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Marketing communication

The Great Global Restructuring

Understanding the new global axis

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The Great Global Restructuring

Introduction

In our previous paper, *Can American exceptionalism continue?*, we examined the structural and strategic foundations underpinning the United States' long-term economic growth and its uniquely shareholder-friendly environment. We identified a compelling formula for enduring success, driven by superior productivity, a culture of innovation and risk-taking, and a stable, predictable regulatory framework.

Collectively, these elements positioned the US as a dominant force in the global economy.

Building on those findings, we now explore the resilience and adaptability of that formula in a rapidly evolving global landscape – what we call the Great Global Restructuring.

The aim is to provide a nuanced perspective on whether the US can continue to deliver outsized returns and maintain its economic edge in a more contested and volatile global environment. We also broaden the lens to assess how those drivers are evolving across Europe, Asia and emerging markets to offer a comparative view of economic adaptability in a shifting global context.

What do we mean by the Great Global Restructuring?

As the world moves into an era marked by heightened geopolitical risk, growing trade and policy uncertainty and diminishing consensus on multilateral, rules-based institutions, we look at how these different forces interconnect and, importantly, what the outcomes could mean for investors.

Rapid advances in AI, alongside its effects on productivity and debt sustainability, set against a backdrop of shifting trade and capital flows, have implications for growth, inflation and the wider investment landscape.

We have gathered views from our equity and fixed income investment professionals, macroeconomists, and political economists to try to make sense of various parameters. The paper is structured into four chapters, each addressing a key dimension of the topic:

1. Productivity: an AI inflection point?

The diminishing influence of labour and capital as primary economic drivers has meant productivity becomes the fundamental key to growth. We discuss whether AI could become the next transformative force – on par with railroads, PCs, and the internet – and explore the balance between technological advancement and investment in the US and globally.

2. The current account: more than just trade

Trade and capital flows are inherently linked. Rebalancing the existing system will likely have multiple macroeconomic and market impacts. Shifts driven by US policies have already begun to take effect. We examine three such shifts underway that may provide clues to the potential impacts of current account rebalancing: repatriation of portfolio flows; shifting foreign direct investment (FDI) flows; and higher fiscal spending in non-US markets.

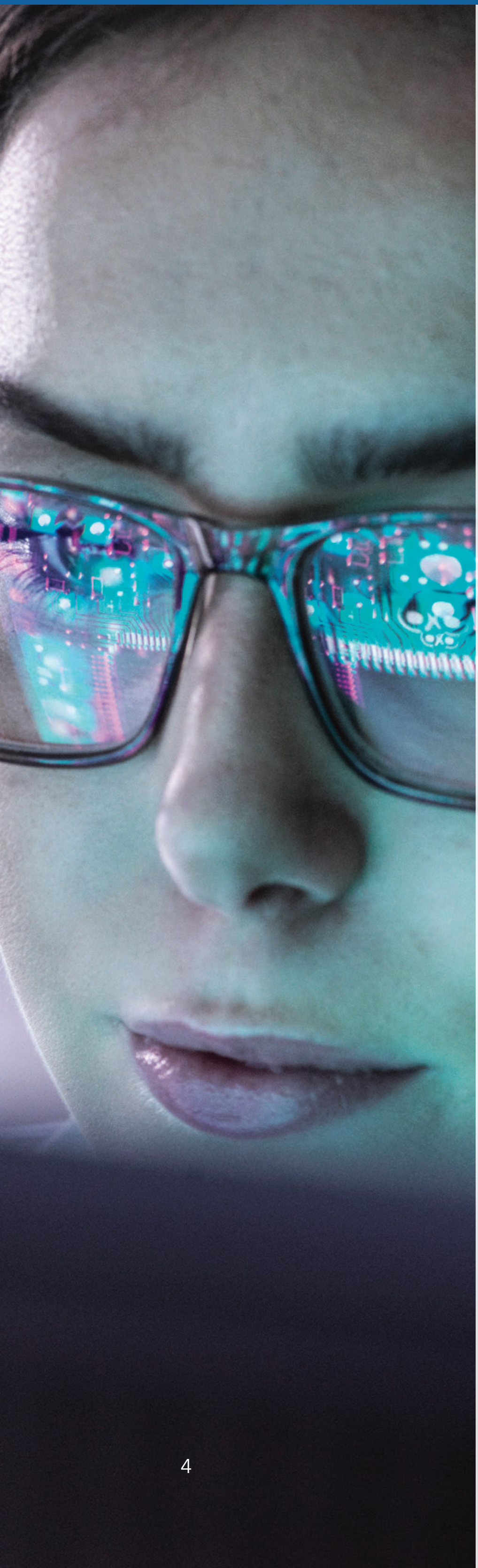
3. Debt sustainability and the US dollar's reserve currency status

Prolonged US economic strength has attracted the world's surplus savings. The US dollar's reserve status has further sustained these flows. As a result, a significant share of US financing has become largely insensitive to interest rate changes. We examine the scale of the budget deficit, explore potential policy levers to address the debt challenge, and consider whether there are viable alternatives to the US dollar.

4. Unlocking shareholder value in a changing regulatory landscape

Strong corporate governance and the rule of law are not just institutional virtues, they are investment imperatives. For decades, the US has set the benchmark by offering investors legal clarity, shareholder empowerment, and deep, liquid capital markets. We compare the US with emerging global competitors and assess the durability of its shareholder-friendly environment.

1 Productivity: an AI inflection point?



Key points

- The US has been the dominant force in global economic growth over recent years. This has been driven by a combination of superior productivity, a culture of innovation and risk-taking, and a stable, predictable regulatory framework.
- As the influence of labour and capital as primary economic drivers diminishes, productivity has become integral to growth. Looking forward, the key question is whether AI can become the next transformative force, on par with railroads, PCs, and the internet.
- Our view is that AI can become a transformative General Purpose Technology (GPT), reshaping industries and redefining productivity. Investors should pay attention to how the benefits from AI play out. Will it provide a broad-based boost to productivity or serve as a strategic advantage for certain countries? The most successful at harnessing the productivity gains from AI and other tech will define the ultimate winners and how economies evolve.

What to watch

- As with any new technology, there is a huge opportunity to invest in the companies that install the capacity to implement and power AI. At some stage that may pivot to the companies that actually use AI. History warns us that the market transition can be a painful dislocation.
- Technology, particularly AI, is displacing labour at an unprecedented rate risking massive disruption of the labour, and therefore consumer markets. Whether or not this eventuates will depend on the rate of investment into new AI-enabled jobs. Investors should watch investment rates carefully.

Introduction

In this chapter, we demonstrate that productivity growth is becoming more important in the growth of productive capacity than labour and capital due to aging populations and capital saturation. We also propose that Artificial Intelligence (AI) will be a critical factor in driving future growth and that this may be a particular advantage for countries that have invested in AI capabilities.

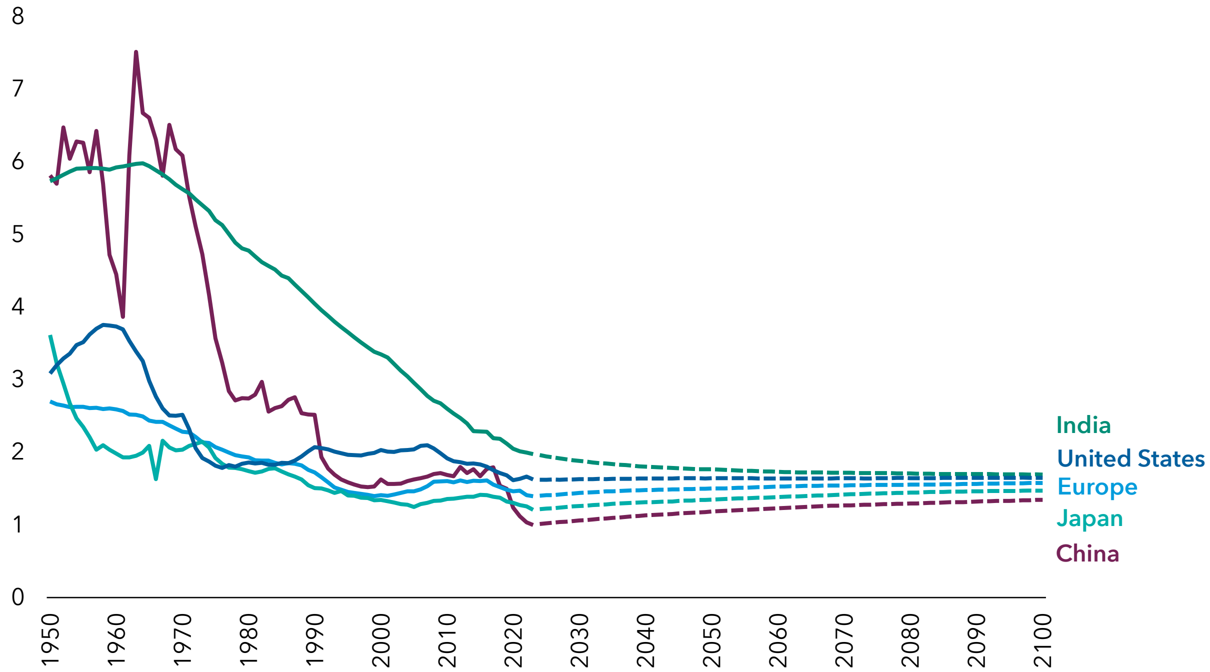
To better understand this perspective, it is helpful to frame the productive capacity of an economy as, firstly, its resources, i.e. labour (workforce) and capital (machines, factories, infrastructure, technology, etc.) and, secondly, its ability to generate income using those resources (productivity). In short, (labour + capital) x productivity.

Workforce and capital

Workforce

Demographics are the key driver for workforce growth. Fertility rates have been declining in many countries since the Second World War. There are multiple factors that are believed to contribute to this, including increased female education and labour force participation, lower child mortality rates, and rising costs of raising children. However, the bottom line is that as we get wealthier, we have fewer children.

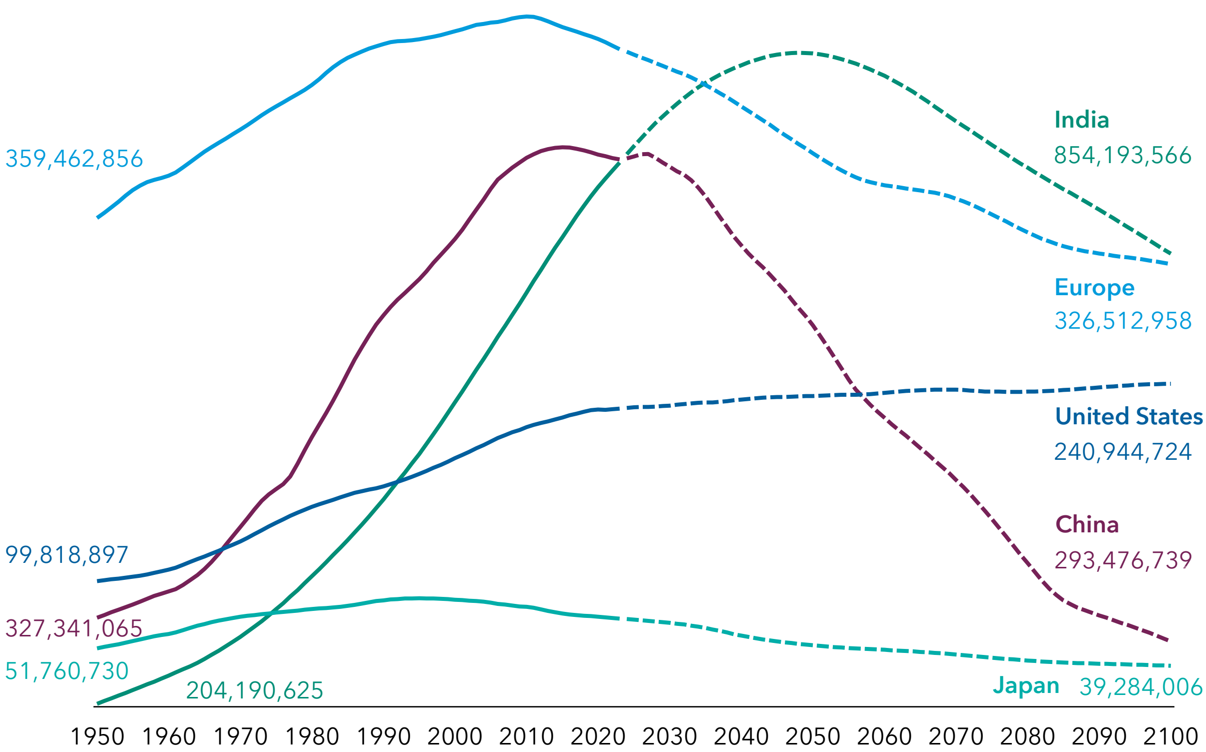
Fertility rate with projections (births per woman)



Forecasts are for illustrative purposes only.
Source: OurWorldinData.org. UN, World Population Prospects (2024)

A consequence of this is that most advanced economies are experiencing aging populations and, in some cases, shrinking workforces, which directly limits economic growth derived simply from a growing workforce. Emerging economies vary with some still enjoying growth in working-age population, which should be an economic tailwind (e.g. India), but others experiencing the same decline in workforce as advanced economies (e.g. China). However, the longer-term trends for emerging economies and advanced economies are ultimately the same.

Working age population (15-64 years)

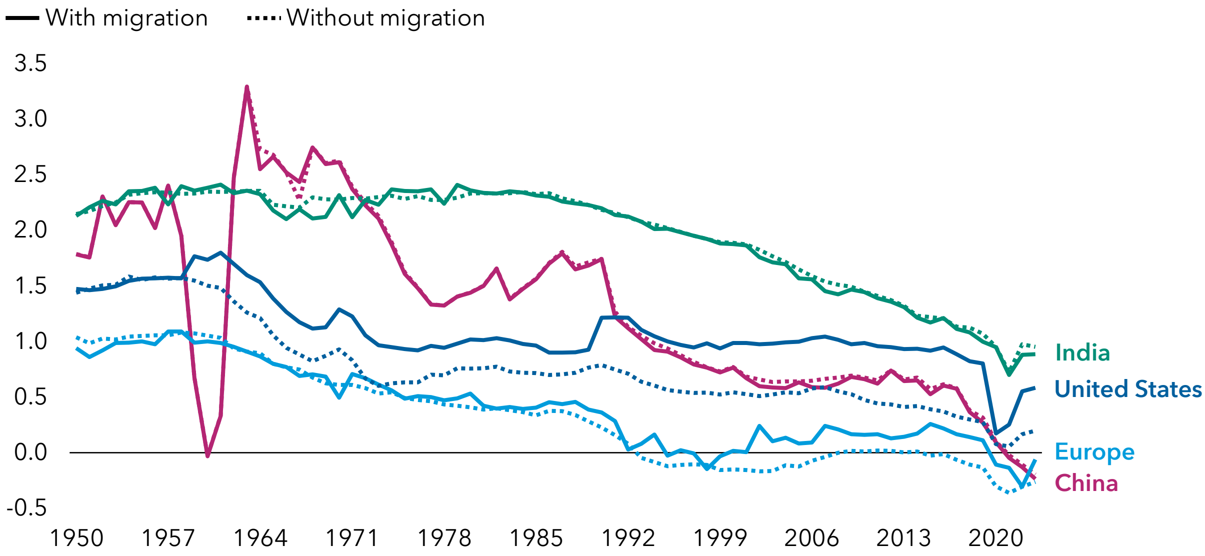


Forecasts are for illustrative purposes only.

Source: OurWorldinData.org. UN, World Population Prospects (2024)

Within this broader trend, there are some important nuances. Relatively speaking, the US has maintained a higher fertility rate than its main global peers, including China. In addition, the US has a strong track record of attracting immigrants and successfully integrating them into the economy, in stark contrast to other countries such as China and Japan, and even Europe. Political and social barriers will likely continue to limit the impact of immigration.

Population growth with and without migration (%)



As at 31 December 2023. Source: OurWorldInData.org. UN, World Population Prospects (2024)

All other factors being equal, this suggests that workforce growth is unlikely to be a significant factor in driving future economic capacity, although we do note that the US may continue to have a marginal advantage in this area relative to most other developed economies.

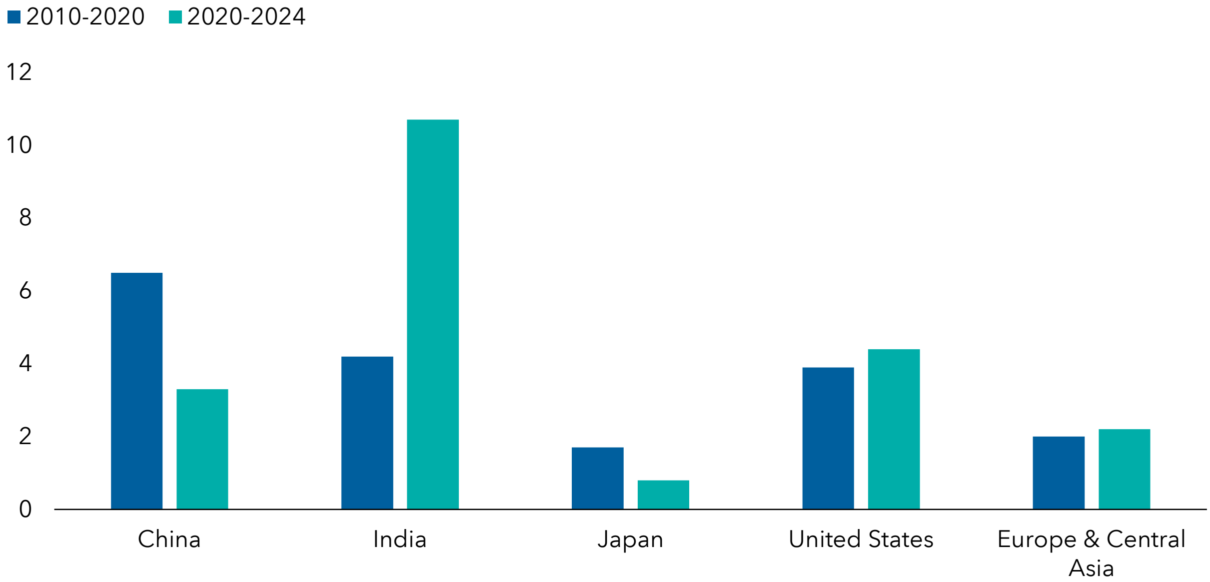
In short, advanced economies face either stagnant or shrinking workforces. Emerging giants like China could see their demographic boon turning to burden, while India's boom should continue for several decades.

Therefore, as labour supply growth wanes, improving the productivity of the workforce becomes paramount.

Capital

Capital refers to the stock of produced assets (machines, factories, infrastructure, technology, etc.) that workers use. Strong investment in capital goods can boost an economy's capacity, but only if those investments are productive.

Gross capital formation; average annual real growth (%)



Sources: Country official statistics, National Statistical Organisations and/or Central Banks; National Accounts data files, Organisation for Economic Co-operation and Development (OECD); Staff estimates, World Bank (WB). Gross capital formation includes acquisitions less disposals of produced assets for purposes of fixed capital formation, inventories or valuables. This indicator is expressed in constant prices, meaning the series has been adjusted to account for price changes over time. The reference year for this adjustment is 2015. This indicator is expressed in US dollars. World Development Indicators, updated 1 July 2025

The US has a strong track record in capital formation, benefiting from investment-friendly policies, deep capital markets, and huge pools of domestic savings (pension funds, etc.) which are funneled back into the economy. Much of this capital formation has been in higher return areas, notably technology, intellectual property and research & development. In addition, US firms are quick to redeploy capital from low to high return applications. This willingness to invest in innovation has expanded the US productive capital stock, underpinning its productivity growth.

In contrast, Europe has invested less than the US, with a lower proportion targeting higher productivity technology and intangible assets.

Japan has a large capital stock after decades of investment in the post-war period but, like its workforce, Japan's capital growth has slowed. Corporates often hold excess cash and have been cautious in capital spending since the 1990s stagnation. That said, Japan still invests significantly in automation and advanced manufacturing equipment, necessary moves given labour shortages. Capital efficiency in Japan is mixed, with certain sectors achieving world class productivity, such as automotives and electronics, while others are less productive, including utilities.

China has been the investment powerhouse for several decades, investing up to 40% of GDP into capital formation, primarily factories, real estate and infrastructure. Initially successful, diminishing returns have now set in, as evidenced by underused real estate and infrastructure. Note also that the capital allocation model has generally been state driven. Sometimes this has led to global dominance, e.g. solar panels and electric vehicles. However, this might also hinder the redirection of capital to more efficient and innovative uses.

Investment in India has been rising to around 30% of GDP, but the efficiency of capital use varies widely. There have been huge strides in digital infrastructure like mobile connectivity and digital payments, but there are also undercapitalised areas like farming and informal enterprises.

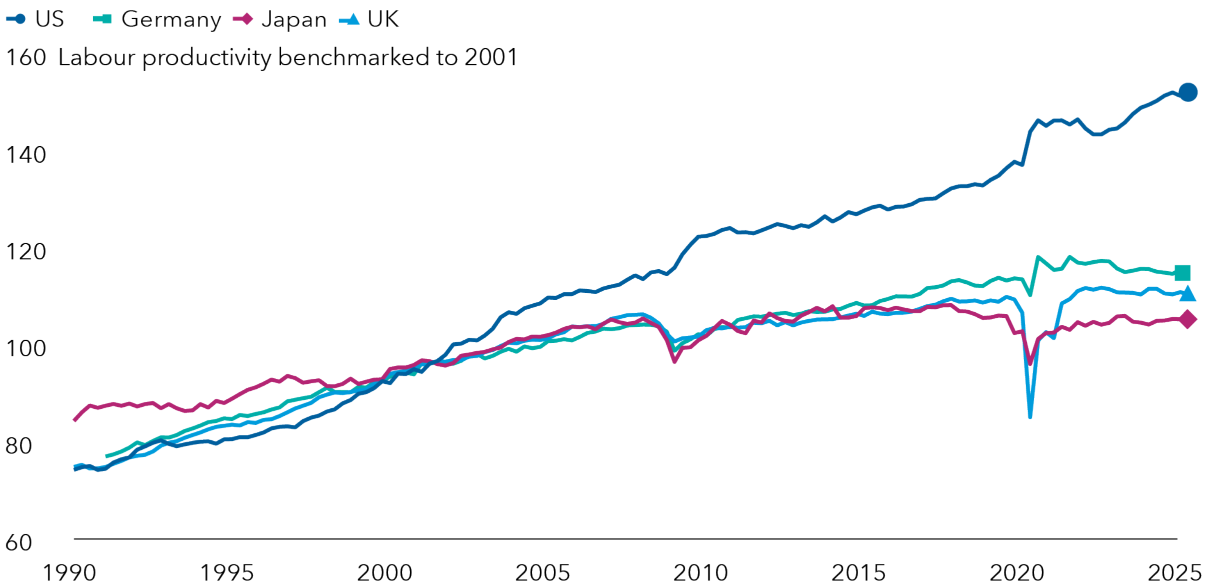
In short, it is not just how much a country invests, but also how well those investments are made. The US has led the world in capital quality and dynamism. Europe has an opportunity to catch up by funding its green and digital transitions, while Japan needs to invest in innovation to overcome labour deficits. China must improve capital efficiency as its prior model wanes, and India must build out infrastructure to unlock its demographic dividend.

Future productivity growth

Let us start with a brief reflection on historic productivity trends.

- **US.** The US has benefited from robust productivity growth since the late 20th century, with key enablers being innovation, rapid tech adoption, and flexible reallocation of labour and capital.
- **Europe.** Following the productivity boom of the 1960s, Europe has struggled with declining productivity, especially since the Global Financial Crisis. Reasons include lower investment in technology, structural rigidities in labour and product markets, and over-regulation.
- **Japan.** Japan had the highest productivity growth rates in the 1950-70s but has been persistently weak since then. While there remain strengths in manufacturing, Japan needs to invest in AI and digitisation to increase its productivity.
- **China.** China experienced spectacular productivity gains as it transitioned from an agrarian to a manufacturing economy. However, diminishing gains have now set in and future productivity growth will depend on innovation and efficiency improvements.
- **India.** After decades of low productivity, India has experienced improvements in the reform era starting in the 1990s, led by the IT sector and the digital leap that enabled internet use and digital ID. Further progress will depend on removing bureaucracy and reforming the rural economy.

The US has been the leader in productivity



As at 20 August 2025. Sources: Capital Group, US Bureau of Labor Statistics, European Central Bank, Japan Cabinet Office, UK Office for National Statistics, Haver Analytics.

Future productivity is likely to be shaped primarily by technological advancements, with AI at the forefront of the tech discussion.

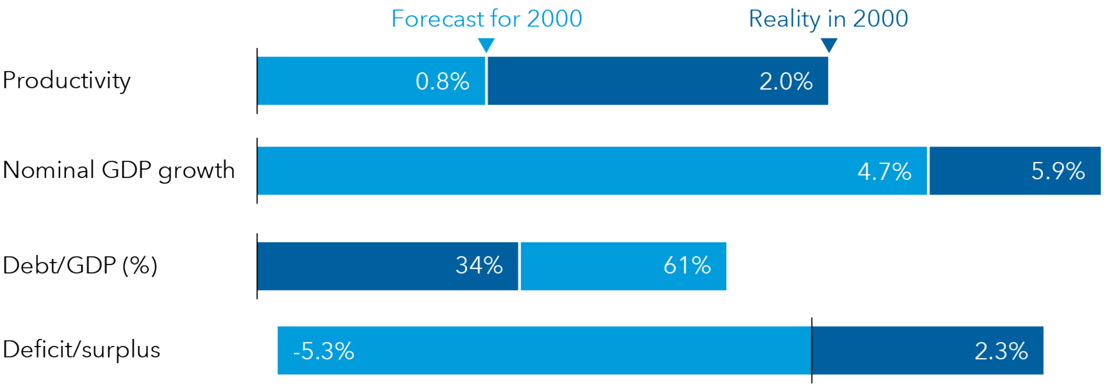
Artificial intelligence as a productivity driver

Throughout history, several technological breakthroughs have emerged as General Purpose Technologies (GPT), transforming multiple industries and substantially raising productivity across countries. For example, the steam engine revolutionised transportation and manufacturing, electricity transformed industry and households, the internal combustion engine again disrupted transportation, the semiconductor created computers, and the internet transformed all aspects of commercial and personal life.

A feature of all these technologies was that, while initial benefits accrued to the inventor and to countries with the capacity to invest in infrastructure, they eventually diffused throughout the global economy delivering gains to all. However, the rate of diffusion varied significantly according to technology and country.

Another feature of these technologies is that their ultimate impact was generally underestimated, as evidenced by the following case study of the personal computing (PC) revolution. Original estimates of productivity growth and other important economic measures were far too cautious compared to the gains that eventually materialised.

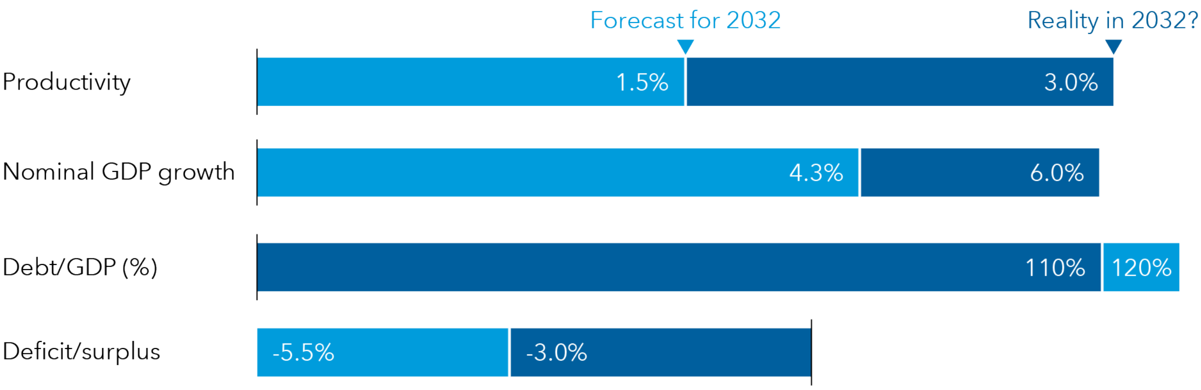
PC forecasts in 1993



Past results are not a guarantee of future results.
As at June 2025. Sources: Philip Laffont, CBO, OMB, Capital Group

A critical question is whether we are making the same mistake today. Transposing the margin of error from the 1990s to current estimates defines a scenario that would be positive for growth, and also have potential favourable impact on the debt trajectory for the US, and potentially other countries.

AI forecasts in 2025



Forecasts are for illustrative purposes only.
As at June 2025. Sources: CBO, OMB, Capital Group

To determine whether AI will have a similar impact, three key questions need to be addressed:

- Will AI drive productivity globally, or be concentrated in several AI winners?
- How will cultural and structural factors impact AI adoption?
- How will AI impact labour markets?

Will AI provide a broad-based boost to productivity globally, or will it serve as a strategic advantage concentrated in certain countries, notably the US and China?

We see three potential scenarios.

- **Widely diffused GPT.** AI may lift productivity in many countries as it is adopted in various applications, leading to a new wave of worldwide productivity growth, helping even aging societies to mitigate labour shortages and allowing developing economies to skip stages of development.

- **Concentrated benefit.** AI's benefits accrue to a few leading nations, particularly the US and China, which are currently at the forefront of AI research and deployment. These two countries account for the majority of AI startup funding, top talent, and research output. By treating these resources as strategic assets, the US and China could secure a disproportionate share of AI's economic gains, further widening the gap between them and other economies.
- **Strategic disruption.** The country that 'wins' in AI, for example by being the first to achieve Advanced General Intelligence (AGI), might use this as a strategic resource, sharing only with its allies.

A most likely outcome could be that AI becomes a General Purpose Technology (GPT), but with uneven rollout. For example, the US and China might be first to adopt AI at scale, but other nations would benefit with a time lag (e.g. Europe), or in specific areas (e.g. Japan in robotics or elderly care, India in its dynamic tech sector).

How evenly will AI be adopted across sectors and regions? What cultural or structural factors might lead to uneven adoption?

Several surveys published at the time of writing this report indicate significant differences in the rate of AI adoption by companies. US and Chinese tech, finance and retail companies are reporting quite high adoption, but there is more cautious adoption in other industries and countries. Cultural and structural factors play a role.

- **Corporate culture and risk appetite:** US business culture tends to 'move fast and break things', embracing even imperfect new technology. In Europe, a more risk-averse culture and stricter privacy laws make companies more tentative about AI. Japan's culture emphasises precision, which might delay AI rollout until proven safe and reliable.
- **Labour market flexibility:** Countries with flexible labour laws (e.g. US and UK) may adopt automation more readily because firms can reassign or lay off workers if needed. In countries with rigid labour protections, like France and Spain, companies might be slower to automate, knowing they cannot easily adjust their workforce. On the other hand, severe labour shortages, e.g. Japan, could force automation despite a conservative ethos, simply because there are insufficient workers otherwise.
- **Digital infrastructure:** To use advanced AI, companies need digital data and processes. Regions that have already undergone a digital transformation (e.g. US and parts of Asia) are better positioned.
- **Government strategy:** China's government explicitly pushes AI adoption through initiatives, such as the China State Council 2025 Directive on Advancing the AI+ Initiative, and by being an eager first customer for things like surveillance AI. This top-down impetus means that even more traditional sectors must experiment with AI. In Europe, regulators are more focused on the limits of AI (to protect privacy, etc.) rather than its adoption, possibly slowing deployment. The US has taken a middle road so far. It has allowed the private sector to lead with regulation mostly in the form of principles or future guidelines. For example, the US executive order on AI in 2023 encourages safe innovation without heavy-handed rules.

What are the implications of AI for employment and labour markets? Will it mostly augment human workers or replace them?

In short, will AI take jobs from humans, or make jobs more productive?

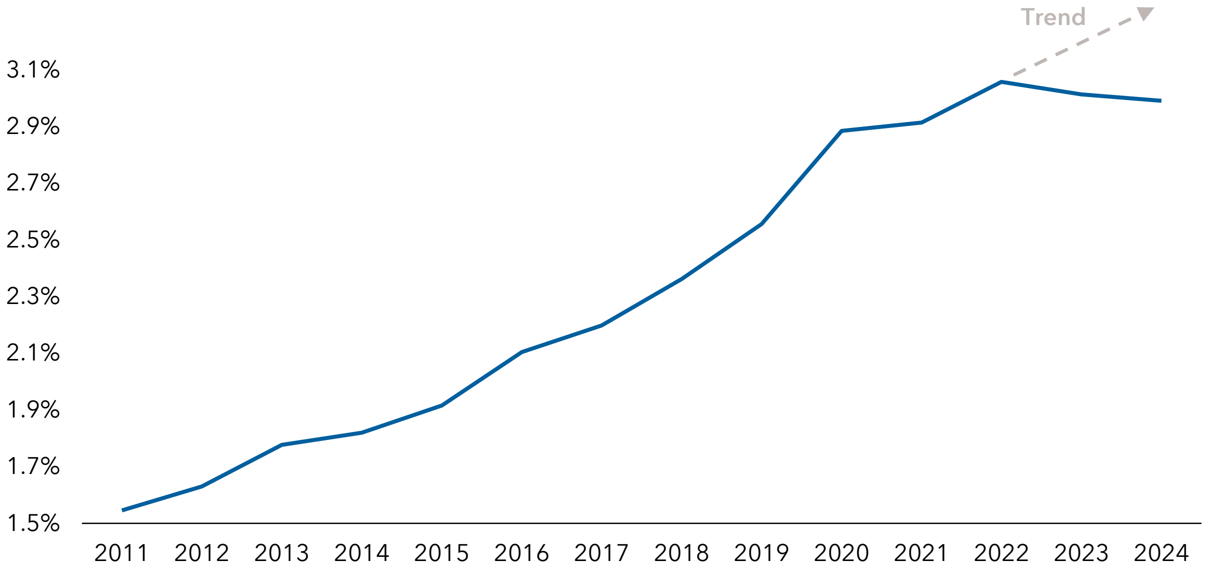
Historically, technology created new jobs even as it destroyed others. For example, while ATMs automated teller work, banks responded by opening more branches, each with a smaller staff focused on more productive roles. In the case of AI, it may create entirely new roles in the AI industry, e.g. AI model trainers, AI maintenance, new AI-driven products, etc. It may also increase demand in certain occupations: if AI makes a doctor 20% more efficient, more patients will be treated, increasing demand for medical services and allied health jobs.

Historically there has often been a time lag between the destruction of old jobs and then the creation of new ones and there are indications that AI might be accelerating the rate at which technology is displacing labour.

Early evidence also suggests that AI could lead to displacement of existing workers, with employment in the IT sector in the US starting to show a sharp deviation below its long-term trend.

Tech's employment share has declined below trend

Tech sector share of total employment

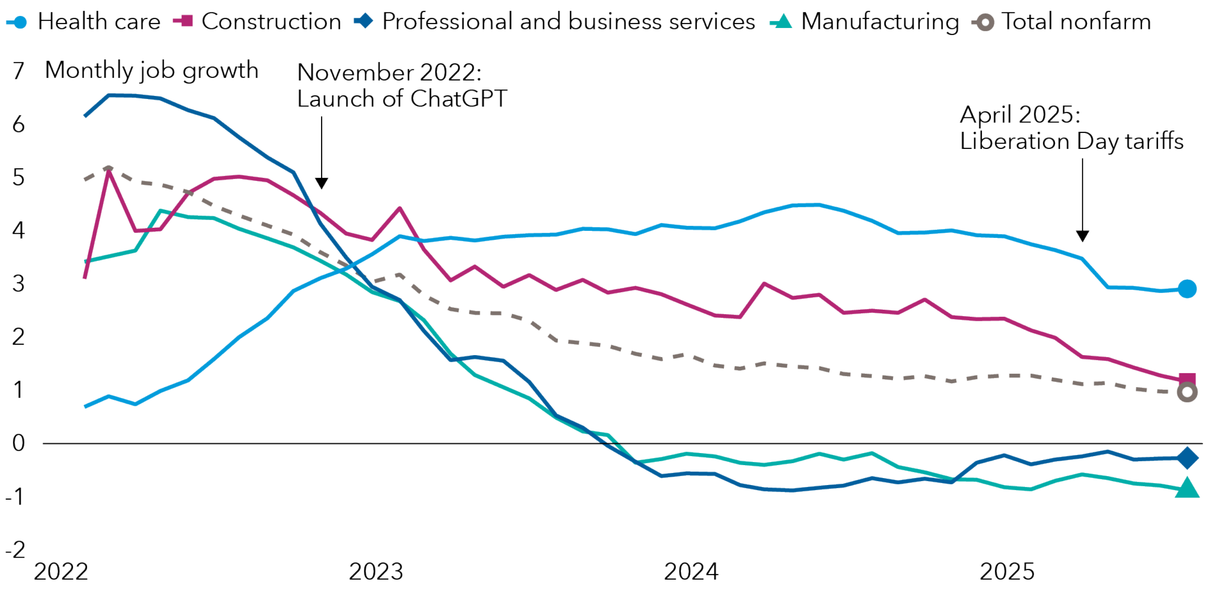


As at 31 December 2024. Sources: US Bureau of Labour Statistics, Haver Analytics, Goldman Sachs Research
Note: Tech refers to the software publishers, data processing and related, web search and related, and computer systems design subsectors.

More granular analysis shows how the acceleration of AI has been coincident with sharp changes in employment trajectory for previously strongly segments like computer infrastructure and internet services.

In addition, there is emerging evidence of similar behaviour in several other industries where anecdotes point to AI adoption.

Jobs are shifting amid AI adoption

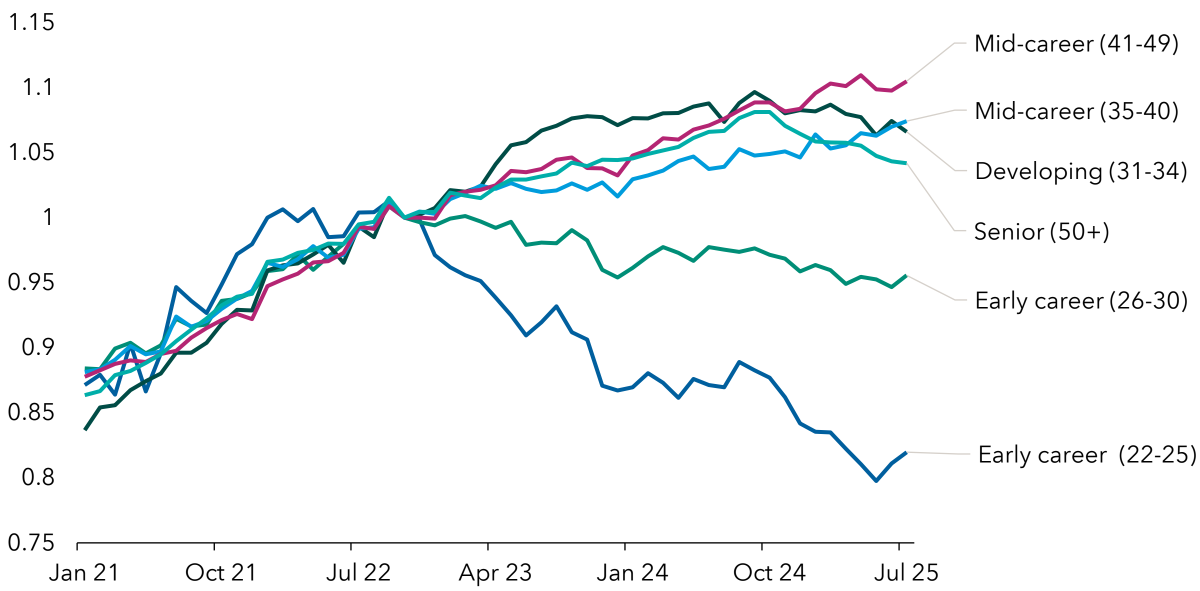


As at 1 August 2025. Sources: Capital Group, US Bureau of Labour Statistics.

A more nuanced trend has been identified in a recent Stanford study showing that, in AI-exposed jobs, younger workers have experienced a decline in employment since the advent of ChatGPT, whereas older workers have seen steadily rising employment.

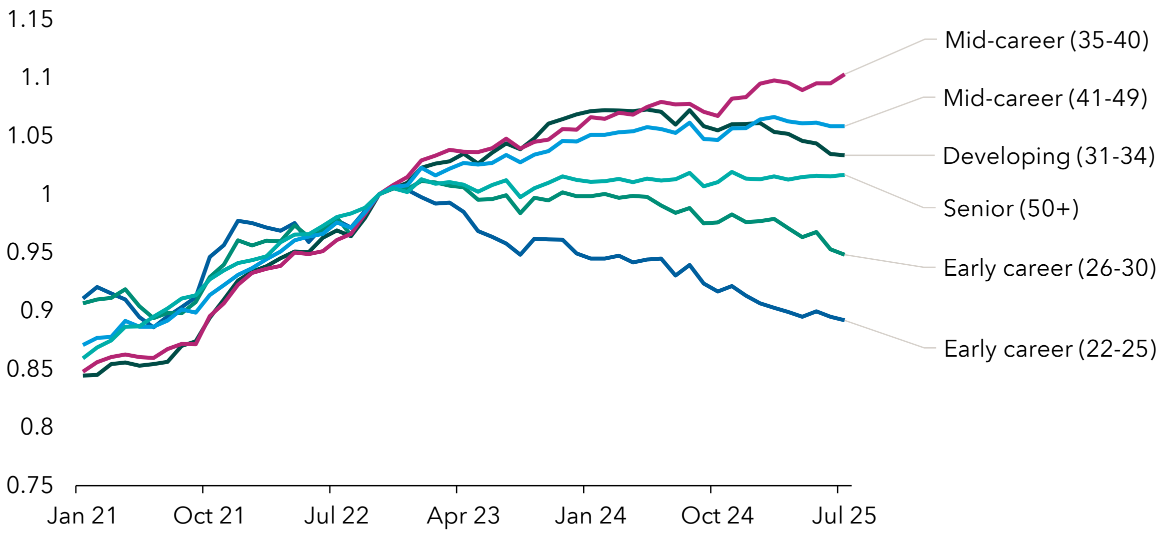
Decline in headcount more pronounced in younger cohorts

Change in headcount among software developers by age



As at 1 July 2025. Source: Stanford University. Employment changes over time, normalised to 1 in October 2022

Change in headcount among customer service representatives by age



As at 1 July 2025. Source: Stanford University. Employment changes over time, normalised to 1 in October 2022

In short, in roles performed by less experienced workers, AI is more likely to take your job, whereas in roles performed by more experienced workers, AI helps you with your job.

However, there is some doubt about whether these recent trends are necessarily driven by the impact of AI. For example, analysis of announcements of layoffs reveals that very few of them mention AI as a reason.

In any case, the critical question is what happens next. We see several possible scenarios.

Mapping the future impact of AI: Investment vs. technology

Investment acceleration

Labour united
A populist push to reallocate corporate profits towards labour.

- Public investment dominates
- Strict regulation of technology
- Abrupt shift from capital to labour
- Inflation >3%, 10-year rates >5%

Goldilocks
Technology drives long-term growth, complementing capex/investment.

- Rising public/private investment
- Technology disrupts industry
- Shift from capital to labour is episodic
- Inflation ~2%, 10-year rates 2%-3%

Technology slowdown | Technology acceleration

Dark ages
Global isolation. Civil/cyber wars reverse global co-operation.

- Countries become isolated
- Trade virtually shut off
- Authoritarian systems displace markets
- Managed prices and rates

Technology dystopia
Technology unleashed. Rise in 'tech unemployment' and deflationary shock.

- Severe technology supply shock
- Swathes of labour markets displaced
- Shift from labour to capital; rising margins & profits
- Prices and rates fall

Investment deceleration

For illustrative purposes only.
As at July 2025. Source: Capital Group

A decisive factor is whether technology and investment move in tandem. Investment enables creation of new roles, many of which may be AI-enabled. Technology is partly the leading-edge AI capability, e.g. progress towards Artificial General Intelligence (AGI), but also the ability of AI to learn how to do new tasks to support a worker in a particular role. This learning rate will likely be higher in roles which are knowledge based, rather than judgment or service-based, e.g. technology, writing, law, medicine.

If technology advances faster than investment, it could create a major supply shock. It would disrupt the labour market but provide a major productivity boost in certain tech-oriented sectors.

However, this would also lead to a shift in the allocation of economic gains away from labour to capital. In short, if a tech company is able to lay off four out of five engineers, the company and the remaining engineers will benefit, but the other four engineers will of course struggle. The resulting rise in unemployment would impact consumer and service industries. It would also impact government tax income and the need to spend on public services such as education and healthcare.

However, if tech advancements fall behind investment, then the economy has time to build new applications for technology, allowing continued productive employment in labour markets. This would likely lead to a shift of economic gains from capital back to labour.

The Goldilocks outcome is one where technology and investments advance together.

Which scenario is most likely to occur? We are currently in a situation where more than US$2 trillion is being invested into the development of AI, making our scenarios of 'labour united' and 'Goldilocks' to be more likely outcomes.

Another key investment question is whether the AI revolution will follow the pathway of prior technological innovations, as defined by economist Carlota Perez. She believes that every technological revolution has two phases:

1. **Installation:** focused on where the infrastructure is built, e.g. rails for the railroads, server and network infrastructure for the internet.
2. **Deployment:** application and implementation e.g. the development of the western part of the US in the railroad era, the adoption of iPhones, social media, ridesharing, etc. in the internet/mobile era.

She also highlighted that the turning point has almost always been marked by a financial crash and recovery. In short, 'booms' tend to produce more infrastructure than needed and 'busts' help to restore productive deployment.

However, we believe that the AI technological revolution may follow a different path. Because it is built on the leverage of existing human knowledge, it has the potential to be productive even during the installation phase.

2 The current account: more than just trade

Key points

- Driven by economic and national security concerns, the US Administration is attempting to correct fundamental trade imbalances through its tariff policy. While these efforts have created volatility in markets, attempts to address trade and capital imbalances are not new. Historically, such measures have been met with limited success.
- Current efforts to reorder global trade, if successful, could have meaningful implications for global capital flows and asset prices.
- Beyond capital flows, there is evidence that the uncertainty around trade and security policy is accelerating cooperation between the rest of the world and motivating governments to pursue more economic self-sufficiency.

What to watch

- Amid the policy-driven news flow, what trade routes and trade agreements are strengthening? The broadening of supply chains beyond China could benefit a range of economies across Southeast Asia, Latin America, Europe and India.
- Countries with large pools of savings invested abroad could find more opportunities to invest domestically. Taiwan and Germany have already shown evidence of this. Who else could follow?
- Europe's increased fiscal stimulus is aimed at driving higher growth from domestic consumption, rather than exports. Greater economic and strategic autonomy could make Europe more resilient, particularly if investments spur innovation, are geographically spread, and spill over into other industries like finance and energy.

Introduction

Rebalancing of the existing system to lessen the gap between countries with a trade deficit or surplus would have multiple potential macroeconomic and market impacts, including:

- Lowering the value of the US dollar against other currencies
- Reducing foreign savings historically recycled into US assets
- Repatriation of portfolio flows out of the US
- Changing foreign direct investment (FDI) patterns
- Shifting political, geopolitical and trade alliances.

History tells us the US has not managed to solve fundamental current account imbalances during past attempts. Efforts to do so have weakened the US dollar and in some cases (by no means always) prompted economic reforms elsewhere, strengthening fundamentals in other regions.

Once again, attempts to rebalance the US current account are underway. Some of the policies under consideration are controversial and while the risk of implementation is low, the consequences for markets could be severe.

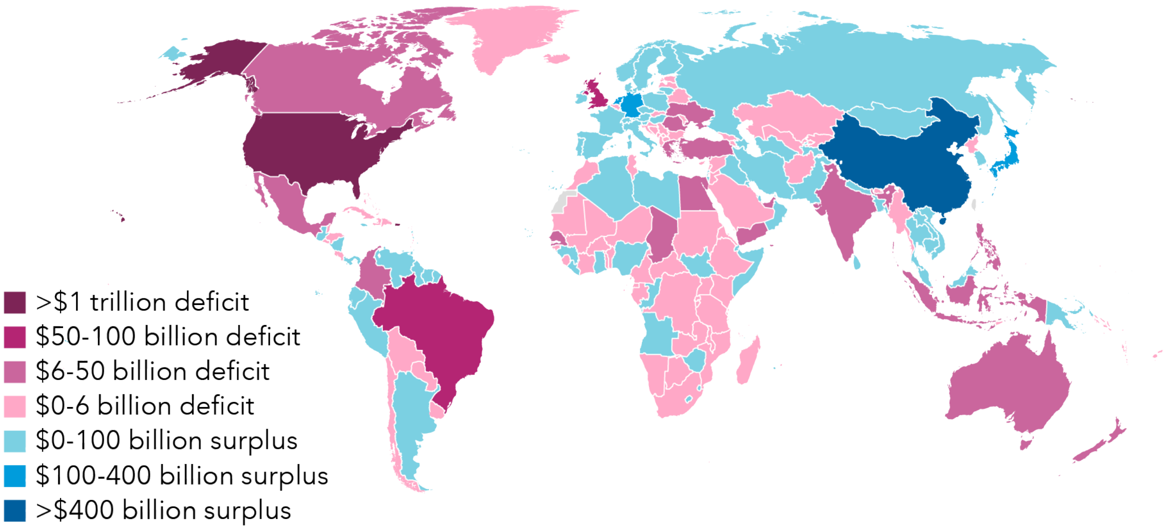
We can start to piece together potential future scenarios by looking at three shifts already underway:

1. **Repatriation of portfolio flows** leading to local currency and equity market rallies. As an example, we look at Taiwan in May 2025
2. **Long-term shifts in FDI flows**
    - FDI is increasingly being driven by geopolitics rather than cost efficiencies.
    - China's exports are moving up the value chain, accelerating export opportunities for emerging markets outside of China in sectors that are less vulnerable to protectionist policies.
    - US investment is increasingly domestic while other regions are strengthening ties with each other.
3. **Fiscal spending is increasing in Europe**

Trade and capital flows are fundamentally linked

One of the key motivations for the US administration's tariff regime is to address its trade imbalance with the rest of the world. The United States has the largest current account deficit globally, while countries such as China, Germany and Japan boast meaningful current account surpluses.

Global current account positions (in US dollars)



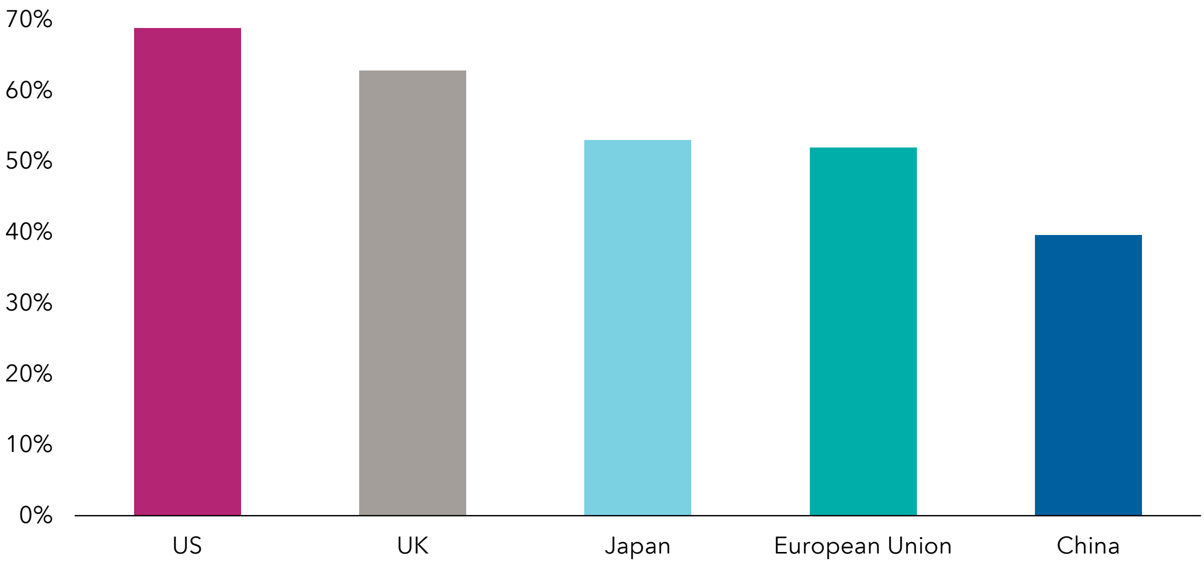
Source: The World Bank. Using data available as at December 2024.

A current account deficit, by itself, provides limited information on the health of an economy. In the case of the United States, it indicates that the country is importing more goods and services than it exports. However, a current account surplus does not necessarily reflect economic strength, as it may suggest a high economic reliance on exports and underinvestment in domestic growth or a lack of domestic consumption.

The US is a consumption-driven economy demanding goods from all over the world, notably from Mexico, China and Canada.

The US is a largely consumption-driven economy

Private consumption (% of GDP)



Data for US, US and EU as at December 2024. Data for Japan is as at September 2024. Data for China as at December 2023.
Source: ceicdata.com

Comparison of Chinese exports with US imports

As at 31 December 2024. Source: United Nations COMTRADE database.

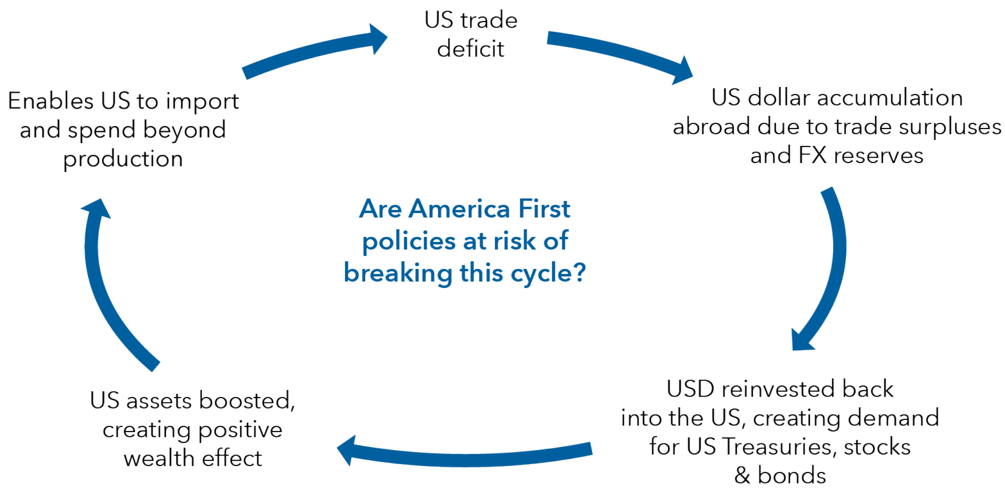
A key aspect of countries with current account surpluses is what they do with their excess savings from trade.

For many countries, excess export savings are reinvested back into US assets, primarily Treasury bonds, and increasingly, in recent years, into US equity markets. Countries with a net saving surplus buy US assets predominantly for three reasons:

- **Trade** purposes (most global trade is settled in US dollars)
- **Investment return** (the US market provides a deep, liquid and historically stable financial market within which to invest).
- **FX reserves** (to stabilise currencies and provide liquidity)

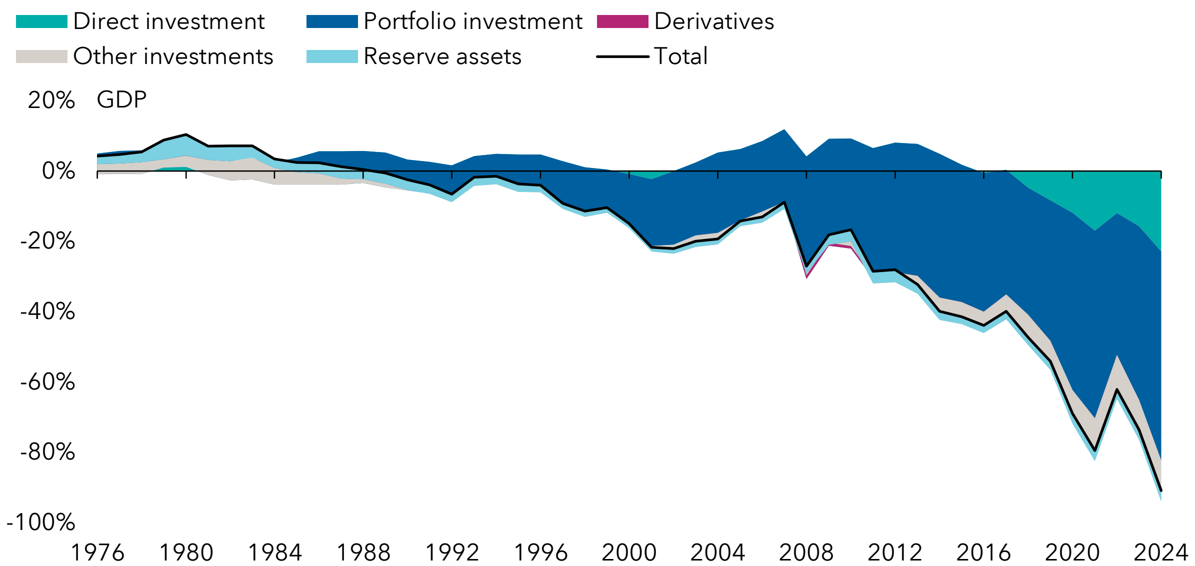
As of June 2025, foreign investors own 18% of the US equity market, 32% of the US Treasury market, and 28% of US corporate bonds, according to St Louis Fed data. Persistent demand for US assets in recent decades has granted the US safe-haven status and balance of payments flexibility with the capacity to run these large deficits. But there is no guarantee this will continue.

The global recycling of US dollars drives a self-reinforcing system
Trade and capital flows together determine the overall balance of payments, although there is disagreement among economists about the causation. What is clear is that a persistent current-account deficit implies the US is spending more than it earns and history suggests this cannot continue indefinitely.



The self-reinforcing properties of this cycle have enabled the US to inexpensively maintain a deeply negative net international investment position (NIIP), meaning that foreigners own more US assets than Americans own foreign assets.

US net international investment position (percentage of GDP)



As at 31 December 2024. Source: Bureau of Economic Analysis

The deterioration of the US's NIIP over the past decade is striking. So, what has driven this?

An increase in foreign financial flows into US assets has been one driver. However, two other factors have been far more meaningful: relative currency valuation (a strong US dollar cycle) and relative asset valuations (strong US equity markets vs the rest of the world). In fact, valuation and currency effects have driven most of the increase in foreign positioning. Since 2008, foreigners' holdings in US equities grew by US$15.7 trillion, and net inflows accounted for just US$1.7 trillion of this increase. From 2019 onward, holdings rose US$9.8 trillion, with only US$1.1 trillion from inflows (BEA data). The US's net equity position became negative in 2020, following a shift in FDI into negative territory in 2018. Since then, both have declined further, indicating that foreigners now own more US equity and business assets than Americans hold abroad.

Given the imbalances and self-reinforcing properties of this system, there is a lot of foreign capital in, and flowing toward a richly valued US market. If this pattern were to decelerate or foreign capital were to move elsewhere as trade relationships change, the implications for asset prices both in the US and the rest of the world could be profound.

What can we learn from history?

The speed at which the current administration is attempting to reorder global trade relationships has created volatility in markets, but it is important to remember that attempts to deal with trade and capital imbalances are not new.

There have been numerous attempts to solve the US deficit and trade imbalances, including the move to end the pegging of the US dollar to gold and the 1985 Plaza Accord. While there were indirect impacts that forced many countries to enhance their financial systems with more sophisticated banking systems, stronger regulations, improved fiscal discipline, independent central banks, and better inflation control, neither of these measures solved the underlying global trade imbalances. The US does not save enough to fund its domestic spending while other countries, notably Switzerland, Germany and Japan, save more than they spend.

Shifts are under way, driven by US policy

It is difficult to know ultimately what the US administration is aiming for, but key speeches such as Trump's on Liberation Day, America First policies, and other actions to date, suggest the administration is focused on narrowing the trade deficit, rebalancing the negative international investment position, and making foreign nations pay for US economic and security protection. This reflects a shift towards a more mercantilist approach to international economic and foreign policy.

The administration has been direct about its intention to use the US dollar as a tool, weakening the currency to boost US exports, reduce the trade deficit and support domestic reindustrialisation policies. Broad tariffs and bilateral trade negotiations are the favoured lever to address the trade deficit by compelling surplus countries to buy more US goods, such as arms, liquefied natural gas (LNG), and agricultural products, while raising government revenue in the process.

Treasury secretary Scott Bessent and Fed board member Stephen Miran have suggested a possible Mar-A-Lago Accord, which would echo the Plaza Accord negotiated by the Reagan administration in the mid-1980s. The Accord is not a formal agreement, but a conceptual framework. It is a set of more unconventional policies put forward by the Trump administration aimed at addressing persistent trade imbalances. Trump, Scott Bessent, and Stephen Miran argue trade deficits result from surplus nations (e.g., China, Germany, Japan) exporting excess capital to the US.

They claim this imbalance can be addressed with unconventional measures. For example, the US might require allies under its security umbrella (e.g. Japan) to exchange their US Treasury holdings for 100-year zero-interest bonds. Alternatively, the US could reinstate foreign withholding taxes on interest income, a policy that was in place prior to 1984. Another proposal is a more cooperative effort under US leadership where China and the EU (surplus entities) and US and UK (deficit nations) agree to boost/reduce consumption respectively. Bessent has also suggested forming a 'coalition of the willing'– including countries like Japan and select Middle Eastern nations – to stimulate demand for long-dated US Treasuries, thereby helping to contain long-term rates while advancing trade initiatives.

These more unconventional capital account policies, alongside higher tariffs, could lead to a disorderly rebalancing scenario, potentially leading to higher US inflation, slower US growth, and/or a gradual deterioration of trust in the US as a safe-haven and investment destination. With many global markets currently trading at record highs, it seems that these risks are not currently being priced into the markets.

What might an America First rebalancing mean for the rest of the world?

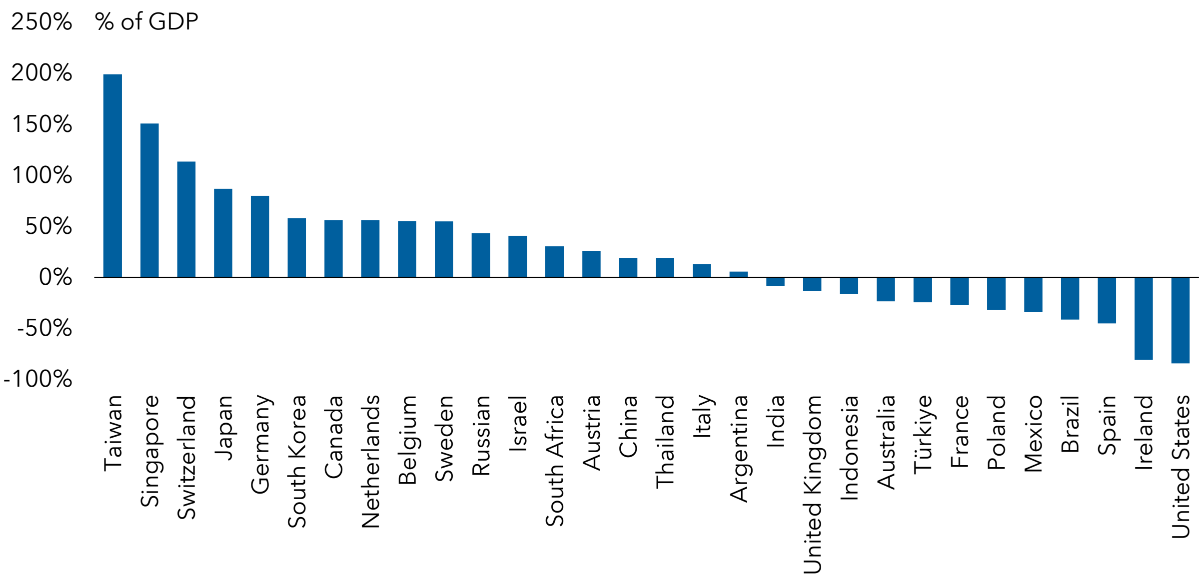
We can start to piece together future long-term scenarios and implications of US rebalancing by looking at three existing shifts.

Repatriation of portfolio flows

The first example followed Liberation Day, when we saw repatriation of portfolio flows back to Taiwan, leading to rally in both local currency and Taiwan's equity market. This was a strong reminder of the potential impact of foreign asset reversals out of the US. It is worth noting that the Taiwanese asset appreciation coincided unexpectedly with US dollar depreciation. This was likely driven by uncertainty created by Liberation Day tariffs, which reduced the incentive to invest, increased the risks of a US recession and raised questions about US creditworthiness.

Taiwan has the largest positive net international investment position (NIIP) globally, measured as a percentage of GDP (US$1.74 trillion). In gross terms, Taiwan's total stock of overseas assets (foreign assets owned by domestic Taiwanese residents) is 388% of GDP, or US$3.0 trillion[1]. Nearly a quarter of this is accumulated on the balance sheets of Taiwan's life insurance companies. Taiwanese exporters have also amassed large onshore dollar deposits.

Net international investment position: Taiwan leads, the US lags



As at 12 May 2025. Sources: MacroBond, IMF, Central bank of Taiwan

In late April 2025, the Taiwanese dollar began appreciating rapidly due to the onshoring of FX deposits from exporters and equity inflows. This event points to two important shifts: a shift in capital allocation, with repatriation into the domestic economy gaining momentum, suggesting Taiwanese investors may hold fewer US assets in the future as domestic opportunities become more attractive; a potential shift in the central bank's managed exchange rate regime towards more flexibility, underpinned by Taiwan's strong economic fundamentals.

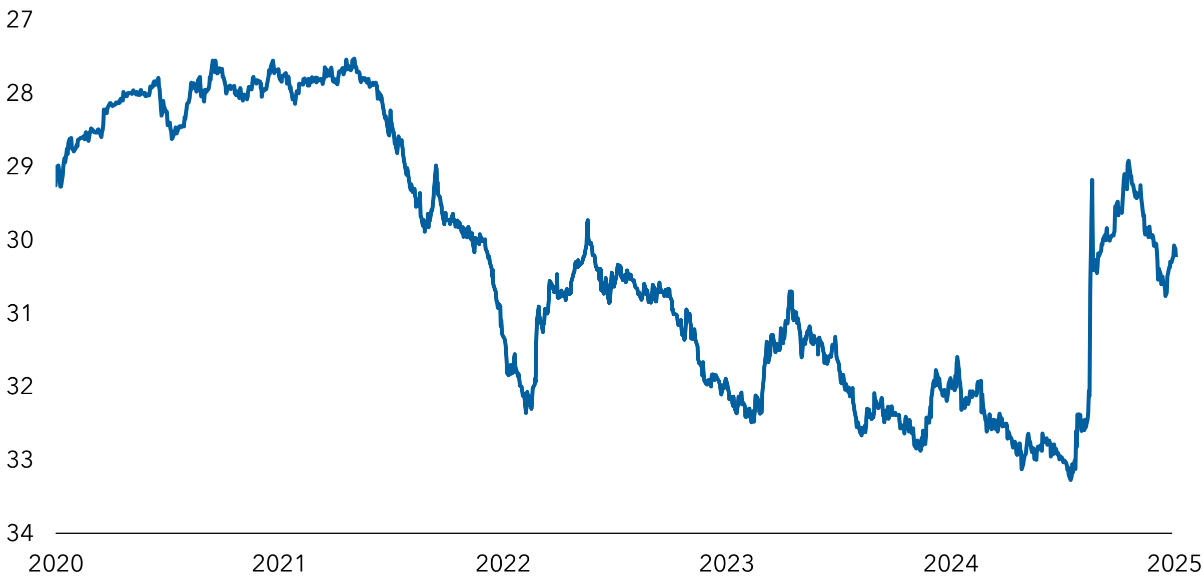
1. As at 31 December 2024. Sources: Central Bank of Taiwan, IMF

The trend of repatriation has been evident for a number of years: In 2019, the 'Taishangs' (Taiwanese businesspeople operating abroad) showed increased asset repatriation in the wake of the trade tensions between the US and China during Trump's first term.

By the end of 2024, these returning businesses had invested over US$77 billion[2] in Taiwan, invigorating the local economy and stock market. The repatriation of assets and domestic economic boom suggest Taiwanese investors may increasingly favour domestic opportunities over US assets. The Taiwanese government has also introduced tax-exemption schemes to attract more long-term funding to its domestic markets, aiming to double domestic assets under management (AUM) from US$900 billion to US$1.8 trillion over the next six years.[2]

These policies could further incentivise local investment and reduce the relative appeal of foreign assets. This capital has not only added liquidity to Taiwan's investment markets but also reinforced valuations and sentiment, contributing to Taiwan's position as one of the highest-ranked economies globally in terms of market cap-to-GDP. The central bank's recent willingness to allow the Taiwan dollar to strengthen may be influenced by the robust economic backdrop. However, the central bank will likely want to avoid excessive currency appreciation, which could harm export competitiveness.

US dollar-Taiwan dollar spot rate



As at 19 September 2025. Source: LSEG

The three primary factors that drove the repatriation of flows into Taiwan, a large pool of domestic investments abroad, strong or improving economic fundamentals and policy support, are not exclusive to that nation. They are present in other markets, including South Korea, Saudi Arabia and Germany and could support a similar influx of capital flows, particularly if we see persistent US policy uncertainty.

2. Source: Taiwan's Ministry of Economic Affairs.

So far, US policies such as Liberation Day have created short-term volatility but fundamental flows into US assets over the first half of 2025 have not changed. The mix has shifted, however, with reduced demand for unhedged bonds more than offset by stronger equity inflows. Hence, overall foreign capital flows into the US have remained firm. The US trade deficit has also remained deeply negative.

Longer-term, the magnitude of foreign asset repatriation likely depends on both 'push' factors – more US policy uncertainty, higher risk of US recession, greater doubts around US creditworthiness; and 'pull' factors – improved economic fundamentals elsewhere that could lead to a structural rebalancing of assets globally.

Long term shifts in FDI

Alongside the potential for changes in portfolio flows, the second shift we have observed is in foreign direct investment (FDI).

FDI tends to be stickier, longer-term capital than portfolio flows, so the trends we are seeing may give us important clues about the future. A few themes are evident: FDI flows are increasingly driven by geopolitics rather than cost efficiencies. For example, companies are diversifying their supply chains away from China, a theme we call 'China+1'. This is driven by geopolitics and tariff risks, but also by the fact that China continues to move its exports up the value chain, leaving opportunities for other countries with large and relatively low-cost labour forces to take share of lower-value exports.

As FDI into China declines, countries straddling geopolitical fault lines are gaining business, positioning themselves as links between the US and China, or China, Europe and other Asian economies.

Consequently, supply chains are getting longer. Economists at the Bank of International Settlements looked at data from more than 25,000[3] companies and found supply chains lengthening as other countries, especially in Asia, became additional stops in trade between China and the US.

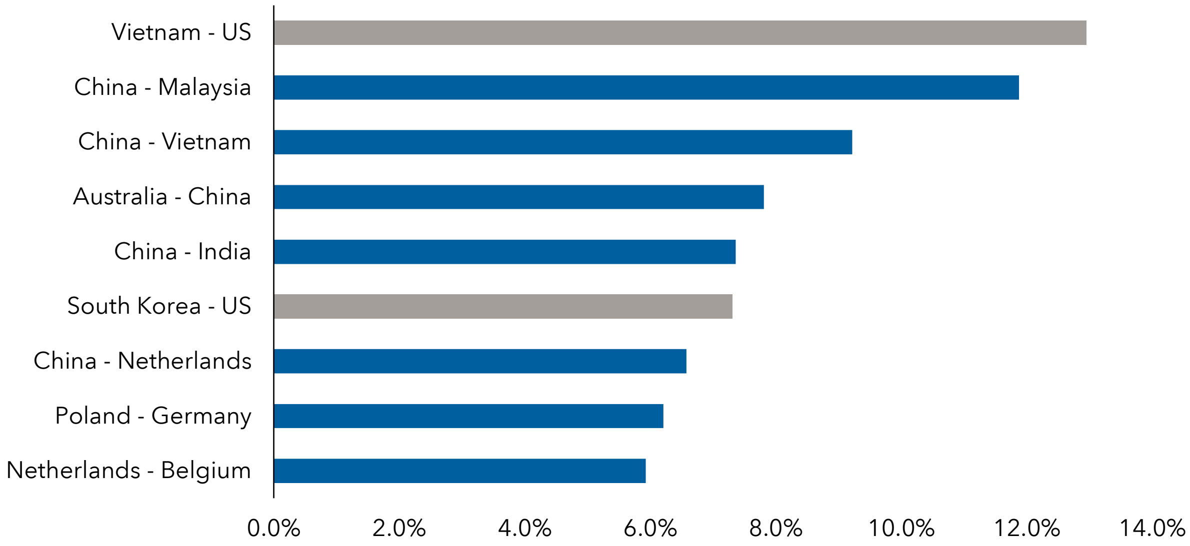
Another shifting pattern appears to be the contrasting trajectories of outbound FDI. The US is decreasing its foreign investments at the same time as China's expands. This is all while regions outside the US appear to be strengthening economic and political ties with each other. Together, this provides some evidence that US protectionism is accelerating cooperation between the rest of the world.

Back in 2000, the United States was the top trading partner for more than 80% of economies. Today, its share has shrunk to 30%, with China now the top trading partner for more than 120 nations. The US share of global imports is about 13.6%. By contrast, the European continent and the three largest Asian economies combined account for 38% of total demand for imports. According to the Global Trade Alert, if the US were to halt all imports, America's key trading partners could recover all their lost exports within five years.

Even before this year's escalation in trade frictions, international commerce had been shifting. Pathways involving Asia and other regions have grown in importance. Since 2018, eight of the ten fastest-growing trade corridors do not include the United States.

3. Bank of International Settlement, October 2023.

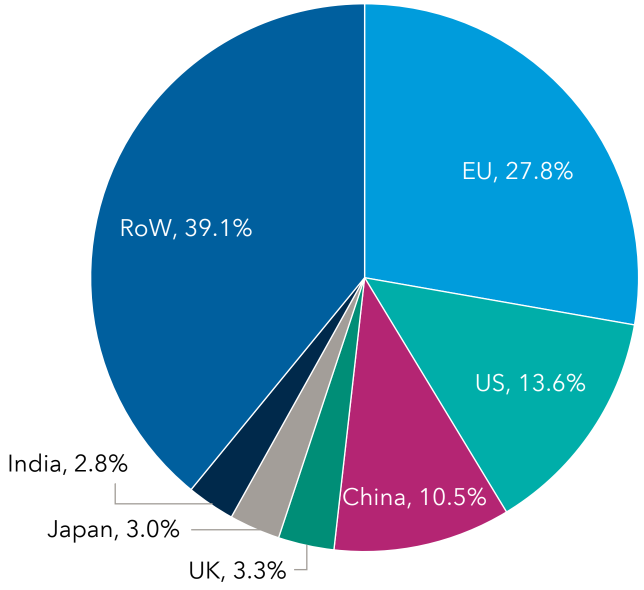
Fastest growing trade corridors (average annual growth 2018-2023, %)



Annual data from 2018-2023. Source: UN ComTrade database

It is possible that US corporations may not be immune to the downside risks in America's retreat from free trade. US multinational corporations currently generate over 40% of their revenue from abroad. Profit margins for S&P 500 companies had nearly doubled to around 13% after the 2000s, coinciding with China's entry into the World Trade Organisation.[4] Diminished trade with those markets could limit these companies' growth potential and profits.

Share of world import of goods



As at December 2024. Source: IMF World Economic Outlook Database

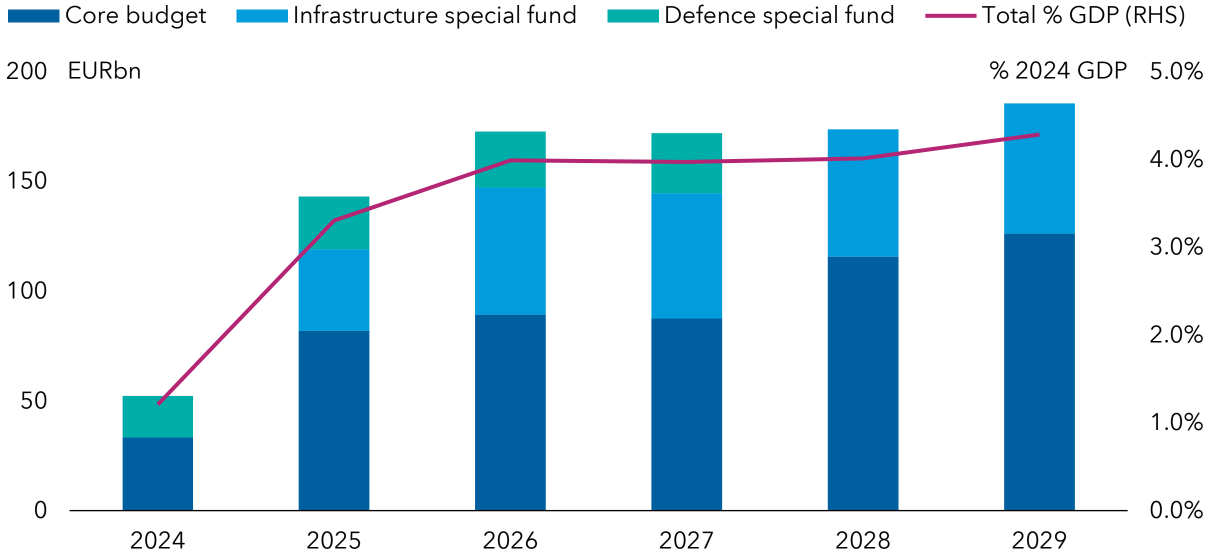
4. Source: Bloomberg

Rising fiscal spending

The third shift is a notable change in fiscal spending in Europe, led by the removal of the German debt brake. US tariffs on European imports are expected to reduce EU GDP by 0.5-0.75% in the short term[5], but tariffs, alongside the war in Ukraine, have also spurred Europe to take steps toward greater economic and strategic autonomy.

The removal of the German debt brake has enabled a dramatic increase in forecast spending.

New federal borrowing for Germany (official projections)



Forecasts are for illustrative purposes only.

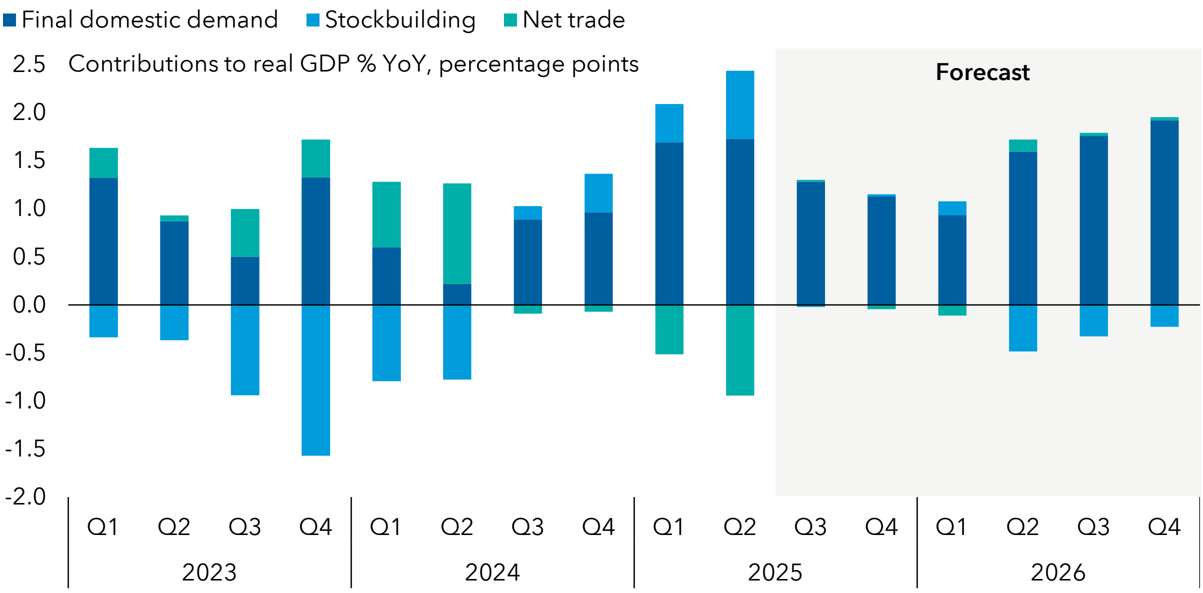
Forecasts as at June 2025. Sources: Datastream, BMF, Deutsche Bank

Achieving greater economic and strategic autonomy includes pursuing a Europe-wide industrial policy, increasing defence spending, and policies to boost consumption. These efforts could make Europe more resilient and innovative in the long run. If realised, there is potential for the EU to avoid deindustrialisation and support long-term growth, especially since defence can spur innovation, tends to be geographically spread, and has natural spillovers to other industries like finance and energy.

European efforts so far suggest the EU knows it needs to raise domestic consumption in order to counter the impact of US-driven rebalancing. Forecasts suggest that domestic demand will become a more meaningful contributor to GDP going forward. This is further supported by cyclical factors: a high household savings rate in Europe compared with the pre-pandemic norm, lower interest rates, resilient labour markets and rising house prices.

5. Source: Capital Group forecast.

Eurozone growth contributions



Forecasts are for illustrative purposes only.
Forecasts as at June 2025. Sources: Eurostat, Capital Group forecasts

Increased domestic spending in Europe, particularly on infrastructure or other growth-oriented initiatives, could reduce the region's current-account surplus over time, and in turn reduce the recycling of capital flows to the US through investments in US equities and debt. This is particularly true for European countries with high savings rates such as Germany, with a long-standing history of exporting excess savings to the US, supporting the US dollar and financing the current-account deficit. Increased domestic spending would likely absorb more of these savings locally, potentially leading to a decline in net capital inflows to the US. This could weaken the US dollar and necessitate adjustments in US fiscal and monetary policies to address reduced external financing.

Furthermore, if growth is successfully stimulated in Europe, this could reduce the relative attractiveness of US assets as European opportunities improve, leading to a breaking of the US-led cycle, and the emergence of a new set of financial market dynamics.

A more fluid, less predictable future

The current account has become more prominent in recent policy discussions, given the US administration's focus on trade deficits, supply chain resilience and a more mercantilist approach to foreign policy. However, it is vital to remember that there are two sides to the current account, and trade is only half the story.

Reducing the US trade deficit goes hand in hand with reducing capital inflows with potentially profound consequences for relative asset valuations across the world. As the three examples (Taiwan portfolio flow repatriation, shifting FDI patterns and changing European spending) illustrate, change is already well under way. As the world shifts, the multilateral institutions and agreements we have known post-World War II are rapidly being replaced by temporary, bi-lateral agreements, which suggests the future is likely to be more fluid and less predictable, with a very different set of risks compared with the past. Navigating this environment will require nimble, flexible, and more active management of equities.

3 Debt sustainability and the US dollar's reserve currency status

Key points

- Prolonged US economic strength has attracted the world's surplus savings and the dollar's reserve status has further sustained these flows. As a result, a significant share of US financing has become largely insensitive to interest rates changes.
- However, as debt levels climb and the global financial architecture evolves, there are growing questions around the foundations of this US 'privilege'. Is there a viable alternative to the dollar, and what could that mean for investors?
- Despite concerns over US debt sustainability and speculation around the dollar's reserve status, our view is the structural dominance of US fixed income markets remains largely unchallenged.

What to watch

- While central banks are gradually diversifying reserves and the dollar index has weakened, investor behaviour towards broader US assets remains stable. Equity markets are at all-time highs and spreads are tight. Watch for shifts in Treasury term premia and cross-currency basis spreads as early indicators of structural demand change.
- Dollar-denominated issuance still dominates global credit markets, anchoring investor allocations. The lack of scalable substitutes, whether in euro sovereigns, renminbi assets, or gold, suggests continued reliance on US fixed income despite US macro risks.
- As debt levels rise, the interest burden becomes a key constraint on how far rates can climb. Investors can use sustainability caps – where interest costs approach nominal GDP growth – as a practical framework to calibrate duration exposure and lock-in income before upside rate potential diminishes.

Introduction

Despite what traditional economic theory might suggest, the United States has long sustained persistent fiscal and trade deficits without sparking a broad sell-off in yields or causing instability in the dollar.

This unusual resilience is rooted in the US dollar's entrenched role as the world's dominant reserve currency – a position that allows the US to borrow at lower costs, attract global capital, and retain its economic dominance despite mounting fiscal pressures. Yet as debt levels climb and the global financial architecture evolves, the foundations of this privilege are increasingly exposed to scrutiny. Understanding how this equilibrium emerged – and what forces could destabilise it – is key to assess the durability of America's economic model.

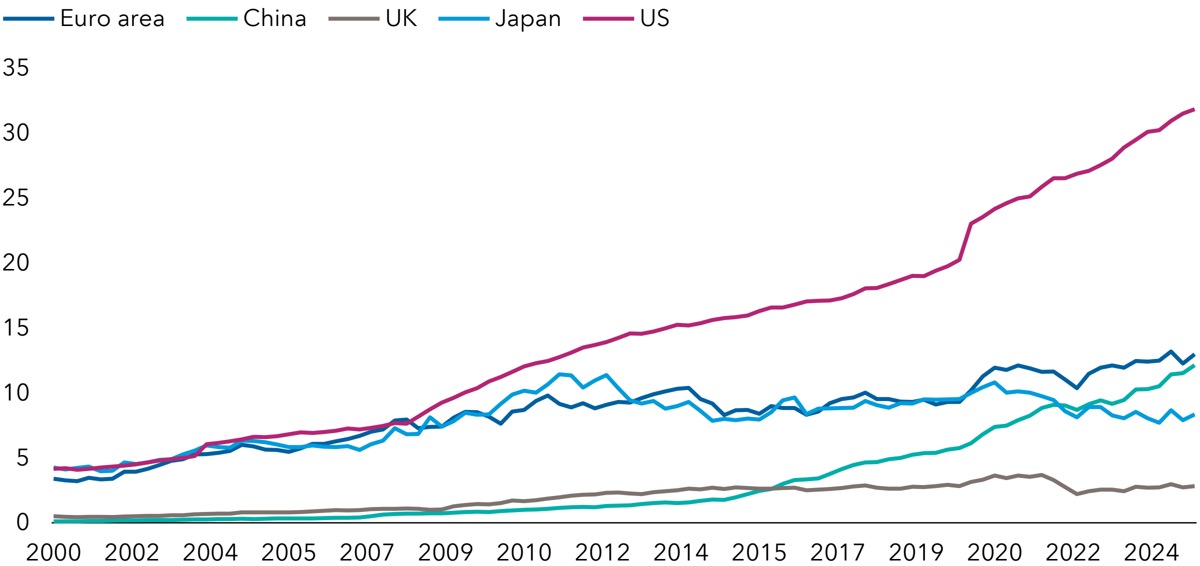
How the US accumulated its debt

Over the past few decades, the US has enjoyed a period of exceptional economic strength, consistently outpacing much of the rest of the world. As outlined in chapter one, this was largely driven by innovation-led productivity gains and a growing workforce – two forces that attracted foreign capital in search of high, yet stable returns. These inflows fuelled the expansion of high-value service sectors, particularly in technology, while also supporting strong domestic consumption.

As the dollar appreciated and the cost of living rose, lower-value sectors, such as manufacturing, gradually lost competitiveness and shifted offshore, notably to China. This global reallocation of production contributed to large trade surpluses in countries like China, Germany, and oil-exporting nations. Rather than reinvesting domestically, these economies recycled their excess savings into US financial markets – especially into US assets, including Treasuries, corporate bonds and equities – which have experienced exponential growth.

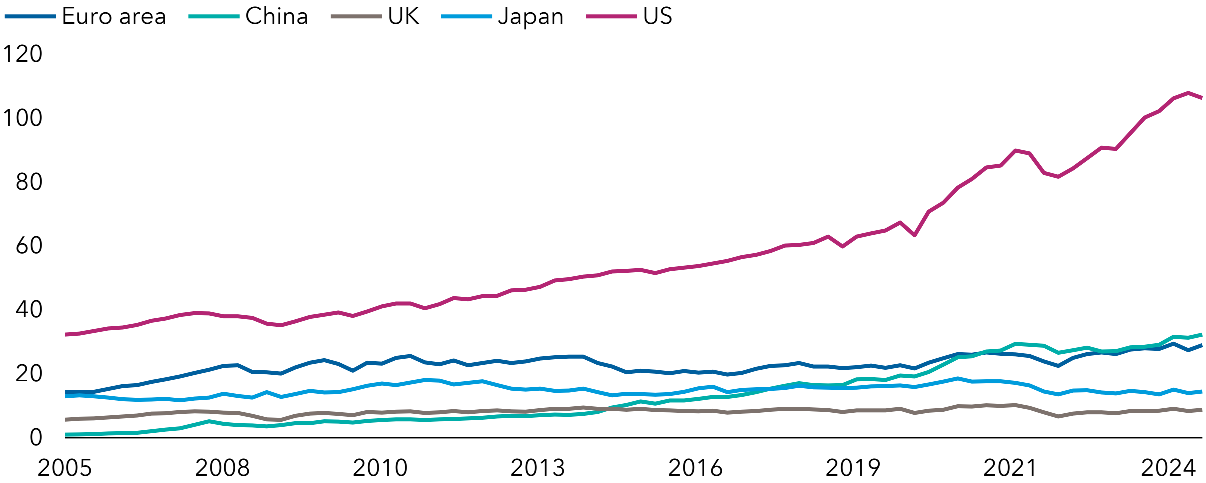
Depth of US capital markets

Stock of government bonds (in trillions of US dollars)



As at 31 March 2025. Source: Bank for International Settlements Debt Statistics

Equity and bond market capitalisation (in trillions of US dollars)



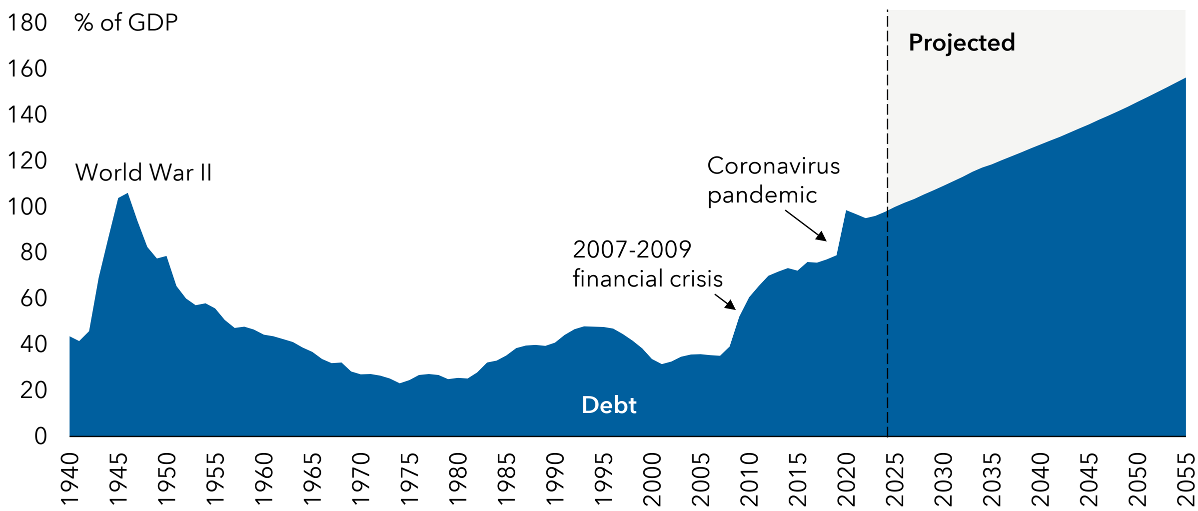
Past results are not a guarantee of future results.

As at 31 March 2025. Sources: Bank of International Settlements Debt Statistics; CEIC Data; Thomson Reuters Datastream; Haver Analytics; and IMF staff calculations. Bond markets include debt securities issued by the general government in all markets, at all maturities, denominated in all currencies at nominal value stocks (except UK, which uses market value stocks due to data availability). Equity markets represented by the following indices: US – S&P 500, Euro area - Euro Stoxx 50, China – Shanghai Shenzhen CSI 300, UK – FTSE All Share, Japan – Topix.

In effect, the US became the destination for a global glut of savings. These foreign capital inflows helped finance America's persistent twin deficits – fiscal and trade – while keeping interest rates low. This, in turn, enabled the US to borrow cheaply and consume beyond its domestic production capacity. This arrangement has conferred a remarkable advantage to the United States, which has underpinned decades of resilience and global leadership.

This dynamic has contributed to the US accumulating a debt-to-GDP ratio exceeding 100%. Moreover, recent fiscal policy developments, such as the One Big Beautiful Bill Act, are projected to lock in deficits around 7% of GDP over the coming years, up from 6.4%, potentially adding approximately US$3.3 trillion to long-term national debt over the next decade. However, it's important to contextualise the nature of the debt surge. The bulk of the increase occurred during two extraordinary events: the 2007–2009 Global Financial Crisis and the 2020 Covid crisis. Excluding these periods, debt-to-GDP has remained relatively stable.

Federal debt held by the public



Forecasts are for illustrative purposes only.

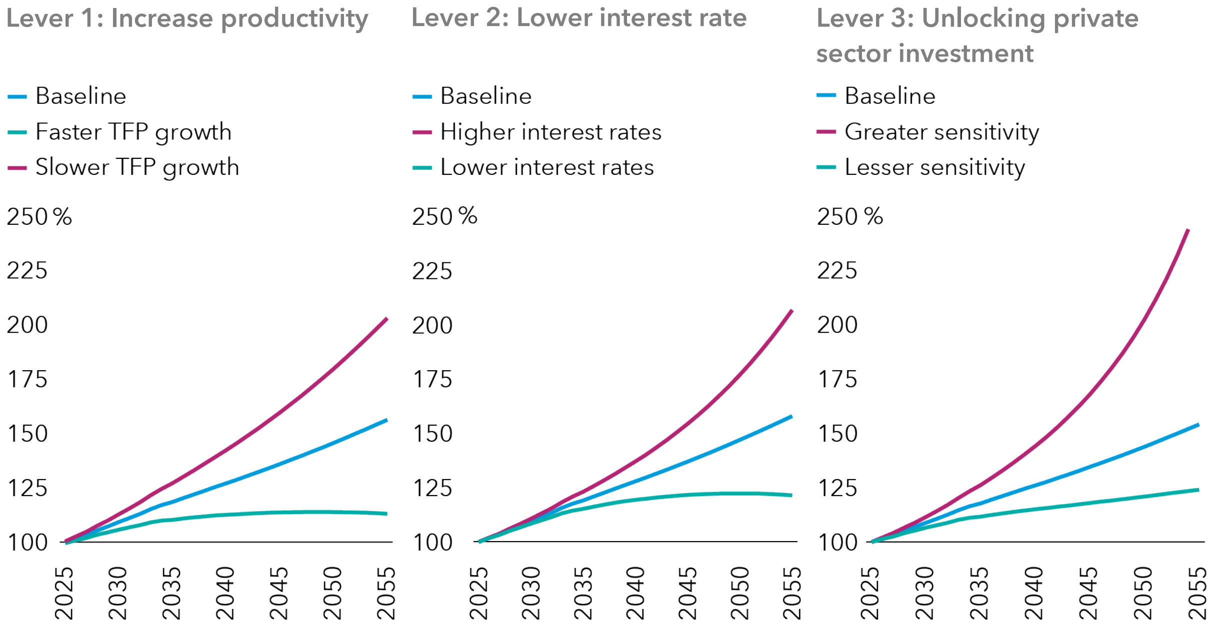
Source: Congressional Budget Office March 2025 report. Projections from 2025 to 2055.

Yet despite this rising debt burden, interest rates have remained historically low. This apparent contradiction – high debt levels coexisting with low borrowing costs – can be explained by the unique global role of the US dollar. Structural demand for dollar-denominated assets has made many investors relatively insensitive to the scale of US debt accumulation, allowing the country to borrow cheaply and maintain financial stability.

Looking ahead, it's important to note that the trajectory of US debt-to-GDP ratio projections are highly contingent on a range of macroeconomic assumptions. These include the future path of interest rates and real GDP growth expectations. Even small deviations in these variables can materially alter debt sustainability projections. For instance, a prolonged period of elevated interest rates could significantly increase debt servicing costs, potentially doubling the debt-to-GDP ratio over the next 30 years. Conversely, a meaningful acceleration in productivity – particularly if driven by widespread adoption of artificial intelligence – could enhance economic growth and fiscal revenues, limiting the increase in the debt burden to approximately 15% over the same horizon.

Importantly, US policymakers retain a broad set of levers to influence these outcomes. Structural reforms such as investing in digital infrastructure and reskilling the workforce to support AI adoption can boost productivity. Monetary strategies like forward guidance or quantitative easing by the Federal Reserve to anchor long-term interest rates can help manage borrowing costs. And fiscal policies such as targeted tax credits for capital expenditures in strategic sectors like clean energy or advanced manufacturing can unlock private sector investment and support long-term growth.

Future path of debt to GDP is highly dependent on multiple assumptions



Forecasts are for illustrative purposes only.

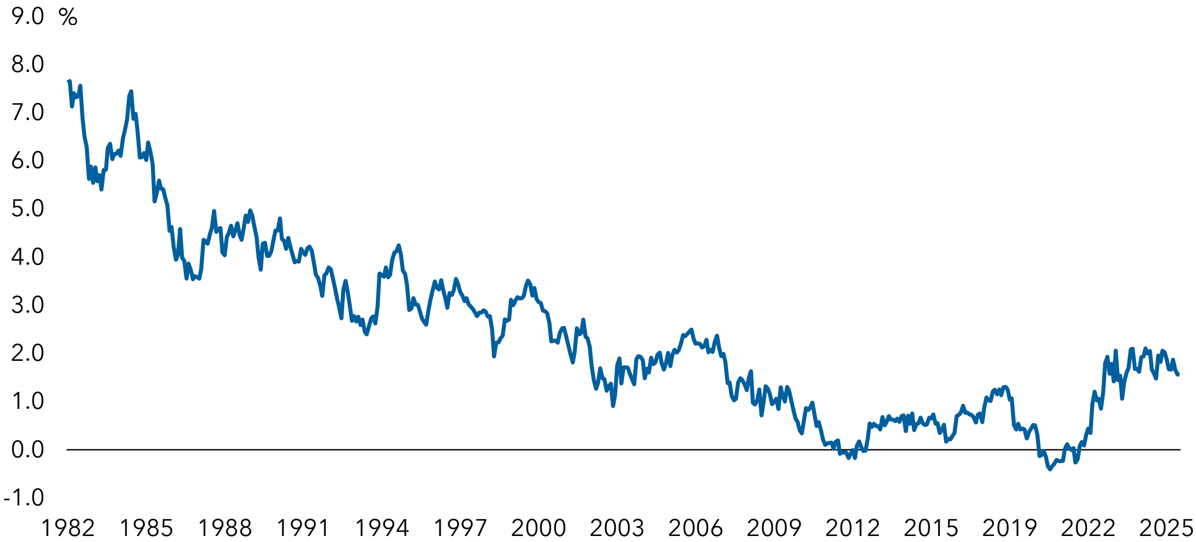
Data reflects projections as at May 2025. Sources: Congressional Budget Office (CBO), Capital Group

1. TFP: Total Factor Productivity. Faster and slower TFP growth reflects TFP in the nonfarm business sector growing 0.5% quicker or slower than the baseline projections.
2. Higher interest rates reflect average interest rates on federal debt above the baseline rate by an amount that starts at 5 basis points in 2025 and increases by that same amount in each year thereafter. Lower interest rates reflect average interest rate on deferral debt being set below the baseline rate by an amount that starts at 5 basis points in 2025 and decreases by the same amount in each year thereafter.
3. Greater sensitivity reflects the scenario where every dollar of change in fiscal deficits reduces private investment by 66 cents. Lesser sensitivity reflects the scenario where government borrowing has no effect on private investment.

Why borrowing costs remain low despite rising debt

Despite the sharp rise in debt, the US 10-year real interest rate has declined over the past four decades. This trend contradicts conventional economic models, which state that rising debt should lead to higher yields as investors demand greater compensation for increased risk. This paradox is best understood through the lens of the dollar's unique status as the world's reserve currency.

10-year real interest rate



As at 1 September 2025. Source: Federal Reserve Bank of Cleveland

The designation of the US dollar as the world's primary reserve currency dates back to the Bretton Woods Agreement of 1944, when global leaders established a new international monetary system in the aftermath of World War II. Under this framework, the dollar was pegged to gold at US$35 per ounce, while other currencies were pegged to the dollar. This arrangement positioned the dollar as the anchor of global finance, giving it immediate credibility and stability. By tying the dollar to gold, the US offered a fixed and trusted benchmark for international transactions, encouraging global adoption and reinforcing confidence in dollar-denominated assets.

Even after the collapse of Bretton Woods in 1971, the dollar retained its dominance. This was due to the sheer size and liquidity of US financial markets, the depth of its capital markets, trust in its financial institutions, and the geopolitical stability of the United States. Over time, the dollar became the default currency for international trade, oil and other commodity pricing and central bank reserves.

As the world's reserve currency, the dollar is held in large quantities by foreign governments, institutions and investors – primarily in US Treasuries, as part of their official reserves. It also means that global trade and finance are largely conducted in US dollars, creating a structural demand for dollar liquidity.

This status confers several privileges on the United States:

- **Structural global demand for Treasuries:** Foreign central banks and sovereign wealth funds consistently purchase US government bonds, keeping yields suppressed even when debt levels rise.
- **Safe-haven status:** In times of global uncertainty, investors flock to dollar assets, reinforcing demand and lowering yields when cheap financing is most needed.
- **Currency stability:** The US can sustain persistent trade deficits without triggering currency crises, as foreign exporters reinvest their dollar earnings into US assets.

This financial arrangement has allowed the US to effectively decouple fiscal discipline from borrowing costs. Unlike most countries, which face immediate market pressure when deficits rise, the US enjoys structural demand for its debt. Recent examples from Europe highlight how quickly markets can react to fiscal missteps. In the UK, the 2022 'mini-budget' under Prime Minister Liz Truss triggered a sharp sell-off in gilts and a spike in yields, ultimately forcing her resignation. More recently in 2025, France's budget deficit of 5.8% of GDP combined with political gridlock over fiscal consolidation prompted a credit rating downgrade warning. This led to the ousting of the prime minister in a no-confidence vote and pushed French 10-year bond yields above those of Greece.

In contrast, the US continues to benefit from a deep and liquid market for its debt, supported by the dollar's global role. This persistent demand has made many investors relatively insensitive to rising debt levels, allowing interest rates to remain low even as fiscal pressures mount.

What could disrupt the dollar's dominance?

It's essential to understand the multifaceted roles the US dollar plays in the global financial system as a medium of exchange, a reserve asset, and a safe haven. Each of these functions is deeply embedded in institutional trust, market infrastructure, and historical precedent, making any challenge to the dollar's dominance a complex and gradual process.

- **Medium of exchange:** more than 50% of global trade and cross border financial claims are invoiced in dollars[1], despite the US accounting for just 13% of global imports[2].
- **Predominant reserve asset:** although its share has gradually declined, the dollar still accounted for 58% of global FX reserves in 2024, down from 65% a decade earlier[3].
- **Private sector haven:** the dollar remains the preferred store of value during global shocks, even when the crisis originates in the US, such as the 2008 Global Financial Crisis[4].

These roles are reinforced by the US's historical leadership in shaping the post-World War II international system and its influence over multilateral institutions. Challenging this dominance would require not just economic shifts, but a reconfiguration of global trust, institutional depth, and capital market infrastructure.

While some policymakers – such as Stephen Miran, Chair of President Trump's Council of Economic Advisers (CEA) – argue that the dollar's reserve status is a 'costly burden' contributing to deindustrialisation and trade deficits, the reality is more complex. The dollar's position of privilege allows the US to borrow at lower rates, run persistent deficits without triggering currency crises, and exert global monetary influence.

1. As at September 2025. Source: Atlantic Council.org
2. As at 31 December 2024. Source: World Trade Organisation
3. As at December 2024. Source: IMF
4. The 2008 Global Financial Crisis not only bolstered America's regulatory influence but underscored the critical role of the Federal Reserve in global finance through the implementation of emergency swap lines.

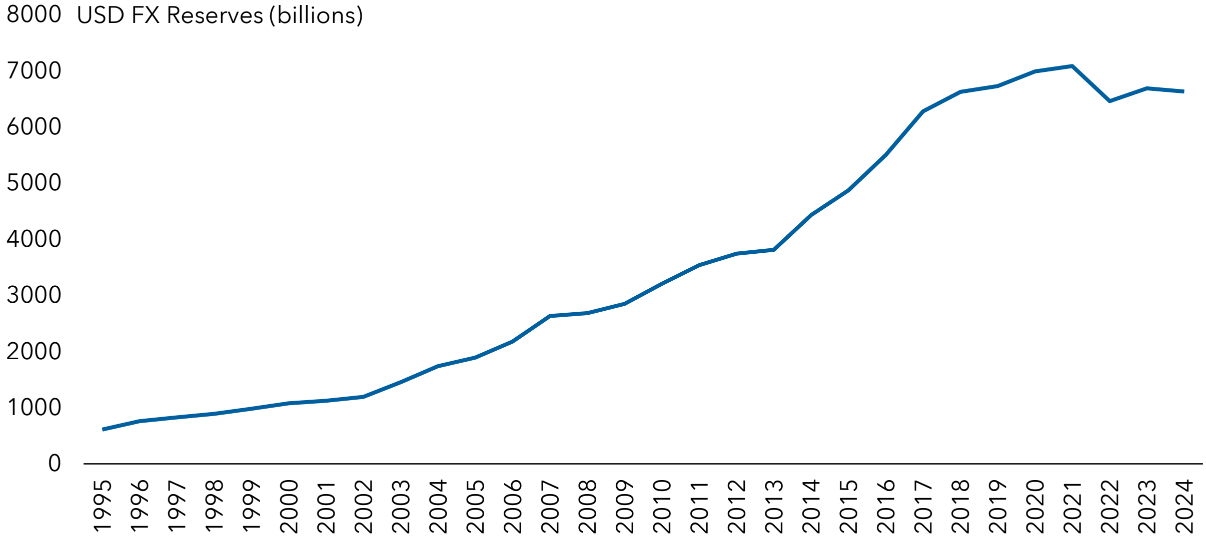
While the dollar's position remains dominant, several structural and political risks could gradually erode its status:

- **Geopolitical fragmentation:** Rising tensions between the US and major economies, alongside increased use of the dollar as a geopolitical tool via sanctions have accelerated efforts to build alternative financial systems. Initiatives like China's Cross-Border Interbank Payment System (CIPS) and bilateral trade agreements denominated in yuan or other currencies reflect a strategic push toward de-dollarisation.
- **Technological disruption:** The emergence of central bank digital currencies (CBDCs) and blockchain-based payment systems could reshape global settlement infrastructure. If widely adopted, these technologies could reduce the need for dollar-based intermediation in cross-border transactions.
- **Loss of institutional credibility:** A loss of independence of the Federal Reserve, should it become subject to political influence, could undermine trust in US monetary policy. At the same time, recurring political standoffs over the debt ceiling, contentious debates on fiscal policy, and disputed elections could signal instability to global investors. If confidence in the reliability of US institutions begins to erode, central banks and reserve managers around the world may begin to reallocate away from dollar-denominated assets.
- **Fiscal Recklessness:** Persistent deficits and rising debt-to-GDP ratios – now projected to remain above 7% – could eventually test investor patience. If markets begin to doubt the US's long-term fiscal sustainability, they may demand higher compensation for risk, pushing up yields and weakening the dollar's safe-haven appeal.

Is there a viable alternative to the dollar?

Although central banks have been gradually diversifying away from the dollar since 2018, the pace has been slow and viable alternatives remain limited. This trend reflects a growing desire to reduce reliance on the dollar but also underscores the reality that few currencies can offer the same depth, stability and global acceptance.

USD FX reserves have plateaued since 2018



As at 31 December 2024. Source: IMF

Potential alternatives might include:

- **Chinese renminbi:** Backed by the world's second largest economy, the yuan has gained some traction. However, strict capital controls, limited convertibility, and geopolitical concerns constrain its role as a global reserve asset.
- **Euro:** The euro is often cited as the most viable alternative to the dollar. However, its appeal is constrained by the absence of a unified eurozone-wide safe asset and fragmented fiscal governance. Sovereign debt markets within the eurozone remain less liquid and less scalable than US Treasuries.
- **Gold and Cryptocurrencies:** While these non-traditional assets have seen increased interest, their high volatility, limited liquidity, and lack of institutional trust make them unsuitable as a stable store of value or viable alternatives to the dollar at scale as yet.

Are we seeing signs of change today?

Recent market developments have sparked debate about whether we are beginning to see early signs of de-dollarisation. While central banks have been gradually diversifying their reserves, investor behaviour remains the most immediate and sensitive barometer of confidence in the US dollar.

At the beginning of President Trump's second term, policies such as tariffs and tax cuts were expected to strengthen the dollar by reducing imports and reducing demand for foreign currency. However, contrary to expectations, the dollar weakened sharply – reflected in a 10% decline in the dollar index in the first half of 2025.

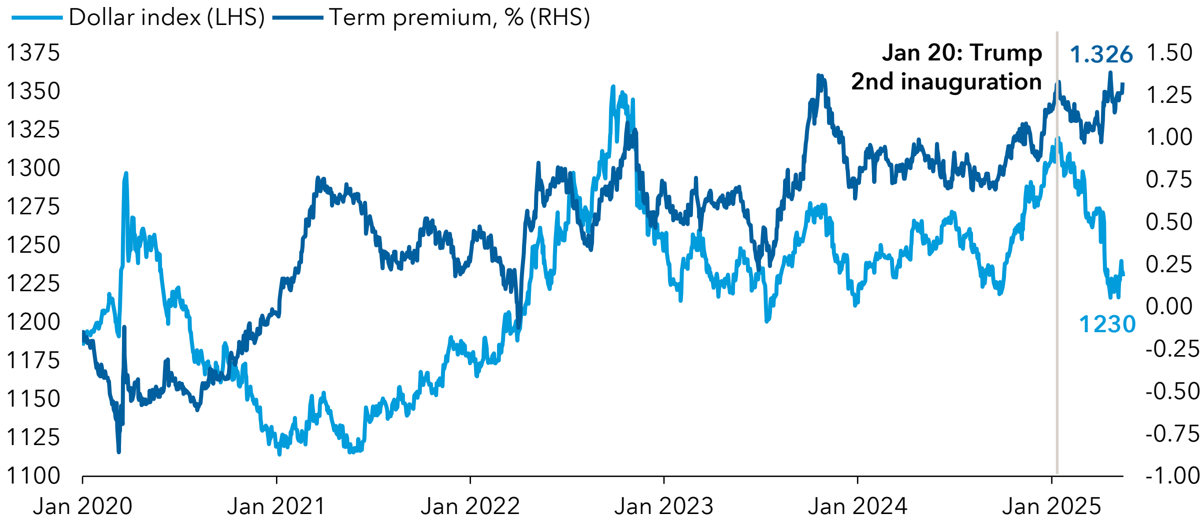
The US dollar has sold off over 2025

As at 19 September 2025. Source: Bloomberg

This unexpected decline has reignited concerns about the long-term sustainability of the dollar's reserve currency status. While multiple narratives have emerged to explain the sell-off, the most coherent interpretation is that markets are beginning to price in a structural discount on the dollar. This reflects growing concerns over US fiscal sustainability, risks to Federal Reserve independence, policy unpredictability under the current administration, and the broader trend of global de-dollarisation.

Yet, the broader asset landscape tells a more nuanced story. If investors were truly rejecting the dollar's reserve status, we would expect a broader sell-off across US assets. Instead, US equities remain near all-time highs, credit spreads are tight and there is no clear risk premium priced into broader US markets. Moreover, the dollar's decline has not been accompanied by a rise in Treasury term premia – the extra yield investors demand for holding longer term bonds, which is a typical signal of structural shifts in demand or a 'buyers' strike' on US bonds.

US dollar and term premium on US Treasuries

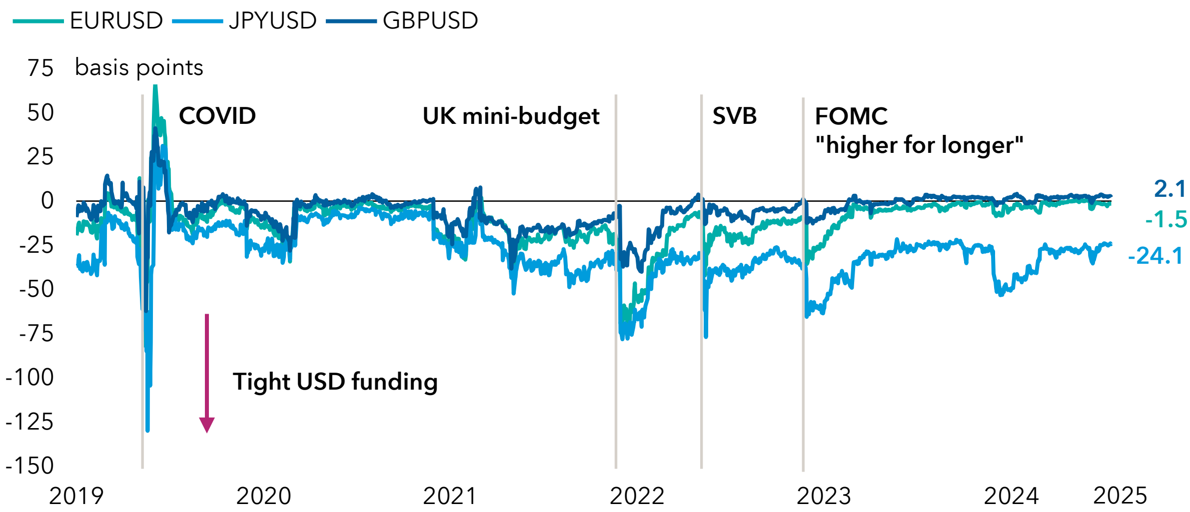


As at 15 May 2025. Sources: Bloomberg data, San Francisco Fed estimates, Capital Strategy Research calculations

Moreover, cross-currency basis spreads – which reflect the cost of swapping into other currencies – have remained stable. This is especially notable in the USD/JPY basis, a key indicator given the popularity of the yen carry trade, where investors borrow in yen to invest in higher-yielding US assets, profiting from the interest rate differential. If confidence in the dollar were eroding, we would expect widening basis spreads and signs of funding strain.

So far, the absence of such shifts suggests that the dollar's reserve role remains intact despite recent depreciation. While the dollar may be facing cyclical headwinds, the structural foundations of its dominance – liquidity, trust, and institutional depth – continue to anchor investor behaviour.

Cross-currency basis (3-months)



As at 15 May 2025. Source: Macrobond. SVB: collapse of Silicon Valley Bank. FOMC: Federal Open Market Committee

Impact on global investing

Do credit markets offer alternatives to the dollar?

Despite growing concerns over US debt sustainability and speculation around the dollar's reserve status, the structural dominance of US fixed income markets remain largely unchallenged. This is particularly evident in global credit markets, where dollar-denominated issuance continues to anchor investor allocations.

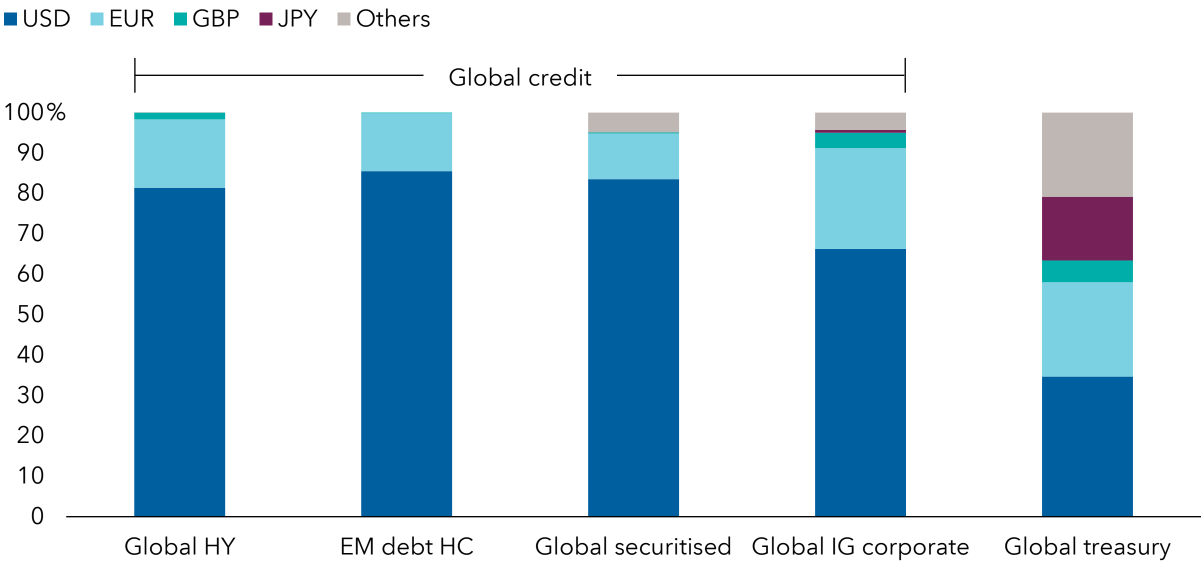
Over 80% of emerging market hard currency debt, global high yield, and securitised credit are issued in dollars. Even in investment grade credit – arguably the most geographically diverse credit segment – more than 65% remains dollar denominated. This reflects not only historical inertia, but also the depth, liquidity, and institutional trust embedded in US capital markets.

The only meaningful avenue of diversification away from the dollar within fixed income is in sovereign debt. Yet even here, US Treasuries represent roughly one third of the global government bond market. Outside of Treasuries, the investable universe of large, liquid, convertible sovereign debt is relatively limited. For example, Germany's government bond market – often cited as a high-quality alternative – is just €1.5 trillion, a fraction of the US$35 trillion US Treasury market.

Gold has seen renewed interest as a safe-haven amid US rates, but its inherent price volatility limits its role as a core reserve asset. Euro-denominated bonds offer some diversification potential, but fragmentation and limited scale constrain their strategic utility.

In summary, while macro risks, ranging from fiscal expansion to potential dollar depreciation, are increasingly reflected in investor narratives, the structural constraints of the global fixed income architecture offer limited avenues for meaningful diversification. This lack of viable alternatives tempers any immediate risk of a broad investor rotation away from US markets.

Fixed income markets breakdown



As at 31 May 2025. Source: Bloomberg.
Representative indices are as follows: Global high yield (HY) – Bloomberg Global High Yield Corporate Index; EM debt HC – Bloomberg EM Hard Currency Aggregate Index; Global Securitised – Bloomberg Global Aggregate Securitised index; Global Investment Grade (IG) Corporate – Bloomberg Global Aggregate Corporates Index; Global Treasury – Bloomberg Global Treasury Index. Others: all other currencies of issuance excluding USD, EUR, GBP and JPY.

Can debt sustainability impose a limit on rates?

The relationship between debt levels and interest rates offers investors a practical framework for managing duration risk. Debt becomes unsustainable when the interest burden – calculated as the average interest rate on government debt multiplied by the debt-to-GDP ratio – exceeds nominal GDP growth. Even with a balanced primary budget (i.e. excluding interest payments), governments must either borrow more or monetise the debt (central banks purchase government bonds) to cover interest costs, both of which can provoke adverse market reactions. The only alternative – running persistent fiscal surpluses – is historically rare due to their economic and political costs.

According to IMF estimates, publicly held debt can reach between 160% and 180% of GDP before it becomes unsustainable. With current publicly held US debt levels hovering around 100% of GDP, this suggests a potential buffer of roughly two decades. However, this projection hinges on continued investor confidence in US debt and the eventual adoption of credible fiscal rules. Without these safeguards, the sustainability threshold could be breached much sooner.

For investors, this framework provides a strategic lens for duration management. When yields approach the sustainability cap, the upside for rates is limited, making it attractive to extend duration and lock in higher income. Conversely, when yields are well below the threshold, the risk of rising rates increases, warranting a reduction in duration to protect against capital losses.

In today's environment, we can apply this framework by estimating nominal GDP growth at around 4% and publicly held US debt at roughly 100% of GDP. This implies a theoretical sustainability cap for average interest rates of approximately 4%.

When market yields exceed this threshold, the upside for rates becomes increasingly constrained, making it an opportune moment to extend duration and lock in elevated income levels. Conversely, if yields are significantly below this cap, the risk of further rate increases rises, suggesting a more defensive stance on duration. This dynamic provides investors with a pragmatic tool to calibrate interest rate exposure in line with macro-fiscal constraints.

4 Unlocking shareholder value in a changing regulatory landscape

Key points

- Global governance standards are converging. While the US has long set the benchmark for shareholder alignment, markets like Japan and South Korea are closing the gap through meaningful governance reforms, driving renewed investor interest.
- Governance is a driver of shareholder value. Strong corporate governance is increasingly recognised as a key determinant of valuation and capital flows. Markets that improve governance often see enhanced investor confidence and stronger long-term returns.
- The competitive landscape is evolving. Despite rising global standards, the US retains structural advantages including deep capital markets, legal clarity, and an active shareholder base, which continue to support its leadership position.

What to watch

- Reform momentum: Track the pace and depth of governance reforms, which may unlock value in markets historically discounted for governance risk.
- Signals of governance deterioration: Be alert to signs of weakening standards, which could warrant a more cautious stance in affected markets.
- Sustained US leadership: Monitor how the US balances its traditional strengths with evolving expectations around transparency, accountability, and stakeholder engagement.

Introduction

Recent shifts in the global landscape have coincided with notable changes in the structure and priorities of the US administration.

These developments are unfolding at a time when the broader world order is already in flux, with emerging powers, evolving alliances and new technologies gaining traction. As a result, we are witnessing the rise of markedly different systems that challenge the traditional frameworks for assessing risks and opportunities. For investors, this means rethinking how to evaluate innovation, policy direction, and institutional strength in a rapidly transforming environment.

Amid this complexity, strong governance continues to be a cornerstone of shareholder value creation, regardless of geopolitical shifts or administrative realignments. In this chapter, we focus on why governance matters more than ever, including how it anchors investor confidence and shapes long-term outcomes.

Governance in transition

United States

For decades, the United States has offered investors a combination of legal clarity, shareholder empowerment and deep, liquid capital markets. Alongside these have been corporate governance standards that strongly align shareholder interests with corporate interests. These pillars have translated into superior long-term shareholder value and a lower risk premium for US assets.

While challenges to certain elements of US governance standards are now making headlines, some have been developing over time, giving us historical context to understand how US systems might evolve.

US developments from 2017–2025

The 2017–2020 period is notable as a phase of recalibration. A series of policy updates and regulatory refinements introduced new dynamics into the governance landscape, which prompted investors to reassess engagement strategies and oversight mechanisms.

Key developments:

- **Regulatory adjustments.** Select provisions of the Dodd-Frank Act were revised to streamline compliance and reduce reporting burdens, particularly for smaller institutions. These changes were intended to enhance capital formation while maintaining core investor protections.
- **SEC rule enhancements.** The US Securities and Exchange Commission (SEC) introduced updates to proxy advisory regulations and shareholder proposal thresholds. These measures were designed to improve transparency and efficiency in the proxy process, though they also reshaped the mechanics of shareholder influence.
- **Evolving ESG discourse.** The treatment of Environmental, Social and Governance (ESG) considerations have continued to evolve, attracting heightened regulatory scrutiny in recent years and sparking diverse viewpoints across the political and investment spectrum. Management boards faced growing expectations to navigate these issues with clarity and responsiveness, reflecting a broader shift in stakeholder priorities.

Timeline: tracking the impact of governance changes[1]

2017 – 2018: Regulatory recalibration and deregulation drive

- The Trump administration initiates broad deregulatory efforts, including easing Dodd-Frank requirements for smaller banks and streamlining compliance across sectors.
- Agencies adopt a 'two-for-one' rule approach, eliminating two regulations for every new one introduced.
- **Market response is positive: financial stocks rally mid-2018 as capital and stress test rules are relaxed.**

2018: Tax reform and shareholder returns

- The Tax Cuts and Jobs Act reduces the corporate tax rate from 35% to 21%, boosting after-tax earnings.
- Companies respond with record share buybacks over US$800 billion in 2018, driving earnings-per-share (EPS) growth and lifting equity markets.
- **Capital expenditure growth lags expectations as firms prioritise returning capital to shareholders.**

2018 – 2021: Proxy process reform amid institutional strains

- The Securities and Exchange commission (SEC) finalises updates to proxy advisory rules and shareholder proposal thresholds, aiming to enhance transparency and efficiency. These changes reshape shareholder engagement dynamics, particularly for smaller investors.
- Political tensions surrounding the 2020 Presidential election test investor confidence in institutional continuity. Despite heightened rhetoric, the Federal Reserve maintained independence and continued to adjust policy based on economic data.
- **Markets remain resilient: the S&P 500 trends upward and credit spreads stay tight, reflecting investor trust in US institutional strength.**

2022 – 2025: ESG and shareholder rights debates

- A shift in regulatory tone brings ESG issues to the forefront, sparking debate over mandates and corporate responsibility.
- Companies navigate a polarised landscape, balancing stakeholder expectations with increased regulatory and political scrutiny on matters relating to climate, diversity, and governance.
- **Amid divided public opinion, the debate is still playing out as to what extent a broader array of considerations contribute to shareholder value.**

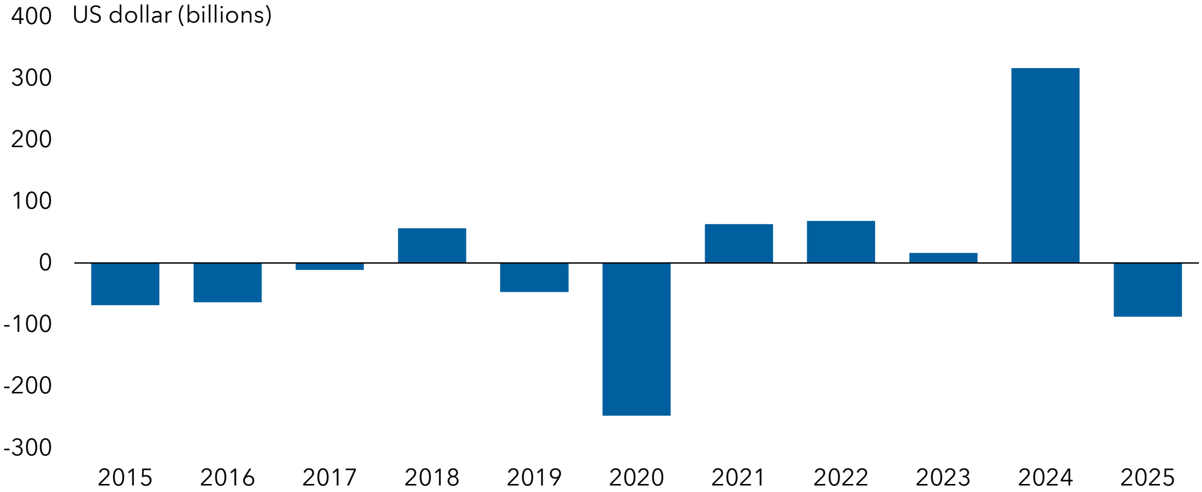
Impact on shareholder value

- **Recalibration of shareholder priorities:** Investors have refocused on foundational governance themes including capital allocation, board composition, and strategic alignment as support for environmental and social proposals sharply declined. Proxy disclosures reflect this shift with an engagement approach centred on financial performance and governance fundamentals.

1. Sources: US Department of the Treasury, Congressional Research Service (CRS), The Street

- **Valuations have remained robust:**[2] While not immune from pockets of volatility, valuations for US stocks have maintained a premium over other markets. The 10-year average forward price-earnings (P/E) multiple for the S&P 500 is 18.7x compared with 14.3x for MSCI EAFE (as at 15 September 2025). Although the valuation premium on US equities is primarily due to superior earnings growth, it does provide an indication of the level of trust investors place on US assets.
- **Strong shareholder and corporate alignment continues:** Stock option issuance is far more common in the US than in other markets. Stock options promote strong alignment of management and shareholder interests and have been a key driver of share price returns. At the same time, the US leads the world in share buybacks, providing a powerful support for EPS growth. Over the past decade, EPS growth has been stronger in the US (and Japan – see more below) than at any time since 1969. EPS expansion has been the greatest among growth stocks, given the prevalence of share buybacks by companies and their extensive use of stock options in total employee compensation.
- **Governance is a competitive advantage:** The failures of Enron and, more recently, Theranos illustrate the importance of governance standards. Enron's collapse was due to fraudulent accounting, lack of board oversight and conflicts of interest. Theranos failed because it misled investors, fostered a secretive culture and had inadequate board expertise. Both scandals exposed serious governance failures. In response to Enron, the US introduced the Sarbanes-Oxley Act (2002) to strengthen corporate accountability, internal controls and board independence.[2] Today, we are increasingly seeing governance become a differentiator. Companies with diverse, independent boards, transparent reporting, and clear shareholder alignment are rewarded with valuation premiums, while firms with governance concerns face rising scrutiny, activist engagement and discounted multiples.
- **Global investors have continued to invest in the US:** Most US equity categories, particularly large blend and tech-focused funds, experienced net redemptions through mid-year, driven by escalating tariffs and heightened policy uncertainty. However, the magnitude of outflows has remained relatively contained. Despite these intermittent pullbacks, investor sentiment has held up, underpinned by resilient corporate fundamentals and consistently strong earnings performance. This cautious optimism reflects a market that, while navigating volatility, continues to find confidence in the underlying strength of US companies.

Calendar year net flows into US equities



Past results are not a guarantee of the future results.

As at 31 July 2025. Source: Broadridge Global Market Intelligence. Includes active and passive funds and ETF flows globally.

2. Sources: Bloomberg, Securities and Exchange Commission

Why the US has had the edge

- **Trusted legal infrastructure:** Robust securities regulation, transparent enforcement and a reliable judiciary have afforded investors significant protection. By global standards, the US scores highly on rule-of-law and governance indicators with the World Bank's governance index consistently ranking the US in the top decile. Until now, investors have consistently paid a premium for US assets, placing their trust in a system that is predictable, fair, and enforceable.
- **High shareholder engagement:** An active shareholder culture has created an environment where institutional investors and activist funds routinely engage with management teams. This dynamic has driven meaningful change; raising accountability through proxy votes, reshaping boardrooms and increasing compensation oversight.
- **Deep, liquid capital markets:** US equity markets, valued at over US$45 trillion, represent almost half of the total capitalisation of global markets.[3] This scale delivers liquidity, enabling efficient capital allocation and shock absorption. The diversity of sectors and the constant scrutiny from analysts, investors and regulators create a feedback loop that reinforces transparency and accountability.

While the US governance landscape is evolving under pressure from multiple stakeholders, its foundational alignment with shareholder interests remains intact. Nevertheless, its dominance is no longer unchallenged, and competition is narrowing the gap.

Global competition

While the US continues to refine its mature governance framework, several markets are undergoing more transformative changes. Japan and South Korea, in particular, have launched ambitious reform agendas aimed at elevating governance standards and unlocking shareholder value. For global investors, these developments present compelling opportunities alongside US allocations.

Japan[4]

Japan began its governance revolution a decade ago moving from a stakeholder-centric model with low capital efficiency to a more shareholder-aligned framework. Since 2014, a series of reforms anchored in the Corporate Governance Code and Stewardship Code have reshaped board structures, investor engagement and capital allocation. The result has been a governance-driven renaissance in Japanese equities.

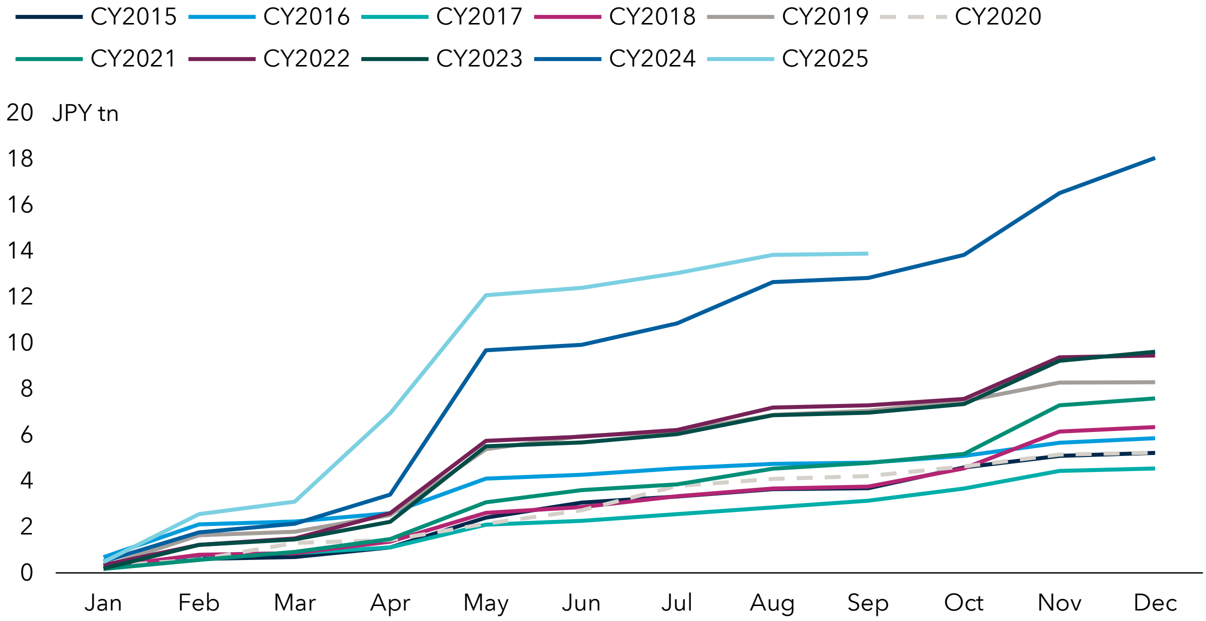
Phase 1 (2015–2023): Building the Foundation

- **Governance codes introduced**
  Japan's Corporate Governance Code (2015) encouraged independent board oversight and shareholder dialogue, while the Stewardship Code pushed institutional investors to actively vote and engage.
  - By 2020, all TOPIX 100 companies had at least two independent directors, up from just 20% in 2013.
  - Between 2015 and 2022, board independence rose to more than one-third and shareholder proposals quadrupled.

3. As at 30 June 2025. Source: Bloomberg
4. Sources: Japan Exchange Group, Financial Services Agency

- **Capital efficiency gains**
  Management teams began prioritising return-on-equity (ROE) and streamlining balance sheets.
  - Average ROE doubled from ~5% in 2010 to ~10% by the late 2010s.
  - Companies unwound cross-shareholdings, divested non-core assets, and redeployed capital into buybacks and debt reduction.
- **Valuation improvement**
  The TOPIX price-to-book ratio rose from ~0.9x in 2012 to ~1.2x by 2019, reflecting a narrowing valuation gap with global peers.

Management focus on capital efficiency has had tangible results
Announced buybacks in Japan (cumulative, JPY trillion)



Past results are not a guarantee of the future results.
As at 19 September 2025. Sources: Nikkei Value Search, Goldman Sachs, Capital Group

Phase 2 (2023–Present): Accelerating capital efficiency[5]

- **Tokyo Stock Exchange (TSE) Prime Market reform**
  In 2022, the Tokyo Stock Exchange launched the Prime Market with stricter governance standards. In 2023, it publicly urged companies trading below book value to improve capital efficiency.
  - By mid-2023, 92% of Prime-listed firms had disclosed plans to raise ROE or optimise balance sheets.
- **Governance code enhancements**
  Revised in 2021, the Code now requires one-third independent directors and encourages board diversity.
  - Compliance is high: nearly all large firms meet independence targets, and female board representation has more than doubled to approximately 15% in the TOPIX 100 index.

5. Sources: Financial Services Agency, Tokyo Stock Exchange

- **Rise of activism**
  Domestic and foreign activists have gained traction with campaigns at major firms like Toshiba, Sony and Olympus.
  - Toshiba's 2023 privatisation marked a milestone in shareholder influence.
- **Cost-of-capital-conscious management disclosure**
  TSE initiated its request for cost-of-capital-conscious management in March 2023. Since then, 92% of Prime Market listed companies have disclosed (this includes companies with a disclosure status of 'under consideration') compared with only 51% of companies listed on the standard market.

Shareholder value impact[6]

Reforms have led to a renaissance in Japan's equity market:

- **Record capital returns**
  Japanese companies have significantly increased dividends and buybacks.
  - For the 2022 financial year, buybacks hit JP¥9 trillion (US$65 billion), doubling the prior year.
  - Dividend yields rose from 1.5% in 2015 to approximately 2.6% in 2023, even as stock prices climbed.
- **Market re-rating**
  Governance reforms have driven a re-rating of Japanese equities.
  - The TOPIX broke 2,300 in mid-2023, its highest level since 1990.
  - Foreign investors were net buyers of JP¥6.3 trillion (US$50 billion) in 2023, the largest inflow in over a decade.
  - The TOPIX forward P/E narrowed its gap with the S&P 500 (14x vs. 18x), reflecting improved investor confidence.
- **Operational performance**
  Governance improvements have translated into stronger fundamentals.
  - Net margins for TOPIX constituents reached 7% in 2022, up from 4% in 2010.
  - ROE stabilised around 10%, narrowing the gap with the U.S. (14%).
  - Earnings per share (EPS) has grown 6.9% over the past decade.
  - Companies like Toyota shifted from cash hoarding to active capital deployment, targeting to maintain an ROE above 10% which has driven stock returns.

Cultural shift and reform momentum

Japan's governance transformation is increasingly self-sustaining. Capital efficiency is now a mainstream topic on earnings calls. Reforms have continued across administrations with broad political and investor support. Even mid- and small-cap firms are voluntarily adopting governance best practices, driven by peer pressure and market incentives.

The Asian Corporate Governance Association (ACGA) awarded Japan its highest governance score ever in 2023 citing improved rules, enforcement and corporate responsiveness.

6. Sources: Japan Exchange Group, Bloomberg, Nikkei

South Korea[7]

South Korea is at a much earlier stage of its reform revolution, but it has taken a leaf from Japan's playbook. South Korean equities have long traded at a discount to global peers, often attributed to governance challenges such as complex cross-shareholding structures, low dividend payouts, and limited board independence. In response, Korea launched the Corporate Value-Up Program (CVUP) in 2024, a market-driven initiative designed to enhance shareholder returns and align corporate practices with global standards.

Key Features of CVUP

- **Voluntary Value-Up plans**
  Listed companies are encouraged to submit multi-year plans targeting improvements in return-on-equity (ROE) and shareholder value. These plans include commitments to higher dividend payouts, share buybacks, simplified group structures, and stronger board independence.
  - By late 2024, over 150 companies (representing nearly half of the KOSPI's free-float market cap) had published such plans.
  - Notably, several major banks pledged to raise dividend payout ratios from sub-20% levels to 30-50%, while chaebols (large family-owned conglomerates) began simplifying structures to reduce valuation discounts.
- **KRX incentives and index inclusion**
  The Korea Exchange (KRX) launched the KRX Value-Up Index which incentivises participation in 'Value-Up' plans through passive flows and reputational benefits.
  - Companies with credible plans also receive reduced listing fees and enhanced visibility.
- **Regulatory support and legal reform**
  While CVUP is voluntary, regulators have signalled potential for mandatory measures if uptake slows.
  - In 2025, Korea's National Assembly passed amendments to the Commercial Act, strengthening minority shareholder rights through mechanisms like cumulative voting for board elections.

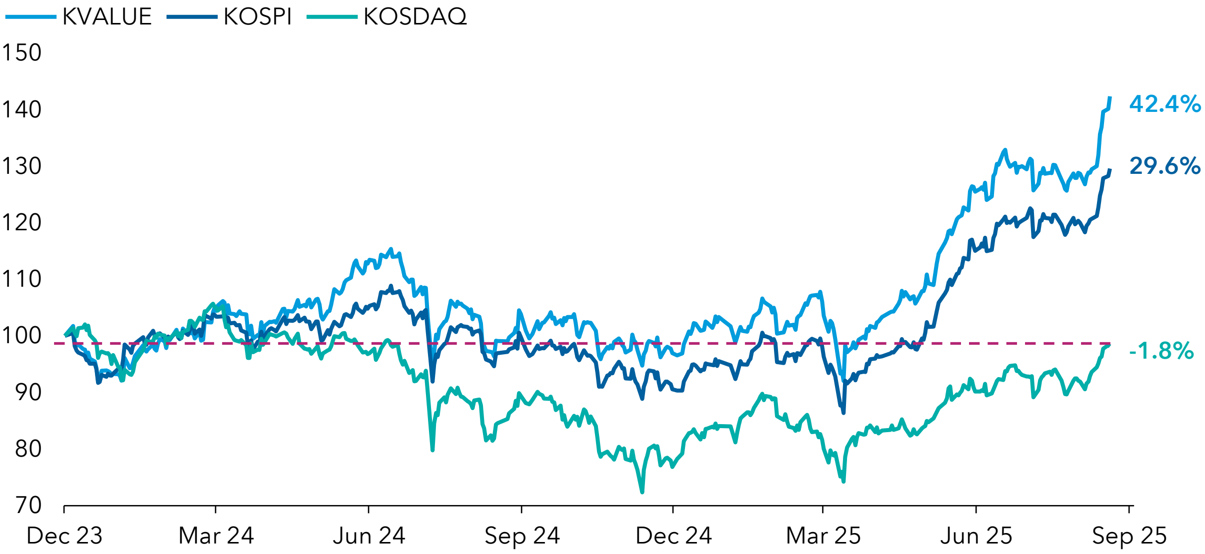
Shareholder value impact

The CVUP initiative has already delivered measurable benefits:

- **Capital returns surge**
  In 2024, Korean companies paid out ₩30.3 trillion in dividends, a 10.5% increase year-on-year, with ₩18 trillion coming from CVUP participants. Share buybacks also hit a record ₩18.8 trillion.
  - Samsung Electronics committed to regular buybacks and higher dividends.
  - Major banks like KB Financial and Shinhan raised payout ratios toward global norms.
- **Market returns and valuation uplift**
  Since the beginning of 2024, KRX Value-Up Index is up 42.4%, significantly outpacing the broader KOSPI (29.6%) and KOSDAQ (-1.8%) indices.

7. Sources: KRX – Korea Exchange, Business Korea

Korea's Value-Up index has outpaced broader Korean equities since 2024



Past results are not a guarantee of future results.
As at 16 September 2025 (rebased to 100 as at 28 December 2023). Source: KRX Market Data System.

  - Foreign investors turned net buyers of Korean equities, reversing years of outflows.
  - The KOSPI 200's price-to-book ratio rose over 2025, re-rating from 0.8x to 1.25x. This reflects a reduced governance discount, although there is still room for improvement.

- **Rising shareholder engagement**
  The 2025 proxy season saw 78 shareholder proposals, a 48% increase from 2024, focused on dividends and board independence.
  - Support levels were significantly higher than in previous years, signalling a cultural shift in investor expectations and corporate responsiveness.

To disclose or not to disclose? Short-term indicators are positive for CVUP participants

	Disclosers	Non-disclosers
Share price return CY 2024	+4.5%	-16.9%
Return-on-equity FY 2024	8.0%	5.5%
Price-to-book ratio FY 2024	0.8x	0.9x
Dividend payout ratio FY 2024	41%	21.4%

Past results are not a guarantee of future results.
As at 31 December 2024. Source: Bloomberg. CY: Calendar year. FY: Financial year.

Korea's governance landscape is evolving meaningfully

- Minority shareholder rights have strengthened through cumulative voting and lower thresholds for legal action.
- Audit independence has improved and board diversity is gaining traction.
- Companies like LG Chem, initially hesitant, joined CVUP after market pressure, announcing special dividends and narrowing valuation gaps.

Challenges remain, such as uneven ambition across value-up plans and potential political shifts. However, these reforms represent structural change and are gaining institutional traction. Korea's efforts are actively closing the gap between sovereign governance strength and corporate governance standards.

Strategic implications for global investors[8]

Governance reforms have made Japan and Korea's equity markets more investable and attractive. Prior to reforms, both markets consistently traded at steep discounts to global peers. In 2012, Korea's cyclically adjusted P/E was approximately 40% below the US, and Japan's was 35% lower. By 2023, those gaps had narrowed to 20% and 15%, respectively, closely tracking the timeline of governance improvements.

Together, these case studies demonstrate that governance reform is a powerful lever for shareholder value creation and can reposition a market in global portfolios.

China: 2024-2025 Governance reforms to unlock shareholder value

While Japan and Korea have led Asia's governance transformation, China is following suit. Regulatory-driven reforms are beginning to reshape corporate behaviour with shareholder value now firmly on the agenda.

Historically, China's governance model diverged from its regional peers. A retail-heavy market and the outsized role of the state meant listed companies, especially state-owned enterprises (SOEs), often prioritised policy over profit. But with capital markets under pressure and investor confidence waning, regulators are pivoting. The China Securities Regulatory Commission (CSRC) is now pushing companies to actively manage market value, aligning corporate actions with investor interests.

A landmark shift: Market value management[9]

In November 2024, the CSRC issued its first comprehensive directive on 'market value management', urging firms to support share prices through dividends, buybacks, M&A, and ROE improvement.

The impact was immediate: During the annual general meeting (AGM) season in 2024, listed companies paid out a record CN¥2.4 trillion in dividends and executed CN¥147.6 billion in share buybacks. This is a record high for both metrics as companies responded to tighter distribution rules and regulatory pressure. The momentum has carried into 2025 with more firms committing to shareholder-friendly actions.

Impact on market sentiment

Markets have responded as intended. Long-standing concerns around capital inefficiency and opacity, from excess cash hoarding to questionable investments, began to ease. With more cash being returned and clearer incentives to boost stock returns, investor sentiment has improved. Undervalued sectors, particularly tech and industrial SOEs known for sitting on idle capital, saw renewed interest as expectations for payouts and restructurings rose.

8. Sources: World Population Review, CEIC, Siblis Research, Monevator
9. Sources: The State Council Information Office The People's Republic of China (SCIO), Taiwan Stock Exchange, Securities Commission Malaysia, Securities and Exchange Commission (Thailand)

SOEs: Governance reforms hits the core

Recognising the outsized role of SOEs, the government is pushing deeper reforms. In January 2024, the State-owned Assets Supervision and Administration Commission (SASAC) announced that 'market value management' would be included in executive performance appraisals at centrally managed SOEs. This marks a major shift: stock price performance and investor returns are now part of the scorecard for China's most powerful corporate leaders.

Regional momentum: Governance rising across Asia

China's governance reforms are not happening in isolation. Taiwan introduced mandatory audit committees for large firms in 2024. Malaysia and Thailand have strengthened minority protections and board oversight. As governance standards rise across Asia and these markets close the gap with the US, global capital is increasingly willing to flow to markets that reward transparency, accountability, and investor alignment.

The message is clear: governance is no longer a soft metric and has become a key lever for value creation. In a world of rising governance parity, the US must continue to earn the trust premium that has historically set it apart.

Governance is a competitive edge: Can the US retain it?

As others rise, the US retains unique strengths of innovation, depth and reinvention

- **Innovation dominance**: A culture of innovation means the US nurtures companies that have become globally dominant and market leaders. Investors will continue to allocate capital to these companies and governance improvements, which many large tech companies are already exhibiting, only enhance the case.
- **Market depth**: The large pools of capital in index funds, pension funds and endowments provide stability and a liquidity premium.
- **Governance adaptability**: From say-on-pay to board risk oversight, the US has shown a capacity for reinvention and has proven that it can evolve. Political turbulence is prompting renewed focus on institutional integrity, potentially raising governance standards over time.

Investors are more attuned to governance issues due to recent events. Paradoxically, this could lead to *higher* governance standards in the long run, just as Enron and Theranos brought renewed focus to board oversight. The US system's ability to learn and adjust should not be underestimated; it has been a key reason for the country's economic leadership over decades.

Conclusion

Signals and developments to watch

The resilience of the US economic model faces new tests as the global economy shifts under the weight of technological disruption, geopolitical realignment and evolving capital flows.

The foundational pillars of productivity, governance, and financial stability remain strong. However, their future trajectory will be shaped by how effectively the US and its global peers adapt to the pressures of the Great Global Restructuring.

For investors, the key developments to monitor going forward include:

- **The pace and impact of technology-driven productivity gains.** AI has the potential to become a transformative General Purpose Technology, reshaping industries and redefining productivity. Investors should pay attention to how the benefits from AI play out globally. Will it provide a broad-based boost to productivity, or will it serve as a strategic advantage concentrated in certain countries? Those most successful in harnessing the productivity gains from AI and other tech will define the ultimate winners and how economies evolve.

  A critical factor is whether technology and investment move in tandem. If technology advances faster than investment, we may see sharp productivity gains at the cost of labour market disruption. If investment leads, there will be time for economies to adapt. The Goldilocks outcome is one where technology and investment advance together.

- **The reconfiguration of trade and investment flows.** Historical attempts to address US trade imbalances have largely fallen short, often weakening the dollar while prompting structural reforms abroad. Today's rebalancing efforts are already reshaping global capital flows.

  In the short term, repatriation of portfolio investments has sparked regional equity rallies. Longer term, foreign direct investment (FDI) may be driven by geopolitical alignment rather than economic rationale, fostering deeper ties among non-US economies and potentially redrawing the global investment map.

- **Debt sustainability and the US dollar.** Projections for US debt-to-GDP are contingent on a range of assumptions with even small deviations materially altering forecasts. Investors should keep an eye on the policy levers that could be implemented, including investments in digital infrastructure and AI-adoption to boost productivity; forward guidance or quantitative easing to anchor long-term interest rates; and capital expenditure in strategic sectors to support long-term growth.

  Depreciation in the US dollar may reflect a discount due to concerns over US fiscal sustainability, central bank independence, and policy unpredictability. However, while the dollar may be facing cyclical headwinds, the structural foundations of its dominance – liquidity, trust, and institutional depth – continue to anchor investor behaviour.

- **Durability of shareholder-centric governance.** Certain elements of US corporate governance are evolving. Strategic alignment has gained prominence, while support for environmental and social proposals has declined. Lessons from past lapses, such as Enron and Theranos, highlight the US system's resilience and its ability to restore investor confidence.

  Strong alignment between management and shareholders remains a core strength of US assets. Yet global peers are catching up. Japan and Korea are proving that governance can be a source of competitive advantage and a driver of equity returns.

These are just some of the dynamics determining the future of American exceptionalism as well as the competitive landscape across developed and emerging markets.

The question is no longer whether change is coming, but how to navigate it.

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