Macro Outlook

PACE KEEPING

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In the US, incoming data continue to point to solid and sustainable growth rather than an economy that is gaining excessive momentum. We remain comfortable with our view that the US economy will continue to hover around its potential growth rate throughout the remainder of 2026 and 2027.

Given the limited pass-through of higher energy prices to US core inflation, reflecting the relatively low exposure of core CPI/PCE components to energy costs, we continue to believe that the underlying disinflationary trend remains firmly in place.

In the EA, incoming hard data for Q3 have been weaker than expected, in contrast to the more optimistic survey-based indicators. In light of our latest Q3 2026 nowcast of 0.2% q/q, which points to a slower pace of economic activity than the 0.6% q/q recorded in Q2 and is consistent with the recent stream of weaker economic releases, we have modestly revised downwards our annual real GDP growth forecast for 2027 to 1.2%, a downward revision of 0.1 percentage points (pp) from our previous baseline.

In line with the findings presented in our recent note ("MACRO FOCUS - Lessons from the past, views from the future" - October 2026) in which we analyse the pass-through of the recent energy shock to core HICP inflation over the remainder of the forecast horizon, we have revised our EA core HICP forecast upwards: we now expect core HICP inflation to remain stable at 2.5% y/y in Q4 2026, compared with 2.3% in our previous baseline. In annual average terms, we now forecast core HICP inflation at 2.3% in 2027, up from 2.1% in our previous baseline.

The overall outlook for the Chinese economy remains unchanged: domestic demand remains weak, while AI is becoming an increasingly important driver of growth in China, primarily through exports rather than investment. We maintain our annual real GDP growth forecast for 2026 at 4.6% y/y. In light of persistent weakness in domestic demand indicators, we have marginally revised down our annual GDP growth forecast for 2027 by 0.2 percentage points (pp) to 4.6%. Regarding inflation, our annual forecast for headline CPI remains unchanged at 1.0% in 2026. Upside risks to inflation stem from developments in Middle Eastern energy markets.

We expect the Fed to keep interest rates unchanged in October, as macroeconomic developments do not warrant a further rate hike, while the proximity of the midterm elections presents an additional challenge. Beyond October, we continue to expect one or two further rate hikes by March 2027, but we do not expect the Fed to deliver the full extent of the tightening currently priced in by markets (three to four additional rate hikes by October 2027).

We expect the ECB to leave interest rates unchanged in October. A rate hike in December remains a possibility, particularly if energy prices do not decline significantly from current levels. Beyond December, however, we expect the ECB to remain on hold in H1 2027 and shift towards an easing bias in H2 2027, with the number of rate cuts ultimately depending on the pace at which core inflation converges towards the ECB's target (compared with our previous forecast of two rate cuts).

We maintain our forecast of no policy rate or reserve requirement ratio (RRR) cuts in 2026 by the PboC, with near-term policy support more likely to come from accelerated fiscal policy implementation.

GROWTH & INFLATION

US – Solid and stable

Incoming data continue to point to solid and sustainable growth rather than an economy that is gaining excessive momentum. We remain comfortable with our view that the US economy will continue to hover around its potential growth rate throughout the remainder of 2026 and 2027.

Given the limited pass-through of higher energy prices to US core inflation, reflecting the relatively low exposure of core CPI/PCE components to energy costs, we continue to believe that the underlying disinflationary trend remains firmly in place.

The data received so far continue to point to solid and sustainable growth rather than an economy that is gaining excessive momentum. Our Q3 2026 GDP growth estimate has been revised upwards marginally from 2.2% to 2.5% quarter-on-quarter, seasonally adjusted at an annualised rate (q/q SAAR). The modest upward revision primarily reflects a mechanical carry-over effect stemming from the annual revisions incorporated in the third estimate of Q2 GDP (revised from 1.5% q/q SAAR in the second estimate to 2.2% in the third) rather than evidence of a materially stronger underlying growth trend.

No signs of overheating. Indeed, while PMIs continue to signal a healthy pace of expansion, the broader flow of data, including international trade (August), inventories (August), PCE data (August), labour market indicators and ISM data (August-September), increasingly challenges the view that the economy is reaccelerating or beginning to overheat. Taken together, recent releases are more consistent with an economy expanding at a steady pace than with a meaningful resurgence in growth momentum.

The data from the last two weeks largely reinforced that narrative. September's NFP report tempered earlier concerns that activity was re-accelerating, while the latest trade and inventory figures prompted a notable downward revision to the Atlanta Fed's GDPNow estimate, from 5.0% q/q SAAR last week to the current estimate of 3.6%. Moreover, real personal spending increased by 0.6% m/m in August, up from 0.1% in July (revised upwards by 0.1 percentage points), with spending on goods rebounding by 1.3% (versus −0.5% in the previous month), while services spending growth cooled slightly to 0.2% (from 0.3%). With a substantial portion of Q3 underlying data still pending, particularly in trade and inventories, we remain comfortable with our view that the US economy will continue to hover around its potential growth rate throughout the remainder of 2026 and into 2027.

Annual revisions confirm that domestic demand remains well positioned to support economic activity. A significant proportion of the revisions were concentrated on the income side of the national accounts, with GDI growth revised upwards throughout H1 2026. Disposable personal income was revised upwards by nearly $300 billion, largely reflecting upward revisions to estimates of interest income, while the household saving rate was also revised substantially upwards. Importantly, these revisions are consistent with a pattern observed repeatedly in the post-COVID period. In our view, they further strengthen the case that household fundamentals have been considerably stronger than suggested by the contemporaneous income and saving data. They also help explain the persistent resilience of consumer spending, which has repeatedly exceeded many forecasters' expectations.

These revisions reinforce our confidence that US households retain a substantial financial cushion and that household balance sheets remain sufficiently strong to

absorb both the recent energy-price shock and the ongoing tightening of financial conditions without materially undermining consumer spending.

Evidence of disinflation persists. Among the key figures to watch in the August report were the core PCE revisions, which we had discussed at length in our August 2026 note, "(NEVER)MIND THE GAP". In line with our preview, revisions to three PCE price components (namely, computer software and accessories, portfolio management and investment advisory services, and legal services) reduced the core PCE annual inflation rate for July by 36 basis points (bp). On average, core PCE inflation through August 2026 is now 0.2 percentage points (pp) lower than previously reported. Moreover, Fed Chairman Kevin Warsh's preferred metric - the share of PCE price components increasing by more than 3% on a six-month-on-six-month, seasonally adjusted annualised basis (6m/6m SAAR) — declined to 52% from 58%. Our main takeaway from the August PCE release is that the revisions to 2026 core PCE inflation were in the expected direction, and the August reading was benign, with the three-month-on-three-month annualised rate (3m/3m SAAR) at 2.0%, marking the seventh consecutive month of deceleration.

Meanwhile, the labour market is not contributing to inflationary pressures, with wage growth slowing further from its already subdued pace over the past year. Average hourly earnings (AHE) rose by only 0.13% m/m in September. Weakness was broad-based: of the 14 sectors, nine recorded a deceleration in monthly wage growth. The information sector, which is closely linked to AI-related demand, posted a notable rebound to +0.9% m/m. However, this appears more consistent with a rebound from the previous month's weakness than with a renewed surge in AI-driven wage pressures. Wage growth in the sector had declined by 0.3% m/m in August, marking its weakest reading since August 2023. As such, September's strength is better interpreted as a normalisation following an unusually weak August reading, rather than as evidence of a fresh acceleration in AI-related demand.

Unpacking the core CPI upside surprise for September. Core CPI for September came in hotter than expected at 0.3% m/m (vs 0.2% consensus).

Core goods picked up to 0.3% from 0.1% prior. Heavily weighted categories such as new vehicles and apparel recorded modest gains, while used cars and recreation commodities jumped. In this regard, we note that toy prices jumped by 4.2% m/m, marking the strongest monthly increase since the inception of this series. The average tariff rate for imported toy products dropped sharply earlier this year, but ex-tariff import prices for video game consoles and machines, table or parlor games (which include semiconductor-heavy products), jumped sharply in recent months. This suggests that CPI's toy prices might be sensitive to the inflationary spillovers from the AI buildout, rather a tariff effect. We expect a normalization of this component in the coming months.

Take the OER increase with a grain of salt. The owners' equivalent rent (OER) component printed hot despite a cool housing market most of the year, suggesting a potential aberration. Indeed, we think that the strength in September did not reflect changes in the underlying rent inflation trend. OER inflation in volatile small cities of the Midwest jumped by 0.9% m/m, the strongest since July 2023, which pushed up the national aggregate number. Some big cities in the South, such as the greater Houston area (+1.0% m/m), were also strong this month. We think that the unexpected strength in rent-related components in September was largely due to idiosyncratic jumps which are unlikely to be repeated in the next month. We continue to believe that inflation of regular rent and OER will gradually decelerate in the medium term.

Excluding rent-related components, CPI supercore decreased at 0.4% m/m. As expected, wireless telecom service prices reported a payback from the unusual strong print in August.

CPI inflation breadth metrics improved in September. In aggregate, the key question is whether inflation momentum remains broad-based or is beginning to re-narrow. Based on the latest data, inflation breadth has narrowed for a fifth consecutive month, suggesting that the stronger-than-expected CPI print was driven by a relatively small number of categories rather than a broad-based acceleration in price pressures.

ANIMA baseline. Our updated baseline, which incorporates our latest Q3 2026 GDP growth estimate of 2.5% q/q SAAR, remains broadly unchanged. We continue to expect economic growth to remain close to its potential rate through the end of 2027, suggesting that the US economy remains well positioned to absorb the current global energy shock without a significant deterioration in domestic economic activity.

On inflation, in line with the findings presented in our recent note *("MACRO FOCUS - Lessons from the past, views from the future" - October 2026*) we now expect year-on-year core PCE inflation to remain at 3.0% in Q4 2026, compared with 2.7% in our previous mechanically adjusted baseline. Thereafter, in line with our prior expectations, favourable base effects should drive a sharp decline to 2.4% in H1 2027, unchanged from our prior forecast, before inflation eases further to 2.15% in H2 2027, slightly below our previous baseline of 2.25%.

EA – No acceleration

Incoming hard data for Q3 have been weaker than expected, in contrast to the more optimistic survey-based indicators. In light of our latest Q3 2026 nowcast of 0.2% q/q, which points to a slower pace of economic activity than the 0.6% q/q recorded in Q2 and is consistent with the recent stream of weaker economic releases, we have modestly revised downwards our annual real GDP growth forecast for 2027 to 1.2%, a downward revision of 0.1 percentage points (pp) from our previous baseline.

In line with the findings presented in our recent note ("MACRO FOCUS - Lessons from the past, views from the future" - October 2026), in which we analyse the pass-through of the recent energy shock to core HICP inflation over the remainder of the forecast horizon, we have revised our core HICP forecast upwards: we now expect core HICP inflation to remain stable at 2.5% y/y in Q4 2026, compared with 2.3% in our previous baseline. In annual average terms, we now forecast core HICP inflation at 2.3% in 2027, up from 2.1% in our previous baseline.

Incoming data for Q3 present a mixed picture. Recent high-frequency releases have further underscored the divergence between sentiment-based indicators and realised economic activity. Although PMIs and other survey indicators continue to point to a resilient economy and strengthening momentum, the incoming hard data have delivered a more mixed and less encouraging signal.

1) The composite PMI was unchanged from its preliminary estimate at 53.1 in September (versus 52.0 in August), with the services PMI also unchanged from its preliminary estimate at 53.0 in September (versus 51.6 in August) – its highest level since November 2025, suggesting that service providers believe continued growth in real disposable income is supporting consumer spending.

2) German industrial data for August were weaker than expected. German manufacturing orders fell by 10.6% m/m in August, significantly below consensus expectations of a 1.0% decline. Manufacturing orders excluding large-scale orders fell by just 0.1%. Headline orders were weighed down by a 61.5% m/m decline in large-scale orders for other transport equipment (aircraft, ships, trains and military vehicles), partially reversing July's sharp increase (+129.4% m/m), which was likely linked to large military orders. Moreover, industrial turnover was flat in

August, falling short of the 2.0% increase indicated by the preliminary estimate, while real manufacturing sales were unchanged in August (compared with a 1.4% m/m decline in July), a substantially weaker outcome than suggested by the preliminary data. Finally, industrial production (IP), excluding construction and energy, recovered only modestly in August, rising by 0.6% m/m and reversing only part of July's 2.0% contraction.

3) Industrial production was also weak across the rest of the euro area (EA). Industrial production declined in August in Spain (−0.7% m/m), France (−0.3% m/m) and Italy (−1.3% m/m). On the demand side, euro area-wide retail sales increased by a modest 0.1% m/m in August, following a 0.6% decline in July. Based on the latest data, the carry-over into Q3 currently stands at −0.3% q/q (compared with +0.2% in Q2), suggesting that private consumption may have lost some momentum relative to Q2, when household spending grew by a solid 0.4% q/q.

Against this backdrop, and in line with our latest nowcast, we have revised down our baseline forecast for Q3 2026 real GDP growth to 0.2% q/q, from the previously expected 0.3%.

The pass-through of higher energy prices to core inflation has remained limited so far… but the impact has likely yet to fully materialise.

Core inflation increased marginally by 0.1 percentage points (pp) in September to 2.5%. Non-energy industrial goods (NEIG) inflation declined by 0.1pp to 1.1% y/y, while services inflation edged up to 3.2% (0.2 pp higher than in August). In our view, there is still little evidence of indirect pass-through from higher energy costs to goods and services prices. Indeed, details from national inflation releases suggest that this month's increase in core inflation may be attributable to other factors. In services, the increase reflected volatility in tourism-related components following a weak August reading, particularly in France, Spain and Germany. For instance, airfares typically decline sharply in September following the summer holidays, while in September 2026 EA airfares rose to 5.8% y/y.

Looking ahead, however, we expect the pass-through to strengthen gradually. As discussed in our recent note (*"MACRO FOCUS - Lessons from the past, views from the future" - October 2026)*, the evidence from our commodity price pass-through framework suggests that a large proportion of the impact of higher energy prices has yet to feed into core inflation.

ANIMA baseline. In line with the findings presented in our recent note (*"MACRO FOCUS - Lessons from the past, views from the future" - October 2026)*, in which we analyse the impact of the recent energy shock on real GDP growth and core HICP inflation over the remainder of the forecast horizon (through the end of 2027), we have revised our GDP growth forecast downwards and our core HICP forecast upwards.

Reflecting our latest Q3 2026 nowcast of 0.2% q/q, which points to a slower pace of economic activity than the 0.6% q/q recorded in Q2 and is consistent with the recent stream of weaker economic data, we have modestly revised downwards our annual real GDP growth forecast for 2027 to 1.2%, a downward revision of 0.1 percentage points (pp) from our previous baseline. This revision reflects the impact of higher energy prices on economic activity. Nevertheless, we continue to expect growth to strengthen in 2027, albeit at a more gradual quarter-on-quarter pace than previously anticipated. Fiscal policy remains expansionary, particularly in Germany, where defence-related spending is expected to provide additional support, while resilient global growth and positive spillovers from the AI investment cycle should continue to underpin economic activity across the region.

We now expect core HICP inflation to remain unchanged at 2.5% y/y in Q4 2026, compared with 2.2% in our previous baseline. In H1 2027, core HICP inflation is now projected to ease only marginally to 2.4% y/y, compared with 2.2% previously, before moderating further to 2.2% in H2 2027, versus 2.1% in our previous baseline. In annual average terms, we now forecast core HICP inflation of 2.3% in 2027, up from 2.1% in our previous baseline.

CHINA – Nothing noteworthy

The overall outlook for the Chinese economy remains unchanged: domestic demand remains weak, while AI is becoming an increasingly important driver of growth in China, primarily through exports rather than investment. We maintain our annual real GDP growth forecast for 2026 at 4.6% y/y. In light of persistent weakness in domestic demand indicators, we have marginally revised down our annual GDP growth forecast for 2027 by 0.2 percentage points (pp) to 4.6%.

Regarding inflation, our annual forecast for headline CPI remains unchanged at 1.0% in 2026. Upside risks to inflation stem from developments in Middle Eastern energy markets.

The overall picture of the Chinese economy remains unchanged: activity on the supply side of the economy remains relatively resilient, while domestic demand continues to be weak. Meanwhile, exports, particularly from high-tech sectors, remain the main driver of economic growth.

Modest PMI improvement as infrastructure activity gains traction. September PMIs showed a modest improvement, with both manufacturing and non-manufacturing indicators returning to expansionary territory, although both remained only marginally above the 50-point threshold. The headline manufacturing PMI rose to 50.1 in September from 49.8 in August, ending a two-month period of contraction, supported by a pick-up in production activity. The production index increased to 51.7, its highest level so far, while the new orders index remained broadly stable at 50.5. In contrast, manufacturing employment weakened for a second consecutive month, highlighting persistent labour market pressures.

External demand remained supportive. The NBS new export orders PMI remained unchanged at 50.0, while the RatingDog manufacturing PMI, which has a greater weighting towards export-oriented firms, rose to 52.1 from 51.5, reaching its highest level in five months.

Stable to slightly weaker holiday data. Based on estimates from the Ministry of Transport (MOT), domestic interregional passenger traffic - which encompasses both public and private transport for commuting, business, education, and leisure - rose by 0.6% y/y during the National Day Golden Week holiday, well below the 6.2% y/y increase recorded during the same holiday last year. Overall, the holiday travel and spending data suggest persistently subdued consumption growth.

Energy inflation remains in the lead. **Core and services inflation remained broadly unchanged and below pre-conflict levels**. Inflation data saw noticeable acceleration in September, with rising oil prices pushing up PPI and energy-related components of CPI, while the impact on core and service CPI remained contained.

In the PPI space, the increase was concentrated in upstream sectors, reflecting higher crude oil, coal and non-ferrous metal prices, while AI-related manufacturing industries continued to benefit from the global AI investment cycle and recorded further price rises. That said, outside the energy and AI, consumer-facing sectors remained among the largest drags on producer prices. CPI inflation, by contrast, edged up only modestly

to 0.9% y/y from 0.8%, with the increase driven by energy rather than demand-led reflation or second-round effects.

ANIMA baseline. We maintain our annual real GDP growth forecast for 2026 at 4.6% y/y. In light of persistent weakness in domestic demand indicators, we have marginally revised down our annual GDP growth forecast for 2027 by 0.2 percentage points (pp) to 4.6%.

Regarding inflation, our annual forecast for headline CPI remains unchanged at 1.0% for 2026 and 1.2% for 2027.

MONETARY POLICY

Fed – A pause in October

We expect the Fed to keep interest rates unchanged in October, as macroeconomic developments do not warrant a further rate hike, while the proximity of the midterm elections presents an additional challenge. Beyond October, we continue to expect one or two further rate hikes by March 2027, but we do not expect the Fed to deliver the full extent of the tightening currently priced in by markets (three to four additional rate hikes by October 2027). We believe the FOMC's assessment of inflation and growth is overly sanguine, while Chair Warsh's rhetoric appears more consistent with a limited recalibration of the monetary policy stance than with the beginning of a prolonged tightening cycle that could ultimately jeopardise economic growth and labour market conditions. **On hold in October.** While financial conditions remain fairly accommodative in the US, we believe the Fed is under no immediate pressure to raise interest rates again in October.

In September, Chair Warsh argued that the decision to raise interest rates was driven by four key considerations, namely (1) resilient and strengthening economic growth; (2) continued labour market resilience; (3) the absence of a meaningful improvement in underlying inflation dynamics; and (4) geopolitical developments that have increased upside risks to the inflation outlook.

Since the September meeting:

1) Economic growth has remained resilient, but it has not gained further momentum.
2) Labour market data released in October have been weaker than expected.
3) Underlying inflation dynamics have improved somewhat in the August data. First, the three-month annualised change in core PCE inflation (3m/3m SAAR) came in at 2.0%. Second, there has been a moderate decline in the share of core PCE components recording price increases of more than 3%, accompanied by an increase in the share of components with price increases below 3%. In other words, underlying inflation pressures have eased modestly across all the measures monitored by Chair Warsh's Fed. While the September CPI data did not bring positive news, we think the combination of the two data allows the Fed to wait-and-.see at the October meeting. Geopolitical developments continue to pose an upside risk to inflation, but there has been no further deterioration since September, and shipping traffic through the Strait of Hormuz has continued to improve.

Moreover, the Federal Reserve's meeting takes place just a few days before the midterm elections and given that markets are not pricing in any policy action at this meeting, a rate move in October could trigger additional volatility in the US Treasury (UST) market at a politically sensitive time.

Against this backdrop, we expect the Fed to leave interest rates unchanged in October. This is also consistent with recent speeches by Fed officials, which have signalled a slightly more dovish stance than the rhetoric surrounding the previous FOMC meeting.

No forward guidance expected. While we expect Chair Warsh to maintain a hawkish tone, we do not anticipate any explicit guidance on future policy decisions. We believe Chair Warsh will emphasise that the Fed is well positioned to adopt a wait-and-see approach, allowing more time to assess incoming economic data before making a decision at its December meeting.

We continue to expect one or two additional rate hikes by March 2027. Beyond October, we expect the Fed to deliver one or two further rate increases by March 2027. Our view remains subject to an unusually high degree of uncertainty, reflecting both potential changes in the Fed's reaction function and several inherently unpredictable factors, such as geopolitical developments in the Middle East.

No further hikes beyond that. At the same time, we continue to believe that the Fed will NOT deliver all the rate increases currently priced in by markets, for the following reasons:

- We continue to believe that the FOMC's assessment of inflation risks is somewhat too pessimistic. Given the limited pass-through of higher energy prices to US core inflation, reflecting the relatively low exposure of core CPI/PCE components to energy costs, we continue to believe that the underlying disinflationary trend remains in place.
- We believe the FOMC's growth assumptions remain somewhat optimistic. While growth is likely to remain around its potential rate throughout 2027, support from private consumption and non-AI capital expenditure is likely to weaken, as the fiscal impulse associated with the One Big Beautiful Bill Act (OBBBA) is expected to gradually diminish during the second half of 2026 before turning modestly contractionary in 2027. Wage growth also continues to moderate.
- Chair Warsh characterised the latest decision as the removal of "a dose of accommodation," arguing that policy rates remain below restrictive levels. In our view, this characterisation is more consistent with a limited recalibration of the monetary policy stance than with the beginning of a prolonged tightening cycle that could ultimately undermine economic growth and labour market conditions.

ECB –Getting very near peak rates

We expect the ECB to leave interest rates unchanged in October. A rate hike in December remains a possibility, particularly if energy prices do not decline significantly from current levels. Beyond December, however, we expect the ECB to remain on hold in H1 2027 and shift towards an easing bias in H2 2027, with the number of rate cuts ultimately depending on the pace at which core inflation converges towards the ECB's target (compared with our previous forecast of two rate cuts).

ECB expected to hold rates in October. We expect the ECB to keep interest rates unchanged in October. While energy prices remain elevated and close to the levels assumed in the ECB's September adverse scenario, we continue to believe that the September ECB staff projections for core inflation are overly optimistic, as evidence of the pass-through of higher energy prices to core inflation remains very limited. Meanwhile, the Governing Council's rhetoric has softened recently, with most members, including some of the more hawkish policymakers (e.g. Isabel Schnabel),

arguing that the second energy-price shock, which began this summer, has yet to affect economic growth. At the same time, financial conditions have continued to tighten as a result of rising sovereign bond yields.

A rate hike remains on the table in December. We believe that a rate hike in December remains a possibility, particularly if: 1) energy prices do not decline significantly from current levels; 2) economic growth does not slow significantly, and 3) core inflation remains around current levels.

Beyond December, however, the likelihood of the ECB remaining on hold is increasing. We believe it is increasingly likely that the ECB will keep interest rates unchanged until H2 2027. Moreover, we remain convinced that the ECB will adopt an easing bias in H2 2027 for the following reasons:

1. **Financial conditions are becoming an increasingly important consideration for the ECB and are tightening rapidly**. In many recent speeches, Governing Council members have emphasised the adverse impact of tightening financial conditions on economic growth, while adopting a softer tone regarding the need for further monetary policy tightening. We consider this a compelling argument. According to our in-house models, financial conditions have tightened significantly since January 2026 and are now at their tightest levels since Q4 2024. Most of the tightening has been driven by increases in core sovereign bond yields, particularly real yields, since the end of June. At current levels, we estimate that the negative impact of tighter financial conditions on economic growth could be as much as 1 percentage point over the following 12 months.
2. **The rise in sovereign yields and spreads is adding to the pressure**. A widening of sovereign spreads can lead to fragmentation in monetary policy transmission and tighter financing conditions in countries where borrowing costs rise more sharply. With elections in Italy and the French presidential election scheduled for next year, the ECB will need to pay particular attention to these developments.
3. Moreover, in the face of widening sovereign spreads, the least controversial way for the ECB to counter this trend would be to signal that it does not intend to deliver the full extent of the rate hikes currently priced in by markets (an additional 60 basis points by June 2027). Other policy instruments, such as slowing quantitative tightening (QT), activating the Transmission Protection Instrument (TPI) or even Outright Monetary Transactions (OMT), would, in our view, require a greater degree of fragmentation and could prove controversial, either because of the eligibility criteria for activation (TPI) or because of the original purpose of the instrument (slowing QT).
4. **Fiscal stance**. While the fiscal stance has been supportive of economic growth this year, the fiscal impulse is expected to turn moderately negative in 2027 and 2028.
5. **The ambiguous role of AI**. According to a recent speech by Philip Lane, while AI's impact on economic growth and the associated wealth effects are positive, they are considerably smaller than those observed in the US and Asia. On the other hand, AI is contributing to higher long-term global sovereign bond yields, which could ultimately weigh on economic growth through tighter financial conditions.

Against this backdrop, we believe that the EA economy is not cyclically positioned to absorb the current energy shock without generating additional wage and core inflation pressures.

How many rate cuts in H2 2027? This will depend on the EA's progress towards disinflation and the resilience of economic growth. With core inflation expected to remain broadly stable at around 2.5% y/y before gradually declining, in line with our revised EA inflation forecasts, we believe that the ECB will want to be reasonably confident that core inflation is converging towards its target. This makes us less confident than previously that the ECB will be able to deliver two rate cuts in H2 2027. We therefore continue to expect the ECB to adopt an easing bias in H2 2027, although the actual number of rate cuts will depend on the pace at which inflation converges towards the target.

PBoC – Broad stance unchanged

We maintain our forecast of no policy rate or reserve requirement ratio (RRR) cuts in 2026, with near-term policy support more likely to come from accelerated fiscal policy implementation.

The PBOC held its third-quarter Monetary Policy Committee (MPC) meeting on 19 September, and the statement was released on 24 September. Compared with the statement following the second-quarter MPC meeting, the overall monetary policy stance remained broadly unchanged. While the PBOC removed the reference to "cross-cyclical adjustment" and added that it would "use a mix of monetary policy tools and adjust them as appropriate", both changes closely mirrored the language used at the July Politburo meeting and therefore, in our view, do not constitute new signals of monetary easing. We maintain our baseline expectation of no policy rate or RRR cuts in 2026. The main incremental change concerned foreign exchange (FX) management: the statement explicitly called for measures to prevent "herd behaviour" and "the self-reinforcement of irrational expectations", suggesting a greater focus on preventing excessive renminbi (RMB) appreciation ahead of the usual year-end surge in foreign exchange settlements.

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