

Weekly Global Economic Update

What's happening this week in economics? Deloitte's team of economists examines news and trends from around the world.

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Week of July 27, 2026

- **Oil prices, inflation, and central banks**
- **Tech-company debt and risks to the outlook**
- **Chinese economic slowdown**

Oil prices, inflation, and central banks

- Shipping traffic passing through the Strait of Hormuz has **fallen** to roughly the level seen prior to the signing of the memorandum of understanding between Iran and the United States, which is now widely considered as no longer operational. Thus, aside from a few brief weeks following the signing, the Strait of Hormuz has been effectively closed for more than four months.

Moreover, Houthi forces in Yemen—which are aligned with Iran—now say that they will block seaborne traffic through the Strait of Bab el Mandeb, which lies at the southern end of the Red Sea and accounts for roughly 8% of the world's oil traffic. Last week, it was **reported** that seven ships headed for Bab el Mandeb turned around amid concerns about potential security risks and disruptions.

- The result has been a sharp rise in the price of crude oil, which hit about US\$100 per barrel last week before reverting to a lower level—the highest since early June, but still far below the US\$125 reached earlier during the conflict. The price of natural gas sold in Europe has **increased** to its highest level in four years. It is not surprising, hence, that the price of oil has gone up. But what is perhaps more surprising is that it has not gone even higher. After all, there is now a physical shortage of oil, with global demand exceeding supply. This gap has mostly been filled by the release of oil reserves by major countries—but those reserves are now at very low levels.

In the United States, for example, **reserves** held by government hit their lowest level since the early 1980s. Yet, if investors expect reserves to continue to decline, oil prices could rise further, given that is the only way in which demand can be brought down to the level of supply.

Then, why haven't oil prices gone higher? There are several potential explanations.

For example, some investors may believe that Iranian leaders likely have a greater capacity to absorb the economic consequences of a prolonged conflict than elected governments facing near-term political pressure: Iran, after all, is not a democracy, and its leaders will likely not lose power any time soon, even as Iranians suffer the economic consequences of the conflict. In the United States, on the other hand, elevated gas prices could become an increasingly important political issue as midterm elections approach.

Thus, some investors are possibly betting on the United States to be more willing to make policy adjustments that help reduce tensions and stabilize energy markets. I think this belief is probably wrong, in which case, the price of oil will likely rise much further.

Another reason for oil-price stability is that the world has far greater reserves than it did in the 1970s, during the last major physical shortage of oil. Vast **volumes** of reserves have been released while production has increased in countries that are not part of the Organization of the Petroleum Exporting Countries. Gulf countries have also diverted oil exports to alternative locations. All of these actions have contributed to the stability of oil prices.

China could be the key, as well: Since the start of the conflict, Chinese refiners have significantly reduced purchases of imported crude, instead relying on domestic reserves. Yet, this may not be sustainable indefinitely. China generally relies on imports for 70% of its crude oil. At some point in the near future, it is likely that China will return to the global crude-oil market. When that happens, and assuming the conflict in the Middle East is not resolved by then, the price of crude could rise sharply.

Thus, one can argue that oil traders may be exhibiting an unwarranted degree of complacency. The International Energy Agency warned that, although the oil market is benefitting from some “cushioning factors” such as the release of reserves, there is reason for concern. It **said** that “the escalation in hostilities affecting the Strait of Hormuz and energy infrastructure in the region increases security-of-supply concerns and uncertainty over the market outlook. There is no room for complacency on oil security amid the escalation in hostilities and a continued drawdown of available commercial inventories.” It also noted that the threatened closure of Red Sea trading routes could exacerbate the situation. On the other hand, the International Energy Agency said that member-country governments still hold about 1 billion barrels of crude oil in reserves.

Meanwhile, regardless of the price of crude, it is the price of refined products that has a direct impact on retail prices and consumer and business expenditures. Since the conflict began, the prices of refined products have risen sharply in relation to crude prices, with the gap more than tripling since February. The spread between the two is known in the industry as the “**crack spread**,” and it is now at an historically high level. In fact, the increase in the crack spread since the conflict began means that, with crude oil at roughly US\$100 per barrel, the true **cost** to the final customer is close to US\$140 per barrel. From that perspective, the rise in crude prices has been more onerous than the nominal crude price implies.

But why has the crack spread widened so much? There are two major explanations: First, since the start of the conflict, attacks on the refining structures in Gulf nations have contributed to a reduction in refining capacity. Plus, even with the existing refining capacity, the disruption in the Strait of Hormuz has limited the ability of Gulf nations to export refined products to its customers around the world.

Second, and perhaps more importantly, Ukraine’s drone attacks on Russian refineries appear to have been very impactful: Russia’s refining capacity has reportedly been diminished enough to cause it to become a net importer of refined products—rather than a net exporter. This has likely contributed

significantly to a global shortage of refining capacity. Moreover, there has been an especially sharp decline in diesel-refining capacity, which is important because trucks and other freight vehicles largely rely on diesel. The result could be a significant increase in the cost of transporting goods.

Meanwhile, the relative stability of crude-oil prices possibly reflects the reality that, with limited refining capacity, demand for crude has diminished. After all, if you can't refine the oil, why bother purchasing? But it is the price of refined products that will contribute to any acceleration in inflation. Thus, for central bankers that want to understand the link between oil prices and inflation, it will be important to keep an eye on the crack spread.

How are financial markets reacting to the current situation? First, equity **prices** have been relatively immune to concerns about the Middle Eastern conflict. Despite **reports** that the administration is considering putting ground troops in Iran, most equity investors appear to be primarily focused on the development of the artificial intelligence economy. AI is seen as a long-term bet that is not necessarily influenced by temporary events in the Middle East.

On the other hand, bond **yields** have risen sharply in many countries including the United States and much of Western Europe. In the United States, for example, the yield on the 10-year Treasury bond increased from roughly 4.4% at the end of June to 4.66% last week, which likely reflects concerns about a potential increase in inflation and, consequently, a tightening of monetary policy. Indeed, as of late last week, the futures **market** showed an implied probability of 33.7% that the US Federal Reserve will boost its benchmark rate at its meeting on July 29, 2026—up from 10.7% one week earlier. Moreover, the implied probability of two or more rate hikes this year was 54.9%—up from 25.9% one week earlier. This shift likely reflects concern about the unfolding of events in the Middle East.

In Europe, the yield on Germany's 10-year bond increased from 2.84% at the end of June to roughly 3.2% late last week. Consequently, the futures market's implied **probability** that the European Central Bank will raise its benchmark interest rate in September is now about 85%.

What about inflation? If the prices of oil, gas, and other commodities continue to be elevated or even rise further, it is likely that inflation could accelerate in the months to come in major economies. The expectation that this will happen is likely the primary factor that will drive central-bank policies.

For the United States, another factor that could drive higher inflation is the possibility of additional tariff rate hikes. Indeed, the administration **announced** last week a new set of tariffs on 60 major trading partners, utilizing Section 301 of the Trade Act of 1974. According to the administration, the new tariffs will be imposed because trading partners have allegedly failed to “impose and effectively enforce a prohibition on the importation of goods produced with forced labor.”

There are some exceptions to the new tariffs, however. They will not apply to Mexico and Canada. In addition, they will not apply to oil, gas, and fertilizers. The result of this new initiative is that the effective **average US tariff rate** is now 12.8%, according to the Yale Budget Lab, which is lower than the peak reached last year but much higher than at any time since the 1930s. It is estimated that the current tariff regime adds about US\$1,100 on average to annual US household expenditures compared to the tariff levels imposed before last year.

Tech-company debt and risks to the outlook

- Recently, there has been a massive **increase** in bond issuance by US-based technology companies. Just six major technology hyperscalars have issued about US\$250 billion in new bonds in the first half of 2026. That is more than double of what they issued throughout 2025. It also exceeds the total issued

by these companies in the last five years. As such, technology companies now account for a record share of corporate bond issuance. When the surge in investment in data centers began, there was plenty of talk about how large tech companies, flush with cash, would not need to borrow. Yet, that trend seems to have changed. Now, eager to preserve their cash reserves, big tech companies have increasingly turned to debt markets to help finance investments.

Traditionally, many tech companies were seen as generating lots of cash and having a modest volume of assets. That is now changing, with the massive investment in data centers. As such, capital expenditures by major AI companies are now roughly equivalent to 94% of free cash flow—up from 40% previously. This partly explains why tech companies are resorting to debt financing.

The large increase in debt issuance raises some questions. Will the market be able to absorb such an increase in supply, especially at a time when the US government continues to borrow heavily? The increase in bond issuance has already had some impact on the economy: Yields on tech-company bonds have **increased** significantly compared to US Treasuries, although yields still remain historically low. However, investor **commentary** suggests that there is growing concern about the ability of the market to absorb more debt. It is widely expected that tech companies are likely to issue a lot more debt in the coming year or two. Plus, yields on US Treasury securities have risen recently, potentially putting more pressure on the corporate bond market.

Until recently, most of the concern about the risk of massive investments in AI centered around the equity market. There was plenty of talk about a potential AI bubble. Yet now, with a sharp increase in debt, there might be concern about the ability of companies to service their debts should there be a downturn in AI-driven revenues.

Notably, the Bank for International Settlements, which advises the world's central banks, has warned about potential risks associated with massive AI investment. In its recent economic outlook, it **said** that “a reversal of AI optimism could ... have major financial consequences, given AI firms’ rising leverage and growing footprint in credit markets. Vulnerabilities extend to their supplier ecosystem, including engineering, procurement, and construction contractors whose balance sheets are comparatively weak, leaving them exposed to any capex pullback by hyperscalers.”

The Bank for International Settlements also noted that the expected future earnings implied by current valuations are unusually high. It suggested that there is “growing investor complacency and reduced compensation for risk-bearing. Post-pandemic exuberance has been largely broad-based across sectors and countries, coinciding with the rapid rise of AI as an investment theme following the release of generative AI tools in late 2022.”

Also, it is worth keeping in **mind** that the cyclically adjusted price/earnings ratio for US stocks is now at its second highest level in history—the highest having been at the peak of the dot-com bubble a quarter century ago. In the past, surges in price/earnings ratios led to market corrections, which often took place quickly. Indeed, the Bank for International Settlements stated that “a major equity-market correction could have larger macroeconomic consequences today than in the past. Household equity exposures have grown over the past few decades, both relative to total wealth and income. A large correction in valuations could have more pronounced wealth effects and sharper consumption pullback than in the past.”

Chinese economic slowdown

- China’s economy grew more slowly in the second quarter of 2026. The Chinese government **reports** that, in the second quarter, real gross domestic product was up 4.3% from a year earlier. Excluding the pandemic period, this was the slowest phase of growth since the 1990s. While exports remained strong, domestic demand remained weak. Both consumer spending and investment grew only

modestly, especially challenged by the continuing troubles in the residential property market. The government commented that there is an imbalance between strong supply and weak demand.

In addition to data on real GDP growth, the Chinese government issued reports on several other indicators. It reported that, in June, **retail** sales continued to exhibit weakness. Sales were up 1% from a year earlier after declining in May and rising slowly in April. This rebound was largely fueled by strong spending on communications equipment, which was up 16.5% from a year earlier. Yet, spending fell sharply for high-value products: spending was down 16.1% for automobiles, down 8.7% for appliances, down 10.5% for building materials, and down 6.6% for furniture.

Also, the government **reported** that, in the first half of 2026, fixed-asset investment was down 5.7% from a year earlier. This represented the weakest performance since the pandemic. Investment in property was down 18% and, excluding property, investment was down 2.7%. Investment in manufacturing was down 1.2%. Weak domestic demand, combined with possible excess capacity, could explain the weakness in non-property investment.

While demand was weak, the government reported strength in supply. Specifically, industrial **production** was up 5.3% in June from a year earlier—the strongest growth in three months. Moreover, manufacturing output was up 6%. By sector, production was up 15.7% for computers and communication, up 18.2% for railway and shipbuilding, and up 8.7% for automotives.

The increase in output was likely meant to support strong exports. Indeed, June **exports** were up by 27% from a year earlier, largely driven by AI-related products. For example, semiconductor exports were up 122%. Also, automotive exports (mostly electric vehicles) were up 70%. Meanwhile, **imports** were up a stunning 36% from a year earlier, likely fueled by demand for inputs used in exportable products. As such, it is no surprise that imports were up very strongly from Taiwan (up 41.1%), South Korea (up 85%), and Japan (up 33.9%).

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