MARTIN CAPITAL
ADVISORS
LLP
A Registered Investment Advisor

JULY 2026 ECONOMIC COMMENTARY by Colton Krueger, Economic Analyst July 21, 2026

The U.S. economy is experiencing a broad-based deceleration as we enter the second half of the year. Growth has moderated, the labor market is showing signs of gradual cooling, and recent progress on inflation faces potential headwinds from an energy shock tied to renewed tension between the United States and Iran. Under new leadership, the Federal Reserve has held interest rates steady while maintaining a noticeably more hawkish stance. While consumer sentiment is beginning to rebound, it remains low by historical standards. Taken together, the incoming data point to an economy that is downshifting even as upside risk to inflation re-emerges.

Growth is running slightly below long-term trends. Real GDP grew at a 2.1% annualized rate in the first quarter of 2026, with computer equipment and software investment, driven largely by the AI infrastructure buildout, alone contributing 1.3 percentage points to that growth. Looking ahead, the Atlanta Fed's GDPNow model currently points to a 1.7% annualized growth rate for the second quarter.

The labor market is generating fewer net new jobs. Nonfarm payrolls rose by 57,000 in June, well short of the 115,000 consensus estimate, while May's labor figures were revised down to 129,000. The unemployment rate edged down to 4.2%, though this drop primarily reflected a 0.3 percentage point decline in the labor force participation rate to 61.5% — the lowest reading since March 2021. Average hourly earnings rose 3.5% year-over-year, tracking roughly in line with annual inflation. Overall, hiring pace has moderated significantly, and the low unemployment rate is increasingly a function of a compressed labor pool rather than accelerating labor demand.

Fed policy remains on hold, but the tone has turned more hawkish under new leadership. The FOMC, in its first meeting led by new Fed chair Kevin Warsh, voted on June 17 to maintain the federal funds target range at 3.50%–3.75%. Rather than reiterating a bias toward cuts, the Committee's communications signal concern that price pressures may prove stickier than previously assumed. Markets have taken notice: futures have completely priced out any near-term rate cuts, with expectations shifting toward an extended pause at the July 29 meeting, or even a rate hike.

Inflation cooled in June, but a fresh oil shock, driven by renewed tensions between the United States and Iran, threatens to challenge that progress. Headline CPI fell 0.4% on the month, bringing the annual rate down to 3.5% from 4.2% in May — marking the first meaningful decline in several months. The June improvement was largely energy-driven, with the energy index falling 5.7% for the month, its sharpest drop since April 2020. While the decline is welcomed, Chair Warsh has reiterated the Fed's commitment to returning inflation to its 2% target. Core CPI was flat on the month at 2.6% year-over-year, down from 2.9%, suggesting underlying services disinflation remains intact.

Treasury yields have moved higher across the curve as rate-cut expectations have faded. The 2-year note yield stood at 4.18% as of July 17, reflecting reduced expectations for near-term Fed easing. The 10-year yield has climbed to 4.57%, and the 30-year has traded above the 5% threshold, both elevated relative to levels seen earlier this year. This steepening in the belly and long end of the curve reflects a market pricing in the risk that inflation may prove more persistent than hoped, even as growth slows. Mortgage rates have tracked the move, with the 30-year fixed rate holding near 6.55% for nine straight weeks, continuing to restrain housing activity as existing home sales fell 2.4% in June.

Forward-looking sentiment and business surveys confirm a cooler macro environment. The University of Michigan's preliminary July survey showed consumer sentiment rising 4.9 points to 54.4, aided almost entirely by falling gasoline prices, but the reading remains 7.3 points below year-ago levels. Business surveys remain in expansionary territory but have softened: the ISM Manufacturing PMI registered 53.3 in June, down 0.7 point from May, but marking its 20th straight month of expansion, while Services slipped to 54.0 from 54.5, its 24th consecutive month of expansion.

Overall, the economy is managing a complex combination of overlapping forces: growth is running below trend, the labor market appears to be losing steam, and a renewed energy shock threatens to complicate the inflation outlook just as the Fed has pivoted toward a more hawkish stance. A soft landing remains a viable baseline path, but it will increasingly depend on a stabilization of the labor market and a de-escalation of the geopolitical tensions affecting global energy markets.

ECONOMIC CHARTS