

The Global View: Resilience through the energy shock

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Key points

- Global economy forecast to grow 2.5% in 2026 despite the energy price shock
- US gross domestic product growth forecast at 2.8% in 2026, with three 25 basis point Federal Reserve rate hikes expected
- China growth forecast at 4.5% in 2026 as domestic demand remains weak
- Bank of Japan and European Central Bank expected to raise rates as inflation pressures persist
- Bank of England expected to leave rates unchanged in 2026 before cutting twice in 2027

The world economy has absorbed the energy price shock well despite the spread of the Iran war to the Red Sea. Assuming the conflict is resolved by year end, we forecast the global economy will expand by 2.5% in 2026, 2.7% in 2027, and 2.6% in 2028.

In a testament to the flexibility of the global energy market, spot oil prices are not out of the historical range so far this year. However, if the Strait of Hormuz remains partly closed, oil prices will increase sharply with flow-on impacts to global inflation and economic growth.

US economy remains strong

The US economy remains strong despite a range of shocks to supply and demand. The retirement of Baby Boomers and sharp cuts to immigration (chart 18) has stalled growth in the supply of workers. The US's energy supply has provided some insulation to the cut to global energy supply. AI investment and tax cuts have supported domestic demand. The strong growth in private demand and loose budget policy has kept the US' current account deficit wide at 3% of GDP. Inflows of foreign capital into US markets have reached record highs and helped fund the surge in AI investment.

We forecast strong US GDP growth of 2.8% in 2026. The unemployment rate has peaked and growth in employment costs remains solid. Higher prices for memory and other electronics inputs have spilled over to higher consumer prices. More policy makers on the Fed have argued for increases to the Funds rate. At his recent speech at Jackson Hole, Fed chair Kevin Warsh suggested he may support a hike if inflation does not fall fast enough. We expect the Federal Reserve to begin a mild tightening cycle on 17 September 2026. We forecast three 25bp hikes to take the Funds rate to a range of 4.25%-4.50% (see [here](#) for details).

China loses momentum

The Chinese economy has lost momentum. GDP growth slowed from 5.0%/yr in Q1 to only 4.3%/yr in Q2, although growth in H1 2026 remained within the government's 4.5%-5.0% target range. The divergence between the export and domestic economies widened further. We expect the divergence to persist given the government's focus on technology self-sufficiency and dominance in strategic industries. Meanwhile, the war-driven boost to inflation is starting to fade. Persistent weakness in domestic demand suggests CPI inflation risks slipping back into deflation. That said, fresh large-scale stimulus remains off the table. At the late July Politburo meeting policymakers struck a supportive tone and pledged to speed up pre-approved spending but did not roll out any major new support measures. We continue to forecast GDP growth of 4.5% this year, alongside a 25bp cut to the reserve requirement ratio and a 10bp reduction in the 7-day reverse repo rate in Q4.

Japan flags faster rate hikes possibility

The Japanese economy has remained resilient in the face of the war-driven surge in energy prices because of government measures. The Bank of Japan (BoJ) judges underlying inflation (chart 20) remains on track to reach a rate consistent with its price stability target later this year. But at the late July meeting, the BoJ noted a risk of overshooting its target. Governor Ueda acknowledged the possibility of faster interest rate hikes. Following the historic joint US-Japan FX intervention, we consider the Takaichi government will tolerate a faster pace of BoJ rate hikes. Otherwise, the Japanese yen risks weakening sharply again, undermining the credibility of US and Japanese authorities and adding to inflation pressures.

As such, we bring forward our expected 25bp BoJ rate hikes to 18 September and 18 December 2026 (previously December 2026 and June 2027). We have also pencilled in one more 25bp hike in April 2027, taking the policy interest rate to 1.75%, near the middle of the BoJ's estimated nominal neutral interest rate range of +1.1% to +2.5%. The risks around our updated forecasts are skewed to a slower pace of rate hikes.

European Central Bank expected to raise rates

We expect the European Central Bank (ECB) to raise the deposit rate by 25bps to 2.50% when they next meet on 10 September (chart 21). The ECB are concerned that higher energy prices will translate to higher core inflation. Financial markets have fully priced a September increase, followed by two more hikes. We had previously expected the September increase to be the last in this cycle. But we have tweaked our view and now expect a final 25bp increase on 18 December taking the deposit rate to 2.75%. Energy prices have remained elevated for longer than we had first expected, raising the risk that higher inflation persists.

Bank of England expected to hold

Financial markets expect around three 25bps hikes from the Bank of England (BoE). In contrast, we expect the BoE will leave interest rates unchanged this year and cut twice in 2027 (chart 22). We judge the weak UK economy and growing spare capacity in the labour market will limit higher energy prices feeding into faster wage growth and persistent underlying inflation.

Canada-US trade tensions persist

Canada has been in the crosshairs of US President Trump again. Trade talks collapsed over a wide range of issues including tariffs on cars, trucks, steel and aluminium (see here for our analysis). As a result, both governments have applied tariffs on US\$20bn of imports from each other. President Trump has also indicated that tariffs on Canadian cars, trucks, auto parts and steel will rise to 50% from 1 January 2027. Our base case is a partial truce by November. However, that will not resolve the underlying disagreement. The broader US-Canada trade dispute is likely to persist through the upcoming USMCA negotiations and potentially well into 2027.

Canada is very dependent on US demand, with around 70% of its goods exports sent to the US. However, the direct tariff hit should remain contained. Around 80% of Canadian products currently enter the US tariff-free because they comply with USMCA rules. The bigger risk is therefore a prolonged trade dispute that weighs on business confidence, investment and hiring. For now, we continue to expect the Bank of Canada (BoC) to hike in December. Governor Macklem struck a more hawkish tone at the latest BoC meeting. The BoC made it clear that inflation remains too high, upside risks have increased and its 2% inflation target will remain the key guide for policy.

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