Global Risks Outlook 2026: Cloudy With a Chance of Boom

MACRO STRATEGY | December 2025

Our Key Risks for the Year

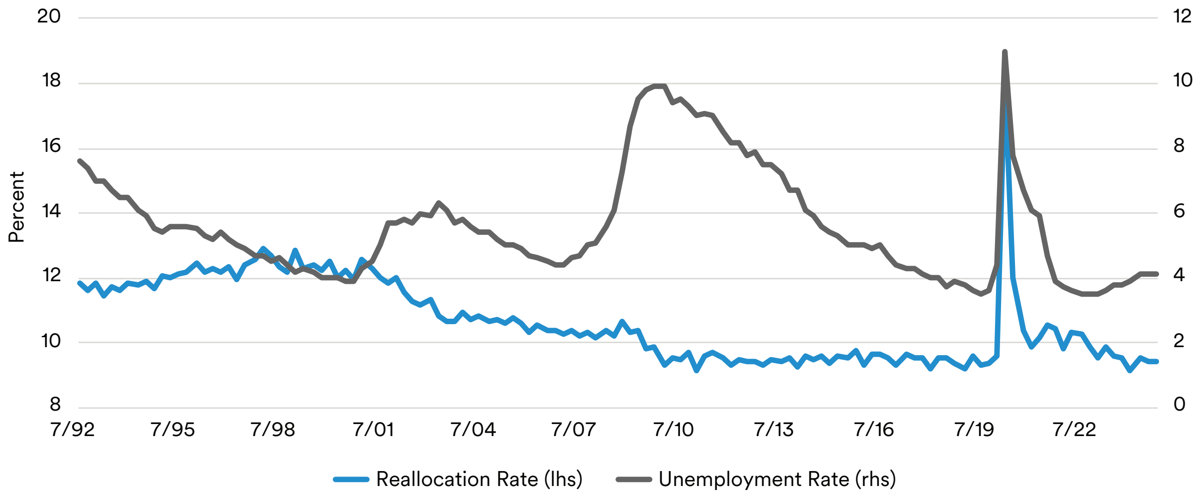
- Jobless Growth
- Trade Policy Resurgence
- Sugar High and Crash
- Geopolitical Tectonics

MetLife Investment Management

Risk: Jobless Growth and Calcification in the Labor Market

Investment-driven growth combined with labor market friction could mean that both sides of the Fed's mandates remain under threat throughout the year.

Figure 1 | Steadily Falling Dynamism in the Labor Market



Source: BLS, MIM. As of 12/7/2025.

In our base case, we expect the investment growth we saw in 2025 to continue into 2026, driven by AI as well as new rules about R&D expensing taking effect. Supply and demand for labor both fell in tandem in 2025, keeping the unemployment rate low. In 2026, we expect that balance to continue.

But the risk of labor market deterioration is heightened.

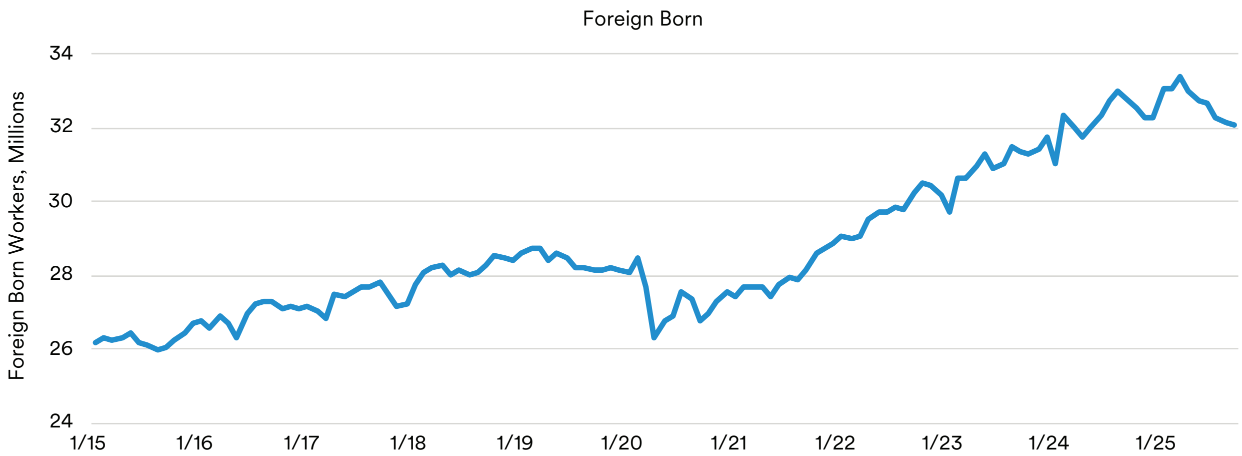
If 2026 is characterized by wider-spread adoption of AI across sectors, then we may see job losses from efficiency gains. Job openings in or using AI would likely increase, but we worry about a mismatch in skills between the job losers and the new jobs openings, which would be difficult to resolve in the near term. The structural mismatch is exacerbated by low labor market dynamism.

In a normal labor market, the impact of a spike in layoffs should be mitigated (to various extents) by workers getting re-hired at other firms. However, in the current environment, which we see continuing into next year, a spike in layoffs may result in an outsized increase in unemployment and a potentially longer recovery because firms are not hiring. Labor market dynamism, as measured by the labor reallocation rate, is likely to stay low.

We are also concerned about dislocations from tariff and immigration policies, which have influenced both the supply and demand of labor. A fuller reckoning may yet become clearer in 2026.

Under our base scenario, companies adapt to the current tariff reality and begin to make longer-term growth decisions, which would be positive for committing to new workers and expanding business. But if tariff policy volatility picks up again, businesses may once again feel the need to protect margins and suspend expansion plans.

Figure 2 | Number of Foreign-Born Workers



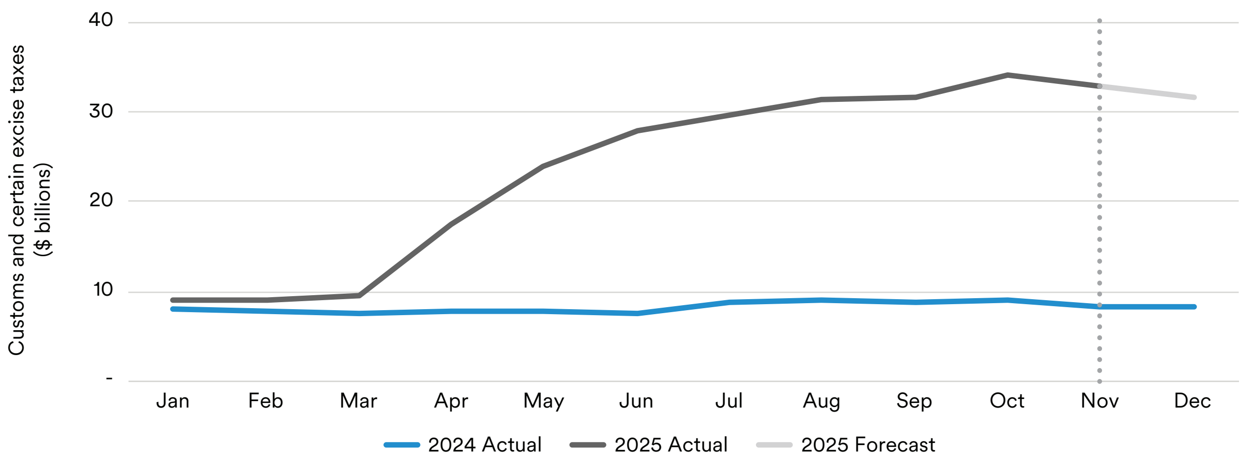
Source: BLS, MIM. As of 12/7/2025.

So far, more restrictive immigration policies have not upset labor supply and demand. Over the 12 months ending September 2025, 700,000 foreign-born workers have exited the labor force. Further declines in labor supply among foreign-born workers could upset the balance in the labor market if demand remains stable.

Risk: Resurgent Trade Policy Volatility

We expect trade policy volatility to continue to settle down, particularly given the upcoming midterm elections in the U.S. and their expected focus on inflation and affordability.However, we see material risks to this base case. The most significant question is likely the Supreme Court decision on IEEPA, with other risks coming from USMCA negotiations and general trade negotiations with other countries.

Figure 3 | Tariff Revenue



Note: Forecast based on average excess revenues versus 2024 tariff revenues.
Source: U.S. Treasury, Treasury General Account. As of 11/28/2025.

On IEEPA tariffs, we are less worried about the Supreme Court ruling against the Trump administration, given the administration's preparations to find alternative approaches. But if the Supreme Court rules in Trump's favor, it could result in a qualitative shift in trade policy with tariffs going from a tool of economic regulation to a tool for geopolitics. The historical linkage of tariffs to taxation has enabled a pro-free-trade slant to U.S. commercial policy. If that link is broken, current and future administrations may have free reign to shift away from global trade and subordinate commerce to geopolitics.

There is also the possibility for a ruling that is neither a decisive win for the Trump administration nor for the plaintiffs, but rather something in between. For example, SCOTUS could broadly permit some kind of tariff-like barrier by the executive branch but not the exact approach that is currently being carried out. Or they could let the tariffs stand and force Congress to explicitly take back powers it has delegated to the executive.[1]

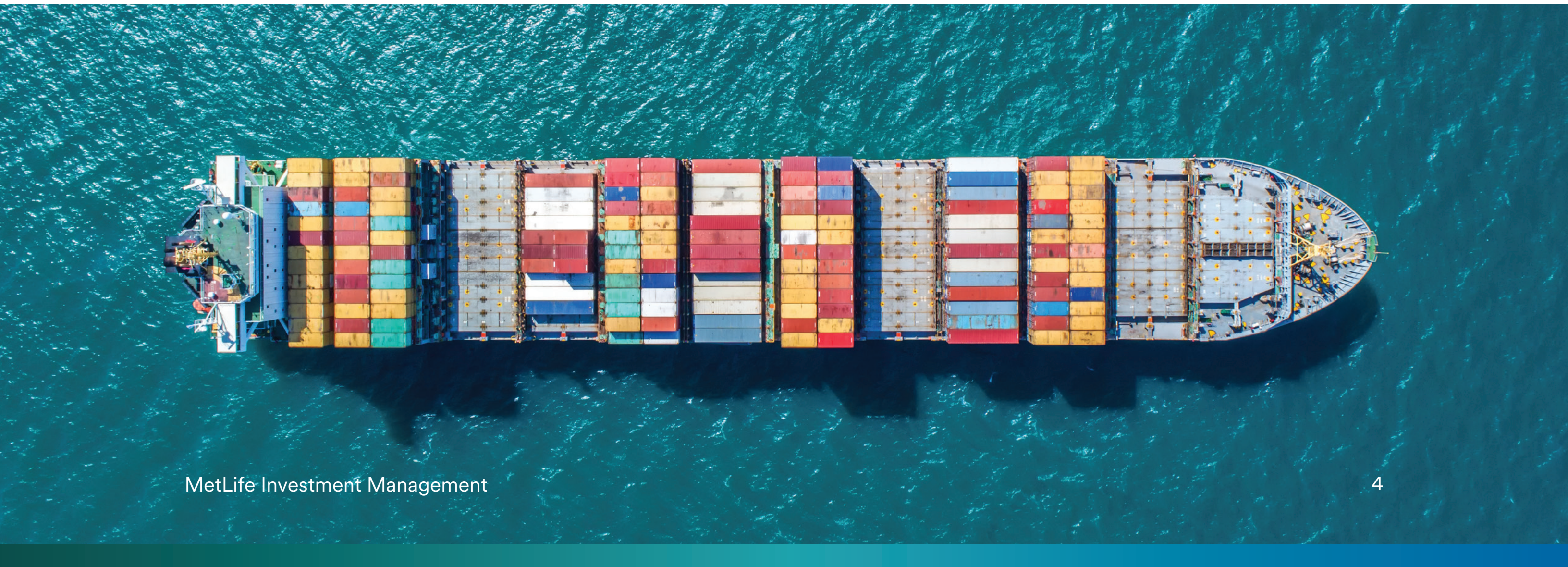
A less consequential, though still relevant, risk for the U.S. is the USMCA extension. We expect that most of the risk is in a positive direction. The Trump administration has already injected substantial uncertainty into the U.S.-Canadian (and Mexican) relationship, where effectively none had existed. If this is resolved with an agreement over USMCA extension, it would herald a reduction in uncertainty. If it is not, there remains a likely scenario that a future administration would have a more sanguine view of the U.S.-Canada relationship and would negotiate it to a new settled agreement.

More broadly, the Trump administration continues to engage in negotiations with U.S. trade partners. That is, the trade war is not over, despite the sense that policy volatility has decreased. Companies — aside from AI-related companies — have “learned to weather the uncertainty” by basically doing nothing. Roughly two-thirds of nonresidential fixed investment in the first half of 2025 was concentrated in AI. Broadening of investment activity is likely dependent on the continued perception that trade policy volatility remains within acceptable bounds for firms.

For Europe, we expect that the sharply higher U.S. tariffs on imports from the EU and U.K. will be a mild drag on Europe’s growth performance next year, largely offset by a stabilization of confidence, the lagged tailwind to growth from monetary policy easing cycles and, in the euro area, the first full year of Germany’s expansionary fiscal policy.

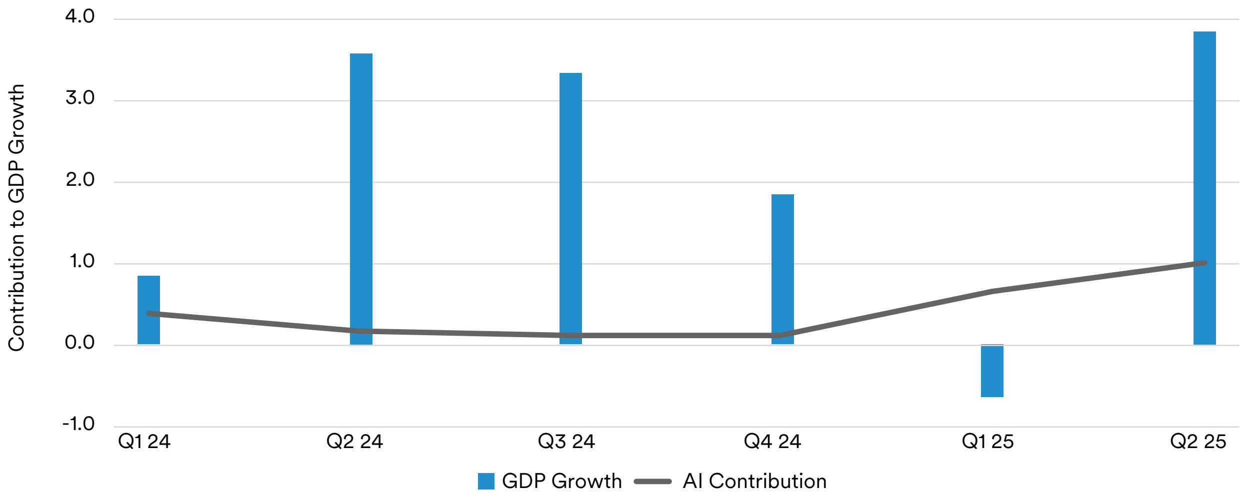
However, the potential for trade tensions with the U.S. to reemerge is a key downside tail risk to Europe’s growth outlook in 2026. Triggers for renewed tensions could include unfavorable outcomes of section 232 investigations into important export sectors for Europe (e.g., non-generic pharma, chemicals, etc.) or the U.S. abandoning its support for Ukraine in its ongoing war with Russia. A key reason for the lack of European tit-for-tat responses to higher U.S. tariff rates in 2025 was the continent’s desire to keep the U.S. on side in that conflict. Should the U.S. unilaterally decide to pull back on its support for Ukraine, European governments may well calculate that they can afford to be more aggressive in their response to U.S. trade policies.

There are also trade risks around the U.S.-China relationship, which we discuss in the last section of our piece.



Risk: Legs to the AI Boom and a Possible Fed Hold

Figure 4 | GDP and Data Centers



Note: AI contribution uses investment in software plus data center construction as a proxy.
Source: U.S. BEA, MIM. As of 11/21/2025

Risks Around AI

In the first half of 2025, U.S. GDP growth was heavily dependent on AI investment — nearly half of the 1.6% average growth rate of H1 2025 could be attributed to AI.[2] We expect 2026 to see the trend continue, with some moderation in both AI investment growth and GDP growth.

An upside risk to our GDP forecast is the possibility of a continued acceleration in investment. Given recent GDP levels, each $29 billion of true value-added capital investment would lead to 0.1% of GDP growth. Projections of CapEx spending on AI in 2026 have been rising and could continue to do so throughout the year.

A key risk that would emanate from this is electricity usage and its potential for raising inflation in a destabilizing way. AI is currently pressuring the electricity grid in places; if this becomes more widespread in 2026, it could have significant political consequences as households are extremely sensitive to electricity prices and its effect on utility bills. This could result in inflation or regulatory measures.

Risks Around a K-Shaped Recession

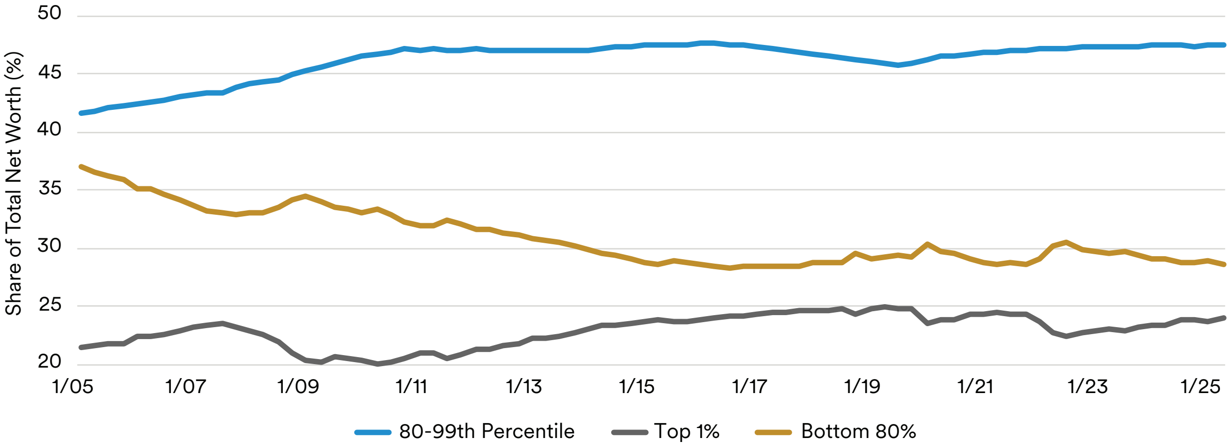
We expect moderate consumption growth in 2026. We see the risks to this view as balanced but substantial on either side.

Risks to the downside include an equity market crash or housing price declines, which would disproportionately hit that 20% of consumers that have been supporting growth for a few years now. Labor market deterioration would hurt consumption, with AI hurting white collar workers more than in a more conventional downturn.

Risks to the upside rest on the continued resilience of the consumer. The shift toward a K-shaped economy dates to the post-GFC era. Since that time, there has been no recession other than an extremely brief one induced by the pandemic. It's possible that consumer spending that relies on a narrow, less economically vulnerable, cohort of people is slightly less likely to fall into a recession because fewer consumers need to be happy to keep spending.

This, of course, sets aside questions of whether this is a desirable, sustainable or politically stable arrangement in the long term.

Figure 5 | Net Worth Distribution



Source: Federal Reserve, Census Bureau, BLS, MIM. As of 12/4/2025.

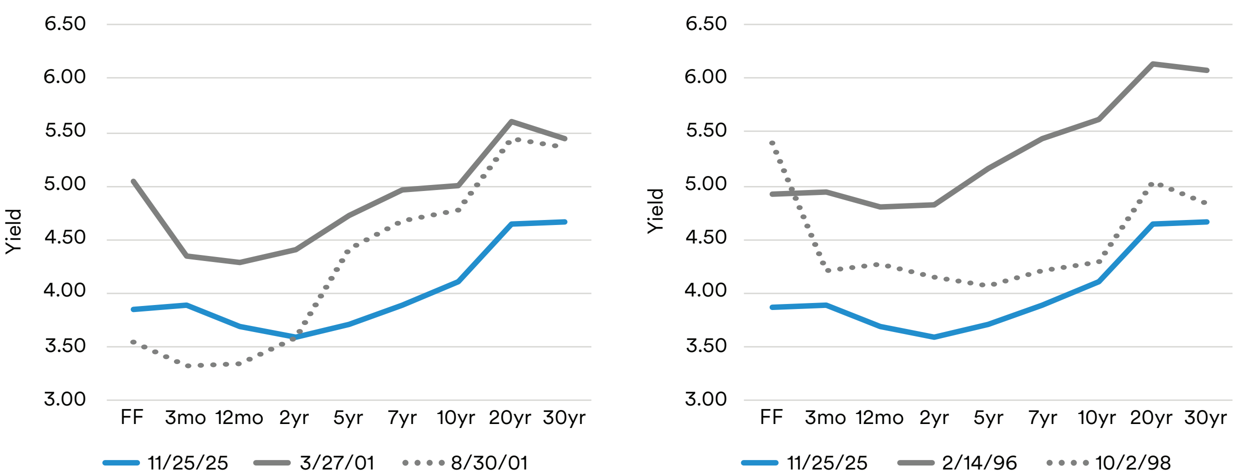
FOMC Risk: Yield Curve Is Positioned for Fed Funds Cuts That Never Happen

We expect the U.S. yield curve to continue to normalize during 2026 as the Fed cuts four more times by year-end 2026.

We see risks tilted toward fewer cuts. While larger rate cuts — or even a recession — are possible, we believe the consumption and investment risks noted above tilt the overall balance toward fewer rate cuts. Additionally, there are inflation risks stemming from the One Big Beautiful Bill Act (OBBBA), which is expected to provide stimulus via larger-than-expected tax rebates.

Our base case is for a situation similar to that of March 2001. The yield curve at that time was similar to the current yield curve. In 2001, the Fed was already in a cutting cycle and continued to cut. However, the current (Q4 2025) yield curve has so far also resembled the July 1996 yield curve. Markets also expected rate cuts then, but they did not take place for another two years.

Figure 6 | Yield Curve Waterfall



Source: Macrobond, MIM, as of 11/25/2025.

Risk: Geopolitical Tectonics

U.S.

Our expectation is for a less active, more gridlocked, U.S. economic policy in 2026. The most persuasive party on inflation control and affordability is likely to have control of the House after the midterms. This should provide some discipline on economic policy. We already see some jockeying among Republicans for the post-Trump future, which may constrain the Trump administration's hand as others seek to press their case.

Off-base-case risks to this are that U.S. economic policy volatility rises again, and the Trump administration enacts more volatile economic policies. Principal among those would be a potential re-emergence of trade policy volatility (as noted above). Another risk is if the Supreme Court permits the firing of Federal Reserve Governor Lisa Cook, which could pave the way for the firing of any Fed governors that oppose presidential views on monetary policy. Inflation expectations would likely rise sharply in response, along with yields at the back end of the yield curve.

Markets are expecting a more favorable regulatory environment, one of President Trump's key unfulfilled campaign promises. Failure to follow through on this — or indeed, if the administration increases regulatory burdens — is a negative risk. Given the administration's enthusiasm for getting involved in market mechanisms, we believe regulatory risks may be underestimated.

Europe

MIM's base-case expectation is that, despite ongoing U.S. efforts to broker a settlement, the Ukraine-Russia war will continue through 2026. However, there are tail risks that a settlement will be imposed on Ukraine, or Russia effectively wins through military means. That would likely drive global energy prices lower, as markets anticipate some loosening of sanctions on Russia's energy exports. It would also raise the potential for further interest rate cuts from the ECB (which our base-case forecasts assume will remain on hold in 2026) and the BoE (where MIM forecasts the Bank Rate to reach 3.25% by mid-year). Finally, there would be additional pressure on European governments to accelerate defense spending to counter an emboldened Russia and compensate for weaker confidence in the post-WW2 western alliance as the role of the U.S. as a reliable ally erodes further.

U.S.-China Tensions

Our baseline is for the U.S.-China "fragile truce" to remain in 2026, given the mutual interest in keeping relations on track. Planned meetings between Trump and Xi next year are seen as an anchor and incentive to maintain dialogue toward a yet undefined deal, while avoiding worst-case outcomes. The potential disruptors to our baseline are lack of follow-through on the Busan agreements, including poor progress on the fentanyl issue or disagreement around China rare earths and U.S. tech export restrictions.

Over the next few years, we anticipate continued medium-to-high intensity "gray zone coercion" by China against Taiwan, without escalation to full conflict. Gray zone tactics blur the line between war and peace, using non-military, ambiguous, and incremental measures to pressure Taiwan without crossing the threshold into open warfare. These tactics are designed to erode Taiwan's resilience, weaken its economic and political stability, and advance Beijing's strategic goals without triggering a U.S. or allied military response.

Beijing will likely leverage non-military tactics like incremental pressure and influence operations to shape Taipei's political and economic environment, especially given the upcoming January 2028 Taiwan general elections, which may see the return of the more China-friendly Kuomintang party (KMT). Although the risk of a hot conflict remains low over the next few years in MIM's view, gray zone tactics raise the risk of an accident and/or escalation (see Figure 7).

As highlighted in Figure 7, gray zone tactics such as civil exploitation warfare or maritime law enforcement heighten the risk of accidental collisions or miscalculations on the high seas. Cyber-enabled economic warfare targeting Taiwan's infrastructure could inadvertently affect U.S. or allied systems, prompting retaliatory measures. Military drills and coercive maneuvers intended as political signaling could be misread by Washington as pre-invasion staging, leading to force posture changes and a spike in tension. U.S. freedom-of-navigation operations and allied naval presence increase the complexity of interactions, making flashpoints harder to control.

Figure 7 | China's Gray Zone Toolkit

Gray Zone Tactics	Description	Potential Trigger of Accident and/or Escalation
Economic Pressure:	Trade and investment restrictions with Taiwan, targeted sanctions, supply chain leverage, restricting Chinese tourist travel to Taiwan.	Retaliatory measures by Taiwan or the U.S. could escalate into broader trade war
Civil Exploitation Warfare:	Influence through business networks and social organizations to advance the CCP's strategic goals in disputed areas — often under the guise of lawful behavior, e.g., using civilian-flagged vessels (e.g., fishing boats, dredgers, cargo ships) to conduct state-directed operations such as sabotage of undersea cables, all to escape accountability making retaliation diplomatically and legally difficult.	Exposure of covert influence could spark political backlash and diplomatic crisis
Maritime Law Enforcement:	Increased patrols and harassment in contested waters. A slightly more aggressive tactic directly employing the Chinese Coast Guard, to help normalize Chinese presence and erode Taiwan's jurisdiction in contested waters (patrols and blockades, boarding and inspections targeting Taiwanese fishing boats or supply vessels, use of non-lethal force (water cannons, ramming), all with a goal of enforcing de facto control over contested waters, but at the same time without triggering retaliation.	Accidental collision or misfire during close encounters with U.S./Taiwan vessels
Energy Vulnerability Exploitation:	Pressure on LNG and power imports. For example, China has illegally installed oil rigs and drilling platforms inside Taiwan's Exclusive Economic Zone (EEZ).	Disruption of energy shipments could lead to U.S. naval escorts and standoffs
Cyber-Enabled Economic Warfare:	Disruption of financial systems and critical infrastructure. China uses cyberattacks to disrupt Taiwan's financial services, energy imports and communications infrastructure.	Cyberattack spillover into U.S. or allied networks could prompt counter-cyber strikes
Political Warfare & Lawfare:	Legal challenges to Taiwan's sovereignty in international forums, e.g., Chinese sanctions on Taiwanese officials (and their family members).	Diplomatic retaliation could harden positions and trigger military signaling
Diplomatic/Digital Isolation:	Blocking Taiwan's participation in global platforms. Beijing's pressure on countries to avoid formal recognition or engagement.	U.S. countermeasures (e.g., high-level visits) could provoke PLA demonstrations
Psychological & Political Pressure:	Disinformation campaigns to erode public confidence. Cyberattacks, disinformation and military drills to wear down Taiwan's resolve and international support.	Exposure of foreign interference could lead to sanctions and military posturing
Intelligence Gathering & Mapping:	Persistent surveillance and data collection. Each incident reveals how Taiwan and its allies respond — how fast they repair, what backups they use, and how they communicate. This helps China map vulnerabilities and refine its strategy for a potential full-scale conflict.	Close-in ISR operations risk interception and escalation during air/sea encounters
Cultural & Identity Integration:	Promoting cross-strait cultural affinity narratives. China offers residence permits, ID cards and employment pathways to Taiwanese citizens, especially youth and academics. These measures aim to normalize cross-strait integration and subtly shift identity toward a shared "Chinese" future.	If linked to covert funding or influence, could trigger political scandal and hardline responses

Source: Rhodium Group, Atlantic Council, Eurasia, MIM as of December 2025.

Endnotes

1. [Guide to SCOTUS Tariff Ruling]
2. This includes a sharp and material increase in software investment and an extremely sharp increase, but still tiny contribution, of data center construction.

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