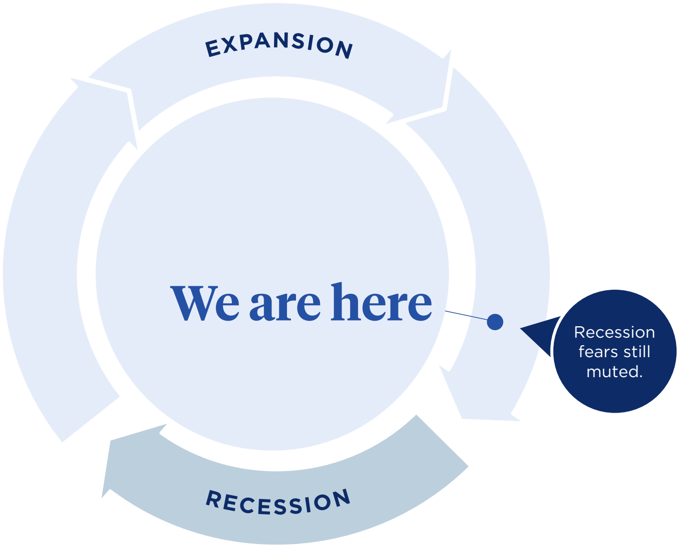
Economic Watch | August 2026

Geopolitics a headwind, not a roadblock



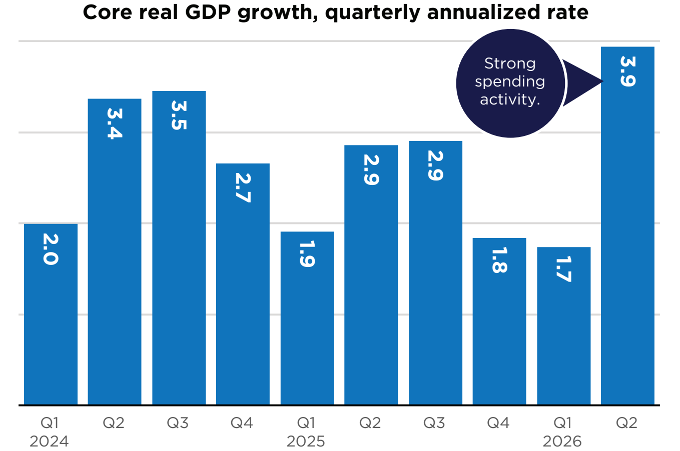
Geopolitical headwinds continue to weigh on the outlook in the second half of 2026, but underlying economic activity remains resilient. Growth could strengthen further if energy prices ease in the months ahead. Fed officials appear divided between keeping rates on hold and raising rates further to counter inflation pressures stemming from the Iran conflict. While energy markets and supply chains should gradually normalize, the risk of more persistent inflation remains elevated. The conflict in the Middle East could continue to influence inflation through year-end, though its effects should fade over time. Barring a further escalation in hostilities, easing tensions would support stronger growth in the second half of 2026 as energy costs stabilize, supply chains improve, and inflation pressures moderate.

Economic Overview

Strong underlying growth in Q2

Headline GDP growth came in softer than expected in the second quarter, rising at a 1.5% annualized pace as net trade weighed heavily on the overall figure. However, core GDP, which focuses on household and business spending, increased a strong 3.9%, pointing to healthy underlying economic momentum. That strength should carry into the third quarter despite higher energy prices, while continued investment in AI and data centers is expected to provide an additional boost to growth through the second half of 2026 and into 2027.

Core real GDP growth, quarterly annualized rate



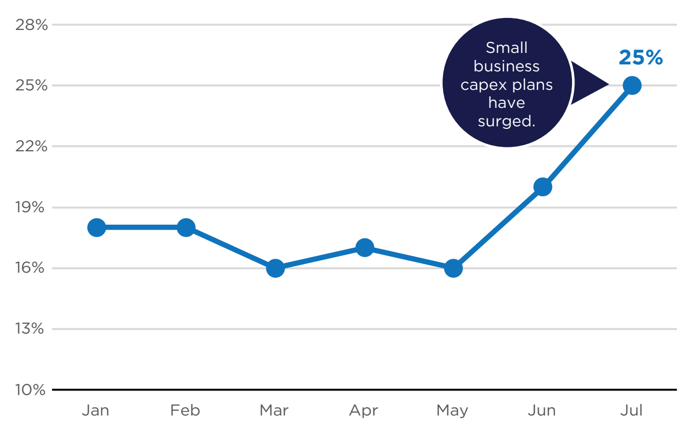
Source: Bureau of Economic Analysis

Economic Overview

Small business capex plans surge

The share of small business owners planning capital expenditures over the next three to six months jumped to 25% in July, up from 20% in June and 16% in May. After remaining subdued for much of the year, investment plans reached their highest level since December 2024. The sharp increase suggests businesses may be moving from delaying projects to ramping up spending, potentially supported by enhanced tax incentives. Some of that investment could be directed toward automation to address labor shortages. If these plans materialize, stronger capital spending should support business investment and broader economic growth.

Small business planning capex, next 3-6 months

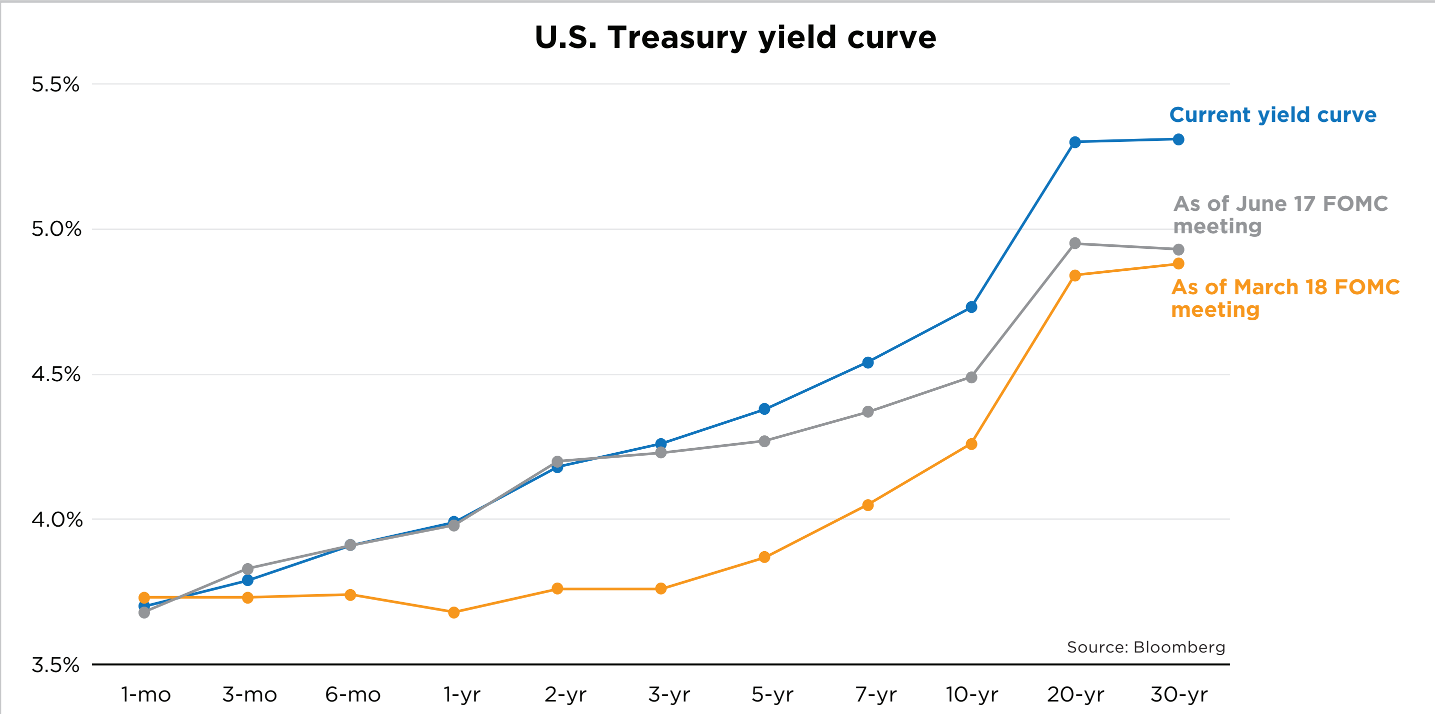


Source: National Federation for Independent Business

Outlook: Minimal Fed guidance as Warsh drives new approach

The first two FOMC meetings under Fed Chair Kevin Warsh have been marked by less communication and limited forward guidance, a notable departure from the approach of recent Fed leaders. With fewer signals from the Fed, financial markets will need to rely more heavily on incoming economic data to assess the path of monetary policy. This data-dependent approach gives policymakers greater flexibility but also increases the risk of market surprises and volatility.

The FOMC has also taken a more hawkish tone as the prolonged Iran conflict puts upward pressure on inflation and raises concerns about second-round effects. Three hawkish dissents at the July meeting underscored the internal policy debate, or "family fight," that Chair Warsh has referenced. While Warsh is unlikely to signal near-term policy decisions at the Jackson Hole symposium in late August, he may provide greater insight into the policy framework and operating philosophy guiding the Fed under his leadership. Meanwhile, the yield curve has steepened amid uncertainty surrounding monetary policy and increased Treasury issuance linked to AI-driven investment activity.



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