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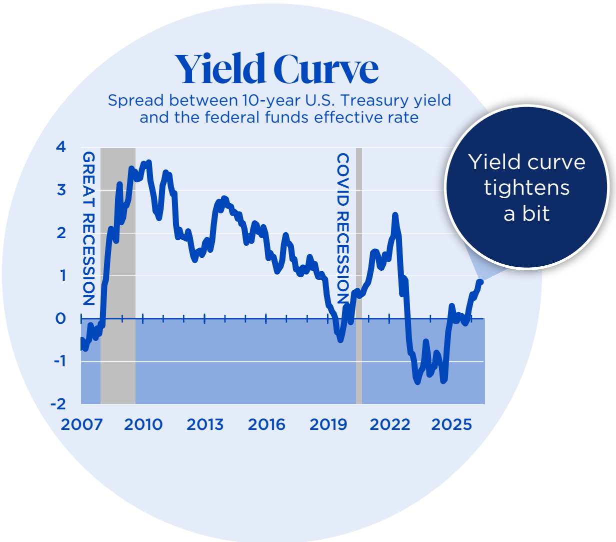
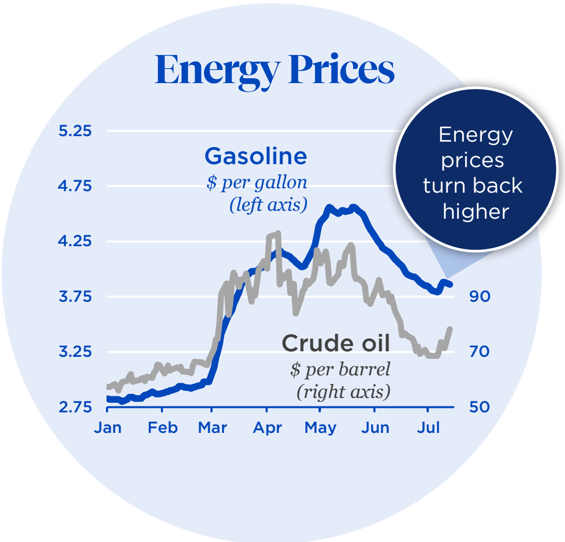
Economic & Financial Markets Monthly Review | July 2026

Growth remains resilient as inflation moderates

Where is the economy now?

The economy enters the second half of 2026 with building momentum from a firming labor market and a resilient consumer sector. Renewed hostilities in the Middle East have sent oil prices higher again, which could present more of a headwind to growth than we were anticipating. Further, employment gains and still-high inflation could lead the Fed to hike rates especially with energy prices rising again. However, our base case remains that economic growth remains solid.





Resilient growth continues

Economic conditions ended the second quarter on a solid note with solid consumer spending amid cooler inflation in June and a firmer hiring trend. The upward reversal in energy prices could dampen economic activity a bit in the second half of 2026, but the consumer and businesses have shown great resilience despite higher energy prices.

Yield curve flattens on rate hike bets

In response to the hawkish turn by the Fed, shorter duration interest rates have climbed as markets price in higher odds of rates hikes in 2026. The spread between the 2- and 10-year yields has tightened to below 50 basis points, akin to levels from last fall. Credit spreads are extremely tight as investor confidence remains high.

Oil prices resume upward climb

Crude oil prices experienced a brief reprieve to nearly pre-conflict levels following the U.S.-Iran MOU and the reopening of the Strait of Hormuz. However, the renewed conflict with Iran underscores that energy markets remain highly sensitive to geopolitical setbacks, maintaining upside risk to gasoline prices and inflation.

What does this mean for the economic outlook?

The economy has successfully navigated the uncertainty caused by the Iran conflict with only modest downside for growth. Solid consumer spending and strong AI capex has underpinned activity.

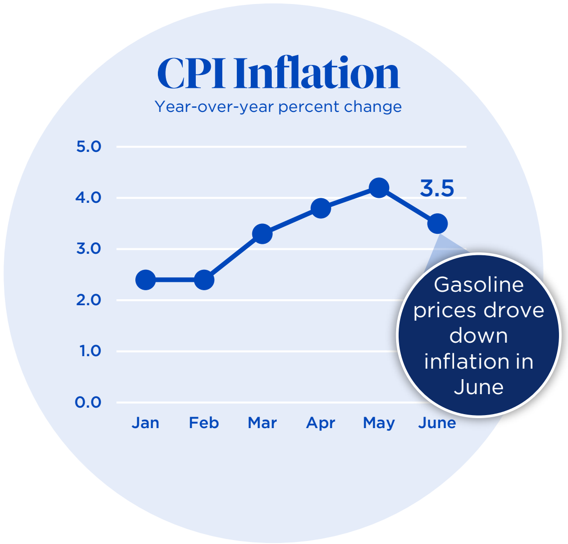
We still expect the Fed to hold the federal funds rate steady over 2026 despite financial markets pricing in a high chance of policy tightening. But a push for rate hikes could gather momentum later this year if inflation remains elevated in the coming months.

Energy prices remain well below their recent peak, but the latest rise in oil prices suggests the path to lower inflation may be less smooth and slower than previously expected.

Economic Review

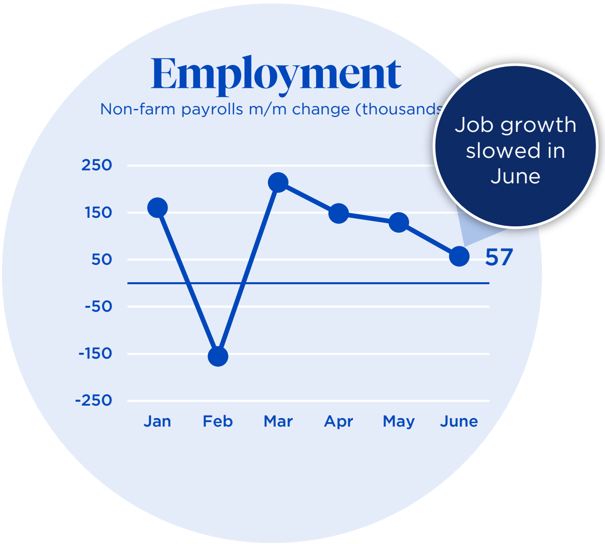
Inflation cools and labor market remains solid

Consumer inflation eased sharply in June as lower gasoline prices pulled headline CPI down and a flat core reading pointed to softer underlying price pressures. At the same time, employment gains moderated but remained solid enough to underscore a still-firm labor market, while a low personal saving rate suggests consumers have stayed resilient but have less cushion if hiring or income growth falter or inflation moves higher again.



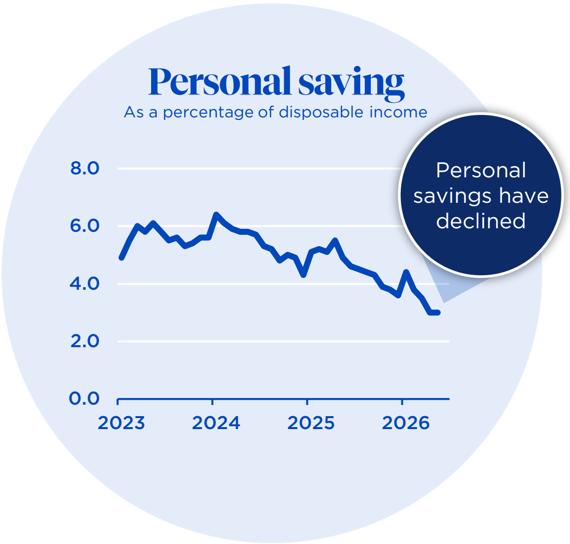
Inflation eases sharply

CPI fell 0.4 percent in June, the biggest decline since April 2020, as a nearly 10 percent drop in gasoline prices pulled headline inflation down to 3.5 percent from 4.2 percent. Core CPI was flat on the month and down to 2.6 percent year-over-year, giving a more reassuring read on underlying price pressures.



Hiring cooled in June

Employment gains cooled in June, with payrolls up 57,000 after averaging over 150,000 in the prior three months. Still, the stronger first-half pace points to a labor market that has improved meaningfully from last year. The unemployment rate ticked lower to 4.2 percent, due in part to participation dropping.



Personal saving rate remains lower

The personal saving rate remains very low, suggesting households are still spending through cost-of-living pressures with limited cash cushion. Outside of a brief dip in 2022, the April and May saving rate of 3.0 percent is lower than only one sustained period on record.

What does this mean for the economic outlook?

The June report gives the Fed more room to stay patient after rising concern that core inflation could remain higher for longer. Still, renewed Middle East tensions and the rebound in oil prices pose upside risk to the view that inflation will keep cooling in the second half of the year.

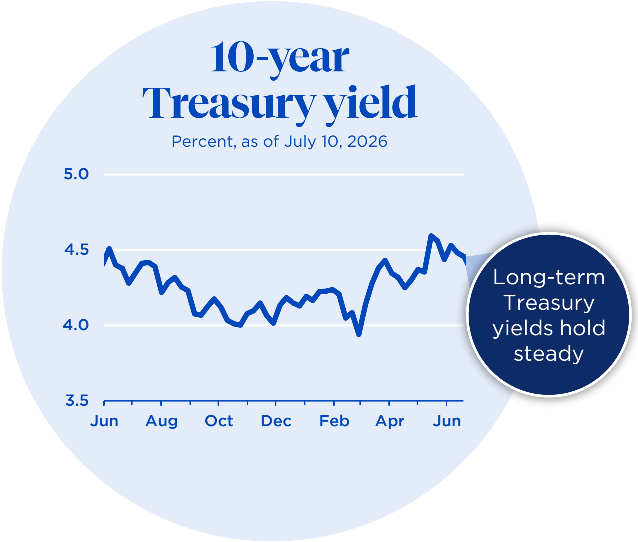
The stronger labor market has helped buffer consumers from higher gasoline prices, alongside large tax refunds, broader tax relief, and equity-market gains. Those tailwinds should help keep consumer spending and overall growth on solid footing in the second half.

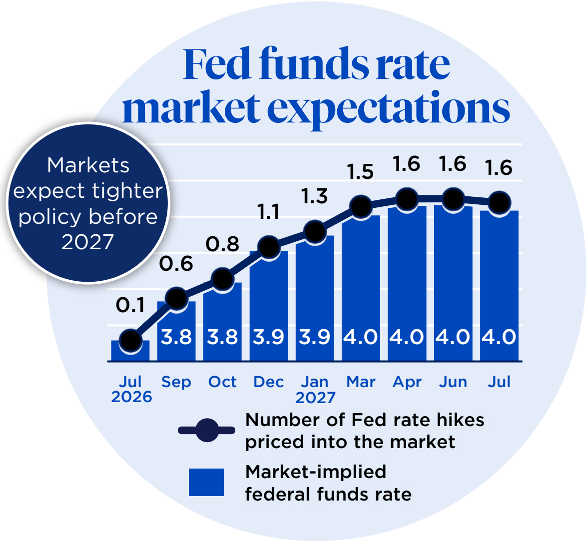
The current savings rate shows that consumers — especially middle and lower-income households — pulled back on saving or dipped into their prior savings to maintain spending in the face of higher inflation. As a result, many households have little buffer in reserve.

Financial Market Review

Equity rally on pause and interest rates stay elevated

Benchmark equity indices are treading water but there has been some notable churn beneath the surface as investors digest fast-moving Iran headlines as well as volatility in technology stocks and Fed policy news. Expectations for Fed rate hikes have kept upward pressure on short-end Treasury yields while the long-end remains mostly steady. We anticipate buoyant corporate earnings and economic growth will keep stock prices trending higher and interest rates elevated.





Equity rally on a longer pause

The benchmark S&P 500 index is flat over the past month as investors contend with news on the Iran conflict, funding for the AI buildout, and Fed policy. The steady performance obscures movements under the surface as certain sectors have sold off while others have rallied. Second-quarter reporting season kicks off this week and earnings expectations are very upbeat.

Interest rates stay high

Short-end yields have climbed as investors see risks of tighter Fed rate policy. Buoyant inflation and growth expectations are keeping long-term Treasury yields elevated especially as oil prices have turned back higher. The spread between the 2- and 10-year has narrowed slightly as a result.

Investors still expect Fed rate hikes

The balance of FOMC opinion is hawkish as new Fed Chair Kevin Warsh reiterates his commitment to price stability. Overall, it appears that investors' early assumption that a Warsh-led Fed would quickly cut rates will not play out. Investors currently see about 25 basis points of Fed rate hikes before 2027.

What does this mean for the economic outlook?

The market's recent performance could merely be a "breather" and movements under the surface a healthy rotation. Strong corporate earnings and resilient economic activity could lift the S&P 500 index by year end, supported by gains beyond companies pursuing AI investment.

Solid economic growth, persistent inflation pressures, and market expectations of Fed rate hikes will likely keep interest rates elevated. The recent re-escalation of Iran tensions risks pushing energy prices and inflation higher, threatening to exert upward pressure on interest rates.

Our baseline forecast expects the federal funds rate to remain steady for the rest of the year. Easing Inflation going forward should allow the Fed to keep the policy rate steady. However, we see risks that the solid labor market and elevated inflation could lead the Fed to hike.

Outlook

Past super-cycles can guide expectations for AI expansion

Artificial Intelligence (AI) has emerged as one of the most significant investment themes of the current decade, driving substantial capital spending on computing infrastructure, data centers, semiconductors, and power generation. While the technology remains in the early stages of adoption, it has already demonstrated the potential to become a long-lasting investment super-cycle in line with previous buildouts for railroads, electrification, and telecoms/IT.

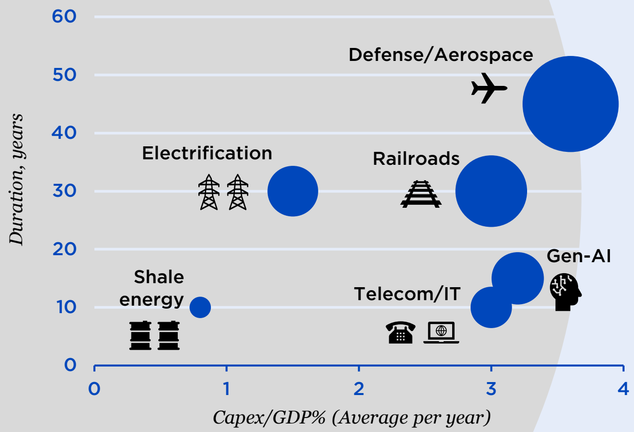
The central lesson from historical super-cycles is that long-term economic gains are driven not by investment itself, but by the productivity improvements that investment enables. Transformative technologies such as electricity, railroads, and telecommunications became powerful growth engines because they evolved into general-purpose technologies that diffused across the economy. In the past, higher productivity super-cycles were disinflationary due to increased capacity. The ultimate impact of AI will depend less on the amount of data center and chip investment, and more on whether AI enables economy-wide organizational transformation and productivity gains.

Capex during U.S. investment super-cycles

Size represents total capex

Gen-AI has the potential to evolve into a general-purpose technology super-cycle.

See the full report



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Forecast

Data as of July 2026

	2025 ACTUAL	2026 ESTIMATE	2027 FORECAST	2028 FORECAST	2029 FORECAST
REAL GDP [1]	2.2%	2.0%	2.3%	2.3%	2.3%
UNEMPLOYMENT RATE [3]	4.5%	4.2%	4.2%	4.2%	4.2%
INFLATION [1] (CPI)	2.8%	**3.2%**	**2.0%**	2.0%	2.0%
TOTAL HOME SALES	4.74	4.79	5.13	5.65	5.86
S&P/COTALITY HOME PRICE INDEX	1.3%	1.9%	2.7%	3.0%	3.0%
LIGHT VEHICLE SALES	16.2	15.9	16.4	16.5	16.5
FEDERAL FUNDS RATE [2]	3.50%	**3.50%**	**3.00%**	3.00%	3.00%
5-YEAR TREASURY NOTE [2]	3.73%	4.00%	3.65%	3.55%	3.55%
10-YEAR TREASURY NOTE [2]	4.18%	4.30%	4.20%	4.00%	4.00%
30-YEAR FIXED-RATE MORTGAGE [2]	6.18%	6.25%	5.80%	5.50%	5.50%
MONEY MARKET FUNDS	4.03%	3.53%	3.15%	3.03%	3.03%

Cooling inflation trend

Our forecast assumes falling energy prices as Iran conflict impacts fade over the second half of 2026. However, the recent renewed fighting and reimposition of the US blockade in the Straight of Hormuz introduces upside risk to our inflation outlook.

Fed to hold rates steady

We maintain our expectation that the Fed will be on hold over 2026 rather than increase rates. But the hotter inflation trend, combined with solid employment gains, could cause more Fed officials to push for rate hikes to cool price conditions.

[1] *Percent change Q4-to-Q4*
[2] *Year end*
[3] *Q4 average*

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Sources

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