Economic Navigator

When Higher Rates Don't Bite

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Executive Summary

- The global economy is undergoing a structural shift, with China moving up the value chain from toys and apparel to semiconductors, industrial machinery, and AI-related technologies, while Japan prepares for higher interest rates and Europe remains stuck in a low-growth environment. Global growth should reach 3.0% in 2026 and 3.4% in 2027. A downshift from 2025 growth of 3.5%.
- Higher interest rates are having a smaller impact on households than in prior cycles, as strong balance sheets, low debt-service burdens, and high net worth buffer consumers from the full effects of Fed tightening. We expect the U.S. to grow 2.1% in 2026 despite the likelihood of higher rates.
- Inflation's return to the Fed's target has been delayed, not derailed, as supply-chain disruptions and higher transportation and energy costs tied to the Middle East conflict have pushed back the timeline for disinflation. Inflation will reach a near term trough of 2.3% in May 2027. However, we are currently in an inflation fog.
- The Charts: Check out the supporting charts on rates, oil, trade, and other global macro factors.

Why the Navigator?

The macroeconomic context is a key component of the investment process. Every asset class — whether credit, equities, currencies, commodities, real estate, or infrastructure — responds to the forces shaping the global economy. Inflation trends, interest rate cycles, fiscal and monetary policy shifts, and economic growth trajectories all influence market behavior and risk-adjusted returns. Ignoring these dynamics means missing the bigger picture.

So, what will the drivers of growth be for the remainder of 2026 and what characteristics of growth are worth noting? How could business and household activity remain robust amid higher rates?

In this edition of the *Economic Navigator*, we explain why higher rates don't bite as we provide an update on our expectations for growth, inflation, and unemployment and what it means for businesses and consumers.

From Toys to Technology, and Other Signs of a Changing Global Economy

The global economy is entering the fall with a handful of important crosscurrents. In China, inflation is finally showing signs of life after a prolonged period of disinflation. Consumer and producer prices both firmed in August, suggesting that pricing pressures inside the world's second-largest economy may have bottomed. That matters beyond China's borders. For much of the past several years, Chinese manufacturers have exported a steady stream of low-cost goods that have helped suppress inflation elsewhere. As factory-gate prices begin to recover, that disinflationary impulse may gradually fade.

At the same time, China's export machine is undergoing a transformation. The country that once supplied the world with toys, apparel, and furniture is increasingly shipping semiconductors, industrial machinery, smartphones, EV batteries, and other high-value manufactured products. Electronics and machinery now represent a much larger share of exports, underscoring a long-term shift up the value chain. Demand tied to artificial intelligence infrastructure and other advanced technologies is reinforcing the transition from labor-intensive production to sophisticated manufacturing and capital goods.

Elsewhere in Asia, investors are increasingly focused on Japan. Expectations for additional Bank of Japan rate increases remain elevated as wage growth and inflation continue to run above levels policymakers once considered sustainable. The yen has strengthened not only against the dollar but also against the euro, pound, and Australian dollar, hinting at a broader reassessment of global funding trades built around cheap Japanese financing. The move reflects both changing interest rate expectations and a gradual unwinding of positions that had benefited from years of ultra-low Japanese rates. Meanwhile, Europe remains stuck in a low-growth environment, with economic activity barely expanding and attention turning to the European Central Bank's next policy decision.

Now Looking Inward

In the United States, businesses continue to describe an economy that is frustratingly uneven. Manufacturing activity improved in August, with most major industries reporting expansion and demand indicators such as new orders and order backlogs remaining resilient despite geopolitical uncertainty. Yet inflation pressures have not fully disappeared. Prices paid by manufacturers have retreated from summer highs but remain elevated enough to keep policymakers uncomfortable. One survey respondent captured the mood succinctly: the economy is getting in the way of otherwise good business.

The labor market tells a similarly mixed story. Unemployment remains low, but worker mobility has slowed considerably as employees show less willingness to leave existing jobs. At the same time, the nation's investment boom remains narrowly concentrated. Spending on data-center construction continues to surge at extraordinary rates, fueled by the race to build artificial-intelligence infrastructure. By contrast, investment in areas such as healthcare, retail, and education construction has softened, highlighting the increasingly uneven nature of business spending.

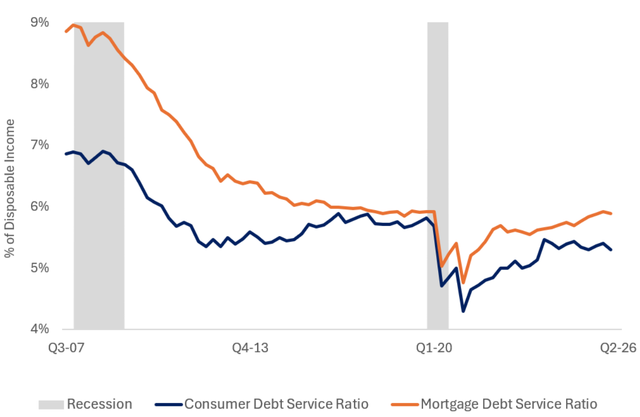
Taken together, these developments point to an economy still growing near a 2% pace but facing persistent inflation pressures. China's move up the technology ladder, Japan's preparation for higher interest rates, and the concentration of U.S. investment in AI-related infrastructure all reflect a world economy that is evolving in important ways. For central bankers, however, the immediate challenge remains familiar: inflation is proving stubborn enough that the debate over additional policy tightening is unlikely to disappear anytime soon.

And Now to the Topic d’Jour: Higher Rates, Smaller Bite

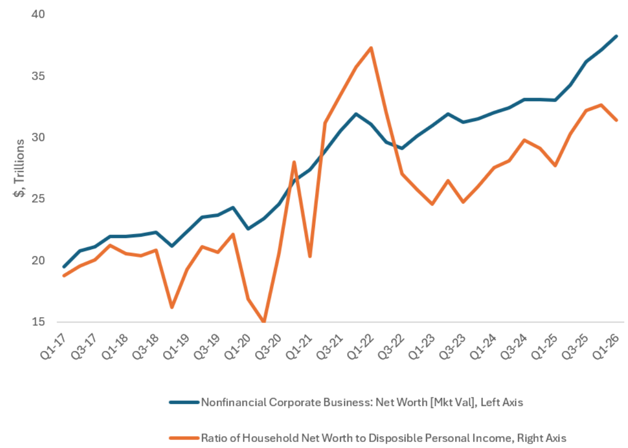
Fixed-rate mortgages and healthy household balance sheets have weakened the economy's traditional sensitivity to monetary policy as compared to just a few decades ago. As we wonder how the Federal Open Market Committee will vote throughout the course of this year and into the next, investors can take some solace that the economy is becoming less sensitive to interest rates. That means nominal growth can continue even if the Fed fails to cut rates or outright increases them.

Higher interest rates aren't packing the punch they once did. Despite mortgage rates remaining near multi-decade highs, many households continue to benefit from loans refinanced or originated during the pandemic-era period of exceptionally low borrowing costs. As a result, the Federal Reserve's rate hikes have had a more muted effect on household cash flows than in prior cycles. The evidence is showing up in debt-service burdens: as of March 2026, consumer debt-service payments accounted for just 5.29% of disposable personal income, while mortgage debt-service payments stood at 5.88%. Those figures remain relatively modest by historical standards and help explain why consumer spending has proven resilient even as borrowing costs have surged. Put simply, the vast stock of fixed-rate mortgages locked in at rates near 3% has insulated many homeowners from today's higher rates, weakening one of the traditional channels through which monetary policy slows economic activity. The result is an economy that appears less interest-rate sensitive than in previous tightening cycles, requiring larger or longer-lasting rate moves to produce the same cooling effect on growth.

Debt Servicing Is Historically Low ...



... And Household Net Worth Is a Buffer



Source: LPL Research, Federal Reserve Board, 9/09/26

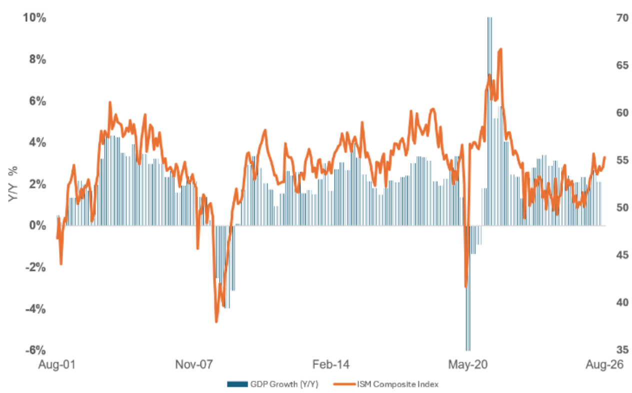
Source: LPL Research, Federal Reserve Board 9/09/26

Past performance is no guarantee of future results. Economic forecasts may not develop as predicted.

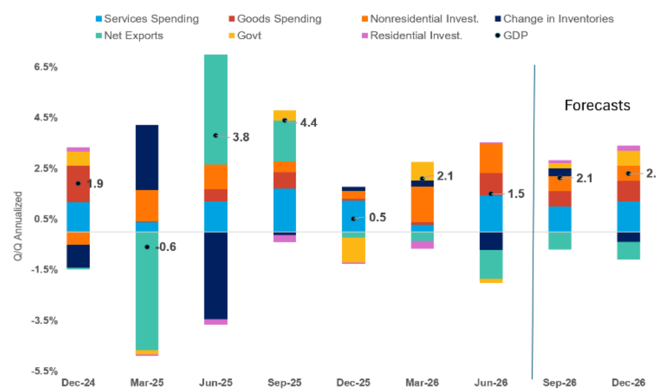
Economic Growth Will Likely Reach 2.1% in 2026 Despite Higher Rates

Financial markets have spent much of the year adjusting to the prospect of additional Federal Reserve tightening, with investors now pricing in a couple of rate hikes before year-end. Yet the economy continues to defy the traditional playbook. Real GDP is expected to grow roughly 2.1% in 2026, supported by a surge in business investment tied to artificial intelligence, intellectual property, and nonresidential structures. Those areas have provided a cushion against the parts of the economy that remain sensitive to borrowing costs, helping sustain growth even as monetary policy stays restrictive.

Businesses Reported Uptick in New Orders...



...Implying Above-Trend Growth Will Continue



Sources: LPL Research, ISM, Bureau of Economic Analysis, 9/09/26

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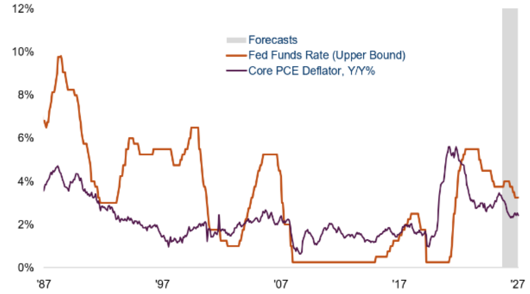
The latest manufacturing and services surveys suggest that resilience may be carrying into the second half of the year. The ISM Composite Index rebounded to 55.3, a level historically associated with above-trend economic growth and expanding business activity. The improvement has been especially notable in cyclical and capital-intensive industries, including Transportation Equipment, Petroleum & Coal Products, Computer & Electronic Products, and Machinery. Taken together, the data point to an economy that is increasingly being driven by investment, production, and productivity-enhancing technologies rather than the interest rate-sensitive sectors that once dominated the business cycle.

Prolonged Middle East Conflict Means Inflation Improvements Are Delayed

At the start of the year, the inflation outlook seemed relatively straightforward. Supply chains were healing, wage pressures were gradually easing, and inflation appeared on track to remain below 3%. Then came the disruptions tied to the conflict in the Middle East. Higher transportation costs, shipping delays, and renewed pressure on energy markets complicated what had looked like a steady march toward the Federal Reserve's target. The result wasn't a reversal of the disinflation trend so much as an interruption. Price pressures proved stickier and more persistent than many forecasters anticipated, forcing economists to push back the timeline for improvement.

The inflation story now appears to be one of delay rather than defeat. Progress is still expected, but it may arrive later than originally thought. Inflation could narrowly slip below the 3% threshold in December, perhaps ending the year around 2.9%, though that figure would not be confirmed until the data are released in early January. More meaningful progress may not emerge until the spring. By April, annual inflation could fall closer to 2.3%, reflecting the fading effects of supply-chain disruptions and a more balanced economy. For Federal Reserve officials, the challenge is that even if inflation is moving in the right direction, the evidence may not arrive soon enough to justify declaring victory this year.

Expect Some Improvements by December…



…But Disinflation Will Take a While

Inflation Dashboard (Y/Y %)	Dec-25	Jan-26	Feb-26	Mar-26	Apr-26	May-26	Jun-26	Jul-26	Aug-26
Import Prices	0.00%	0.21%	0.99%	2.26%	4.52%	6.81%	6.68%	5.95%	
Producer Prices	3.09%	3.04%	3.35%	4.28%	5.70%	5.83%	5.54%	4.66%	
Services Prices Index	65.10	66.60	63.00	70.70	70.70	71.30	67.70	70.30	72.60
Manufacturing Price Index	58.50	59.00	70.50	78.30	84.60	82.10	73.00	71.10	71.10
Global Supply Chain Pressure Index	0.58	0.48	0.59	0.68	1.85	1.83	1.20	0.94	1.06
Gasoline Prices: U.S. Average	2.91	2.84	2.93	3.70	4.13	4.50	4.05	3.97	4.08
Consumer Prices (CPI)	2.68%	2.39%	2.41%	3.26%	3.81%	4.25%	3.53%	3.36%	
Consumer Prices (CPI) Ex Housing	2.37%	2.05%	2.15%	3.43%	4.05%	4.61%	3.58%	3.38%	
Rent Prices (CPI)	2.92%	2.84%	2.68%	2.56%	2.79%	2.92%	2.84%	2.86%	
PCE Deflator	2.88%	2.88%	2.87%	3.54%	3.80%	4.11%	3.72%	3.70%	
PCE Deflator: Core Services Ex Housing	3.29%	3.60%	3.34%	3.53%	3.60%	3.97%	3.91%	3.85%	

Sources: LPL Research, AAA, Bureau of Economic Analysis, Bureau of Labor Statistics, NY Fed, ISM 9/09/26
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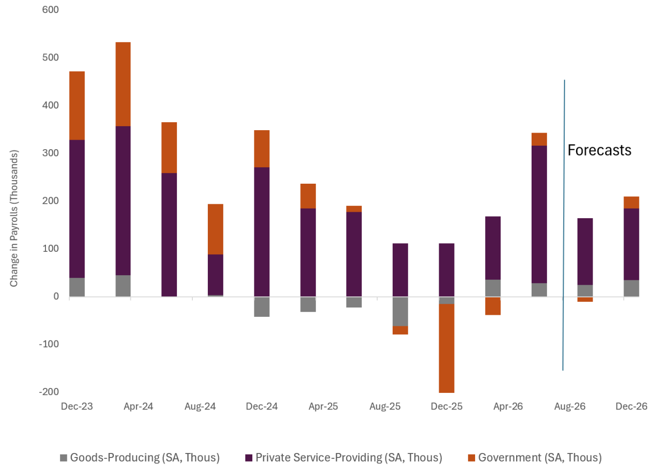
Unemployment Rate Will Likely Rise to 4.5% by the End of the Year, But Solid Market Overall

August payrolls increased by 162,000, while July's gain was revised modestly higher, reinforcing the view that the labor market remains on solid footing. The strength of this report is likely to shift a few more Federal Reserve officials toward the hawkish side of the policy debate. Beneath the headline numbers, labor-market dynamics continue to evolve. Employment among younger workers remains relatively soft, potentially reflecting increased adoption of artificial intelligence and automation, while workers ages 35 to 44 continue to post the strongest employment-to-population ratios, highlighting the growing value employers place on experience. At the same time, durable goods manufacturing remains on an upward trajectory, consistent with recent ISM surveys that point to a broadening manufacturing renaissance across several industries. In contrast, the Information and Financial sectors have continued to trim payrolls as firms focus on cost management and efficiency gains.

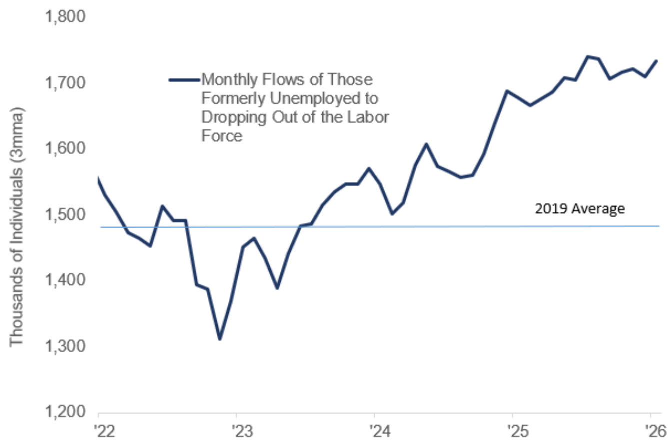
The unemployment rate held steady at 4.1%, suggesting labor-market conditions remain relatively tight and below the Congressional Budget Office's estimate of the noncyclical unemployment rate of 4.4%. While we see little evidence that wage pressures are accelerating in a way that would reignite inflation, Federal Reserve officials may interpret the labor market's resilience differently. Taken together, recent labor metrics have strengthened the case for additional monetary tightening. Ironically, financial markets may experience less volatility from a quarter-point increase than from another meeting in which policymakers opt to stand pat, extending uncertainty about the policy path ahead.

Job Growth Set to Continue ...



Source: LPL Research, Bureau of Labor Statistics 9/09/26

...but People Are Dropping Out of the Labor Force



Source: LPL Research, Bureau of Labor Statistics 9/09/26

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A World Economy in Transition

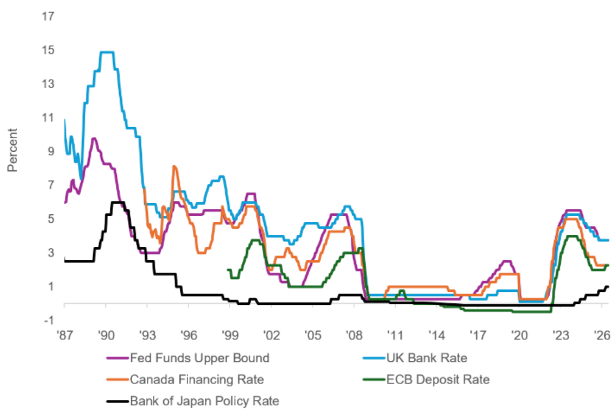
The global economy is being reshaped by a series of structural shifts that are complicating the outlook for growth, inflation, and monetary policy. China is moving beyond its traditional role as a source of low-cost manufactured goods, with exports increasingly dominated by semiconductors, industrial machinery, smartphones, and other technology-related products. At the same time, signs of firmer inflation in China suggest one of the world's biggest exporters may no longer exert the same disinflationary force on global goods prices that it did in recent years. Meanwhile, Japan is preparing for a world of higher interest rates, supporting a stronger yen and potentially unwinding years of capital flows built around ultra-low Japanese borrowing costs. Europe, by contrast, remains mired in sluggish growth, highlighting the widening divergence among the world's major economies.

In the United States, the economy continues to show surprising resilience despite restrictive monetary policy. Manufacturing activity is improving, business surveys point to steady demand, and a surge in investment tied to artificial intelligence and data-center construction is providing a powerful tailwind for growth. Equally important, households have proven far less sensitive to higher borrowing costs than many economists expected. Strong balance sheets, historically low debt-service burdens, and a large stock of fixed-rate mortgages locked in during the pandemic have muted the traditional impact of Federal Reserve tightening. As a result, the economy appears capable of growing near 2% even as markets price in the possibility of additional rate increases.

That resilience, however, has come at a cost. Earlier expectations that inflation would remain comfortably below 3% this year were disrupted by supply-chain strains and higher transportation and energy costs tied to the prolonged conflict in the Middle East. Inflation is still expected to move lower, but the timeline has been pushed back. Progress now looks more like a delay than a derailment, with inflation potentially slipping below 3% only at year-end before moving closer to the Fed's target during the first half of next year. For policymakers, the challenge is clear: growth remains solid, labor markets remain relatively healthy, and inflation pressures have eased only gradually. In a world where China is moving up the value chain, AI investment is reshaping business spending, and consumers are insulated from higher rates, the old economic playbook may no longer apply as neatly as it once did.

Appendix: Supporting Macro Charts

Bank of Japan Finally on a Tightening Path



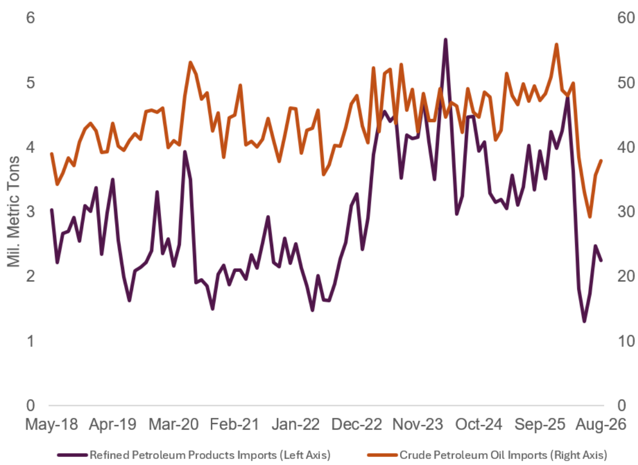
Source: LPL Research, BOC, BOE, BOJ, ECB, Federal Reserve Board 9/09/26

Global Purchasing Managers Composite Index

	Aug-26	Jul-26	Jun-26	May-26	Apr-26	Mar-26	Feb-26	Jan-26	Dec-25
Global	53.5	52.7	52.0	51.9	51.8	51.0	53.3	52.5	52.0
Developed Mkts	54.1	53.3	51.2	50.6	51.1	50.5	52.2	52.6	51.9
Emerging Mkts	52.4	51.2	53.0	53.6	52.7	51.4	55.1	52.3	52.1
U.S.	56.0	54.5	51.9	51.5	51.7	50.3	51.9	53.0	52.7
Eurozone	52.0	52.0	50.0	48.5	48.8	50.7	51.9	51.3	51.5
Germany	51.8	51.3	49.5	48.8	48.4	51.9	53.2	52.1	51.3
France	48.5	49.4	47.2	44.9	47.6	48.8	49.9	49.1	50.0
Italy	53.6	52.5	50.8	50.4	50.5	49.2	52.1	51.4	50.3
Spain	55.8	56.5	53.3	50.2	48.7	52.4	51.5	52.9	55.6
U.K.	52.5	52.2	49.3	49.7	52.6	50.3	53.7	53.7	51.4
Russia	50.6	49.6	48.9	49.2	49.1	48.8	50.8	52.1	50.0
Japan	53.5	52.7	52.8	51.1	52.2	53.0	53.9	53.1	51.1
China	52.1	50.8	53.6	54.0	53.1	51.5	55.4	51.6	51.3
India	54.3	54.3	57.1	59.3	58.2	57.0	58.9	58.4	57.8
Brazil	49.1	48.8	50.7	49.5	52.4	49.9	51.3	49.9	52.1

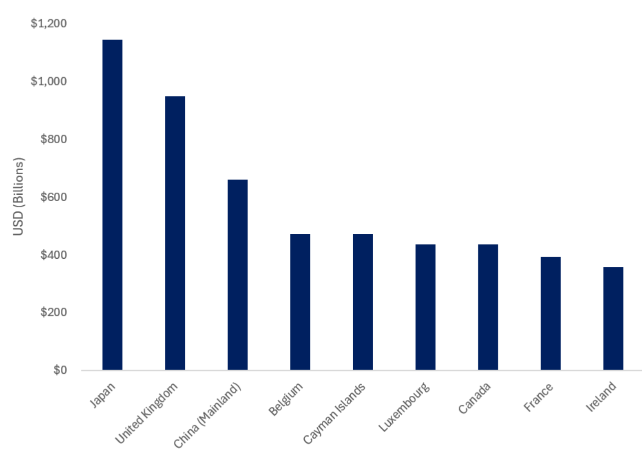
Source: LPL Research, S&P Global 9/09/26

China Importing Less Oil



Source: LPL Research, China General Administration of Customs 9/09/26

Japan: The Largest Foreign Holder of U.S. Treasuries



Source: LPL Research, U.S. Treasury 9/09/26

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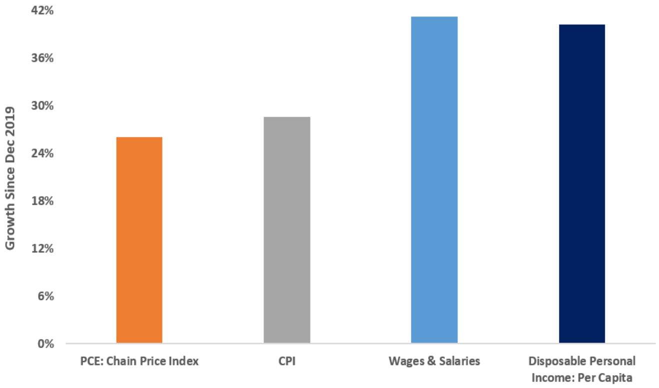
Incomes Have Outpaced Inflation



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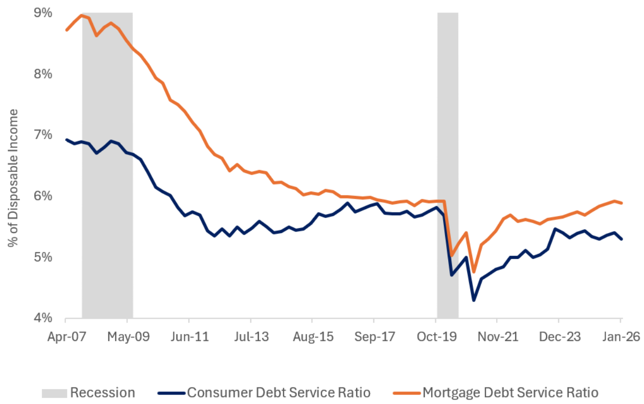

Source: LPL Research, Bureau of Economic Analysis, Bureau of Labor Statistics 9/09/26 Source: LPL Research, Federal Reserve 9/09/26

Forecasts Imply 2026 May Be a Pivotal Year

	2025				2026						
Growth	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**2024**	**2025**	**2026**
Nominal GDP (Y/Y %)	4.6	4.6	5.4	5.4	6.1	6.6	6.2	6.0	5.3	5.0	6.3
Real GDP (Yr/Yr %)	2.0	2.1	2.3	2.0	2.7	2.1	1.6	2.2	2.8	2.1	2.1
Real GDP (Q/Q Annualized)	-0.7	3.8	4.4	0.5	2.1	1.5	2.1	2.3			
Consumer Spending	0.6	2.5	3.5	1.9	0.54	3.45	1.9	1.8	2.9	2.6	1.9
Government Spending	−1.0	-0.1	2.2	-5.6	4.43	-0.97	2.0	3.4	3.8	1.1	1.3
Private Investment	23.3	-13.8	0	2.3	7.9	2.7	6.1	6.2	3.0	1.9	3.8
Exports	0.2	−1.8	9.6	-3.3	10.87	4.50	4.8	2.7	3.6	1.6	4.3
Imports	38	−29.3	-4.4	-1.0	11.80	12.51	6.6	5.8	5.8	2.7	3.5
Real Final Sales to Domestic Purchasers (Q/Q Ann.)	1.4	2.4	2.8	0.6	2.2	3.3	2.4	2.2	3.1	2.4	2.5
Business Sector											
Nonfarm Productivity (Q/Q Annualized)	-0.9	4.2	5.2	1.6	0.82	1.42	1.0	1.8	2.9	2.2	2.4
Corporate Profits After Taxes (Yr/Yr %)	7.5	4.8	10.8	10.2	11.42	20.31	12.0	14.0	3.9	8.4	8.1
Industrial Production (Yr/Yr %)	0.7	0.5	1.7	1.5	0.83	1.38	0.5	0.4	-0.6	1.1	1.2
Consumer											
Real disposable income (Yr/Yr %)	2.0	1.8	1.8	1.0	0.72	-0.12	1.4	1.7	2.9	1.7	1.5
Retail Sales (Yr/Yr %)	4.5	4.3	4.4	3.0	3.9	6.3	5.1	5.5	2.6	4.0	5.1
Retail Sales Ex-Autos (Yr/Yr %)	4.3	3.9	4.2	3.7	4.6	7.1	4.4	3.7	2.8	4.0	5.2
Consumer Confidence	99.8	93.1	97.4	94.2	90.7	92.2	90.0	93.0	104.5	96.1	91.5
Light Vehicle Sales (Mil. Units, SAAR)	16.4	16.2	16.5	15.7	15.5	16.4	16.5	16.1	15.9	16.2	16.1
Jobs & Housing											
Unemployment rate (%)	4.1	4.2	4.3	4.5	4.3	4.3	4.3	4.4	4.0	4.3	4.3
Nonfarm Payroll (Change in Thousands)	61	101	70	-116	218	242	210	205	1459	29	219
Housing Starts (Mil. Units)	1.40	1.35	1.35	1.32	1.42	1.34	1.30	1.35	1.37	1.36	1.4
Existing Home Sales (Annualized, Millions)	4.08	4.01	4.04	4.16	4.05	4.12	4.05	4.10	4.06	4.07	4.08
Inflation, Annual											
Consumer Price Index (CPI)	2.7	2.5	2.9	2.7	2.7	3.8	3.3	2.9	3.0	2.7	3.2
Core CPI	3.1	2.8	3.1	2.7	2.5	2.7	2.7	2.5	3.3	2.9	2.8
PCE Inflation	2.6	2.4	2.7	2.8	3.1	3.9	3.5	3.2	2.6	2.6	3.4
Core PCE Inflation	2.8	2.7	2.9	2.9	3.1	3.4	3.2	3.0	2.9	2.8	2.9
Brent Crude Spot Price (Average, $)	75.81	68.01	68.97	63.63	80.21	103.28	89.00	78.00	79.86	68.19	87.62
Rates											
Fed Funds (%, Upper Bound, Period End)	4.50	4.50	4.25	3.75	3.75	3.75	4.00	4.00	4.50	4.25	3.88
Mortgage Rates (30-year Fixed, Period End)	6.79	6.77	6.39	6.27	6.56	6.53	6.80	6.75	6.49	6.60	6.66

Source: LPL Research, Federal Reserve Bank of Philadelphia, Bloomberg 9/09/26
Disclosures: Past performance is no guarantee of future results. Forecasts may not materialize as predicted and are subject to change. Shaded areas are forecasts and are subject to change as additional data is published.

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All index data from FactSet.

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