



VIEWPOINT

Economic Commentary:

Inflation Accelerates as Household
Purchasing Power Weakens

June 2026



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The U.S. economy ended May facing a difficult combination of rising inflation, weakening household purchasing power and growing geopolitical uncertainty as the war with Iran continued without meaningful progress toward resolution. While economic activity remains positive, the underlying data increasingly points to a two-speed economy: one supported by strong business investment in artificial intelligence (AI) infrastructure and fiscal stimulus, and another characterized by a strained consumer sector facing declining real incomes and mounting financial stress. Against this backdrop, incoming Federal Reserve Chair Kevin Warsh inherits a central bank that is becoming increasingly hawkish as inflation accelerates and growth risks mount.

Inflation accelerates above target

Inflation remains the dominant concern for policymakers. The Personal Consumption Expenditures (PCE) price index rose to 3.8% year over year in April, while Core PCE – the Federal Reserve’s preferred inflation gauge – accelerated to 3.3%, its highest level since November 2023 and well above the Fed’s 2.0% target. Inflation momentum has been particularly troubling. Core PCE has been steadily accelerating since mid-2025, with both the three-month and six-month annualized rates approaching 4.0%, indicating that inflation pressures are broadening rather than easing.

Consumer inflation data tells a similar story. The Consumer Price Index (CPI) increased from 2.4% year over year in February to 3.8% in April, driven largely by higher gasoline and energy prices following the outbreak of the Iran conflict. Policymakers are less concerned about the initial rise in energy prices than they are about the secondary effects. Historically, sustained increases in energy costs eventually spread throughout the economy, affecting transportation, manufacturing, food production and services. As expected, the May CPI report showed a 0.5% monthly increase, pushing the year-over-year inflation rate to 4.2% and reinforcing concerns that inflation will remain elevated for longer than previously expected.

Household finances under growing strain

The consumer sector, which accounts for roughly two-thirds of U.S. economic activity, is showing increasing signs of strain. Real disposable personal income declined 0.5% in April, marking the third consecutive monthly decline. On a year-over-year basis, real disposable income is now down 1.1%, the weakest reading in three years. This deterioration reflects a simple reality: inflation is rising faster than incomes are.

The pressure on household finances is also evident in wage data. Real average weekly earnings fell 0.2% in April after a much steeper 0.9% decline in March. A year ago, real weekly earnings were growing at 1.8%. Today, they are contracting. Although nominal wages continue to rise, those gains are being overwhelmed by inflation, resulting in declining purchasing power for many households.

Consumer spending has remained surprisingly resilient, but the sources of support are increasingly unsustainable. Real personal consumption expenditures increased just 0.1% in April and 2.1% over the past year. Spending continues to outpace income growth, which is a trend that has prevailed for most of the last two years. Consumers have been able to maintain spending largely through unusually large tax refunds, reduced savings and greater reliance on credit.

These coping mechanisms are showing signs of exhaustion. The personal saving rate has fallen to multi-year lows, while credit card delinquencies have climbed to their highest levels in fifteen years. Personal bankruptcies have increased nearly 17% over the past year and are now at their highest level since the COVID recession. Taken together, these indicators suggest that household balance sheets are deteriorating and that consumer spending may become a larger drag on economic growth in the months ahead.

Investment offsets consumer slowdown

Despite these challenges, overall economic growth remains positive. The second estimate of first quarter 2026 real GDP growth was revised down to 1.6% annualized from the initial estimate of 2.0%. While growth has slowed, the economy has avoided outright contraction. However, the composition of growth reveals important shifts. Higher tax refunds helped offset some of the damage from rising energy prices, while business investment — particularly AI-related capital expenditures — provided much of the economy's forward momentum.

Consumer spending, traditionally the primary engine of economic growth, increased at only a 1.4% annualized pace during the first quarter, down from 1.9% in the prior quarter and well below the stronger pace seen during the middle of last year. By contrast, investment in AI infrastructure continues to surge. Spending on data centers, cloud computing, semiconductors and digital infrastructure remains exceptionally strong, creating what many analysts describe as a "two-speed" economy. Technology and AI-related sectors continue to expand rapidly while more traditional consumer-facing sectors face increasing headwinds.

This investment boom is providing meaningful support to growth, but it is not without limitations. Much of the economic value generated by AI-related spending is accruing to foreign semiconductor manufacturers and technology suppliers, reducing the domestic multiplier effect. Nevertheless, loose fiscal policy and strong AI investment continue to offset some of the weakness emerging elsewhere in the economy.

Cost pressure build across sectors

Business activity surveys suggest the economy retains some momentum. The ISM Manufacturing Index rose to 54.0 in May from 52.7 in April, indicating continued expansion. New orders strengthened across most industries while inventories continued to decline, suggesting demand remains healthy. However, manufacturers increasingly cite rising oil, fuel and raw material costs as major challenges. Higher input costs are creating shipment delays, compressing margins and generating pricing pressures that customers are increasingly unwilling or unable to absorb.

The services sector also remains in expansion territory. The ISM Nonmanufacturing Index increased to 54.5 in May, supported by gains in business activity and new orders. At the same time, inflation pressures continue to build. The services price index reached its highest level since August 2022, with firms reporting broad-based increases in costs, particularly energy-related expenses.

The Federal Reserve's latest Beige Book paints a similar picture. Economic activity improved modestly across most regions during the seven weeks ending in late May, with ten of the twelve Federal Reserve districts reporting slight to moderate growth. However, businesses also reported increasing difficulty passing higher costs through to consumers. While higher-income households continue to spend freely, middle- and lower-income consumers are increasingly cutting back on discretionary purchases as higher gasoline and living costs strain budgets.

Labor market softens beneath the surface

The labor market remains one of the economy's more resilient areas, though important signs of weakness are emerging beneath the surface. Nonfarm payrolls increased by 172,000 in May, exceeding expectations, and were accompanied by sizable upward revisions to March and April employment gains. Hiring was particularly strong in leisure and hospitality as businesses prepared for the upcoming FIFA World Cup, while local government employment also increased due to World Cup-related planning activities. The unemployment rate remained unchanged at 4.3%.

However, details within the household employment survey were less encouraging. Employment rose by 149,000, but the increase was entirely due to growth in part-time positions. Full-time employment declined by 79,000 following an even larger decline in April and has fallen in four of the past five months. This shift from full-time to part-time employment suggests labor market conditions are not as strong as headline payroll figures imply.

Wage growth continues to moderate. Average hourly earnings increased 0.3% in May, while the year-over-year pace slowed to 3.5%, down from 4.0% a year earlier. The continued erosion of purchasing power is expected to weigh on consumer spending and eventually slow hiring activity.



The Fed weighs higher rates

The Federal Reserve faces an increasingly difficult policy environment. At its June 16–17 meeting, Chair Kevin Warsh will confront elevated inflation, slowing real income growth and growing geopolitical uncertainty. With inflation expected to remain above target for the foreseeable future, markets have now fully priced in one interest rate hike by year-end. The outlook for both the U.S. and global economies will depend heavily on developments in the Middle East. Sustained disruptions to energy production and shipping routes would likely place further downward pressure on growth while simultaneously keeping inflation elevated, leaving policymakers with few easy choices in the months ahead.

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