July 2026

Monthly Market Update

AgWest FARM CREDIT

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%*

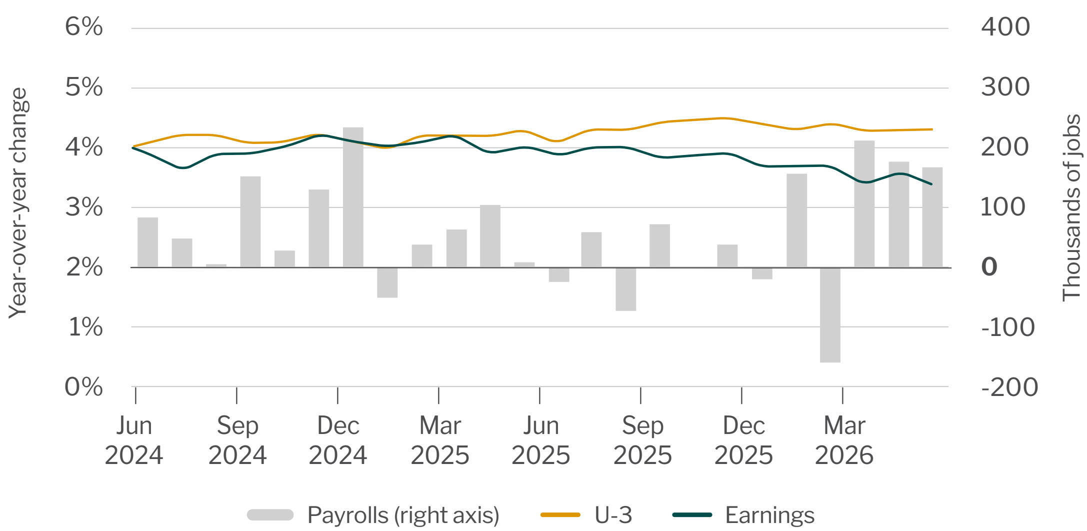
**Longer run projections for core-PCE are not collected.*
Source: Federal Reserve Board.

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.

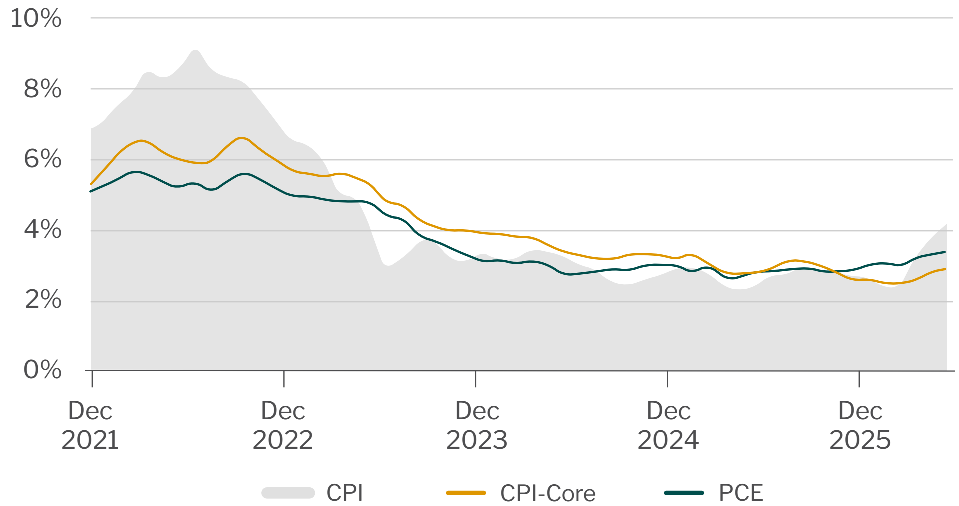
Core CPI was 2.9% in May, compared with 3.3% core PCE in April and 2.4% for the Dallas Fed trimmed mean PCE. Differences between CPI and PCE reflect index composition, weighting, and market dynamics.

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

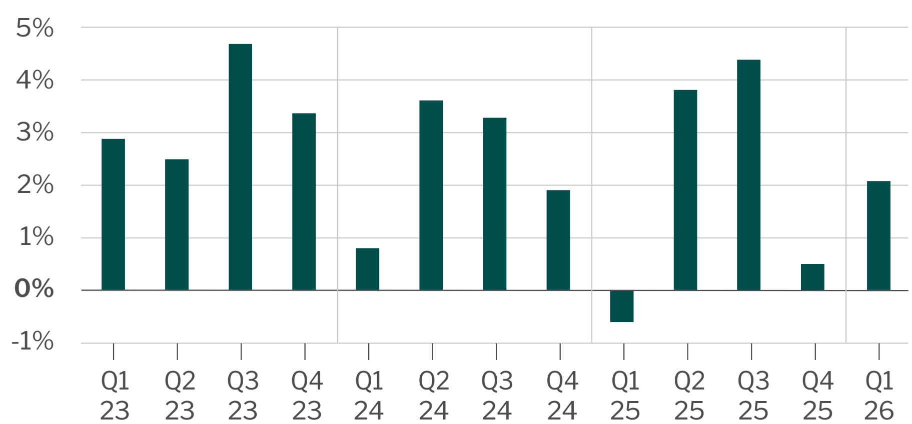
The final reading on Q1 2026 real GDP was revised upward to 2.1%, from the prior estimate of 1.6%. The improvement was mainly driven by stronger net exports, as much weaker imports lifted the trade contribution to growth. Private investment also helped support the upward revision, while government spending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