July 2026

Monthly Market Update

Industry updates

General sentiment – *Producer liquidity tightens amid prolonged headwinds.*

Producer working capital remains under pressure as financial stress across agriculture continues to build. Farmer sentiment declined for the third consecutive month in June, driven largely by concerns over rising input costs and weaker crop and livestock prices, according to the Purdue University-CME Group Ag Economy Barometer. Only 12% of producers surveyed reported being better off financially than a year ago, and fewer than one-quarter expect their financial position to improve over the next year. Similarly, a Farm Journal survey of agricultural economists found just 19% expect margins to recover within the next one to two years, while half believe broad-based profitability in crop agriculture is unlikely to return for another three to five years. Persistently high input costs, rising debt levels and shrinking working capital continue to strain farm balance sheets, increasing the likelihood that more operations may need to pursue financial restructuring to remain viable. Farm financial stress is becoming increasingly evident in bankruptcy trends. Year-to-date Chapter 12 farm bankruptcies have climbed to a six-year high as producers grapple with profitability.

Crop inputs

Continued U.S.-Iran tensions, including another flare in hostilities in early July, have increased upside risk for oil and fertilizer prices. Markets are not yet signaling a return to the severe supply disruptions seen earlier in 2026.

Crude oil prices fall.

Crude oil prices declined in June before markets added back some risk premium in July. Oil prices remain below their spring peak, supported by market expectations for periodic escalations and de-escalations (not prolonged shutdown of Gulf exports), weakening global oil demand expectations, and slowing economic growth in several regions. Natural gas prices strengthened modestly during June as above-normal temperatures across much of the U.S. increased electricity demand. Global Liquified Natural Gas markets remained tight as Middle East export flows recovered slowly, and international buyers continued to rely heavily on U.S.

Fertilizer prices begin to ease.

Fertilizer prices eased slightly toward the end of June as the temporary peace agreement between the U.S. and Iran eased supply constraints. It remains unclear whether prices will continue to soften given the recent flare up in hostilities. Nitrogen markets have been the most impacted by the conflict and more recently have been pressured by rising natural gas costs. Phosphate prices also remained firm due to the conflict, reduced operating rates at plants, sulfur shortages and ongoing export restrictions from major suppliers. President Trump temporarily suspended countervailing duties on certain phosphate imports, though the full impact to prices and supply remains unclear.

Transportation costs increase.

Bulk shipping rates were mixed in June as softening in the Capesize category dampened gains across other vessel sizes. (Capesize is one of the largest categories of dry bulk ships primarily used for iron ore and coal trades. Their freight rates matter because they influence the broader dry-bulk shipping market.) Grain shipments drove demand in the U.S. Gulf and South Atlantic regions. Container rates spiked in June, underscoring how strong demand and rising shipper urgency are outpacing continued fleet expansion. The surge occurred earlier than typical peak shipping periods, as some shippers acted ahead of expiring tariff exemptions, the introduction of new tariffs, and added costs linked to higher fuel demand during peak season. This earlier-than-usual peak suggests the typical July rate spike may be more muted or could even give way to softening rates. Trucking rates rose in June due to seasonal agricultural demand, elevated fuel costs and tightening carrier capacity.

Labor H2-A guestworkers program grows.

Beginning in June 2026, the Adverse Effect Wage Rate (AEWR) will shift to a two-tiered system, with Tier 1 (covering most workers) for low-skill roles and Tier 2 for positions requiring at least three months of experience. The new structure also allows lower wages for workers receiving free housing, with a floor tied to state minimum wage. In California, for example, wages are expected to drop from $19.89 per hour to $16.45 for Tier 1 and $18.71 for Tier 2. H-2A demand remains robust, with certifications rising across all AgWest states in the first half of 2026 compared to a year earlier. Lower labor costs will have the greatest impact in California and Washington, where labor-intensive fruit and vegetable production drives heavy reliance on H 2A workers.

Almonds and pistachios – *Weather impacts both almond and pistachio crops.*

Almond prices steadily rose in June on solid demand and tightening supply. Nonpareil kernels drove the gains while inshells lagged on sluggish demand from India. India, the largest export market, reduced purchases in the second half of June due to adequate inventories, elevated prices, expectation prices will fall when the 2026 crop hits the market, and delayed monsoon rains. (Diwali, a holiday that drives almond demand, occurs following the monsoon season.) The European Union approved duty-free access for U.S. tree nut imports up to 500,000 metric tons (551,156 tons) beginning July 1. While positive for the industry, it remains unclear how it will impact demand. (Season-to-date exports to Europe as of June 30, 2026 were 314.7 thousand tons, up 5.5% year over year.) Market attention is shifting to the 2026 crop. Blue Diamond's latest estimate suggests the crop will come in between 2.65 and 2.7 billion pounds. The crop is maturing about ten days early and is showing notable variability in conditions due to weather impacts. High production costs are also leading many growers to reduce inputs. The Almond Board's position report in June showed sales on the upcoming 2026 crop at 92 million pounds, significantly above last season but below the 5-year average.

Pistachio prices continued to rise in June as the market prepares for a short 2026 crop. Reports suggest production levels could be down by as much as 50% due to excessive heat during bloom. Shipment to retailers surged in May, driven by a 30% increase in exports as buyers competed to secure supply. Some processors had reportedly worked through their inventories by the end of June, while others are rationing.

Visit our **almonds and pistachios webpage** for information on trade fundamentals and tariffs.

Apples – *Apple prices hold steady.*

Apple prices increased in June and shipments to retailers continue at a solid pace. USApples reports national inventories are down 8% from this time last season, in line with the five-year average, and this suggests minimal risk of a large inventory carry-over. Anecdotal reports continue to point to a 2026 apple crop that is smaller than the previous three years. Warm weather in March and frost events in April impacted fruit quality for producers in northern Washington. Reports suggest India's 2026 crop will be down significantly due to insufficient chilling hours and challenging weather conditions. India and the U.S. appear close to a bilateral trade agreement and while details are scarce, it may lead to a reduced duty rate (India applies a 50% duty on fresh apples from the U.S.). A small crop coupled with a reduced duty rate may create export opportunities for U.S. growers, particularly for the Red Delicious variety. The Washington State Tree Fruit Association (WSTFA) announced it will discontinue its August 1st forecast, a long-time industry staple that provided an early look into the apple crop size. WSTFA reported increasing challenges in accurately estimating crop sizes due to a confluence of variables, including fruit sizing, packouts, weather events, evolving horticultural practices and other changing growing conditions. Inaccurate estimates can have material impacts on the industry, particularly as they help to frame contract negotiations among marketing desks and retailers.

Northwest cherry producers face mixed conditions. While early-season cherries generally achieved strong prices, mid-season fruit faced the greatest pressure as production levels ramped up and quality fell. Weather related challenges reduced overall production, damaged quality in some orchards, and caused some growers to leave fruit unharvested. Producers with high yields and strong quality will fare better than their counterparts. Despite challenges, export levels and Rainier prices are reportedly strong and appear to be bright spots within the industry.

Visit our **apples webpage** for information on trade fundamentals and tariffs.

Cattle – *Drought challenges an otherwise strong market.*

Strong cattle prices continue to support cow-calf profitability, but drought and water shortages are increasing production risks across the West. Cow-calf producers throughout AgWest's territory continue to benefit from historically strong cattle markets, with national steer calf prices up 24% year over year in mid-June and AgWest states averaging even stronger gains of 28%. In Montana, fall calf contracts reportedly reached $2,800 to $3,150 per head, reflecting tight cattle supplies and resilient beef demand. However, producers face headwinds with 70% of Arizona pasture and 38% of Montana pasture rated poor or very poor. These conditions are tightening forage supplies, prompting many cattle producers to secure hay supplies ahead of fall.

Margin pressure is increasing across the cattle supply chain as historically high feeder cattle prices and shrinking cattle supplies shape market dynamics. Feedlot operators and backgrounders are paying record prices to procure cattle, leading buyers to become more selective with placements and making risk management increasingly important to protect margins. At the same time, packers' profitability is struggling in the current market. Packers are beginning to reduce slaughter capacity to better align with tighter cattle supplies. This is highlighted by JBS's planned closure of beef processing facilities in Pennsylvania and Tennessee. Reduced processing capacity and fewer active buyers could lessen competition for cattle.

New World screwworm remains a closely monitored animal health issue, though market impacts have been limited thus far. The first U.S. case was confirmed on June 3 in Texas along the Mexican border. Confirmed cases increased to 29 by June 30 and the disease also surfaced in New Mexico. Cattle futures markets responded bearishly, but price impacts were short-lived. Currently the largest risks for cattle producers stem from market uncertainty and consumer perception rather than widespread livestock losses. USDA continues to focus on targeted quarantines and sterile fly releases as part of its eradication and containment strategy. States are also taking proactive steps to strengthen biosecurity measures and limit the spread of animal diseases. In Idaho, health certificates are required for all livestock and domestic pets entering the state. Additionally, Idaho has implemented restrictions prohibiting the entry of livestock originating from or transiting through Mexico, regardless of health certification status or method of transportation.

Visit our **cattle webpage** for information on trade fundamentals and tariffs.

Dairy – *Strong demand offsets headwinds, but milk supplies continue to build.*

Strong export demand continues to support dairy markets, but growing milk supplies are weighing on prices. USDA's May Milk Production report showed U.S. milk production increased 2.3% year over year, driven by both herd expansion and higher milk output per cow. The national dairy herd grew by approximately 10,000 head in May, while upward revisions to April data added another 10,000 cows, extending a trend of steady growth fueled in part by strong beef-on-dairy economics and historically high calf values.

Export markets remain the strongest source of demand for the dairy sector. April marked the seventh consecutive month of year-over-year export growth, with U.S. dairy exports increasing 15% on a milk-solids-equivalent basis. Through the first four months of 2026, exports were up 12% from the same period last year, representing the strongest start to a year on record. Cheese continues to lead export growth, with April volumes reaching a record high and increasing 30% year over year, while butterfat exports also posted impressive gains thanks to competitive U.S. pricing and strong shipments into Middle Eastern markets.

Milk prices are expected to remain under pressure despite strong export performance. Expanding milk production, ample product inventories, and softer domestic demand have created headwinds for prices. After an impressive rally earlier this year, nonfat dry milk and cheese prices have begun to soften as supply growth matches demand. While whey prices have remained comparatively stable due to continued consumer demand for protein products, Class III and Class IV milk futures are generally expected to remain rangebound through the remainder of 2026. Future price direction will likely depend on export demand, currency values, and broader economic conditions.

Dairy fundamentals across AgWest's territory remain generally positive, supported by healthy milk checks, robust processor demand and strong beef revenues. However, producers are increasingly balancing those positives against higher feed costs, drought-related water concerns, and expectations for tighter margins in the months ahead. As a result, operational efficiency, risk management, and financial discipline remain top priorities for dairy operations in the West.

Strong beef-on-dairy economics continue to provide an important financial cushion for many producers. Arizona dairies reported day-old calf values near $1,800 per head, helping offset milk price volatility and support profitability. Favorable milk checks during the second quarter and widespread use of Dairy Revenue Protection (DRP) programs have further strengthened margins. At the same time, extreme heat has reduced alfalfa quality and lowered winter wheat yields in parts of Arizona, while similar feed-related challenges have emerged elsewhere in the West.

Water availability is a continued risk across much of AgWest's dairy territory. Although many Arizona dairies rely primarily on groundwater and face less immediate exposure to Colorado River shortages, water uncertainty continues to shape producer decisions throughout the West. California producers are closely monitoring litigation surrounding groundwater extraction fees in the Tulare Lake Subbasin. Idaho has seen a variety of water allocations lowered following a statewide declaration of drought declared in April.

Highly Pathogenic Avian Influenza (HPAI) cases have increased alongside spring bird migrations, with Idaho accounting for most recent dairy detections in June. While current impacts on milk production remain limited and HPAI does not pose food safety concerns for dairy products, producers are closely monitoring developments. Any broader resurgence of HPAI could temporarily reduce milk output and add volatility to markets.

The outlook for the remainder of 2026 remains cautiously optimistic. Strong export demand, healthy processor demand, and favorable beef-on-dairy economics continue to support margins, but expanding milk supplies, elevated input costs, and ongoing water concerns are creating a less favorable market environment.

Visit our **dairy webpage** for information on trade fundamentals and tariffs.

Forest products – *Lumber prices gain slightly as industry enters peak construction season.*

Lumber prices increased moderately in June due to tightening supplies and flat demand. Flat to declining production levels in the U.S. and reduced imports from Canada have lowered softwood lumber supply. The housing market remains flat overall, with single family home sales and starts down in both April and May. Multi-family home starts fell by 42% in May, one of the largest drops on record. Regionally, conditions are mixed as homebuyers increasingly prioritize affordability. The West is experiencing broad declines in home values while gains are observed in the Midwest and South. Congress passed the 21st Century Road to Housing Act (the Act), though it remains unclear if President Trump will sign it. The Act is a comprehensive bill intended to increase housing supply and affordability by reducing regulatory barriers, encouraging local housing development, expanding affordable housing programs, supporting manufactured housing, and limiting the role of large institutional investors in the single-family housing market.

Log markets across Oregon and Washington remained generally stable to firm through June, supported by steady mill demand and adequate inventories. Demand is strongest for larger-diameter Douglas-fir, specialty logs, cedar, poles, and veneer-quality timber, while smaller sawlogs continue to face limited outlets and weaker pricing. Mills are actively buying but doing so conservatively due to housing market concerns.

Visit our **forest products webpage** for information on trade fundamentals and tariffs.

Hay – *Western producers see price improvements, but water remains the wild card.*

Hay markets across the West are entering the second half of 2026 in a stronger position than a year ago, supported by higher prices, limited carryover stocks and steady demand. However, ongoing drought conditions, irrigation uncertainty and water allocation challenges remain the biggest risks to production and profitability through the remainder of the growing season.

Across AgWest's footprint, acreage trends remain relatively stable, suggesting supply-side adjustments are unlikely to significantly alter market dynamics through the remainder of the season.

Conditions by state:

Arizona – Hay quality has declined due to early-season heat, though demand for lower-quality forage remains supportive. Prices are generally around $200 per ton, with expectations for modest improvement if weather cooperates. Water availability remains a significant concern, particularly given anticipated Colorado River shortages and the potential for reduced allocations under future drought contingency plans.

California - Market conditions remain favorable, with producers reporting stronger prices than expected. In the Southern San Joaquin Valley, third cutting has been completed with no major yield or weather concerns due to irrigated production systems. Producers reported hay prices approximately $30 per ton above last year, with recent third-cutting alfalfa selling near $225 per ton. Demand appears supported by both dairy and retail channels. In Imperial Valley, growers are seeing prices around $200-$205 per ton, and continue utilizing deficit irrigation programs amid growing concerns about Colorado River water supplies and the potential for future allocation reductions.

Idaho - The market remains firm, with prices generally steady to $5 per ton higher than a month ago and above year-ago values. Demand is uneven, as some dairies remain on the sidelines while others actively contract supplies. Cattle ranchers have been among the most aggressive buyers due to ongoing drought concerns. Water availability remains the state's primary challenge. Several irrigation districts have warned of possible late-season water curtailments, prompting some growers to prioritize corn irrigation over hay production. Southern and eastern Idaho are increasingly concerned that reduced water allocations will limit second and third cuttings, while some farmers reliant on mountain runoff have already lost irrigation water. Well-irrigated operations are generally in a better position. Concerns are growing in eastern Idaho that many operations may only achieve a single cutting this year. Organic hay markets remain especially firm.

Montana - Dryland hay conditions in southern Montana range from poor to very poor due to spring freezes, drought, high temperatures, and wind. In contrast, northern Montana has recently received substantial rainfall, improving yield expectations to near-average or potentially above-average levels. Irrigated hay producers experienced poor first-cutting yields due to freeze damage but are optimistic about stronger second and third cuttings. Hay supplies remain tight, with much of the available crop already committed. New-crop high-quality alfalfa has sold between

$225-$230 per ton, utility hay around $200 per ton, and wheat hay near $170 per ton. Strong cattle-sector demand and ongoing drought concerns continue to support prices.

Oregon - Hay growers are increasingly focused on water availability as drought conditions worsen. Several irrigation districts may impose water restrictions later this summer, creating concerns about maintaining production through subsequent cuttings. Despite these risks, first cutting has progressed well, with producers actively baling and preparing for second cutting. Demand for old-crop hay remains slow, while interest in new-crop supplies has improved. Hay quality and yields generally look favorable, aided by cooler temperatures and timely moisture. Baker Valley producers reported 2026 alfalfa sales near $250 per ton.

Washington - Market conditions continue to improve compared to 2025. Limited carryover inventories have supported higher prices, with alfalfa values generally running $20-$30 per ton above last year's levels. Higher-quality alfalfa is trading around $215-$220 per ton, feeder hay near $175 per ton, and premium Timothy horse hay between $235-$240 per ton. While profitability has improved, rain events during first cutting created some quality variability, though yields are generally average.

Visit our **hay webpage** for information on trade fundamentals and tariffs.

Lemons and oranges – *Mixed conditions for lemon and orange crops.*

Valencia prices increased slightly for medium to large sized fruit in June. Smaller fruit is seeing increased shipments to retailers, but a slight decline in prices over the past month. Fruit quality is good, and the size profile is above average. Imports are expected to pick up in July, and this aligns with navel harvest wrapping up in California. The orange crop in Chile, the largest foreign supplier to the U.S., appears to have good quality and size. Orange production in Brazil is reportedly down 13% year over year due to both disease pressures and challenging weather conditions. Brazil is the largest global supplier of fruit for concentrate.

Lemon prices remain well above last season, with gains in larger fruit sizes observed in June. Harvest continues along the coast of California and fruit quality is reportedly good. Global supplies are down due to lower production in Europe and Turkey, and this is supportive of prices. Seasonal imports picked up in June, primarily from Argentina, and prices are up 26% year over year.

Visit our **lemons and oranges webpage** for information on trade fundamentals and tariffs.

Potatoes – *Smaller crop, same challenge.*

Potato supplies have tightened considerably, but weak demand continues to limit price recovery. USDA's June 1 stocks report showed total U.S. potato inventories at 54.7 million cwt, their lowest level since 2014. Despite tighter supplies, open-market potato prices remain depressed. The disconnect between lower inventories and weaker prices suggests demand remains softer than expected, although there is speculation that Pacific Northwest inventories may be understated.

Potato acreage continues to decline as growers adjust to weaker market conditions and ongoing profitability concerns. USDA's June 30 Acreage Report showed total U.S. potato planted area down 3.3% from 2025, marking the smallest planted acreage in more than 70 years. Across AgWest territory, acreage was largely unchanged in Oregon and Washington, while California reduced plantings by 1,000 acres and Idaho planted 15,000 fewer acres year over year. Notably, the Idaho Potato Commission's satellite-based estimate suggests acreage is more than 1,000 acres lower than USDA's reported total. While acreage reductions could help improve market balance over time, producers remain focused on managing margins amid continued uncertainty surrounding prices, input costs, and demand trends.

Pacific Northwest potato conditions remain generally favorable, though water availability continues to shape production decisions across the region. Potato development is running ahead of normal in most growing areas. In Idaho, localized frost and hail damage have affected some acres, and drought and water availability remain concerns. Washington's Columbia Basin continues to benefit from favorable growing conditions, supporting near-normal crop progress, with both yields and tuber size profiles expected to be strong. In contrast, Oregon's Klamath Basin remains heavily influenced by water availability, which is expected to limit planted acreage and result in lower potato production this season.

Producer profitability remains under pressure despite tighter potato supplies and favorable growing conditions. Open-market Russet potato prices remain well below year-ago levels and below breakeven for many operations. Until demand improves or pricing strengthens, profitability is expected to remain a key concern across the industry.

Visit our **potatoes webpage** for information on trade fundamentals and tariffs.

Wheat – *U.S. wheat outlook diverges as Plains struggle while PNW excels.*

The U.S. winter wheat crop is facing its poorest conditions in more than three decades. Nationally, as of July 5, just 26%

of the crop is rated as good-to-excellent condition. Major wheat production states in the Plains region including Kansas, Nebraska, Oklahoma, and Texas, are particularly stressed, with less than 15% of their crop in good-to-excellent condition. As a result, yields and quality are expected to decline significantly in this region, leading to more abandoned acres and lower national production. National yield estimates are projected to fall 14.8% year over year, while USDA's updated June forecast projects winter wheat production down 26.5% from 2025.

In contrast, the crop conditions across the Pacific Northwest provide a bright spot, with above-average yield potential emerging. Crop development is running one to two weeks ahead of average, with most of the crop rated as good-to-excellent condition. Recent rain and cooler temperatures in late June helped stabilize grain fill, improve test weights, and align development closer to seasonal norms. Washington and Idaho report winter wheat yields ranging from average to near-record levels, with some operations anecdotally expecting yields up to ~30% above normal.

Montana wheat conditions remain mixed, with improved moisture offset by earlier drought and wind damage. While recent rains and cooler temperatures have improved grain fill, conditions remain uneven. Early dryness, topsoil loss, and limited input application continue to constrain yield potential in some areas. Crop prospects are generally strongest across central and northern regions. Growing season precipitation in northeastern Montana has rebounded to nearly 12 inches year-to-date versus the less than 6.5 inches last year, supporting crop development.

Wheat margins remain under pressure. Cash prices have fallen to roughly $6.30 per bushel, down from nearly $7.00 per bushel in May. Higher interest costs on operating lines and weakened working capital positions are pushing growers to sell grain "off the combine" rather than store it. This reflects limited confidence in post-harvest price recovery and a broader shift toward cash-flow-driven marketing decisions.

Transportation constraints on the Snake and Columbia Rivers are adding downside risk to basis levels and producer returns. Lower river levels may limit barge draft and constrain harvest-time shipping capacity, slowing exports and raising working capital needs for elevators. These challenges are particularly impactful as off-coast freight rates have climbed to roughly $1.30 to $1.35 per bushel, significantly eroding net returns and compressing margins.

Visit our **wheat webpage** for information on trade fundamentals and tariffs.

Wine and wine grapes – *Inventory surplus persists as demand stays soft.*

Markets continue to be characterized by falling consumption among low- to mid-value wines and excess bulk inventory levels. According to NIQ data, year-over-year off-premise and on-premise sales declined 2% by value in May 2026. Declines in off-premise sales occurred across nearly all major varieties except Sauvignon Blanc. Direct-to-Consumer shipment values fell 5% year-over-year and declines were observed across each region except Napa Valley. Bulk wine inventories are at/near peak levels, with more recent gains occurring in the coastal growing regions of California due to weak demand and excess custom crush (particularly in Sonoma, Mendocino, Napa and Lake Counties).

Wine grape crops are developing early across California due to mild early-season weather, which may result in challenges later in the season depending on summer heat. Some growers are removing vineyards, idling acreage, reducing inputs and/or selling assets in response to weak markets. These actions may lead to a smaller, more variable 2026 crop. Harvest is expected to begin in August and buyers are reportedly delaying purchases to better understand how retail sales are trending. Crops are also coming on earlier than average in Oregon and Washington, though it remains too early to gauge quality or yield.

Visit our **wine and wine grapes webpage** for information on trade fundamentals and tariffs.

Spotlight: Ag equipment markets cool

Higher input costs, tighter credit conditions, and ongoing commodity price volatility have reduced working capital, leading many producers to delay or scale back equipment purchases. U.S. farm equipment markets remain under pressure in 2026.

New equipment sales have been hit the hardest. In 2025, more than 65% of equipment dealers reported revenue declines for new equipment. Conditions have continued to soften in 2026, with U.S. new farm tractor sales down 21.6% year over year in May, and every month this year posting lower sales compared to 2025, according to the Association of Equipment Manufactures. In June, Creighton University's Farm Equipment Sales Index reported its 34th straight month of contraction.

While both new and used equipment markets have softened, the used market has held up somewhat better. Approximately 26% of dealers expected revenue growth in used equipment, compared to only 18% for new equipment. Strong auction activity, driven largely in part by retirement sales, has supported used equipment demand, particularly for well-maintained older machinery.

Even with softer demand, farm equipment prices have remained elevated. Prior to 2021, machinery prices were relatively stable, but supply chain shortages of steel and microchips during the COVID-19 pandemic drove a sharp increase in costs. In 2024, ag machinery prices continued to rise, but at a slower pace. Despite this easing, USDA's May 2026 index of prices paid by farmers for machinery reached a record 172.5, up 1.3% year over year, underscoring that inflationary pressures remain in place.

Index of prices paid by farmers for machinery

Source: USDA National Agriculture Statistics Service.

Equipment decisions are becoming more strategic. For producers, disciplined cash flow management is increasingly critical, with careful evaluation of whether to repair existing equipment, purchase used or invest in new. For dealers, understanding farm-level profitability drivers remains essential, as equipment demand continues to lag broader shifts in the ag economy.

Quarterly Economic Update

Market commentary as of July 2, 2026

Executive summary

The U.S. economy remains resilient with stable consumption and employment, though there are increasing signs of stress for lower income households. While oil prices have nearly returned to pre-U.S.-Iran war levels, there are lingering impacts from the recent spike. A new Fed Chairman coupled with persistently above-target inflation levels have caused the outlook for monetary policy rates to shift from rate cuts to rate hikes. The market expects at least one 25-basis point rate hike before year-end and Warsh will begin making changes in how the Fed operates and communicates.

Economic drivers

Consumer spending and labor market remain steady

Retail sales rose for the fourth consecutive month in May, though remained generally flat when factoring in inflation. Sales were up 6.9% compared to a year ago, driven in part by increased spending at gas stations. Given recent declines in gas prices, retail sales growth may slow over the coming months. Wealthier consumers are continuing to spend despite higher inflation, likely due to stronger equity market gains, while lower-income households may be dipping into savings or increasing credit card usage to make ends meet. Nominal average annual hourly earnings continue to expand, growing by 3.4% in May, and this should continue to support consumer spending and Gross Domestic Product (GDP).

Economic stress increases for lower income households

The divergence among lower and higher income households is growing. A recent Moody's Analytics analysis shows the top 10% of earners now account for about 50% of consumer spending, representing the continuance of a multi-decade trend. This trend is supported by the wealth effect given rising asset values among high income earners, and falling real incomes among low-wage earners. With 70% of GDP driven by consumer spending, a drop in equity and/or home values could have a significant impact on the U.S. economy. Stress among lower income earners appears to be rising, with household debt on the rise along with increasing delinquencies on credit cards, student loans and auto loans.

Conflict in Iran drives volatility and uncertainty

The conflict between the U.S. and Iran and subsequent closure of the Strait of Hormuz have driven energy, stock and bond volatility over the last several months. On July 8, President Trump announced the end of a temporary ceasefire in response to Iranian attacks on shipping vessels. Even if this policy is reversed, shipping companies are likely to increase risk premiums given the instability. If war resumes, the impact could be significant. Oil prices would likely shoot up along with gas prices. Rising inflation expectations would add upward pressure to interest rates as the Fed considers tightening monetary policy rates. If fighting were to spread to other countries in the region and the war lasted for years, there would likely be increased federal deficits to fund military action, increases in treasury bond issuance, and upward pressure on interest rates.

Monetary policy expectations shift

The appointment of Kevin Warsh as the new Fed Chairman along with above-target inflation rates are shifting policy expectations. At the June Federal Open Market Committee (FOMC) meeting, policymakers kept the federal funds rate at 3.5-3.75% due to inflation remaining above their 2% target. The core personal consumption expenditures index (core-PCE) came in at 3.4% in May. The June 17 monetary policy statement reiterated the Committee's commitment to stable prices, saying "The Committee will deliver price stability." The tone of the statement suggested policy rates would likely remain higher for longer.

The Fed's stance may have softened somewhat since the June policy statement. In a recent speech, Chairman Warsh said inflation expectations have improved as "inflation risks have come down," which leaves open the flexibility to hold rates steady for a time. Federal funds futures indicate policy rates are expected to be unchanged at the July FOMC meeting, but rate hikes at the September or October policy meetings could be in play depending on upcoming inflation reports.

In June, Warsh announced the formation of five task forces to evaluate Fed communications, the balance sheet, data quality, productivity and the Fed's inflation framework. The task forces have a deadline of year-end to conclude their findings. We have already seen an impact on Fed communications. The number of words in the policy statement was trimmed to about 130 compared to the average of over 300. It did not include any forward guidance on future rates or the potential path of policy.

Risks to the economy

- The conflict in Iran restarts and results in regional instability, engagement from other military powers such as Russia and China, persistently high oil prices and a global recession.
- Rising inflation incentivizes the Fed to raise interest rates in 2026, which could lead to deeper selloffs in equity markets and a drop in consumer demand.
- Credit headwinds intensify due to monetary policy and economic uncertainty, further tightening lending standards, pressuring collateral values lower and increasing maturing debt concentrations.
- Labor market cooling continues and unemployment moves higher, possibly to 5.0%, as global geopolitical tensions and trade uncertainty slows economic growth.
- Rising federal debt levels increase inflation and treasury yields, weaken the U.S. dollar and reduce the capacity of the U.S. government to respond to an economic crisis and war. Sustained growth in debt could lead to a fiscal debt crisis, and subsequent hardship for the American people.
- Rising prices and consumer debt loads lead to greater financial stress, particularly among low wage earners who spend more of their income on essentials. Coupled with a weaker equity market and deterioration in the wealth effect, this may eventually slow consumer spending and pressure home affordability. Delinquencies for consumer credit cards and auto loans are trending higher.

Economic data and trends

Fed updates and treasury yields

The Fed released its latest forecast for the economy as part of its monetary policy statement on June 17. Real GDP growth projections were revised lower as consumer spending, higher inflation and gas prices offset higher tax refunds. A minor decrease in unemployment was reported as job gains keep pace with the workforce. Inflation is projected to trend higher as energy prices respond to weaker supplies due to the war in Iran. One or two rate hikes were added to the outlook in response to elevated inflation projections. These increases are projected to unwind in 2027 and 2028 as inflation trends toward the Fed's 2.0% target.

Federal Reserve projections as of June 2026

Indicator	2026	2027	2028	*Longer run
Real GDP growth *December 2025 projection*	2.2% *2.4%*	2.3% *2.3%*	2.2% *2.1%*	2.0% *2.0%*
Unemployment rate *December 2025 projection*	4.3% *4.4%*	4.3% *4.3%*	4.2% *4.2%*	4.2% *4.2%*
PCE inflation *December 2025 projection*	3.6% *2.7%*	2.3% *2.2%*	2.0% *2.0%*	2.0% *2.0%*
Core PCE inflation *December 2025 projection*	3.3% *2.7%*	2.5% *2.2%*	2.1% *2.0%*	
Federal funds rate *December 2025 projection*	3.8% *3.4%*	3.6% *3.1%*	3.4% *3.1%*	3.1% *3.1%*

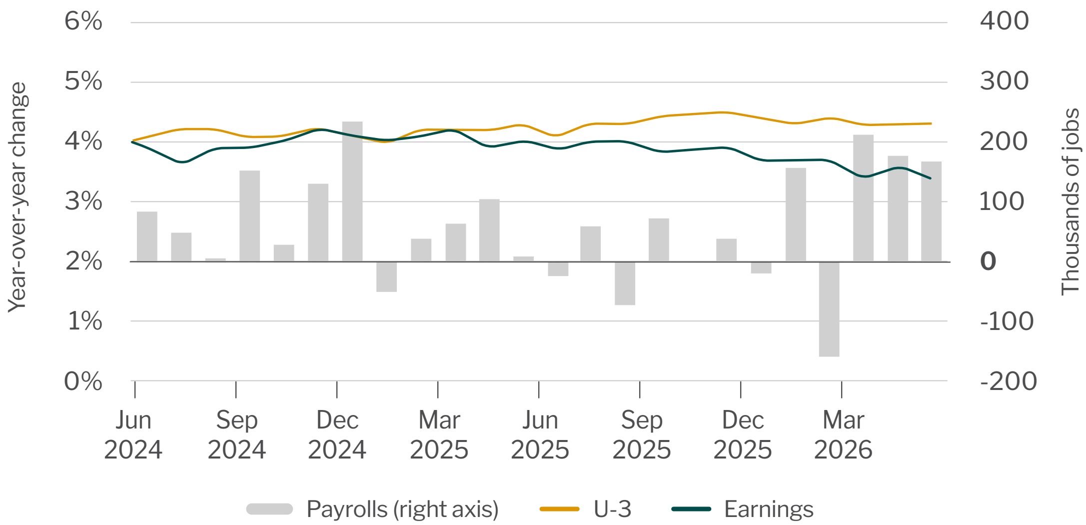
**Longer run projections for core-PCE are not collected.*
Source: Federal Reserve Board.

The 2-year Treasury yield is expected to fluctuate in a range of 4.00-4.50% for the next couple of months while 10-year Treasury yields range between 4.30-4.60%. This outlook could change dramatically due to developments in the Middle East and other risks to the outlook.

Employment

May's labor market was stronger than expected. Unemployment was unchanged at 4.3%, while nonfarm payrolls rose 172,000, which exceeded market expectations for an increase of 88,000. Revisions to the prior two months' reports resulted in an increase of 93,000. Payrolls have increased by more than 170,000 for three straight months. Some of the increase is related to the U.S. hosting the World Cup, which may be a headwind for payrolls in July and August. Wages rose 0.3% to $37.53/hour. Compared to a year ago wages are up 3.4%.

Jobs, unemployment and hourly earnings



Source: U.S. Bureau of Economic Analysis.

Inflation

The Consumer Price Index (CPI) rose 4.2% year over year in May, the highest level since April 2023. The U.S.-Iran conflict remains a risk factor for inflation given continued hostilities. Despite the price of oil coming down to pre-war levels, the daily national average price for unleaded gas is 80-85 cents higher compared to the start of the conflict. It will likely require ship traffic through the Strait of Hormuz to return to normal flows and refinery inventories to replenish before gas prices trend back to pre-war levels.

Overall CPI increased 0.5% for the month, while core CPI, which excludes food and energy, rose a more modest 0.2%. The main pressure came from energy, especially gasoline, which rose 7.0% in May and 40.5% year over year. Food prices increased 0.2% for the month and are up 3.1% year over year, while housing costs rose 0.3% monthly and 3.3% year over year.

Within core inflation, commodity prices excluding food and energy declined 0.1%, while services excluding energy rose 0.3%. Services are a much larger share of core CPI at 60%, compared with 19% for commodities.

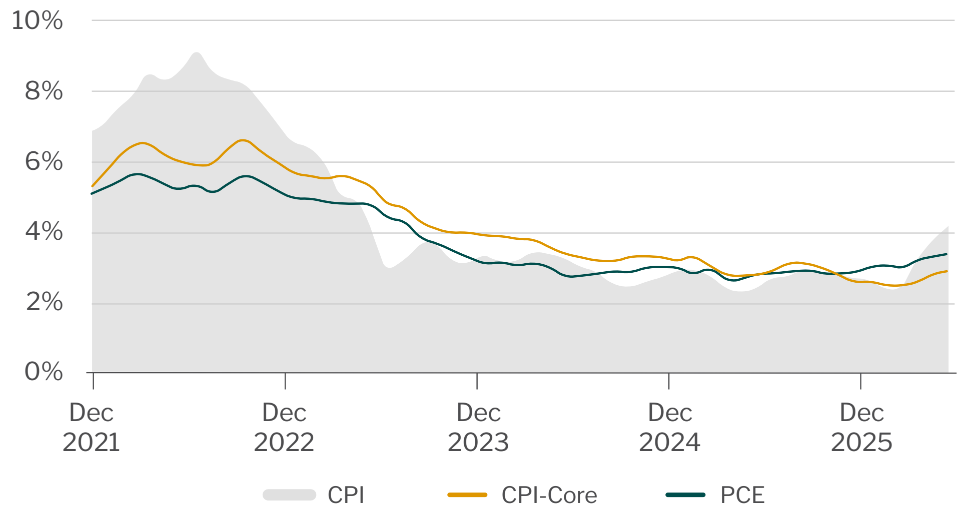
Core CPI was 2.9% in May, compared with 3.3% core PCE in April and 2.4% for the Dallas Fed trimmed mean PCE. Differences between CPI and PCE reflect index composition, weighting, and market dynamics.

Key sources of inflation include:

- Oil, fuel and fertilizer prices fed through the supply chain
- Tariff pass-through and trade uncertainty
- Seasonality and services inflation
- Structural forces such as deglobalization and supply chain realignment

Housing continues to play an outsized role in inflation measures. Owners' Equivalent Rent (OER), which captures the imputed cost of housing services, remains sticky and contributes significantly to core inflation. While the U.S. methodology for housing inflation is considered more comprehensive than those used in many other countries, it may overstate "true" inflation during periods of market adjustment.

Consumer Price Index



Source: U.S. Bureau of Labor Statistics. U.S. Bureau of Economic Analysis.

Gross Domestic Product

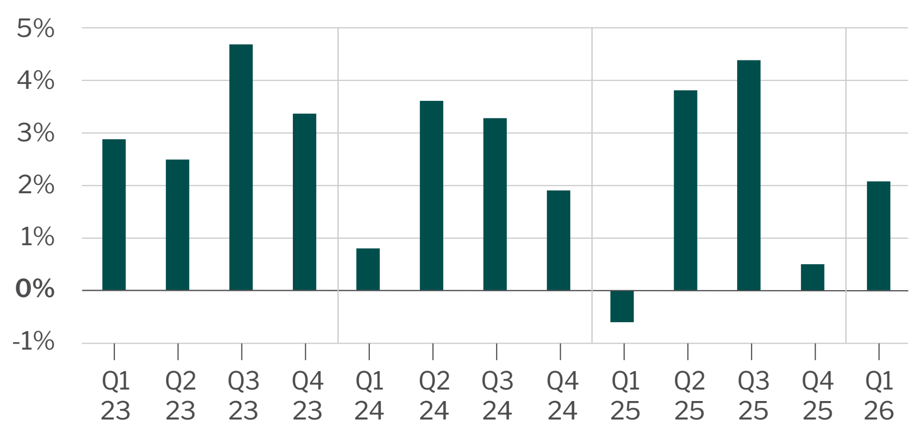
The final reading on Q1 2026 real GDP was revised upward to 2.1%, from the prior estimate of 1.6%. The improvement was mainly driven by stronger net exports, as much weaker imports lifted the trade contribution to growth. Private investment also helped support the upward revision, while government spending showed little change.

However, the positive revision was partly offset by weaker consumer spending, especially on services, suggesting that underlying household demand was softer than the headline GDP improvement implies. Nominal GDP, which is unadjusted for inflation, also improved, expanding at a 5.8% annualized rate versus 5.1% in the previous revision.

The report suggests slightly higher inflation pressure, with the Q1 personal consumption expenditures price index being revised up to 4.6%, compared with 4.5% previously.

Looking ahead, economic activity is projected to grow around 2.0-2.5% during 2026, supported by continued wage growth and service-sector strength. Growth is constrained by higher interest rates, elevated consumer debt, and geopolitical uncertainty. The probability of recession within the next 12 months is estimated at approximately 25%, reflecting a meaningful but not dominant downside risk.

Real Gross Domestic Product (GDP)



Source: U.S. Bureau of Economic Analysis.