STATE STREET INVESTMENT MANAGEMENT

July 31, 2026
Commentary

Weekly Economic Perspectives

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Weekly Highlights

A volatile week in markets amid split Fed decision and currency interventions.

US: FOMC Rate Decision (Upper Bound)
3.75%
On hold with hawkish split.

US: GDP (Q2, saar, advance)
1.5%
Slowing down.

GE: GDP (Q2, q/q sa, prelim)
0.2%
Above expectations but still modest.

BoE: Policy Rate
3.75%
On hold but hike bar increased.

UK: Mortgage Approvals (Jun, thous)
58.2
Above expectations.

UK: Nationwide House PX (Jul, m/m)
0.1%
Weak.

JP: Retail Sales (Jun, y/y)
0.5%
Below expectations.

JP: BOJ Policy Rate (Jul)
1.0%
Setting up the next hike.

AU: CPI (Jun, y/y)
3.8%
Reinforces our dovish bias.

US: The Dissents Tell the Story

The second FOMC meeting under the leadership of Chair Warsh was more edgy and triggered more market volatility. There was no change to the Fed Funds rate (still at the 3.50-3.75% range) but there were three dissents in favor of an immediate hike. Given the terseness of the FOMC statement (essentially unchanged from June), the individual statements put forth by the three dissenters offer more color on the question of policy direction.

Minneapolis Fed President Kashkari: “But to manage against the risk that high inflation could become entrenched, I would rather tighten policy incrementally as we gather more data on the path of inflation and employment. If inflation remains elevated, in my view, a potential series of small policy moves would be better than waiting and eventually concluding that even bolder actions were necessary. On the other hand, if inflation durably fades, a strategy of small policy steps would allow the FOMC to slow or pause subsequent adjustments without unnecessary impact on the real economy.”

Dallas Fed President Logan: “Labor, consumption and financial market conditions indicate that monetary policy is not restraining the economy. Without any policy restraint, inflation will likely continue to trend above target until there’s an unanticipated shock. The FOMC cannot count on unanticipated shocks to achieve its goals and can always adjust policy if unanticipated shocks occur. Modest action in the near term would reduce the likelihood of needing to take sharper action later."

Cleveland Fed President Hammack: "A higher federal funds rate would help restrain economic activity and reduce inflationary pressures. I preferred to move at our recent meeting because I did not see the current policy stance as appropriately restrictive."

The three excerpts above share a common thread: the idea that inflation is not convincingly trending toward the target and that policy is not sufficiently restrictive to make that happen. As such, some tightening is needed, and it is better to do it gradually. In other words, start early and go slow rather than wait and go fast. Critically, none of the dissenters appear to believe that the Fed is "behind the curve" and the tightening they seem to imply is still very much a pre-emptive kind of action. This is important because if even the hawks see tightening as pre-emptive, the majority of the FOMC members likely believe that there is still a window of time before rate hikes become compelling. And that window can bring about favorable data evidence that makes the hikes less, rather than more compelling over time. We continue to believe the Fed will just barely remain on hold this year.

Figure 1: Softer Ending To A Bumpy Year For the US Economy

Source: Macrobond, State Street Investment Management, U.S. Bureau of Economic Analysis (BEA)

Meanwhile, advance estimates for second quarter GDP peg growth at a lower-than-expected 1.5% seasonally adjusted annualized rate (saar) (Figure 1). Private consumption made an outsized contribution, but the strength is partly financed by dissaving and partly boosted by the World Cup. Fixed investment was robust but with split performance across segments (strong equipment and IP, weak structures and residential). Trade was a sizable detractor. The data remains consistent with our 2.3% full-year GDP growth forecast.

BoE: On Hold with Hike Bar Rises

The BoE left rates unchanged at 3.75%, but its policy message mattered more than the decision itself. In our view, this was a dovish hold, with the bar for another hike now meaningfully higher.

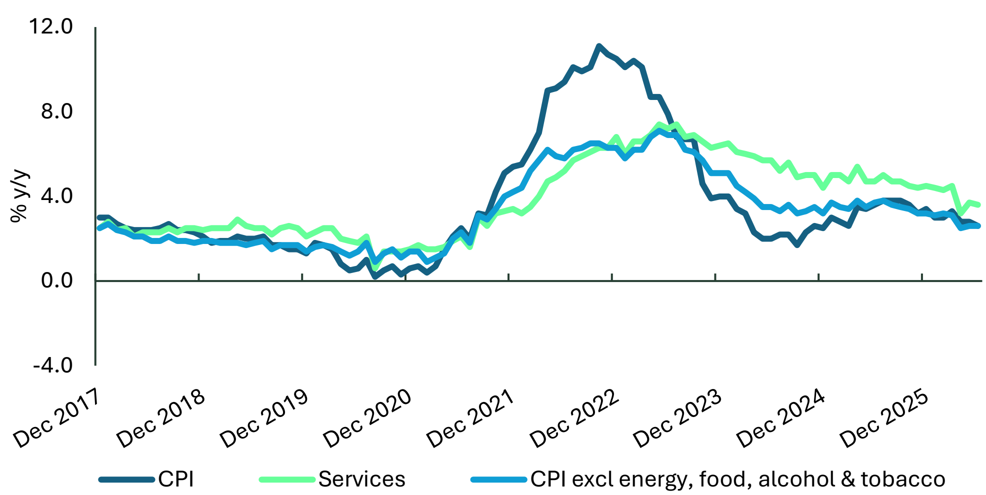
At first glance, the vote split looked hawkish, with Mann joining Pill and Greene in backing tighter policy. But that signal should not be overread. The center of gravity on the MPC is shifting towards patience, reinforced by softer labor market and inflation data. While hawkish members can still point to upside risks, they now need much clearer evidence to make the case for renewed tightening.

The reaction function is therefore key. The recent rise in energy prices has attracted the MPC's attention, but energy volatility alone is unlikely to push the Bank back into tightening mode. For hikes to return, the BoE would need evidence that higher energy costs are feeding into wages, pricing behavior and inflation expectations. For now, that evidence remains limited. Business surveys point in the same direction: firms are not adjusting wage or price plans solely because of higher energy costs.

Taken together, this leaves policy asymmetric. Near-term inflation volatility may keep the BoE cautious on cuts, but without clearer signs of persistence, it is unlikely to justify restarting hikes.

Our base case is therefore for the BoE to stay on hold for now, before resuming cuts in Q2 next year.

Figure 2: UK Inflation Stays Contained, But Still in Focus



Source: ONS, State Street Investment Management

BoJ: First Joint Intervention In 15-years

The Bank of Japan (BoJ) left its policy rate unchanged at 1.0%, with a neutral stance, maintaining a cautious but still hawkish stance. The decision was not unanimous, with board member Hajime Takata reportedly dissenting in favor of a

25bp hike, underscoring growing concern within the Board about upside inflation risks. In its statement, the BoJ reiterated that underlying inflation is moving closer to its 2% objective and that accommodative financial conditions continue to support the economy. Importantly, the Bank emphasized that it would continue normalizing their monetary policy if its economic and price outlook materialize as expected.

The updated Outlook Report painted a broadly constructive picture of Japan's economy. While growth is expected to moderate in FY2026 amid higher energy costs and uncertainty stemming from the Middle East, the BoJ believes the economy will remain supported by accommodative financial conditions, government measures, and robust global demand linked to AI investment. The most notable change was on inflation. The Bank now expects core CPI inflation to rise clearly above 2% during the second half of FY2026 before easing back toward target thereafter. The Bank highlighted several catalysts behind this view, including continued wage-price pass-through, elevated energy costs, yen depreciation, and rising semiconductor-related costs linked to strong global AI demand.

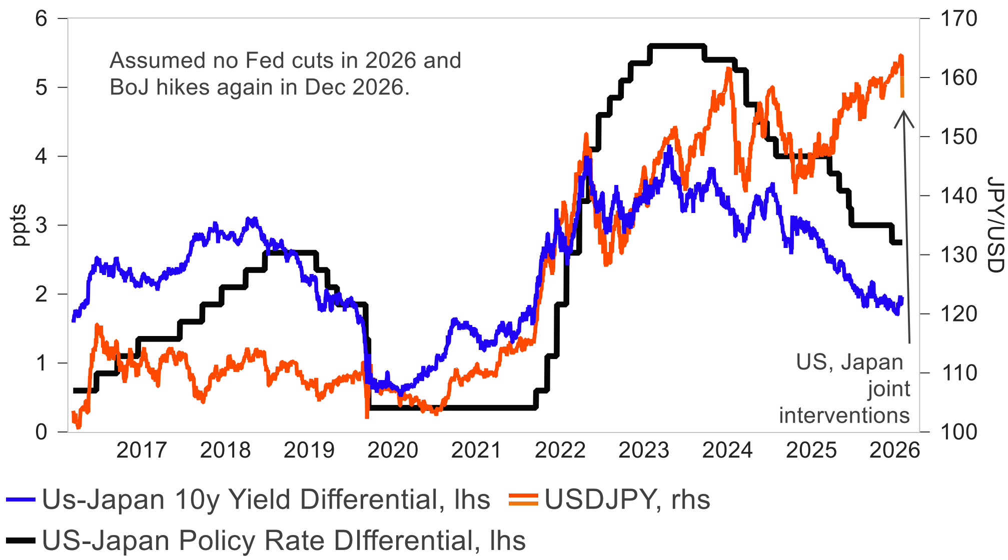
Governor Ueda's press conference reinforced the message that inflation risks are increasingly tilted to the upside. He noted that several board members now see higher inflation risks and indicated that the BoJ could accelerate the pace of normalization if monetary conditions remain excessively accommodative. Of particular interest was his explicit reference to AI-related demand as a factor warranting close monitoring. Ueda argued that strong global AI investment is influencing demand conditions and could have broader implications for prices through semiconductors and related supply chains. On the currency, he stressed that yen volatility is having a larger impact on inflation than in the past and warned that policymakers must pay greater attention to exchange-rate-driven price pressures now that underlying inflation is much closer to target. His comments suggest the BoJ increasingly views yen weakness not simply as a market development but as a factor with direct implications for achieving price stability.

The yen remains the key risk to Japan's inflation outlook and the clearest point of tension between policymakers and financial markets. Around the BoJ meeting, coordinated intervention by the Ministry of Finance and US authorities helped strengthen the yen to around 156.6 against the dollar by Monday noon. In our view, these interventions are significant because they highlight policymakers' growing discomfort with the yen and reinforce the case for further policy normalization. As a result, we expect continued volatility, with the yen remaining highly sensitive to data flow, policy communications and shifts in global rate expectations.

While a September rate hike cannot be ruled out, we view it at 25% probability. The case has strengthened nonetheless, given the yen's renewed importance in the inflation outlook and the proximity of bank holidays around the September meeting. However, such an outcome would require a particularly supportive combination of domestic and global data, along with carefully coordinated guidance from policymakers in both the countries. While the rationale is increasingly compelling, the hurdle for a September hike remains high.

More broadly, a divergence has emerged between rates and currency markets. Bond investors are increasingly recognizing that the BoJ is moving steadily along the path of policy normalization, while FX markets have been less convinced that the Bank will ultimately tighten enough to materially alter Japan's interest rate differential with the rest of the world. We believe this skepticism underestimates the BoJ's commitment to normalization. The Bank has consistently prepared markets for each stage of the process and remains firmly in control of the pace and direction of policy. This gap in expectations is narrowing as a result of the coordinated interventions, but the market may react sharply to dataflow and guidance from policymakers.

Figure 3: When Will The Yen Settle?



Source: Macrobond, State Street Investment Management, Bank of Japan (BOJ)

Overall, this week's decision does little to alter our baseline view. While the BoJ opted to pause, the combination of upside inflation risks, resilient domestic demand, ongoing wage gains, and an AI-driven boost to investment activity remains consistent with a gradual normalization cycle. The tone of both the statement and Governor Ueda's remarks suggests that policymakers are becoming more confident that inflation can be sustained around target. As such, we continue to expect the BoJ to remain firmly in the driver's seat and retain our forecast for another rate hike Q4 2026, most likely once policymakers gain more confidence that recent inflation pressures are translating into durable underlying price momentum.

Week in Review

A summary of macro data releases from the past week.

Country	Release (Date, format)	Consensus	Actual	Last	Comments
Monday, Jul 27					
US	Durable Goods Orders (Jun, prelim)	1.8%	0.3%	-4.0%	Modestly rebounded.
US	Dallas Fed Manf. Activity (Jul)	2.0	1.3	0.0	Modest improvement.
GE	IFO Business Climate (Jul)	86.0	86.6	85.7	Third consecutive monthly increase
Tuesday, Jul 28					
US	FHFA House Price Index (May, m/m)	0.1%	0.3%	-0.1%	Better-than-expected rebound.
US	Richmond Fed Manufact. Index (Jul)	6.0	5.0	4.0	Improved but only gradually.
US	Conf. Board Consumer Confidence (Jul)	92.4	90.8	92.2 (↑)	Consumers remain cautious.
FR	Consumer Confidence (Jul)	85.0	86.0	84.0	Continues to recover but still fragile.
Wednesday, Jul 29					
US	MBA Mortgage Applications (Jul 24)	n/a	-6.4%	1.9%	Largest weekly decline in about two months.
US	FOMC Rate Decision (Upper Bound)	3.75%	3.75%	3.75%	On hold with hawkish split.
UK	Mortgage Approvals (Jun, thous)	57.1	58.2	56.6 (↑)	Above expectations.
AU	CPI (Jun, y/y)	4.0%	3.8%	4.0%	Downside surprise, but an RBA pivot is still far.
Thursday, Jul 30					
US	Personal Income (Jun)	0.3%	0.2%	0.7%	Growth moderating.
US	Personal Spending (Jun)	0.4%	0.3%	0.9% ↑)	Less solid than expected.
US	Initial Jobless Claims (Jul 25, thous)	200	197	188	Below expectations.
US	Continuing Claims (Jul 18, thous)	1,795	1,782	1,789	Below expectations.
US	GDP (Q2, q/q annualized, advance)	2.0%	1.5%	2.1%	Slowing down.
UK	Bank of England Bank Rate	3.75%	3.75%	3.75%	On hold but signaled a dovish tilt.
GE	GDP (Q2, q/q sa, prelim)	0.1%	0.2%	0.3%	Modest growth, supported mainly by exports.
GE	CPI (Jul, y/y, prelim)	2.7%	2.8%	2.3%	Reaccreted, driven by higher energy prices.
FR	GDP (Q2, q/q, prelim)	0.2%	0.2%	-0.1%	Domestic demand remains weak.
IT	GDP (Q2, q/q wda, prelim)	0.1%	0.2%	0.3%	Slightly higher than expected.
IT	Unemployment Rate (Jun)	5.0%	5.7%	5.3% (↑)	Highest since November 2025.
AU	Building Approvals (Jun, m/m)	-0.5%	7.2%	-1.1%	Led by high density approvals.
Friday, Jul 31					
US	MNI Chicago PMI (Jul)	56	57.6	56.7	Solid.
US	U. of Mich. Sentiment (Jul, final)	54.0	55,2	49.5	Highest reading since February 2026
UK	Nationwide House PX (Jul, m/m)	0.1%	0.1%	0.0%	Weak.
GE	Unemployment Claims Rate (Jul, sa)	6.3%	6.4%	6.3%	Weakening.
FR	CPI (Jul, y/y, prelim)	1.8%	2.1%	1.8%	Reaccreted, driven by higher energy prices.
IT	Consumer Confidence Index (Jul)	92.8	94.2	92.4	Above market expectations.
JN	Jobless Rate (Jun)	2.5%	2.5%	2.5%	Labor market at equilibrium.
JN	Retail Sales (Jun, m/m)	-1.6%	-4.1%	1.7%	Big downside surprise.
JN	Industrial Production (Jun, m/m, prelim)	1.0%	1.3%	0.1%	Going strong.
JN	BOJ Target Rate	1.00%	1.0%	1.00%	Neutral hold.

Source: data, Bloomberg®; for commentary, SSIM Economics.

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