STATE STREET INVESTMENT MANAGEMENT

September 18, 2026
Commentary

Weekly Economic Perspectives

Contents

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Global Macro Highlights

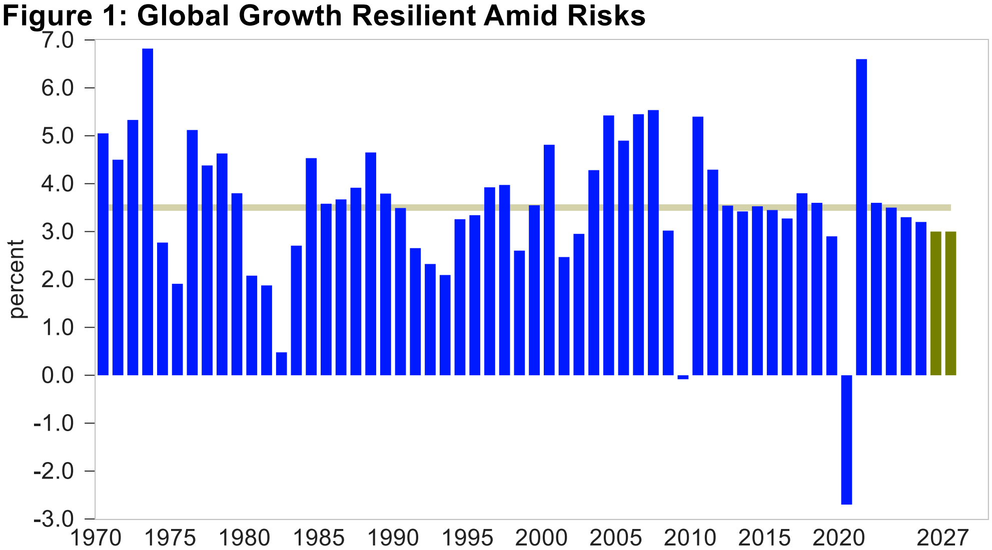
Revisiting Assumptions, Reassessing Resilience

Our June update occurred amid much improved news on the Iran war front, and our assumption at the time was that a lasting de-escalation of the conflict would allow central banks to look through the energy-related inflation spike that was already visible globally. Events have since proved that assessment overly optimistic. As we stand, there is no indication of short-term de-escalation, while recent damage to Saudi oil infrastructure highlights broadening risks. Meanwhile, adjustment channels that worked well in the early stages (i.e., the run-down of stored reserves) are being gradually exhausted. Hence, risks of more meaningful disruptions—via price as well as physical shortages—are rising. Should they fully materialize, they will not hit evenly. The US remains more insulated than Europe or Asia, though certainly not immune.

Notably, the unfolding of events so far has been sufficient to move global central banks off the sidelines. The ECB, the BoJ, and the Fed all hiked at their September meetings, and all are poised to do more. Still, markets look to us to have taken the hiking cycle expectations a bit too far. We do not believe that underlying economic momentum is sufficiently robust to withstand a full-on tightening cycle, nor do we believe rate hikes to be effective in neutralizing the sources of inflation (energy supply shock and AI demand pull).

Admittedly, economic growth has been impressively resilient so far and our global forecasts have held up surprisingly well. But this should not be read as an absence of vulnerabilities. Rather, it is the mathematical result of a seemingly relentless AI infrastructure buildout, which is a strength while happening and a potential threat to future growth, should it stall. The consumer seems pretty unhappy everywhere and real household spending remains under pressure both in Europe and Japan. Even in the US, spending resilience so far has come at the cost of declining savings. Investment momentum carries 2026, but we need consumers to come back in 2027.

Figure 1: Global Growth Resilient Amid Risks



Source: Macrobond, State Street Investment Management, IMF WEO

Summary of World Output[1] and Inflation[2] (Annual percent change)

	Weight	History					Forecast	
	2023	2021	2022	2023	2024	2025	2026	2027
World Growth	100.0	6.6	3.6	3.5	3.3	3.2	3.0	3.0
Advanced Economies	40.5	6.0	2.9	1.7	1.8	1.6	1.6	1.6
US	14.9	6.2	2.5	2.9	2.8	2.1	2.3	2.1
Euro area	11.9	6.4	3.6	0.4	0.9	1.5	1.0	1.3
Germany	3.2	3.9	1.9	-0.7	-0.5	0.4	0.9	1.2
France	2.3	6.8	2.8	1.6	1.1	0.9	0.6	1.0
Italy	1.9	8.8	5.0	1.0	0.6	0.7	0.8	0.9
Japan	3.4	3.7	1.3	0.7	-0.2	1.2	0.8	0.9
UK	2.2	8.5	5.2	0.3	1.1	1.3	0.8	0.8
Canada	1.4	6.0	4.7	2.0	2.0	1.7	1.0	1.3
Australia	1.0	5.4	4.2	2.1	1.0	2.0	1.7	1.9
Developing Economies	59.5	7.0	4.1	4.7	4.3	4.3	4.0	4.0
China	19.1	9.2	3.1	5.4	5.0	5.0	4.6	4.4
Advanced Economy Inflation	40.5	3.1	7.3	4.6	2.6	2.4	3.2	2.4
US	14.9	4.7	8.0	4.1	3.0	2.7	3.3	2.2
Euro area	11.9	2.6	8.4	5.5	2.4	2.2	2.9	2.2
Germany	3.2	3.1	6.9	6.0	2.3	2.2	2.7	2.2
France	2.3	1.7	5.2	4.9	2.0	1.0	2.3	1.9
Italy	1.9	1.9	8.2	5.7	1.0	1.6	2.8	2.0
Japan	3.4	-0.2	2.5	3.3	2.7	3.2	2.0	2.5
UK	2.2	2.6	9.1	7.4	2.5	3.4	3.2	3.0
Canada	1.4	3.4	6.8	3.9	2.4	2.1	2.8	2.3
Australia	1.0	2.9	6.6	5.6	3.2	2.8	3.8	2.8
Developing Economies	59.5	5.8	9.5	8.0	7.7	4.9	6.1	5.0
China	19.1	0.9	2.0	0.2	0.2	0.0	1.1	0.9
Value of World Output ($ trl)								
At Market Exchange Rates		97.4	101.4	105.7	115.6	126.4	134.2	141.5
At Purchasing Power Parities		155.4	172.3	184.3	201.0	219.1	225.8	232.6

[1] Real GDP; [2] Consumer Price Inflation

Weight is the share of world GDP on a purchasing power parity basis (IMF *World Economic Outlook)*

Historical data sources: Oxford Economics, IMF. Forecast: SSGA Global Macro and Policy Research

Politics and Geopolitics

The Real Midterm Risk: Energy, Not Politics

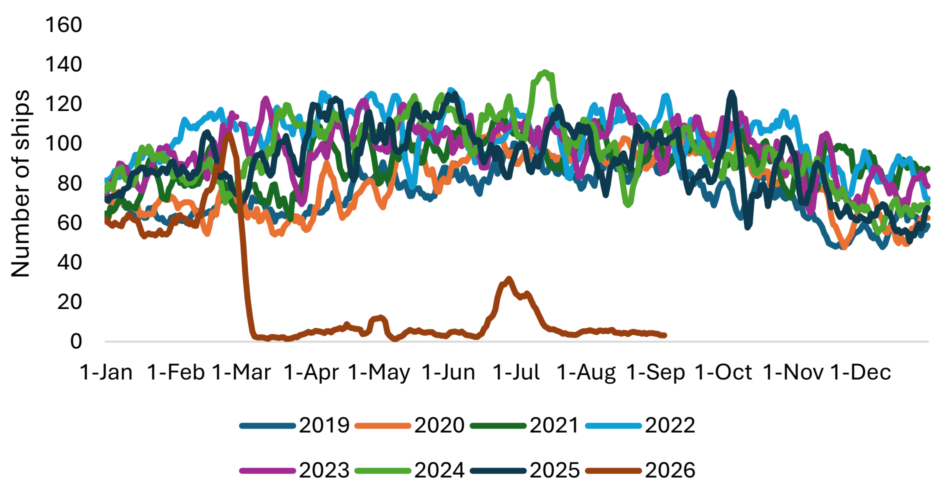
The US midterms on 3 November are the main event on the policy calendar. However, their importance lies less in their results and more in the incentives they create for the Middle East energy crisis—the largest threat to an otherwise constructive macroeconomic outlook.

The economic impact of the crisis has been milder than feared so far. Stock releases and market adaptation materially reduced the shortfall in crude oil, although the shortfall in energy product persists. This has limited the stagflationary hit to the global economy.

Yet the crisis is far from over. The US and Iran remain caught in a cycle of escalation and de-escalation, with tensions rising again in recent weeks. Our base case remains a contained but prolonged conflict. The cycle has an underlying logic: Iran uses pressure on energy markets to raise the cost to the US of continuing the confrontation, which causes the US to back down. This can persist, provided neither side—deliberately or accidentally—crosses the other's red lines.

While the conflict continues, the Strait remains effectively closed. Visible crossings are far below historical levels (see Figure 1). Evidence suggests that the number of "dark" crossings is material. However, these are risky and intermittent.

Figure 2: Ships crossing the Strait of Hormuz (7-day moving average)



Source: IMF, State Street Investment Management

The midterms increase the risk of escalation. Heading into the elections, the US response is constrained by the risk of an electoral backlash. Iran therefore has an incentive to escalate to lock in concessions before the vote. After the election, the dynamic flips. The administration may feel freer to escalate—particularly if it concludes that delay favors Iran. Either path threatens energy supply.

As for the mid-terms themselves, investment implications are limited. Little major legislation is likely before the next Congress convenes in January. Federal funding expires on 11 December, creating shutdown risk during the lame-duck session, but history suggests that any broader economic effect would be modest.

The next government will likely be divided. Republicans are likely to lose control of at least one of the Congressional chambers, which narrows the scope of realistic policy initiatives. Bipartisan measures may still advance in areas such as healthcare costs or digital finance, but big initiatives like a tax cut that create waves at the macro level are unlikely. Policy impulse would instead come from executive and regulatory action, with sector-specific effects in such sectors as energy, finance and pharmaceuticals but only a modest aggregate macroeconomic impact.

Foreign policy would remain the main source of policy risk. Foreign affairs is the domain of the executive, so divided government would do little to constrain the administration in this area. In fact, domestic gridlock encourages greater activism abroad. A renewed confrontation with Europe looks likely.

The baseline view points toward a persistent energy-market tightness and global stagflationary headwinds in the medium-term. Near term, however, the midterms create a clear escalation window and the possibility of a renewed supply shock.

The 2026 midterms themselves are unlikely to produce major policy changes. While the election could still have incremental effects on select sectors, the more important signal for investors is that US political and policy volatility will likely remain elevated, setting the stage for potentially larger market-moving shifts during the 2028 presidential election cycle.

Country Macro Highlights

Please see individual country commentaries in respective sections below

US: Solid, But Not Very Broad

Perhaps surprisingly considering all that has transpired in the geopolitical sphere over the last three months, there were **only minimal changes to our growth and inflation forecasts** this round. 2026 real GDP growth remains pegged at 2.3% while the headline CPI inflation projection is lowered by a tenth to 3.3%. For next year, we lowered GDP growth by a tenth to 2.1% and raised the inflation forecast by a tenth to 2.2%. In the big scheme of things and given the risks around the outlook, these are insignificant changes. The story, then, is not about "what has changed" as it is about "what is going on".

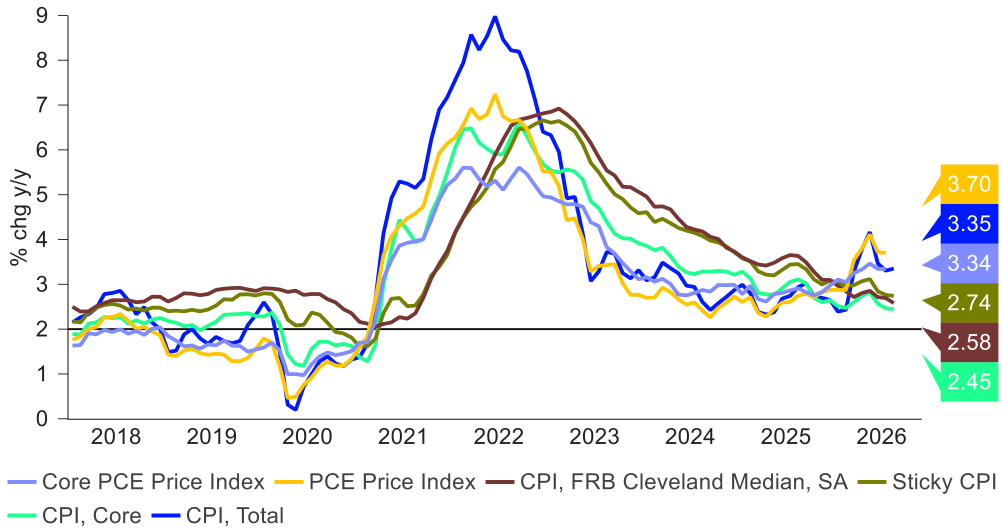
So, what is going on with the US economy? **We see a picture of resilience and strength that is, however, not universally true across the spectrum.** Rather, the K-shape extends beyond the consumer space to also characterize the investment landscape. Just as high-income consumers are driving aggregate spending, so does the AI-buildout fuel a surge in private equipment and IP investments. For example, real private fixed investment in equipment was up 9.0% y/y during the first half, while real private IP investment was up 9.1% y/y. Contrast that with residential fixed investment which contracted 4.7% y/y or structures investments which declined 5.2% y/y. You get the picture. **This is a two-speed economy, and so the outlook becomes increasingly dependent on the fast-growing segments continuing to expand robustly.** The signals coming from companies' capex plans suggest they will; the obvious risk is that something (regulatory changes, competitive pressures, cost of capital?) triggers a sharper slowdown…And yet, there is also a risk that things continue apace for an extended period. So our baseline forecasts implies a moderate slowdown that still leaves private non-residential investment growing 4.8% next year on top of this year's 6.6% gain. Residential investment continues to contract marginally in 2027 as higher rates delay the recovery in housing demand, slow the reduction in completed homes inventory, and remove builders' incentives to begin new construction.

What slows? Consumption, and only marginally. In fact, the more meaningful slowdown in consumption has already occurred this year (2.1%, following 2.6% in 2025), though that is largely a mathematical artifact. Sequential q/q growth is essentially unchanged from 2025, but the foundation of that growth is a bit shakier. Spending this year was aided by tax refunds and a material reduction in the personal saving rate (to a very low 3.0%); those engines won't fire the same way in 2027. **What supports consumption growth going forward is the anticipated improvement in real incomes as inflation moderates.** Therein lies a vulnerability insofar as workers appear to have very limited bargaining power despite a low 4.1% unemployment rate. Even minimal labor displacement due to AI adoption could further undermine that, caping income gains. We look for household consumption growth to ease to just under 2.0% next year.

The labor market remains a fascinating and somewhat puzzling chapter in the larger macro narrative. Employment data has been unusually volatile lately, with the evidence suggesting stabilization in hiring following a soft patch in 2025.

Meanwhile, the sharp decline in the labor force participation rate has lowered the unemployment rate to 4.1% as of August, below the Fed estimation of the neutral unemployment rate. And yet, despite all this, wage inflation continues to moderate: average hourly earnings (AHE) for production and non-supervisory employees stood at 3.3% y/y—the lowest since 2019. **The good news is that the labor market is not a source of inflationary pressures at the moment, has not been for a while, and is unlikely to become one any time soon.**

Figure 3: US Inflation Front and Center For The Fed



Source: Macrobond, State Street Investment Management, U.S. Bureau of Labor Statistics (BLS), Federal Reserve Bank of Atlanta, Federal Reserve Bank of Cleveland, U.S. Bureau of Economic Analysis (BEA)

The bad news is that we still have an inflation problem. Headline consumer price inflation stood at 3.4% y/y in August, core CPI was 2.4% and (most problematic for the Fed) core PCE inflation 3.3% y/y. This is the backdrop that drove the FOMC to raise the Fed Funds rate by 25 bp at the September meeting. **The median dot implies one more hike this year, which we expect in December.** We then expect an extended hold, but think it is quite possible that the Fed ends up reversing one of those hikes by the end of 2027.

Canada: Weakening Foundations

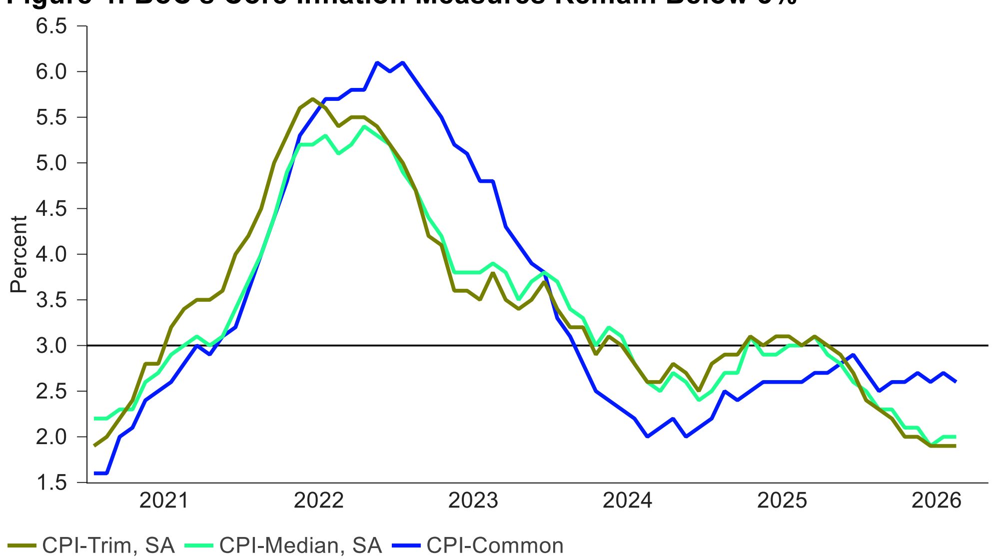
Canada has dodged recession, but not the forces holding back a convincing recovery. Stronger first-quarter data lift our 2026 growth forecast to 1.0%, 0.1 percentage points above June. That resilience is unlikely to last. New U.S. tariffs now cover 5% of Canadian exports, while Canada's counter-tariffs will raise costs at home. As the shock spreads through the economy, momentum should fade in the second half, leaving growth at just 1.3% in 2027, 0.4 percentage points below our June forecast.

The economy's traditional engines are unlikely to come to the rescue. Consumer spending has remained resilient, supported by government transfers and wealth gains, but higher energy costs will increasingly squeeze household budgets towards year-end and into early 2027. Housing offers little relief. Rising global bond yields have pulled Canadian borrowing costs higher, dimming the prospect of a meaningful rebound and removing another source of near-term growth.

The labor market looks reassuring at first glance, but the foundations are weaker than the headline suggests. Unemployment fell to 6.4% in August, yet hiring remains subdued and job gains are increasingly concentrated in a handful of regions. Tariffs threaten to widen that divide, leaving strength in the energy patch unable to carry the national economy.

This is the fault line in the monetary-policy debate. **Markets are treating higher oil prices and a firmer labor market as a signal that several rate increases lie ahead**. **We think that conclusion is premature.** Oil may boost producing regions, but it also erodes household purchasing power and raises costs for businesses nationwide. Meanwhile, core inflation remains broadly close to target, restrained by spare capacity, persistent trade uncertainty and far less AI-related demand pressure than in the US. An October increase therefore looks unlikely, although the next activity and inflation releases will be pivotal before the BoC's 28 October meeting.

Figure 4: BoC's Core Inflation Measures Remain Below 3%



Source: State Street Investment Management, Statistics Canada

The strongest route out of this low-growth trap lies in investment. Canada needs a new engine, one capable of rebuilding productive capacity and reversing years of capital erosion caused by trade uncertainty. The prize is substantial, but so are the barriers: high yields, elevated energy costs and fragile global risk appetite. Recent federal tax measures could help unlock capital spending, making a stronger investment response an upside risk to our forecasts.

Canada's outlook is therefore a race between a slowdown already under way and an investment revival that has yet to begin. Trade tensions, pressured households and weak housing are weighing on growth now; stronger capital spending could reshape the economy later. **USMCA-related risks have deteriorated**, and our baseline assumes current arrangements endure for now. Further escalation would deepen the slowdown, while a durable agreement could release pent-up investment and accelerate the recovery. Until that shift becomes visible, we expect the BoC to look through oil-driven inflation and keep rates on hold. **Canada has escaped recession, but it has not yet earned a rate hike.**

UK: Limited Insurance Tightening Likely

The economy is growing but on shaky foundations, just as the energy shock returns. The central question is whether higher energy prices fade or force the BoE to tighten into an already fragile economy.

That tension shapes our forecast revisions. Stronger Q2 growth lifts our 2026 GDP forecast by 0.1ppt, but the energy shock leads us to cut 2027 growth by 0.1ppt and raise inflation by 0.2ppt. Our 2026 inflation forecast is unchanged, while more hawkish BoE communication reinforces our expectation of further tightening.

The BoE is edging towards an insurance hike, but markets are pricing more tightening than the economy can bear. The MPC voted 6–3 to hold Bank Rate at 3.75%, with Huw Pill, Megan Greene and Catherine Mann backing a 25bp rise. Persistent energy pressure could soon persuade a majority to support higher rates.

The immediate pressure is already visible. Headline inflation rose in August, largely because of higher petrol prices. With household energy bills set to increase by 4% in October and rise sharply again in January, inflation is likely to move well above 4% early next year. That level matters because BoE research suggests stronger second-round effects become more likely as inflation exceeds 4%. It therefore helps explain the more hawkish tone from Andrew Bailey, Sarah Breeden, Clare Lombardelli and Dave Ramsden.

The case for action depends on how the Middle East conflict feeds through. A temporary inflation spike would require little response; broader pressure on wages and domestic costs would be more concerning. Subdued food, core and core-services inflation still support the first outcome, although the risk of persistence rises the longer energy prices remain elevated.

Yet the domestic economy offers little evidence that the shock is becoming entrenched. Private-sector regular pay growth was 2.9% in the three months to July, slightly below the pace consistent with the 2% inflation target. Payrolls fell by 26k in August, July's decline was revised higher, and vacancies dropped again, suggesting wage pressure should remain contained.

The growth data point in the same direction. GDP rose 0.4% m/m in July, but gains centred on business services while consumer-facing activity contracted. As higher energy bills, borrowing costs and fading seasonal support weigh on demand, we expect momentum to trough in late 2026 or early 2027.

The MPC therefore faces an inflation shock, not an overheating economy. If energy prices stay elevated until early 2027, **we expect two 25bp insurance hikes,** likely in November and February 2027. Market pricing of four hikes looks excessive given that policy is already restrictive, inflation is weighing on activity, and much of the rise in interest rates reflects risk premia. **Our forecast also has a clear off-ramp**. A durable peace agreement that lowers energy prices in the next few weeks would probably remove the need for a hike.

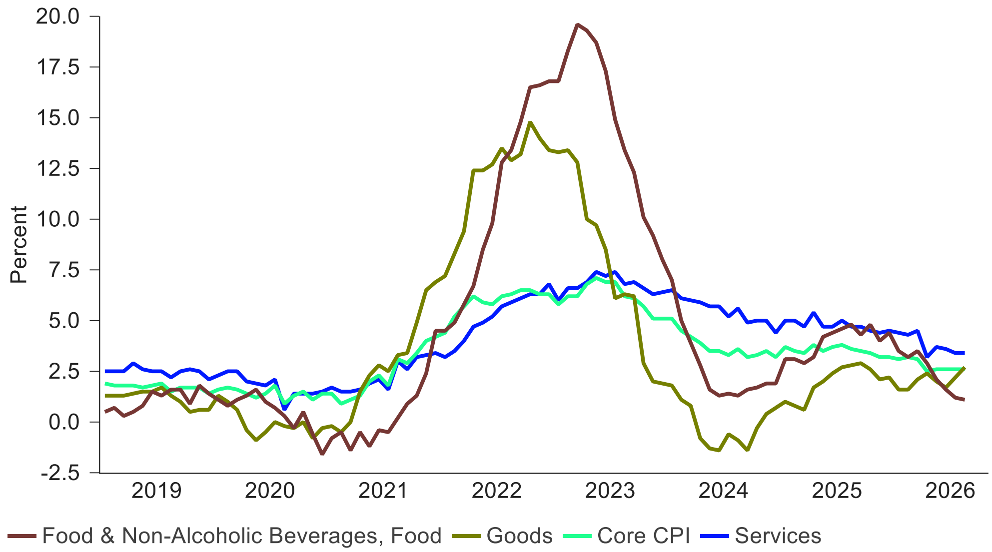
At the same time, quantitative tightening is entering its final phase. The BoE will retain £120bn against the currency stock; of the remaining £368bn, £222bn will mature by 2034 and the balance will be sold at £20bn a year.

The BoE and the Debt Management Office are also exploring whether the government could buy the Bank's gilt holdings. Such direct sales could smooth the unwind by replacing less liquid, higher-yielding bonds with benchmark issuance and lowering costs.

Another broader concern, however, is fiscal. Higher global bond yields could sharply erode government headroom if current pricing feeds into the Office for Budget Responsibility's Budget forecasts. Stronger recent growth therefore offers only temporary relief: inflation, tighter policy and rising debt-service costs all point to a weaker 2027.

Overall, limited insurance tightening is becoming more likely, but weak domestic demand argues against a full hiking cycle. Energy inflation may prompt the BoE to raise rates, while elevated yields will further tighten fiscal and financial conditions. Together, these pressures deepen the slowdown into 2027.

Figure 5: UK Inflation: No Second - Round Effects - Yet



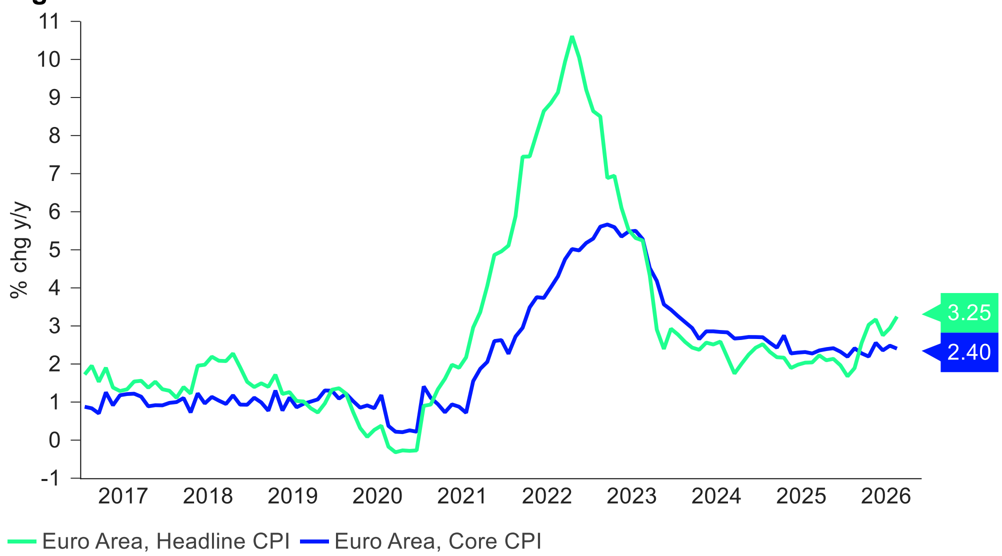
Source: State Street Investment Management, U.K. Office for National Statistics (ONS)

Eurozone: Not Bad, But Uninspiring

The eurozone is the lone region where our growth forecasts have improved slightly this round. This is less a function of genuine momentum and more a reflection of downside risks not having materialized to the extent we feared they might. We upgraded the 2026 real GDP growth forecast by two tenths to 1.0%, and the 2027 projection by one tenth to 1.3%. Even so, the growth underperformance relative to the US remains stark. Risks to the outlook remain significant and center on the possibility of more acute energy supply disruptions that move beyond price to actual physical shortages. These risks must be acknowledged, although similar concerns at the start of the Ukraine war did not ultimately materialize.

The more foundational challenge is the lack of vibrancy in both household consumption and investment, visible not only in regional data, but also within key economies. Government spending is the helpful counterbalance, yet it is not what we would like to see growth support come from. Specifically, we look for private consumption to grow 1.0% in 2026, slower than last year, while governments spending picks up to 1.8%. Fixed investment has been oscillating sharply of late but the small sequential declines in Q1 and Q2 of this year imply a disappointing annual gain. Germany's dismal performance on this front—heading into a fourth consecutive year of declining fixed investment—is a key reason behind the regional-level malaise. The lack of visible improvement here despite the focus on domestic defense investments speaks to an intensifying competitive threat in the manufacturing sector. This issue is likely to make the EU-China trade relationship more tense going forward.

Figure 6: ECB's Sole Task Needs Some Attention



Source: Macrobond, State Street Investment Management, Eurostat

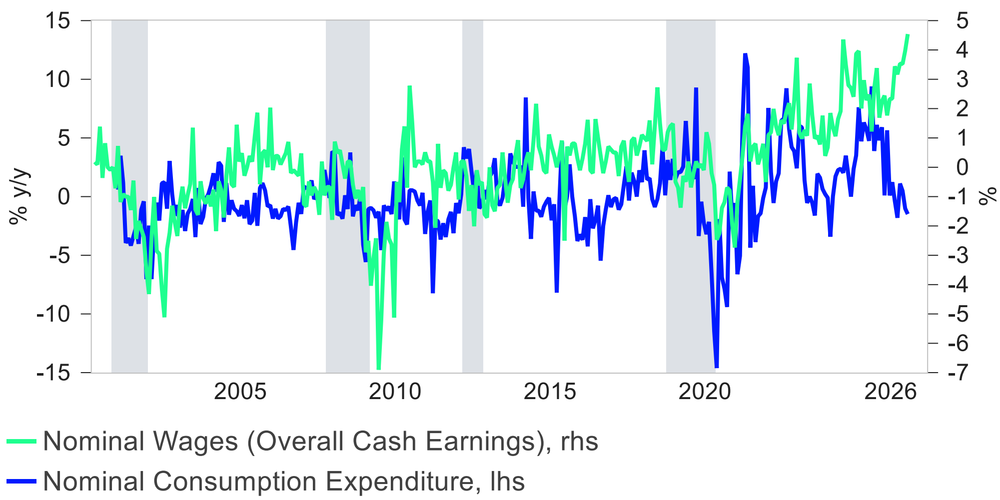
Headline inflation has jumped as a result of the Iran war and its persistence drives a one-tenth and a three-tenth increase in inflation forecasts this year and next, to 2.9% and 2.2%, respectively. The ECB has responded early with a fist hike in June, followed by another in September, despite not much evidence of second-round effects so far. Even so, the conviction is that it is only a matter of time before these materialize, so another hike by year-end now looks likely unless the conflict backdrop improves materially by then. The resilience demonstrated so far by the regional economy, and especially the labor market strength, are reassuring the central bank that it can focus on the inflation task without undue damage to the growth picture.

Japan: New Phase

The Bank of Japan (BoJ) raised rates as widely expected but delivered a clear signal that further tightening is unlikely to come in a hurry. This aligns with our out-of-consensus view that policy moves would become increasingly data dependent. Notably, the two recently appointed Board members nominated by Prime Minister Takaichi voted against the hike. While their dissent was not entirely unexpected, both cited concerns about a potentially slowing economy.

The policy guidance in the *Change in Guideline for Money Market Operations* was materially less hawkish than the July *Outlook Report*. The statement explicitly noted that growth has been supported by government measures and AI-related demand offsetting the drag from the Iran conflict, perhaps an indirect reference to slower consumption, a risk we have highlighted last week. Inflation language also became more measured, emphasizing that CPI is currently only in the 1.5%-2.0% range and that underlying inflation is merely approaching 2%.

Figure 7: Divergence Between Japanese Wages and Consumption



Source: Macrobond, State Street Investment Management, Japanese Statistics Bureau, Ministry of Internal Affairs & Communications, Japanese Ministry of Health, Labour & Welfare

We interpret this as a sign that the BoJ is becoming more cautious as the policy rate, now at 1.25%, has entered the range of estimated nominal neutral rates. The Bank may be approaching the limits of its normalization narrative. The yen's sharp depreciation beyond 157 against the dollar following the decision suggests markets were positioned for a more hawkish outcome and were ultimately disappointed.

During the press-conference, Governor Ueda emphasized that policy has entered a "new phase" and warned against the risks of overly aggressive tightening. Questioned repeatedly about the terminal rate, Ueda stressed that it can only be determined retrospectively and that the BoJ does not have a predefined destination for rates. As he noted, *"whether conditions would still be accommodative after a rate hike to 1.5% will be judged based on economic and financial variables at that time."*

Importantly, Governor Ueda also emphasized the strength of bank lending, with the difference between loan and deposit growth hovering near historic highs and signaling still-accommodative financial conditions. While this remains supportive of economic activity, lending growth has historically moved closely with CPI inflation, which has shown some modest easing in recent months. Neither series has weakened materially, but the lack of further acceleration suggests that nominal momentum may be plateauing. As such, the signal remains constructive but not sufficiently strong to argue for a more aggressive tightening path, supporting the BoJ's data-dependent and cautious stance.

The overall message for us is simple: the BoJ still sees scope for further hikes, but the timing is less urgent and will depend heavily on incoming data.

We continue to expect growth of 0.8% in 2026 and only modestly accelerate to 0.9% in 2027. Household consumption is likely to remain subdued, while export volumes should recover from Q4. In the near term, however, these dynamics point to weaker Q3 growth data, due in November. That release will be critical for expectations surrounding a December or January hike.

Our conviction on the precise timing of the next hike has diminished following this meeting. We still expect at least one additional increase over the medium term, with December or January remaining the most plausible window. However, a weaker-than-expected Q3 growth report could easily push the next move into Q1. We also think the BoJ may have an incentive to complete tightening by July, before the Board composition becomes materially more dovish and before inflation moderates further toward the Bank's price stability target in 2027.

That said, the meeting also revealed that the BoJ retains meaningful flexibility should inflation surprise materially to the upside. While we see relatively low probability to such an outcome, policymakers appear to have sufficient room to accelerate the pace of tightening if underlying inflation rises more sharply than expected. In other words, the Bank has become more cautious on the baseline but has not closed the door on a faster hiking cycle in a different inflation scenario.

The key upside risk to inflation remains energy-related cost pressures, particularly through naphtha. The concern is not the direct impact of higher freight costs, but their potential to broaden price increases across downstream manufacturing and chemical supply chains. Since the escalation of the Iran conflict, the cost of transporting clean petroleum products from Ras Tanura to Tokyo has surged to around $188 per tonne, roughly five times higher than a year ago.

While rate hikes cannot reverse such supply-side price pressures, market and political dynamics may still influence the BoJ's reaction function. Prime Minister Takaichi reshuffled her cabinet days before the meeting but retained Economy Minister Kiuchi, an important signal for the future direction of fiscal policy, government borrowing and household demand support.

At the same time, the government is considering broader fiscal reforms, including removing the consumption tax on food and doing away with ministry spending ceilings and reducing reliance on supplementary budgets. Japan also missed the prospect of a Fitch ratings upgrade because of concerns surrounding government spending, as government debt to GDP ratio has been easing for some time.

Together, these developments suggest market scrutiny of Japan's fiscal trajectory is likely to remain intense, keeping upward pressure on bond yields and leaving the yen vulnerable to further volatility in the months ahead.

Australia: Landing In Terminal 5

The Reserve Bank of Australia (RBA) has been one of the frontrunners in the current phase of global monetary tightening and may yet have further work to do. While other central banks are converging toward a similar conclusion that inflation risks remain uncomfortably elevated, Australia stands out as an economy where demand has proven more resilient than headline growth numbers imply. We continue to expect the RBA to retain a tightening bias and see a reasonable path toward a terminal cash rate closer to 5.0% over our forecast horizon.

Part of this resilience stems from the uneven distribution of economic strength across households. Consumer surveys increasingly point to a two-speed economy, with lower-income households continuing to report significant financial stress while confidence among higher-income households has recovered much more meaningfully. Aggregate demand is driven disproportionately by higher-income households, which control a larger share of spending power and wealth.

According to the Grattan Institute's analysis of Melbourne Institute's HILDA Survey, median gross household income is around A$127,000, while the 20th percentile is approximately A$53,000. This suggests a substantial share of Australian households sit well above the income cohorts exhibiting the greatest weakness in sentiment surveys. Consumer sentiment measures have consistently highlighted stress among lower-income households, but conditions among middle- and higher-income cohorts have generally held up better. As a result, the weakness evident in headline sentiment indicators may overstate the degree of softness in aggregate consumption and the broader economy.

Consequently, monetary policy may be biting hardest where spending power is lowest while proving less restrictive for the consumer segments that matter most for aggregate demand.

This leaves the near-term policy outlook largely in the hands of the labor market. We have long expected another rate hike and continue to think a strong August employment report would provide sufficient justification for the RBA to move as early as September. Admittedly, a weaker labor-market outcome could delay action and keep the Board on hold temporarily, especially considering the release of August CPI on the day after the RBI meets.

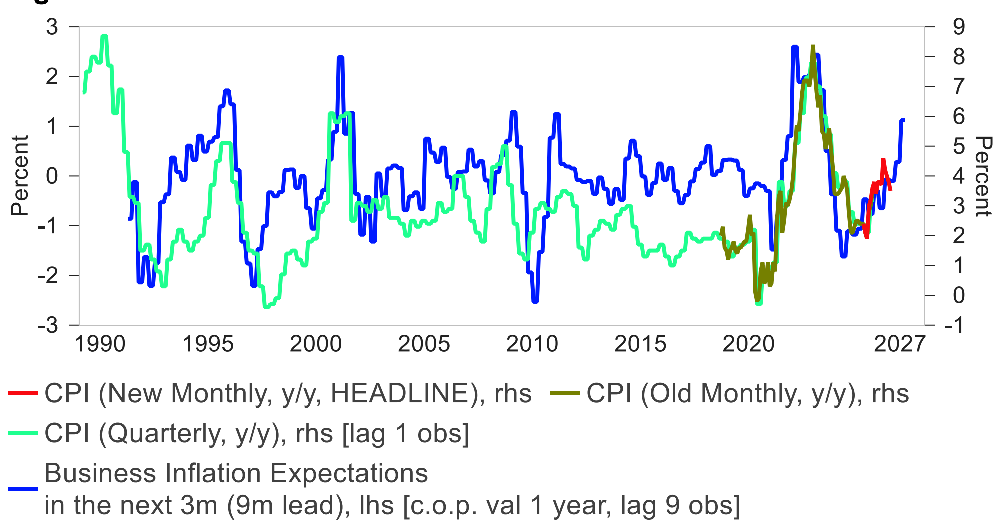
Our bias remains toward a rebound following July's softness, making the bar not very high for a September 29 hike. Inflation remains above target and, as Governor Michele Bullock noted in her parliamentary testimony last week, *"upside risks to inflation appear to be materializing"*, reflecting factors such as the Middle East conflict, the AI-driven investment boom and weather-related disruptions. Moreover, second-round effects *"could prove more persistent and require a stronger policy response"*. Taken together, the inflation backdrop continues to argue for a tightening bias.

That said, the debate within the Board is likely becoming more balanced. While the case for further tightening has strengthened, policy is already approaching its most restrictive setting since the end of the mining boom. The cumulative effects of higher interest rates are still working their way through the economy.

Complicating the outlook further is Australia's transition to a monthly inflation framework. Markets are still learning how to interpret monthly CPI outcomes, including the role of seasonality and the extent to which individual surprises should influence the policy outlook. Higher-frequency data provide more information, but not necessarily more clarity, leaving uncertainty unusually elevated.

One leading indicator worth watching is businesses' three-month-ahead inflation expectations tracked by the RBA, which have historically shown a reasonable lead relationship with CPI (Figure 8). Recent movements suggest inflation pressures may remain firmer like the RBA has been thinking.

Figure 8: Where Is Australia's Inflation Headed?



Source: Macrobond, State Street Investment Management, Reserve Bank of Australia, Australian Bureau of Statistics

Against this backdrop, our base case remains that the cash rate subsequently moving higher, with a meaningful possibility that the RBA rounds out the cycle at 5.0% if inflation proves sticky and the labor market remains more resilient than expected. Beyond that point, however, policymakers are likely to become increasingly mindful of cumulative tightening, slowing global growth, and the lagged effects of higher interest rates. We continue to forecast below-trend growth, inflation gradually returning toward target through 2027, and unemployment rising toward our long-standing peak forecast of 4.8%. As a result, the next phase of the cycle is more likely to be characterized by a prolonged hold at restrictive levels, followed eventually by modest easing, rather than an aggressive and sustained hiking campaign.

China: Still Unbalanced

China's Q3 data confirm an economy that still produces impressively but consumes only reluctantly. Industrial output accelerated to 5.2% y/y in August from 4.5% in July, comfortably beating the 4.8% consensus, while exports rose 25% y/y and lifted the monthly trade surplus to a 2026 record of USD 119.1 billion. The composition of those shipments matters: semiconductor exports jumped about 130% y/y and vehicle exports rose 43%, so the external engine is now powered by the global AI and technology cycle rather than by low-cost assembly. Household demand went the other way. Retail sales grew only 0.4% y/y in August, slowing from 0.6% in July and missing the 0.8% consensus. Put simply, China is producing more successfully than it is consuming.

The divergence is equally visible in investment and the labour market. Urban fixed-asset investment contracted 7.2% y/y in the first eight months of the year, a deeper decline than the 6.7% recorded through July, which shows that the capital-spending cycle is still shrinking even as factory output expands. The surveyed urban unemployment rate edged up to 5.3% in August from 5.2%, which the statistics bureau attributed mainly to the graduation season. Business surveys carry the same message. The official manufacturing PMI improved to 49.8 from 49.2 but stayed below the expansion threshold, with new orders recovering to 50.6 while the employment index slipped to 48.7. Non-manufacturing activity was unchanged at 49.0, so services are not yet filling the gap left by weaker construction.

The property sector remains the largest obstacle to a more durable recovery. New home prices fell 0.1% month on month in August, the third consecutive monthly decline, although the annual pace of decline narrowed to 3.0% from 3.2% in July, the slowest fall this year. Tier-one cities managed a 0.1% monthly gain, yet tier-two and tier-three markets continued to weaken, which confirms that stabilisation is still confined to the strongest locations. Analysts polled in late August expected property investment to shrink roughly 20% this year, a materially deeper contraction than the 12% decline projected in May. The sector is no longer deteriorating at the pace seen earlier in the downturn, but it is not contributing to growth either, and it continues to weigh on household wealth, confidence and local-government finances.

Inflation tells a similar story of production-side strength and consumption-side weakness. Consumer prices rose 0.8% y/y in August, up from 0.5% in July, while core inflation edged up to 1.0%. Producer prices rose 3.8% y/y, ahead of the 3.6% consensus and faster than July's 3.5%. The pickup, however, owes more to higher global commodity and energy costs and to favourable base effects than to any genuine revival in household demand, and factory-gate gains were concentrated in energy-related and electronics sectors, where memory-chip shortages pushed prices higher. Food prices remained in deflation, falling 1.4% y/y. In other words, China is regaining pricing power upstream without a comparable recovery downstream.

Policy remains supportive but deliberately targeted. The statistics bureau itself acknowledged an acute imbalance between strong supply and weak demand, and warned that the adverse impact of the external environment has intensified, which is an unusually direct official admission. Measures announced through the quarter have concentrated on recapitalising state banks and insurers, guiding developers away from the presale model, and extending the maximum mortgage term to forty years from thirty. Authorities continue to show little appetite for the broad credit expansion that characterised previous cycles. That restraint contains financial risk, but it also implies a slower path toward rebalancing growth away from investment and exports toward consumption.

Overall, China's economy is more stable than it was a year ago, but rebalancing remains incomplete. Exports, high-tech manufacturing and strategic industrial investment continue to provide reliable support, while consumption, investment and property lag behind. The central challenge is no longer generating output; it is generating enough domestic demand to absorb that output. Until household income growth, confidence and spending strengthen more decisively, China's growth model will continue to rely disproportionately on industry and exports, leaving headline growth hostage to an external environment that Beijing does not control.

Figure 9: China Production Leads While Consumption and Property Lag

Source: Macrobond, State Street Investment Management, China National Bureau of Statistics (NBS)

Week in Review

Our summary of the key global data releases from the past week.

Country	Release (Date, format)	Consensus	Actual	Last	Comments
Monday, Sep 14					
CA	Manufacturing Sales (Jul, m/m)	-0.2%	-0.4%	0.3% (↑)	Weak.
CA	CPI (Aug, y/y)	3.0%	3.0%	3.0%	OK.
JN	Industrial Production (Jul, m/m, final)	n/a	-0.2%	0.1%	Needs to bounce back.
Tuesday, Sep 15					
US	Empire Manufacturing (Sep)	15	7.6	20.6	Not the key manufacturing signal.
UK	Average Weekly Earnings (Jul, 3m y/y)	3.9%	3.9%	4.2% (↑)	Softening.
UK	ILO Unemployment Rate (Jul, 3 mths)	4.9%	4.9%	4.9%	In line with expectations.
GE	ZEW Survey Expectations (Sep)	40.0	34.7	34.2	Energy concerns.
FR	CPI (Aug, y/y, final)	2.4%	2.4%	2.4%	No news.
JN	Tertiary Industry Index (Jul, m/m)	0.3%	0.4%	-0.2%	Good.
Wednesday, Sep 16					
US	MBA Mortgage Applications (Sep 11)	n/a	-4.1%	-2.7%	High rates choke demand,
US	Retail Sales Advance (Aug, m/m)	0.8%	1.2%	-0.5% (↑)	Solid.
US	FOMC Rate Decision (Upper Bound)	4.00%	4.00%	3.75%	We look for another hike in December.
UK	CPI (Aug, y/y)	3.1%	3.1%	2.9%	Led by higher energy prices
CA	Housing Starts (Aug, thous)	240	229.0	229.4	Weak.
CA	Building Permits (Jul, m/m)	-4.8%	-17.3%	18.3%	Weak.
JN	Core Machine Orders (Jul, m/m)	-1.2%	-3.7%	9.7%	Pay back.
AU	Westpac Leading Index (Aug, m/m)	n/a	-0.04%	0.02% (↓)	Not looking great, but not worse either.
Thursday, Sep 17					
US	Philadelphia Fed Business Outlook (Sep)	32.5	37.8	47.4	Intensifying price pressures.
US	Initial Jobless Claims (Sep 12, thous)	207	196	206	Very low.
US	Continuing Claims (Sep 5, thous)	1,780	1,730	1,769 (↓)	Very low.
US	Housing Starts (Aug, thous)	1,319	1,275	1,309 (↑)	Very weak.
US	Building Permits (Aug, thous, prelim)	1,410	1,394	1,433	Very weak.
US	Pending Home Sales (Aug, m/m)	-0.1%	0.3%	-2.6% (↓)	Soft.
UK	Bank of England Bank Rate	3.75%	3.75%	3.75%	Hawkish communication
Friday, Sep 18					
US	Industrial Production (Aug, m/m)	0.3%	0.0%	0.2%	Manufacturing declined.
UK	Retail Sales (Aug, m/m)	-0.2%	0.5%	-0.5%	Better than expected.
JN	National CPI (Aug, y/y)	2.0%	1.9%	1.9%	Another miss.
JN	BOJ Target Rate	1.25%	1.25%	1.00%	Dovish hike.

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*This figure is presented as of March 31, 2025 and includes ETF AUM of $1,553.58 billion USD of which approximately $106.42 billion USD in gold assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated. Please note all AUM is unaudited.

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Exp. Date: 09/30/2027