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# Economic Update

FEBRUARY 2026

## Commentary

Markets have been a little skittish in February given concerns over several major economic factors. The sheer volume of artificial intelligence (AI) spending has had some investors wondering whether the ultimate return will be enough to justify the large outlays. The Supreme Court struck down many of the Trump administration's tariffs (those imposed under the International Emergency Economic Powers Act), which creates further uncertainty on future tariffs and a new risk factor related to potential refunds on tariffs already collected. Inflation data (at least based on the Fed's preferred measure) continues to be stubbornly high. Equity markets declined in February, with the S&P 500 falling 1.3% and remaining flat in 2026 to date.

At the Federal Open Market Committee (FOMC) meeting in late January, Chairman Powell stated that the economy has been expanding at a solid pace and that the labor market may be stabilizing. Since that statement, we've had a labor market report that was largely stronger than expected. The unemployment rate dropped to 4.3% from 4.5% a few months ago, and January's job growth was higher than expected. Despite the improvement, there are still concerns about how narrow the job gains have been. Healthcare and social assistance accounted for 95% of net job creation in January and a large majority of the jobs last year. Unless job gains start to broaden out, we have a hard time classifying the labor market as healthy.

After months of speculation, President Trump nominated Kevin Warsh as the new Fed Chair. Given that wanting lower interest rates was a prerequisite for the job, nobody should be surprised by Warsh's current views. He argues for lower interest rates via an expected productivity surge from recent AI investments. In essence, increased productivity will allow for higher economic growth without creating higher inflation. His other main views are for a lower Fed balance sheet and less regulation. We expect him to be confirmed in time to take the chairmanship when Powell's term ends in May. Powell can continue to remain at the FOMC until his term as governor ends in January 2028. Whether he chooses to do so is a matter for great debate. We tend to believe that he will elect to remain on at least through the midterm elections given the recent threats to the Fed's independence.

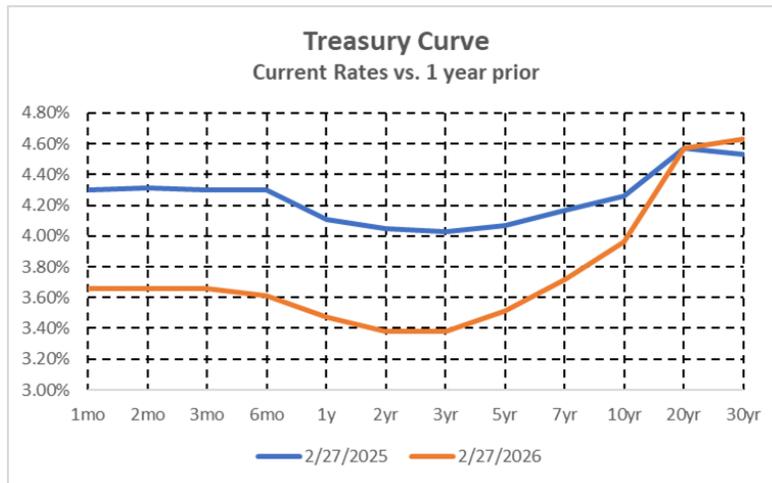
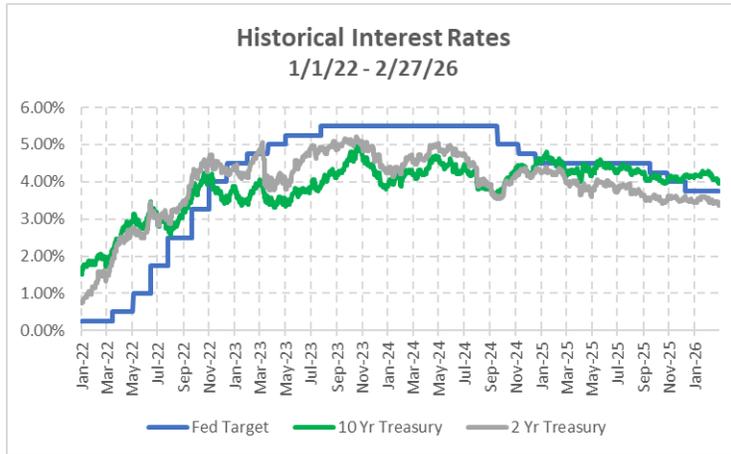
Q4 gross domestic product (GDP) was weaker than expected, but mainly due to the government shutdown. Consumer spending slowed from the previous quarter, but the pace for the year was largely in line with 2024. There should be a nice bounce back in Q1 due to higher government spending with the government reopened. In addition, the consumer will experience a tailwind with higher tax refunds than the previous year. We see the economy growing near 2.5% in 2026.

## THIS MONTH

- COMMENTARY
- FIXED INCOME OUTLOOK
- LABOR READINGS
- INFLATION READINGS
- CONSUMER READINGS

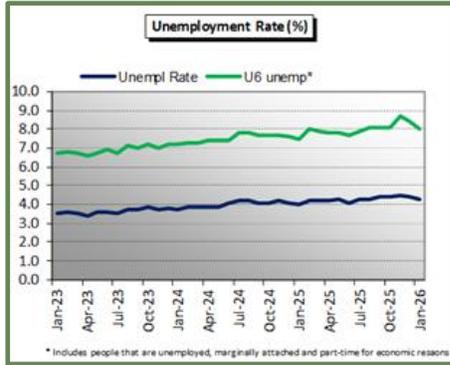
### Fixed Income Outlook

Treasury rates moved lower during February on concerns about AI-related economic growth. The next FOMC meeting is March 18, and the market is pricing in little chance of a rate move. The market is currently pricing in a cut in June and another in September/October. We do believe that the new chair will achieve a consensus for those two cuts as most Fed participants believe we are still in restrictive territory. After that, there will have to be clearer direction in weakening labor and/or lower inflation to ease further. Who the chairman is certainly matters, but he is only one vote of 12.



**Labor Readings**

(Data source: Bloomberg)



**Unemployment Rate Moves Lower**

The unemployment rate in January defied expectations and declined to 4.3% from 4.4% the previous month. The market was expecting the rate to remain unchanged. The underlying details of the report were strong as both the labor force and employment posted significant gains.

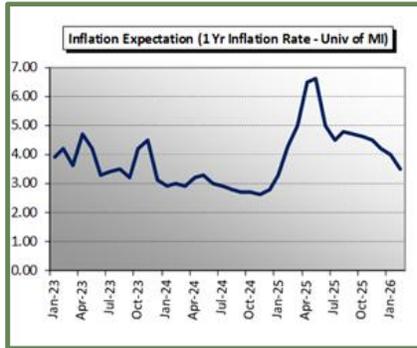


**Payroll Growth Stronger Than Expected**

Payroll growth in January exceeded expectations. Payrolls increased by 130,000 jobs versus the forecasted gain of 65,000. Unfortunately, almost all of the job growth was concentrated in the healthcare and social assistance sector.

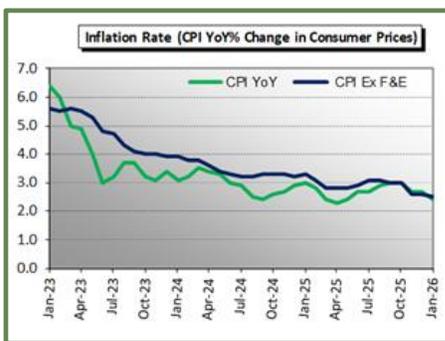
## Inflation Readings

(Data source: Bloomberg)



### Expected Inflation Continues to Decline

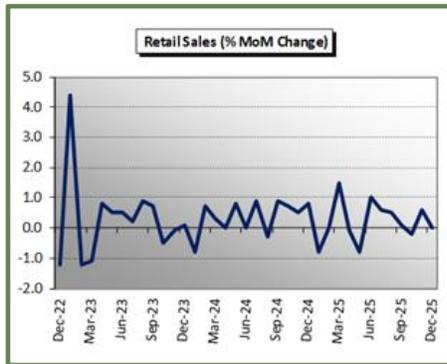
Consumers' expectation for future inflation rates have fallen significantly since the middle of last year. The Fed wants to ensure that higher inflation expectations do not get embedded into consumers' psyche and they will find the recent downward trend encouraging.



### Consumer Inflation Slower Than Expected

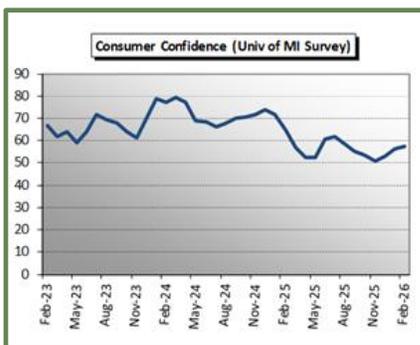
Consumer inflation in January was weaker than expected. Headline inflation rose by 2.4% on a year-over-year basis, and core inflation rose by 2.5%. Both were lower than December's pace. January's inflation rate typically increases as businesses often hike prices when the calendar turns. This time, the price change was relatively muted.

**Consumer Readings**  
 (Data source: Bloomberg)



**Consumer Spending Stalls**

Consumer spending was unchanged from the prior month in December. This was below the expected increase of a .4% and the pace of .6% from the prior month. Eight out of the 13 retail categories experienced decreases from the prior month.



**Consumer Confidence Improves**

Consumer confidence increased to its highest level in six months in the preliminary February reading. Sentiment increased to 57.3 versus an expectation of 55. Sentiment improved the most among those that owned equities as the stock market has continued its bullish run. On the flipside, consumers expressed concerns about the job market with the highest level in over five years of those expected to lose their own jobs.