

2Q26 Economic Summary

The second quarter of 2026 marked a turning point on two fronts that had dominated markets for more than a year: geopolitical risk began to recede, and the Federal Reserve got a new boss. A tentative ceasefire between the U.S. and Iran was announced on April 7. Although the truce proved fragile and was extended repeatedly amid mutual accusations of violations, investors increasingly bet on de-escalation and shrugged off the lingering disruption to oil flows. At the same time, Jerome Powell's tenure as Fed Chair came to a close, and Kevin Warsh took the helm in mid-June. Warsh hit the ground running at his first meeting, delivering a shorter, more direct policy statement that removed the Fed's easing bias and confirmed the Committee's commitment to price stability.

Equity markets staged an impressive rally during the quarter, with the Dow, S&P 500 and Nasdaq all touching record highs as fears of an escalating Middle East conflict and a stalling AI trade both faded. Fixed income markets did not fare as well, however. Treasury yields drifted higher across the curve on the combination of persistent inflation, ballooning fiscal deficits and the Fed's more hawkish tone. The front end of the curve bore the brunt of the repricing as investors steadily walked back expectations for Fed rate cuts and began entertaining the prospect of a hike. Longer-term yields were comparatively range-bound for most of the quarter, keeping the yield curve's positive slope intact but noticeably narrower than earlier in the year.

Despite ongoing uncertainty, the U.S. economy remained resilient. Although GDP growth appears to have downshifted somewhat in the second quarter, underlying growth fundamentals remain intact. Business investment stayed strong, with companies continuing to pour capital into AI-related equipment, software and data center infrastructure. Consumer spending held up despite elevated prices making some households more budget conscious. While lower and middle-income families tended to focus spending on essentials, higher-income households remained largely insulated from the swings in energy and food costs, continuing to spend freely on travel, luxury goods and other discretionary items. Residential investment continued to drag on growth as mortgage rates climbed back into the mid-6% range due to the energy-driven back-up in Treasury yields. Rising borrowing costs combined with elevated home prices and weak builder sentiment offset the improvement in housing affordability seen earlier in the year.

The labor market remained healthy, but job growth cooled during the quarter. Nonfarm payrolls rose by a combined 334,000 in 2Q26, but the pace of growth slowed sharply from month to month, with June payrolls coming in at a notably weaker-than-expected 57,000. Despite the deceleration, the underlying trend remained firm with the unemployment rate ending the quarter at 4.2%, the lowest level since June 2025. Jobless claims remained broadly contained, signaling that actual layoffs stayed muted even as job-cut announcements circulated. Job openings also remained relatively stable with construction and leisure & hospitality seeing the largest increases in vacancies. On the wage front, average hourly earnings continued to grind higher, keeping wage growth in focus for Fed policymakers.

Inflation took a turbulent path during the quarter, whipsawed by the war's impact on energy markets. Headline CPI accelerated in April and climbed further in May, when the annual rate reached 4.2%, its hottest reading in more than three years, as the conflict kept oil prices elevated. Price pressures reversed sharply in June, however, as a de-escalation in hostilities allowed energy costs to tumble, pulling headline CPI down to 3.5% year-over-year. Core inflation, which strips out food and energy, followed a similar but more muted arc, rising to 2.9% in May, its highest level since last September, before easing back to 2.6% in June as shelter and services costs cooled. Even with the June relief, both measures remain well above the Fed's 2% target.

Kevin Warsh wasted no time making his mark at the June FOMC meeting, introducing a new era of limited forward guidance and announcing the establishment of five separate task forces to review areas he believes are central to the broad conduct of monetary policy. The new Chair also squashed investor fears about Fed independence by vowing to restore price stability, stating that officials are "unambiguous and unanimous" in their commitment to the 2% inflation goal. As expected, the Committee voted to leave the target range for the fed funds rate unchanged at 3.50%-3.75%, where it has sat since the Fed's last cut in December 2025. However, the dot plot revealed a notably hawkish shift in outlook as 9 of 18 officials penciled in at least one rate hike by year-end 2026.

The road ahead for monetary policy remains uncertain. The path for rates will likely hinge on whether the conflict with Iran stays contained and core inflation resumes its descent, or whether a fresh energy shock and stubborn services costs force the Fed's hand toward tightening.