Corporate Federal Credit Union

Economic Update

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Commentary

It appears that the Trump Administration has made several New Year's resolutions and is intent on fulfilling many of them in short order. As the calendar turned, the administration took "control" of Venezuela, upped the ante to remove the Fed president, and increased pressure to take over Greenland. The markets largely shrugged off the risks of the first two but got spooked when the president threatened additional tariffs on those countries that opposed his designs to impose U.S. authority over Greenland. As has been the norm over the past 12 months, rapid negative equity market reaction caused the administration to soften their stance. The 2% equity market selloff was quickly reversed, and equities are back in positive territory for 2026.

Turning to the economy, the key statistic so far this year has been the unemployment rate edging down to 4.4% in December from an initially reported 4.6% in November (which was later revised lower to 4.5%). The unemployment rate has barely budged since July and only moved marginally higher (.3%) on a year-over-year basis. Job growth has slowed down considerably since the end of 2024 but so has labor supply growth. Given the change in immigration policy, there may be approximately 100,000 fewer additional workers per month versus during Biden's term. That means that the breakeven job-growth rate (which holds the unemployment rate steady) is only about 25,000 jobs per month (near the current pace).

There are several tailwinds for the economy as we enter 2026. There is fiscal stimulus that comes because of the passing of the One Big Beautiful Bill Act last year. Most of that is in the form of tax relief. The "no tax" on overtime and tips, the increase in the state and local tax (SALT) cap deduction, and the additional standard deduction for seniors will provide an additional $1,000 per household, on average, into consumers' pockets. This should keep consumer spending elevated. The monetary easing in 2025 should start to be felt this year (and more easing may be on the way). We also expect less detrimental impact from tariff policy and bounce back activity in Q1 from the government shutdown towards the end of last year.

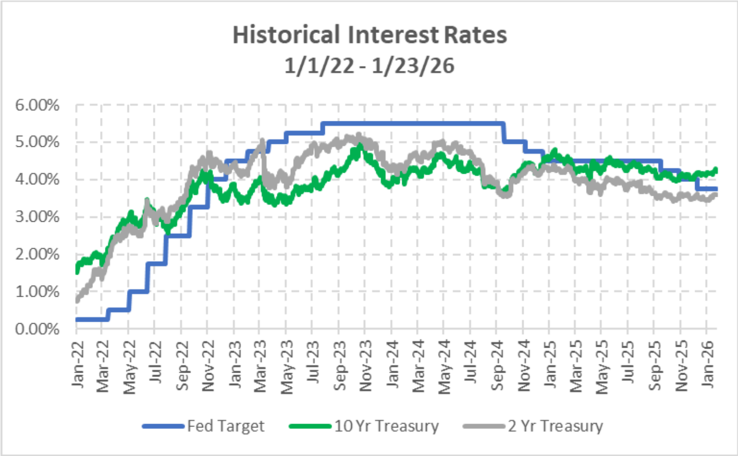
These tailwinds should help to offset a cooling labor market. We see the economy growing near 2.5% in 2026. Risks to the upside and downside appear balanced currently. In the near-term, we are most concerned about actions that could negatively impact the wealth effect as spending has become more concentrated in higher income households. Long-term, the fiscal situation will need to be addressed.

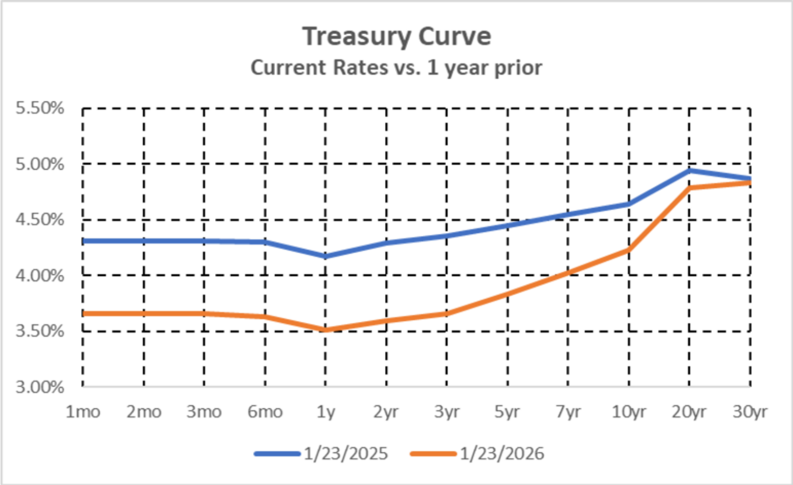
Fixed Income Outlook

Treasury rates are marginally higher in January largely due to stronger than expected economic data. There is a Fed meeting on January 28, with almost no expectation of a rate move. The market is pricing in two Fed cuts in 2026, with the first occurring in June. Powell's chairmanship

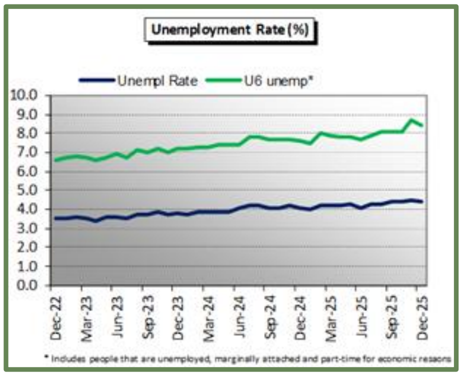
THIS MONTH

ends in May, with his successor likely to be named soon. According to prediction markets, Blackrock CIO, Rick Rieder (48% chance) and Kevin Warsh (32% chance) are the favorites. Whether Powell and Lisa Cook remain at the Federal Open Market Committee for the remainder of 2026 (and beyond) will help to shape the voting dynamics. For now, expect both to stay on and see two rate cuts as a reasonable expectation.





Labor Readings
(Data source: Bloomberg)



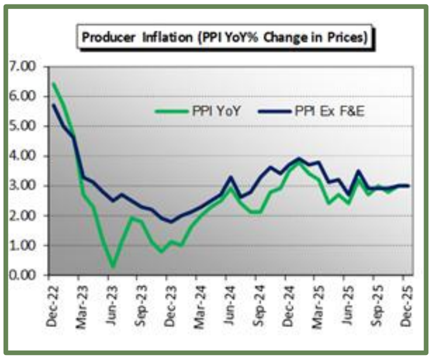
Unemployment Rate Declines

The unemployment rate in December declined to 4.4% from 4.5% the previous month (revised down from 4.6%). For the year, the unemployment rate increased by .3%. The underlying details of the report were mixed as the labor force shrank and employment grew.

Payroll Growth Stays Slow

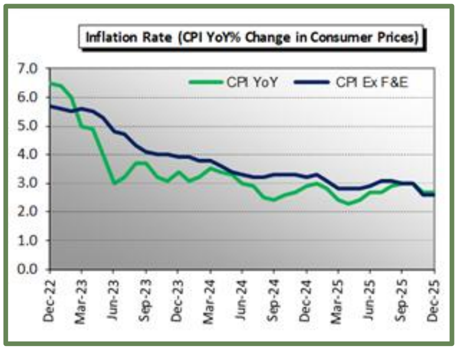
Payroll growth in December came in below expectations. Payrolls increased by 50,000 jobs versus the forecasted gain of 70,000. In addition, the prior two months were revised downwards by 76,000. Three-month average payroll growth ended 2025 at -22,000 jobs versus 209,000 jobs at the end of 2024.

Inflation Readings
(Data source: Bloomberg)



Producer Prices Higher Than Expected

Producer prices increased by more than expected in November. (December data will be released later this month.) Prices rose by 3% on a year-over-year basis on both headline and core inflation. The numbers indicate that companies are limiting the degree of passthrough of wholesale price increases to the consumer.

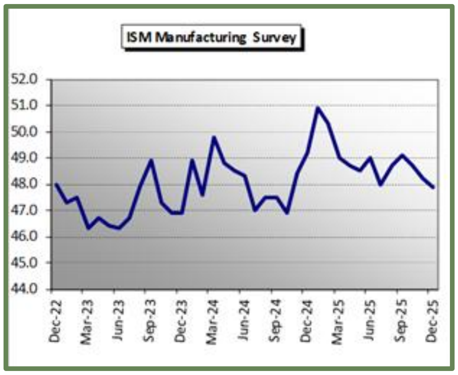


Consumer Inflation Slightly Cooler Than Expected

Consumer inflation in December came in marginally below estimates. Headline inflation rose by 2.7% on a year-over-year basis and core inflation rose by 2.6%. Both were unchanged from the pace in November. The core inflation rate stands at a four-year low.

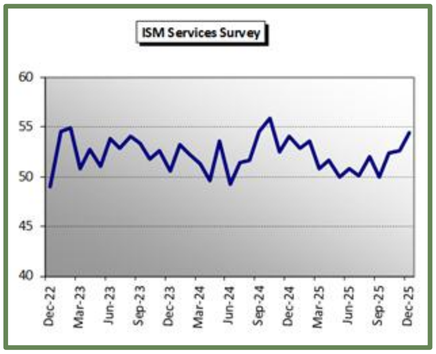
Economic Readings

(Data source: Bloomberg)



Manufacturing Survey Shows Continued Weakness

The ISM manufacturing survey dropped to a one-year low in December. The survey result was 47.9 versus an expectation of 48.4. A number below 50 indicates a contraction. New orders declined for the fourth consecutive month.



Services Survey Shows Strength

The ISM services industry rose to its highest level in over a year in December. The gauge came in at 54.4 versus an expected level of 52.2. A number above 50 indicates expansion. New orders rose by the highest amount since September 2024.