



VIEWPOINT

SPECIAL MID-QUARTER EDITION

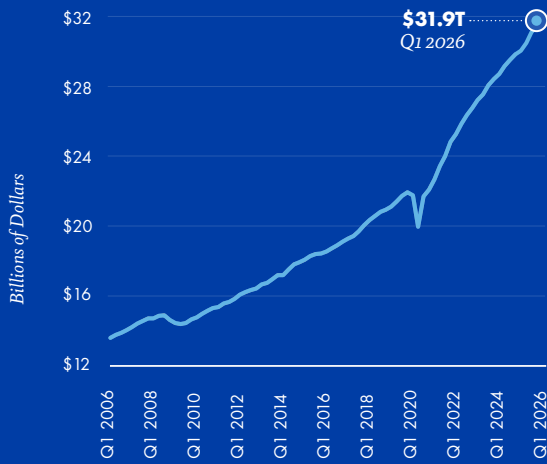
Economic Commentary:

Labor Market Softens
Beneath Headline Data

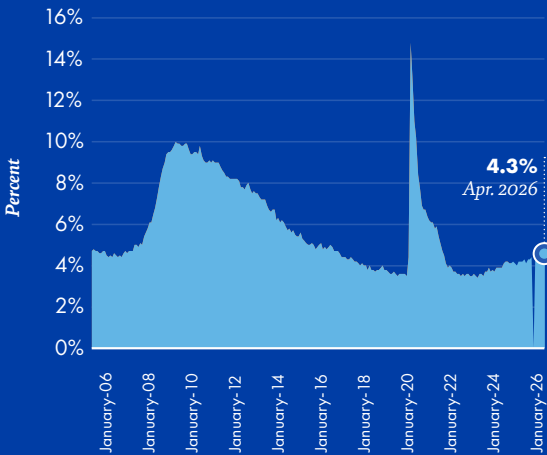
May 2026



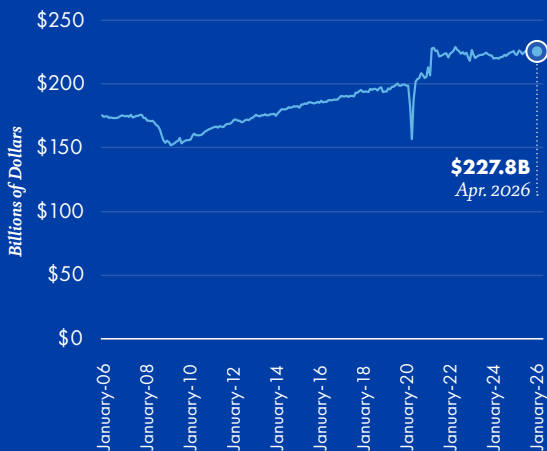
GROSS DOMESTIC PRODUCT (GDP)



UNEMPLOYMENT RATE



RETAIL / FOOD SERVICE SALES



Source: Northmarq, U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, U.S. Bureau of the Census; Oct 2025 data not available

May 2026

The U.S. economy entered 2026 with slowing momentum even before the outbreak of the Iran conflict, and the war has introduced a new layer of uncertainty for policymakers, businesses and consumers. The most immediate impact has been a sharp increase in energy prices, which has complicated the Federal Reserve’s policy outlook by intensifying inflation pressures while simultaneously weakening household purchasing power and threatening slower economic growth.

Persistent inflation pressures

At the center of the current debate is the Federal Reserve’s dual mandate of maintaining price stability and maximum employment. Inflation has accelerated meaningfully in recent months, driven initially by persistent service-sector inflation, the spillover effects of tariffs, and growing price pressures tied to the artificial intelligence (AI) investment boom. Policymakers now face the difficult task of determining whether elevated inflation will prove temporary or whether higher energy costs will spread more broadly through the economy.

The latest inflation data underscore the challenge. The Personal Consumption Expenditures (PCE) price index rose sharply in March, posting the strongest monthly increase since the inflation peak of mid-2022. Core PCE – the Fed’s preferred inflation measure – increased to 3.2% year over year, well above the Fed’s 2.0% target. Momentum in the inflation data has been particularly concerning, with three- and six-month annualized readings running materially above target levels.



The April Consumer Price Index (CPI) also accelerated, rising from 2.4% year over year in February to 3.8%. Much of the increase reflects higher gasoline and energy prices following the outbreak of the war, although core inflation measures remain stubbornly elevated as well. Energy-driven inflation typically feeds through into broader consumer prices over time, affecting transportation, food packaging, manufacturing and services.

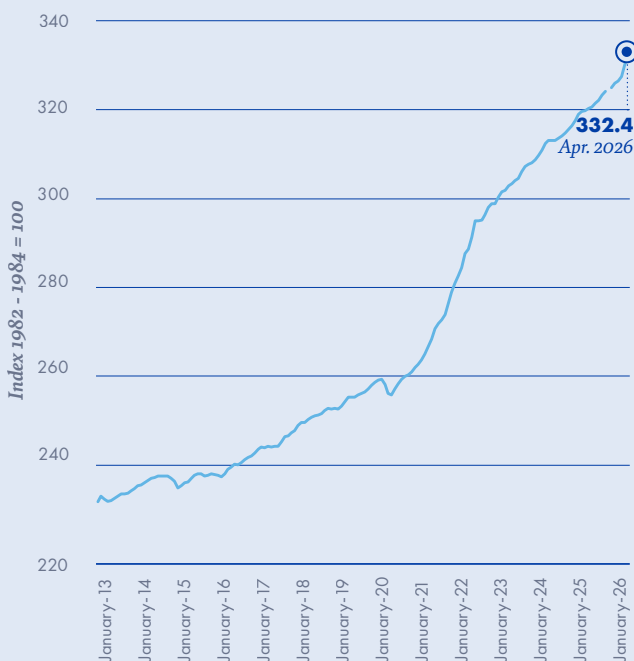
Although some inflation pressures tied to tariffs and energy may eventually fade, other drivers appear more persistent. The rapid AI buildout across the economy has generated unusually strong demand for semiconductors, memory components and information-processing equipment, contributing to ongoing pricing pressures in technology-related sectors.

Spending supported by credit

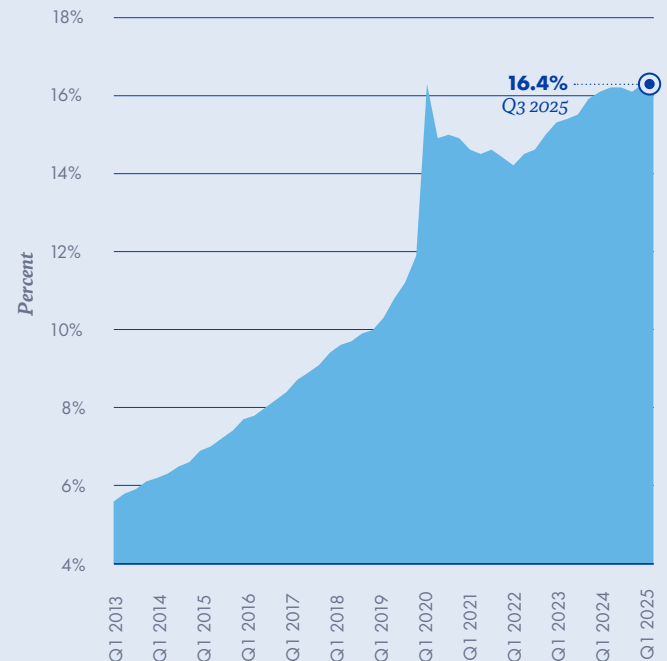
The consumer sector presents a mixed but increasingly fragile picture. Consumer spending in March was supported by unusually large tax refunds and continued reliance on savings and credit. Real personal consumption expenditures increased 0.2% during the month and 2.1% year over year. However, much of the increase in spending reflected higher gasoline prices and temporary tax-related cash flow rather than durable income growth.

For the second consecutive month, real disposable personal income declined, falling -0.1% in March, indicating that income growth is failing to keep pace with inflation. On a year-over-year basis, real disposable income is growing just 0.4% – the weakest pace in three years. Consumers have increasingly relied on savings and credit cards to sustain spending. The personal saving rate has fallen steadily and now sits near multi-year lows, while credit card delinquencies have begun to rise.

CONSUMER PRICE INDEX (CPI)



E-COMMERCE RETAIL SALES (% OF TOTAL SALES)



Source: Northmarq, U.S. Bureau of Labor Statistics, U.S. Bureau of the Census; Oct 2025 data not available for CPI and e-commerce data after Dec 30, 2025 not available

Consumer spending is therefore vulnerable to further weakening as higher energy costs continue to erode purchasing power.

Real wages are also under pressure. Although nominal wage growth remains positive, inflation has offset much of those gains. Real average hourly earnings declined -0.6% in March, -0.5% in April and were down -0.3% year over year.

Fiscal policy is also contributing to inflationary risks. Large federal budget deficits continue to inject stimulus into the economy even as inflation remains elevated. Concerns are growing that sustained fiscal expansion, combined with rising government debt levels, could make it more difficult for inflation expectations to return fully to the Fed's target.

Growth led by AI investment

Despite elevated inflation, economic growth has not collapsed. The initial estimate for first-quarter 2026 real GDP showed annualized growth of 2.0%, though part of the strength reflected a rebound following disruptions tied to the prior government shutdown in late 2025. Growth in the first quarter was supported by business investment and relatively resilient private-sector demand.

Business investment tied to AI infrastructure has emerged as one of the strongest areas of the economy. Corporate spending on data centers, cloud computing, semiconductors and digital infrastructure remains robust, contributing to a "two-speed" economy in which technology and AI-related sectors continue to expand while more traditional consumer-facing industries weaken.

Labor market softening underneath

The labor market continues to send conflicting signals. For the second consecutive month, nonfarm payroll growth exceeded consensus expectations, increasing by 115,000 in April. On the surface, payroll growth has remained surprisingly resilient, with healthcare, education, retail and transportation sectors all contributing to job gains. The unemployment rate remained unchanged at 4.3%.

However, beneath the headline numbers, the labor market appears softer than the payroll reports suggest. The household employment survey has shown repeated declines in employment, the labor force has contracted in several recent months, and the job-finding rate remains weak. Wage growth has also cooled considerably, with three-month annualized wage growth slowing to 2.8%, the softest pace since 2023.

A "no-hire, no-fire" dynamic increasingly characterizes employment conditions. Businesses appear reluctant to aggressively expand payrolls due to uncertainty surrounding the war, inflation and future demand. At the same time, companies have generally avoided large-scale layoffs outside of a few sectors, most notably technology.

Productivity supports cost stability

Productivity growth has become one of the most important supports for the economy. Annual productivity gains remain near 3.0%, well above prior-cycle averages. Current productivity data likely do not yet fully capture the long-term benefits of AI adoption, suggesting that additional productivity gains could emerge over the next several years.

Strong productivity growth has also helped restrain labor costs. Unit labor costs have remained relatively subdued at 1.2% year over year, reducing the risk that wage growth becomes a major source of sustained inflation pressure.

Fed holds amid inflation risks

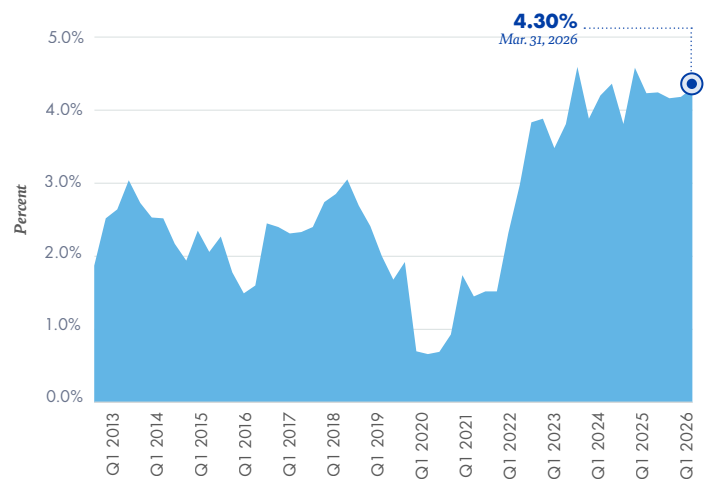
Against this backdrop, the Federal Reserve remains cautious. Policymakers left interest rates unchanged at their April 28–29 meeting and signaled concern that inflation may remain elevated longer than previously expected. While weaker consumer spending and slower growth could eventually justify rate cuts, the recent acceleration in inflation has made the Fed reluctant to ease policy prematurely.

Markets are currently not expecting any Fed rate cuts for the remainder of the year.

The outlook for the global economy will depend heavily on developments in the Middle East. The duration of disruptions to oil production and shipping routes remains the key uncertainty. Sustained energy disruptions would place additional downward pressure on global growth while simultaneously keeping inflation elevated.

Overall, the U.S. economy appears increasingly dependent on productivity growth and business investment to offset weakening consumer fundamentals. Inflation remains too high for the Federal Reserve's comfort, while the labor market is softening beneath the surface. The combination of elevated energy prices, slowing real income growth, persistent inflation and geopolitical uncertainty suggests that economic conditions are likely to remain challenging in the months ahead.

10-YEAR TREASURY RATE



Source: Northmarq, U.S. Federal Reserve; graph includes quarter-end values and may not illustrate daily high or low points throughout the quarter

For more information please contact:

John Beuerlein | Chief Economist, Pohlads Companies

Lanie Beck | Senior Director, Content Strategy
lbeck@northmarq.com | (918) 494-2690

Northmarq

3500 American Blvd W, Suite 500
Minneapolis, MN 55431
(952) 356-0100
www.northmarq.com