will trade in the mid to low $50s per barrel for most of the year, below US drilling breakeven prices.

Demand continues to bifurcate with gasoline demand starting to flatten and decline, likely peaking in 2028, while jet fuel, petrochemicals and diesel demand continuing to increase. Population growth and GDP growth are key drivers of oil demand. However, the rate of population growth has been declining, which will impact long-term demand.

Key notes on demand: 1) The adoption of BEVs and PHEVs is expected to reduce gasoline demand. While the U.S. EV market penetration remains low, it is higher in China and Europe, with over 50% of new car sales in China are EVs and ~24% in the EU. 2)This shift is expected to have a continuing impact on refinery profitability; diesel crack spreads are expected to remain robust, keeping diesel prices elevated relative to crude; 3) Demand growth is shifting from traditional markets like the U.S. and Europe to emerging markets such as India, Brazil, Singapore, Turkey, Malaysia, Thailand, Vietnam and Indonesia. These countries are expected to drive future demand growth.

On the supply side: 1) OPEC+ faces the issues of continuing to bring back the last of their voluntary supply cuts from 2023 after bringing back 2.7m b/d of supply in 2025. If OPEC+ agrees to new supply cuts to support prices in the face of oversupply it would be a boon to their governmental spending, but could incur US geopolitical pressure. 2) Non-OPEC countries, including Canada, Brazil, Guyana, and Kazakhstan, are expected to increase production contributing to the oversupply narrative, but lower prices could curtail these increases. 3)The U.S. is forecasted to shrink production by about 180k b/d by our projections in 2026. Breakeven prices for tight oil are between $55-62 per barrel (WTI). The cost of drilling has increased, leading to consolidation in the upstream industry in the US.

The Trump administration's policies, particularly regarding sanctions and direct strikes on Iran and Venezuela, could impact global oil supply. The potential lifting of sanctions on Russia may also affect supply dynamics, however we do not see this as materially affecting markets for some time.

Natural Gas

Overall, the gas market in 2026 will be shaped by significant supply expansions, particularly from the U.S., and robust demand from Europe and Asia, leading to moderate price increases. U.S. (Henry Hub) natural gas prices are forecasted to average around $3.4/MMBtu in 2026, rising to $3.85/MMBtu by 2027 due to higher LNG export demand. We forecast TTF gas prices to reach an average of €27/MWh in 2026 and fall to €26/MWh in 2027, while JKM gas markets will reach $9.60/MMBtu in 2026 and then fall to $8.60/MMBtu in 2027. However, volatility risks persist, particularly if Asian demand surprises to the upside or if project delays constrain expected LNG additions. Storage adequacy and infrastructure resilience will remain critical, especially during winter periods when Europe's reliance on LNG peaks.

The coming year will see incremental improvements in global LNG availability, primarily driven by new capacity from the United States and Qatar, which should help ease the residual tightness in European gas balances. Global LNG export capacity is expected to rise by 8% in 2026 from 2025 levels, while we forecast total available supplies will come in at around 460 million tons. Several large-scale LNG projects are scheduled to ramp up in 2026, adding significant volumes to the global pool. The United States remains the dominant growth engine, with expansions at Gulf Coast terminals and new projects like Golden Pass LNG expected to deliver substantial capacity. Qatar's North Field expansion will also begin contributing meaningful volumes, reinforcing its position as a cornerstone supplier. Russia has also further LNG capacity expansions in the pipeline for 2026, with availability of its fleet to be improved if sanctions on its Arctic LNG 2 plant are lifted in the event of a Ukraine-Russia ceasefire or peace agreement. For Europe and its energy prices, these developments are critical. The EU's deliberate phase-out of Russian pipeline gas and LNG—cemented by regulatory bans and infrastructure reconfiguration— has left (U.S.) LNG as the primary marginal source of supply. While Europe successfully navigated the transitional years through aggressive LNG procurement and demand-side adjustments, the additional U.S. and Qatari volumes in 2026 will provide a cushion against volatility, reducing the risk of price spikes during seasonal demand peaks. A Ukraine-Russia peace would only further lift LNG supply availability on the global market.

LNG market dynamics will hinge on Asian demand. The region accounts for roughly 62% of global LNG imports, and its demand trajectory in 2026 will be the single most important determinant for global gas prices. If Asian demand growth accelerates beyond expectations—driven by economic recovery, coal-to-gas switching, or weather-related factors—the additional U.S. and Qatari volumes could be absorbed quickly, tightening the market and pushing prices higher.

Narrowing global price spreads and potential U.S. price strength will reshape trade economics, but structural demand growth from LNG and AI-driven power needs will keep the market well-supported.

Data centers powered by natural gas turbines remain a huge upside driver to demand in the medium term (2-3 years out) but are have only succeeded at pushing up regional power prices over the past year.

In terms of supply we note that: 1) The U.S. is expected to play a crucial role in meeting global LNG demand, with exports projected to rise by over 10% in 2026. This increase is driven by the commissioning of new terminals like Plaquemines LNG and the Corpus Christi LNG stage 3 terminal; 2) Russia's pipeline exports to China are set to increase, reducing China's reliance on LNG imports. The expansion of the Power of Siberia line will contribute to this shift; 3) Europe is seeking alternatives to Russian gas due to sanctions and the expiration of the Ukraine transit deal. This will likely increase European demand for LNG; 4) New LNG export terminals, primarily in North America, will provide some relief to the tight global LNG market. Significant capacity additions are only expected from 2027/2028.

In terms of demand, we note that: 1) China will remain the largest importer of LNG, with demand expected to grow by roughly 3% in 2026. However, higher pipeline supplies from Russia may dent overall LNG demand; 2) The European Commission has tightened gas storage targets, which will drive higher LNG demand to meet these requirements. Western European LNG demand is forecasted to rise by around 4% in 2026; 3) Japan's LNG demand may flatten as the country restarts several nuclear plants, reducing its reliance on LNG for power generation; 4) Weather patterns and industrial demand will significantly influence gas usage. For instance, colder winters or increased industrial activity will drive higher demand.

Eurozone

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An Arctic Chill

President Trump has revived his interest in Greenland reiterating that the US *"needs Greenland from the standpoint of national security."* with officials confirming that "a range of options" is under discussion, including the use of US military power. While the rhetoric is strong, officials have downplayed the risk of imminent military action, suggesting the preferred route is one that supports an independent Greenland. According to Reuters, US officials have floated payments of $10,000–$100,000 per Greenlander to secure consent for joining the US.

Still, this stance strains US-Europe relations at a time when Europe relies on US support for Ukraine. Danish Premier Mette Frederiksen has warned that an attack on Greenland – part of NATO – would *"stop everything, including NATO and the security established since WWII."* In a rare joint statement, leaders from France, Germany, Italy, Poland, Spain, the UK, and Denmark stressed NATO unity and Arctic security. They reaffirmed principles of sovereignty and territorial integrity, declaring that Greenland's future is for its people and Denmark to decide.

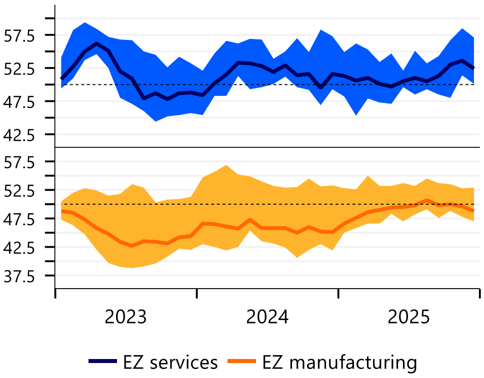
Europe's deterrence options, however, are limited. Diplomacy remains the preferred path. Some have suggested to boost EU military presence in the Arctic – though this would strain resources. Altogether the situation emphasizes Europe's weaknesses in the military and foreign policy space.

As such, this may also serve as another wake-up call for Europe to strengthen its defenses and economic resilience. Expect a further shift toward realpolitik: higher government spending or tough trade-offs elsewhere. A non-hostile US takeover of Greenland – perhaps via a Compact of Free Association – could still unsettle markets. It might raise risk premiums, push European rates higher if defense spending accelerates, or lower them if household caution dampens growth, and thereby inflation. Greenland's vast reserves of critical minerals – rare earths, lithium, cobalt – make it strategically interesting for the green transition and defense industries. Increased extraction of available critical materials and minerals could reduce countries' dependence on China. A real military clash, on the other hand, would likely spell NATO's end, opening scenarios like Russian aggression on Europe's eastern flank – a much more severe tail risk for markets.

Economy in a soft-spot, but defense production gaining traction?

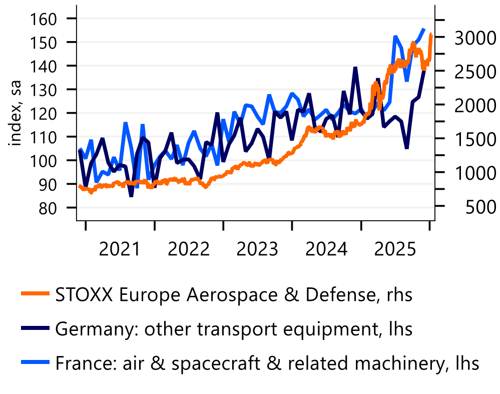
Recent PMI surveys suggest eurozone economic activity softened somewhat end-2025. We believe this is more demand than supply-driven, with both global and domestic (consumer) demand weakening. German retail sales and French consumer spending data for November lend support to that view, although October data were firm. It is also in line with our forecast, which assumes softer domestic demand due to a cooling labor market and slowing real wage gains.

Figure 1: Softness in manufacturing and pullback in services PMIs (index ranges for countries)



Source: Macrobond, RaboResearch 2026

Figure 2: Defense production starting to gain traction?



Source: Macrobond, Bloomberg, RaboResearch 2026

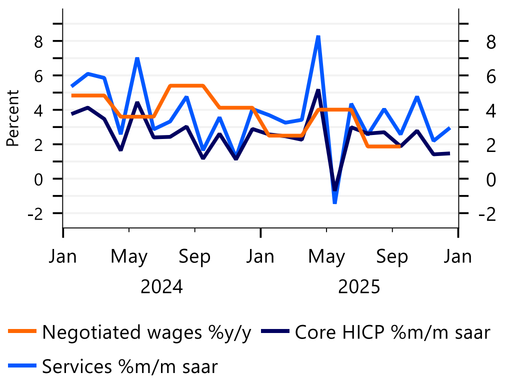
That said, the defense spending impulse appears to be gaining traction. After a series of orders in October and November, German lawmakers authorized a historic arms procurement package totaling €52 billion last December. This included funding for personal equipment, upgraded Puma infantry fighting vehicles, Arrow-3 missile defense systems, and spy satellites.

There is a significant domestic component to these purchases which should become visible in the data in the coming months, as contracts are signed. In November, domestic orders for 'other transport equipment' were already up 227% y/y, orders for fabricated metal products +27% y/y and computer, electronic and optical products +25% y/y. Output in defense-oriented sectors has also been on the rise, both in Germany and France (figure 2).

For now this has not proved sufficient to offset the general weakness in other sectors (and in overall demand), but we believe the economy should regain traction over the course of this year. As we noted last month, there is room for growth further out. Financing conditions for businesses have improved, with corporate borrowing costs and risk premiums are now closer to US levels. And, despite a recent uptick due to geopolitical tensions, cold spells and other specific factors, European gas prices remain significantly lower than a year ago. Diesel (gasoil) spreads have also tightened since mid-November. Future supply chain disruptions remain a key risk for the economy, however; this risk is being highlighted again by the 'Greenland issue', but in particular the possibility of China willing to play its critical raw materials card, as it showed last year.

Altogether the Eurozone economy likely lost some momentum at the end of 2025, although our 0% q/q growth forecast may prove a bit too pessimistic. Weakness may still spill over into early 2026, but over the course of 2026 we expect a gradual rebound in growth, driven by domestic demand, in particular investment and – in a more gradual fashion – consumer spending.

Figure 3: Underlying trend in inflation is slowing



Source: Macrobond, RaboResearch 2026

After persistence of services sector inflation in 2025 (see figure 3), there are now increasing signs that underlying inflation is easing. This should also be positive for Eurozone consumers which have been confronted with a slowdown in wage growth last year, following a 'catching up' phase during 2023-2024. Inflation should hover near the ECB's target over the next two years with near-term risks skewed to a modest undershoot due to lower energy prices and Chinese overcapacity driving cheap imports.

Table 1: Economic forecast

	2025	*2026*	*2027*	*Q4/25*	*Q1/26*	*Q2/26*	*Q3/26*
GDP	1.4	0.9	1.2	0.0	0.2	0.3	0.4
Consumption	1.2	0.9	1.1	0.2	0.3	0.3	0.3
Investment	2.0	1.3	2.1	0.2	0.6	0.6	0.6
Government	1.6	1.1	0.9	0.1	0.3	0.3	0.3
Trade	-0.4	-0.2	0.0	-0.1	-0.1	0.0	0.0
Inventories	0.3	0.1	0.0	0.0	0.0	0.0	0.0
CPI (%y-o-y)	2.1	1.9	2.0	2.1	1.7	2.0	1.8
Unemployment rate	6.3	6.2	6.1	6.3	6.3	6.2	6.2

Source: Rabobank

The Netherlands

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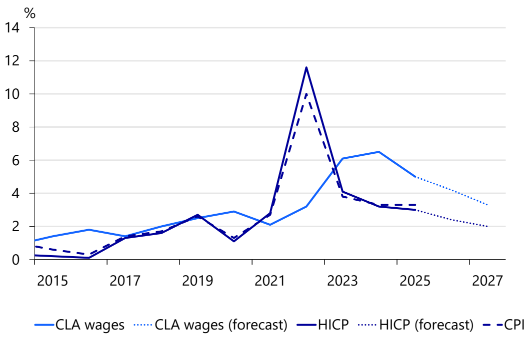
The unusually cold and snowy weather has disrupted traffic and public transport this January and is likely to lead to higher energy bills. And while international geopolitics and complex Dutch coalition talks – a centre-right minority coalition of D66, CDA and VVD seeking support from opposition parties on specific themes – are a source of uncertainty, economic trends are largely positive.

Bright outlook for households

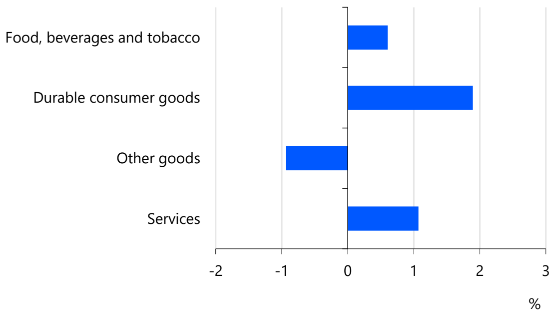
Collective labor agreement (CLA) wages rose by an average of 5% in 2025, and inflation was 3% (HICP). According to the Dutch Consumer Price Index (CPI), inflation was 3.3%. Wages pushed up service prices, and tobacco excise duties pushed up food prices, while energy prices fell slightly and goods prices only rose moderately. The improvement in purchasing power in 2025 is reflected in household consumption. December figures are not in yet, but based on data for January until November we see that households in particularly bought more durable consumer goods than in the same months of 2024. Measured from 2021, both CLA wages and the CPI have risen by 22.5%, thus recouping the loss in purchasing power caused by the 2022 inflation peak.

Figure 1: Wages outpace inflation



Source: Statistics Netherlands (CBS), RaboResearch

Figure 2: Domestic consumption



Source: Statistics Netherlands (CBS)

For 2026 and 2027, we expect a more moderate development of wages and inflation, with collective labor agreement (CLA) wage growth of 4.2% and 3.3%, and inflation (HICP) averaging 2.4% and 2.0% respectively. In addition, many retirees will see their purchasing power increase substantially this year: the pension funds that switched to the new system on January 1, 2026, are expected to increase pension payments from March or April by an average of over 13%, according to estimates from AON pension advisors. This concerns approximately one and a half million retirees. Whether they will use this extra income for additional consumption or cautiously set it aside remains to be seen. In any case, it is a windfall for the treasury, as tax revenues will increase and spending on benefits will decrease somewhat.

Unemployment slightly increased over the course of 2025, from 3.8% at the beginning of the year to 4.0% in the months of September, October, and November. At the same time, employment also rose, while the number of people outside the labor force decreased. All in all, the labor market remains tight.

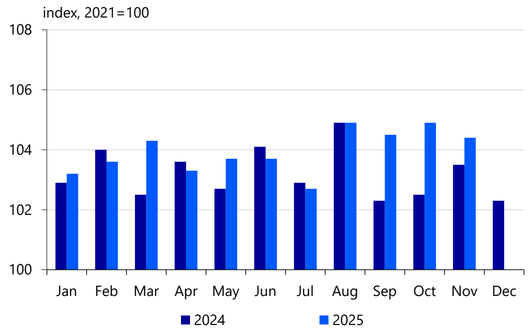
Mixed signals for the business sector

Headline figures can be misleading. For example, the number of bankruptcies fell considerably in 2025; 3,220 companies and institutions went bankrupt, compared to 3,782 in 2024. Meanwhile, however, the number of voluntary business closures increased: in the first three quarters of 2025, 12,415 companies ceased their activities, compared to 11,185 in the first three quarters of 2024. These are companies with more than one employee. We see the same pattern with sole proprietorships without employees: a decrease in the number of bankruptcies, but an increase in voluntary business closures.

In recent months, manufacturing output has repeatedly recorded positive growth figures: production grew in September, October, and November by 2.1%, 1.9%, and 0.7% respectively compared to the same months in 2024. However, the momentum is flat: from August 2025, there has been no growth anymore. This is clearly visible in a graph with an adjusted y-axis (Figure 3). Although the increase in defense spending brings opportunities for part of the Dutch industry, we see that some activities in the chemical sector are being discontinued. For 2026 and 2027, we therefore expect very limited growth; see also our (Dutch) Sector Forecasts.

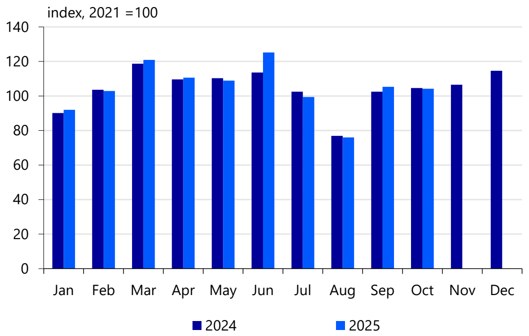
The opposite effect may occur in figures for investment in tangible fixed assets. Investments in fixed assets declined in October 2025 compared to a year earlier. It is likely that this will also be the case in November and December – bearing in mind that at the end of 2024, there was a small peak in investment (figure 4). This was largely caused by investments in delivery vans brought-forward for tax reasons, thus limiting growth in 2025. We expect higher growth in investments for 2026 and 2027, both in the private sector (1.5% and 1.9%, respectively) and in the government sector (3.0% and 4.5%).

Figure 3: Manufacturing growth slows down



Source: Statistics Netherlands (CBS), seasonally adjusted

Figure 4: Investment in tangible fixed assets



Source: Statistics Netherlands (CBS)

Table 1: Economic forecasts

	2025	*2026*	*2027*	*Q4/25*	*Q1/26*	*Q2/26*	*Q3/26*
GDP	1.7	1.3	1.3	0.4	0.3	0.3	0.3
Priv. consumption	1.6	1.8	1.9	0.5	0.5	0.5	0.5
Govt. consumption	2.6	1.7	1.5	0.3	0.3	0.3	0.3
Bus. investment	-2.3	1.5	1.9	0.5	0.5	0.5	0.6
Govt. investment	6.5	3.0	4.5	1.6	1.5	1.6	1.6
Exports	2.2	2.1	2.4	0.6	0.5	0.5	0.5
Imports	2.5	3.0	3.1	0.8	0.7	0.7	0.7
HICP (% y/y)	3.0	2.4	2.0	2.7	2.6	2.5	2.3
Unemployment rate	3.9	4.1	4.3	4.0	4.0	4.1	4.1

Source: Rabobank

United Kingdom

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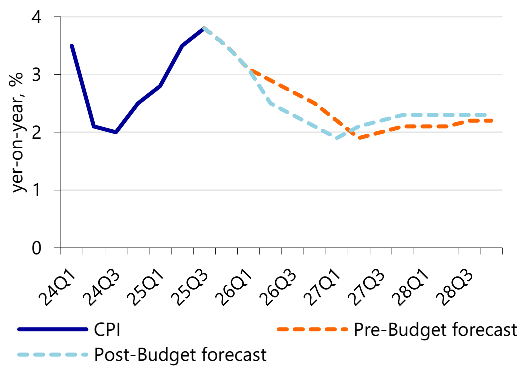
Risks shifting

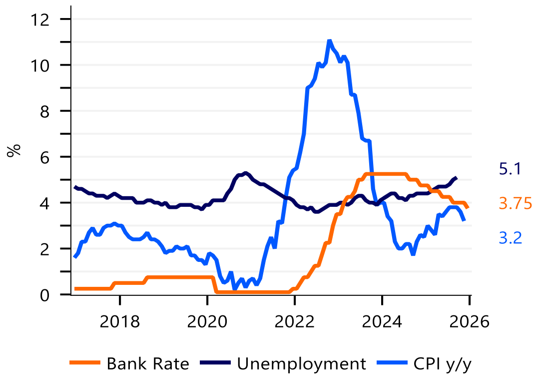
The Bank of England enters 2026 with the risks shifting in a direction that favours policy easing. November CPI undershot expectations at 3.2% y/y; core inflation also printed at 3.2%, while services eased to 4.4%. The inflation scare should continue to fade as headline CPI falls further, in particular in 26Q2 when last year's regulated price rises roll out of the annual comparison and as the rail-fare freeze and energy measures filter through. We forecast inflation to reach 2%, or possibly even fall below it. Services inflation remain firmer than goods, but not uncomfortably so. And even if the sharp fall in headline CPI does not fully reflect changes in underlying slack, it will help the Monetary Policy Committee to sell rate cuts to the market. Against that backdrop, our base case remains two 25bp cuts before mid-year, taking Bank Rate to 3.25%.

Figure 1: The Autumn Budget leads to lower inflation in 2026, higher inflation in 2027



Source: Macrobond, RaboResearch

Figure 2: The balance of risks has shifted



Source: Macrobond, RaboResearch

If anything, the labour market is cooling faster than the Bank would like. The post-pandemic fall in the employment rate is chiefly due to weaker labour demand, not falling participation. In fact, after a few weak years, labour market activity is now essentially back at pre-pandemic levels (economic inactivity is about 21%, close to the 2019 average of 20.8%), with rising inactivity due to ill health being offset by long-running declines in family-related inactivity and early retirement. In other words, the UK lacks jobs, not job seekers.

The counterpart to the recent fall in labour demand is a rise in unemployment. The ONS estimate has drifted up to 5.1%, and we expect it to stay elevated for a while. The increase reflects both the broader demand slowdown and 2025's rise in employer National Insurance contributions, which raised labour costs. These effects have been felt most by younger workers, some of whom have found themselves priced out of the labour market. Vacancies have cooled and, here too, youth bear the brunt. This could have a positive impact on productivity, however. A near-term increase in productivity looks likely if firms continue prioritising cost control and extracting efficiency gains from existing staff rather than expanding headcount, as there is still fat to trim after the post-Covid hiring boom. Corporate reluctance to hire weakens employees' negotiating leverage, further reducing the risk of inflation persistence.

Private-sector regular pay growth has slowed from around 6% to 3.8% over the past year, and current momentum suggests it will reach 3% by end-2026 as workers' bargaining power fades. Indicators of "labour leverage" (such as the ratio of voluntary quits to involuntary redundancies) have fallen to their lowest level (excluding Covid) since 2012, consistent with muted job-to-job flows. Minimum-wage increases, especially for 18–20-year-olds, will keep some firmness in the pay distribution, but the overarching picture is one of gradual nominal pay deceleration into 2026.

The growth outlook hardly argues for restraint either. UK GDP expanded just 0.1% in Q3, likely contracted in Q4, and consensus points to only modest, trend-like growth this year. We also note that private-sector spending has risen a mere 3% over the last six years, with consumers seeing no per capita spending growth as they save more than before. Part of this higher voluntary saving reflects structurally greater uncertainty; part reflects the arithmetic that, with interest rates well ahead of inflation, it simply pays to save. Against this backdrop, easier monetary policy could provide a much-needed boost to growth.

Rates outlook

With Bank Rate currently at 3.75%, monetary policy is probably still restrictive, but the monetary policy *impulse* is already slightly positive. Fiscal policy, by contrast, is still a drag. Although the Autumn Budget measures increase spending in 2026, the OBR still projects a notable consolidation in the primary balance this fiscal year. Experience over the last two years, however, raises doubts about the government's ability to deliver the sharp consolidation that is pencilled in.

Our forecasts imply further slack emerging in the labour market this year as inflationary pressures fade. That should allow the MPC to normalise policy towards a neutral level. The MPC sees this in a 3.00-3.50% range. The timing of cuts will hinge on incoming data. The December statement and minutes suggest the Committee could cut more slowly than quarterly if the data track the Bank's projections. Our forecasts are weaker, so we expect earlier easing than the guidance implies, with cuts in Q1 and Q2, with the risk of additional moves in 26H2 if the economy fails to gain traction.

Translating policy into market rates, we expect the short end to drift a little lower as cuts arrive. That argues for a limited bull steepening, with the one- to five-year segment following Bank Rate down by perhaps 15–25bp over the year, provided the market does not start to reprice future hikes as we are seeing with the ECB. The early-January rally fits this narrative, pulling benchmark gilt yields to multi-week lows as investors brought forward easing bets.

Further out the curve the story is more nuanced. A lower policy rate and a reduction in long-dated gilt supply are supportive, and there is room for 10-year gilts to move to the low-4s on the back of this. Yet the UK remains a high-beta market to shifts in global and domestic risk premia. Political risk is the wild card: if the trends in the polls continue, May's local and devolved elections could emerge as a focal point for volatility, with the possibility of Labour leadership turbulence. Any narrative that questions medium-term fiscal credibility could resurrect risk premia, even as cuts are pulling the short-end down. The long end will surely take its cue from the cuts, but remains vulnerable to "hiccups" if it is being undermined by politics.

Table 1: Economic forecasts

	2025	*2026*	*2027*	*Q3/25*	*Q4/25*	*Q1/26*	*Q2/26*
GDP	1.4	1.1	1.3	0.1	0.2	0.3	0.3
Consumption	0.9	0.8	0.9	0.2	0.2	0.2	0.2
Investment	3.1	0.3	1.6	-0.3	0.1	0.2	0.3
Government	2.0	2.7	1.2	0.3	0.5	0.8	0.7
Export	3.3	0.3	1.0	-0.1	0.0	0.0	0.2
Import	3.0	0.2	1.0	-0.3	0.0	0.0	0.2
CPI (%y-o-y)	3.4	2.5	2.3	3.5	3.0	2.6	2.6
Unemployment rate	4.8	5.2	5.0	5.1	5.1	5.2	5.2

Source: Rabobank

United States

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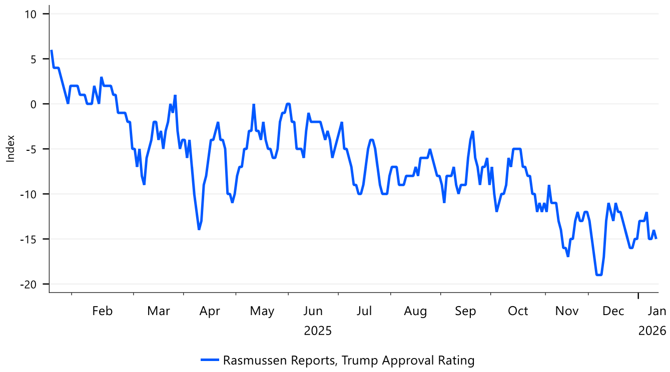
The Powell subpoena

On January 11, Powell released a statement that *"on Friday, the Department of Justice served the Federal Reserve with grand jury subpoenas, threatening a criminal indictment related to my testimony before the Senate Banking Committee last June. … This new threat is not about my testimony last June or about the renovation of the Federal Reserve buildings. It is not about Congress's oversight role… Those are pretexts. The threat of criminal charges is a consequence of the Federal Reserve setting interest rates based on our best assessment of what will serve the public, rather than following the preferences of the President."*

Since Powell's term as Fed Chair ends on May 15, the latest move by the Trump administration could only affect his stance as Chair at the next three FOMC meetings (January, March, April). At present, the Fed does not seem inclined to cut in January, so the administration could be trying to raise the sense of urgency in the Committee. Keep in mind that the midterm elections take place in November and given the lags of monetary policy, the Republicans need rate cuts fast. We discussed this more elaborately in Alignment.

Figure 1: Why Trump wants rate cuts



Source: Macrobond

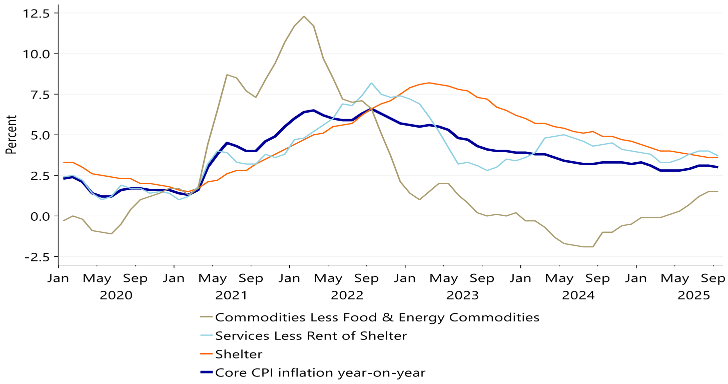
It may also be an attempt to end his *governorship* prematurely, which runs through January 31, 2028. If Powell decides to stay he would remain a voter in the FOMC and could lead the opposition against the Trump loyalists. However, if this legal action fails, it may actually cause Powell to serve his full term as Governor, instead of resigning after the end of his Chairmanship, which is the more usual course of events. Powell's response to the subpoena has been unusually defiant, clearly stating that this was an attempt to influence monetary policy. This break from his usual evasive reaction pattern suggests that the probability of Powell staying on the Board through January 2028 has increased. In other words, the subpoena could very well backfire and induce Powell into becoming a resistance leader in the Fed for the next couple of years.

Besides rubbing Powell the wrong way, the subpoena could also raise questions in Congress about the intentions of the Trump administration. Republican senator Thom Tillis, who is not up for re-election, has said he would oppose confirmation of any Fed nominee until the legal matter is resolved. Since Tillis is a member of the Senate Banking Committee, where Republicans have a 13-11 majority, he could block the advancement of nominations through the panel.

This would mean that any Trump nominee will be scrutinized more severely by the Senate, but in the end there will be a Trump-loyalist at the helm of the Fed. It just may take a little longer to get clarity about who is going to be the next Fed Chair. But as we explained in *Alignment*, it does not really matter who is going to take over from Powell, because it is going to be a Trump-loyalist. This is also why have pencilled in a rate cut at the June meeting, which should be the first chaired by Trump's nominee.

The subpoena may very well backfire and Treasury Secretary Bessent is reported to have expressed his concern about the reactions in the Senate and the financial markets to President Trump. On Sunday, Trump distanced himself somewhat from this action by saying on NBC that he didn't know about the Justice Department subpoenas and that any criminal investigation wouldn't be related to disagreements the White House has had with Powell over interest rates. The investigation is being run out of the office of Washington's US attorney Jeanine Pirro. So it is very well possible that this is an action driven by (over)zealous Trump-loyalists in the government, rather than a directive from the White House.

Figure 2: Persistent inflation is slowing down the Fed's cutting cycle



Source: Macrobond

Nevertheless, Powell's subpoena sends a message to other FOMC participants and possible nominees for the Board of Governors and the Chair: this administration will leave no stone unturned if you do not comply with the wishes of President Trump. The result is, as we have warned in Trumping the Fed well before the re-election of Trump, that the Fed's independence will be reduced. Therefore, we still expect three rate cuts of 25bp each before the midterm elections.

Table 1: Economic forecasts

	2025	*2026*	*2027*	*Q1/26*	*Q2/26*	*Q3/26*	*Q4/26*
GDP	2.1	1.8	1.7	1.0	1.2	1.2	1.2
Consumption	2.7	1.8	1.7	1.2	1.2	1.2	1.2
Business inv.	3.2	0.5	2.3	-0.4	0.8	1.2	1.6
Residential inv.	-2.0	-2.6	1.3	-2.4	-0.8	0.0	0.4
Government	0.8	0.5	0.8	1.6	0.8	0.8	0.8
Trade	-0.1	0.6	0.0	0.1	0.1	0.0	0.1
Inventories	0.0	-0.1	0.1	0.0	0.0	0.0	0.0
CPI (% YoY)	2.9	2.9	2.5				
Unemployment rate	4.2	4.6	4.5				

Note: * Contribution in pp. Source: Rabobank

Canada

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Arctic anxiety

Recent comments from the Trump Administration have induced anxiety amongst habitants of the arctic circle. After a military operation in which the US captured Venezuelan President Nicolás Maduro, Trump made comments about potentially annexing Greenland.

Global leaders espoused concerns about Greenland's independence (from the US, not from Denmark), including Mark Carney who asserted that the future of Greenland will be "solely" up to the people of Denmark and Greenland, but of course, also clarified that "[Canada's] closest partnership is with the United States. And we'll work with everybody to make sure that we move forward together."

CAD has weakened more than 1% against USD since the beginning of the year, with much of that jump taking place after news of the Venezuela operation broke out. But this means that USD/CAD is back to early-December levels of 1.39, and is currently trading between the 50D and 200D EMA at 1.385 and 1.400, respectively.

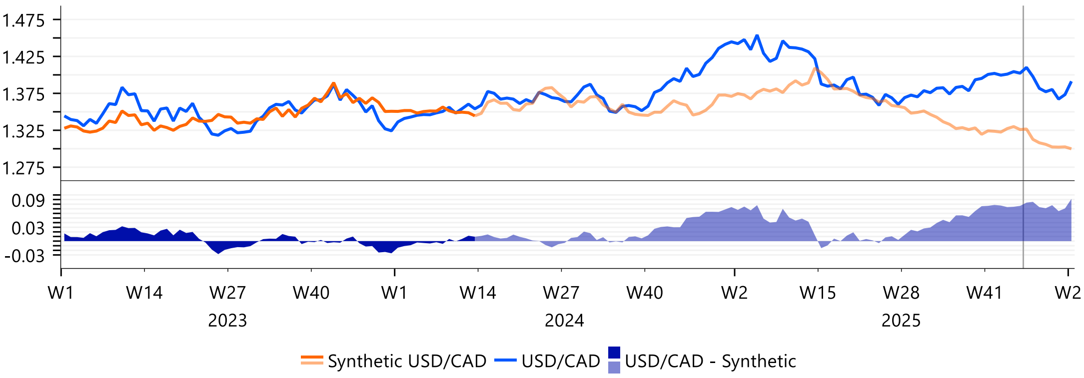
While implied vols spiked briefly in reaction to the news of US intervention (and the ensuing thrteats made against Greenland), the magnitude of the one day move were still smaller than jumps seen in December, and 1-week implied vols reached a peak of only 4.8%, comfortably below last month's peak, and have since headed lower to 3.7%.

Additionally, it seems like the US has no intentions of a military invasion in Greenland...for now. When aspirations of Greenlandish aspirations were first announced amidst the chaos of Maduro's capture, Trump appeased reporters by saying that he would push off the Greenland conversation for 20 days or so. But the US' Greenland envoy has further quelled fears after saying on CNBC that "Trump backs independent Greenland" and that he "[doesn't] think Trump is ready to seize Greenland." We'll see if he's singing the same tune a month from now.

In the meantime, while the US ponders what it should do with its newly acquired Venezuelan oil fields, Canada may end up having to clean up some collateral damage. Venezuelan sour crude, which has been both locked up and sanctioned, could pose a threat to Canadian crude exports, and provide support for Alberta Premier Danielle Smith's proposed oil pipeline, which seeks to further diversify buyers for Canadian crude.

We flagged several months ago that USD/CAD had diverged from what we would consider to be it's theoretical fair value as derived from Canadian equities, and the US-CA 2 year interest rate differential. USD/CAD has been elevated beyond this level due to a "tariff premium" as CAD is devalued due to a deteriorating economy and poor growth prospects.

Figure 1: USD/CAD has diverged from its synthetic value



Source: RaboResearch, Bloomberg, Macrobond

Part of the story is that USD/CAD has correspondingly become de-correlated from many of the assets that typically inform its value, like oil, volatility, US equities, etc. In the past few days, many have argued that CAD has slumped on the back of lower oil prices, but the price action suggests otherwise. Indeed, crude oil has traded sideways since the US military action in Venezuela, albeit with some spikes on the Monday following, but even still, USD/CAD was not closely tracing crude at all.

Venezuela's oil output has dropped from 3.2 million barrels per day (b/d) in the early 2000s to about 900,000 b/d today, with 800,000 b/d exported—only a small share to the U.S., where its heavy, sour crude is important for Gulf Coast refineries. Most Venezuelan exports go to China and Cuba, though China could easily replace these barrels with Canadian or Middle Eastern supply. Canada currently produces around 5 million b/d of similar heavy crude, making it a critical source for U.S. refiners. While Venezuela could theoretically compete with Canadian barrels, doing so would require tens of billions in investment and 5–7 years of repairs and construction.

Furthermore, USD/CAD has not been correlated with oil since October of last year. While oil still matters for the world to function, it doesn't matter too much to USD/CAD, not when the rest of the Canadian economy is under pressure. Indeed, the only asset that we track that has re-correlated with USD/CAD is the S&P 500, which suggests that in addition to the trend of rapid CAD depreciation, we're also seeing USD appreciation as American equities stay strong. Regular readers will know we have flagged for many years that oil matters for USD/CAD when there is a sharp move of significant amplitude, slow shifts in oil prices play little role in driving the Loonie.

Impasse

Headline inflation appears to have moved in the right direction, having printed very close to the 2% benchmark throughout 2025. However, as a reminder, this figure has been helped by the removal of the Carbon Tax in March of 2025 (the effects of the removal will be priced out of the CPI calculation by March 2026), so we look to core inflation as a more accurate indicator at this point in time. Core inflation (both 'median' and 'trim') has printed at 2.8% y/y in November, which is warmer than preferred. We will see the next CPI inflation data print for December on January 19.

Meanwhile, activity has been disappointing. While GDP growth "rebounded" in Q3, registering well-above expectations at 2.61%, this increase was driven almost entirely by an offset in net exports as Canadians boycott American goods. We maintain the view that weak household consumption coupled with weak imports is not indicative of a thriving economy.

We believe that the Bank of Canada is stuck at an impasse. While the steady deterioration of both Canadian activity and labor would normally be conducive to cuts, the external nature of the primary driver (tariffs) means that "monetary policy cannot offset the impacts of a trade war." Any additional cuts from the Bank are functionally useless, which means all Macklem and crew can do is sit on their hands and hope that Carney can negotiate a deal with the US sooner rather than later.

As the Bank of Canada maintains its overnight rate at 2.25%, we believe that the Fed has some more room in 2026. Our Fed whisperer, Philip Marey, is forecasting three more Fed cuts in 2026, starting in Q2, and a terminal rate of 3.00% reached by the end of the year. Further narrowing of the U.S.-CA rate differential will likely weaken some of the USD strength against CAD, providing somewhat of a ceiling to USD/CAD, but the benefits of this ceiling are somewhat cancelled out by the tariff premium and persistent weakness in the face of economic challenges ahead.

Mexico

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Who's next?

Just a few days after 2026 started, the US conducted a military operation in Venezuela to arrest Maduro for charges being levied against him for narco-terrorism. The immediate question to follow was "who's next?"

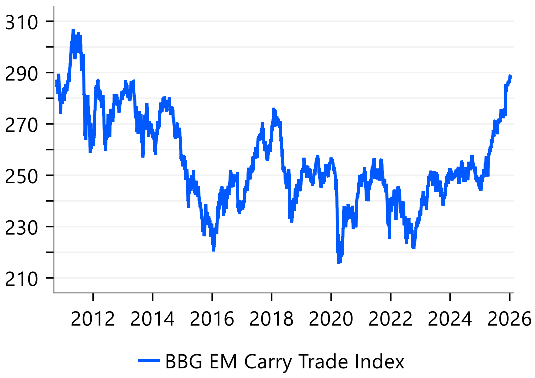
While we have previously highlighted Sheinbaum's tact in negotiating with Trump, Trump's suggestion that the US send troops across the border to tackle the cartels has not slowed, and it appears that the recent events have only emboldened his rhetoric further. On January 8, Trump said in an interview on Fox news that the US would consider land-based strikes against Mexican cartels. Sheinbaum immediately condemned the comments and asserted that she did not think Trump was serious. Things have calmed since then. Just three days later, Sheinbaum announced in a press conference that she and Trump had a "very good talk" on the phone, praised the 50% decline in Mexico-US fentanyl trafficking, and asserted that "[Mexico] operate[s] in Mexico, no one else." But for how long?

We have flagged previously that we believe that Trump will leverage the upcoming USMCA review in June to push for increased military "collaboration" between the US and Mexico when it comes to tackling the cartels. We do not believe that the USMCA will be torn up and thrown away (and even if it were to happen, the USMCA couldn't be fully dismantled until 2032 at the earliest). But we do think that Trump will threaten to do so, and we also do not expect the USMCA to make it through the review in its current form. We see this posing an upside risk to USD/MXN as a spike in volatility triggers profit taking of long MXN carry positions. The Trump Administration will use what leverage it has to close any "loopholes" that they believe have disenfranchised Americans, and there will almost certainly be changes. Either way, Trump seems re-emboldened and will use the USMCA and other tools (Statecraftian or Lovecraftian) in order to bend the Sheinbaum Administration to his whims.

The carry pageant

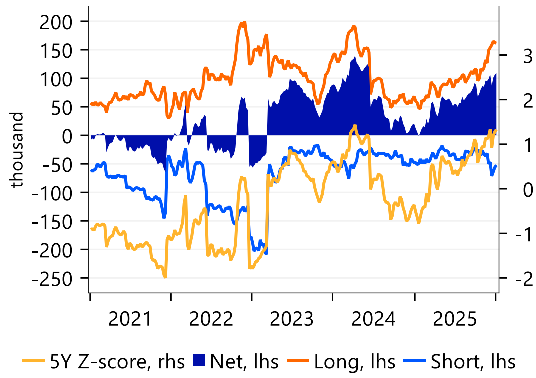
USD/MXN has been surprisingly resistant in light of the whirlwind happening around it. USD/MXN has been trading in a very tight range, roughly between 17.85 and 18.00 since Christmas, with MXN hovering around its strongest level since July 2024, and poised to head lower. At the time of writing, the 14D RSI is at 33.1, heading towards the oversold range, which is actually the exact opposite move of what one might expect after the President of the US publicly threatened to strike Mexico.

Figure 1: The BBG Carry Index is at its strongest since 2011



Source: Bloomberg

Figure 2: Non-commercial MXN net long positioning



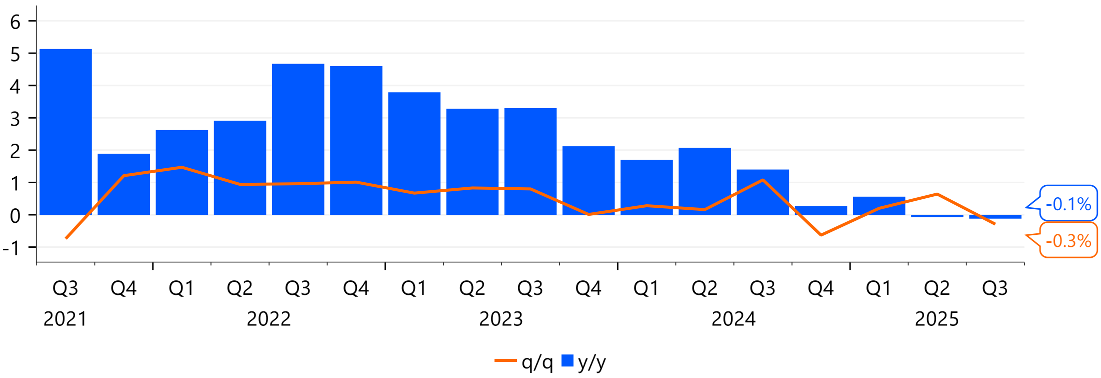
Source: RaboResearch, Bloomberg, Macrobond

The story still ties back to carry. The Bloomberg Emerging Markets Cary Index is at its highest level since 2011, and non-commercial speculators net long MXN positioning is net 109,301 contracts as of January 6, which is the most net long since June 2024. The heightened appeal for carry is still driven by comparatively attractive interest rates in Mexico and historically low peso implied volatility. The Banxico overnight interest rate is currently 7.00%, which is one of the highest emerging markets interest rates. However, Mexico faces some competition at the carry pageant, with Brazil's overnight rate still at 15%. Indeed, if that wasn't the case, USD/MXN would likely be trading lower.

(FI)FA-ntastic

Try as she might to appease Trump, the Mexican economy is still hurting under the pressure of US tariffs. Mexican GDP growth has been trending tangibly lower, registering -0.3% q/q and -0.1% y/y in Q3. Much of this contraction on a year-over-year basis was concentrated in weak gross fixed capital formation, namely private gross fixed capital formation (versus public) which contracted by 12.46% y/y in Q3, after contracting by 12.56% in Q2. Uncertainty is clearly weighing on private sector investment decisions. However, public fixed capital formation has been showing consistent weakness as well, contracting for the past four consecutive quarters.

Figure 3: Mexican GDP growth



Source: Rabobank, Bloomberg, Macrobond

The next few quarters are likely to pan out similarly as the manufacturing sector in Mexico continues to deteriorate. Industrial productions volumes has contracted on a m/m term in 14 out of the last 25 months while the y/y measure has registered in the negatives for almost two years to date.

However not all is doomed. Next year, Mexico will be hosting the World Cup, along with the US and Canada. This suggests that when the World Cup beings in June, Mexico can expect a dramatic pick up in tourism and consequent direct consumption. We do expect this to bolster economic activity in Q3, but it should be noted that some of the economic improvement may be tempered by the co-incident nature of the USMCA review period, in which industries will once again likely be facing heightened trade uncertainty.

While continued and rapid economic deterioration should make the rate path for Banxico clear, Hawk Heath still has his own gripes with the pace of inflation, as core inflation is still hotter than the Bank's tolerance band at 4.33% y/y as of December 2025. Some of the environmental pressures in the headline, such as those affecting agricultural products, have ebbed quickly, but are still at risk of resurging.

We're forecasting two more 25bp cuts from Banxico to bring the overnight rate down to a terminal level of 6.50%..

Brazil

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Inflation: ends 2025 within the target range

We see CPI inflation at 4.2% by end-2026 and 3.9% by end-2027. In December, CPI inflation saw an uptick of 0.33% m/m, following November's 0.18% m/m increase. For 2025, inflation ultimately accumulated a rise of 4.3% y/y, compared to 4.8% y/y in 2024. This performance eventually kept inflation within the tolerance range (1.5%-4.5%) of the inflation target, set at 3.0%. Along 2025, Brazil's inflationary landscape showed conflicting trends. In June, inflation then reached 5.5%, with core inflation above the target, and expectations unanchored on the back of a heated economy. Since then, other than the record harvest and commodity slowdown, the BRL appreciation has been crucial in alleviating inflationary pressures, particularly on food, industrial goods, and fuel prices, while the economy started slowing down. For now, regulated prices and services continue to exert pressure, hindering a faster decline, while keeping core inflation above the target and expectations still unanchored. Looking ahead to 2026, a gradual economic slowdown and reduced agricultural impact are anticipated, even though we expect the BRL to experience volatility due to uncertainties ahead of the elections in October. These factors are likely to contain inflation pressures.

Fiscal policy: challenge in an election year

We see the gross debt-to-GDP ratio at 84.0% in 2026 and 85.3% in 2027, up from 79.5% in 2025. The projection for the primary result in 2025 remains at -0.6% of GDP, attributed to the enhanced performance of royalty revenues, notwithstanding the deceleration in tax revenues and the escalation in expenditures. The fiscal target was met due to robust revenue collection associated with the labor market and extraordinary revenues, such as dividends from BNDES (national development bank). The gross debt is anticipated to reach 79.5% of GDP, which is below the initial estimate, influenced by a more appreciated exchange rate and revisions to nominal GDP. For 2026, a deficit of 0.25% of GDP is projected, contingent upon extraordinary revenues, with an increase in recurring revenues through elevated tax rates and a reduction to tax benefits. Federal expenditures are expected to accelerate, with an average annual growth of 4.8%, propelled by court-ordered payments and new income transfer and credit measures. The principal risk for 2026 is the adoption of measures that may weaken the restrictions imposed by the fiscal framework, which are already deemed insufficient to impose a stronger public debt stabilisation.

Real activity: activity continues to decelerate

We project GDP growth of 1.6% in 2026 and 3.0% in 2027. The GDP for 25Q3recorded a growth of 0.1% q/q (1.8% y/y), reflecting the slowdown in economic activity, particularly in components more sensitive to monetary policy. The sectoral composition of growth shifted towards less cyclical segments, such as extractive industries and transportation. Initial indicators for 25Q4 show mixed signals: retail sales exceeded expectations, while service revenue fell short, without altering the deceleration trajectory. The reacceleration of credit to households boosted expanded retail sales, while the manufacturing industry and the volume of services provided to households continue to decelerate gradually. For 2025, we maintain our projection of 2.2% growth. For 2026, the GDP growth projection remains at 1.6%, considering the possible implementation of countercyclical fiscal and parafiscal measures and a potentially more robust credit performance. Despite the various stimulus programs announced by the government, there are concerns regarding the high indebtedness of households and companies, both at historically elevated levels, especially in the context of a possible inflection point in the labor market.

Monetary policy: still hawkish for now

We anticipate a looming cutting cycle to the Selic rate in 2026. During the final meeting of 2025, the Copom unanimously decided to hold the Selic rate at 15.00%, thereby reinforcing the strategy of sustaining elevated interest rates over an extended period to ensure alignment with the inflation target. Despite the economic slowdown and more tempered expectations, the Committee continues to adopt a hawkish stance and does not exclude the possibility of further rate increases if deemed necessary. The minutes from December's meeting reflect increased confidence in the disinflation process, deeming the current interest rate level sufficient to guide inflation down towards the target. Central Bank Governor Gabriel Galípolo has asserted that no pre-determined decisions exist for forthcoming meetings, highlighting that decisions will not rely on a single indicator. In our forecast, we anticipate the Selic rate will remain at 15.00% through the first quarter of 2026, with potential reductions in the second quarter contingent upon economic data. For the upcoming meeting, the Copom will still likely be operating without two new Deputy Governors (Economic Policy and Financial System Organization and Resolution), as the mandates of the previous ones expired at the close of 2025 and replacements have not been appointed by the administration and cleared by the Senate.

Foreign exchange: Positive export momentum to partially offset volatility

We see USD/BRL at 5.60 by end-2026 and 5.55 by end-2027. During 2025, the BRL appreciated by 11% against the USD, aligning with a global trend of emerging market currency appreciation and dollar depreciation, driven by the diversification away from US assets and the initiation of monetary easing by the Federal Reserve. Domestically, the BRL was also propped up by a substantial interest rate spread, as the Selic rate was kept at historically high level, rendering carry trades attractive. More fundamentally, in 2025, the trade balance achieved a surplus of US 68.3 billion (2024: US$ 74.1 billion). The 7.9% y/y decline is explained by the annual growth of imports (+7.2% y/y) outpacing that of exports (+1.8% y/y), despite the dramatic announcement of US tariffs on Brazilian goods, ultimately partially reversed. For 2026, while our team does not see a repeat of the global dollar weakening, and we see carry trades being partially unwound as the Copom is poised to start cutting the Selic rate, presidential elections in Brazil typically bring volatility to the BRL. That said, we have revised up our trade balance surplus projection to US$ 72.0 billion (previously US$ 68.0 billion). On the one hand, the deceleration of the domestic economy may contribute to a reduction in imports. On the other, the recently approved trade agreement between the European Union and Mercosur will stimulate Brazil and fellow Mercosur partners to keep seeking new export destinations in light of global geopolitical uncertainty.

	2025	*2026*	*2027*	*Q3/25*	*Q4/25*	*Q1/26*	*Q2/26*
GDP	2.2	1.6	3.0	1.8	1.6	1.1	1.4
Consumption	1.2	1.3	4.0	0.4	0.3	2.0	1.5
Government	1.5	2.9	1.8	1.8	1.2	1.4	3.2
Investment	3.3	0.7	9.2	2.3	-1.6	-4.5	0.7
Exports	3.6	2.6	1.3	7.2	3.8	2.9	2.9
Imports	4.8	1.3	8.7	2.2	0.8	-1.6	2.1
CPI (% YoY)	5.0	3.8	3.9	5.2	4.5	4.7	4.3
Selic rate (eop)	15.00	12.50	11.50	15.00	15.00	15.00	13.50
Unemployment rate	6.0	6.4	6.7	5.6	5.5	6.4	6.3

China

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Horse sense

The New Year for China (the year of the fire horse) has started and yet again it promises to be an interesting one. In a world that is characterized by constant geopolitical and economic upheaval, we expect that Beijing will continue to use its horse sense while navigating its course through potentially choppy waves. While China will continue to face the existing challenges that we have often discussed during past years, the first choppy wave that could rock the boat are new threats from the US to impose tariffs of 25% on countries that continue trading with Iran. This significantly increases the risk that the trade truce between China and the US will be upended.

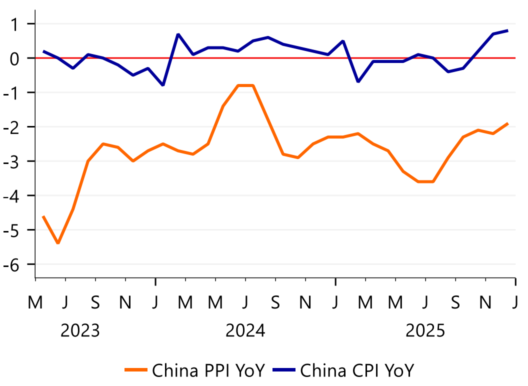
As we have also discussed previously, this should not be too much of a surprise. The trade policies form the current White House have been quite erratic, and as such we have always considered the intermediate deals between the US and China as fragile at best. But the erratic nature of the current US administration works both ways, meaning that Trump could very well 'TACO' again as it did before during its dealings with China. Unlike many other countries that have bent or bowed to Trumps demands, China has remained unfazed. The reason is clear, China – to speak in the words of Trump – actually holds important cards. China's near-monopoly in mining and processing of rare earths that are necessary for the tech- and defence sector provides China with important leverage for at least the foreseeable future.

Moreover, the current (trade) policies of the current US administration drive several countries away from the US and towards China. Canada is a noticeable example of this trend. At the moment of writing Mark Carney is about to make the first official visit by a Canadian leader in eight years.

The potential impact is at least twofold. First, it will severely hamper US efforts to form a Western block to counter China's trade practices, which the US (and an increasing number of other countries) regard as unfair. Something that Treasury Secretary Bessent has said was one of the goals of the current administration in order to force China's hand to adjust its trade practices.

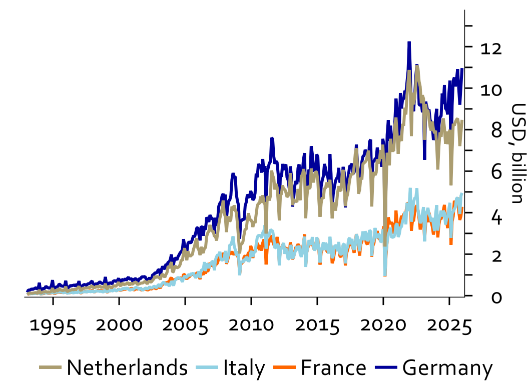
Secondly, it provides an incentive for countries (including traditional US allies) to increase trade with China. This could create win-win situations for these countries and China, since the latter is also seeking for alternatives to compensate for lost exports towards the US. Given the above, China's gains are not limited to economics, but may also strengthen China's geopolitical position and influence. China's exports to- and China's trade surplus with EU member states continued to grow during 2025.

Figure 1: Deflationary pressures are likely to persist despite the recent uptick in inflation.



Source: Macrobond

Figure 2: China's exports to EU member states continued to rise during 2025.



Source: Macrobond

Hold your horses!

Looking at inflation data the latest inflation figures showed a sharp uptick in inflation. Inflation went up to 0.80% YoY in December while November data came in at 0.70% YoY. The last time that CPI data came in at 0.7% YoY was in February 2024 and the last time inflation was above 0.8% was in February 2023. The reasons for these low levels of inflation are a combination of several factors.

As we discussed before, oversupply combined with ongoing declining real estate prices, suppressed levels of consumption and wage growth losing steam are the most important factors. Looking at the causes of this uptick in inflation we see that the two main product categories that contributed to consumer price growth are food and services. The question that arises is whether the most recent inflation figures indicate that the days of low levels of inflation are now behind us. We think it is way too early to make this call and on the contrary, think that inflation figures are likely to drop again in the near future First of all, food prices are volatile and are as such are not a good indicator for long(er) term trends like the factors we mentioned above. Furthermore, the PPI data indicates ongoing price pressures in the manufacturing sector that are yet to be passed through to consumer prices as can been seen in figure 1.

Backing the wrong horse?

Turning to the FX front we have witnessed a stronger-than-expected appreciation of the renminbi vis a vis the dollar. While our forecast had predicted the right direction, USD/CNH declined significantly more than we anticipated with a 2.26% fall since the start of November at the moment of writing. One of the reasons is that the PBOC lowered its main policy rate (7-day RRR) less than we expected. The PBOC had less incentives to lower interest rates because the economy continued to perform quite well, especially exports performed much better than we predicted.

This leads us to review our USD/CNH forecast although we do think chances that the currency pair will experience a rebound have increased because of the fast pace of the appreciation vis a vis the dollar. However, our main argumentation outlined in our FX special let's see what happens still stands. Given this thesis and the argumentation above, we expect USD/CNH to show a rebound during the first quarter of this year to a level of around 7.05 after which we do expect the renminbi to strengthen again towards 7.00. From this perspective we continue to think we are backing the right horse.

This forecast remains heavily reliant on our assumption that the trade truce between the US and China will hold until November this year. Furthermore it hinges on our assumption that China is becoming more serious when it comes to stimulating domestic demand and that China will continue to experience at least some pressure from its trading partners to rebalance trade and increase its imports. The fact that China's imports in December rose significantly more than market expectations (5.7% YoY vs 0.90% expected) seems to back our assumption but of course it remains to be seen if at the end of this year, we indeed not backed the wrong horse.

Table 1: Economic forecasts

	2025	*2026*	*2027*	*Q1/26*	*Q2/26*	*Q3/26*	*Q4/26*
GDP	4.9	4.6	4.2	1.4	1.2	1.0	1.0
CPI (% y/y)	-0.2	0.2	0.3	0.1	0.2	0.2	0.2
Unemployment (Urban %)	5.20	5.30	5.40	5.30	5.30	5.30	5.30
PBOC 7-day RRR (%)	1.40	1.20	1.00	1.40	1.30	1.30	1.20
USD/CNH	7.00	7.00	6.95	7.05	7.00	7.00	7.00

Source: RaboResearch

Australia

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State of play

As we enter 2026 the Australian market is again focused on inflation pressures. The Reserve Bank of Australia cut the cash rate three times in 2025 (February, May & August) to reach the current level of 3.60%. However, monthly inflation readings for the month of July onwards (Figure 1) have shown an acceleration in price growth as household spending drove an acceleration in overall economic growth.

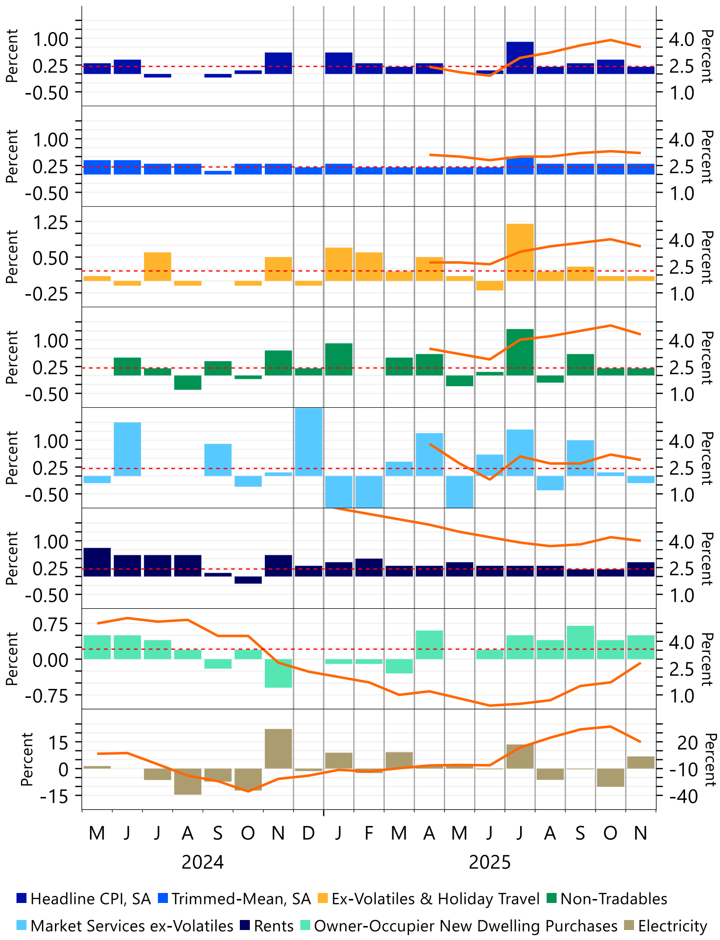
Growth in demand was running at 2.1% YoY as at the end of Q3 2025. The RBA believes that the 'potential' growth rate – the maximum rate at which the economy can grow without experiencing an acceleration in inflation – is about 2% p.a.

Since the potential growth rate cannot be directly observed, it must be inferred by movements in other indicators.

The blip up in inflation in the second half of 2025 is supportive of the RBA's view that the economy may now be growing at an unsustainably brisk rate. However, a weakening trend in the jobs market as growth in the labour supply outstrips growth in employment presents an argument that the potential growth rate of the economy may be higher than the RBA's estimates.

This is a view that RaboResearch subscribes to.

Figure 1: Monthly CPI inflation, selected indices



Source: ABS, RaboResearch
Notes: Coloured columns denote MoM price changes (LHS), orange lines denote YoY price changes (RHS), red dashed line denotes MoM rate consistent with CPI at target (0.21% MoM).
**Please note y-axis changes for electricity pane.

Outlook for interest rates

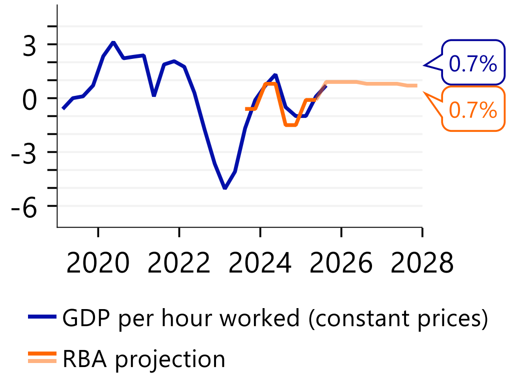
The recent rise in inflation has prompted a sharp upward repricing in market expectations for the future path of the RBA cash rate. At time of writing, the market-implied probability of a 25bp rate hike by the RBA at its meeting on the 3rd of February is 27%. A 25bp rate hike is fully priced in to market expectations by the August RBA meeting, with an additional 25bp hike by year-end priced at an approximately 50-50 chance. The December labour force report due out on January 22nd and – especially – the December quarter CPI inflation report due out on January 28th will be critical in firming up market expectations of the RBA's actions at the February policy meeting.

Recent comments from RBA Deputy Governor Hauser that the "likelihood – at least in the near-term – of further rate cuts is probably very low" notwithstanding, RaboResearch maintains an out of consensus forecast for the next movement in the RBA cash rate to be down rather than up. We do agree with Hauser that this is unlikely to occur in the near-term, and we therefore project a final 25bp cut to the cash rate to occur no earlier than the May RBA meeting.

Our more dovish view on interest rates is predicated on two things:

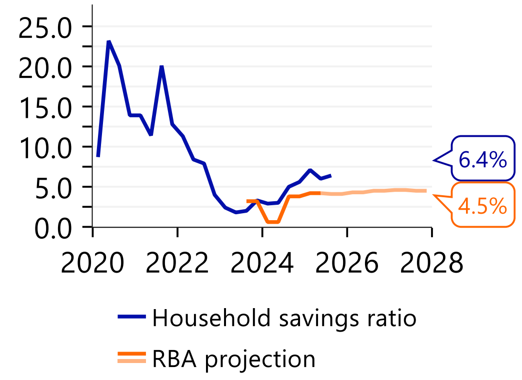
1. We are more optimistic about the recovery in productivity growth than the RBA appears to be.
2. We believe there are reasons to believe that monetary policy is currently still slightly restrictive. It therefore stands to reason that that restrictiveness will at some point be removed.

Figure 2: Australian labour productivity growth



Source: ABS, RBA
Note: Figure is for year-on-year growth

Figure 3: Australian household savings ratio



Source: ABS, RBA

Labour productivity in Australia has begun growing again after a period of decline. Labour productivity is measured by GDP per hour worked. With GDP likely to grow even more quickly in the months ahead, and growth in total hours worked slowing since January, it is likely that Australia will see a mechanical lift in the rate of labour productivity growth.

Falling net inward migration is also resulting in slower growth in the labour force which ought to give still robust business investment an opportunity to increase the capital stock per worker – further boosting productivity growth. This is especially the case as past investments in AI technologies become more integrated into business processes.

In terms of financial conditions, the household savings ratio and the AUD trade-weighted index both currently exceed the RBA's forecasts issued in November. Australian credit spreads remain tight, but Australian bonds and equity markets have underperformed global peers. Momentum in house price growth appears to be waning as borrowers fret over potential rate rises, which has also been reflected in the stalling recovery in consumer confidence.

Table 1: Economic forecasts

	2025	*2026*	*2027*	*Q1/25*	*Q2/25*	*Q3/25*	*Q4/25*
GDP	1.9	2.3	2.3	0.3	0.6	0.7	0.6
Consumption	2.0	2.3	2.3	0.4	0.9	0.6	0.6
Business investment	1.0	2.0	2.0	-0.7	0.1	0.4	0.5
Government	3.4	2.3	2.3	0.3	1.0	0.7	0.6
Export	2.2	3.7	2.3	-0.7	1.7	2.1	1.4
Import	2.4	3.8	2.4	0.1	1.4	1.1	1.1
CPI, % y/y	2.8	3.1	2.5	2.4	2.1	3.2	3.6
Unemployment rate	4.2	4.4	4.5	4.1	4.1	4.3	4.4

Source: RaboResearch

Forecasts

Table 1: Economic Forecasts

	2025	2026	2027		2025	2026	2027
United States				**Eurozone**			
GDP growth	2.1	1.8	1.7	GDP growth	1.4	0.9	1.2
Inflation rate	2.9	2.9	2.5	Inflation rate	2.1	1.9	2.0
Unemployment rate	4.2	4.6	4.5	Unemployment rate	6.3	6.2	6.1
China				**United Kingdom**			
GDP growth	4.9	4.6	4.2	GDP growth	1.4	1.1	1.3
Inflation rate	-0.2	0.2	0.3	Inflation rate	3.4	2.5	2.3
Unemployment rate	n/a	n/a	n/a	Unemployment rate	4.8	5.2	5.0
Brazil				**The Netherlands**			
GDP growth	2.2	1.6	3.0	GDP growth	1.7	1.3	1.3
Inflation rate	5.0	3.8	3.9	Inflation rate	3.0	2.4	2.0
Unemployment rate	6.0	6.4	6.7	Unemployment rate	3.9	4.1	4.3

Source: Rabobank

Table 2: Swap rate forecasts

	15 Jan	3M	6M	12M		15 Jan	3M	6M	12M
USD					**EUR**				
Fed funds target	3.75	3.50	3.25	3.00	ECB depo rate	2.00	2.00	2.00	2.00
SOFR	3.65	3.50	3.25	3.00	ESTR	1.93	1.93	1.93	1.93
3m Libor	3.67	3.53	3.28	3.03	3m Euribor	2.02	2.10	2.16	2.12
2y swap	3.36	3.20	3.10	3.00	2y swap	2.24	2.15	2.20	2.35
5y swap	3.48	3.25	3.20	3.15	5y swap	2.51	2.45	2.45	2.55
10y swap	3.81	3.65	3.65	3.75	10y swap	2.85	2.80	2.80	3.00
30y swap	4.16	4.00	4.00	4.10	30y swap	3.14	3.15	3.15	3.40
CAD					**GBP**				
Overnight target	2.25	2.25	2.25	2.25	Base rate	3.75	3.50	3.25	3.25
3m CORRA	2.25	2.25	2.25	2.25	3m term SONIA	3.70	3.40	3.25	3.25
2y swap	2.44	2.44	2.36	2.29	2y swap	3.45	3.40	3.30	3.30
5y swap	2.73	2.66	2.62	2.58	5y swap	3.60	3.60	3.50	3.40
10y swap	3.11	3.09	3.09	3.17	10y swap	3.94	3.80	3.70	3.60
30y swap	3.49	3.45	3.45	3.53	30y swap	4.41	4.30	4.10	4.00
MXN					**BRL**				
Overnight rate	7.00	6.75	6.50	6.50	SELIC target	15.00	14.00	13.50	12.25
3m swap	7.01	6.61	6.36	6.36	3m	14.71	13.69	12.63	12.05
2y swap	7.07	6.54	6.29	6.63	2y swap	12.97	12.45	12.08	11.74
5y swap	7.55	7.28	7.23	7.98	5y swap	13.30	12.37	12.09	11.85
10y swap	8.00	7.87	7.86	7.83	10y swap	13.52	12.89	12.49	12.19
30y swap	8.36	8.21	8.19	8.14					

Source: Rabobank

Table 3: FX forecasts

	15 Jan	*3M*	*6M*	*12M*		*15 Jan*	*3M*	*6M*	*12M*
Majors					**Latin America**				
EUR/USD	1.16	1.16	1.17	1.18	USD/BRL	5.39	5.50	5.60	5.65
GBP/USD	1.34	1.32	1.31	1.33	USD/MXN	17.81	18.00	19.00	18.60
USD/JPY	158.7	150.0	148.0	145.0	USD/CLP	882	905	915	905
USD/CAD	1.39	1.38	1.41	1.40	USD/COP	3683	3795	3880	3930
AUD/USD	0.67	0.66	0.67	0.69	USD/PEN	3.36	3.35	3.40	3.40
NZD/USD	0.57	0.58	0.59	0.60	**Asia**				
EUR/CHF	0.93	0.92	0.92	0.94	USD/CNY	6.97	7.05	7.00	7.00
EUR/NOK	11.72	11.80	11.75	11.70					
EUR/SEK	10.70	10.80	10.70	10.50					
EUR/DKK	7.47	7.45	7.45	7.45					

Source: Rabobank

Table 4: Commodities forecasts

	Unit	*15 Jan*	*2026Q1*	*2026Q2*	*2026Q3*	*2026Q4*
Energy						
Brent	*USD/bbl*	64.36	60.0	57.0	57.0	59.0
WTI	*USD/bbl*	59.99	56.0	53.5	53.5	55.5

Source: Rabobank

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