Vanguard

How will AI shape the economy and markets in 2026?

Vanguard's 2026 economic and market outlook: Global summary

We highlight the top-level findings of Vanguard's full economic and market outlook, including our 2026 economic forecasts, the prospects for economic growth and which asset classes we believe offer the strongest risk-return profiles.

Financial markets are exuberant and there are some good reasons for that. Despite megatrend headwinds in 2025 like demographic slowdowns and rising tariffs, economies held firm. US corporate earnings growth and fundamentals stayed strong, powered by artificial intelligence (AI) investment and other positive technology shocks.

Our data-driven megatrends framework shows these supply-side forces will shift again in 2026. How well AI investment will counteract negative shocks shapes our economic outlook. Over the next five years, we see an 80% chance that economic growth diverges from consensus expectations. These projections shape our investment outlook and offer somewhat unconventional - yet increasingly compelling - investment opportunities for increasingly frothy financial markets.

Vanguard's 2026 economic forecasts

Country / region	Growth	Core inflation	Policy rate (year-end 2025)	Policy rate (year-end 2026)	Key risk to our view
US	2.25%	2.6%	4.0%	3.75%	AI optimism collapses and investment buildout stalls
Euro area	1.0%	1.8%	2.0%	2.0%	Inflation materially undershoots the 2% target
UK	0.8%	2.6%	4.0%	3.25%	Fiscal sustainability concerns intensify
China	4.5%	1.0%	1.3%	1.2%	Technology innovation and investment accelerate

Notes: Forecasts are as at 20 November 2025. For the US, growth is defined as the year-over-year change in fourth-quarter GDP. For the euro area, the UK and China, growth is defined as the annual change in real (inflation-adjusted) GDP in the forecast year compared with the previous year. Inflation is core inflation and thus excludes volatile food and energy prices. For the US, the euro area and the UK, core inflation is defined as the year-over-year change in the fourth quarter compared with the previous year. For China, core inflation is defined as the average annual change compared with the previous year. For the US, core inflation is based on the core Personal Consumption Expenditures Index. For the euro area, the UK and China, core inflation is based on the core Consumer Price Index. For US monetary policy, Vanguard's forecast refers to the top end of the Federal Open Market Committee's target range. The euro area's policy rate is the deposit facility. The UK's policy rate is the Bank Rate. China's policy rate is the seven-day reverse repo rate.

Source: Vanguard.

Higher economic growth is on the horizon, particularly for the US

We anticipate that AI will stand out among other megatrends, given its capacity to transform the labour market and drive productivity. AI investment's outsized contribution to economic growth represents the key risk factor in 2026.

The ongoing wave of AI-driven physical investment is expected to be a powerful force, reminiscent of past periods of major capital expansion such as the development of railroads in the mid-19th century and the late-1990s information and telecommunications surge. Our analysis suggests that this investment cycle is still underway, supporting our projection of up to a 60% chance that the US economy will achieve 3% real GDP growth in the coming years; a rate materially above most professional and central bank forecasts.

But this future is not quite now. In 2026, the US is positioned for a more modest acceleration in growth to about 2.25%, supported by AI investment and fiscal thrust from the One Big Beautiful Bill Act. The first half of the year may be softer given the lingering effects of the stagflationary megatrend shocks of tariffs and demographics, as well as yet-to-materialise broad-based gains in worker productivity. The labour markets, which cooled markedly in 2025, should stabilise by the end of 2026, helping the unemployment rate to stay below 4.5%.

Economic growth is expected to keep US inflation somewhat persistent, remaining above 2% by the close of 2026. This combination of solid growth and still-sticky inflation suggests that the US Federal Reserve (Fed) will have limited scope to cut rates below our estimated neutral rate of 3.5%. Because of this view, our Fed forecast is a bit more hawkish than the bond market's expectations.

Given similar AI-related dynamics, our forecast for China's economic growth is also above consensus expectations in 2026. Despite ongoing external and structural challenges, real GDP growth is more likely to register 5% than 4%.

Conversely, our risk assessment for the euro area is more consensus-like given the lack of strong AI dynamics. We anticipate growth to hover near 1% in 2026, as the drag from higher US tariffs is offset by increased defence and infrastructure spending. Inflation should stay close to the 2% target, allowing the European Central Bank to maintain its current policy stance throughout the year. For the UK, we expect a downshift in growth to 0.8% in 2026, driven by tighter fiscal policy, as taxes rise to meet the government's fiscal rules.

A differentiated investment playbook

Our capital markets outlook differs across markets, asset classes and investment time horizons. Overall, our medium-term outlook for multi-asset portfolios remains constructive, with positive after-inflation returns likely to continue. In 2026, US technology stocks could well maintain their momentum given the rate of investment and anticipated earnings growth.

But let us be clear, risks are growing amid this exuberance, even if it appears "rational" by some metrics. More compelling investment opportunities are emerging elsewhere, even for those investors most bullish on AI's prospects. Our conviction in this view is growing and it parallels investment returns in previous technology cycles.

Our capital markets projections show that the strongest risk-return profiles across public investments over the coming five to 10 years are, in the following order:

1. High-quality fixed income.
2. US value-oriented equities.
3. Non-US developed markets equities.

We maintain our secular view that high-quality bonds offer compelling real returns given higher neutral rates. Returns should average near current portfolio income levels, representing a comfortable margin over the rate of expected future inflation. That's the primary reason why bonds are back, regardless of what central banks do in 2026. Importantly, fixed income should also

provide diversification in a world where AI disappoints, leading to lower growth; a scenario with odds that we calculate to be 25%–30%.

We remain most guarded in our assessment of US growth stocks, which admittedly have outperformed most other investments by an astounding margin. Yet as we will show in this outlook, our muted expected returns for the technology sector are entirely consistent with our more bullish prospects for an AI-led US economic boom.

The heady expectations for US technology stocks are unlikely to be met for at least two reasons. The first is the already-high earnings expectations, and the second is the typical underestimation of creative destruction from new entrants into the sector, which erodes aggregate profitability. Volatility in this sector, and hence the US stock market overall, is very likely to increase. Indeed, our muted US equity forecast of 4.2%–5.2% annualised returns (in GBP) over the next 10 years is nearly singlehandedly driven by our risk-return assessment of large-cap technology companies.

The history of investing during technology cycles reveals some counterintuitive, yet increasingly compelling, investment opportunities regardless of whether AI proves transformative or not. Both US value-oriented and non-US developed markets equities should benefit most over time as AI's eventual boost to growth broadens to consumers of AI technology. Economic transformations are often accompanied by such equity market shifts over the full technology cycle.

Overall, these three investment opportunities are both offensive and defensive. This risk assessment holds no matter whether today's AI exuberance ultimately proves rational or not.

Vanguard's global economics, markets, and portfolio construction teams

Joseph Davis, PhD, Global Chief Economist
Kevin Khang, PhD, Senior Global Economist

Americas
Roger A. Aliaga-Díaz, PhD, Chief Economist, Americas
Joshua Hirt, CFA, Senior US Economist
Adam Schickling, CFA
Halim Abourachid, MSc
Rhea Thomas
Kevin Zhao, PhD
Sarina Fard

Asia-Pacific
Qian Wang, PhD, Chief Economist, Asia-Pacific
Grant Feng, PhD, Senior Asia-Pacific Economist
Ashleigh Gunn

Europe
Jumana Saleheen, PhD, Chief Economist, Europe
Shaan Raithatha, CFA, Senior European Economist
Josefina Rodriguez, MSc
Aly Maghraby, MSc

Capital Markets Model Research Team
Qian Wang, PhD, Global Head of Capital Market Research
Kevin DiCiurcio, CFA, Head of Capital Market Research
Ian Kresnak, CFA
Lukas Brandl-Cheng, MSc
Amelia Sha, MBA
Alex Qu
Ben Vavreck, CFA

Asset Allocation Research Team
Roger Aliaga-Díaz, PhD, Global Head of Portfolio Construction
Giulio Renzi-Ricci, MSc, Head of Asset Allocation Research
Lucas Baynes
Maziar Nikpour, PhD
Ollie Harvey, MSc
Joana Rocha, MSc

CFA® is a registered trademark owned by CFA Institute.

Connect with Vanguard®

global.vanguard.com

IMPORTANT: The projections or other information generated by the Vanguard Capital Markets Model® regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results, and are not guarantees of future results. VCMM results will vary with each use and over time. The VCMM projections are based on a statistical analysis of historical data. Future returns may behave differently from the historical patterns captured in the VCMM. More important, the VCMM may be underestimating extreme negative scenarios unobserved in the historical period on which the model estimation is based.

The Vanguard Capital Markets Model® is a proprietary financial simulation tool developed and maintained by Vanguard's primary investment research and advice teams. The model forecasts distributions of future returns for a wide array of broad asset classes. Those asset classes include US and international equity markets, several maturities of the US Treasury and corporate fixed income markets, international fixed income markets, US money markets, commodities, and certain alternative investment strategies. The theoretical and empirical foundation for the Vanguard Capital Markets Model is that the returns of various asset classes reflect the compensation investors require for bearing different types of systematic risk (beta). At the core of the model are estimates of the dynamic statistical relationship between risk factors and asset returns, obtained from statistical analysis based on available monthly financial and economic data from as early as 1960. Using a system of estimated equations, the model then applies a Monte Carlo simulation method to project the estimated interrelationships among risk factors and asset classes as well as uncertainty and randomness over time. The model generates a large set of simulated outcomes for each asset class over several time horizons. Forecasts are obtained by computing measures of central tendency in these simulations. Results produced by the tool will vary with each use and over time.

The primary value of the VCMM is in its application to analysing potential client portfolios. VCMM asset-class forecasts—comprising distributions of expected returns, volatilities, and correlations—are key to the evaluation of potential downside risks, various risk–return trade-offs, and the diversification benefits of various asset classes. Although central tendencies are generated in any return distribution, Vanguard stresses that focusing on the full range of potential outcomes for the assets considered, such as the data presented in this paper, is the most effective way to use VCMM output.

The VCMM seeks to represent the uncertainty in the forecast by generating a wide range of potential outcomes. It is important to recognise that the VCMM does not impose "normality" on the return distributions, but rather is influenced by the so-called fat tails and skewness in the empirical distribution of modelled asset-class returns. Within the range of outcomes, individual experiences can be quite different, underscoring the varied nature of potential future paths. Indeed, this is a key reason why we approach asset-return outlooks in a distributional framework.

Investment risk information

The value of investments, and the income from them, may fall or rise and investors may get back less than they invested. Any projections should be regarded as hypothetical in nature and do not reflect or guarantee future results.

Past performance is not a reliable indicator of future results. The performance data does not take account of the commissions and costs incurred in the issue and redemption of shares.

Important information

This is directed at professional investors and should not be distributed to, or relied upon by retail investors.

This is designed for use by, and is directed only at persons resident in the UK.

The information contained herein is not to be regarded as an offer to buy or sell or the solicitation of any offer to buy or sell securities in any jurisdiction where such an offer or solicitation is against the law, or to anyone to whom it is unlawful to make such an offer or solicitation, or if the person making the offer or solicitation is not qualified to do so. The information does not constitute legal, tax, or investment advice. You must not, therefore, rely on it when making any investment decisions.

The information contained herein is for educational purposes only and is not a recommendation or solicitation to buy or sell investments.

Issued by Vanguard Asset Management Limited, which is authorised and regulated in the UK by the Financial Conduct Authority.

© 2025 Vanguard Asset Management Limited. All rights reserved. *2539_12/25*

Vanguard®

ISGVEMO 122025