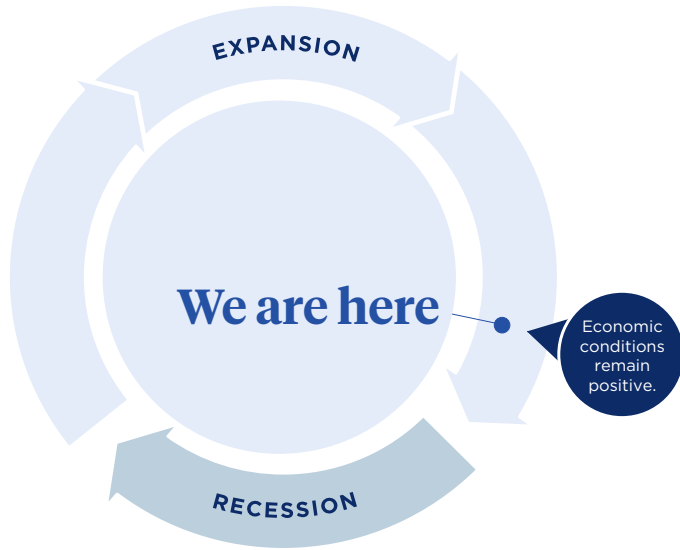


U.S. economy weathers another inflation spike.



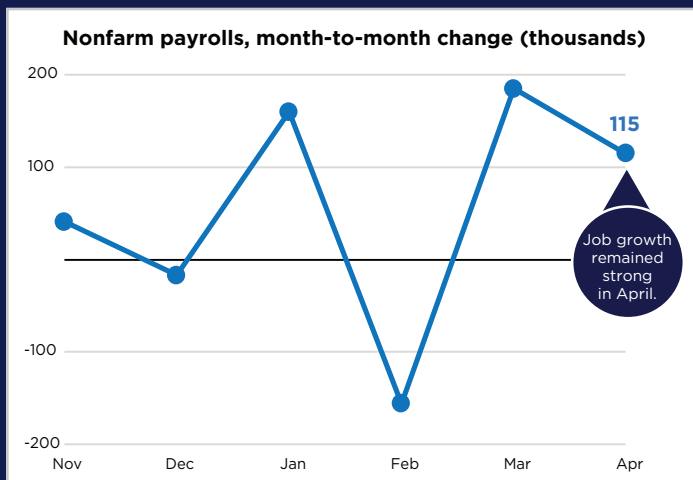
Headwinds from higher energy costs are expected to slow GDP growth in the coming months as consumers pare spending while businesses cut in vestment plans. Interest rates remain elevated and the Fed could be on pause until late in the year— adding further drag on expected purchases of auto and homes over 2026.

We expect that sluggish near-term growth will give way to an upswing in activity in the second half of 2026 if energy markets start to normalize over the summer. However, for now, higher energy costs, elevated uncertainty, and the hit to confidence is offsetting some of the fiscal stimulus from the One Big, Beautiful Bill Act.

Economic Overview

Strong hiring buffers the energy shock

Hiring was solid in April, with payrolls up 115,000 and gains led by private services. Healthcare and social assistance remained the main driver, but hiring broadened to retail, wholesale trade, transportation and warehousing, and leisure and hospitality. The unemployment rate held at a low 4.3%. The labor market has stayed firm despite Iran-war uncertainty. Higher gasoline prices will weigh on spending, but solid hiring should support income and confidence. With job growth still well above the estimated break-even pace and inflation rising on energy costs, the Fed is likely to be on hold for longer.



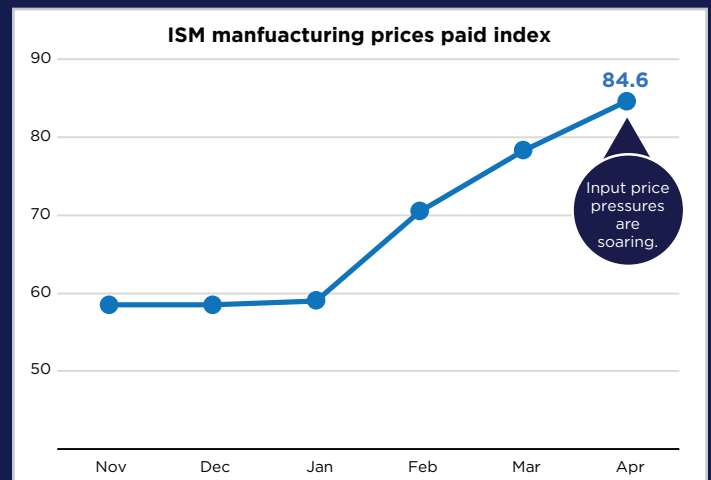
Source: Bureau of Labor Statistics

Economic Overview

Input cost pressures intensify

The ISM manufacturing prices paid index has surged in recent months to its highest level in four years, and the three-month climb from January to April was the largest in over 20 years. The sharp rise reflects intensifying input cost pressures tied to the closing of the Strait of Hormuz.

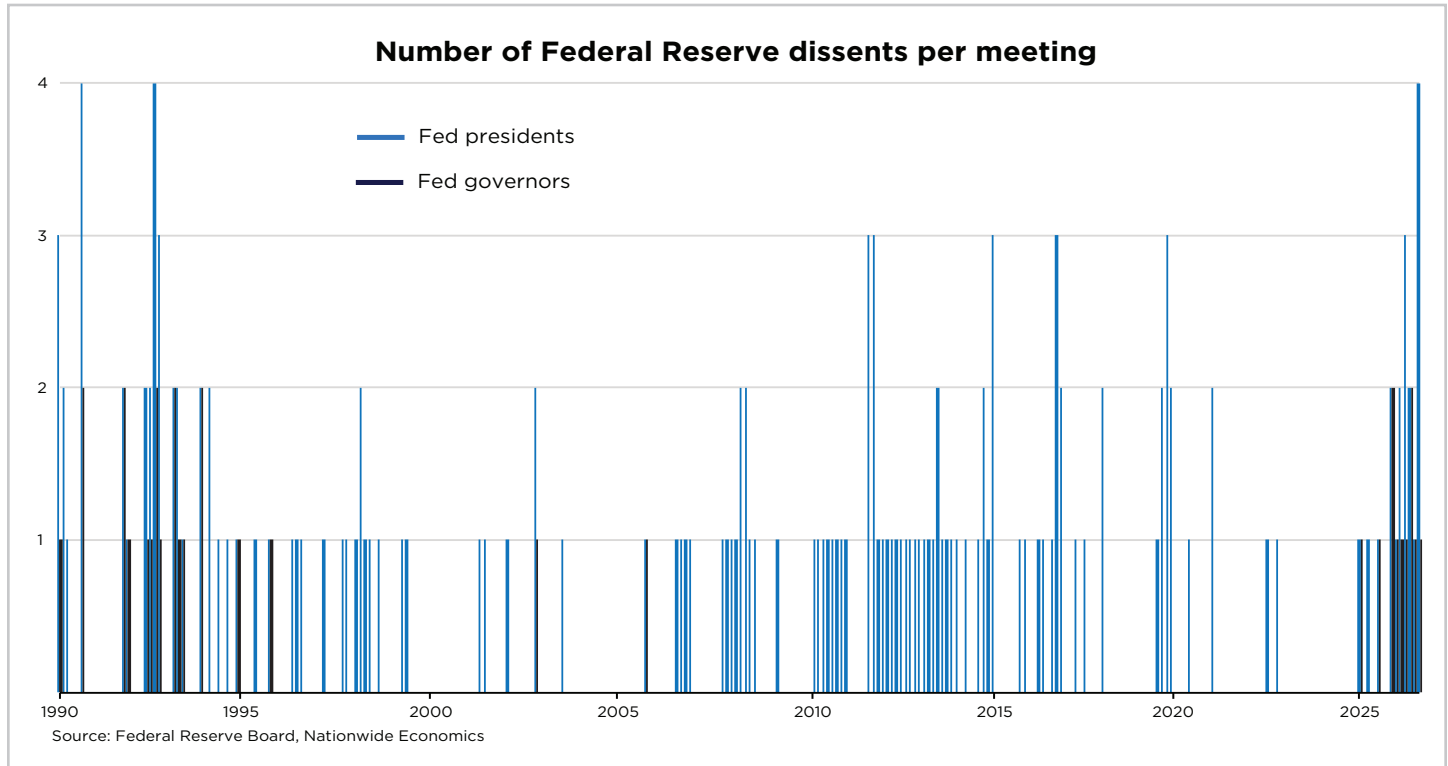
The jump in manufacturing input costs raises the risk that consumer goods inflation moves higher later this year as producers pass through at least part of those added costs. The ISM services prices paid index has also risen, although manufacturing is flashing the stronger warning signal.



Source: Institute for Supply Management

Outlook: Fed divisions could drive a longer pause in rates

While the FOMC held interest rates steady at its April meeting, there were four dissents for the first time since 1992—highlighting the hardening divisions between Fed officials. Three of the dissents represented the hawkish wing of the committee who wanted a more neutral policy stance given inflationary pressures from the spike in energy prices, as opposed to the current bias that leans towards an eventual rate cut. Commentary from Jerome Powell, during his last press conference as Fed chair, implied that most members preferred to keep rates on hold for some time given the uncertainty in the outlook. Incoming Fed Chair Kevin Warsh is likely to push for lower interest rates over time, but he may have difficulty convincing the other 11 voting FOMC members (which will include Powell as a Fed Governor for the time being) that such a move is warranted by current economic conditions. Given that energy prices could be elevated over the summer due to the lengthening Iranian conflict, an extended Fed pause is likely until at least late in 2026. We now expect only one rate cut in Q4 2026 with rising odds that the Fed stays on hold into 2027 — although a rate hike remains a low probability despite the hawkish shift.



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