Corporate Federal Credit Union

Economic Update

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Commentary

Equity markets were relatively unchanged for the second consecutive month as the market digests the on-again/off-again dynamics of the war with Iran. Bond markets are becoming increasingly concerned that the Fed is falling behind the curve by not raising rates in the face of higher inflation. The 30-year Treasury bond hit its highest level since 2007 this month.

The Fed met earlier this week, and for the first time in a while, the outcome of the meeting was somewhat uncertain prior to their decision. The market placed a 1 in 3 chance that the Fed would hike rates by 25 basis points. Ultimately, the Fed remained on hold, but three of the voters dissented in favor of a rate hike. Chairman Warsh, at just his second meeting at the helm, continues to emphasize a less communicative Fed, but did offer a few tidbits of information. He mentioned that the Fed could change the measure of inflation that they target in the future. (They currently use Personal Consumption Expenditures inflation, but there is a bevy of other inflation indicators that exist.) He also implied that there could be other tools to fight inflation rather than rate hikes. Lastly, he suggested that the markets have already done the tightening for the Fed since Treasury yields have shifted higher over the last few months. All these factors point to a chairman that appears less inclined to move the fed funds rate higher.

The initial estimate of Q2 gross domestic product (GDP) was also released earlier this week. The headline number was lower than expected with a decrease in growth to 1.5% from 2.1% the previous quarter. This number is deceiving since it includes the volatile items of net exports and inventories, which don’t necessarily correlate with the underlying production in the economy. We think that a better measure of underlying demand is a metric called “final sales to private domestic purchasers.” This measure climbed to 3.9% this quarter versus 1.7% in Q1 and is at its highest level since early 2023. Strong consumer spending and business investment have helped to spur the economy forward.

Inflation data improved this month (based on June’s figures) given the large decrease in gasoline prices. Prices declined as the outlook for the end of the war with Iran improved in June, but tensions have flared up since then and gas prices have started to climb again. This looks like a brief reprieve before the pace of inflation picks up again.

Our current economic outlook has relatively slow employment growth with continued high inflation. Consumer and business spending should show continued strength for at least the next few quarters. We remain concerned about the unevenness of economic growth in terms of breadth of job creation and consumer spending, but little indicates that a downturn is imminent.

THIS MONTH

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- INFLATION READINGS
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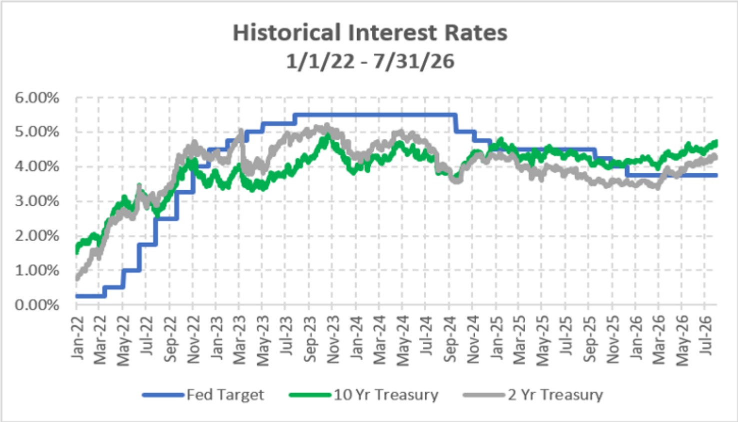
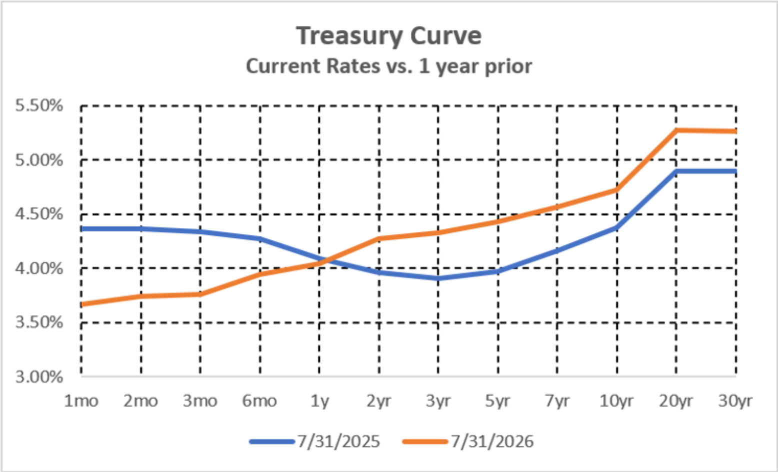
Fixed Income Outlook

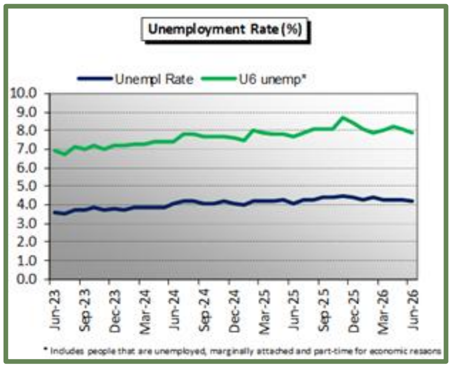
Treasury rates moved moderately higher in the intermediate to long-end part of the curve largely due to concerns over the Fed's willingness to battle inflation by moving short-end rates higher. The market is pricing in 65% odds of a Fed hike at their next meeting in September, and two cumulative hikes are priced in by March 2027. We still believe that Chairman Warsh would rather leave rates where they are, but he will need some more help from the data, or he is likely to get outvoted prior to year-end. We are shifting our call to one rate hike from now until the end of the year.





Labor Readings

(Data source: Bloomberg)



Unemployment Rate Declines

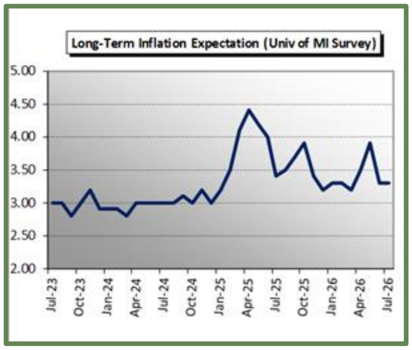
The unemployment rate decreased to 4.2% in June versus 4.3% for the prior three months. This is the lowest unemployment rate over the past year. The market was expecting the rate to remain unchanged. Despite the decrease in the unemployment rate, the details of the report were weak as there was a large number of people who left the workforce. The labor force participation rate hit its lowest level since early 2021.

Payroll Growth Slows

Payroll growth came in lower than expected in June. The number of jobs increased by 57,000 versus an expected gain of 113,000. In addition, the previous two months were revised lower. The current three-month average payroll growth of 111,000 remains well above most estimates of the unemployment rate breakeven pace.

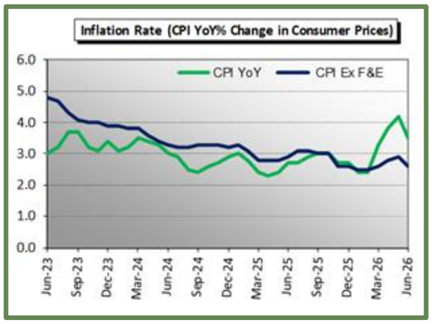
Inflation Readings

(Data source: Bloomberg)



Inflation Expectations Still Relatively Subdued

Despite inflation levels being above the Fed's target consecutively for over five years, inflation expectations have only moderately increased. Expectations have increased since the war with Iran but remain not that far from the pre-pandemic (2015-2019) average of 2.50%.

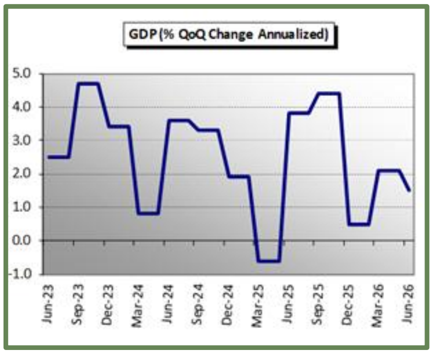


Consumer Inflation Much Softer

Consumer inflation in June was negative on a month-over-month basis for the first time in six years. The decrease was largely due to much lower gasoline prices on the expectation of an end to the war with Iran. On a year-over-year basis, the rate of inflation fell more than expected on both the headline and core metrics.

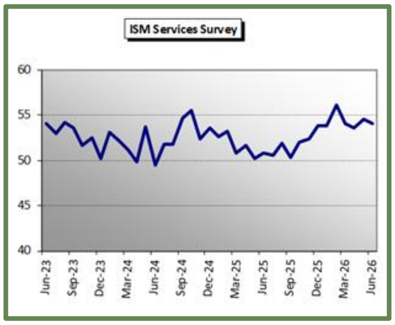
Economic Growth Readings

(Data source: Bloomberg)



GDP Growth Slows

GDP growth for Q2 of 2026 fell to 1.5% from 2.1% the prior quarter. The decline was largely due to the negative impact of net exports and inventories. A better measure for underlying growth, final sales to domestic private purchasers, increased to 3.9% from 1.7% the prior quarter due to higher consumer spending and business investment.



Services Survey Remains Strong

The Institute for Supply Management (ISM) services industry fell modestly in June to 54 from 54.5 the prior month. The result was in line with market expectations. Measures of business activity and new orders decreased, but the employment component jumped by the most since 2024.