



**Andrew Kohl**  
Chief Investment Officer  
Alloya Corporate FCU

# Economic Update

MAY 2026

## Commentary

In a tale of two markets, the equity market continues to surge ahead while fixed income prices decline (yields rise). Since the war with Iran started at the end of February, the stock market (as measured by the S&P 500) is up 10%, and the 10-year Treasury's price is down 4% (yields up by .50%). Stocks seem to rally anytime there is any indication that the conflict with Iran is nearing an end, while bonds largely shrug. The artificial intelligence (AI) boom is helping drive equities higher. Concerns over inflation and deficits are hurting bond prices.

On the inflation front, there is reason for concern. After a decrease over the last several years from pandemic-related highs, inflation has leapt higher over the past few months and is now running at a pace almost double the Fed's inflation target of 2%. Gasoline prices are almost 50% higher since the end of February, and food prices rose close to 1% in April alone (the largest gain in almost four years). It is unclear how fast inflation will decline and by what magnitude once the war with Iran is resolved. Of concern is that higher expectations of inflation are starting to get embedded into consumers' psyche. If that pattern holds, the Fed will be forced to raise rates.

Economic growth for Q1 2026, based on gross domestic product (GDP), was revised downwards from the initial estimate of 1.6% to 1.4%. Consumer spending was also marked lower and appears to be losing momentum. Consumer spending increased by 3.4% in 2024, 2.1% in 2025 and just 1.4% in the latest quarter. This trend suggests that consumers are facing increasing headwinds from a stagnant job market and rising cost of living expenses. Inflation-adjusted disposable income has fallen for three consecutive months, and the savings rate, at 2.6%, hit its lowest level since 2022.

As Kevin Warsh is now confirmed as the next Fed chair, he is facing a much different set of circumstances than when he was lobbying to get the job. The Fed appears poised to drop its easing bias at his first meeting rather than cutting rates as President Trump would have liked. We expect Warsh to make his initial mark by adjusting how the Fed communicates (fewer press conferences and forward guidance) rather than adjusting rates in the near term.

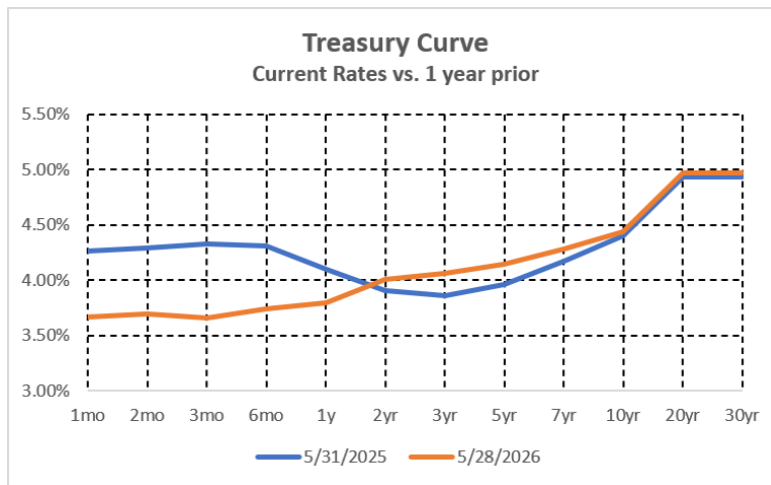
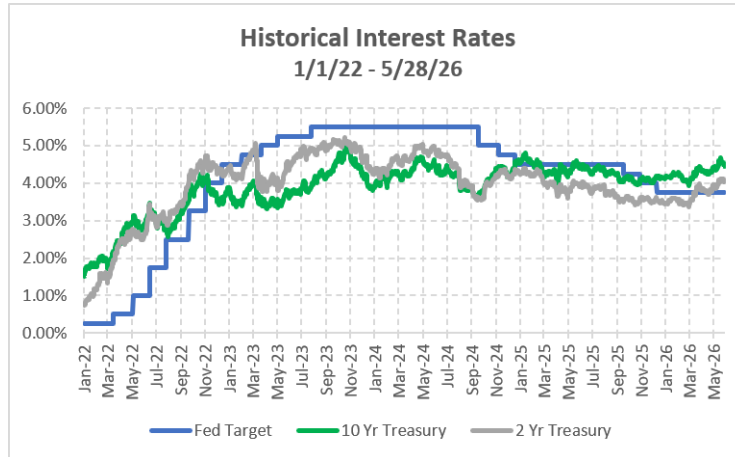
In our view, the odds of a stagflationary scenario are increasing. The longer the war drags on, the tougher it will be on the consumer. Despite better-than-expected jobs numbers over the last few months, we believe that the labor market remains in a precarious position. The boom in AI spending has helped spur the economy along the last few quarters, but the consumer will need some relief to ensure continued growth.

## THIS MONTH

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

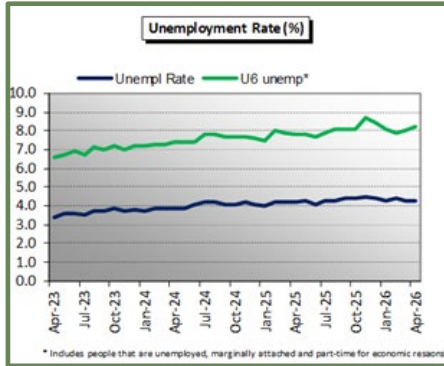
### Fixed Income Outlook

Treasury rates moved marginally higher during May as the Iranian conflict has not reached a resolution. Market pricing has the Fed increasing rates by 25 basis points toward the end of this year. We continue to believe that the next Fed move is a rate cut, but we don't see one occurring until much later in the year or early in 2027.



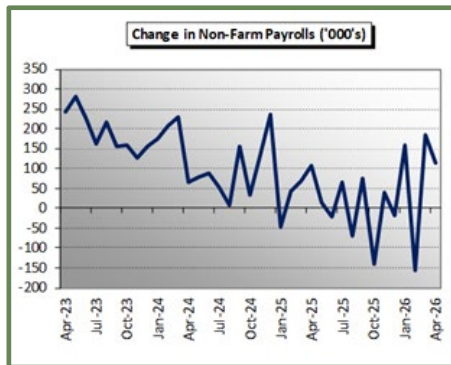
**Labor Readings**

(Data source: Bloomberg)



**Unemployment Rate Holds Steady**

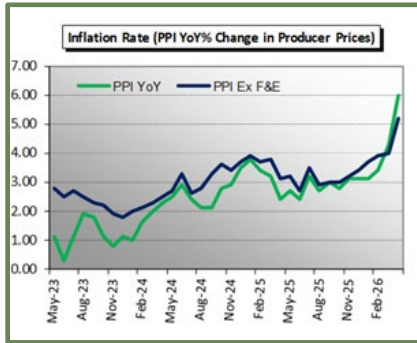
The unemployment rate remained at 4.3% in April. The market was expecting the rate to remain unchanged. On a year-over-year basis, the unemployment rate has barely budged. Details of the report were relatively weak. The labor force participation rate continues to decline, and broader measures of unemployment have started to rise over the last few months.



**Payrolls Strong Again**

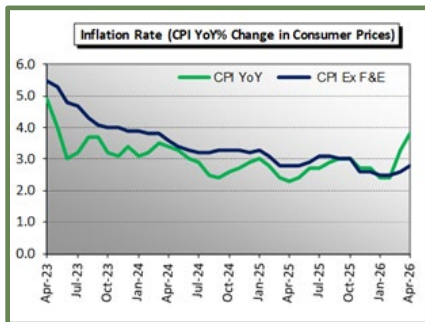
Payrolls beat estimates for the second consecutive month in April. The number of jobs increased by 115,000 versus an expected gain of 65,000. It was the strongest two-month gain since 2024.

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



**Producer Inflation Soars Higher**

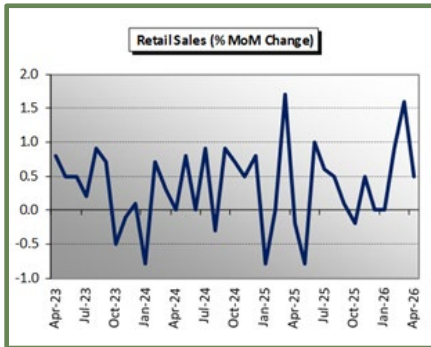
Producer inflation increased by 6% on a year-over-year basis in April. This was the fastest pace since 2022. The market was expecting an increase of 4.8%. Service costs climbed the most in four years as costs for truck transportation of freight jumped the most on record in data going back to 2009.



**Consumer Inflation Continues to Climb**

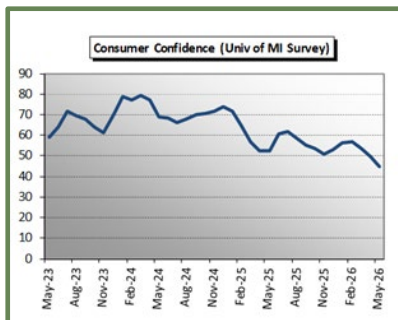
Consumer inflation in April climbed again due to rising gasoline and food costs. Year-over-year inflation levels rose at a 3.8% pace versus 2.4% a few months ago. The market was expecting a 3.7% increase.

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



**Consumer Spending Resilient**

Consumer spending in April increased for the third consecutive month. Spending increased by .5% on a month-over-month basis, which was in line with expectations. The advance was broad-based with nine of the 13 categories increasing. For now, it appears that stock market gains and tax refunds are helping consumers grapple with higher prices.



**Consumer Confidence Keeps Falling**

Consumer confidence in May dropped to the lowest on record in data going back to 1978. In addition, long-term inflation expectations increased from 3.4% to 3.9%. Higher cost of living expenses are weighing heavily on confidence. Consumers' perception of their financial situation matched the lowest level recorded.